HERITAGE FINANCIAL CORP /WA/
Form 424B3
December 08, 2010
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The Information in this preliminary prospectus supplement and the accompanying prospectus is not complete and may be changed. This preliminary prospectus supplement and the accompanying prospectus are not an offer to sell these securities and they are not soliciting an offer to buy these securities in any state or jurisdiction where the offer or sale is not permitted.

Filed Pursuant to Rule 424(b)(3)
Registration No. 333-167145

Subject to Completion, Dated December 8, 2010

Preliminary Prospectus Supplement To Prospectus Dated June 7, 2010

Shares

Common Stock

We are offering shares of our common stock. Our common stock is listed on the NASDAQ Global Select Market under the symbol HFWA. On December 7, 2010, the last reported sale price of our common stock on the NASDAQ Global Select Market was $14.60 per share.

Investing in our common stock involves a high degree of risk. See Risk Factors beginning on page S-14 of this prospectus supplement to read about factors you should consider before buying our common stock.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus supplement or the accompanying prospectus. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	$	$ 45,000,000
Underwriting discounts and commissions	$	$
Proceeds to Heritage Financial Corporation (before expenses)	$	$

We have granted the underwriters a 30-day option to purchase up to an additional shares of our common stock at the public offering price, less underwriting discounts and commissions within 30 days of the date of this prospectus supplement to cover over-allotments, if any.

The shares of common stock offered by this prospectus supplement are not savings accounts, deposits or other obligations of a bank or savings institution and are not insured by the Federal Deposit Insurance Corporation or any other government agency.

The underwriters expect to deliver the common stock in book-entry form only, through the facilities of The Depository Trust Company, against payment in New York, New York on or about December , 2010, subject to customary closing conditions.

Keefe, Bruyette & Woods

Book Running Manager

D.A. Davidson & Co.

The date of this prospectus supplement is December , 2010.

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Prospectus Supplement

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ABOUT THIS PROSPECTUS SUPPLEMENT

You should rely only on the information contained in or incorporated by reference in this prospectus supplement and the accompanying prospectus and any free writing prospectus we authorize to be delivered to you. We have not, and the underwriters have not, authorized anyone to provide you with additional information or information different from that contained in or incorporated by reference in this prospectus supplement and the accompanying prospectus or in any free writing prospectus. If anyone provides you with different or inconsistent information, you should not rely on it. We are offering to sell, and seeking offers to buy, our common stock only in jurisdictions where the offers and sales are permitted. The information contained in or incorporated by reference in this prospectus supplement, the accompanying prospectus, and any such free writing prospectus is accurate only as of their respective dates. Our business, financial condition, results of operations and prospects may have changed since those dates.

This prospectus supplement is a supplement to the accompanying prospectus that is also a part of this document. This prospectus supplement and the accompanying prospectus are part of a registration statement that we filed with the Securities and Exchange Commission (the SEC), using a shelf registration process. Under the shelf registration statement, we may offer and sell shares of our common stock described in the accompanying prospectus in one or more offerings. In this prospectus supplement, we provide you with specific information about the terms of this offering. Both this prospectus supplement and the accompanying prospectus include important information about us, our common stock and other information you should know before investing in our common stock. This prospectus supplement may also add, update and change information contained in the accompanying prospectus. To the extent that any statement that we make in this prospectus supplement is inconsistent with the statements made in the accompanying prospectus, the statements made in the accompanying prospectus are deemed modified or superseded by the statements made in this prospectus supplement. You should read this prospectus supplement and the accompanying prospectus as well as the documents incorporated herein by reference described under Incorporation of Certain Documents by Reference before investing in our common stock.

All references in this prospectus supplement to Heritage, we, us, our or similar references mean Heritage Financial Corporation and its consolidated subsidiaries and all references in this prospectus supplement to Heritage Financial Corporation mean Heritage Financial Corporation excluding its subsidiaries, in each case unless otherwise expressly stated or the context otherwise requires.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus supplement, the accompanying prospectus and the documents incorporated by reference may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements often include the words believes, expects, anticipates, estimates, forecasts, intends, plans, targets, potentially, probably, projects, outlook or sim or conditional verbs such as may, will, should, would and could. These forward-looking statements are subject to known and unknown risks uncertainties and other factors that could cause actual results to differ materially from the results anticipated, including:

- our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we have acquired, including the Cowlitz Bank and Pierce Commercial Bank acquisitions described in this prospectus supplement, or may in the future acquire, into our operations and our ability to realize related revenue synergies and cost savings within expected time frames or at all, and any goodwill charges related thereto and costs or difficulties relating to integration matters, including but not limited to customer and employee retention, which might be greater than expected;

