

HERITAGE COMMERCE CORP
Form PRE 14A
March 22, 2019

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A
(RULE 14A-101)
INFORMATION REQUIRED IN PROXY STATEMENT

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant ☒

Filed by a Party other than the Registrant ☐

Check the appropriate box:

- ☒ Preliminary Proxy Statement
- ☐ **Confidential, for Use of the Commission Only** (as permitted by Rule 14a-6(e)(2))
- ☐ Definitive Proxy Statement
- ☐ Definitive Additional Materials
- ☐ Soliciting Material under §240.14a-12

HERITAGE COMMERCE CORP

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- ☒ No fee required.
- ☐ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
- (1) Title of each class of securities to which transaction applies:
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 - (1) Amount Previously Paid:
 - (2) Form, Schedule or Registration Statement No.:
 - (3) Filing Party:
 - (4) Date Filed:
-

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HERITAGE COMMERCE CORP

April [•], 2019

Dear Shareholder:

You are cordially invited to attend the 2019 Annual Meeting of Shareholders, which will be held at 1:00 p.m., Pacific Daylight Time (PDT) on Thursday, May 23, 2019, at Heritage Commerce Corp's offices, located at 150 Almaden Boulevard, San Jose, California, 95113.

The accompanying Notice of Annual Meeting and proxy statement describe the business that will be conducted at the meeting and provide information about Heritage Commerce Corp. We have also enclosed our 2018 Annual Report on Form 10-K.

Your continued support is appreciated and we hope you will attend the Annual Meeting. Whether or not you are personally present, it is very important that your shares be represented at the meeting. Accordingly, please sign, date, and promptly mail the enclosed proxy card. You may also vote over the Internet or by telephone by following the instructions on the proxy card. If you attend the meeting and prefer to vote in person, you may do so.

Sincerely,

Jack W. Conner
Chairman of the Board

Walter T. Kaczmarek
President and Chief Executive Officer

150 Almaden Boulevard, San Jose, California 95113 • Telephone (408) 947-6900 • Fax (408) 947-6910

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HERITAGE COMMERCE CORP

**150 Almaden Boulevard
San Jose, California 95113**

Notice of Annual Meeting of Shareholders

- Date and Time:** Thursday, May 23, 2019, at 1:00 p.m., Pacific Daylight Time (PDT).
- Place:** Heritage Commerce Corp's offices located at 150 Almaden Boulevard, San Jose, California 95113.
- Items of Business:**
1. To elect 10 members of the Board of Directors, each for a term of one year;
 2. To approve an advisory proposal on the Company's executive compensation;
 3. To approve an amendment to our Articles of Incorporation to increase the number of authorized shares of our common stock from 60,000,000 to 100,000,000;
 4. To ratify the selection of Crowe LLP as the Company's independent registered public accounting firm for the year ending December 31, 2019; and
 5. To transact such other business as may properly come before the meeting, and any adjournment or postponement.
- Record Date:** You can vote if you are a shareholder of record on March 28, 2019.
- Mailing Date:** The proxy materials are being distributed to our shareholders on or about April [•], 2019, and include our Annual Report on Form 10-K, Notice of Annual Meeting, this proxy statement, and proxy or voting instruction card.
- Important Notice Regarding the Internet Availability of Proxy Materials:** The proxy statement and Annual Report on Form 10-K are available at www.heritagecommercecorp.com. **Your Vote is Important.** Please vote as promptly as possible by using the Internet or telephone or by signing, dating and returning the enclosed proxy card.

By Order of the Board of Directors,

Deborah Reuter
Executive Vice President
and Corporate Secretary

April [•], 2019
San Jose, California

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**PROXY STATEMENT FOR HERITAGE COMMERCE CORP
2019 ANNUAL MEETING OF SHAREHOLDERS
INFORMATION ABOUT THE ANNUAL MEETING AND VOTING**

Why did you send me this proxy statement?

We sent you this proxy statement and the enclosed proxy card because our Board of Directors (the "Board of Directors" or the "Board") is soliciting your proxy to vote at the 2019 Annual Meeting of Shareholders. This proxy statement summarizes the information you need to know to cast an informed vote at the Annual Meeting. However, you do not need to attend the Annual Meeting to vote your shares. Instead, you may simply complete, sign and return the enclosed proxy card. You may also vote by telephone or the Internet by following the instructions on the proxy card.

Along with this proxy statement, we are also sending you the Heritage Commerce Corp 2018 Annual Report on Form 10-K, which includes our consolidated financial statements. Heritage Commerce Corp is also referred to in this proxy statement as the "Company."

Who is entitled to vote?

We will begin sending this proxy statement, the attached Notice of Annual Meeting and the enclosed proxy card on or about April [•], 2019, to all shareholders entitled to vote. Shareholders who were the record owners of the Company's common stock at the close of business on March 28, 2019, are entitled to vote. On this record date, there were [•] shares of common stock outstanding.

What constitutes a quorum?

A majority of the outstanding shares of the common stock entitled to vote at the Annual Meeting must be present, in person or by proxy, in order to constitute a quorum. We can only conduct the business of the Annual Meeting if a quorum has been established. We will include proxies marked as abstentions and broker non-votes in determining the number of shares present at the Annual Meeting.

How many votes do I have?

Each share of common stock entitles you to one vote in person or by proxy, for each share of common stock outstanding in your name on the books of the Company as of March 28, 2019, the record date for the Annual Meeting on any matter submitted to a vote of the shareholders, except that in connection with the election of directors (Proposal 1), you may cumulate your shares (*see "What is cumulative voting and how do I cumulate my shares?" on page 3*). The proxy card indicates the number of votes that you have as of the record date.

Is voting confidential?

We have a confidential voting policy to protect the privacy of our shareholders' votes. Under this policy, ballots, proxy cards and voting instructions returned to banks, brokers and other nominees are kept confidential. Only the proxy tabulator and the Inspector of Election have access to the ballots, proxy cards and voting instructions.

How do I vote by proxy?

You may vote by granting a proxy or, for shares held in street name, by submitting voting instructions to your broker or other nominee. If your shares are held by a broker or other nominee, you will receive instructions that you must follow to have your shares voted. If you hold your shares as a shareholder of record, you may vote by completing, signing and dating the enclosed proxy card and returning it promptly in the envelope provided. You may also vote by telephone or over the Internet (see page 3). Returning the proxy card will not affect your right to attend the Annual Meeting and vote.

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If you properly fill in your proxy card and send it to us in time to vote, your "proxy" (one of the individuals named on your proxy card) will vote your shares as you have directed. If you sign the proxy card but do not make specific choices, your proxy will vote your shares as recommended by the Board of Directors as follows:

"FOR" the election of all 10 nominees for director;

"FOR" the approval of the advisory proposal on the Company's executive compensation;

"FOR" the approval of the amendment to the Articles of Incorporation to increase the number of authorized shares; and

"FOR" the ratification of the selection of Crowe LLP as our independent registered public accounting firm for 2019.

For the election of directors (Proposal 1), a shareholder may withhold authority for the proxy holders to vote for any one or more of the nominees by marking the enclosed proxy card in the manner instructed on the proxy card. Unless authority to vote for the nominees is withheld, the proxy holders will vote the proxies received by them for the election of the nominees listed on the proxy card as directors of the Company. Your proxy does not have an obligation to vote for nominees not identified on the preprinted proxy card (that is, write-in candidates). Should any shareholder attempt to "write in" a vote for a nominee not identified on the preprinted card (and described in these proxy materials), your proxy will NOT vote the shares represented by your proxy card for any such write-in candidate, but will instead vote the shares for any and all other indicated candidates. If any of the nominees should be unable or decline to serve, which is not now anticipated, your proxy will have discretionary authority to vote for a substitute who shall be designated by the present Board of Directors to fill the vacancy. In the event that additional persons are nominated for election as directors, your proxy intends to vote all of the proxies in such a manner, in accordance with the cumulative voting, as will assure the election of as many of the nominees identified on the proxy card as possible. In such event, the specific nominees to be voted for will be determined by the proxy holders, in their sole discretion.

What do I have to do to vote my shares if they are held in the name of my broker?

If your shares are held by your broker, sometimes called "street name" shares, you must vote your shares through your broker. You should receive a form from your broker asking how you want to vote your shares. Follow the instructions on that form to give voting instructions to your broker. Under the rules that govern brokers who are voting with respect to shares held in street name, brokers have the discretion to vote such shares on routine, but not on non-routine matters. A "broker non-vote" occurs when your broker does not vote on a particular proposal because the broker does not receive instructions from the beneficial owner and does not have discretionary authority. Proposal 1 (election of directors), Proposal 2 (advisory proposal on the executive compensation), and Proposal 3 (approval of the amendment to the Articles of Incorporation to increase the number of authorized shares) are non-routine items on which a broker may vote only if the beneficial owner has provided voting instructions. Proposal 4 (ratification of independent registered public accounting firm) is a routine item.

What are the procedures for attending the Annual Meeting?

Only shareholders owning the Company's common stock at the close of business on March 28, 2019, or their legal proxy holders, are entitled to attend the Annual Meeting. You must present photo identification for admittance. If you are a shareholder of record, your name will be verified against the list of shareholders of record on the Record Date prior to your admission to the Annual Meeting. If you are not a shareholder of record but hold shares through a bank, broker or other nominee, you must provide proof of beneficial ownership on the Record Date, such as your most recent account statement prior to

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March 28, 2019, or other similar evidence of ownership. If you do not provide photo identification or comply with the other procedures outlined above, you will not be admitted to the Annual Meeting.

How do I vote in person?

If you plan to attend the Annual Meeting and desire to vote in person, we will give you a ballot form when you arrive. However, if your shares are held in the name of your broker, bank or other nominee, you must bring a power of attorney from your nominee in order to vote at the Annual Meeting.

May I vote over the Internet or by telephone?

Shareholders whose shares are registered in their own names may vote either over the Internet or by telephone. Special instructions for voting over the Internet or by telephone are set forth on the enclosed proxy card. The Internet and telephone voting procedures are designed to authenticate the shareholder's identity and to allow shareholders to vote their shares and confirm that their voting instructions have been properly recorded.

If your shares are registered in the name of a bank or brokerage firm, you may be eligible to vote your shares by telephone or over the Internet. Most U.S. banks and brokerage firms are clients of Broadridge Financial Solutions ("Broadridge"). As such, shareholders who receive either a paper copy of their proxy statement or electronic delivery notification have the opportunity to vote by telephone or over the Internet. If your bank or brokerage firm is a Broadridge client, your proxy card or Voting Instruction Form ("VIF") will provide the instructions. If your proxy card or VIF does not provide instructions for Internet and telephone voting, please complete and return the proxy card in the self-addressed, postage-paid envelope provided.

What is cumulative voting and how do I cumulate my shares?

For the election of directors (Proposal 1), California law provides that a shareholder of a California corporation, or his/her proxy, may cumulate votes in the election of directors. That is, each shareholder may cast that number of votes equal to the number of shares owned by him/her, multiplied by the number of directors to be elected, and he/she may cumulate such votes for a single candidate or distribute such votes among as many candidates as he/she deems appropriate.

Certain affirmative steps must be taken by you in order to be entitled to vote your shares cumulatively for the election of directors. At the shareholders' meeting at which directors are to be elected, no shareholder is entitled to cumulate votes (i.e., cast for any one or more candidates a number of votes greater than the number of the shareholder's shares) unless the candidates' names have been placed in nomination at the meeting and prior to the commencement of the voting and at least one shareholder has given notice at the meeting and prior to commencement of the voting of the shareholder's intention to cumulate votes. If any shareholder has given such notice, then every shareholder entitled to vote may cumulate votes for candidates in nomination and give one candidate a number of votes equal to the number of directors to be elected multiplied by the number of votes to which that shareholder's shares are entitled, or distribute the shareholder's votes on the same principle among any or all of the candidates, as the shareholder thinks appropriate. The candidates receiving the highest number of votes, up to the number of directors to be elected, will be elected.

The proxies designated on your proxy card do not, at this time, intend to cumulate votes, to the extent they have the shareholder's discretionary authority to do so, pursuant to the proxies solicited in this proxy statement unless another shareholder gives notice to cumulate, in which case your proxy may cumulate votes in accordance with the recommendations of the Board of Directors. Therefore, discretionary authority to cumulate votes in such an event is solicited in this proxy statement.

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May I change my vote after I return my proxy?

If you fill out and return the enclosed proxy card, or vote by telephone or over the Internet, you may change your vote at any time before the vote is conducted at the Annual Meeting. You may change your vote in any one of four ways:

You may send to the Company's Corporate Secretary another completed proxy card with a later date.

You may notify the Company's Corporate Secretary in writing before the Annual Meeting that you have revoked your proxy.

You may attend the Annual Meeting and vote in person.

If you have voted your shares by telephone or over the Internet, you can revoke your prior telephone or Internet vote by recording a different vote, or by signing and returning a proxy card dated as of a date that is later than your last telephone or Internet vote.

What if I receive multiple proxy cards?

If you receive multiple proxy cards, your shares are probably registered differently or are in more than one account. Vote all proxy cards received to ensure that all your shares are voted. Unless you need multiple accounts for specific purposes, we recommend that you consolidate as many of your accounts as possible under the same name and address. If the shares are registered in your name, contact our transfer agent, EQ Shareowner Services, 1-866-883-3382; otherwise, contact your bank, broker or other nominee.

What vote is required to approve each proposal?

Approval of Proposal 1 (election of directors) requires a plurality of votes cast for each nominee. This means that the 10 nominees who receive the most votes will be elected. So, if you do not vote for a particular nominee, or you indicate "WITHHOLD AUTHORITY" to vote for a particular nominee on your proxy card, your vote will not count either "for" or "against" the nominee. Abstentions will not have any effect on the outcome of the vote. You may cumulate your votes in the election of directors as described under "*What is cumulative voting and how do I cumulate my shares?*" on page 3. Broker non-votes will not count as a vote on the proposal and will not affect the outcome of the vote.

Proposal 3 (approval of an amendment to the Company's Articles of Incorporation to increase the number of authorized shares) requires the affirmative vote of a majority of the shares issued and outstanding on the Record Date. For purposes of Proposal 3, abstentions and broker non-votes will have the same effect as a negative vote.

Proposal 2 (advisory proposal on the executive compensation) and Proposal 4 (ratification of independent registered public accounting firm) each requires a vote that satisfies two criteria: (i) the affirmative vote for the proposal must constitute a majority of the common shares present or represented or by proxy and voting on the proposal at the Annual Meeting; and (ii) the affirmative vote for the proposal must constitute a majority of the common shares required to constitute the quorum. For purposes of Proposal 2 and 4, abstentions and broker non-votes will not affect the outcome under clause (i), which recognizes only actual votes cast. However, abstentions and broker non-votes will affect the outcome under clause (ii) if the number of affirmative votes, though a majority of the votes represented and cast, does not constitute a majority of the voting power required to constitute a quorum. The ratification of the appointment of the independent registered public accounting firm for 2019 is a matter on which a broker or other nominee is generally empowered to vote and, therefore, no broker non-votes are expected to exist with respect to Proposal 4.

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How will voting on any other business be conducted?

Your proxy card confers discretionary authority to your proxy to vote your shares on the matters which may properly be presented for action at the Annual Meeting, and may include action with respect to procedural matters pertaining to the conduct of the Annual Meeting.

What are the costs of soliciting these proxies?

We will pay all the costs of soliciting these proxies. In addition to mailing proxy soliciting material, our directors, officers and employees also may solicit proxies in person, by telephone or by other electronic means of communication for which they will receive no compensation. We will ask banks, brokers and other institutions, nominees and fiduciaries to forward the proxy materials to their principals and to obtain authority to execute proxies. We will then reimburse them for their reasonable expenses. We have hired Advantage Proxy to seek the proxies of custodians, such as brokers, which hold shares which belong to other people. This service will cost the Company approximately \$4,500 plus expenses.

How do I obtain an Annual Report on Form 10-K?

A copy of our 2018 Annual Report on Form 10-K accompanies this proxy statement. If you would like another copy of this report, we will send you one without charge. The Annual Report on Form 10-K includes a list of exhibits filed with the Securities and Exchange Commission ("SEC"), but does not include the exhibits. If you wish to receive copies of the exhibits, we will send them to you. Please write to:

**Heritage Commerce Corp
150 Almaden Boulevard
San Jose, California 95113
Attention: Executive Vice President and Corporate Secretary**

You can also find out more information about us at our website www.heritagecommercecorp.com. Our website is available for information purposes only and should not be relied upon for investment purposes, nor is it incorporated by reference into this proxy statement. On our website you can access electronically filed copies of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, Section 16 filings, and amendments to those reports and filings, free of charge. The SEC also maintains a website at www.sec.gov that contains reports, proxy statements and other information regarding SEC registrants, including the Company.

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The following table sets forth information as of February 28, 2019, pertaining to beneficial ownership of the Company's common stock by persons known to the Company to own 5% or more of the Company's common stock, nominees to be elected to the Board of Directors, the executive officers named in the Summary Compensation Table presented in this proxy statement, and all directors and executive officers of the Company, as a group. This information has been obtained from the Company's records, or from information furnished directly by the individual or entity to the Company.

For purposes of the following table, shares issuable pursuant to stock options which may be exercised within 60 days of February 28, 2019, are deemed to be issued and outstanding and have been treated as outstanding in determining the amount and nature of beneficial ownership and in calculating the percentage of ownership of those individuals possessing such interest, but not for any other individuals.

Name of Beneficial Owner(1)	Position	Shares Beneficially Owned(2)(3)	Exercisable Options	Percent of Class(3)
Michael E. Benito	Executive Vice President/Banking Division of Heritage Bank of Commerce	75,389(4)(20)	27,000	0.17%
Julianne M. Biagini-Komas	Director	26,886(5)		0.06%
Frank G. Bisceglia	Director	135,510(6)	25,000	0.31%
Margo G. Butsch	Executive Vice President and Chief Credit Officer of Heritage Bank of Commerce	13,035(7)(20)	6,035	0.03%
Jack W. Conner	Director and Chairman of the Board	102,121(8)		0.24%
Jason DiNapoli	Director	291,694(9)		0.67%
Steven L. Hallgrimson	Director	124,673(10)	6,345	0.29%
Walter T. Kaczmarek	Chief Executive Officer, President and Director	132,333(11)(20)	15,000	0.31%
Lawrence D. McGovern	Executive Vice President and Chief Financial Officer	105,206(12)(20)	30,000	0.24%
Robert T. Moles	Director	71,677(13)	21,500	0.17%
Laura Roden	Director	28,273(14)	10,700	0.07%
Ranson W. Webster	Director	633,851(15)	25,000	1.46%
Keith A. Wilton	Executive Vice President, Director, and Chief Operating Officer and President of Heritage Bank of Commerce	94,058(16)(20)		0.22%
All directors, and executive officers (13 individuals)		1,834,706		4.22%
BlackRock Inc.		3,028,833(17)		7.00%
Dimensional Fund Advisors LP., Inc.		2,221,513(18)		5.13%
T. Rowe Price Associates, Inc.		6,064,670(19)		14.01%

1. Except as otherwise noted, the address for all persons is c/o Heritage Commerce Corp, 150 Almaden Boulevard, San Jose, California, 95113.
2. Subject to applicable community property laws and shared voting and investment power with a spouse, the persons listed have sole voting and investment power with respect to such shares unless otherwise noted. Listed amounts reflect all previous stock splits and stock dividends.
3. Includes shares beneficially owned (including options exercisable within 60 days of February 28, 2019, as shown in the "Exercisable Options" column).

