

# Heritage Financial Corporation



## Acquisition of Valley Community Bancshares, Inc. March 12, 2013

INVESTOR PRESENTATION

**NASDAQ: HFWA**





# Forward-Looking Statements

This presentation includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which can be identified by words such as “may,” “expected,” “anticipate,” “continue,” or other comparable words. In addition, all statements other than statements of historical facts that address activities that Heritage Financial Corporation (“HFWA”) expects or anticipates will or may occur in the future are forward-looking statements. Readers are encouraged to read the Securities and Exchange Commission (“SEC”) reports of HFWA, particularly its Form 10-K for the fiscal year ended December 31, 2012, for meaningful cautionary language discussing why actual results may vary materially from those anticipated by management. Specific risks in this presentation include whether Valley Community Bancshares, Inc. (“Valley”) shareholders approve the merger, whether the companies receive regulatory approval for the merger, whether the conditions to closing are satisfied, the timing of the closing and management’s ability to effectively integrate the companies, whether the companies have accurately predicted acquisition and consolidation expenses, the timing and amount of savings from consolidation, and the expected earnings contributions of both companies.

HFWA will file a registration statement and other relevant documents concerning the transaction with the SEC and appropriate state and federal banking authorities as soon as practical. HFWA and Valley will prepare a proxy statement/prospectus and other relevant documents concerning the proposed transaction for the Valley shareholders. Investors are urged to read such proxy statement/prospectus and registration statements regarding the proposed transaction as they become available and any other relevant documents filed with the SEC, as well as any amendments or supplements to those documents because they will contain important information. You will be able to obtain a free copy of the registration statement, as well as other filings including the proxy statement/prospectus at the SEC’s internet site (<http://sec.gov>). The documents can also be obtained, without charge, by directing a written request to either Heritage Financial Corporation, P.O. Box 1578, Olympia, WA, 98501, Attention: Brian Vance, or Valley Community Bancshares, Inc., 1307 East Main, Puyallup WA 98372, Attention: David Brown. HFWA and Valley and their respective directors and executive officers may be deemed to be participants in the solicitation of proxies from the Valley shareholders in connection with the merger. Information about the directors and executive officers of Valley and the interests of these participants may be obtained by reading the proxy statement/prospectus regarding the proposed transaction when it becomes available.