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the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and changes in our allowance for loan losses and provision for loan losses that may be impacted by deterioration in the housing and commercial real estate markets;

changes in general economic conditions, either nationally or in our market areas;

changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources;

risks related to acquiring assets in or entering markets in which we have not previously operated and with which we may not be familiar;

fluctuations in the demand for loans, the number of unsold homes and other properties and fluctuations in real estate values in our market areas;

results of examinations of us by the Board of Governors of the Federal Reserve System (the Federal Reserve Board) and of our bank subsidiaries by the Federal Deposit Insurance Corporation (the FDIC), the Washington State Department of Financial Institutions, Division of Banks (the Washington DFI) or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, require us to increase our reserve for loan losses, write-down assets, change our regulatory capital position or affect our ability to borrow funds or maintain or increase deposits, which could adversely affect our liquidity and earnings;

legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, including the recently adopted Dodd-Frank Act and regulations that have been or will be promulgated thereunder and interpretation of regulatory capital or other rules;

our ability to control operating costs and expenses;

further increases in premiums for deposit insurance;

the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation;

difficulties in reducing risk associated with the loans on our balance sheet;

staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our workforce and potential associated charges;

computer systems on which we depend could fail or experience a security breach;

our ability to retain key members of our senior management team;

costs and effects of litigation, including settlements and judgments;

our ability to implement our branch expansion strategy;

changes in consumer spending, borrowing and savings habits;

the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions;

adverse changes in the securities markets;

inability of key third-party providers to perform their obligations to us;

changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods;

other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services and the other risks described elsewhere in this prospectus supplement, the accompanying prospectus and the incorporated documents; and

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- future legislative or regulatory changes in the TARP Capital Purchase Program, including our inability to redeem securities issued to the Treasury in connection with the TARP Capital Purchase Program.

Some of these and other factors are discussed in this prospectus supplement under the caption Risk Factors and elsewhere in this prospectus supplement and in the incorporated documents. Such developments could have a material adverse impact on our business, financial position and results of operations.

Any forward-looking statements are based upon management s beliefs and assumptions at the time they are made. We undertake no obligation to publicly update or revise any forward-looking statements included or incorporated by reference in this prospectus supplement or the accompanying prospectus or to update the reasons why actual results could differ from those contained in such statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking statements discussed in this prospectus supplement or the accompanying prospectus or the incorporated documents might not occur, and you should not put undue reliance on any forward-looking statements.

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PROSPECTUS SUPPLEMENT SUMMARY

This summary highlights information contained elsewhere in, or incorporated by reference into, this prospectus supplement and the accompanying prospectus. As a result, this summary is not complete and does not contain all of the information that may be important to you or that you should consider before investing in our common stock. You should read this entire prospectus supplement and accompanying prospectus, including the Risk Factors section, and the documents incorporated by reference, which are described under Incorporation of Certain Documents by Reference in this prospectus supplement. Unless otherwise expressly stated or the context otherwise requires, all information in this prospectus supplement assumes that the underwriters do not exercise their option to purchase additional shares of our common stock to cover over-allotments, if any.

Heritage Financial Corporation

Heritage Financial Corporation is a bank holding company incorporated in the State of Washington. We are primarily engaged in the business of planning, directing and coordinating the business activities of our wholly owned bank subsidiaries, Heritage Bank and Central Valley Bank. Heritage Bank is a Washington-chartered commercial bank that conducts business from its main office in Olympia, Washington as well as its twenty-four branch offices located in communities from Seattle, Washington to Portland, Oregon. Central Valley Bank is a Washington-chartered commercial bank that conducts business from its main office in Toppenish, Washington as well as its five branch offices located in Yakima and Kittitas counties in Washington. As a bank holding company, Heritage Financial Corporation is subject to regulation by the Federal Reserve Board. Heritage Bank and Central Valley Bank are subject to regulation by the Washington DFI and the FDIC. As of September 30, 2010, we had total consolidated assets of $1.3 billion, total net loans receivable of $865.0 million, total deposits of $1.1 billion and total stockholders equity of $163.0 million**.** Net income applicable to common shareholders for the nine months ended September 30, 2010 was $2.6 million, or $0.23 per diluted common share.

On November 21, 2008, Heritage Financial Corporation completed a sale to the United States Department of the Treasury (the Treasury) of 24,000 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A, (the Series A preferred stock), for an aggregate purchase price of $24.0 million in cash, with a related warrant to purchase 276,074 shares of its common stock for a ten-year period at an exercise price of $13.04 per share. During September 2009, Heritage Financial Corporation received net proceeds of approximately $46.6 million in a public offering of its common stock, which under the terms of the warrant reduced the number of shares of our common stock underlying the warrant by 50% to 138,037 shares. The Series A preferred stock pays a cumulative dividend of 5.0% per annum for the first five years and 9.0% per annum thereafter, if not redeemed within the first five years. The Series A preferred stock can be redeemed at its liquidation preference (which is $1,000 per share), plus all accrued and unpaid dividends.