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4. Includes 16,125 shares of restricted stock that have not vested and of which Mr. Benito has the right to vote.
5. Includes 1,190 shares of restricted stock that have not vested and of which Ms. Biagini-Komas has the right to vote.
6. Includes 93,237 shares as one of two trustees of the Bisceglia Family Trust, and 11,000 shares held by Mr. Bisceglia in a personal Individual Retirement Account. Also includes 1,632 shares of restricted stock that have not vested and of which Mr. Bisceglia has the right to vote.
7. Includes 7,000 shares of restricted stock that have not vested and of which Ms. Butsch has the right to vote.
8. Includes 19,515 shares held by Mr. Conner's spouse. Also includes 2,117 shares of restricted stock that have not vested and of which Mr. Conner has the right to vote.
9. Includes 251,694 shares held by a partnership and 20,000 shares held by Mr. DiNapoli's children.
10. Includes 90,628 shares held directly. Includes 3,500 shares held in a SEP IRA account, 2,000 shares held in a personal IRA account, 4,000 shares held in Mr. Hallgrimson's private foundation, 3,000 shares held by Mr. Hallgrimson's spouse, 7,000 shares in a limited liability company with his son, 2,900 shares that Mr. Hallgrimson holds as trustee of various trusts and 5,300 shares held in accounts of others over which Mr. Hallgrimson has voting and investment power. Also includes 1,632 shares of restricted stock that have not vested and of which Mr. Hallgrimson has the right to vote.
11. Includes 41,000 shares held in a personal Individual Retirement Account. Also includes 45,731 shares of restricted stock that have not vested and of which Mr. Kaczmarek has the right to vote.
12. Includes 4,980 shares held by Mr. McGovern in a personal Individual Retirement Account. Also includes 22,350 shares of restricted stock that have not vested and of which Mr. McGovern has the right to vote.
13. Includes 18,295 shares held by Mr. Moles' spouse. Also includes 1,632 shares of restricted stock that have not vested and of which Mr. Moles has the right to vote.
14. Includes 1,632 shares of restricted stock that have not vested and of which Ms. Roden has the right to vote.
15. Includes 8,493 shares held indirectly. Also includes 1,632 shares of restricted stock that have not vested and of which Mr. Webster has the right to vote.
16. Includes 28,000 shares of restricted stock that have not vested and of which Mr. Wilton has the right to vote.
17. BlackRock, Inc. is an investment management firm and may be deemed to beneficially own 3,028,833 shares of the Company which are held of record by clients of BlackRock, Inc. The address for BlackRock, Inc. is 55 East 52nd Street, New York, NY 10055. All of the foregoing information has been obtained by Schedule 13G filed with the SEC on February 4, 2019.
18. Dimensional Fund Advisors LP is an investment management firm and may be deemed to beneficially own 2,221,513 shares of the Company which are held of record by clients of Dimensional Fund Advisors LP. The address for Dimensional Fund Advisors LP is Building One, 6300 Bee Cave Road, Austin, TX 78746. All of the foregoing information has been obtained by Schedule 13G filed with the SEC on February 8, 2019.

19.

T. Rowe Price Associates, Inc. is an investment management firm and may be deemed to beneficially own 6,064,670 shares of the Company which are held of record by clients of T. Rowe Price Associates, Inc. the address for T. Rowe Price Associates, Inc. is 100 East Pratt Street, Baltimore, MD 21202. All of the foregoing information has been obtained by Schedule 13G filed with the SEC on February 14, 2019.

20.

The Company's Employee Stock Ownership Plan owns 108,270 shares of our common stock, all of which have been allocated. These include shares held for the account of the following named executive officers and includes in the table for Mr. Kaczmarek 1,906 shares, Mr. McGovern 5,506 shares, Mr. Benito 2,289 shares, and zero shares for Ms. Butsch and Mr. Wilton. Mr. Kaczmarek and Mr. McGovern are two of the three trustees of the Employee Stock Ownership Plan. As trustees, they have the power to vote any unallocated shares of the Employee Stock Ownership Plan (currently no shares are unallocated) and allocated shares for which voting instructions are not otherwise provided.

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CORPORATE GOVERNANCE AND BOARD MATTERS

The Board of Directors is committed to good business practices, transparency in financial reporting and the highest level of corporate governance. To that end, the Board continually reviews its governance policies and practices, as well as the requirements of the Sarbanes-Oxley Act of 2002 and the listing standards of the Nasdaq Stock Market, to help ensure that such policies and practices are compliant and up to date.

Board of Directors

Board Independence

In 2018 eight (8) out of nine (9) members of the Board of Directors were independent directors, as defined by the applicable rules and regulations of the Nasdaq Stock Market, as follows:

Julianne M. Biagini-Komas
Frank G. Bisceglia
Jack W. Conner, Chairman of the Board
J. Philip DiNapoli*
Jason DiNapoli*
Steven L. Hallgrimson
Robert T. Moles
Laura Roden
Ranson W. Webster

*

J. Philip DiNapoli retired from the Board of Directors and Jason DiNapoli joined the Board of Directors in July 2018.

Board and Committee Meeting Attendance

During the fiscal year ended December 31, 2018, our Board of Directors held a total of 12 meetings. For the meetings directors were qualified to attend in 2018, each incumbent director who was a director during 2018 attended at least 75% of the aggregate of (a) the total number of such meetings and (b) the total number of meetings held by the standing committees of the Board on which such director served.

Director Attendance at Annual Meetings of Shareholders

The Board believes it is important for all directors to attend the Annual Meeting of Shareholders in order to show their support for the Company and to provide an opportunity for shareholders to communicate any concerns to them. The Company's policy is to encourage, but not require, attendance by each director at the Company's Annual Meeting of Shareholders. All of the directors of the Company are encouraged to attend the Annual Meeting of Shareholders and at the 2018 Annual Meeting of Shareholders all of our directors were in attendance.

Communications with the Board

Shareholders may communicate with the Board of Directors, including a committee of the Board or individual directors, by writing to the Corporate Secretary, Heritage Commerce Corp, 150 Almaden Boulevard, San Jose, California 95113. Each communication from a shareholder should include the following information in order to permit shareholder status to be confirmed and to provide an address to forward a response if deemed appropriate:

The name, mailing address and telephone number of the shareholder sending the communication; and

If the shareholder is not a record holder of our common stock, the name of the record holder of our common stock beneficially owned must be identified along with the shareholder.

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Our Corporate Secretary will forward all appropriate communications to the Board or individual members of the Board specified in the communication. Our Corporate Secretary may (but is not required to) review all correspondence addressed to the Board or any individual member of the Board, for any inappropriate correspondence more suitably directed to management. Communications may be deemed inappropriate for this purpose if it is reasonably apparent from the face of the correspondence that it relates principally to a customer dispute. Our policies regarding the handling of security holder communications were approved by a majority of our independent directors.

Nomination of Directors

The Company has a Corporate Governance and Nominating Committee. The duties of the Corporate Governance and Nominating Committee include the recommendation of candidates for election to the Company's Board of Directors.

The Corporate Governance and Nominating Committee's minimum qualifications for a director are persons of high ethical character who have both personal and professional integrity, which is consistent with the image and values of the Company. The Corporate Governance and Nominating Committee considers some or all of the following criteria in considering candidates to serve as directors:

commitment to ethical conduct and personal and professional integrity as evidenced through the person's business associations, diversity, service as a director or executive officer or other commitment to ethical conduct and personal and professional integrity as evidenced in organizations and/or education;

objective perspective and mature judgment developed through business experiences and/or educational endeavors;

the candidate's ability to work with other members of the Board of Directors and management to further our goals and increase shareholder value;

the ability and commitment to devote sufficient time to carry out the duties and responsibilities as a director;

demonstrated experience at policy making levels in various organizations and in areas that are relevant to our activities;

the skills and experience of the potential nominee in relation to the capabilities already present on the Board of Directors; and

such other attributes, including independence, relevant in constituting a board that also satisfies the requirements imposed by the SEC and the Nasdaq Stock Market.

The Corporate Governance and Nominating Committee does not have a separate policy for consideration of any director candidates recommended by shareholders. Instead, the Corporate Governance and Nominating Committee considers any candidate meeting the requirements for nomination by a shareholder set forth in the Company's Bylaws (as well as applicable laws and regulations) in the same manner as any other director candidate. The Corporate Governance and Nominating Committee believes that requiring shareholder recommendations for director candidates to comply with the requirements for nominations in accordance with the Company's Bylaws ensures that the Corporate Governance and Nominating Committee receives at least the minimum information necessary for it to begin an appropriate evaluation of any such director nominee.

Section 5.14 of the Company's Bylaws provide that any shareholder must give advance written notice to the Company of an intention to nominate a director at a shareholder meeting. Notice of intention to make any nominations must be delivered to the Secretary of the Company at the principal executive offices of the Company not later than the close of business 90 days nor earlier than the close of business 120 days

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prior to the first anniversary of the preceding year's annual meeting. If the date of the annual meeting is more than 30 days before or more than 60 days after such anniversary date of the annual meeting, notice by the shareholder must be delivered not earlier than the close of business 120 days prior to such annual meeting and not later than the close of business 90 days prior to such annual meeting or 10 days following the day on which public announcement of the date of such meeting is first made by the Company.

To be in proper written form, a shareholder's notice to the Corporate Secretary must provide as to each person, whom the shareholder proposes to nominate for election as a director (each referred to as the "Nominee"): (1) all information relating to the Nominee that is required to be disclosed in solicitations of proxies for election of directors in an election contest, or is otherwise required, in each case pursuant to and in accordance with Regulation 14A under the Securities Exchange Act of 1934 (the "Exchange Act"); (2) the Nominee's written consent to being named in the proxy statement as a nominee and to serving as a director if elected; (3) the number of shares of capital stock of any bank, bank holding company, savings and loan association or other depository institution owned beneficially by the Nominee and the identities and locations of any such institutions; (4) whether the Nominee has ever been convicted of or pleaded nolo contendere to any criminal offense involving dishonesty or breach of trust, filed a petition in bankruptcy or been adjudged bankrupt; (5) a written statement executed by the Nominee acknowledging that as a director of the Company, the Nominee will owe a fiduciary duty exclusively to the Company and its shareholders; (6) a representation whether the Nominee satisfies the requirements of Section 2.2(b) of the Company's Bylaws (see below); (7) whether and the extent to which any hedging or other transaction or series of transactions has been entered into by or on behalf of the Nominee respect to any securities of the Company, and a description of any other agreement, arrangement or understanding (including any short position or any borrowing or lending of shares), the effect or intent of which is to mitigate loss to, or to manage the risk or benefit of share price changes for, or to increase or decrease the voting power of the Nominee; and (8) a description of all arrangements or understandings between the shareholder and the Nominee and any other person or persons (naming such person or persons) pursuant to which the nomination is to be made by the shareholder.

The notice must also set forth with respect to the shareholder submitting the nomination: (1) the name and address of the shareholder (and beneficial owner, if applicable), as it appears on the Company's books, (and of such beneficial owner, if applicable) and any other shareholders and beneficial owners known by such shareholder to be supporting the Nominee(s) for election; (2) the class or series and number of shares of capital stock of the Company that are, directly or indirectly, owned beneficially and of record by such shareholder (and by such beneficial owner, if applicable); (3) any derivative positions with respect to shares of capital stock of the Company held or beneficially held by or on behalf of such shareholder (and by or on behalf of such beneficial owner), the extent to which any hedging or other transaction or series of transactions has been entered into with respect to the shares of capital stock of the Company by or on behalf of such shareholder (and by or on behalf of such beneficial owner), and the extent to which any other agreement, arrangement or understanding has been made, the effect or intent of which is to increase or decrease the voting power of such shareholder (and such beneficial owner) with respect to shares of capital stock of the Company; (4) a representation that the shareholder is a holder of record of stock of the Company entitled to vote at the meeting and intends to appear in person or by proxy at the meeting to propose the Nominee; and (5) a representation whether the shareholder (or the beneficial owner, if any), intends or is part of a group that intends to deliver a proxy statement and/or form of proxy to holders of at least the percentage of the Company's outstanding capital stock required to elect the nominee or otherwise to solicit proxies from shareholders in support of such nomination (and a copy of such documents must be provided with the notice). The information required of clauses (3) and (4) must be supplemented not later than ten days following the record date to disclose the information contained in clauses (3) and (4) above as of the record date.

The Company may require any proposed nominee to furnish such other information as it may reasonably require to determine: (1) the eligibility of the Nominee to serve as a director of the Company

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(including the information required to be set forth in the shareholder's notice of nomination of such person as a director as of a date subsequent to the date on which the notice of such person's nomination was given); and (2) whether the Nominee qualifies as an "independent director" or "audit committee financial expert" under applicable law, securities exchange rule or regulation, or any publicly-disclosed corporate governance guideline or committee charter of the Company.

Nominees for the Board of Directors must also meet certain qualifications set forth in Section 2.2(b) of our Bylaws, which prohibit the election as a director of any person who is a director, executive officer, branch manager or trustee for any unaffiliated commercial bank, savings bank, trust company, savings and loan association, building and loan association, industrial bank or credit union that is engaged in business in: (1) any city, town or village in which the Company or any affiliate or subsidiary thereof has offices; or (2) any city, town or village adjacent to a city, town or village in which the Company or any affiliate or subsidiary thereof has offices.

J. Philip DiNapoli retired from the Board of Directors in July 2018. Upon recommendation of the Corporate Governance and Nominating Committee, the Board of Directors elected Jason DiNapoli to fill the vacancy created by the resignation of J. Philip DiNapoli. Jason DiNapoli is the son of J. Philip DiNapoli.

At the Board of Directors meeting held January 24, 2019, Walter T. Kaczmarek announced that he would be retiring as Chief Executive Officer and President of Heritage Commerce Corp and as Chief Executive Officer of Heritage Bank of Commerce effective August 8, 2019. Mr. Kaczmarek will continue as a member of the Board of Directors after his retirement. Upon recommendation of the Corporate Governance and Nominating Committee and in accordance with its succession plan, the Board of Directors elected Keith A. Wilton to succeed Mr. Kaczmarek as Chief Executive Officer and President of Heritage Commerce Corp and Heritage Bank of Commerce effective August 8, 2019. The Board of Directors also increased the size of the Board to 10 persons and elected Mr. Wilton to the Board of Directors effective February 1, 2019.

The Corporate Governance and Nomination Committee has recommended the election of Jason DiNapoli and Keith A. Wilton as directors at the 2019 Annual Meeting.

Diversity of the Board of Directors

In considering diversity of the Board (in all aspects of that term) as a criteria for selecting nominees in accordance with its charter, the Corporate Governance and Nominating Committee takes into account various factors and perspectives, including differences of viewpoint, high quality business and professional experience, education, skills and other individual qualities and attributes that contribute to Board heterogeneity, as well as race, gender and national origin. The Committee does not assign specific weights to particular criteria and no particular criterion is necessarily applicable to all prospective nominees. The Committee seeks persons with leadership experience in a variety of contexts and industries. The Committee believes that this expansive conceptualization of diversity is the most effective means to implement Board diversity. The Corporate Governance and Nominating Committee will assess the effectiveness of this approach as part of its annual review of its charter.

Term of Office

Directors serve for a one-year term or until their successors are elected. The Board does not have term limits, instead preferring to rely upon the evaluation procedures described herein as the primary methods of ensuring that each director continues to act in a manner consistent with the best interests of the shareholders and the Company.

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Board Committees

The Board may delegate portions of its responsibilities to committees of its members. These standing committees of the Board meet at regular intervals to attend to their particular areas of responsibility. Our Board has five standing committees: Audit Committee, Compensation Committee, Corporate Governance and Nominating Committee, Finance and Investment Committee, and Strategic Initiatives Committee. In addition, Heritage Bank of Commerce maintains a Loan Committee. An independent director, as defined by the applicable rules and regulations of the Nasdaq Stock Market, chairs the Board and its other standing committees (including Heritage Bank of Commerce's Loan Committee). The Chair determines the agenda, the frequency and the length of the meetings and receives input from Board members.

Executive Sessions

Independent directors meet in executive sessions throughout the year including meeting annually to consider and act upon the recommendation of the Compensation Committee regarding the compensation and performance of the Chief Executive Officer.

Evaluation of Board Performance

A Board assessment and director self-evaluations are conducted annually in accordance with an established evaluation process and includes performance of committees. The Corporate Governance and Nominating Committee oversees this process and reviews the assessment and self-evaluation with the full Board.

Management Performance and Compensation

The Compensation Committee reviews and approves the Chief Executive Officer's evaluation of the top management team on an annual basis. The Board (largely through the Compensation Committee) evaluates the compensation plans for senior management and other employees to ensure they are appropriate, competitive and properly reflect the Company's objectives and performance.

Director Stock Ownership Guidelines

The Board has adopted a policy that each member of the Board who is not an employee of the Company is expected to hold a minimum number of shares of the Company's common stock. In 2018, each such director was expected to hold, at a minimum, \$200,000 market value shares of the Company's common stock. The policy was changed in January 2019 to require a minimum ownership of 17,500 shares of the Company's common stock. Any director not meeting the minimum level as of the effective date of their election to the Board has three years to bring his or her holdings up to this minimum level. The Corporate Governance and Nominating Committee will review this policy on an annual basis.

Code of Ethics

The Board expects all directors, as well as officers and employees, to display the highest standard of ethics, consistent with the principles that have guided the Company over the years.

The Board has adopted an Executive and Principal Financial Officer's Code of Ethics that applies to the Chief Executive Officer, Chief Financial Officer and the senior financial officers of the Company to help ensure that the financial affairs of the Company are conducted honestly, ethically, accurately, objectively, consistent with generally accepted accounting principles and in compliance with all applicable governmental law, rules and regulations. We will disclose any amendment to, or a waiver from a provision of our Code of Ethics on our website. The Executive and Principal Financial Officer's Code of Ethics is available on our website at www.heritagecommercecorp.com.

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Reporting of Complaints/Concerns Regarding Accounting or Auditing Matters

The Company's Board of Directors has adopted procedures for receiving and responding to complaints or concerns regarding accounting and auditing matters. These procedures were designed to provide a channel of communication for employees and others who have complaints or concerns regarding accounting or auditing matters involving the Company.

Employee concerns may be communicated in a confidential or anonymous manner to the Audit Committee of the Board. The Audit Committee Chair will make a determination on the level of inquiry, investigation or disposal of the complaint. All complaints are discussed with the Company's senior management and monitored by the Audit Committee for handling, investigation and final disposition. The Chair of the Audit Committee will report the status and disposition of all complaints to the Board of Directors.

INFORMATION ABOUT DIRECTORS AND EXECUTIVE OFFICERS

The Board of Directors

The Board of Directors oversees our business and monitors the performance of management. In accordance with corporate governance principles, the Board does not involve itself in day-to-day operations. The directors keep themselves informed through, among other things, discussions with the Chief Executive Officer, other key executives and our principal outside advisors (legal counsel, outside auditors, and other consultants), by reading reports and other materials that we send them and by participating in Board and committee meetings.

The Company's Bylaws currently permit the number of Board members to range from 9 to 15, leaving the Board authority to fix the exact number of directors within that range. The Board has fixed the current number of directors at 10.

Board Leadership Structure

The Board of Directors is committed to maintaining an independent Board, and a majority of the Board has been comprised of independent directors. It has further been the practice for many years of the Company to separate the roles of Chief Executive Officer and Chairman of the Board in recognition of the differences between the two roles. The Chief Executive Officer is responsible for setting the strategic direction for the Company and the day-to-day leadership and performance of the Company. The Chairman of the Board provides guidance to the Chief Executive Officer, sets the agenda for Board meetings, presides over meetings of the full Board (including executive sessions), and facilitates communication among the independent directors and between the independent directors and the Chief Executive Officer. The Board further believes that the separation of the duties of the Chief Executive Officer and the Chairman of the Board eliminates any inherent conflict of interest that may arise when the roles are combined, and that an independent director who has not served as an executive of the Company can best provide the necessary leadership and objectivity required as Chairman of the Board.

Board Authority for Risk Oversight

The Board has active involvement and the responsibility for overseeing risk management of the Company arising out of its operations and business strategy. The Board monitors, reviews and reacts to material enterprise risks identified by management. The Board receives specific oral and written reports from officers with oversight responsibility for particular risks within the Company. Reports cover executive management on financial, credit, liquidity, interest rate, capital, operational, legal and regulatory compliance and reputation risks and the Company's degree of exposure to those risks. The Board helps ensure that management is properly focused on risk by, among other things, reviewing and discussing the performance of senior management and business line leaders.

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Board committees also have responsibility for risk oversight in specific areas. The Audit Committee oversees financial, accounting and internal control risk management policies. The Company's internal Risk Management Steering Committee reports directly to the Audit Committee. The Audit Committee is responsible for monitoring the Company's overall risk program. The Audit Committee receives quarterly reports from the Risk Management Steering Committee and the Company's internal audit department. The Audit Committee reports periodically to the Board on the effectiveness of risk management processes in place, risk trends, and the overall risk assessment of the Company's activities. The Compensation Committee assesses and monitors risks in the Company's compensation program. The Corporate Governance and Nominating Committee recommends director candidates with appropriate experience and skills who will set the proper tone for the Company's risk profile and provide competent oversight over our material risks.

The Committees of the Board

The Board may delegate portions of its responsibilities to committees of its members. These standing committees of the Board meet at regular intervals to attend to their particular areas of responsibility. Our Board has five standing committees: the Audit Committee, Compensation Committee, Corporate Governance and Nominating Committee, Finance and Investment Committee, and Strategic Initiatives Committee. In addition, Heritage Bank of Commerce also maintains a Loan Committee.