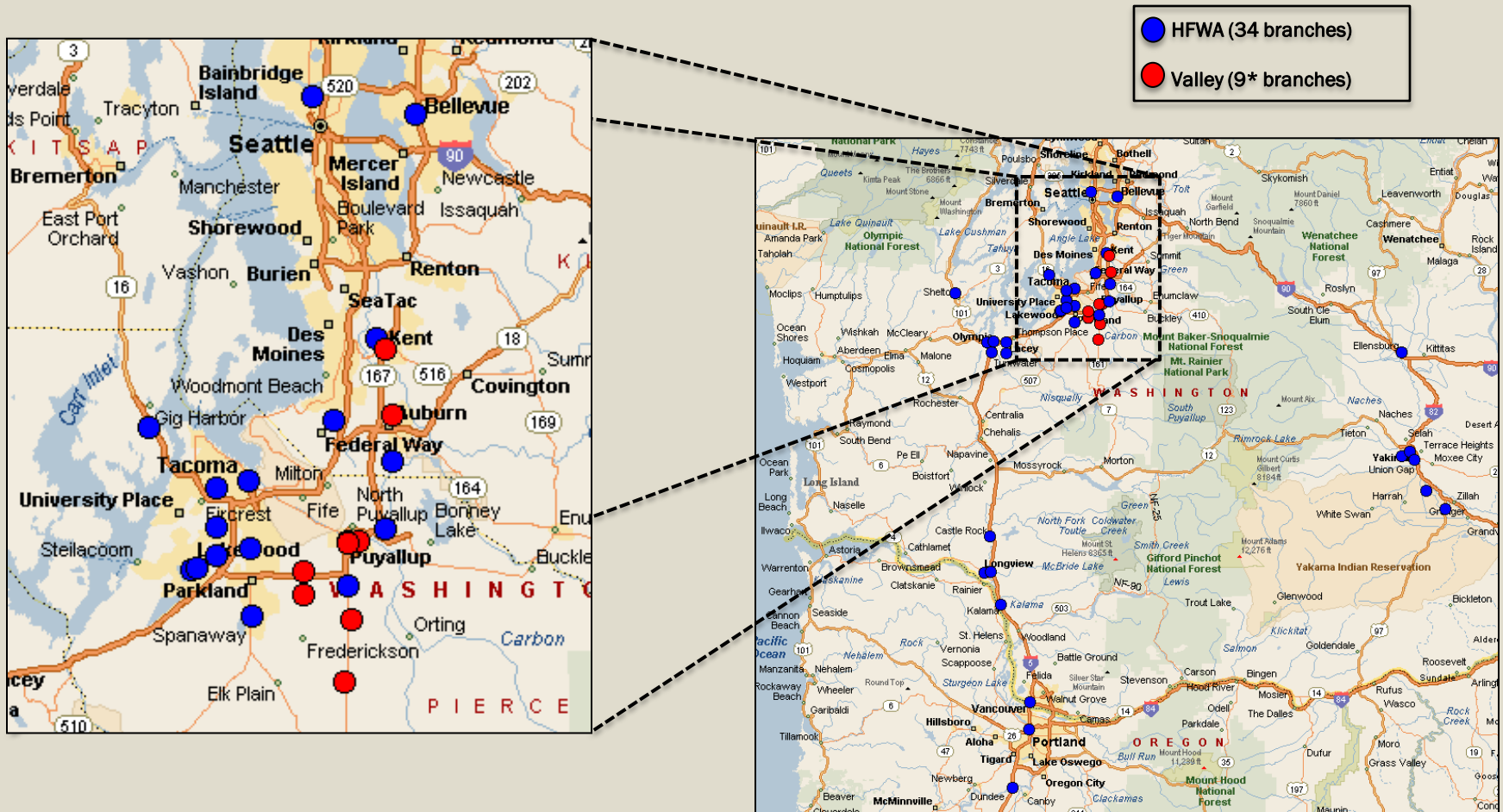
# Transaction Highlights

- Effective use of capital
- In line with 2013 strategic objective to seek acquisitions within the current footprint
- Further enhances the franchise branch network in the Puget Sound Region
  - Complements recent Northwest Commercial Bank acquisition
  - Notable increase in Pierce and King County deposit market share
- Attractive loan and deposit portfolio mix
  - 87% commercial real estate and commercial & industrial loans
  - 77% in non-maturity deposits
- Valley Bank has a consistent and proven track record
  - Asset quality metrics among the strongest in the Pacific Northwest
  - Sustained and strong earnings
- Financially attractive deal pricing and structure with conservative modeling assumptions
  - Accretive to earnings in first full year following close
  - Significant cost savings to be realized
- This transaction marks HFWA's 4<sup>th</sup> acquisition in the past 3 years





# Expanding Pacific Northwest Franchise



\*1 location is a drive-up facility only

Source: Company documents, SNL Financial & Microsoft MapPoint.



# Transaction Overview

<b>Transaction Value:</b>	Approximately \$44.2 million (including cash out of stock options)
<b>Offer Price Per Share:</b>	\$39.00
<b>Consideration Mix:</b>	50% of Valley shares exchanged for \$19.50 cash 50% of Valley shares exchanged for 1.3611 HFWA shares
<b>Stock Option Treatment:</b>	In-the-money stock options cashed out (approximately \$232 thousand)
<b>Board Representation:</b>	One Valley Board member will join the Board of HFWA
<b>Exchange Ratio:</b>	Fixed exchange ratio
<b>Collars:</b>	A 20% collar above and below HFWA's stock price of \$14.33
<b>Walk-away Provision:</b>	If HFWA's stock price drops below \$11.46 HFWA has the option to fill with cash or stock or walk-away
<b>Termination Fee:</b>	\$1.76 million
<b>Required Approvals:</b>	Customary regulatory approvals and Valley shareholder approval
<b>Expected Closing:</b>	Q3 2013



# Transaction Financial Impact

## Purchase Accounting Adjustments (pre-tax):

- Estimated credit mark of 2.0% or ~\$279 thousand
- Estimated \$1.5 million mark-up on real estate and other assets
- Estimated core deposit intangible equaling 1.0% of Valley's core deposits <sup>(1)</sup>

## Other Financial Impacts:

- Estimated cost savings of between 45% and 50%
  - Phased-in 50% in 2013 and 100% in 2014
  - Assumes consolidation of four branches
- Estimated after-tax deal related expenses of \$2.0 million

<sup>(1)</sup> Core deposits represent total deposits less total certificates of deposit.