Our business consists primarily of lending and deposit relationships with small businesses and their owners in our market areas and attracting deposits from the general public. We also make residential and commercial construction, income property, and consumer loans and originate for sale or investment purposes first mortgage loans on residential properties located in Oregon and Washington State.

Heritage Bank, the larger of our two bank subsidiaries, with assets of $1.1 billion and deposits of $958.1 million at September 30, 2010, was established in 1927. Originally founded as a savings and loan association, Heritage Bank implemented a growth strategy in 1994 to expand its offerings from traditional savings and loan products to a full range of products and services for both personal and business banking, which culminated in its conversion to a commercial bank charter in 2004. We acquired our other subsidiary bank, Central Valley Bank, in 1999. Central Valley Bank first opened for business in 1962 and serves the Yakima Valley region of

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Washington with a primary focus on small business and agricultural lending. In 1998, we acquired North Pacific Bank, a Washington-chartered commercial bank in Tacoma, Washington. In 2006, we acquired Western Washington Bancorp and its wholly-owned subsidiary, Washington State Bank, N.A., located in Federal Way, Washington. Both banks were merged into Heritage Bank.

During 2010, Heritage Bank completed two FDIC assisted transactions which have played an integral role in our overall growth strategy. On July 30, 2010, Heritage Bank assumed most of the non-brokered deposits, with a fair value of approximately $343.9 million, and acquired assets with a fair value of approximately $344.8 million including $145.3 million in loans of Cowlitz Bank, and its Bay Bank division. The FDIC excluded most non-performing loans, all other real estate owned and most brokered deposits from the transaction. Pursuant to a loss sharing agreement with the FDIC, the FDIC has agreed to reimburse Heritage Bank for 80% of losses on the acquired loans (other than consumer loans of $2.3 million). The loss sharing agreement for commercial loans is in effect for five years for loss sharing with an additional three years for recoveries only from the July 30, 2010 acquisition date. The loss sharing agreement for single family residential mortgage loans is in effect for ten years, as to both shared losses and recoveries, from the July 30, 2010 acquisition date. Cowlitz Bank was a full service commercial bank headquartered in Longview, Washington that operated nine branch locations in Washington and Oregon. Heritage Bank also received regulatory approval to exercise trust powers and has continued to operate the trust division of Cowlitz Bank. As of July 30, 2010 there were $55.8 million in trust assets under management by the trust division. For further discussion of the loans covered under the loss sharing agreements with the FDIC and related financial matters for this transaction see footnotes (6) and (7) in Selected Historical Financial Information.

On November 5, 2010, Heritage Bank, assumed all of the deposits, with a fair value of approximately $181.5 million, and acquired assets with a fair value of approximately $210.7 million, including $142.9 million in loans, of Pierce Commercial Bank, which operated one branch located in Tacoma, Washington. The FDIC and Heritage Bank entered into a purchase and assumption agreement without a loss sharing agreement.

Our common stock is traded on the NASDAQ Global Select Market under the symbol HFWA. Our principal executive offices are located at 201 Fifth Avenue S.W., Olympia, Washington 98501. Our telephone number is (360) 943-1500.

Our Strategies

Our primary objective is to be a well-capitalized, profitable community banking organization, with balanced growth while emphasizing lending and deposit relationships with small and medium size businesses along with their owners and the general public. We consider ourselves as an innovative team providing financial services focusing on the success of our customers. Our stated mission is: Continuously Improve Customer Satisfaction, Employee Empowerment and Shareholder Value. We will seek to achieve our objective through the following strategies:

Expand geographically as opportunities present themselves. We are committed to continuing the controlled expansion of our franchise through strategic acquisitions designed to increase our market share. We believe that consolidation across the community bank landscape will continue to take place and further believe that, with our capital and liquidity positions, approach to credit management and extensive acquisition experience, we are well positioned to take advantage of acquisitions or other business opportunities in our market areas, including additional FDIC-assisted transactions. In markets where we wish to enter or expand our business, we will also consider opening *de novo* offices. In the past, we have successfully integrated acquired institutions and opened *de novo* branches. We plan to acquire or build one to two branches per year in strategic growth locations. We will continue to be disciplined and opportunistic as it pertains to future acquisitions and *de novo* branching focusing on the Pacific Northwest markets we know and understand.