Audit Committee. The Company has a separately designated standing Audit Committee established in accordance with Section 3(a)(58) (A) of the Securities Exchange Act of 1934, as amended. The Audit Committee charter adopted by the Board sets out the responsibilities, authority and specific duties of the Audit Committee. The Audit Committee charter is available on the Company's website at www.heritagecommercecorp.com.

The responsibilities of the Audit Committee include the following:

oversight of our financial, accounting and reporting process, our system of internal accounting and financial controls, and our compliance with related legal and regulatory requirements;

the appointment, compensation, retention and oversight of our independent auditors, including conducting a review of their independence, reviewing and approving the planned scope of our annual audit, overseeing the independent auditors' work, and reviewing and pre-approving any audit and non-audit services that may be performed by them;

review with management and our independent auditors the effectiveness of our internal controls over financial reporting;

approve the scope and engagement of external audit services and review significant accounting policies and adjustments recommended by the independent auditors and address any significant, unresolved disagreements between the independent auditors and management;

review and discuss the annual audited financial statements with management and the independent auditors prior to publishing the annual report and filing the Annual Report on Form 10-K with the SEC;

review and discuss with management and the independent auditors any significant changes, significant deficiencies and material weaknesses regarding internal controls over financial reporting required by the Sarbanes-Oxley Act of 2002, and oversee the corrective action taken to mitigate any significant deficiencies and material weaknesses identified;

review with management and the independent auditors the effect of significant regulatory and accounting initiatives, changes, and pronouncements as well as significant and unique transactions and financial relationships;

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review with the independent auditors the matters required to be discussed by Auditing Standards No. 61, and receive and discuss with the independent auditors disclosures regarding the auditors' independence;

oversee the internal audit function and the audits directed under its auspices;.

establish policies to ensure all non-audit services provided by the independent auditors are approved prior to work being performed; and

oversee and report to the full Board on the effectiveness of the Company's risk management processes and overall risk assessment of the Company's activities.

Each member of the Audit Committee meets the independence criteria as defined by applicable rules and regulations of the SEC for audit committee membership and is independent and is "financially sophisticated" as defined by the applicable rules and regulations of the Nasdaq Stock Market. The members of the Audit Committee are Julianne M. Biagini-Komas, Steven L. Hallgrimson (Committee Chair), and Laura Roden. The Audit Committee met 14 times during 2018.

During 2017, the Board of Directors determined that Mr. Steven L. Hallgrimson has: (1) an understanding of generally accepted accounting principles and financial statements; (2) an ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves; (3) an experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by our financial statements, or experience actively supervising one or more persons engaged in such activities; (4) an understanding of internal control over financial reporting; and (5) an understanding of audit committee functions.

Therefore, in 2018 the Board determined that Mr. Hallgrimson meets the definition of "audit committee financial expert" under the applicable rules and regulations of the SEC and is "financially sophisticated" as defined by the applicable rules and regulations of the Nasdaq Stock Market. The designation of a person as an audit committee financial expert does not result in the person being deemed an expert for any purpose, including under Section 11 of the Securities Act of 1933. The designation does not impose on the person any duties, obligations or liability greater than those imposed on any other audit committee member or any other director and does not affect the duties, obligations or liability of any other member of the Audit Committee or Board of Directors.

The Audit Committee Report for 2018 appears on page 59 of this proxy statement.

Compensation Committee. The Company has a separately designated Compensation Committee, which consists entirely of independent directors as defined by the applicable rules and regulations of the Nasdaq Stock Market. The Compensation Committee has adopted a charter, which is available on the Company's website at www.heritagecommercecorp.com. The Compensation Committee has the following responsibilities:

review and approve our compensation philosophy;

review industry compensation practices and our relative compensation positioning;

review the incentive compensation programs by the Company to evaluate and ensure that none of them encourage excessive risk;

retain compensation consultants to provide independent professional advice;

approve compensation paid to our Chief Executive Officer and other executive officers;

review and approve the Compensation Discussion and Analysis appearing in our proxy statement;

review director compensation programs, plans and awards;

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administer our short-term and long-term executive incentive plans and stock or stock-based plans; and

review and approve general employee welfare benefit plans and other plans on an as needed basis.

The members of the Compensation Committee are Julianne M. Biagini-Komas (Committee Chair), Frank G. Bisceglia, Robert T. Moles, and Ranson W. Webster. The Committee met 10 times during 2018.

Corporate Governance and Nominating Committee. The Company has a separately designated Corporate Governance and Nominating Committee, which consists of entirely independent directors as defined by the applicable rules and regulations of the Nasdaq Stock Market. The Corporate Governance and Nominating Committee have adopted a charter, which is available on the Company's website at www.heritagecommercecorp.com.

The purposes of the Corporate Governance and Nominating Committee include the following responsibilities:

identifying individuals qualified to become Board members and making recommendations to the full Board of candidates for election to the Board;

recommending to the Board corporate governance guidelines;

leading the Board in an annual review of its performance; and

recommending director appointments to Board committees.

The members of the Corporate Governance and Nominating Committee are Steven L. Hallgrimson, Robert T. Moles, and Ranson W. Webster (Committee Chair). The Committee met 5 times during 2018.

Finance and Investment Committee. The Finance and Investment Committee is responsible for the development of policies and procedures related to liquidity, asset-liability management, and supervision of the Company's investments. The Committee also oversees and reviews internal financial reports including annual forecasts and budgets, and stress test analysis prepared by management. The members of the Finance and Investment Committee are Frank G. Bisceglia, Jack W. Conner (Committee Chair), Walter T. Kaczmarek, and Laura Roden. The Finance and Investment Committee met 8 times during 2018.

Strategic Initiatives Committee. The principal duties of the Strategic Initiatives Committee are to provide oversight and guidance to senior management regarding the strategic direction of the Company, including development of an overall strategic business plan. The members of the Strategic Initiatives Committee are Jack W. Conner, Jason DiNapoli, Walter T. Kaczmarek, Laura Roden (Committee Chair), and Ranson W. Webster. The Strategic Initiatives Committee met 5 times during 2018.

Heritage Bank of Commerce Loan Committee. The Heritage Bank of Commerce Loan Committee is responsible for the approval and supervision of loans and the development of the Company's loan policies and procedures. The members of the Loan Committee are Julianne M. Biagini-Komas, Frank G. Bisceglia (Committee Chair), Jason DiNapoli, Walter T. Kaczmarek, and Robert T. Moles. The Loan Committee met 37 times during 2018.

Role of Compensation Consultant

The Compensation Committee of the Board of Directors retained McLagan, an Aon Hewitt Company ("McLagan") as its independent compensation consultant in the fourth quarter of 2018 and it delivered its report in the first quarter of 2019.

The Compensation Committee has the authority to obtain assistance and advice from advisors to assist it with the evaluation of compensation matters without the approval or permission of management or the Board. The Compensation Committee uses advisors to obtain candid and direct advice independent of

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management, and takes steps to satisfy this objective. First, in evaluating firms to potentially provided advisory services to the Compensation Committee, the Compensation Committee considers if the firm provides any other services to the Company. In addition, while members of management may assist the Compensation Committee in the search for advisors, the Compensation Committee ultimately and in its sole discretion makes the decision to hire or engage a consultant and provides direction as to the scope of work to be conducted. The Chair of the Compensation Committee has evaluated the relationship of the compensation consultant with both the Company and the Compensation Committee, including the nature and amount of work performed for the Compensation Committee during the year. The Compensation Committee retained McLagan, to:

review existing compensation programs for executive officers;

provide information based on third-party data and analysis of compensation programs at comparable financial institutions for the design and implementation of our executive compensation programs;

assist the Compensation Committee in forming a peer group; and

provide independent information as to the reasonableness and appropriateness of the compensation levels and compensation programs of the Company as compared to comparable financial services companies.

Executive Officers of the Company

Set forth below is certain information with respect to the executive officers of the Company:

Name	Position
Walter T. Kaczmarek	President and Chief Executive Officer of Heritage Commerce Corp and Chief Executive Officer of Heritage Bank of Commerce
Keith A. Wilton	Executive Vice President and Chief Operating Officer of Heritage Commerce Corp and President of Heritage Bank of Commerce
Michael E. Benito	Executive Vice President/Banking Division of Heritage Bank of Commerce
Margo G. Butsch	Executive Vice President and Chief Credit Officer of Heritage Bank of Commerce
Lawrence D. McGovern	Executive Vice President and Chief Financial Officer of Heritage Commerce Corp and Heritage Bank of Commerce

Biographical information for Walter T. Kaczmarek and Keith A. Wilton is found under "Proposal 1 Election of Directors."

Michael E. Benito, age 58, has served as Executive Vice President/Banking Division of Heritage Bank of Commerce since January 2012. Mr. Benito joined Heritage Bank of Commerce in 2003 as Senior Vice President/Director of Sales & Business Development. From 1998 through 2003, Mr. Benito served as a Managing Director for Greater Bay Bank and from December 1986 through 1998, he served as Regional Vice President with Imperial Bancorp. Mr. Benito began his banking career more than 32 years ago at Union Bank of California (formerly Union Bank).

Margo G. Butsch, age 55, has served as Executive Vice President and Chief Credit Officer of Heritage Bank of Commerce since July 2017. Ms. Butsch joined Heritage Bank of Commerce through Focus Business Bank which was acquired by Heritage Bank of Commerce in August 2015. After the acquisition, Ms. Butsch joined Heritage Bank of Commerce as Vice-President/Credit Administration and was

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promoted to Senior Vice President/Credit Administration in November 2015. Since 1995 and prior to joining Heritage Bank of Commerce, Ms. Butsch held various Vice-President and Senior Vice President relationship management and loan administration positions with Focus Business Bank, The Independent Bankers Bank, Greater Bay Bank, and Imperial Bank.

Lawrence D. McGovern, age 64, has served as Executive Vice President and Chief Financial Officer of Heritage Commerce Corp and Heritage Bank of Commerce since July 1998.

Compliance with Section 16(a) of the Securities Exchange Act of 1934

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Company's directors, executive officers and persons who own more than 10% of a registered class of the Company's equity securities, to file with the SEC initial reports of ownership and reports of changes in ownership of common stock and other equity securities. They are required by SEC rules and regulations to furnish the Company with copies of all Section 16(a) forms they file.

To the Company's knowledge, based solely on review of the copies of such reports furnished to the Company and written representations that no other reports were required, all Section 16(a) filing requirements applicable to our executive officers and directors were complied with during the year ended December 31, 2018.

Transactions with Management

Some of the Company's directors and executive officers, as well as other related persons (as defined under "Policies and Procedures for Approving Related Party Transactions" below), are customers of, and have banking transactions with, the Company's subsidiary, Heritage Bank of Commerce, in the ordinary course of business, and Heritage Bank of Commerce expects to have such ordinary banking transactions with these persons in the future. In the opinion of the management of the Company and Heritage Bank of Commerce, all loans and commitments to lend included in such transactions were made in the ordinary course of business, on substantially the same terms, including interest rates and collateral, as those prevailing for comparable transactions with other persons of similar creditworthiness, and do not involve more than the normal risk of collectability or present other unfavorable features. Loans to individual directors, officers and related persons must comply with Heritage Bank of Commerce's lending policies and statutory lending limits. In addition, prior approval of Heritage Bank of Commerce's Board of Directors is required for all loans advanced to directors and executive officers. These loans are exempt from the loan prohibitions of the Sarbanes-Oxley Act.

Policies and Procedures for Approving Related Party Transactions

The Board of Directors has adopted a written Statement of Policy with Respect to Related Party Transactions. Under this policy, any "related party transaction" may be consummated or may continue only if the Audit Committee approves or ratifies the transaction in accordance with the guidelines in the policy and if the transaction is on terms comparable to those that could be obtained in arm's length dealings with an unrelated third party. For purposes of this policy, a "related person" means: (1) any person who is, or at any time since the beginning of the Company's last fiscal year was, a director or executive officer of the Company or a nominee to become a director of the Company; (2) any person who is known to be the beneficial owner of more than 5% of any class of the Company's voting securities; (3) any immediate family member of any of the foregoing persons, which means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of the director, executive officer, nominee or more than 5% beneficial owner, and any person (other than a tenant or employee) sharing the household of such director, executive officer, nominee or more than 5% beneficial owner; and (4) any firm, corporation or other entity in which

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any of the foregoing persons is employed or is a partner, principal or in a similar position, or in which such person has a 10% or greater beneficial ownership interest.

A "related party transaction" is a transaction in which the Company or any of its subsidiaries is a participant and in which a related person had or will have a direct or indirect interest, other than transactions involving: (1) less than \$5,000 when aggregated with all similar transactions; (2) customary bank deposits and accounts (including certificates of deposit); and (3) loans and commitments to lend included in such transactions that are made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing for comparable transactions with other persons of similar creditworthiness, and do not involve more than the normal risk of collectability or present other unfavorable features to the Company.

A related party who has a position or relationship with a firm, corporation, or other entity that engaged in a transaction with the Company shall not be deemed to have an indirect material interest within the meaning of this policy where the interest in the transaction arises only: (1) from such related party's position as a director of another corporation or organization that is party to the transaction; (2) from the direct or indirect ownership by the related party of less than a 10% equity interest in another person (other than a partnership) which is a party to the transaction; or (3) from the related party's position as a limited partner in a partnership in which the related party has an interest of less than 10%, and the related party is not a general partner of and does not hold another position in the partnership.

The Board of Directors has determined that the Audit Committee is best suited to review and approve related party transactions. The Committee considers all of the relevant facts and circumstances available to the Committee, including (if applicable) but not limited to: (1) the benefits to the Company; (2) the impact on a director's independence in the event the related person is a director, an immediate family member of a director or an entity in which a director is a partner, shareholder or executive officer; (3) the availability of other sources for comparable products or services; (4) the terms of the transaction; and (5) the terms available to unrelated third parties or to employees generally. No member of the Audit Committee may participate in any review, consideration or approval of any related person transaction with respect to which such member or any of his or her immediate family members is the related person. The Committee will approve only those related person transactions that are in, or are not inconsistent with, the best interests of the Company and its shareholders, as the Committee determines in good faith. The Audit Committee conveys its decision to the Chief Executive Officer, who conveys the decision to the appropriate persons within the Company.

Compensation Discussion and Analysis

This Compensation Discussion and Analysis identifies the Company's current compensation philosophy and objectives and describes the various methodologies, policies and practices for establishing and administering the compensation programs for our executives including the named executive officers. The strategies and policies of the Compensation Committee have been developed so that there is a direct correlation between executive compensation and the Company's overall performance and individual performance. The individuals who served as the Company's Chief Executive Officer and Chief Financial Officer during 2018, as well as, the other individuals included in the Summary Compensation Table, are referred to as the "named executive officers."

Overview of Compensation Philosophy

Our compensation philosophy is driven by our objective to attract and retain the premier talent needed to lead our Company in an extremely competitive environment and to strongly align the interests of our executives with those of our shareholders for the long term. Our executive compensation is aligned with our overall business strategy, with a focus on driving growth, profitability and long-term value for our shareholders.

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We structure our executive compensation program with a mix of base salary, annual performance-based cash incentive awards and long-term equity awards to incentivize and reward those individuals who make the greatest contributions to our performance and creation of shareholder value over time.

The first goal of our compensation program is to link a reasonable percentage of executive compensation to the financial performance of the Company. We achieve this goal by providing our named executive officers the opportunity to significantly increase their annual cash compensation through our variable performance based cash award incentive plan. The plan awards improvement in the Company's performance in key financial metrics on an annual basis. We also expect that as those improvements are maintained and built upon, they will be reflected in the Company's stock price.

The second goal of our compensation program is to align the interests of our executive officers with the interests of our shareholders. We use equity awards (stock options and/or restricted stock) to reward the long-term efforts of management and to retain management. These equity awards serve to increase the ownership stake of our management in the Company, further aligning the interests of the executives with those of our shareholders.

The third goal of our compensation program is to attract and retain highly competent executives. Our executives, and particularly our named executive officers, are talented managers and they are often presented with opportunities at other institutions, including opportunities at potentially higher compensation levels. We seek to attract and retain our executives by setting base compensation and incentives at competitive levels and awarding equity based awards. We also consider other forms of executive pay, including severance arrangements (including change of control provisions) as a means to attract and retain our executive officers including the named executive officers.

The use of these compensation programs and benefits enables us to reinforce our pay-for-performance philosophy, align our executives' interests with shareholders, and strengthen our ability to attract, retain and motivate highly qualified executives. We believe that this combination of programs provides an appropriate mix of fixed and variable pay, balances short-term operational performance with long-term shareholder value, and encourages executive recruitment and retention.

Compensation Program Objectives and Rewards

The components of Company's compensation and benefits programs are driven by our business environment and are designed to enable us to achieve the goals of our compensation program within a framework that adheres to the Company's mission and values. The programs' objectives are to:

Reflect our position as a leading community bank in our service areas;

Attract, engage and retain the workforce that helps ensure our current and future success;

Motivate and inspire employee behavior that fosters a high performance culture;

Support a one company culture;

Support overall business objectives;

Provide shareholders with a superior rate of return over the long term; and

Create shareholder value through the continuous provision of quality service to our customers.

Consequently, the guiding principles of our programs are to:

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Promote and maintain a high performance banking organization;

Remain competitive in our marketplace for talent;

Balance our compensation costs with our desire to provide value to employees and shareholders; and

Avoid encouraging excessive risk taking.

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To this end, we will measure success of our programs by:

Overall business performance and employee engagement;

Ability to attract and retain key talent;

Costs and business risks that are limited to levels that optimize risk and return; and

Employee understanding and perceptions that ensure program value equals or exceeds program cost.

All of our compensation and benefits for our named executive officers described below have as a primary purpose our need to attract, retain and motivate the highly talented individuals whose performance will enable us to succeed in creating shareholder value in a highly competitive marketplace. Beyond that, different elements have specific purposes designed to reward different performance and retention goals.

Base salary and benefits are designed to:

Reward core competence in the executive role relative to position, performance, experience and responsibility;

Provide fixed cash compensation with merit increases competitive with the market place; and

Control fixed expenses.

Annual incentive variable cash awards are designed to:

Focus employees on annual financial objectives derived from the business plan that lead to long-term success;

Provide annual variable performance based cash awards to reward and motivate achievement of critical annual performance metrics selected by the Compensation Committee; and

Foster a pay for performance culture that aligns our compensation programs with our overall business strategy.

Equity based compensation awards are designed to:

Align the interests of executives with those of our shareholders;

Promote teamwork by tying compensation significantly to the value of our common stock;

Attract the next generation of management by providing significant capital accumulation opportunities; and

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Retain executives by providing a long-term-oriented program whose value could only be achieved by remaining with and performing for the Company.

Change of control and separation benefits:

Individual employment contracts with certain executives provide for change of control and separation benefits;

Separation benefits provide benefits to ease an employee's transition due to an unexpected employment termination by the Company due to ongoing changes in the Company's employment needs; and

Change in control benefits encourage key executives to remain focused on the Company's business in the event of rumored or actual fundamental corporate changes which will enhance shareholder value.

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Manage excessive risk-taking through plan design and oversight of incentive plans:

Incentive awards are capped;

Performance objectives are aligned with annual financial plan approval by the Board of Directors;

Multiple financial metrics are used taking into account performance and risk;

A "claw-back policy" is applied to performance based cash payments;

Payouts are modified through the use of risk-based capital ratio metrics;

Long-term incentive equity awards are deferred through vesting requirements; and

The Compensation Committee has discretion to reduce cash bonus payments.

Role of Shareholder Input

The Compensation Committee has been mindful of the strong support our shareholders expressed for our compensation program when making executive compensation decisions, including base salary adjustments and long-term incentive awards. In making these executive compensation decisions, which are discussed more fully below, the Compensation Committee's main considerations included our shareholders' support for our executive compensation program, and the peer and market information provided by the Compensation Committee's compensation consultant. The Compensation Committee will continue to consider our shareholders' views when making executive compensation decisions in the future.

Commencing last year we are including a say-on-pay non-binding advisory proposal every year with our annual meeting proxy statement. Last year our non-binding shareholder advisory vote on executive compensation was approved, with approximately 97% of voting shareholders casting their votes in favor of the say-on-pay resolution.