# Overview of Valley Bank

## Overview:

Headquarters:	Puyallup, WA
Year Established (BHC / Bank):	1998 / 1972
Number of Branches:	9*
FTE:	67
Assets / FTE (\$000s):	\$3,615

## Balance Sheet & Capital

Assets (\$000s):	\$242,220
Deposits (\$000s):	\$212,501
Gross Loans:	\$125,085
Loans / Deposits:	58.9%
Securities / Assets:	25.9%
TCE / TA:	11.7%
Tier 1 Leverage Ratio:	11.2%

## Profitability (FYE 2012)

ROAA:	0.78%
ROAE:	6.57%
Net Interest Margin:	3.68%
Cost of Interest-Bearing Deposits:	0.25%
Efficiency Ratio:	69.82%

## Asset Quality

NPAs / Assets:	1.00%
NPAs / (Loans + OREO):	1.93%
Reserves / Loans:	1.78%
Reserves / NPAs:	91.94%
NCOs / Avg. Loans:	0.04%

- Valley Bank has a history of strong and stable profitability with an average ROAA of 0.97% over the past 5 years
- Strong asset quality has been maintained throughout the economic recession
- Attractive low-cost funding mix (total cost of funds was 0.17% as of 12/31/2012)

Note: Consolidated Valley Community Bancshares, Inc. financials not publicly available.

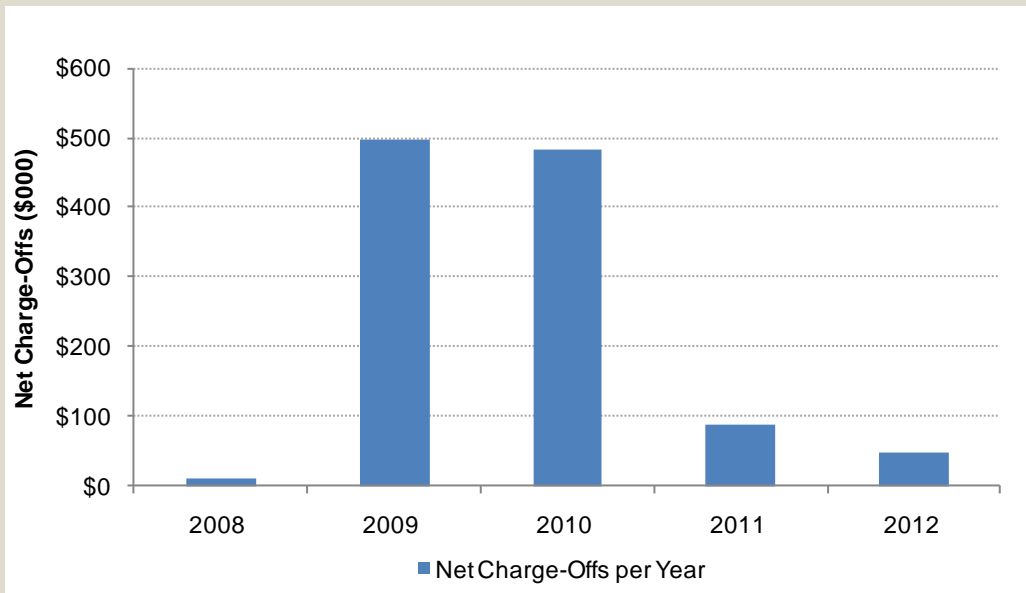
\*1 location is a drive-up facility only

FTE = Full-time employees

Source: SNL Financial & Valley Bank call report data.