Focus on Asset Quality. A strong credit culture is a high priority for us. We have a well-developed credit approval structure that has enabled us to maintain a standard of asset quality that we believe is conservative while maintaining our lending objectives. We will continue to focus on loan types and markets that we know well and have a historical record of success. We focus on loan relationships that are well diversified in both size and industry types. With respect to commercial business lending, which is our predominant lending activity, we view ourselves as cash-flow lenders obtaining additional support from realistic collateral values, personal guarantees and secondary sources of repayment. We have a problem loan resolution process that is focused on quick detection and feasible solutions. We seek to maintain strong internal controls and subject our loans to periodic internal loan review as well as a third party loan review process.

Maintain Strong Balance Sheet. In addition to our focus on our underwriting, we believe that the strength of our balance sheet has thus far enabled us to endure the economic downturn afflicting the Pacific Northwest better than many of our competitors. As of September 30, 2010, the ratio of our allowance for loan losses to total noncovered loans (loans not subject to the loss sharing agreements are referred to as noncovered loans) was 3.3% and the ratio of the allowance to non-performing noncovered loans was 95.6%. Our liquidity position is also strong, with $177.7 million in cash and cash equivalents as of September 30, 2010. As of September 30, 2010, the regulatory capital ratios of our subsidiary banks were well in excess of the levels required for well-capitalized status, and our consolidated total risk-based capital, Tier 1 risk-based capital and leverage ratios were 19.8%, 18.5% and 12.2%, respectively.

Deposit Growth. Our strategic focus is to continuously grow deposits with emphasis on total relationship banking with our business and retail customers. We continue to seek to increase our market share in our communities by providing exceptional customer service, focusing on relationship development with local businesses and strategic branch expansion. Our primary focus is to maintain a high level of non-maturity deposits to internally fund our loan growth with a low reliance on maturity (certificate) deposits. At September 30, 2010, as a percentage of our total deposits, non-maturity deposits were 64.2%. We maintain state of the art technology-based products, such as on-line personal financial management, business cash management, and business remote deposit products that enable us to compete effectively with banks of all sizes. Our retail management team is well seasoned and has strong ties to the communities we serve with a strong focus on relationship building and customer service.

Emphasize business relationships with a focus on commercial lending. We will continue to provide primarily commercial business, commercial real estate and residential construction loans with an emphasis on owner occupied commercial real estate and commercial business lending, and the deposit balances that accompany these relationships. We provide our business customers with an array of competitive deposit and cash management products through a variety of delivery channels with state of the art technologies. Our lending staff is well seasoned with extensive knowledge of our markets and adds value through a focused advisory role that we believe strengthens our customer relationships and loyalty. We currently have and will seek to maintain a diversified portfolio of lending relationships without concentrations in any industry.

Recruit and retain highly competent personnel to execute our strategies. Our compensation and staff development programs are aligned with our strategies to grow our loans and core deposits while maintaining our focus on asset quality. Our incentive systems are designed to achieve well-balanced and high quality asset growth while maintaining appropriate mechanisms to reduce or eliminate incentive payments when appropriate. Our equity compensation programs and retirement benefits are designed to build and encourage employee ownership at all levels of the company to align employee performance objectives with corporate growth strategies and shareholder value. We have a strong corporate culture, which is supported by our commitment to internal development and promotion from within as well as the retention of management and officers in key roles.

Risk Factors

An investment in our common stock involves certain risks. You should carefully consider the risks described under Risk Factors beginning on page S-14 of this prospectus supplement and in the Risk Factors section included in our Annual Report on Form 10-K for the year ended December 31, 2009, as well as other information included or incorporated by reference into this prospectus supplement and the accompanying prospectus, including our financial statements and the notes thereto, before making an investment decision. See Incorporation of Certain Documents by Reference.

The Offering

Common stock we are offering	shares
Common stock to be outstanding after this offering	shares(1)(2)
Over-allotment option	shares
Use of proceeds	Our estimated net proceeds from this offering are approximately $ million, or approximately $ million if the underwriters exercise their over-allotment option in full, after deducting underwriting discounts and commissions and other estimated expenses of this offering. We intend to use the net proceeds of this offering for general corporate purposes, which may include, without limitation, investments at the holding company level, providing capital to support the organic growth of our subsidiary banks, and acquisitions or other business opportunities in our market areas, including FDIC-assisted transactions. We also may seek the approval of our regulators to utilize a portion of the proceeds of this offering and other cash available to us to repurchase all or a portion of the Series A preferred stock and warrant that we issued to Treasury. See Use of Proceeds.
NASDAQ Global Select Market Symbol	HFWA
Settlement Date	Delivery of shares of our common stock will be made against payment therefor on or about December , 2010.