Role of Compensation Committee in Determining Compensation

The Compensation Committee of the Board of Directors has strategic and oversight responsibility for the overall compensation and benefits programs for executives of the Company. These responsibilities include establishing, implementing, and continually monitoring the compensation structure, policies, and programs of the Company. The Compensation Committee also periodically reviews, assesses and monitors the performance, and regularly reviews the design and function, of the Company's incentive compensation arrangements to ensure that any risk-taking incentives are consistent with regulatory guidance and the safety and soundness of the organization. The Compensation Committee is responsible for assessing and approving the total compensation paid to the Chief Executive Officer and all executive officers. The Compensation Committee is responsible for determining whether the compensation paid to each of these executives is fair, reasonable and competitive, and whether the compensation program serves the interests of the Company's shareholders.

At least annually, the Compensation Committee reviews the executive compensation program overall, and establishes base salaries, target annual cash bonus opportunities and equity grants (if any) for the fiscal year. In setting these elements of compensation, the Compensation Committee reviews the total target compensation for our executives and also considers developments in compensation practices outside of the Company. Specifically, the Compensation Committee is provided with competitive positioning data for similarly situated executives at companies in our peer group, as well as summary consolidated information about our executives' total compensation and pay history to use in setting individual compensation elements and making decisions on total executive compensation levels. Peer data is a helpful reference for the Compensation Committee to assess the competitiveness and appropriateness of our executive compensation program within the banking industry and the broader business community. Ultimately, the

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Compensation Committee applies its own business judgment and experience to determine the individual compensation elements, the amount of each compensation element and total target compensation

The Compensation Committee generally targets compensation in relation to the Company's Compensation Peer Group (discussed under "*Market Positioning and Pay Benchmarking*"). Base salary is targeted at the 60th percentile, total cash (salary and incentive cash awards) is targeted at the 70th percentile, and total direct compensation (total cash plus the three-year average value of equity awards) is targeted at the 75th percentile. We target above the median because of the competition in our market for talented executives and our desire to attract and, more importantly, retain and motivate talented individuals we believe are necessary to achieve the goals and objectives of our Board of Directors. Depending upon Company and individual performance, as well as the various other factors discussed in this Compensation Discussion and Analysis, target and actual total direct compensation of our executives, as well as individual compensation elements, may be within, below or above the market range for their positions.

The Compensation Committee is comprised of four independent directors who satisfy The Nasdaq Stock Market listing requirements and relevant SEC regulations on independence. The Compensation Committee's Chair regularly reports to the Board of Directors on the Compensation Committee actions and recommendations. To evaluate and administer the compensation practices of the Chief Executive Officer and other executive officers, the Compensation Committee meets a minimum of four times a year. The Compensation Committee also holds special meetings and meets telephonically to discuss extraordinary items, such as the hiring or dismissal of executive officers.

Role of the Chief Executive Officer

The Chief Executive Officer is not a member of the Compensation Committee but is invited to attend meetings as necessary to provide input and recommendations on compensation for the other named executive officers. The Chief Executive Officer provides the Compensation Committee with his assessment of the performance of each named executive officer and his perspective on the factors described above in developing his recommendations for the executive's compensation, including salary adjustments, incentive bonuses, annual equity grants and equity grants awarded in conjunction with promotions. Because the Chief Executive Officer works closely with and supervises our executive team, the Compensation Committee believes that the Chief Executive Officer provides valuable insight in evaluating their performance. The Chief Executive Officer also provides the Compensation Committee with additional information regarding the effect, if any, of market competition and changes in business strategy or priorities. The Compensation Committee takes the Chief Executive Officer's general input into consideration when determining and approving executive officer compensation, including for the named executive officers other than the Chief Executive Officer.

Role of Compensation Consultants

Generally, at least every two years the Compensation Committee retains the services of an independent executive compensation consultant to assess the competitiveness of our compensation programs, conduct other research as directed by the Compensation Committee, and support the Compensation Committee in the design and implementation of executive and Board of Director compensation. In the fourth quarter of 2016, the Compensation Committee retained McLagan, an Aon Hemitt Company ("McLagan") to: (1) review existing compensation programs; (2) provide market benchmark information pertaining to both cash and noncash compensation for executives; (3) provide recommendations and guidance to the Compensation Committee to support its oversight over such compensation programs; and (4) provide other advice and consultation, including guidance relative to evolving compensation-related regulatory requirements and industry best practices. McLagan delivered its report in the first quarter of 2017 ("*2017 Report*"). The information from the 2017 Report was used in

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making compensation decisions for 2018. McLagan was more recently retained in the fourth quarter of 2018 and provided its report in the first quarter of 2019.

Representatives of the compensation consultant attend meetings of the Compensation Committee as requested and also communicate with the Compensation Committee outside of meetings. The compensation consultant reports to the Compensation Committee rather than to management, although representatives of the firm may meet with members of management, including our Chief Executive Officer for purposes of gathering information on proposals that management may make to the Compensation Committee. During fiscal 2017, the compensation consultant met with various executives to collect data and obtain management's perspective on the fiscal 2017 compensation for our executives. The Compensation Committee may replace its compensation consultant or hire additional advisors at any time. There are no known conflicts of interests between McLagan and the Company.

Market Positioning and Pay Benchmarking

Many factors are taken into account in determining the actual positioning of each executive officer's compensation, including the executive's experience, responsibilities, management abilities and job performance, overall performance of the Company, current market conditions and competitive pay for similar positions at comparable companies. In addition, the Compensation Committee reviews the relationship of various positions between departments, the affordability of desired pay levels and the importance of each position within the Company. These factors are considered by the Compensation Committee in a subjective manner without any specific formula or weighting.

McLagan, in consultation with the Compensation Committee, selected a custom peer group of financial institutions to establish a "Compensation Peer Group" for the 2017 Report. The companies included in the Compensation Peer Group were selected from publicly traded banks in California, Oregon and Washington based on: (1) compatibility of the bank based on size as measured through total assets between \$1.1 billion and \$5.0 billion (median of \$2.6 billion); (2) similarity of their product lines and business focus; and (3) comparable performance criteria relating to nonperforming assets (less than 4% of assets). In addition to the Compensation Peer Group, McLagan's primary data sources also included its proprietary regional and community banking database and published industry survey data for national and California banks. The American Bankers Association (ABA) Compensation and benefits survey was also reviewed by McLagan. Compensation Peer Group and proprietary survey data represented actual 2015 compensation information. The ABA data represented actual 2014 compensation information, adjusted to 2015 at an annual rate of 3%. McLagan adjusted national survey data upwards by 27.4% for regional salary differentials, and also to reflect higher costs of salaries in the Company's principal market.

The Comparative Peer Group and the comparative survey data were used to benchmark executive compensation levels against banks that have executive positions with responsibilities similar in breadth and scope to ours and that compete with us for executive talent. The Compensation Committee reviewed and analyzed compensation for the Chief Executive Officer and the other named executive officers for the 2018 Compensation Program.

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The Compensation Peer Group component companies used in the evaluation of the Company's executive compensation programs in the 2017 Report for executive officers were as follows:

Bank of Commerce Holdings	Hanmi Financial Corp
Bank of Marin Bancorp	Heritage Financial Corp.
Cascade Bancorp*	Heritage Oaks Bancorp*
Central Valley Community Bancorp	Pacific Continental Corp.
CU Bancorp*	Pacific Premier Bancorp
Farmers & Merchants Bancorp	Preferred Bank
First Foundation Inc.	Provident Financial Holdings
First Northern Community Bancorp	Sierra Bancorp
FNB Bancorp*	TriCo Bancshares

*

Since acquired by another financial institution.

In the fourth quarter of 2018, the Compensation Committee again engaged McLagan to provide a report for the Committee's review and consideration in the first quarter of 2019 ("2019 Report") of the Company's compensation programs for executive officers. McLagan, in consultation with the Compensation Committee, selected a custom peer group of financial institutions to establish a "Compensation Peer Group" for the 2019 Report. The companies included in the Compensation Peer Group were selected from publicly traded banks in California, Colorado, Nevada, Oregon, Utah and Washington based on: (1) compatibility of the bank based on size as measured through total assets with a median of \$3.8 billion as of December 31, 2018; (2) similarity of their product lines and business focus; and (3) comparable performance criteria including, asset growth, profitability, credit quality, capitalization and total shareholder return. In addition to the Compensation Peer Group, McLagan's primary data sources also included its proprietary 2018 Regional & Community Banking Survey database. Peer Group and proprietary survey data represented actual 2017 compensation information. McLagan aged salary data aged to 2019 at annual rate of 3%. National survey data was adjusted upward 28% to account for the cost of salaries and wages in San Jose, California relative to the national average.

The Compensation Peer Group component companies used in the evaluation of the Company's executive compensation programs in the 2019 Report for executive officers were as follows:

Bank of Commerce Holdings	National Bank Holdings
Bank of Marin Bancorp	Opus Bank
BayCom Corp	Pacific Mercantile Bancorp
Central Valley Community Bancorp	Peoples Utah Bancorp
Farmers & Merchants Bancorp	Preferred Bank
First Foundation Inc.	RBB Bancorp
Hanmi Financial Corp.	Sierra Bancorp
Heritage Financial Corp.	TriCo Bancshares
Luther Burbank Corp.	Westamerica Bancorp

Chief Executive Officer Compensation

The Compensation Committee meets with the other independent directors each year in an executive session without management present to evaluate the performance of the Chief Executive Officer. The Compensation Committee also confers with the Chief Executive Officer when setting his base salary. The Chief Executive Officer does not participate in any deliberations regarding his own compensation. The Compensation Committee annually reviews and approves goals and objectives relevant to the Chief Executive Officer and evaluates the Chief Executive's performance against those objectives. The

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Compensation Committee typically considers corporate financial performance, the Company's achievement of its short and long-term goals versus its strategic objectives and financial targets. With the assistance of the compensation consultant, the Compensation Committee also considers the compensation data related to the Compensation Peer Group for base pay, total cash compensation, and total direct compensation. The Compensation Committee approves the Chief Executive Officer's compensation level based on its evaluation. In its review the Committee believes that the Chief Executive Officer's performance has been exemplary and that his leadership and management have been critical to the continual improvement and success of the Company. The Compensation Committee in its review of the 2017 Report approved an increase in the Chief Executive Officer base salary to \$500,000 for 2018. This brought the Chief Executive Officer's base salary to approximately 7.2% below the 60th percentile based on the 2017 Report.

Base Salary Decisions for the Other Named Executive Officers

Generally the Compensation Committee believes that executive base salaries should be targeted so as not to be substantially below the 60th percentile of the Compensation Peer Group for executives in similar positions with similar responsibilities. Base salaries are reviewed annually and adjusted as necessary to realign them with market levels after taking into account the value of the position in the marketplace, career experience, and the contribution and performance of the individual. Although each of the named executive officers has an employment agreement with the Company, the initial base salary in each of the agreements may be increased (and has been in the past) in accordance with the Chief Executive Officer's evaluation of the executive's performance and the Compensation Committee's evaluation of the Company's overall compensation programs and policies.

In 2018, the Compensation Committee considered the pay practices of the Compensation Peer Group and the analyses and recommendations provided by its independent consultant in the 2017 Report. In the evaluation of base salaries for 2018 for the named executive officers, the Compensation Committee reviewed the 60th percentile for the Compensation Peer Group, but also considered the minimum, mid-range and maximum salaries paid to similarly situated positions at companies in the Compensation Peer Group as well as the performance levels of the named executive officers. As a result of its review the Compensation Committee made the following changes to the base salary of the named executive officers effective April 1, 2018:

Named Executive	2018 Salary
Walter T. Kaczmarek	\$ 500,000
Keith A. Wilton	\$ 361,920
Michael E. Benito	\$ 282,067
Margo Butsch	\$ 255,000
Lawrence D. McGovern	\$ 308,437

For 2019, the Compensation Committee reviewed the 2019 Report, which indicated that on average the Company's salaries paid in 2018 were 11% below the 50th percentile and 16% below the 60th percentile of estimated market 2019 salaries. At its March 2019, meeting the Compensation Committee approved the following salaries for 2019 that approximate for each of the named executives the 60th percentile of estimated market 2019 salaries:

Named Executive	2019 Salary
Keith A. Wilton	\$ 400,000
Michael E. Benito	\$ 296,000
Margo Butsch	\$ 290,000
Lawrence D. McGovern	\$ 340,000

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Walter T. Kaczmarek has announced his retirement effective August 8, 2019 as Chief Executive Officer and President of the Company. He will remain as a director following his retirement. In view of his retirement, the Committee did not increase his salary for 2019 and it will remain at \$500,000 on an annual basis through August 8, 2019.

Base salary drives the formula used in the Management Incentive Plan as discussed below under "Management Incentive Plan." Base salary is the only element of compensation that is used in determining the amount of contributions permitted under the Company's 401(k) plan.

Management Incentive Plan

We provide annual performance-based cash incentive awards linked to achievement against certain corporate performance goals under our Management Incentive Plan ("Incentive Plan"). The Compensation Committee believes that the annual performance metrics used in the bonus plan contribute to driving long-term stockholder value, play an important role in influencing executive performance and are an important component of our compensation program to help attract, motivate and retain our executives.

To establish our executive officers' individual target cash bonus opportunities, which are expressed as a percentage of base salary, the Compensation Committee considers competitive pay data, input from its compensation consultant, and the level, position, objectives and scope of responsibilities of each executive, as well as considerations of internal parity among similarly situated Company executives.

In late fiscal year 2017, based on its review of our executive compensation program, peer company data, and the other factors described above, the Compensation Committee approved the following target annual cash bonus opportunities for fiscal 2018, which remained unchanged from fiscal 2017 levels.

The payouts for executives under the Incentive Plan are targeted to provide aggregate cash compensation together with base salary at the 70th percentile of our Compensation Peer Group when we reach our target annual financial performance ("Target"). Smaller payouts can be awarded if we reach 90% to 95% of our target performance ("Threshold"). Larger payouts can be awarded if we achieve 105% to 110% of target performance ("Maximum"). Payouts generally are not calculated by mathematical interpolation (on a continuous scale), therefore an incentive level must be reached or exceeded for a cash award.

Named Executive	As a percent of base salary		
	Threshold	Target	Maximum
Walter T. Kaczmarek	10%	45%	75%
Keith A. Wilton	10%	40%	60%
Michael E. Benito	10%	40%	60%
Margo G. Butsch	10%	40%	60%
Lawrence D. McGovern	10%	40%	60%

The Compensation Committee reviews and approves the financial metrics for each plan year. The Compensation Committee identifies from three to six financial metrics which may be revised from year to year to align them with the Company's annual strategic plan. The Compensation Committee determines the weighting of financial metrics each year based upon recommendations from the Chief Executive

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Officer. For 2018, the following financial metrics along with the relative weights of each financial metric were established by the Compensation Committee:

Financial Metrics	Weight
Pre-Tax Income	20%
Nonperforming Assets	15%
Loan Growth	20%
Noninterest Income	15%
Noninterest Expense	15%
Deposit Growth	15%

The Compensation Committee believes pre-tax income is a valid measurement in assessing how the Company is performing from a financial standpoint. Pre-tax income is an accepted accounting measures that drives earnings per share and shareholder returns over the long term. Noninterest income and noninterest expense are important components of net income that senior management and the Board of Directors sought to improve upon in 2018. In addition, the Compensation Committee, in consultation with the Chief Executive Officer, concluded that management should continue its focus on credit quality and loan and deposit growth. Financial metrics for noninterest income and noninterest expense are financial metrics that drive overall net income. The Compensation Committee believes that nonperforming assets are an effective measure to monitor the Company's progress in improving its credit quality. Further, in view of the Company's plans to continue its focus on growth, the Compensation Committee sought to incentivize and measure growth by increases in outstanding loans and deposits.

The Compensation Committee did not realign the weighting of the mix of the financial metrics in 2018 from 2017. Because the Compensation Committee believed that the Incentive Plan should also balance risk-taking with performance, the Compensation Committee maintained a risk-based capital element to the Incentive Plan. If the total risk-based capital ratio was below 10% at year-end 2018, bonus payments would be reduced to zero. The Incentive Plan is also subject to a claw back policy if financial statements or other financial metric criteria are found to be materially inaccurate as determined by the Audit Committee.

Performance objectives were generally identified through our annual financial planning and budgeting process. Senior management developed a financial plan for 2018, and the financial plan was reviewed and approved by the Board of Directors. The Compensation Committee received recommendations from senior management for financial performance objective ranges. In setting the Threshold, Target and Maximum levels, the Compensation Committee considered specific circumstances anticipated to be encountered by the Company during the coming year and the level of improvement from year-to-year required to achieve the performance level. The Compensation Committee believed that the Threshold, Target and Maximum levels established for the Incentive Plan in 2018 were sufficiently challenging given the economic climate and the level of growth and improvement in the various financial metrics that would have to occur to meet the various performance objectives.

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For 2018, performance was assessed relative to performances for the year ended December 31, 2018, as shown below and compared to actual results:

Financial Metrics	Threshold (90% of Plan)	Target (Plan)	Maximum (110% of Plan)	2018 Actual
Pre-Tax Income	\$ 50,065,000	\$ 55,628,000	\$ 61,191,000	\$ 48,655,000
Nonperforming Assets	\$ 14,300,000	\$ 13,000,000	\$ 11,700,000	\$ 14,887,000
Loans Outstanding(1)	\$ 1,645,409,000	\$ 1,732,009,000	\$ 1,818,609,000	\$ 1,866,405,000
Noninterest Income(2)	\$ 9,380,000	\$ 10,422,000	\$ 11,464,000	\$ 9,308,000
Noninterest Expense(3)	\$ 66,875,000	\$ 64,875,000	\$ 62,875,000	\$ 75,521,000
Deposits Outstanding (4)	\$ 2,430,897,000	\$ 2,558,839,000	\$ 2,686,781,000	\$ 2,622,634,000

- (1) Threshold and Maximum at 95% and 105% of plan (includes factored receivables).
- (2) Securities gains or losses excluded from calculations.
- (3) 90% and 110% of plan not used. A \$2.0 million differential below and over Target was used for Threshold and Maximum.
- (4) Threshold and Maximum at 95% and 105% of plan (excludes brokered deposits, CDARS and State CDs).

During the first quarter of the following fiscal year, the Compensation Committee assesses the performance of the Company for each financial metric comparing the actual fiscal year results to the pre-determined performance objectives for each financial metric calculated with reference to the pre-determined weight accorded the financial metric, and an overall percentage amount for the award is calculated. In addition, the Compensation Committee has discretionary authority to include qualitative subjective measures which may increase or decrease an award by an additional 15% of base salary. The positive discretion may be utilized to address completion of special projects, department initiatives, or favorable achievements reflected in regulatory exam results. The Compensation Committee may also use its discretion in adjusting financial metrics and performance objectives for unexpected economic conditions or changes in the business of the Company.

During 2018 the Company completed the acquisition of Tri-Valley Bank and United American Bank. Both transactions closed in the second quarter of 2018. The addition of Tri-Valley Bank and United American Bank in the second quarter materially impacted the 2018 budget that served as the basis for the financial metrics for the Incentive Plan. As a result of the acquisitions, the Company did not meet the "Threshold" for Pre-Tax Income, Nonperforming Assets, Noninterest Income and Noninterest Expense. The Company, however, reached (i) "Maximum" for Loans Outstanding, and (ii) "Target" for Deposits. Based on these results, the Chief Executive Officer would have been entitled to a cash award of 21.75% of his salary and the other named executive officers would have been entitled to 18.0% of their respective base salaries. The Compensation Committee reviewed these results and also reviewed the Incentive Plan matrix with the quantitative metrics originally approved for the 2018 calendar year. In its discussions the Compensation Committee reviewed the performance of the Chief Executive Officer and the other named executive officers for 2018. The Compensation Committee recognized a balancing of the satisfaction of the various metrics as a result of the acquisitions with the metrics that were not achieved. The Compensation Committee particularly noted the exceptional efforts made by the management team in negotiating, closing, integrating and converting two different bank acquisitions during the first six months of 2018. The Compensation Committee reviewed its discretionary authority under the Plan that allows it to adjust the Incentive Plan and payout for a year for extraordinary events that affect the Company (including mergers) that were not incorporated in the development of the Incentive Plan at the beginning of the year. The Committee also reviewed its discretionary authority to increase or decrease a payout by an additional 15% of salary for qualitative performance reasons. The Compensation Committee concluded that the Chief

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Executive Officer should earn an award equal to 30% of his base salary and the other named executive officers should earn an award equal to 25% of their respective base salaries as follows:

Named Executive	Bonus Award
Walter T. Kaczmarek	\$ 148,500
Keith A. Wilton	\$ 89,610
Michael E. Benito	\$ 70,003
Margo G. Butsch	\$ 62,500
Lawrence D. McGovern	\$ 76,368

Equity Based Compensation

The Compensation Committee periodically reviews our equity compensation program from a market perspective as well as in the context of our overall compensation philosophy. The Compensation Committee also considers the appropriateness of various equity vehicles, such as stock options, and restricted stock as well as overall program costs (which include both stockholder dilution and compensation expense), when evaluating the long-term incentive mix.