# Strong Asset Quality

Valley Net Charge-Off History



Cumulative net charge-offs since 2008 total \$1.1 million

- Valley has maintained strong asset quality throughout the economic downturn, despite being located in a region that was not immune to the recession



# In-Market Deposit Franchise Expansion

## Pierce County

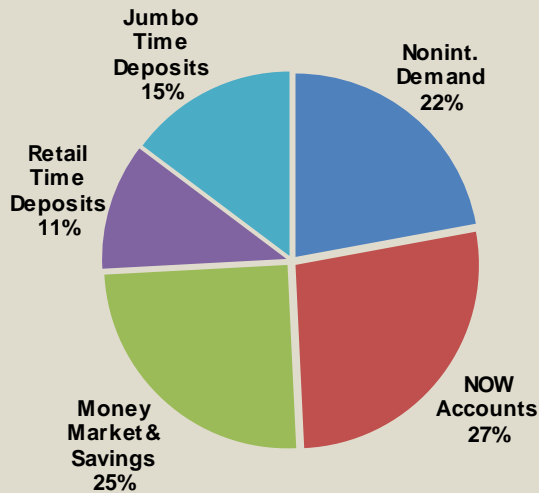
2012 Rank	Institution (ST)	2012 Number of Branches	2012 Deposits in Market (\$000)	2012 Total Market Share (%)
1	Columbia Banking System Inc. (WA)	22	1,541,409	17.65
2	KeyCorp (OH)	28	1,295,122	14.83
3	Bank of America Corp. (NC)	19	1,285,820	14.73
4	Wells Fargo & Co. (CA)	14	1,183,766	13.56
5	JPMorgan Chase & Co. (NY)	19	629,834	7.21
	<b>Pro Forma</b>	<b>17</b>	<b>574,316</b>	<b>6.58</b>
6	U.S. Bancorp (MN)	23	493,981	5.66
<b>7</b>	<b>Heritage Financial Corp. (WA)</b>	<b>10</b>	<b>403,116</b>	<b>4.62</b>
8	Umpqua Holdings Corp. (OR)	11	313,600	3.59
9	Mitsubishi UFJ Finl Grp Inc	8	190,715	2.18
<b>10</b>	<b>Valley Community Bcshs Inc (WA)</b>	<b>7</b>	<b>171,200</b>	<b>1.96</b>
11	Timberland Bancorp Inc. (WA)	5	158,660	1.82
12	HomeStreet Inc. (WA)	2	120,214	1.38
13	Commencement Bank (WA)	1	115,369	1.32
14	Washington Federal Inc. (WA)	4	103,533	1.19
15	Sunwest Bank (CA)	2	101,708	1.16
<b>Total For Institutions In Market</b>		<b>199</b>	<b>8,731,311</b>	

## King County

2012 Rank	Institution (ST)	2012 Number of Branches	2012 Deposits in Market (\$000)	2012 Total Market Share (%)
1	Bank of America Corp. (NC)	92	17,079,370	29.76
2	Wells Fargo & Co. (CA)	62	7,642,973	13.32
3	U.S. Bancorp (MN)	57	7,171,379	12.49
4	JPMorgan Chase & Co. (NY)	83	5,559,521	9.69
5	KeyCorp (OH)	66	5,110,206	8.90
6	Washington Federal Inc. (WA)	30	2,592,770	4.52
7	Mitsubishi UFJ Finl Grp Inc	14	1,462,637	2.55
8	HomeStreet Inc. (WA)	11	1,059,585	1.85
9	HSBC	4	864,531	1.51
10	East West Bancorp Inc. (CA)	4	857,261	1.49
11	W.T.B. Financial Corp. (WA)	2	829,135	1.44
12	Sterling Financial Corp. (WA)	18	790,448	1.38
13	First Financial Northwest Inc (WA)	1	748,600	1.30
14	Zions Bancorp. (UT)	1	725,563	1.26
15	Columbia Banking System Inc. (WA)	14	683,910	1.19
<b>25</b>	<b>Pro Forma</b>	<b>7</b>	<b>135,162</b>	<b>0.34</b>
<b>30</b>	<b>Heritage Financial Corp. (WA)</b>	<b>5</b>	<b>96,060</b>	<b>0.17</b>
<b>41</b>	<b>Valley Community Bcshs Inc (WA)</b>	<b>2</b>	<b>39,102</b>	<b>0.07</b>
<b>Total For Institutions In Market</b>		<b>557</b>	<b>57,396,911</b>	

# Pro Forma Deposit Composition

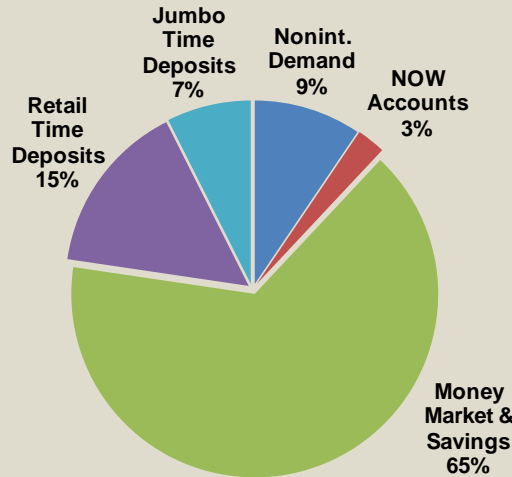
## HFWA



Deposit Composition (\$000)	Amount	% of Total
Noninterest Demand	\$247,048	22.1 %
NOW Accounts	303,487	27.1
Money Market & Savings	278,509	24.9
Retail Time Deposits	124,039	11.1
Jumbo Time Deposits	164,888	14.7
<b>Total Deposits</b>	<b>\$1,117,971</b>	<b>100.0 %</b>

Cost of Total Deposits: 0.34%

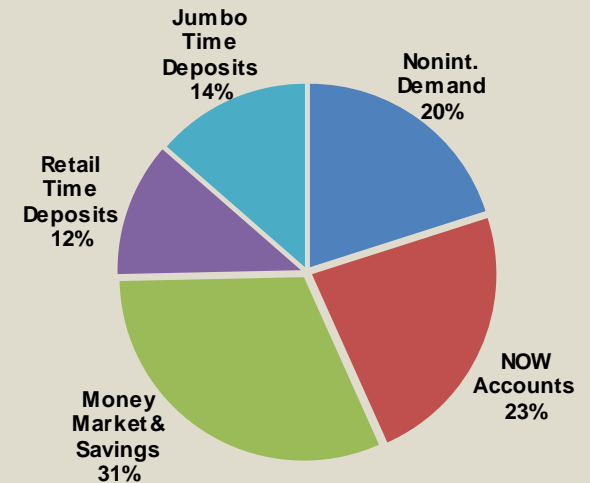
## Valley



Deposit Composition (\$000)	Amount	% of Total
Noninterest Demand <sup>(1)</sup>	\$20,104	9.5 %
NOW Accounts	5,371	2.5
Money Market & Savings	138,866	65.3
Retail Time Deposits	32,379	15.2
Jumbo Time Deposits	15,781	7.4
<b>Total Deposits</b>	<b>\$212,501</b>	<b>100.0 %</b>

Cost of Total Deposits : 0.17%

## Pro Forma



Deposit Composition (\$000)	Amount	% of Total
Noninterest Demand	\$267,152	20.1 %
NOW Accounts	308,858	23.2
Money Market & Savings	417,375	31.4
Retail Time Deposits	156,418	11.8
Jumbo Time Deposits	180,669	13.6
<b>Total Deposits</b>	<b>\$1,330,472</b>	<b>100.0 %</b>

Cost of Total Deposits : 0.31%

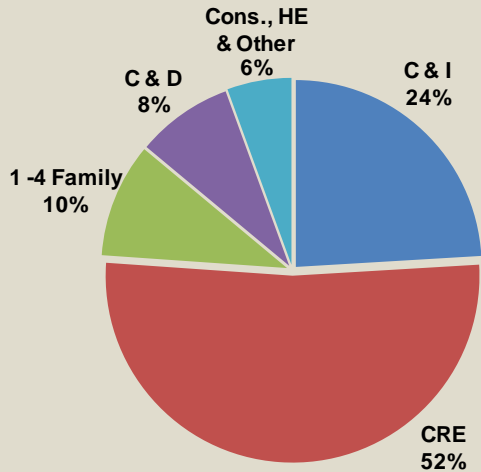
Note: Excludes pro forma impact of Northwest Commercial Bank on 1/9/2013.

<sup>(1)</sup> Service utilized by Valley internally reclassifies certain money market accounts to demand accounts (demand deposits ~25% of total deposits)

Source: Company filings & SNL Financial; data for the quarter ended 12/31/2012.