(1) The number of our shares outstanding immediately after the closing of this offering is based on shares of common stock outstanding as of November 30, 2010.

(2) Unless otherwise indicated, the number of shares of common stock presented in this prospectus supplement excludes (a) shares issuable pursuant to the exercise of the underwriters over-allotment option, (b) 689,261 shares of common stock issuable upon exercise of outstanding stock options as of November 30, 2010, with a weighted average exercise price of $17.56 per share, (c) 501,639 shares of common stock issuable pursuant to potential future awards under our equity compensation plans, and (d) 138,037 shares of common stock issuable upon exercise by the Treasury of a ten-year warrant with an initial exercise price of $13.04 per share issued pursuant to the Treasury TARP Capital Purchase Program.

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Selected Historical Financial Information

The following table sets forth selected consolidated financial information as of and for the years ended December 31, 2009, 2008, 2007, 2006 and 2005 (most of which has been derived from our audited consolidated financial statements), and as of and for the nine months ended September 30, 2010 and 2009 (which is unaudited). The unaudited financial information as of and for the nine months ended September 30, 2010 and 2009 has been prepared on the same basis as our audited financial statements and includes, in the opinion of management, all adjustments necessary to fairly present the data for such periods. The results of operations for the nine months ended September 30, 2010 are not necessarily indicative of the results of operations to be expected for the full year or any future period. This information should be read in conjunction with our consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2009, and our Quarterly Report on Form 10-Q for the quarter ended September 30, 2010. See Incorporation of Certain Documents by Reference.

Our summary consolidated financial information and other financial data contain information determined by methods other than in accordance with U.S. Generally Accepted Accounting Principles (GAAP). These measures include tangible book value per common share and tangible common equity to tangible assets. Tangible book value per common share may be important to investors interested in changes from period to period in book value per share exclusive of changes in intangible assets. Tangible common equity to tangible assets may be important to many investors interested in the equity to assets ratio exclusive of the effect of changes in intangible assets on equity and total assets. Reconciliations of the GAAP and the non-GAAP financial measures presented are contained within the summary consolidated financial information table.

	For the Nine Months Ended September 30,		For the years ended December 31,				
	2010	2009	2009	2008	2007	2006	2005
	(Dollars in thousands, except per share data)						
Operations Data:							
Interest income	$ 40,505	$ 40,055	$ 53,341	$ 56,948	$ 62,391	$ 55,237	$ 45,428
Interest expense	6,394	9,112	11,645	18,606	25,770	19,465	11,547
Net interest income	34,111	30,943	41,696	38,342	36,621	35,772	33,881
Provision for loan losses	9,095	14,440	19,390	7,420	810	720	810
Noninterest income	7,205	6,414	8,667	8,824	8,572	7,954	6,630
Noninterest expense	26,882	23,519	30,895	30,419	28,288	27,082	24,183
Federal income tax (benefit) expense	1,746	(411)	(503)	2,976	5,387	5,377	5,042
Net income (loss)	3,593	(191)	581	6,351	10,708	10,547	10,476
Dividends accrued and discount accreted on preferred shares	995	989	1,320	143			
Net income (loss) applicable to common stockholders	2,598	(1,180)	(739)	6,208	10,708	10,547	10,476
Earnings (loss) per common share							
Basic	0.24	(0.17)	(0.10)	0.93	1.62	1.64	1.69
Diluted	0.23	(0.17)	(0.10)	0.93	1.60	1.59	1.64
Cash dividends per common share(1)		0.10	0.10	0.56	0.84	0.81	0.71
Performance Ratios:							
Net interest spread(2)	4.29%	4.30%	4.25%	4.11%	3.86%	4.30%	4.75%
Net interest margin(3)(5)	4.53%	4.62%	4.57%	4.59%	4.50%	4.83%	5.08%
Efficiency ratio(4)(5)	65.06%	62.96%	61.34%	64.50%	62.59%	61.94%	59.69%
Return on average assets(5)	0.44%	(0.03)%	0.06%	0.71%	1.23%	1.33%	1.46%
Return on average common equity(5)	2.52%	(1.72)%	(0.72)%	6.98%	12.87%	14.18%	16.13%