The Compensation Committee believes that equity based compensation should be a significant component of total executive compensation to align executive compensation with the long-term performance of the Company and to encourage executives to make value enhancing decisions for the benefit of our shareholders. Each of the named executive officers is eligible to receive equity compensation. The Compensation Committee is responsible for determining equity grants to all staff members, including named executive officers. The Compensation Committee may also grant equity-based awards to award performance, coincide with promotions and hirings, and for recruiting and retention purposes.

In considering whether to grant an equity award and the size of the grants to be awarded, the Compensation Committee considers, with respect to each executive officer, the salary level, the contributions expected toward the growth and profitability of the Company and, to the extent available, peer survey data indicating grants made to similarly situated officers at comparable financial institutions.

The Company's Amended and Restated 2004 Equity Plan (the "2004 Plan") provided for the grant of non-qualified and incentive stock options, and restricted stock. In 2013, the Board of Directors and shareholders approved the 2013 Equity Incentive Plan (the "2013 Plan") and the 2004 Plan was terminated. Stock options and restricted stock awards issued under the 2004 Plan remain outstanding. The Compensation Committee approved all awards under the 2004 Plan and continues to do so under the 2013 Plan. The Compensation Committee is the administrator of the 2013 Plan.

We may grant stock options to our executives to align their interests with those of our shareholders and as an incentive to remain with us. The Compensation Committee believes that options to purchase shares of our common stock, with an exercise price equal to the market price of our common stock on the date of grant, are inherently performance-based and are a very effective tool to motivate our executives to build shareholder value and reinforce our position as a growth company. With stock options, our executives can realize value only to the extent that the market price of our common stock increases during the period that the option is outstanding, which provides a strong incentive to our executives to increase shareholder value. Further, because these options typically vest over a four-year period, they incentivize our executives to build value that can be sustained over time.

The Compensation Committee approves primarily nonstatutory stock options instead of incentive stock options because of the tax advantages available to the Company for nonstatutory options and because employees generally do not take full advantage of the tax benefits available to them from incentive stock options.

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We also may grant restricted stock to our executives. Restricted stock aligns the interests of our executives with those of our shareholders and helps manage the dilutive effect of our equity compensation program. Our awards of restricted stock are subject to time-based vesting. Because restricted stock has value to the recipient even in the absence of stock price appreciation, awards of restricted stock help us retain and incentivize executives during periods of market volatility, and also result in our granting fewer shares of common stock than through stock options of equivalent grant date fair value. Our awards of restricted stock typically vest over a three to four-year period for executives, and we believe that, like stock options, they help incentivize our executives to build value that can be sustained over time.

The Compensation Committee has established a stock option and restricted stock policy which recognizes that stock options and restricted stock have an impact on the profits of the Company under current accounting rules and also have a dilutive effect on the Company's shareholders. Accordingly, they are recognized as a scarce resource and option grants and awards of restricted stock are given the same consideration as any other form of compensation. The Compensation Committee has established ranges for the amount of options that may be granted that depend on the individual's position with the Company and whether the option is awarded as an incentive to attract an individual, to retain an individual or to reward performance. The Compensation Committee has established ranges for restricted stock awards.

We do not backdate options or grant options or award restricted stock retroactively. In addition, we do not coordinate grants of options or awards of restricted stock so that they are made before announcement of favorable information, or after announcement of unfavorable information. The Company's options and restricted stock are granted at fair market value on a fixed date or event (the first day of service for new hires and the date of Compensation Committee approval for existing employees), with all required approvals obtained in advance of or on the actual grant date. All grants to executive officers require the approval of the Compensation Committee and the Board of Directors. Fair market value has been consistently determined as the closing price on The Nasdaq Global Select Market on the grant date. In order to ensure that an option exercise price or restricted stock date of grant valuation fairly reflects all material information, without regard to whether the information seems positive or negative, every grant of options and restricted stock is contingent upon an assurance by management and legal counsel that the Company is not in possession of material undisclosed information. If the Company is in a "black-out" period for trading under its trading policy or otherwise in possession of inside information, the date of grant is suspended until the second business day after public dissemination of the information. We do not grant stock options with a so-called "reload" feature, nor do we loan funds to employees to enable them to exercise stock options. We have never re-priced stock options.

The Company's general practice has been to grant options and restricted stock only on the annual grant date at a Compensation Committee and Board of Directors' regular meeting held during the first quarter for the named executive officers as well as current staff, and at any other Compensation Committee meeting (whether a regular meeting or otherwise) held on the same date as a regularly scheduled Board meeting (which are held monthly) as required to attract new staff, retain staff or recognize key specific achievements.

In March 2019, the Compensation Committee approved the following restricted stock awards for 2019:

Named Executive	Restricted Shares
Walter T. Kaczmarek	25,000
Keith A. Wilton	20,000
Michael E. Benito	12,000
Margo G. Butsch	12,000
Lawrence D. McGovern	15,000

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Retirement Plans

Our Amended and Restated Supplemental Retirement Plan ("SERP") is an element of our compensation program that was offered to certain executive officers. These types of plans had been commonly offered in the community bank industry for some time. The SERP is a nonqualified defined benefit plan and is unsecured and unfunded and there are no plan assets. When the Company offered key employees participation in the SERP, including some but not all of the named executive officers, the supplemental retirement benefit awarded was based on the individual's position within the Company and a vesting schedule determined by the desirability of incenting the retention element of the program. The participant receives his or her vested benefit at retirement. A participant whose employment terminates after the normal retirement date will receive 100% of his or her supplemental retirement benefit, payable monthly, commencing on the first of the month following retirement (unless selected otherwise by the participant and except executive officers who will receive their benefit six months following retirement) and continuing until the death of the participant (unless the joint survivor option is selected). For information on the plan, see "Supplemental Retirement Plan for Executive Officers." The Company has reduced its use of the SERP as a program to attract and retain executives and key employees. It has been more than seven years since the Company has offered SERP benefits to executives and key employees.

Prohibition on Speculation in Company Stock

Our stock trading guidelines prohibit executives from speculating in our stock, which includes, but is not limited to, short selling (profiting if the market price of the securities decreases), buying or selling publicly traded options, including writing covered calls, and hedging or any other type of derivative arrangement that has a similar economic effect.

Termination of Employment and Change in Control Provisions

We recognize that it is possible that we may be involved in a transaction involving a change of control of the Company, and that this possibility could result in the departure or distraction of our executives to the detriment of our business. The Compensation Committee and the Board of Directors believe that the prospect of such a change of control transaction would likely result in our executives facing uncertainties about their future employment and distractions resulting from concern over how the potential transaction might affect them.

To allow our executives to focus solely on making decisions that are in the best interests of our shareholders in the event of a possible, threatened, or pending change of control transaction, and to encourage them to remain with us despite the possibility that a change of control might affect them adversely, each of our named executives and chief executive officer have change of control provisions in their respective employment agreements that provide them with certain payments and benefits in the event of the termination of their employment within 120 days prior to, or the 24 month period following, a change of control of the Company (referred to as the "change of control period"). The Compensation Committee and the Board believe that these "double-trigger" agreements serve as an important retention tool to ensure that personal uncertainties do not dilute our executives' complete focus on building shareholder value.

The Compensation Committee considers the use of change of control provisions and severance provisions on a case by case basis depending on the individual's position with the Company and the need to attract and/or retain the individuals. The employment agreements for Mr. Kaczmarek, Mr. Benito, and Mr. McGovern contain excise tax gross-up provisions for purposes of Section 280G of the Internal Revenue Code of 1986, as amended. It has been the policy of the Company since those agreements were entered into to exclude such provisions from its executive contracts.

The severance benefits provided for our named executive officers were determined by the Compensation Committee based on its judgment of prevailing market practices at the time each

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agreement was entered into. At present, we have employment agreements with the Chief Executive Officer and the other named executive officers, which detail their eligibility for payments under various termination scenarios. In addition, certain equity grants made to the named executive officers provide for vesting of stock options and restricted stock upon a change of control. We have disclosed the severance and/or change in control payouts that would be payable to each named executive officer if the triggering event occurred on December 31, 2018, in the "Change in Control Arrangements and Termination of Employment" section in this proxy statement.

Tax Considerations

Section 162(m) ("Section 162(m)") of the Internal Revenue Code of 1986, as amended, limits the allowable deduction for compensation paid or accrued with respect to the Chief Executive Officer and each of the four other most highly compensated executive officers of a publicly held corporation to no more than \$1 million per year.

In light of Section 162(m), it is the policy of the Compensation Committee to modify, where necessary, our executive compensation program to maximize the tax deductibility of compensation paid to our executive officers when and if the \$1 million threshold becomes an issue. At the same time, the Compensation Committee also believes that the overall performance of our executives cannot in all cases be reduced to a fixed formula and that the prudent use of discretion in determining pay levels is in our best interests and those of our shareholders. Under some circumstances, the Compensation Committee's use of discretion in determining appropriate amounts of compensation may be essential. In those situations where discretion is or can be used by the Compensation Committee, compensation may not be fully deductible.

Section 409A ("Section 409A") of the Internal Revenue Code of 1986, as amended, among other things, limits flexibility with respect to the time and form of payment of deferred compensation. If a payment or award is subject to Section 409A, but does not meet the requirements that exempt such amounts from taxation under such section, the recipient is subject to: (i) income tax at the time the payment or award is not subject to a substantial risk of forfeiture; (ii) an additional 20% tax at that time; and (iii) an additional tax equal to the amount of interest (at the underpayment rate under the Internal Revenue Code plus one percentage point) on the underpayment that would have occurred had the award been includable in the recipient's income when first deferred or, if later, when not subject to a substantial risk of forfeiture. We have made modifications to our plans and arrangements such that payments or awards under those arrangements either are intended to not constitute "deferred compensation" for Section 409A purposes (and will thereby be exempt from Section 409A's requirements) or, if they constitute "deferred compensation," are intended to comply with the Section 409A statutory provisions and final regulations.

Accounting Considerations

Accounting considerations play an important role in the design of our executive compensation program. Accounting rules require us to expense the fair value of restricted stock awards and the estimated fair value of our stock option grants which reduces the amount of our reported profits. The Compensation Committee considers the amount of this expense in determining the amount of equity compensation awards.

Dodd-Frank and Regulating Considerations

The Compensation Committee undertakes to review, consider and approve compensation decisions in accordance with proposed regulations and guidelines set forth under Dodd-Frank and bank regulators. Dodd-Frank requires the federal bank regulators and the SEC to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities, including the Company

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and Heritage Bank of Commerce, having at least \$1 billion in total assets that encourage inappropriate risks by providing an executive officer, employee, director or principal stockholder with excessive compensation, fees, or benefits or that could lead to material financial loss to the entity. The proposed regulations apply to incentive compensation paid to "covered persons" at covered financial institutions, including executive officers. The proposed regulations prohibit a covered financial institution from creating or maintaining an incentive-based compensation arrangement that encourages inappropriate risks by providing a covered person either: (i) with excessive compensation; or (ii) with incentive-based compensation that could lead to material financial loss to the financial institution. A compensation arrangement would be considered able to lead to material financial loss unless: (a) it balances risk and financial reward; (b) is compatible with effective controls and risk management; and (c) is supported by strong corporate governance.

The Federal Reserve and Federal Deposit Insurance Corporation have also issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking.

Compensation Committee Report

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 401(b) of Regulation S-K with management and, based on such review and discussions, the Compensation Committee recommended to the Board that the Compensation Discussion and Analysis be included in this proxy statement.

Compensation Committee of the Board

Julianne M. Biagini-Komas, Chair
Frank G. Bisceglia
Robert T. Moles
Ranson W. Webster

Executive Compensation Tables

The following table provides for the periods shown, information as to compensation for services of the Company's principal executive officer, principal financial officer, and the three other executive officers of the Company who had the highest total compensation (as defined in accordance with applicable regulations) with respect to the year ended 2018 (collectively referred to as the "named executive officers"):

Table of Contents**Summary Compensation Table**

Name and Principal Position (a)	Year (b)	Salary (\$) (c)(1)	Bonus (\$) (d)	Stock Awards (\$) (e)(2)	Option Award (\$) (f)(2)	Non-Equity Incentive Plan Compensation (\$) (g)(3)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$) (h)(4)	All Other Compensation (\$) (i)(5)	Total (\$) (j)
Walter T. Kaczmarek	2018	\$ 495,000		\$ 420,000	\$	\$ 148,500	\$	\$ 48,950	\$ 1,112,450
President & Chief Executive Officer of	2017	\$ 470,000		\$ 217,200	\$	\$ 186,824	\$ 92,700	\$ 40,302	\$ 1,007,026
Heritage Commerce Corp and	2016	\$ 435,303		\$ 155,100	\$	\$ 163,238	\$ 11,200	\$ 25,305	\$ 790,146
Chief Executive Officer of Heritage Bank of Commerce									
Keith A. Wilton	2018	\$ 358,440		\$ 201,600	\$	\$ 89,610	\$	\$ 32,229	\$ 681,879
Executive Vice President & Chief Operating	2017	\$ 341,750		\$ 173,760	\$	\$ 114,486	\$	\$ 34,614	\$ 664,610
Officer of Heritage Commerce Corp and President	2016	\$ 319,250		\$ 93,060	\$	\$ 116,526	\$	\$ 12,722	\$ 541,558
of Heritage Bank of Commerce									
Michael E. Benito	2018	\$ 280,013		\$ 100,800	\$	\$ 70,003	\$ 24,000	\$ 28,053	\$ 502,869
Executive Vice President/Banking Division	2017	\$ 271,852		\$ 86,880	\$	\$ 91,070	\$ 126,400	\$ 26,258	\$ 602,427
of Heritage Bank of Commerce	2016	\$ 263,352		\$ 77,550	\$	\$ 96,123	\$ 101,000	\$ 20,011	\$ 558,036
Margo G. Butsch	2018	\$ 250,000		\$ 117,600	\$	\$ 62,500	\$	\$ 14,431	\$ 444,531
Executive Vice President & Chief Credit Officer of	2017	\$ 190,153		\$ 21,450	\$	\$ 63,701	\$	\$ 7,120	\$ 282,424
Heritage Bank of Commerce									
Lawrence D. McGovern	2018	\$ 305,471		\$ 151,200	\$	\$ 76,368	\$	\$ 30,030	\$ 563,069
Executive Vice President & Chief Financial	2017	\$ 293,824		\$ 130,320	\$	\$ 98,431	\$	\$ 27,118	\$ 549,693
Officer of	2016	\$ 282,824		\$ 84,788	\$	\$ 103,231	\$ 152,200	\$ 19,125	\$ 642,168
Heritage Commerce Corp and Heritage Bank of Commerce									

- (1) The amounts in column (c) include amounts voluntarily deferred by each of the named executive officers into their 401(k) plan accounts. For 2018, Mr. Kaczmarek deferred \$24,500, Mr. McGovern deferred \$24,500, Mr. Benito deferred \$24,500, Ms. Butsch deferred \$24,500 and Mr. Wilton deferred \$24,500.
- (2) The amounts shown in columns (e) and (f) reflect the applicable full grant date fair values for stock options and stock awards in accordance with ASC 718 (excluding the effect of forfeitures), and are reported for the fiscal year during which the stock options and stock awards were issued. The assumptions used in calculating the valuation for stock options and stock awards may be found in Note 13 to the Company's consolidated financial statements for the year ended December 31, 2018, included in the Company's Annual Report on Form 10-K, filed with the SEC on March 14, 2019.
- (3) The amounts shown in column (g) for 2018 reflect payments made under the terms of the Management Incentive Plan for 2018 performance and paid in the first quarter of 2019.
- (4) The amounts shown in column (h) for 2018 represent only the aggregate change in the actuarial present value of the accumulated benefit under the Company's Supplemental Executive Retirement Plan from December 31, 2017 to December 31, 2018. The amounts in column (h) were determined using interest rate and mortality rate assumptions consistent with those used in the Company's consolidated financial statements and include amounts which the named executive officer may not currently be entitled to receive because such amounts are not vested. Assumptions used in the calculation of these amounts are included in Note 14 to the Company's consolidated financial statements for the year ended December 31, 2018, included in the Company's Annual Report on Form 10-K, filed with the SEC on March 14, 2019.

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(5)

The amounts shown in column (i) for 2018 include the following for each named executive:

Named Executive	Economic Value of Death Benefit of Life Insurance for Beneficiaries(*)	401(k) Plan Company Matching Contributions	Other Insurance Benefit	Vacation	Auto Compensation	Cash Dividend on Unvested Restricted Stock Award	Total
Walter T. Kaczmarek	\$ 9,177	\$ 2,500	\$ 6,858	\$	\$ 12,000	\$ 18,415	\$ 48,950
Keith A. Wilton	\$	\$ 2,500	\$ 3,564	\$	\$ 8,400	\$ 17,765	\$ 32,229
Michael E. Benito	\$ 2,297	\$ 2,500	\$ 2,419	\$ 5,424	\$ 8,400	\$ 7,013	\$ 28,053
Margo G. Butsch	\$	\$ 2,500 <	(2,504)	(2,991)			
Net cash flows used in financing activities	(19,829)	(21,501)					
Increase (decrease) in cash and cash equivalents	(9,519)	21,037					
Cash and Cash Equivalents at:							
Beginning of period	21,565	26,226					
End of period	\$ 12,046	\$ 47,263					

See accompanying notes to unaudited condensed consolidated financial statements.

Denny's Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 1. Introduction and Basis of Presentation

Denny's Corporation, through its wholly owned subsidiaries, Denny's Holdings, Inc. and Denny's, Inc., owns and operates the Denny's restaurant brand, or Denny's.

Our unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Therefore, certain information and notes normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. In our opinion, all adjustments considered necessary for a fair presentation of the interim periods presented have been included. Such adjustments are of a normal and recurring nature. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions; however, we believe that our estimates, including those for the above-described items, are reasonable. These interim condensed consolidated financial statements should be read in conjunction with our consolidated financial statements and notes thereto for the year ended December 26, 2007 and the related Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in our Annual Report on Form 10-K for the fiscal year ended December 26, 2007. The results of operations for the interim periods presented are not necessarily indicative of the results for the entire fiscal year ending December 31, 2008.

Note 2. Summary of Significant Accounting Policies

Effective December 27, 2007, the first day of fiscal 2008, we adopted Statement of Financial Accounting Standards No. 159 ("SFAS 159"), "The Fair Value Option for Financial Assets and Financial Liabilities." SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. We did not elect the fair value reporting option for any assets and liabilities not previously recorded at fair value.

Effective December 27, 2007, the first day of fiscal 2008, we adopted the provisions of Statement of Financial Accounting Standards No. 157 ("SFAS 157"), "Fair Value Measurements" for financial assets and liabilities, as well as any other assets and liabilities that are carried at fair value on a recurring basis in financial statements. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements, the Financial Accounting Standards Board ("FASB") having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS 157 does not require any new fair value measurements. We applied the provisions of FSP FAS 157-2, "Effective Date of FASB Statement 157," which defers the provisions of SFAS 157 for nonfinancial assets and liabilities to the first fiscal period beginning after November 15, 2008. The deferred nonfinancial assets and liabilities include items such as goodwill and other nonamortizable intangibles. We are required to adopt SFAS 157 for nonfinancial assets and liabilities in the first quarter of fiscal 2009 and are still evaluating the impact on our Condensed Consolidated Financial Statements.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

Fair Value Measurements as of June 25, 2008

June 25, 2008	Quoted Prices in	Significant Other	Significant Valuation Unobservable Technique
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	Active Markets for Identical Assets/Liabilities (Level 1)		Observable Inputs (Level 2)		Inputs (Level 3)	
	(In thousands)					
Deferred compensation plan investments	\$	6,713	\$	6,713	\$	—
Interest rate swap liability		(2,850)		—		(2,850)
Total	\$	3,863	\$	6,713	\$	(2,850)

There have been no other material changes to our significant accounting policies and estimates from the information provided in Note 2 of our Consolidated Financial Statements included in our Form 10-K for the fiscal year ended December 26, 2007, except as noted in Note 3.