# Pro Forma Loan Composition

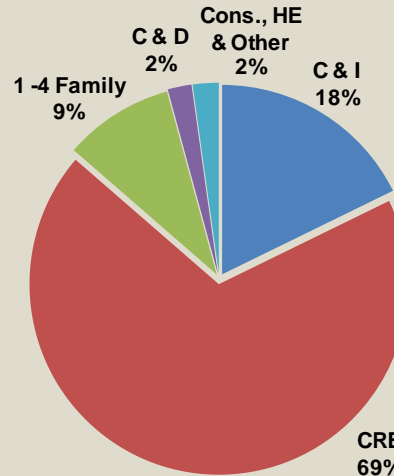
## HFWA



Loan Composition (\$000)	Amount	% of Total
Commercial & Industrial	\$247,429	24.1 %
Commercial Real Estate	535,397	52.1
1-4 Family Residential	102,298	9.9
C&D	86,246	8.4
Cons, HE & Other	57,244	5.6
<b>Gross Loans &amp; Leases</b>	<b>\$1,028,614</b>	<b>100.0 %</b>

Yield on Loans and Leases: 6.22%

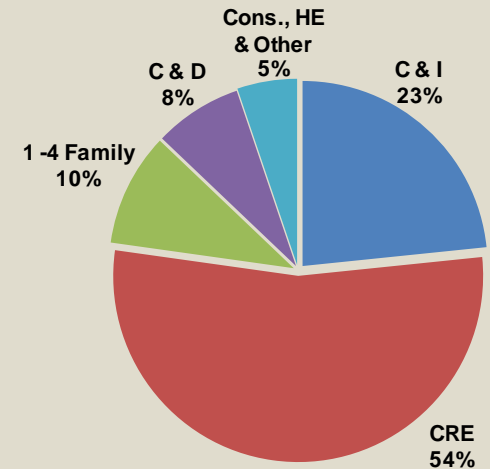
## Valley



Loan Composition (\$000)	Amount	% of Total
Commercial & Industrial	\$22,239	17.8 %
Commercial Real Estate	85,912	68.6
1-4 Family Residential	11,753	9.4
C&D	2,538	2.0
Cons, HE & Other	2,758	2.2
<b>Gross Loans &amp; Leases</b>	<b>\$125,200</b>	<b>100.0 %</b>

Yield on Loans and Leases: 5.40%

## Pro Forma



Loan Composition (\$000)	Amount	% of Total
Commercial & Industrial	\$269,668	23.4 %
Commercial Real Estate	621,309	53.8
1-4 Family Residential	114,051	9.9
C&D	88,784	7.7
Cons, HE & Other	60,002	5.2
<b>Gross Loans &amp; Leases</b>	<b>\$1,153,814</b>	<b>100.0 %</b>

Yield on Loans and Leases: 6.13%

# Pro Forma Financial Impact

## Earnings Accretion & Return <sup>(1)</sup>:

2014 EPS Accretion:	> 19%
2015 EPS Accretion:	> 24%
IRR:	> 16%
Tangible Book Value Earnback Period:	<4.5 years, using incremental earnings <sup>(2)</sup> <1.5 years, on static basis <sup>(3)</sup>

## Capital Ratios:



### Pro Forma

TCE / TA:	13.9%	11.7%	11.7%
Leverage Ratio:	13.6%	11.2%	11.7%
Tier 1 Ratio:	18.7%	20.3%	16.4%
Total Risk-Based Capital Ratio:	19.9%	21.6%	17.7%

Note: Impact includes completed acquisition of Northwest Commercial Bank on 1/9/2013.

<sup>(1)</sup> Based on internal earnings estimates

<sup>(2)</sup> Incremental tangible book value earnback represents the number of years to eliminate tangible book value dilution at closing utilizing just the incremental earnings realized through the merger (it ignores HFWA stand alone earnings)

<sup>(3)</sup> Static tangible book value earnback represents the number of years to eliminate tangible book value dilution at closing utilizing combined pro forma earnings





# Investment Value

- Accretive to earnings in the first full year after closing
- A continuing and consistent execution of our growth and acquisition strategies within existing geographic footprint
- Drives growth, efficiency and scale strategies
- A continuation of our capital leveraging strategies
- Expected cost saves complements our strategic branch efficiency plans
- Increased size and scale favorably positions the company for further acquisitions and growth strategies

# Heritage Financial Corporation



**NASDAQ: HFWA**