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	As of September 30, 2010	2009	As of December 31, 2009	2008	2007	2006	2005
Balance Sheet Data:							
Total assets	$ 1,254,534	$ 1,017,956	$ 1,014,859	$ 946,145	$ 886,055	$ 852,893	$ 751,152
Noncovered loans receivable, net	730,946	758,123	746,083	793,303	768,945	739,596	643,538
Loans covered under FDIC loss-sharing agreements(6)	134,011						
Total loans, net	864,957	758,123	746,083	793,303	768,945	739,596	643,538
Loans held for sale	1,127		825	304	447		263
FDIC indemnification asset(7)	16,084						
Deposits	1,068,020	845,147	840,128	824,480	776,280	725,921	636,504
Federal Home Loan Bank advances					14,990	37,167	39,900
Securities sold under agreement to repurchase	15,687	9,404	10,440				
Stockholders equity	163,035	158,557	158,498	113,147	84,967	78,639	66,120
Less: goodwill	13,012	13,012	13,012	13,012	13,012	13,081	6,640
Less: other intangible assets	1,909	365	346	424	502	580	
Tangible equity	148,114	145,180	145,140	99,711	71,453	64,978	59,480
Less: preferred stock	23,582	23,456	23,487	23,367			
Tangible common equity	124,532	121,724	121,653	76,344	71,453	64,978	59,480
Book value per common share	12.52	12.23	12.21	13.40	12.79	11.99	10.57
Less: goodwill and other tangible assets per common share	1.34	1.21	1.21	2.00	2.03	2.08	1.06
Tangible book value per common share(8)	11.18	11.02	11.00	11.40	10.76	9.91	9.51
Equity to assets ratio	13.0%	15.6%	15.6%	12.0%	9.6%	9.2%	8.8%
Capital Ratios:							
Average equity to average assets	14.9%	11.9%	12.9%	10.3%	9.5%	9.4%	9.1%
Tangible common equity to tangible assets(9)	10.1%	12.1%	12.1%	8.2%	8.2%	7.7%	8.0%
Total risk-based capital ratio	19.8%	20.2%	20.7%	13.7%	10.7%	10.4%	10.8%
Tier 1 risk-based capital ratio	18.5%	18.9%	19.4%	12.5%	9.5%	9.1%	9.5%
Leverage ratio	12.2%	15.1%	14.6%	11.0%	8.2%	8.0%	8.2%
Asset Quality Ratios(6):							
Nonperforming noncovered loans to noncovered loans	3.49%	4.56%	4.27%	0.42%	0.13%	0.37%	0.13%
Allowance for loan losses to noncovered loans	3.33%	3.20%	3.38%	1.91%	1.33%	1.35%	1.30%
Allowance for loan losses to nonperforming noncovered loans	95.55%	70.21%	79.33%	454.0%	1,016.1%	360.1%	1,016.3%
Nonperforming noncovered assets to total noncovered assets	2.53%	3.52%	3.32%	0.57%	0.13%	0.36%	0.16%

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	As of September 30, 2010	2009	As of December 31, 2009	2008	2007	2006	2005
Other Data:							
Number of banking offices	30	20	20	20	20	20	18
Number of full-time equivalent employees	302	223	222	217	224	233	211

(1) Revised for stock dividends. During the first quarter of 2009, we suspended our cash dividends on our common stock to preserve our capital.

(2) Net interest spread is the difference between the average yield on interest earning assets and the average cost of interest bearing liabilities.

(3) Net interest margin is net interest income divided by average interest earning assets.

(4) The efficiency ratio is noninterest expense divided by the sum of net interest income and noninterest income.

(5) Ratios for the nine month periods are annualized.

(6) Loans subject to a loss sharing agreement with the FDIC are identified as covered loans in this prospectus supplement.

(7) We established an FDIC indemnification asset of $16.1 million, which represents the present value of the estimated losses on covered loans to be reimbursed by the FDIC under the loss sharing agreement. The FDIC indemnification asset will be reduced as losses are recognized on covered loans and loss sharing payments are received from the FDIC. Estimated losses in excess of acquisition date estimates will immediately increase the FDIC indemnification asset by a credit to noninterest income. Conversely, if estimated losses are less than acquisition date estimates, the FDIC indemnification asset will be reduced by a charge to noninterest income on a prospective basis over the shorter of the remaining term of the shared-loss agreements or the remaining life of the loans. Since the FDIC indemnification asset was initially recorded at estimated fair value using a discount rate, a portion of the discount is taken into noninterest income at each reporting date. The covered loans acquired in the Cowlitz Bank acquisition are and will continue to be subject to our internal and external credit review. As a result, if and when credit deterioration is noted subsequent to the July 30, 2010 acquisition date, the deterioration will be measured through our loan loss reserving methodology and a provision for credit losses will be charged to earnings with a partially offsetting noninterest income item reflecting the increase to the FDIC indemnification asset. As a result of this accounting treatment related to our FDIC indemnification asset, currently no portion of our allowance for loan losses is allocated to covered loans.

(8) Tangible book value per common share is defined as total shareholders equity, less any outstanding preferred stock, reduced by recorded goodwill and other intangible assets divided by total common shares outstanding.