Note 3. Adjustments Related to Goodwill

In March 2008, we recorded adjustments to correct an error in accounting for goodwill in relation to the sale of restaurant operations during the quarters ending March 28, 2007, June 27 2007, September 26, 2007 and December 26, 2007. Historically, we did not write-off goodwill when we sold restaurant units to franchisees. Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" requires that a portion of the entity level goodwill should be written off based on the relative fair values of the restaurant unit being sold and the remaining value of the entity, in our case, Denny's. The adjustments had no impact on previously reported cash flows.

The following line items on the Consolidated Statements of Operations for the quarter and two quarters ended June 27, 2007 and the fiscal year ended December 26, 2007 were impacted by the adjustments:

	Quarter Ended June 27, 2007			Two Quarters Ended June 27, 2007			Fiscal Year Ended December 26, 2007		
	Unadjusted	Adjustmen	Adjusted	Unadjusted	Adjustmen	Adjusted	Unadjusted	Adjustmen	Adjusted
	(In thousands, except per share amounts)								
Operating gains, losses and other charges, net	\$ (13,047)	\$ 1,022	\$ (12,025)	\$ (15,680)	\$ 1,106	\$ (14,574)	\$ (34,828)	3,746	(31,082)
Total operating costs and expenses	216,594	1,022	217,616	440,675	1,106	441,781	855,838	3,746	859,584
Operating income	24,348	(1,022)	23,326	37,018	(1,106)	35,912	83,530	(3,746)	79,784
Net income before taxes	13,623	(1,022)	12,601	15,149	(1,106)	14,043	39,905	(3,746)	36,159
Provision for income taxes	2,123	(105)	2,018	2,486	(113)	2,373	5,192	(384)	4,808
Net income	11,500	(917)	10,583	12,663	(993)	11,670	34,713	(3,362)	31,351
	\$ 0.12	\$ (0.01)	\$ 0.11	\$ 0.14	\$ (0.02)	\$ 0.12	\$ 0.37	\$ (0.04)	\$ 0.33

Basic net
income per
share

Diluted net
income per
share

\$	0.12	\$	(0.01)	\$	0.11	\$	0.13	\$	(0.01)	\$	0.12	\$	0.35	\$	(0.03)	\$	0.32
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The following line items on the Consolidated Balance Sheet as of December 26, 2007 were impacted by the adjustments:

	December 26, 2007	Adjustment (In thousands)	Adjusted December 26, 2007
Goodwill	\$ 46,185	\$ (3,746)	\$ 42,439
Total assets	381,102	(3,746)	377,356
Deferred income taxes	11,963	(384)	11,579
Total long-term liabilities	428,505	(384)	428,121
Total liabilities	559,972	(384)	559,588
Total shareholders' deficit	(178,870)	(3,362)	(182,232)
Total liabilities and shareholders' deficit	381,102	(3,746)	377,356

The following reflects the adjusted quarterly data for fiscal 2007:

	Fiscal Year Ended December 26, 2007			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In thousands, except per share data)			
Company restaurant sales	\$ 215,801	\$ 218,316	\$ 216,792	\$ 193,712
Franchise and licensing revenue	20,950	22,626	24,617	26,554
Total operating revenue	236,751	240,942	241,409	220,266
Total operating costs and expenses	224,165	217,616	225,529	192,274
Operating income	\$ 12,586	\$ 23,326	\$ 15,880	\$ 27,992
Net income	\$ 1,087	\$ 10,583	\$ 4,950	\$ 14,731
Basic net income per share (a)	\$ 0.01	\$ 0.11	\$ 0.05	\$ 0.16
Diluted net income per share (a)	\$ 0.01	\$ 0.11	\$ 0.05	\$ 0.15

- (a) Per share amounts do not necessarily sum to the total year amounts due to changes in shares outstanding and rounding.

Note 4. Assets Held for Sale

Assets held for sale of \$1.9 million and \$6.7 million, as of June 25, 2008 and December 26, 2007, respectively, include restaurants to be sold to franchisees and certain real estate properties. We expect to sell each of these assets within 12 months. Our Credit Facility (defined in Note 7) requires us to make mandatory prepayments to reduce outstanding indebtedness with the net cash proceeds from the sale of specified real estate properties. As a result, we classified a corresponding \$0.4 million of our long-term debt as a current liability in our Consolidated Balance Sheet as of December 26, 2007. This amount represents the net book value of the specified properties as of the balance sheet date. As of June 25, 2008, there were no properties included in assets held for sale for which mandatory prepayment was required.

Note 5. Goodwill and Other Intangible Assets

The changes in carrying amounts of goodwill for the two quarters ended June 25, 2008 are as follows:

	(In thousands)
Balance at December 26, 2007	\$ 42,439
Write-offs associated with sale of restaurants	(1,253)
Reversal of valuation allowance related to deferred tax assets (Note 11)	(122)
Balance at June 25, 2008	\$ 41,064

The following table reflects goodwill and intangible assets as of June 25, 2008 and December 26, 2007:

	June 25, 2008		December 26, 2007	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Goodwill	\$ 41,064	\$ —	\$ 42,439	\$ —
Intangible assets with indefinite lives:				
Trade names	\$ 42,414	\$ —	\$ 42,395	\$ —
Liquor licenses	262	—	279	—
Intangible assets with definite lives:				
Franchise and license agreements	55,727	37,819	61,903	42,036
Foreign license agreements	241	132	241	125
Intangible assets	\$ 98,644	\$ 37,951	\$ 104,818	\$ 42,161
Other assets with definitive lives:				
Software development costs	\$ 31,675	\$ 25,515	\$ 30,853	\$ 24,560

Note 6. Operating Gains, Losses and Other Charges, Net

Operating gains, losses and other charges, net are comprised of the following:

	Quarter Ended		Two Quarters Ended	
	June 25, 2008	June 27, 2007	June 25, 2008	June 27, 2007
	(In thousands)			
Gains on sales of assets and other, net	\$ (3,176)	\$ (13,457)	\$ (12,924)	\$ (16,644)
Restructuring charges and exit costs	5,719	1,192	6,754	1,830
Impairment charges	484	240	484	240
Operating gains, losses and other charges, net	\$ 3,027	\$ (12,025)	\$ (5,686)	\$ (14,574)

Gains on Sales of Assets

Proceeds and gains on sales of assets for the quarters ended June 25, 2008 and June 27, 2007 were comprised of the following:

	Quarter Ended June 25, 2008		Quarter Ended June 27, 2007	
	Net Proceeds	Gains	Net Proceeds	Gains
	(In thousands)			
Sales of restaurant operations and related real estate to franchisees	\$ 5,544	\$ 2,201	\$ 20,241	\$ 12,637
Sales of other real estate assets	1,647	944	911	305
Recognition of deferred gains	—	31	—	515
Total	\$ 7,191	\$ 3,176	\$ 21,152	\$ 13,457

Proceeds and gains on sales of assets for the two quarters ended June 25, 2008 and June 27, 2007 were comprised of the following:

	Two Quarters Ended June 25, 2008		Two Quarters Ended June 27, 2007	
	Net Proceeds	Gains	Net Proceeds	Gains
	(In thousands)			
Sales of restaurant operations and related real estate to franchisees	\$ 21,999	\$ 11,943	\$ 21,853	\$ 12,956
Sales of other real estate assets	1,622	919	5,035	3,142
Recognition of deferred gains	—	62	—	546

Total	\$	23,621	\$	12,924	\$	26,888	\$	16,644
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Restructuring Charges and Exit Costs

Restructuring charges and exit costs were comprised of the following:

	Quarter Ended		Two Quarters Ended	
	June 25, 2008	June 27, 2007	June 25, 2008	June 27, 2007
	(In thousands)			
Exit costs	\$ 815	\$ 588	\$ 1,655	\$ 735
Severance and other restructuring charges	4,904	604	5,099	1,095
Total restructuring and exit costs	\$ 5,719	\$ 1,192	\$ 6,754	\$ 1,830

Severance and other restructuring charges of \$4.9 million for the quarter ended June 25, 2008 primarily resulted from severance costs of \$4.3 million related to the reorganization to support our ongoing transition to a franchise-focused business model, which led to the elimination of approximately 50 positions.

The components of the change in accrued exit cost liabilities are as follows:

	(In thousands)
Balance, beginning of year	\$ 8,339
Provisions for units closed during the year (1)	414
Changes in estimates of accrued exit costs, net (1)	1,241
Payments, net	(1,831)
Interest accretion	409
Balance, end of quarter	8,572
Less current portion included in other current liabilities	1,957
Long-term portion included in other noncurrent liabilities	\$ 6,615

(1) Included as a component of operating gains, losses and other charges, net.

Estimated net cash payments related to exit cost liabilities in the next five years are as follows:

	(In thousands)
Remainder of 2008	\$ 1,321
2009	2,182
2010	1,626
2011	1,401
2012	1,143
Thereafter	2,997
Total	10,670
Less imputed interest	2,098
Present value of exit cost liabilities	\$ 8,572

As of June 25, 2008 and December 26, 2007, we had accrued severance and other restructuring charges of \$4.5 million and \$1.3 million, respectively. The balance as of June 25, 2008 is expected to be paid during the next 12 months.

Note 7. Long-Term Debt

Credit Facility

Our subsidiaries, Denny's, Inc. and Denny's Realty, LLC (the "Borrowers"), have a senior secured credit agreement consisting of a \$50 million revolving credit facility (including up to \$10 million for a revolving letter of credit facility), a \$137 million term loan and an additional \$37 million letter of credit facility (together, the "Credit Facility"). At June 25, 2008, we had outstanding letters of credit of \$35.3 million (comprised of \$35.0 million under our letter of credit facility and less than \$0.3 million under our revolving facility). There were no revolving loans outstanding at June 25, 2008. These balances result in availability of \$2.0 million under our letter of credit facility and approximately \$49.7 million under the revolving facility.

The revolving facility matures on December 15, 2011. The term loan and the \$37 million letter of credit facility mature on March 31, 2012. The term loan amortizes in equal quarterly installments at a rate equal to approximately 1% per annum with all remaining amounts due on the maturity date. The Credit Facility is available for working capital, capital expenditures and other general corporate purposes. We will be required to make mandatory prepayments under certain circumstances (such as required payments related to asset sales) typical for this type of credit facility and may make certain optional prepayments under the Credit Facility. We believe that our estimated cash flows from operations for 2008, combined with our capacity for additional borrowings under our Credit Facility, will enable us to meet our anticipated cash requirements and fund capital expenditures through the end of 2008.

The Credit Facility is guaranteed by Denny's Corporation and its other subsidiaries and is secured by substantially all of the assets of Denny's and its subsidiaries. In addition, the Credit Facility is secured by first-priority mortgages on 119 company-owned real estate assets. The Credit Facility contains certain financial covenants (i.e., maximum total debt to EBITDA (as defined under the Credit Facility) ratio requirements, maximum senior secured debt to EBITDA ratio requirements, minimum fixed charge coverage ratio requirements and limitations on capital expenditures), negative covenants, conditions precedent, material adverse change provisions, events of default and other terms, conditions and provisions customarily found in credit agreements for facilities and transactions of this type. We were in compliance with the terms of the Credit Facility as of June 25, 2008.

A commitment fee of 0.5% is paid on the unused portion of the revolving credit facility. Interest on loans under the revolving facility is payable at per annum rates equal to LIBOR plus 250 basis points and will adjust over time based on our leverage ratio. Interest on the term loan and letter of credit facility is payable at per annum rates equal to LIBOR plus 200 basis points. Prior to considering the impact of the interest rate swap described below, the weighted-average interest rate under the term loan was 4.7% and 7.1% as of June 25, 2008 and June 27, 2007, respectively.

Interest Rate Swap

During the second quarter of fiscal 2007, we entered into an interest rate swap with a notional amount of \$150 million to hedge a portion of the cash flows of our variable rate debt. We designated the interest rate swap as a cash flow hedge of our exposure to variability in future cash flows attributable to interest payments on the first \$150 million of floating rate debt. Under the terms of the swap, we pay a fixed rate of 4.8925% on the \$150 million notional amount and receive payments from the counterparties based on the 3-month LIBOR rate for a term ending on March 30, 2010, effectively resulting in a fixed rate of 6.8925% on the \$150 million notional amount at the inception of the swap. Interest rate differentials paid or received under the swap agreement are recognized as adjustments to interest expense.

Prior to December 26, 2007, to the extent the swap was effective in offsetting the variability of the hedged cash flows, changes in the fair value of the swap were not included in current earnings, but were reported as adjustments to other comprehensive income. At December 26, 2007, we determined that a portion of the underlying cash flows related to the swap (i.e., interest payments on \$150 million of floating rate debt) were no longer probable of occurring over the

term of the interest rate swap as a result of the probability of paying the debt down below \$150 million through scheduled repayments and prepayments with cash from the sale of company-owned restaurant operations to franchisees. As a result, we discontinued hedge accounting treatment. The losses related to the fair value of the swap included in accumulated other comprehensive income as of December 26, 2007 will be amortized to other nonoperating expense over the remaining term of the interest rate swap. Additionally, changes in the fair value of the swap are recorded in other nonoperating expense.

The changes in accumulated other comprehensive income related to the swap for the quarter and two quarters ended June 25, 2008 are as follows:

	Quarter Ended June 25, 2008 (In thousands)	Two Quarters Ended June 25, 2008
Accumulated Other Comprehensive Income, beginning of period	\$ (2,091)	\$ (2,353)
Amortization of unrealized losses related to the interest rate swap (recorded in other nonoperating expense)	297	559
Accumulated Other Comprehensive Income, end of period	\$ (1,794)	\$ (1,794)

The changes in fair value of the interest rate swap for the quarter and two quarters ended June 25, 2008 are as follows:

	Quarter Ended June 25, 2008	Two Quarters Ended June 25, 2008 (In thousands)
Fair value of the interest rate swap, beginning of period	\$ (4,723)	\$ (2,753)
Change in the fair value of the interest rate swap (recorded in other nonoperating expense)	1,881	(2,489)
Termination of swap	(8)	2,392
Fair value of the interest rate swap, end of period	\$ (2,850)	\$ (2,850)

On March 26, 2008, we terminated \$50 million notional amount of the interest rate swap. The termination resulted in a \$2.4 million cash payment, which was made during the quarter ended June 25, 2008.

By using a derivative instrument to hedge exposures to changes in interest rates, we expose ourselves to credit risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. We minimize the credit risk by entering into transactions with high-quality counterparties whose credit rating is evaluated on a quarterly basis.

Note 8. Defined Benefit Plans

The components of net pension cost of our pension plan and other defined benefit plans as determined under Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions," as amended by Statement of Financial Accounting Standards No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans," are as follows:

	Pension Plan Quarter Ended		Other Defined Benefit Plans Quarter Ended	
	June 25, 2008	June 27, 2007	June 25, 2008	June 27, 2007
	(In thousands)			
Service cost	\$ 87	\$ 88	\$ —	\$ —
Interest cost	851	789	48	47
Expected return on plan assets	(966)	(879)	—	—
Amortization of net loss	150	224	5	6
Net periodic benefit cost	\$ 122	\$ 222	\$ 53	\$ 53

	Pension Plan Two Quarters Ended		Other Defined Benefit Plans Two Quarters Ended	
	June 25, 2008	June 27, 2007	June 25, 2008	June 27, 2007
	(In thousands)			
Service cost	\$ 175	\$ 175	\$ —	\$ —
Interest cost	1,694	1,572	97	95
Expected return on plan assets	(1,939)	(1,764)	—	—
Amortization of net loss	300	441	10	12
Net periodic benefit cost	\$ 230	\$ 424	\$ 107	\$ 107

We made contributions of \$0.9 million and \$1.8 million to our qualified pension plan during the two quarters ended June 25, 2008 and June 27, 2007, respectively. We made contributions of \$0.1 million and \$0.2 million to our other defined benefit plans during the two quarters ended June 25, 2008 and June 27, 2007, respectively. We expect to contribute \$0.5 million to our qualified pension plan and \$0.5 million to our other defined benefit plans during the remainder of fiscal 2008.

Additional minimum pension liability of \$10.8 million is reported as a component of accumulated other comprehensive loss in the Condensed Consolidated Statement of Shareholders' Deficit and Comprehensive Loss as of June 25, 2008 and December 26, 2007.

Note 9. Share-Based Compensation

Total share-based compensation included as a component of net income was as follows:

	Quarter Ended		Two Quarters Ended	
	June 25, 2008	June 27, 2007	June 25, 2008	June 27, 2007
	(In thousands)			
	\$ 168	\$ 209	\$ 39	\$ 682

Share-based compensation related to liability classified restricted stock units								
Share based compensation related to equity classified awards:								
Stock options	\$	686	\$	421	\$	925	\$	619
Restricted stock units		111		426		575		858
Board deferred stock units		67		79		123		160
Total share-based compensation related to equity classified awards								
		864		926		1,623		1,637
Total share-based compensation	\$	1,032	\$	1,135	\$	1,662	\$	2,319

Additionally, during the two quarters ended June 25, 2008, we issued approximately 97,000 shares of common stock in lieu of cash to pay approximately \$0.3 million of incentive compensation.

Stock Options

During the two quarters ended June 25, 2008, we granted approximately 1.5 million stock options to certain employees and approximately 0.2 million stock options to the non-employee members of our Board of Directors. These stock options vest evenly over 3 years and have a 10-year contractual life.

The weighted average fair value per option of options granted during the two quarters ended June 25, 2008 was \$1.18. The fair value of the stock options granted in the period ended June 25, 2008 was estimated at the date of grant using the Black-Scholes option pricing model. Use of this option pricing model requires the input of subjective assumptions. These assumptions include estimating the length of time employees will retain their vested stock options before exercising them ("expected term"), the estimated volatility of our common stock price over the expected term and the number of options that will ultimately not complete their vesting requirements ("forfeitures"). Changes in the subjective assumptions can materially affect the estimate of the fair value of share-based compensation and consequently, the related amount recognized in the Consolidated Statements of Operations.

We used the following weighted average assumptions for the stock option grants for the two quarters ended June 25, 2008:

Dividend yield	0.0%
Expected volatility	50.1%
Risk-free interest rate	2.7%
Weighted-average expected term	4.6 years

The dividend yield assumption was based on our dividend payment history and expectations of future dividend payments. The expected volatility was based on the historical volatility of our stock for a period approximating the expected life. The risk-free interest rate was based on published U.S. Treasury spot rates in effect at the time of grant with terms approximating the expected life of the option. The weighted average expected term of the options represents the period of time the options are expected to be outstanding based on historical trends.

As of June 25, 2008, there was approximately \$2.8 million of unrecognized compensation cost related to unvested stock option awards outstanding, which is expected to be recognized over a weighted average of 2.3 years.

Restricted Stock Units

During the two quarters ended June 25, 2008, we made payments of \$0.4 million (before taxes) in cash and issued 0.1 million shares of common stock related to the restricted stock unit awards that vested as of December 26, 2007

Accrued compensation expense included as a component of the Condensed Consolidated Balance Sheet was as follows:

	June 25, 2008	December 26, 2007
	(In thousands)	
Liability classified restricted stock units:		
Other current liabilities	\$ 1,377	\$ 1,170
Other noncurrent liabilities	\$ 2,277	\$ 2,828
Equity classified restricted stock units:		
Additional paid-in capital	\$ 4,166	\$ 3,925

As of June 25, 2008, we had approximately \$3.1 million of unrecognized compensation cost (approximately \$0.9 million for liability classified units and approximately \$2.2 million for equity classified units) related to all unvested restricted stock unit awards outstanding, which is expected to be recognized over a weighted average of 1.8 years.

Board Deferred Stock Units

During the two quarters ended June 25, 2008, we granted approximately 0.1 million deferred stock units (which are equity classified) with a weighted-average grant date fair value of \$3.30 per unit to non-employee members of our Board of Directors. These awards are restricted in that they may not be converted to shares until the recipient has ceased serving as a member of the Board of Directors for Denny's Corporation at which time the awards automatically convert to shares. During the quarter ended June 25, 2008, one board member did not stand for reelection. As a result, the board member's deferred stock units were converted into shares of common stock.

Note 10. Accumulated Other Comprehensive Income (Loss)

Total comprehensive income was \$7.8 million and \$14.1 million for the two quarters ended June 25, 2008 and June 27, 2007, respectively

The components of Accumulated Other Comprehensive Income (Loss) in the Condensed Consolidated Statement of Shareholder's Deficit are as follows:

June 25, 2008	December 26, 2007
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	(In thousands)	
Additional minimum pension liability	\$ (10,791)	\$ (10,791)
Unrealized gain on hedged transaction	(1,794)	(2,353)
Accumulated other comprehensive income (loss)	\$ (12,585)	\$ (13,144)

Note 11. Income Taxes

The provision for income taxes was \$0.1 million and \$0.7 million for the quarter and two quarters ended June 25, 2008, respectively, compared with \$2.0 million and \$2.4 million for the quarter and two quarters ended June 27, 2007, respectively. The provision for income taxes for the first two quarters of 2008 and 2007 was determined using our effective rate estimated for the entire fiscal year. The two quarters ended June 27, 2007 also included the recognition of \$0.3 million of current tax benefits and a \$0.6 million reduction to the valuation allowance. These items resulted from the enactment of certain federal and state laws that benefited us during the second quarter of 2007.

We have provided valuation allowances related to any benefits from income taxes resulting from the application of a statutory tax rate to our net operating losses ("NOL") generated in previous periods. In addition, during 2008 and 2007, we utilized certain federal and state NOL carryforwards whose valuation allowance was established in connection with fresh start reporting on January 7, 1998. Accordingly, federal and state deferred tax expense was recorded in connection with fresh start reporting on January 7, 1998 with a corresponding reduction to the goodwill. The amounts recognized were approximately \$0.0 million and \$0.1 million for the quarter and two quarters ended June 25, 2008, respectively, and \$2.4 million and \$2.5 million for the quarter and two quarters ended June 27, 2007, respectively.

The reduction in our effective tax rate for the two quarters ended June 25, 2008 was due primarily to the utilization of federal net operating loss carryforwards from periods prior to fresh start reporting on January 7, 1998. These federal net operating loss carryforwards were fully utilized during fiscal 2007. We still have certain state net operating loss carryforwards from periods prior to fresh start reporting that have been utilized in both fiscal 2007 and 2008.

Note 12. Net Income Per Share

	Quarter Ended		Two Quarters Ended	
	June 25, 2008	June 27, 2007	June 25, 2008	June 27, 2007
	(In thousands, except for per share amounts)			
Numerator:				
Numerator for basic and diluted net income per share - net income	\$ 3,151	\$ 10,583	\$ 7,275	\$ 11,670
Denominator:				
Denominator for basic net income per share – weighted average shares	95,017	93,692	94,922	93,554
Effect of dilutive securities:				
Options	2,797	4,159	2,724	4,131
Restricted stock units and awards	1,097	1,116	1,013	1,111
Denominator for diluted net income per share - adjusted weighted average shares and assumed conversions of dilutive securities	98,911	98,967	98,659	98,796
Basic net income per share	\$ 0.03	\$ 0.11	\$ 0.08	\$ 0.12
Diluted net income per share	\$ 0.03	\$ 0.11	\$ 0.07	\$ 0.12
Stock options excluded (1)	3,814	1,853	3,182	1,799

(1) Excluded from diluted weighted-average shares outstanding as the impact would have been antidilutive.

Note 13. Supplemental Cash Flow Information

	Two Quarters Ended	
	June 25, 2008	June 27, 2007
	(In thousands)	
Income taxes paid, net	\$ 668	\$ 1,231
Interest paid	\$ 17,540	\$ 18,144
Noncash investing activities:		
Net proceeds receivable from disposition of property	\$ 3,223	\$ —
Notes received in connection with disposition of property	\$ 2,390	\$ —
Noncash financing activities:		
Issuance of common stock, pursuant to share-based compensation plans	\$ 771	\$ 222
Execution of capital leases	\$ 2,613	\$ 597

Note 14. Related Party Transactions

During the quarter and two quarters ended June 25, 2008, we sold company-owned restaurants to franchisees that are former employees. We received cash proceeds of \$0.7 million and \$1.9 million from the sale of restaurant operations to these related parties during the two periods, respectively.

Note 15. Implementation of New Accounting Standards

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162 ("SFAS 162"), "The Hierarchy of Generally Accepted Accounting Principles." SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States (the GAAP hierarchy). This Statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AICPA Codification of Auditing Standards, AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." We do not currently believe that adopting SFAS 162 will have a material impact on our Condensed Consolidated Financial Statements.

In April 2008, the FASB issued FASB Staff Position Financial Accounting Standard 142-3 ("FSP FAS 142-3"), "Determination of the Useful Life of Intangible Assets." FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets." The intent of the FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141, "Business Combinations." We are required to adopt FSP FAS 142-3 in the first quarter of 2009 and will apply it prospectively to intangible assets acquired after the effective date.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161 ("SFAS 161"), "Disclosures about Derivative Instruments and Hedging Activities," which amends and expands Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS 161 requires tabular disclosure of the fair value of derivative instruments and their gains and losses. This Statement also requires disclosure regarding the credit-risk related contingent features in derivative agreements, counterparty credit risk, and strategies and objectives for using derivative instruments. We are required to adopt SFAS 161 in the first quarter of 2009. We are currently evaluating the impact of adopting SFAS 161 on our Condensed Consolidated Financial Statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160 ("SFAS 160"), "Noncontrolling Interests in Consolidated Financial Statements — an amendment of ARB No. 51." SFAS 160 amends Accounting Research Bulletin No. 51, "Consolidated Financial Statements" to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary, which is sometimes referred to as minority interest, is an ownership interest in the consolidated entity that should be reported as equity in our Consolidated Financial Statements. Among other requirements, this Statement requires that the consolidated net income attributable to the parent and the noncontrolling interest be clearly identified and presented on the face of the consolidated income statement. SFAS 160 is effective for the first fiscal period beginning on or after December 15, 2008. We are required to adopt SFAS 160 in the first quarter of 2009. We are currently evaluating the impact of adopting SFAS 160 on our Condensed Consolidated Financial Statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007) ("SFAS 141R"), "Business Combinations." SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in an acquiree and the goodwill acquired. SFAS 141R applies to business combinations for which the acquisition date is on or after the first fiscal period beginning on or after December 15, 2008. SFAS 141R will also require that any additional reversal of deferred tax asset valuation allowance established in connection with fresh start

reporting on January 7, 1998 be recorded as a component of income tax expense rather than as currently reflected as a reduction to the goodwill established in connection with the fresh start reporting. We are required to adopt SFAS 141R in the first quarter of 2009. We are currently evaluating the impact of adopting SFAS 141R on our Condensed Consolidated Financial Statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS 157 does not require any new fair value measurements. Effective December 27, 2007, the first day of fiscal 2008, we adopted the provisions of SFAS 157 for financial assets and liabilities, as well as any other assets and liabilities that are carried at fair value on a recurring basis in financial statements. See Note 2 to the Condensed Consolidated Financial Statements. We applied the provisions of FSP FAS 157-2, "Effective Date of FASB Statement 157," which defers the provisions of SFAS 157 for nonfinancial assets and liabilities to the first fiscal period beginning after November 15, 2008. The deferred nonfinancial assets and liabilities include items such as goodwill and other nonamortizable intangibles. We are required to adopt SFAS 157 for nonfinancial assets and liabilities in the first quarter of fiscal 2009 and are still evaluating the impact on our Condensed Consolidated Financial Statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the Condensed Consolidated Financial Statements upon adoption.

Note 16. Commitments and Contingencies

There are various claims and pending legal actions against or indirectly involving us, including actions concerned with civil rights of employees and guests, other employment related matters, taxes, sales of franchise rights and businesses and other matters. Based on our examination of these matters and our experience to date, we have recorded reserves reflecting our best estimate of liability, if any, with respect to these matters. However, the ultimate disposition of these matters cannot be determined with certainty. We record legal expenses and other litigation costs as those costs are incurred.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion is intended to highlight significant changes in our financial position as of June 25, 2008 and results of operations for the quarter and two quarters ended June 25, 2008 compared to the quarter and two quarters ended June 27, 2007. The forward-looking statements included in Management's Discussion and Analysis of Financial Condition and Results of Operations, which reflect our best judgment based on factors currently known, involve risks, uncertainties, and other factors which may cause our actual performance to be materially different from the performance indicated or implied by such statements. Such factors include, among others: competitive pressures from within the restaurant industry; the level of success of our operating initiatives and advertising and promotional efforts; adverse publicity; changes in business strategy or development plans; terms and availability of capital; regional weather conditions; overall changes in the general economy (including with regard to energy costs), particularly at the retail level; political environment (including acts of war and terrorism); and other factors included in the discussion below, or in Part II. Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Part I. Item 1A. Risk Factors, contained in our Annual Report on Form 10-K for the year ended December 26, 2007.

Statements of Operations

The following table contains information derived from our Condensed Consolidated Statements of Operations expressed as a percentage of total operating revenues, except as noted below. Percentages may not add due to rounding.

Quarter Ended		Two Quarters Ended	
June 25, 2008	June 27, 2007	June 25, 2008	June 27, 2007

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(Dollars in thousands)

Revenue:

Company restaurant sales	\$ 163,233	85.8%	\$ 218,316	90.6%	\$ 332,826	86.2%	\$ 434,117	90.9%
Franchise and license revenue	27,039	14.2%	22,626	9.4%	53,442	13.8%	43,576	9.1%
Total operating revenue	190,272	100.0%	240,942	100.0%	386,268	100.0%	477,693	100.0%

Costs of company restaurant sales (a):

Product costs	39,032	23.9%	56,323	25.8%	80,979	24.3%	111,449	25.7%
Payroll and benefits	69,021	42.3%	91,932	42.1%	142,749	42.9%	184,800	42.6%
Occupancy	9,976	6.1%	13,024	6.0%	20,528	6.2%	26,152	6.0%
Other operating expenses	24,730	15.1%	31,782	14.6%	49,938	15.0%	62,095	14.3%
Total costs of company restaurant sales	142,759	87.5%	193,061	88.4%	294,194	88.4%	384,496	88.6%

Costs of franchise and license revenue (a)

	8,520	31.5%	6,933	30.6%	16,691	31.2%	13,408	30.8%
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General and administrative expenses

	15,537	8.2%	17,167	7.1%	31,152	8.1%	33,093	6.9%
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Depreciation and amortization

	9,892	5.2%	12,480	5.2%	20,133	5.2%	25,358	5.3%
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Operating gains, losses and other charges

	3,027	1.6%	(12,025)	(5.0%)	(5,686)	(1.5%)	(14,574)	(3.1%)
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Total operating costs and expenses

	179,735	94.5%	217,616	90.3%	356,484	92.3%	441,781	92.5%
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Operating income

	10,537	5.5%	23,326	9.7%	29,784	7.7%	35,912	7.5%
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Other expenses:

Interest expense, net	8,883	4.7%	10,953	4.5%	18,084	4.7%	22,294	4.7%
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Other nonoperating expense (income), net

	(1,617)	(0.8%)	(228)	(0.1%)	3,759	1.0%	(425)	(0.1%)
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Total other expenses, net

	7,266	3.8%	10,725	4.5%	21,843	5.7%	21,869	4.6%
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Net income before income taxes

	3,271	1.7%	12,601	5.2%	7,941	2.1%	14,043	2.9%
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Provision for income taxes

	120	0.1%	2,018	0.8%	666	0.2%	2,373	0.5%
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Net income

	\$ 3,151	1.7%	\$ 10,583	4.4%	\$ 7,275	1.9%	\$ 11,670	2.4%
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Other Data:

Company-owned average unit sales	\$ 442		\$ 428		\$ 875		\$ 844	
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Franchise average unit sales

	368		380		735		746	
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Company-owned equivalent units (b)

	369		510		380		514	
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Franchise equivalent units (b)

	1,178		1,032		1,168		1,028	
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Same-store sales increase (decrease) (company-owned) (c)(d)	(0.7)%	2.8%	0.0%	0.5%
Guest check average increase (d)	6.4%	3.6%	6.1%	3.1%
Guest count decrease (d)	(6.7)%	(0.8)%	(5.7)%	(2.6)%
Same-store sales increase (decrease) (franchised and licensed units) (c) (d)	(3.7)%	4.0%	(2.3)%	1.6%

(a) Costs of company restaurant sales percentages are as a percentage of company restaurant sales. Costs of franchise and license revenue percentages are as a percentage of franchise and license revenue. All other percentages are as a percentage of total operating revenue.

(b) Equivalent units are calculated as the weighted average number of units outstanding during a defined time period.

(c) Same-store sales include sales from restaurants that were open the same days in both the current year and prior year.

(d) Prior year amounts have not been adjusted for 2008 comparable units.

Quarter Ended June 25, 2008 Compared with Quarter Ended June 27, 2007

	Quarter Ended	
	June 25, 2008	June 27, 2007
Company-owned restaurants, beginning of period	373	517
Units opened	2	—
Units acquired from franchisees	—	—
Units sold to franchisees	(20)	(28)
Units closed	(1)	(1)
End of period	354	488
Franchised and licensed restaurants, beginning of period	1,177	1,028
Units opened	2	2
Units acquired by Company	—	—
Units purchased from Company	20	28
Units closed	(8)	(7)
End of period	1,191	1,051
Total company-owned, franchised and licensed restaurants, end of period	1,545	1,539

Company Restaurant Operations

During the quarter ended June 25, 2008, we incurred a 0.7% decrease in same-store sales, comprised of a 6.4% increase in guest check average and a 6.7% decrease in guest counts. Company restaurant sales decreased \$55.1 million, or 25.2%, primarily resulting from a 141 equivalent-unit decrease in company-owned restaurants. The decrease in equivalent-units primarily resulted from the sale of company-owned restaurants to franchisees as part of our Franchise Growth Initiative.

Total costs of company restaurant sales as a percentage of company restaurant sales decreased to 87.5% from 88.4%. Product costs decreased to 23.9% from 25.8% due to favorable shifts in menu mix. Payroll and benefits costs increased to 42.3% from 42.1% primarily as a result of increased group insurance and management staffing costs, offset by a decrease in restaurant staffing related to improved scheduling. Occupancy costs increased slightly to 6.1% from 6.0%. Other operating expenses were comprised of the following amounts and percentages of company restaurant sales:

	Quarter Ended					
	June 25, 2008		June 27, 2007			
	(Dollars in thousands)					
Utilities	\$	8,080	4.9%	\$	10,032	4.6%
Repairs and maintenance		3,607	2.2%		4,818	2.2%
Marketing		5,592	3.4%		7,315	3.4%
Legal		487	0.3%		985	0.4%
Other direct costs		6,964	4.3%		8,632	4.0%
Other operating expenses	\$	24,730	15.1%	\$	31,782	14.6%

The overall decrease in other operating expenses primarily results from the sale of company-owned restaurants to franchisees.

Franchise Operations

Franchise and license revenue and costs of franchise and license revenue were comprised of the following amounts and percentages of franchise and license revenue for the periods indicated:

	Quarter Ended						
	June 25, 2008			June 27, 2007			
	(Dollars in thousands)						
Royalties	\$	17,156	63.5%	\$	15,521	68.6%	
Initial and other fees		1,056	3.9	%	1,257	5.6	%
Occupancy revenue		8,827	32.6%		5,848	25.8%	
Franchise and license revenue		27,039	100.0%		22,626	100.0%	
Occupancy costs		6,886	25.5%		4,932	21.8%	
Other direct costs		1,634	6.0%		2,001	8.8%	
Costs of franchise and license revenue	\$	8,520	31.5%	\$	6,933	30.6%	

Royalties increased by \$1.6 million, or 10.5%, primarily resulting from a 146 equivalent-unit increase in franchised and licensed units, as compared to the prior year quarter, offset by the effects of a 3.7% decrease in same-store sales. The increase in equivalent-units resulted from the sale of company-owned restaurants to franchisees. The increase in occupancy revenue of \$3.0 million, or 50.9%, is also primarily the result of the sale of restaurants to franchisees.

Costs of franchise and license revenue increased by \$1.6 million, or 22.9%. The increase in occupancy costs of \$2.0 million, or 39.6%, is primarily the result of the sale of company-owned restaurants to franchisees. Other direct costs benefited by \$0.4 million, or 18.3%, primarily as a result of the reorganization of the field management structure that occurred in the third quarter of 2007. As a percentage of franchise and license revenue, costs of franchise and license revenue increased to 31.5% for the quarter ended June 25, 2008 from 30.6% for the quarter ended June 27, 2007.

Other Operating Costs and Expenses

Other operating costs and expenses such as general and administrative expenses and depreciation and amortization expense relate to both company and franchise operations.

General and administrative expenses are comprised of the following:

	Quarter Ended	
	June 25, 2008	June 27, 2007
	(In thousands)	
Share-based compensation	\$ 1,032	\$ 1,135
General and administrative expenses	14,505	16,032
Total general and administrative expenses	\$ 15,537	\$ 17,167

Depreciation and amortization is comprised of the following:

	Quarter Ended	
	June 25, 2008	June 27, 2007
	(In thousands)	
Depreciation of property and equipment	\$ 7,669	\$ 9,632
Amortization of capital lease assets	827	1,216
Amortization of intangible assets	1,396	1,632
Total depreciation and amortization expense	\$ 9,892	\$ 12,480

The overall decrease in depreciation and amortization expense is due primarily to the sale of company-owned restaurants to franchisees during fiscal 2007 and 2008.

Operating gains, losses and other charges, net are comprised of the following:

	Quarter Ended	
	June 25, 2008	June 27, 2007
	(In thousands)	
Gains on sales of assets and other, net	\$ (3,176)	\$ (13,457)
Restructuring charges and exit costs	5,719	1,192
Impairment charges	484	240
Operating gains, losses and other charges, net	\$ 3,027	\$ (12,025)

During the quarter ended June 25, 2008, we recognized \$2.2 million of gains on the sale of 20 restaurant operations to seven franchisees for net proceeds of \$5.5 million compared to \$12.6 million of gains on the sale of 28 restaurant operations to five franchisees for net proceeds of \$20.2 million during the prior year quarter. The remaining gains for the two periods resulted from the sale of real estate related to closed restaurants and restaurants operated by franchisees and the recognition of deferred gains.

Restructuring charges and exit costs were comprised of the following:

	Quarter Ended	
	June 25, 2008	June 27, 2007
	(In thousands)	
Exit costs	\$ 815	\$ 588
Severance and other restructuring charges	4,904	604
Total restructuring and exit costs	\$ 5,719	\$ 1,192

During the quarter ended June 25, 2008, we recognized \$4.3 million in severance and other restructuring charges related to a reorganization to support our ongoing transition to a franchise-focused business model. The reorganization led to the elimination of approximately 50 positions.

Operating income was \$10.5 million for the quarter ended June 25, 2008 compared with \$23.3 million for the quarter ended June 27, 2007.

Interest expense, net is comprised of the following:

	Quarter Ended	
	June 25, 2008	June 27, 2007
	(In thousands)	
Interest on senior notes	\$ 4,363	\$ 4,363
Interest on credit facilities	2,355	4,201
Interest on capital lease liabilities	915	995
Letters of credit and other fees	504	590
Interest income	(228)	(321)
Total cash interest	7,909	9,828
Amortization of deferred financing costs	277	297
Interest accretion on other liabilities	697	828
Total interest expense, net	\$ 8,883	\$ 10,953

The decrease in interest expense resulted primarily from the repayment of \$100.3 million on the credit facilities during 2007.

The provision for income taxes was \$0.1 million and \$2.0 million for the quarter ended June 25, 2008 and June 27, 2007, respectively. The provision for income taxes for the quarters of 2008 and 2007 was determined using our effective rate estimated for the entire fiscal year. The quarter ended June 27, 2007 also included the recognition of \$0.3 million of current tax benefits and a \$0.6 million reduction to the valuation allowance. These items resulted from the enactment of certain federal and state laws that benefited us during the second quarter of 2007. We have provided valuation allowances related to any benefits from income taxes resulting from the application of a statutory tax rate to our net operating losses ("NOL") generated in previous periods. In addition, during 2008 and 2007, we utilized certain federal and state NOL carryforwards whose valuation allowance was established in connection with fresh start reporting on January 7, 1998. Accordingly, for the quarter ended June 25, 2008 and June 27, 2007, we recognized approximately \$0.0 million and \$2.4 million, respectively, of federal and state deferred tax expense with a corresponding reduction to the goodwill that was recorded in connection with fresh start reporting on January 7, 1998. The reduction in our effective tax rate for the quarter ended June 25, 2008 was due primarily to the utilization of federal net operating loss carryforwards from periods prior to fresh start reporting on January 7, 1998. These federal net operating loss carryforwards were fully utilized during fiscal 2007. We still have certain state net operating loss carryforwards from periods prior to fresh start reporting that have been utilized in both fiscal 2007 and 2008.

Net income was \$3.2 million for the quarter ended June 25, 2008 compared with \$10.6 million for the quarter ended June 27, 2007 due to the factors noted above.