(9) Tangible common equity to tangible assets is defined as total shareholders equity, less any outstanding preferred stock, reduced by recorded goodwill and other intangible assets divided by total assets reduced by recorded goodwill and other intangible assets.

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RISK FACTORS

Investing in our common stock involves risks. In deciding whether to invest in our common stock, you should carefully consider the following risks, which should be read together with our other disclosures in this prospectus supplement and the accompanying prospectus and in the documents we incorporate by reference. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently deem immaterial, also may become important factors that affect us. If any of the following risks occurs, our business, financial condition or results of operations could be materially and adversely affected. In that case, the value of our common stock could decline and you could lose part or all of your investment. To the extent any of the risk factors set forth below identify risks previously identified in our periodic reports filed under the Securities Exchange Act of 1934, as amended, the risk factors set forth below supersede those contained in our periodic reports. Otherwise, the risk factors set forth below supplement those contained in our periodic reports.

Risks Associated with Our Business

The following are certain risks that management believes are specific to our business. This should not be viewed as an all inclusive list or in any particular order.

Our business strategy includes significant growth plans, and our financial condition and results of operations could be negatively affected if we fail to grow or fail to manage our growth effectively.

We intend to pursue a significant growth strategy for our business. We regularly evaluate potential acquisitions and expansion opportunities. If appropriate opportunities present themselves, we expect to engage in selected acquisitions of financial institutions in the future, including FDIC-assisted transactions, branch acquisitions, or other business growth initiatives or undertakings. There can be no assurance that we will successfully identify appropriate opportunities, that we will be able to negotiate or finance such activities or that such activities, if undertaken, will be successful.

Our growth initiatives may require us to recruit experienced personnel to assist in such initiatives. Accordingly, the failure to identify and retain such personnel would place significant limitations on our ability to successfully execute our growth strategy. In addition, to the extent we expand our lending beyond our current market areas, we could incur additional risk related to those new market areas. We may not be able to expand our market presence in our existing market areas or successfully enter new markets.

If we do not successfully execute our acquisition growth plan, it could adversely affect our business, financial condition, results of operations, reputation and growth prospects. In addition, if we were to conclude that the value of an acquired business had decreased and that the related goodwill had been impaired, that conclusion would result in an impairment of goodwill charge to us, which would adversely affect our results of operations. While we believe we have the executive management resources and internal systems in place to successfully manage our future growth, there can be no assurance growth opportunities will be available or that we will successfully manage our growth. See -If the goodwill we have recorded in connection with acquisitions becomes impaired, our earnings and capital could be reduced and -Our strategy of pursuing acquisitions and de novo branching exposes us to financial, execution and operational risks that could adversely affect us for additional risks related to our acquisition strategy.

The current economic conditions in the market areas we serve may continue to adversely impact our earnings and could increase the credit risk associated with our loan portfolio.

Substantially all of our loans are to businesses and individuals in the states of Washington and Oregon, and a continuing decline in the economies of our primary market areas of the Pacific Northwest could have a material adverse effect on our business, financial condition, results of operations and prospects. In particular, the Puget

Sound region and the Portland, Oregon area have experienced substantial home price declines and increased foreclosures. A series of large Pacific Northwest businesses have implemented substantial employee layoffs and scaled back plans for future growth. Additionally, acquisitions and consolidations have resulted in substantial employee layoffs, along with a significant increase in office space vacancies in downtown Seattle. The Yakima Valley has likewise seen increased unemployment and a continued decline in housing prices.

A further deterioration in economic conditions in the market areas we serve could result in the following consequences, any of which could have a materially adverse impact on our business, financial condition and results of operations:

- loan delinquencies, problem assets and foreclosures may increase;
- we may increase our provision for loan losses;
- demand for our products and services may decline;
- collateral for loans made may decline further in value, in turn reducing customers borrowing power, reducing the value of assets and collateral associated with existing loans; and
- low cost or non-interest bearing deposits may decrease.

Our loan portfolio is concentrated in loans with a higher risk of loss.