Two Quarters Ended June 25, 2008 Compared with Two Quarters Ended June 27, 2007

	Two Quarters Ended	
	June 25, 2008	June 27, 2007
Company-owned restaurants, beginning of period	394	521
Units opened	3	1
Units acquired from franchisees	—	1
Units sold to franchisees	(41)	(34)
Units closed	(2)	(1)
End of period	354	488
Franchised and licensed restaurants, beginning of period	1,152	1,024
Units opened	11	5
Units acquired by Company	—	(1)
Units purchased from Company	41	34
Units closed	(13)	(11)
End of period	1,191	1,051
Total company-owned, franchised and licensed restaurants, end of period	1,545	1,539

Company Restaurant Operations

During the two quarters ended June 25, 2008, same-store sales remained unchanged, but were comprised of a 6.1% increase in guest check average and a 5.7% decrease in guest counts. Company restaurant sales decreased \$101.3 million, or 23.3%, primarily resulting from a 134 equivalent-unit decrease in company-owned restaurants. The decrease in equivalent-units primarily resulted from the sale of company-owned restaurants to franchisees as part of our Franchise Growth Initiative.

Total costs of company restaurant sales as a percentage of company restaurant sales decreased to 88.4% from 88.6%. Product costs decreased to 24.3% from 25.7% due to favorable shifts in menu mix. Payroll and benefits increased to 42.9% from 42.6% primarily as a result of increased management staffing costs, offset by a decrease in

restaurant staffing related to improved scheduling. Occupancy costs increased to 6.2% from 6.0%. Other operating expenses were comprised of the following amounts and percentages of company restaurant sales:

	Two Quarters Ended					
	June 25, 2008		June 27, 2007			
	(Dollars in thousands)					
Utilities	\$	16,345	4.9%	\$	20,795	4.8%
Repairs and maintenance		7,265	2.2%		8,765	2.0%
Marketing		11,229	3.4%		14,468	3.3%
Legal		872	0.3%		1,530	0.4%
Other direct costs		14,227	4.3%		16,537	3.8%
Other operating expenses	\$	49,938	15.0%	\$	62,095	14.3%

The overall decrease in other operating expenses primarily results from the sale of company-owned restaurants to franchisees. As a percentage of company restaurant sales, other direct costs in fiscal 2007 benefited from \$0.6 million of insurance proceeds resulting from income lost due to hurricanes.

Franchise Operations

Franchise and license revenue and costs of franchise and license revenue were comprised of the following amounts and percentages of franchise and license revenue for the periods indicated:

	Two Quarters Ended			
	June 25, 2008		June 27, 2007	
	(Dollars in thousands)			
Royalties	\$ 33,992	63.6%	\$ 30,319	69.6%
Initial fees	2,262	4.2%	1,776	4.1%
Occupancy revenue	17,188	32.2%	11,481	26.3%
Franchise and license revenue	53,442	100.0%	43,576	100.0%
Occupancy costs	13,407	25.1%	9,534	21.9%
Other direct costs	3,284	6.1%	3,874	8.9%
Costs of franchise and license revenue	\$ 16,691	31.2%	\$ 13,408	30.8%

Royalties increased by \$3.7 million, or 12.1%, primarily resulting from a 140 equivalent-unit increase in franchised and licensed units, as compared to the prior year period, offset by the effects of a 2.3% decrease in same-store sales. The increase in equivalent-units resulted from the sale of company-owned restaurants to franchisees. The increase in occupancy revenue of \$5.7 million, or 49.7%, is also primarily the result of the sale of company-owned restaurants to franchisees.

Costs of franchise and license revenue increased by \$3.3 million, or 24.5%. The increase in occupancy costs of \$3.9 million, or 40.6%, is primarily the result of the sale of company-owned restaurants to franchisees. Other direct costs benefited by \$0.6 million, or 15.2%, primarily as a result of the reorganization of the field management structure that occurred in the third quarter of 2007. As a percentage of franchise and license revenue, costs of franchise and license revenue increased to 31.2% for the two quarters ended June 25, 2008, as compared to 30.8% for the two quarters ended June 27, 2007.

Other Operating Costs and Expenses

General and administrative expenses are comprised of the following:

	Two Quarters Ended	
	June 25, 2008	June 27, 2007
	(In thousands)	
Share-based compensation	\$ 1,662	\$ 2,319
General and administrative expenses	29,490	30,774
Total general and administrative expenses	\$ 31,152	\$ 33,093

The decrease in share-based compensation expense is primarily due to the adjustment of the liability classified restricted stock units to fair value as of June 25, 2008.

Depreciation and amortization is comprised of the following:

	Two Quarters Ended	
	June 25, 2008	June 27, 2007
	(In thousands)	
Depreciation of property and equipment	\$ 15,541	\$ 19,436
Amortization of capital lease assets	1,670	2,425
Amortization of intangible assets	2,922	3,497
Total depreciation and amortization expense	\$ 20,133	\$ 25,358

The overall decrease in depreciation and amortization expense is due primarily to the sale of company-owned restaurants to franchisees during fiscal 2007 and 2008.

Operating gains, losses and other charges, net are comprised of the following:

	Two Quarters Ended	
	June 25, 2008	June 27, 2007
	(In thousands)	
Gains on sales of assets and other, net	\$ (12,924)	\$ (16,644)
Restructuring charges and exit costs	6,754	1,830
Impairment charges	484	240
Operating gains, losses and other charges, net	\$ (5,686)	\$ (14,574)

During the two quarters ended June 25, 2008, we recognized \$11.9 million of gains on the sale of 41 restaurant operations to eleven franchisees for net proceeds of \$22.0 million compared to \$13.0 million of gains on the sale of 34 restaurant operations to six franchisees for net proceeds of \$21.9 million during the prior year period. The remaining gains for the two periods resulted from the sale of real estate related to closed restaurants and restaurants operated by

franchisees and the recognition of deferred gains.

Restructuring charges and exit costs were comprised of the following:

	Two Quarters Ended	
	June 25, 2008	June 27, 2007
	(In thousands)	
Exit costs	\$ 1,655	\$ 735
Severance and other restructuring charges	5,099	1,095
Total restructuring and exit costs	\$ 6,754	\$ 1,830

During the two quarters ended June 25, 2008, we recognized \$4.3 million in severance and other restructuring charges related to a reorganization to support our ongoing transition to a franchise-focused business model. The reorganization led to the elimination of approximately 50 positions.

Operating income was \$29.8 million for the two quarters ended June 25, 2008 compared with \$35.9 million for the two quarters ended June 27, 2007.

Interest expense, net is comprised of the following:

	Two Quarters Ended	
	June 25, 2008	June 27, 2007
	(In thousands)	
Interest on senior notes	\$ 8,726	\$ 8,726
Interest on credit facilities	5,019	8,853
Interest on capital lease liabilities	1,858	1,999
Letters of credit and other fees	997	1,183
Interest income	(501)	(672)
Total cash interest	16,099	20,089
Amortization of deferred financing costs	554	585
Interest accretion on other liabilities	1,431	1,620
Total interest expense, net	\$ 18,084	\$ 22,294

The decrease in interest expense resulted primarily from the repayment of \$100.3 million on the credit facilities during 2007.

The provision for income taxes was \$0.7 million and \$2.4 million for the two quarters ended June 25, 2008 and June 27, 2007, respectively. The provision for income taxes for the two quarters of 2008 and 2007 was determined using our effective rate estimated for the entire fiscal year. The two quarters ended June 27, 2007 also included the recognition of \$0.3 million of current tax benefits and a \$0.6 million reduction to the valuation allowance. These items resulted from the enactment of certain federal and state laws that benefited us during the second quarter of 2007. We have provided valuation allowances related to any benefits from income taxes resulting from the application of a statutory tax rate to our net operating losses ("NOL") generated in previous periods. In addition, during 2008 and 2007, we utilized certain federal and state NOL carryforwards whose valuation allowance was established in connection with fresh start reporting on January 7, 1998. Accordingly, for the two quarters ended June 25, 2008 and June 27, 2007, we recognized approximately \$0.1 million and \$2.5 million, respectively, of federal and state deferred tax expense with a corresponding reduction to the goodwill that was recorded in connection with fresh start reporting on January 7, 1998. The reduction in our effective tax rate for the two quarters ended June 25, 2008 was due primarily to the utilization of federal net operating loss carryforwards from periods prior to fresh start reporting on January 7, 1998. These federal net operating loss carryforwards were fully utilized during fiscal 2007. We still have certain state net operating loss carryforwards from periods prior to fresh start reporting that have been utilized in both fiscal 2007 and 2008.

Net income was \$7.3 million for the two quarters ended June 25, 2008 compared with \$11.7 million for the two quarters ended June 27, 2007 due to the factors noted above.

Liquidity and Capital Resources

Our primary sources of liquidity and capital resources are cash generated from operations, borrowings under our Credit Facility (as defined in Note 7) and, in recent years, cash proceeds from the sale of surplus properties and sales of restaurant operations to franchisees. Principal uses of cash are operating expenses, capital expenditures and debt repayments.

The following table presents a summary of our sources and uses of cash and cash equivalents for the periods indicated:

	Two Quarters Ended	
	June 25, 2008	June 27, 2007
	(In thousands)	
Net cash provided by operating activities	\$ 7,131	\$ 28,850
Net cash provided by investing activities	3,179	13,688
Net cash used in financing activities	(19,829)	(21,501)
Net increase (decrease) in cash and cash equivalents	\$ (9,519)	\$ 21,037

The decrease in operating cash flows primarily resulted from the runoff of working capital deficit following the sale of restaurant operations to franchisees and the timing of certain operating expense payments. We believe that our estimated cash flows from operations for 2008, combined with our capacity for additional borrowings under our credit facility, will enable us to meet our anticipated cash requirements and fund capital expenditures through the end of 2008.

Net cash flows provided by investing activities were \$3.2 million for the two quarters ended June 25, 2008. These cash flows primarily represent net proceeds of \$18.0 million on sales of restaurant operations to franchisees, real estate related to restaurants operated by franchisees and other assets. The proceeds were offset by capital expenditures of \$17.4 million for the two quarters ended June 25, 2008, of which \$2.6 million was financed through capital leases. Our principal capital requirements have been largely associated with the maintenance of our existing company-owned restaurants and facilities, new construction, remodeling and our strategic initiatives, as follows:

	Two Quarters Ended	
	June 25, 2008	June 27, 2007
	(In thousands)	
Facilities	\$ 4,994	\$ 5,419
New construction	3,756	3,570
Remodeling	4,436	1,597
Strategic initiatives	1,557	—
Other	86	406
Capital expenditures	14,829	10,992
Acquisitions	—	2,208
Capital expenditures and acquisitions	\$ 14,829	\$ 13,200

Cash flows used in financing activities were \$19.8 million for the two quarters ended June 25, 2008, which included \$14.8 million of prepayments and \$3.0 million of scheduled debt payments made through a combination of asset sale proceeds, as noted above, and surplus cash.

Our credit facility consists of a \$50 million revolving credit facility (including up to \$10 million for a revolving letter of credit facility), a \$137 million term loan and an additional \$37 million letter of credit facility. At June 25, 2008, we had outstanding letters of credit of \$35.3 million (comprised of \$35.0 million under our letter of credit facility and \$0.3 million under our revolving facility). There were no revolving loans outstanding at June 25, 2008. These balances result in availability of \$2.0 million under our letter of credit facility and \$49.7 million under the revolving facility.

The revolving facility matures on December 15, 2011. The term loan and the \$37 million letter of credit facility mature on March 31, 2012. The term loan amortizes in equal quarterly installments at a rate equal to approximately 1% per annum with all remaining amounts due on the maturity date. The credit facility is available for working capital, capital expenditures and other general corporate purposes. We will be required to make mandatory prepayments under certain circumstances (such as required payments related to asset sales) typical for this type of credit facility and may make certain optional prepayments under the credit facility.

The credit facility is guaranteed by Denny's Corporation and its other subsidiaries and is secured by substantially all of the assets of Denny's and its subsidiaries. In addition, the credit facility is secured by first-priority mortgages on 119 company-owned real estate assets. The credit facility contains certain financial covenants (i.e., maximum total debt to EBITDA (as defined under the credit facility) ratio requirements, maximum senior secured debt to EBITDA ratio requirements, minimum fixed charge coverage ratio requirements and limitations on capital expenditures), negative covenants, conditions precedent, material adverse change provisions, events of default and other terms, conditions and provisions customarily found in credit agreements for facilities and transactions of this type. We were in compliance with the terms of the credit facility as of June 25, 2008.

As of June 25, 2008, interest on loans under the revolving facility is payable at per annum rates equal to LIBOR plus 250 basis points and will adjust over time based on our leverage ratio. Interest on the term loan and letter of credit facility is payable at per annum rates equal to LIBOR plus 200 basis points. Prior to considering the impact of the interest rate swap, the weighted-average interest rate under the term loan was 4.7% as of June 25, 2008.

Our working capital deficit was \$73.4 million at June 25, 2008 compared with \$73.6 million at December 26, 2007. We are able to operate with a substantial working capital deficit because (1) restaurant operations and most food service operations are conducted primarily on a cash (and cash equivalent) basis with a low level of accounts receivable, (2) rapid turnover allows a limited investment in inventories, and (3) accounts payable for food, beverages and supplies usually become due after the receipt of cash from the related sales.

Implementation of New Accounting Standards

See Notes 2 and 15 to our Condensed Consolidated Financial Statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

We have exposure to interest rate risk related to certain instruments entered into for other than trading purposes. Specifically, borrowings under the term loan and revolving credit facility bear interest at variable rates based on LIBOR plus a spread of 200 basis points per annum for the term loan and letter of credit facility and 250 basis points per annum for the revolving credit facility.

During the second quarter of fiscal 2007, we entered into an interest rate swap with a notional amount of \$150 million to hedge a portion of the cash flows of our variable rate debt. We designated the interest rate swap as a cash flow hedge of our exposure to variability in future cash flows attributable to interest payments on the first \$150 million of floating rate debt. Under the terms of the swap, through March 26, 2008, we paid a fixed rate of 4.8925% on the \$150 million notional amount and received payments from the counterparties based on the 3-month LIBOR rate for a term ending on March 30, 2010, effectively resulting in a fixed rate of 6.8925% on the \$150 million notional amount. On March 26, 2008, we terminated \$50 million of the notional amount of the interest rate swap. As of June 25, 2008, the swap effectively increases our ratio of fixed rate debt from approximately 56% of total debt to approximately 88% of total debt.

Based on the levels of borrowings under the credit facility at June 25, 2008, if interest rates changed by 100 basis points our annual cash flow and income before income taxes would change by approximately \$0.4 million. This computation is determined by considering the impact of hypothetical interest rates on the variable rate portion of the credit facility at June 25, 2008. However, the nature and amount of our borrowings under the credit facility may vary as a result of future business requirements, market conditions and other factors.

Our other outstanding long-term debt bears fixed rates of interest. The estimated fair value of our fixed rate long-term debt (excluding capital lease obligations and revolving credit facility advances) was approximately \$170.2 million, compared with a book value of \$175.4 million at June 25, 2008. This computation is based on market quotations for the same or similar debt issues or the estimated borrowing rates available to us. Specifically, the difference between the estimated fair value of long-term debt compared with its historical cost reported in our consolidated balance sheets at June 25, 2008 relates primarily to market quotations for our Denny's Holdings, Inc. 10% Senior Notes due 2012.

We also have exposure to interest rate risk related to our pension plan, other defined benefit plans and self-insurance liabilities. A 25 basis point increase or decrease in discount rate would decrease or increase our projected benefit obligation related to our pension plan and other defined benefit plans by \$1.7 million and \$0.1 million, respectively, and impact our net periodic benefit cost related to our pension plan by \$0.1 million. The impact of a 25 basis point increase or decrease in discount rate on periodic benefit costs related to our other defined benefit plans would be less than \$0.1 million. A 25 basis point increase or decrease in discount rate related to our self-insurance liabilities would result in a decrease or increase of \$0.2 million, respectively.

Commodity Price Risk

We purchase certain food products such as beef, poultry, pork, eggs and coffee, and utilities such as gas and electricity, which are affected by commodity pricing and are, therefore, subject to price volatility caused by weather, production problems, delivery difficulties and other factors that are outside our control and which are generally unpredictable. Changes in commodity prices affect us and our competitors generally and often simultaneously. In general, we purchase food products and utilities based upon market prices established with vendors. Although many of the items purchased are subject to changes in commodity prices, the majority of our purchasing arrangements are structured to contain features that minimize price volatility by establishing fixed pricing and/or price ceilings and floors. We use these types of purchase arrangements to control costs as an alternative to using financial instruments to hedge commodity prices. We have determined that our purchasing agreements do not qualify as derivative financial instruments or contain embedded derivative instruments. In many cases, we believe we will be able to address commodity cost increases which are significant and appear to be long-term in nature by adjusting our menu pricing or changing our product delivery strategy. However, competitive circumstances could limit such actions and, in those circumstances, increases in commodity prices could lower our margins. Because of the often short-term nature of commodity pricing aberrations and our ability to change menu pricing or product delivery strategies in response to commodity price increases, we believe that the impact of commodity price risk is not significant.

We have established a policy to identify, control and manage market risks which may arise from changes in interest rates, commodity prices and other relevant rates and prices. We do not enter into financial instruments for trading or speculative purposes.

Item 4. Controls and Procedures

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended, (the "Exchange Act") our management conducted an evaluation (under the supervision and with the participation of our President and Chief Executive Officer, Nelson J. Marchioli, and our Executive Vice President, Growth Initiatives, Chief Administrative Officer and Chief Financial Officer, F. Mark Wolfinger) as of the end of the period covered by this report, of the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e) under the Exchange Act. Based on that evaluation, Messrs. Marchioli and Wolfinger each concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There have been no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) of the Exchange Act that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

There are various claims and pending legal actions against or indirectly involving us, including actions concerned with civil rights of employees and guests, other employment related matters, taxes, sales of franchise rights and businesses and other matters. Based on our examination of these matters and our experience to date, we have recorded our best estimate of legal and financial liabilities, if any, with respect to these matters. However, the ultimate disposition of these matters cannot be determined with certainty.

Item 4. Submission of Matters to a Vote of Security Holders

The annual meeting of stockholders of Denny's Corporation was held on Wednesday, May 21, 2008, and the following matters were voted on by the stockholders of Denny's Corporation:

(i) Election of Directors			
Name	Votes For	Votes Against	Votes Abstained
Vera K. Farris	85,611,630	670,535	169,601
Brenda J. Lauderback	80,460,640	5,912,363	78,763
Nelson J. Marchioli	85,957,890	412,563	81,313
Robert E. Marks	85,980,444	301,986	169,336
Michael Montelongo	85,668,795	700,837	82,134
Louis P. Neeb	85,942,393	340,711	168,662
Donald C. Robinson	85,935,556	347,236	168,974
Donald R. Shepherd	85,654,585	630,430	166,751
Debra Smithart-Oglesby	85,737,996	636,451	77,319

(ii) Ratification of the Selection of KPMG LLP as the independent registered public accounting firm for the fiscal year ending December 31, 2008		
Votes For	Votes Against	Votes Abstaining

85,663,819	672,445	115,502
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(iii) Proposal to approve the Denny's Corporation 2008 Omnibus Incentive Plan			
Votes For	Votes Against	Votes Abstaining	Broker Non-Votes
67,991,863	8,699,059	63,005	9,697,839

Item 6. Exhibits

a. The following are included as exhibits to this report:

Exhibit No.	Description
10.1	Denny's Corporation 2008 Omnibus Incentive Plan (incorporated by reference to Exhibit 99.1 to the Current Report on Form 8-K of Denny's Corporation filed with the Securities and Exchange Commission on May 27, 2008)
10.2	Denny's Corporation Amended and Restated 2004 Omnibus Incentive Plan

- 31.1 Certification of Nelson J. Marchioli, President and Chief Executive Officer of Denny's Corporation, pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of F. Mark Wolfinger, Executive Vice President, Growth Initiatives, Chief Administrative Officer and Chief Financial Officer of Denny's Corporation, pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Nelson J. Marchioli, President and Chief Executive Officer of Denny's Corporation and F. Mark Wolfinger, Executive Vice President, Growth Initiatives, Chief Administrative Officer and Chief Financial Officer of Denny's Corporation, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DENNY'S CORPORATION

Date: July 29, 2008

By: /s/ F. Mark Wolfinger
F. Mark Wolfinger
Executive Vice President,
Growth Initiatives,
Chief Administrative Officer and
Chief Financial Officer

Date: July 29, 2008

By: /s/ Jay C. Gilmore
Jay C. Gilmore
Vice President,
Chief Accounting Officer and
Corporate Controller