Repayment of our commercial business loans is often dependent on the cash flows of the borrower, which may be unpredictable, and the collateral securing these loans may fluctuate in value. We offer different types of commercial loans to a variety of businesses with a focus on real estate related industries and businesses in agricultural, healthcare, legal, and other professions. The types of commercial loans offered are business lines of credit, term equipment financing and term real estate loans. We also originate loans that are guaranteed by the Small Business Administration, or SBA, and are a preferred lender of the SBA. Commercial business lending involves risks that are different from those associated with real estate lending. Real estate lending is generally considered to be collateral based lending with loan amounts based on predetermined loan to collateral values and liquidation of the underlying real estate collateral being viewed as the primary source of repayment in the event of borrower default. Our commercial business loans are primarily made based on our assessment of the cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The borrowers cash flow may be unpredictable, and collateral securing these loans may fluctuate in value. Although commercial business loans are often collateralized by equipment, inventory, accounts receivable, or other business assets, the liquidation of collateral in the event of default is often an insufficient source of repayment because accounts receivable may be uncollectible and inventories may be obsolete or of limited use, among other things. Accordingly, the repayment of commercial business loans depends primarily on the cash flow and credit worthiness of the borrower and secondarily on the underlying collateral provided by the borrower. In addition, as part of our commercial business lending activities, we originate agricultural loans. Payments on agricultural loans are typically dependent on the profitable operation or management of the related farm property. The success of the farm may be affected by many factors outside the control of the borrower, including adverse weather conditions that prevent the planting of a crop or limit crop yields, declines in market prices for agricultural products and the impact of government regulations. In addition, many farms are dependent on a limited number of key individuals whose injury or death may significantly affect the successful operation of the farm. If the cash flow from a farming operation is diminished, the borrower s ability to repay the loan may be impaired.

As of September 30, 2010, our noncovered commercial loans totaled $398.2 million, or approximately 53% of our total noncovered loan portfolio.

Our income property loans, consisting of commercial and multi-family real estate loans, involve higher principal amounts than other loans and repayment of these loans may be dependent on factors outside our control or the control of our borrowers. We originate commercial and multi-family real estate loans for individuals and businesses for various purposes, which are secured by commercial properties. These loans

typically involve higher principal amounts than other types of loans, and repayment is dependent upon income generated, or expected to be generated, by the property securing the loan in amounts sufficient to cover operating expenses and debt service, which may be adversely affected by changes in the economy or local market conditions. For example, if the cash flow from the borrower s project is reduced as a result of leases not being obtained or renewed, the borrower s ability to repay the loan may be impaired. Commercial and multifamily mortgage loans also expose us to greater credit risk than loans secured by residential real estate because the collateral securing these loans typically cannot be sold as easily as residential real estate. In addition, many of our commercial and multifamily real estate loans are not fully amortizing and contain large balloon payments upon maturity. Such balloon payments may require the borrower to either sell or refinance the underlying property in order to make the payment, which may increase the risk of default or non-payment.

If we foreclose on a commercial and multi-family real estate loan, our holding period for the collateral typically is longer than for one-to-four family residential mortgage loans because there are fewer potential purchasers of the collateral. Additionally, commercial and multi-family real estate loans generally have relatively large balances to single borrowers or related groups of borrowers. Accordingly, if we make any errors in judgment in the collectability of our commercial and multi-family real estate loans, any resulting charge-offs may be larger on a per loan basis than those incurred with our residential or consumer loan portfolios.

As of September 30, 2010, our commercial and multi-family real estate loans totaled $223.5 million, or 29% of our total noncovered loan portfolio.

Our construction loans are based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction lending can involve a higher level of risk than other types of lending because funds are advanced partially based upon the value of the project, which is uncertain prior to the project s completion. Because of the uncertainties inherent in estimating construction costs as well as the market value of a completed project and the effects of governmental regulation of real property, our estimates with regards to the total funds required to complete a project and the related loan-to-value ratio may vary from actual results. As a result, construction loans often involve the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project and the ability of the borrower to sell or lease the property or refinance the indebtedness. If our estimate of the value of a project at completion proves to be overstated, it may have inadequate security for repayment of the loan and may incur a loss.

As of September 30, 2010, our noncovered construction loans totaled $62.9 million, or approximately 8% of our total noncovered loan portfolio. Of these loans, $29.9 million, or approximately 48%, were residential construction related and $33.0 million, or approximately 52% were multi-family and commercial construction related. Approximately $20.3 million, or 32%, of our total construction loans were non-performing noncovered loans at September 30, 2010.

Our allowance for loan losses may prove to be insufficient to absorb losses in our loan portfolio.

Lending money is a substantial part of our business. Every loan carries a certain risk that it will not be repaid in accordance with its terms or that any underlying collateral will not be sufficient to assure repayment. This risk is affected by, among other things:

- cash flow of the borrower and/or the project being financed;
- the changes and uncertainties as to the future value of the collateral, in the case of a collateralized loan;
- the credit history of a particular borrower;
- changes in economic and industry conditions; and
- the duration of the loan.

We maintain an allowance for loan losses, on our non-covered loans, which is a reserve established through a provision for loan losses charged against income, which we believe is appropriate to provide for probable

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losses in our loan portfolio. The amount of this allowance is determined by our management through a periodic review and consideration of several factors, including, but not limited to: