

HERITAGE FINANCIAL CORP /WA/

Form 424B3

March 14, 2014

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**Filed Pursuant to Rule 424(b)(3)  
Registration Statement No. 333-192985**

## **MERGER PROPOSED YOUR VOTE IS VERY IMPORTANT**

Dear Shareholder:

We are pleased to report that the boards of directors of Heritage Financial Corporation, or Heritage, and Washington Banking Company, or Washington Banking, have each approved a merger of our two companies. We believe that this combination will create one of the premier community banking franchises in Western Washington and the Pacific Northwest. Under the merger agreement, Washington Banking will merge with and into Heritage, with Heritage as the surviving corporation. Each outstanding share of Washington Banking common stock, other than dissenting shares, will be converted into the right to receive, promptly following the completion of the merger, 0.89000 of a share of Heritage common stock and \$2.75 in cash.

Although the number of shares of Heritage common stock that holders of Washington Banking common stock will receive for the stock portion of the merger consideration is fixed, the market value of those shares will fluctuate with the market price of Heritage common stock and will not be known at the time Washington Banking shareholders vote on the merger agreement. Based on the closing price of Heritage's common stock of \$15.89 on the NASDAQ Global Select Market, or NASDAQ, on October 23, 2013, immediately prior to the public announcement of the merger agreement, the value of the per share merger consideration payable to Washington Banking shareholders was \$16.89. Based on the closing price of Heritage's common stock of \$18.14 on NASDAQ on March 4, 2014, the last practicable trading day before the printing of this joint proxy statement/prospectus, the value of the per share merger consideration payable to Washington Banking shareholders was \$18.89. **We urge you to obtain current market quotations for Heritage common stock (NASDAQ: trading symbol HFWA ) and Washington Banking common stock (NASDAQ: trading symbol WBCO ).** Based on the number of shares of Washington Banking common stock currently outstanding and reserved for issuance under various equity plans, the maximum number of shares of Heritage common stock issuable in the merger is expected to be approximately 14.1 million.

Heritage and Washington Banking will each hold a special meeting of their respective shareholders in connection with the merger. Heritage and Washington Banking shareholders will be asked to vote to approve the merger agreement and related matters as described in the attached joint proxy statement/prospectus. Approval of the merger agreement by Heritage and Washington Banking shareholders requires the affirmative vote of the holders of two-thirds of the votes entitled to be cast.

The special meeting of Heritage shareholders will be held on April 14, 2014. The special meeting of Washington Banking shareholders will be held on April 15, 2014.

**Heritage's board of directors unanimously recommends that Heritage shareholders vote FOR approval of the Heritage merger proposal and FOR each of the other items to be considered at the Heritage special meeting.**

**Washington Banking's board of directors unanimously recommends that Washington Banking shareholders vote FOR approval of the Washington Banking merger proposal and FOR each of the other items to be considered at the Washington Banking special meeting.**

**This joint proxy statement/prospectus describes the special meetings of Heritage and Washington Banking, the documents related to the merger and other related matters. Please carefully read this entire joint proxy statement/prospectus, including Risk Factors, beginning on page 28, for a discussion of the risks relating to the proposed merger. You also can obtain information about Heritage and Washington Banking from documents that each has filed with the Securities and Exchange Commission.**

/s/ Brian L. Vance

/s/ John L. Wagner

Brian L. Vance

John L. Wagner

*President and Chief Executive Officer*

*President and Chief Executive Officer*

*Heritage Financial Corporation*

*Washington Banking Company*

**Neither the Securities and Exchange Commission nor any state securities commission or any bank regulatory agency has approved or disapproved the shares of Heritage stock to be issued in the merger or passed upon the adequacy or accuracy of this joint proxy statement/prospectus. Any representation to the contrary is a criminal offense.**

**The securities to be issued in the merger are not savings or deposit accounts or other obligations of any bank or nonbank subsidiary of Heritage or Washington Banking, and they are not insured by the Federal Deposit Insurance Corporation or any other governmental agency.**

*The date of this joint proxy statement/prospectus is March 4, 2014, and is first being mailed or otherwise delivered to the shareholders of Heritage and Washington Banking on or about March 14, 2014.*

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**Heritage Financial Corporation**

201 Fifth Avenue SW

Olympia, Washington 98501

(360) 943-1500

**Notice of Special Meeting of Heritage Financial Corporation Shareholders**

**Date: April 14, 2014**

**Time: 2:00 p.m., local time**

**Place: The DoubleTree Hotel,  
415 Capitol Way N., Olympia, Washington**

To Heritage Financial Corporation Shareholders:

We are pleased to notify you of and invite you to a special meeting of shareholders (which we refer to as the Heritage special meeting ). At the Heritage special meeting, you will be asked to vote on the following matters:

the approval of the Agreement and Plan of Merger, dated as of October 23, 2013, by and between Heritage and Washington Banking Company, pursuant to which Washington Banking will merge with and into Heritage, and the approval of the issuance of Heritage common stock to Washington Banking shareholders in connection with the merger (which we refer to as the Heritage merger proposal ); and

a proposal to adjourn the Heritage special meeting, if necessary or appropriate, to solicit additional proxies in favor of the Heritage merger proposal (which we refer to as the Heritage adjournment proposal ).

Only holders of record of Heritage common stock as of the close of business on February 28, 2014 are entitled to notice of, and to vote at, the Heritage special meeting and any adjournments or postponements of the Heritage special meeting. Approval of the Heritage merger proposal requires the affirmative vote of holders of at least two-thirds of the outstanding shares of Heritage common stock. The Heritage adjournment proposal will be approved if a majority of the votes cast on those proposals at the Heritage special meeting are voted in favor of those proposals.

**Heritage's board of directors has unanimously approved the merger agreement, has determined that the merger agreement and the transactions contemplated thereby, including the merger, are advisable and in the best interests of Heritage and its shareholders, and unanimously recommends that Heritage shareholders vote FOR the Heritage merger proposal, and FOR the Heritage adjournment proposal.**

**Your vote is very important.** We cannot complete the merger unless Heritage's shareholders approve the Heritage merger proposal.

To ensure your representation at the Heritage special meeting, please complete and return the enclosed proxy card or submit your proxy by telephone or via the Internet. Whether or not you expect to attend the Heritage special meeting in person, please vote promptly. If you hold your shares in street name through a bank, broker or other nominee and

wish to vote your shares in person at the Heritage special meeting, then you must obtain a legal proxy from the holder of record authorizing you to do so by contacting your bank, broker or other nominee.

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The enclosed joint proxy statement/prospectus provides a detailed description of the Heritage special meeting, the Heritage merger proposal, the documents related to the Heritage merger proposal and other related matters. We urge you to read the joint proxy statement/prospectus, including the documents incorporated in the joint proxy statement/prospectus by reference, and its appendices carefully and in their entirety.

By Order of the Board of Directors

Kaylene M. Lahn

*Senior Vice President and Corporate Secretary*

March 14, 2014

Olympia, Washington

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**Washington Banking Company**

450 SW Bayshore Drive

Oak Harbor, Washington 98277

(360) 240-6458

**Notice of Special Meeting of Washington Banking Company Shareholders**

**Date: April 15, 2014**

**Time: 10:00 a.m., local time**

**Place: Best Western Harbor Plaza,  
33175 State Route 20, Oak Harbor, Washington**

To Washington Banking Company Shareholders:

We are pleased to notify you of and invite you to a special meeting of shareholders (which we refer to as the Washington Banking special meeting ). At the Washington Banking special meeting, you will be asked to vote on the following matters:

the approval of the Agreement and Plan of Merger, dated as of October 23, 2013, by and between Heritage Financial Corporation and Washington Banking, pursuant to which Washington Banking will merge with and into Heritage (which we refer to as the Washington Banking merger proposal );

a proposal to adjourn the Washington Banking special meeting, if necessary or appropriate, to solicit additional proxies in favor of the Washington Banking merger proposal (which we refer to as the Washington Banking adjournment proposal ); and

the approval, on an advisory (non-binding) basis, of compensation that may become payable to certain executive officers of Washington Banking in connection with the merger (which we refer to as the Washington Banking compensation proposal ).

Only holders of record of Washington Banking common stock as of the close of business on February 28, 2014 are entitled to vote at the Washington Banking special meeting and any adjournments or postponements of the Washington Banking special meeting. Approval of the Washington Banking merger proposal requires the affirmative vote of holders of at least two-thirds of the outstanding shares of Washington Banking common stock. The Washington Banking adjournment proposal and Washington Banking compensation proposal will be approved if a majority of the votes cast on those proposals at the Washington Banking special meeting are voted in favor of those proposals.

**Washington Banking's board of directors has unanimously approved the merger agreement, has determined that the merger agreement and the transactions contemplated thereby, including the merger, are advisable and**

**in the best interests of Washington Banking and its shareholders, and unanimously recommends that Washington Banking shareholders vote FOR the Washington Banking merger proposal, FOR the Washington Banking adjournment proposal and FOR the Washington Banking compensation proposal.**

**Your vote is very important.** We cannot complete the merger unless Washington Banking's shareholders approve the Washington Banking merger proposal.

To ensure your representation at the Washington Banking special meeting, please complete and return the enclosed proxy card or submit your proxy by telephone or via the Internet. Whether or not you expect to attend the Washington Banking special meeting in person, please vote promptly. If you hold your shares in street name through a bank, broker or other nominee and wish to vote your shares in person at the Washington Banking special meeting, then you must obtain a legal proxy from the holder of record authorizing you to do so by contacting your bank, broker or other nominee.

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The enclosed joint proxy statement/prospectus provides a detailed description of the Washington Banking special meeting, the Washington Banking merger proposal, the documents related to the Washington Banking merger proposal and other related matters. We urge you to read the joint proxy statement/prospectus, including the documents incorporated in the joint proxy statement/prospectus by reference, and its appendices carefully and in their entirety.

In connection with the merger, Washington Banking shareholders will have the opportunity to exercise dissenters rights in accordance with the procedures specified in the Washington Business Corporation Act (Chapter 23B.13 of the Revised Code of Washington ( RCW and RCW Chapter 23B.13 )). RCW Chapter 23B.13 is included in the accompanying joint proxy statement/prospectus as **Appendix D. Prior to the vote on the Washington Banking merger proposal, Washington Banking shareholders who wish to assert dissenters rights must notify the Corporate Secretary of Washington Banking of their intent to dissent.** For information on how Washington Banking shareholders may perfect their right to dissent on the Washington Banking merger proposal, see the section of this joint proxy statement/prospectus entitled *The Merger Washington Banking Shareholder Dissenters Rights* on page 86. A dissenting shareholder who follows the required procedures may receive cash in an amount equal to the fair value of his or her shares of Washington Banking common stock in lieu of the merger consideration provided for under the merger agreement. A shareholder who chooses to dissent pursuant to RCW Chapter 23B.13 may provide the required notice specified therein to Washington Banking s principal executive offices at 450 SW Bayshore Drive, Oak Harbor, Washington 98277. For additional details about dissenters rights, please refer to the section entitled *The Merger Washington Banking Shareholder Dissenters Rights* on page 86 and **Appendix D** in the accompanying joint proxy statement/prospectus.

By Order of the Board of Directors

Shelly L. Angus

*Senior Vice President and Corporate Secretary*

March 14, 2014

Oak Harbor, Washington

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**REFERENCES TO ADDITIONAL INFORMATION**

This joint proxy statement/prospectus incorporates important business and financial information about Heritage and Washington Banking from documents filed with the Securities and Exchange Commission, or the SEC, that are not included in or delivered with this joint proxy statement/prospectus. You can obtain any of the documents filed with or furnished to the SEC by Heritage and/or Washington Banking at no cost from the SEC's website at <http://www.sec.gov>. You may also request copies of these documents, including documents incorporated by reference in this joint proxy statement/prospectus, at no cost by contacting the appropriate company:

Heritage Financial Corporation  
201 Fifth Avenue SW  
Olympia, Washington 98501  
Attention: Kaylene M. Lahn,

Washington Banking Company  
450 SW Bayshore Drive  
Oak Harbor, Washington 98277  
Attention: Shelly L. Angus,

Senior Vice President and

Senior Vice President and

Corporate Secretary

Corporate Secretary

(360) 943-1500

(360) 240-6458

**You will not be charged for any of these documents that you request. To obtain timely delivery of these documents, you must request them no later than five business days before the date of your company's special meeting. This means that Heritage shareholders requesting documents must do so by April 7, 2014, in order to receive them before the Heritage special meeting, and Washington Banking shareholders requesting documents must do so by April 8, 2014, in order to receive them before the Washington Banking special meeting.**

You should rely only on the information contained in, or incorporated by reference into, this document. No one has been authorized to provide you with information that is different from that contained in, or incorporated by reference into, this document. This document is dated March 4, 2014, and you should assume that the information in this document is accurate only as of such date. You should assume that the information incorporated by reference into this document is accurate as of the date of the document that includes such information. Neither the mailing of this document to Heritage shareholders or Washington Banking shareholders nor the issuance by Heritage of shares of Heritage stock in connection with the merger will create any implication to the contrary.

Information on the websites of Heritage or Washington Banking, or any subsidiary of Heritage or Washington Banking, is not part of this document or incorporated by reference herein. You should not rely on that information in deciding how to vote.

**This document does not constitute an offer to sell, or a solicitation of an offer to buy, any securities, or the solicitation of a proxy, in any jurisdiction to or from any person to whom it is unlawful to make any such offer or solicitation in such jurisdiction. Except where the context otherwise indicates, information contained in this document regarding Heritage has been provided by Heritage and information contained in this document regarding Washington Banking has been provided by Washington Banking.**

See "Where You Can Find More Information" on page 132 for more details.

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A Agreement and Plan of Merger, dated as of October 23, 2013, by and between Heritage Financial Corporation and Washington Banking Company

B Opinion of D.A. Davidson & Co.

C Opinion of Sandler O Neill & Partners, L.P.

D RCW Chapter 23B.13 of the Washington Business Corporation Act

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**QUESTIONS AND ANSWERS ABOUT THE MERGER AND THE SPECIAL MEETINGS**

The following are some questions that you may have about the merger and the special meetings, and brief answers to those questions. We urge you to read carefully the entire joint proxy statement/prospectus because the information in this section does not provide all of the information that might be important to you with respect to the merger and the special meetings. Additional important information is contained in the documents incorporated by reference into this joint proxy statement/prospectus. See **Where You Can Find More Information** on page 132.

Unless the context otherwise requires, throughout this document, **Heritage** refers to Heritage Financial Corporation, **Washington Banking** refers to Washington Banking Company and **we, us and our** refers collectively to Heritage and Washington Banking.

**Q: What is the merger?**

A: Heritage and Washington Banking have entered into an Agreement and Plan of Merger, dated as of October 23, 2013 (which we refer to as the **merger agreement** ), pursuant to which Washington Banking will be merged with and into Heritage, with Heritage continuing as the surviving corporation (we refer to this transaction as the **merger** ). Immediately following the merger, Washington Banking's wholly owned subsidiary bank, Whidbey Island Bank, will merge with Heritage's wholly owned subsidiary bank, Heritage Bank (we refer to this transaction as the **bank merger** ). A copy of the merger agreement is attached to this joint proxy statement/prospectus as **Appendix A**.

**Q: Why am I receiving this joint proxy statement/prospectus?**

A: We are delivering this document to you because you are a shareholder of either Heritage or Washington Banking and this document is a joint proxy statement being used by both the Heritage and Washington Banking boards of directors to solicit proxies of their respective shareholders in connection with approval of the merger and related matters. This document is also a prospectus that is being delivered to Washington Banking shareholders because Heritage is offering shares of its stock to Washington Banking shareholders in connection with the merger. The merger cannot be completed unless the shareholders of Heritage approve the merger agreement and the issuance of Heritage stock in the merger (which we refer to as the **Heritage merger proposal** ) and the shareholders of Washington Banking adopt the merger agreement (which we refer to as the **Washington Banking merger proposal** ).

**Q: In addition to the Heritage merger proposal, what else are Heritage shareholders being asked to vote on?**

A: Heritage is soliciting proxies from its shareholders with respect to one additional proposal; completion of the merger is not conditioned upon approval of this additional proposal:

a proposal to adjourn the Heritage special meeting, if necessary or appropriate, to solicit additional proxies in favor of the Heritage merger proposal (which we refer to as the Heritage adjournment proposal ).

**Q: In addition to the Washington Banking merger proposal, what else are Washington Banking shareholders being asked to vote on?**

A: Washington Banking is soliciting proxies from holders of its common stock with respect to two additional proposals; completion of the merger is not conditioned upon approval of either of these additional proposals:

a proposal to adjourn the Washington Banking special meeting, if necessary or appropriate, to solicit additional proxies in favor of the Washington Banking merger proposal (which we refer to as the Washington Banking adjournment proposal ); and

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a proposal to approve, on an advisory (non-binding) basis, the compensation that certain executive officers of Washington Banking may receive that is based on or otherwise relates to the merger (which we refer to as the Washington Banking compensation proposal ).

**Q: What will Washington Banking shareholders receive in the merger?**

A: Each outstanding share of Washington Banking common stock (except for dissenting shares) will be converted into the right to receive, promptly following the completion of the merger, 0.89000 of a share of Heritage common stock and \$2.75 in cash (which we refer to as the merger consideration ). Heritage will not issue any fractional shares of Heritage common stock in the merger. Washington Banking shareholders who would otherwise be entitled to a fractional share of Heritage common stock upon completion of the merger will instead receive an amount in cash equal to the fractional share interest multiplied by the average of the volume weighted price (rounded to the nearest one ten thousandth) of Heritage common stock on NASDAQ for the ten trading days ending on the trading day immediately preceding the trading day the merger is completed (which we refer to as the average Heritage common stock price ).

Because the number of shares of Heritage common stock that holders of Washington Banking common stock will receive is fixed, the market value of the stock portion of the merger consideration will fluctuate with the market price of Heritage common stock and will not be known at the time Washington Banking shareholders vote on the merger agreement.

**Q: What will Heritage shareholders receive in the merger?**

A: Heritage shareholders will retain their shares, they will not receive any consideration for their shares in the merger. If you are a Heritage shareholder, each share of Heritage common stock that you hold before the merger will continue to represent one share of Heritage common stock after the merger.

**Q: How will the merger affect outstanding Washington Banking stock options and restricted stock unit awards?**

A: The outstanding Washington Banking stock options and restricted stock unit awards will be affected as follows: *Stock Options*. Each option granted by Washington Banking to purchase shares of Washington Banking common stock will be converted into an option to purchase Heritage common stock on the same terms and conditions as were applicable prior to the merger, subject to adjustment of the exercise price and the number of shares of Heritage common stock issuable upon exercise of such option based on the per share value of the merger consideration. All outstanding options granted by Washington Banking are fully vested.

*Restricted Stock Unit Awards*. Each restricted stock unit award in respect of a share of Washington Banking common stock will fully vest at the effective time of the merger and will be converted into a restricted stock unit award in respect of the number of shares of Heritage common stock on the same terms and conditions as were applicable prior to the merger, adjusted based on the per share value of the merger consideration.

**Q: How does Heritage's board of directors recommend that I vote at the Heritage special meeting?**

A: After careful consideration, Heritage's board of directors unanimously recommends that you vote FOR the Heritage merger proposal, and FOR the Heritage adjournment proposal.

Each of the directors and executive officers of Heritage has entered into a voting agreement with Washington Banking, pursuant to which they have agreed to vote FOR the Heritage merger proposal, and FOR any other matter required to be approved by the shareholders of Heritage to facilitate the transactions contemplated by the merger agreement. For more information regarding the voting agreements, please see the section entitled The Merger Agreement Voting and Support Agreements beginning on page 103.

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For a more complete description of Heritage's reasons for the merger and the recommendations of the Heritage board of directors, please see the section entitled "The Merger: Heritage's Reasons for the Merger; Recommendation of Heritage's Board of Directors" beginning on page 53.

**Q: How does Washington Banking's board of directors recommend that I vote at the Washington Banking special meeting?**

A: After careful consideration, Washington Banking's board of directors unanimously recommends that you vote FOR the Washington Banking merger proposal, FOR the Washington Banking adjournment proposal and FOR the Washington Banking compensation proposal.

Each of the directors and executive officers of Washington Banking has entered into a voting agreement with Heritage, pursuant to which they have agreed to vote FOR the Washington Banking merger proposal, and FOR any other matter required to be approved by the shareholders of Washington Banking to facilitate the transactions contemplated by the merger agreement. For more information regarding the voting agreements, please see the section entitled "The Merger Agreement: Voting and Support Agreements" beginning on page 103.

For a more complete description of Washington Banking's reasons for the merger and the recommendations of the Washington Banking board of directors, please see the section entitled "The Merger: Washington Banking's Reasons for the Merger; Recommendation of Washington Banking's Board of Directors" beginning on page 55.

**Q: When and where are the special meetings?**

A: The Heritage special meeting will be held at The DoubleTree Hotel, 415 Capitol Way N., Olympia, Washington on April 14, 2014, at 2:00 p.m. local time.

The Washington Banking special meeting will be held at the Best Western Harbor Plaza, 33175 State Route 20, Oak Harbor, Washington on April 15, 2014, at 10:00 a.m. local time.

**Q: What do I need to do now?**

A: After you have carefully read this joint proxy statement/prospectus and have decided how you wish your shares to be voted, please promptly take the steps identified in the following sentences so that your shares are represented and voted at your company's special meeting, as applicable. If you hold your shares in your name as a shareholder of record, you must complete, sign, date and mail your proxy card in the enclosed postage-paid return envelope as soon as possible. Alternatively, you can provide your proxy directing how you want your shares voted through the internet or by telephone. Information and applicable deadlines for providing your proxy through the internet or by telephone are set forth in the enclosed proxy card instructions. If you hold your shares in street name through a bank or broker, you must direct your bank or broker how to vote in accordance with the instructions you have received from your bank or broker.

**Q: Who is entitled to vote?**

A: *Heritage Special Meeting.* Holders of record of Heritage common stock at the close of business on February 28, 2014 which is the date that the Heritage board of directors has fixed as the record date for the Heritage special meeting, are entitled to vote at the Heritage special meeting.

*Washington Banking Special Meeting.* Holders of record of Washington Banking common stock at the close of business on February 28, 2014, which is the date that the Washington Banking board of directors has fixed as the record date for the Washington Banking special meeting, are entitled to vote at the Washington Banking special meeting.

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**Q: How will my shares of common stock held in the Heritage Financial Corporation 401(k) Employee Stock Ownership Plan be voted?**

Heritage maintains a 401(k) employee stock ownership plan ( KSOP ) which owned 367,558 shares or 2.3% of Heritage's common stock as of the record date. Heritage employees participate in the KSOP. Each KSOP participant may instruct the trustee of the plan how to vote the shares of Heritage common stock allocated to his or her account under the KSOP by completing a vote authorization form. If a KSOP participant properly executes a vote authorization form, the KSOP trustee will vote the participant's shares in accordance with the participant's instructions. KSOP shares for which proper voting instructions are not received will not be voted. In order to give the trustee sufficient time to vote, all vote authorization forms, which are in the form of a proxy card, must be received from KSOP participants by the transfer agent on or before April 9, 2014.

**Q: What constitutes a quorum?**

A: *Heritage Special Meeting.* The presence at the Heritage special meeting, in person or by proxy, of holders of a majority of the outstanding shares of Heritage common stock entitled to vote at the special meeting will constitute a quorum for the transaction of business. Abstentions and broker-nonvotes will be treated as shares that are present at the meeting for the purpose of determining the presence of a quorum.

A: *Washington Banking Special Meeting.* The presence at the Washington Banking special meeting, in person or by proxy, of holders of at least a majority of the outstanding shares of Washington Banking common stock entitled to vote at the special meeting will constitute a quorum for the transaction of business. Abstentions and broker-nonvotes will be treated as shares that are present at the meeting for the purpose of determining the presence of a quorum.

**Q: If my shares are held in street name through a bank, broker or other nominee, will my bank, broker or other nominee vote my shares for me?**

A: No. Your bank, broker or other nominee cannot vote your shares without instructions from you. Please follow the voting instruction form provided by your bank, broker or other nominee. The effects of failing to instruct your bank, broker or other nominee how to vote your shares of Heritage or Washington Banking common stock on each of the proposals to be considered at the Heritage or Washington Banking special meetings are described below.

**Q: What is the vote required to approve each proposal at the Heritage special meeting?**

A: *Heritage merger proposal:* To approve the Heritage merger proposal, at least two-thirds of the Heritage common stock outstanding and entitled to vote thereon must be voted in favor of such proposal. If you mark **ABSTAIN** on your proxy, fail to submit a proxy or fail to vote in person at the Heritage special meeting or fail to instruct your bank or broker how to vote with respect to the Heritage merger proposal, it will have the same effect as a vote **AGAINST** the proposal.

*Heritage adjournment proposal:* The Heritage adjournment proposal will be approved if the votes cast in favor of such proposal at the Heritage special meeting exceed the votes cast in opposition. If you mark **ABSTAIN** on your proxy, fail to submit a proxy or fail to vote in person at the Heritage special meeting or fail to instruct your bank or broker how to vote with respect to the Heritage adjournment proposal, it will have no effect on the proposal.

**Q: What is the vote required to approve each proposal at the Washington Banking special meeting?**

A: *Washington Banking merger proposal:* To approve the Washington Banking merger proposal, at least two-thirds of the Washington Banking common stock outstanding and entitled to vote thereon must be voted in favor of such proposal. If you mark **ABSTAIN** on your proxy, fail to submit a proxy or fail to vote in

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person at the Washington Banking special meeting or fail to instruct your bank or broker how to vote with respect to the Washington Banking merger proposal, it will have the same effect as a vote AGAINST the proposal.

*Washington Banking adjournment proposal:* The Washington Banking adjournment proposal will be approved if the votes cast in favor of such proposal at the Washington Banking special meeting exceed the votes cast in opposition. If you mark ABSTAIN on your proxy, fail to submit a proxy or fail to vote in person at the Washington Banking special meeting or fail to instruct your bank or broker how to vote with respect to the Washington Banking adjournment proposal, it will have no effect on such proposal.

*Washington Banking compensation proposal:* The Washington Banking compensation proposal will be approved if the votes cast in favor of such proposal at the Washington Banking special meeting exceed the votes cast in opposition. If you mark ABSTAIN on your proxy, fail to submit a proxy or fail to vote in person at the Washington Banking special meeting or fail to instruct your bank or broker how to vote with respect to the Washington Banking compensation proposal, it will have no effect on such proposal.

**Q: What will happen if Washington Banking's shareholders do not approve the Washington Banking advisory (non-binding) proposal on compensation?**

A: The vote on the Washington Banking compensation proposal is a vote separate and apart from the vote to approve the Washington Banking merger proposal and other related proposals. You may vote for this proposal and against the Washington Banking merger proposal and other related proposals, or vice versa. Because the vote on this proposal is advisory only, it will not be binding on Heritage or Washington Banking and will have no impact on whether the merger is consummated or on whether any contractually obligated payments are made to Washington Banking's named executive officers. Washington Banking is seeking your approval of these payments, on an advisory (non-binding) basis, in order to comply with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and related SEC rules.

**Q: Why is my vote important?**

A: If you do not vote by proxy or in person at your company's special meeting, it will be more difficult for your company to obtain the necessary quorum to hold its special meeting. In addition, your failure to submit a proxy or vote in person, or failure to instruct your bank or broker how to vote, or abstention will have the same effect as a vote AGAINST the merger proposal at your company's special meeting. The merger agreement must be approved by the affirmative vote of the holders of at least two-thirds of the outstanding shares of Heritage common stock entitled to vote at the Heritage special meeting and approved by the affirmative vote of the holders of at least two-thirds of the outstanding shares of Washington Banking common stock entitled to vote at the Washington Banking special meeting.

**Q: Can I attend my company's special meeting and vote my shares in person?**

A: Yes. All shareholders of Heritage and all shareholders of Washington Banking, including shareholders of record and shareholders who hold their shares through banks, brokers, nominees or any other holder of record, are

invited to attend their respective meetings. Holders of record of Heritage and Washington Banking common stock can vote in person at the Heritage special meeting and Washington Banking special meeting, respectively. If you wish to vote in person at your company's special meeting and if you are a shareholder of record, you should bring the enclosed proxy card and proof of identity. If you hold your shares in street name through a broker, or beneficially own your shares through another holder of record, you will need to bring with you and provide to the inspectors of election proof of identity and a letter from your bank, broker, nominee or other holder of record confirming your beneficial ownership of common stock as of the record date and authorization for you to vote such shares at your company's special meeting (a legal proxy from your holder of record). At the appropriate time during your company's special meeting, the shareholders present will be asked whether anyone wishes to vote in person. You should raise your hand at this time to receive a ballot to record your vote. Everyone who attends the special meeting must abide by the rules for the conduct of the meeting distributed at the meeting by your company.

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**Q: Can I change my proxy or voting instructions?**

A: *Heritage shareholders:* Yes. If you are a holder of record of Heritage common stock, you may revoke your proxy at any time before it is voted by (1) signing and returning a proxy card with a later date, (2) delivering a written revocation to Heritage's corporate secretary, (3) attending the Heritage special meeting in person and voting by ballot at the special meeting, or (4) voting by telephone or the internet at a later time. Attendance at the Heritage special meeting will not automatically revoke your proxy. A revocation or later-dated proxy received by Heritage after the vote is taken at the Heritage special meeting will not affect your previously submitted proxy. Heritage's corporate secretary's mailing address is: Corporate Secretary, Heritage Financial Corporation, 201 Fifth Avenue SW, Olympia, Washington 98501. If you hold your shares in street name through a bank or broker, you should contact your bank or broker to change your voting instructions.

*Washington Banking shareholders:* Yes. If you are a holder of record of Washington Banking common stock, you may revoke your proxy at any time before it is voted by (1) signing and returning a proxy card with a later date, (2) delivering a written revocation to Washington Banking's corporate secretary, (3) attending the Washington Banking special meeting in person and voting by ballot at the special meeting, or (4) voting by telephone or the internet at a later time. Attendance at the Washington Banking special meeting by itself will not automatically revoke your proxy. A revocation or later-dated proxy received by Washington Banking after the vote is taken at the Washington Banking special meeting will not affect your previously submitted proxy. Washington Banking's corporate secretary's mailing address is: Corporate Secretary, Washington Banking Company, 450 SW Bayshore Drive, Oak Harbor, Washington 98277. If you hold your shares in street name through a bank or broker, you should contact your bank or broker to change your voting instructions.

**Q: Will Heritage be required to submit the proposal to approve the merger agreement to its shareholders even if Heritage's board of directors has withdrawn, modified or qualified its recommendation?**

A: Yes. Unless the merger agreement is terminated before the Heritage special meeting, Heritage is required to submit the proposal to approve the merger agreement to its shareholders even if Heritage's board of directors has withdrawn or modified its recommendation.

**Q: Will Washington Banking be required to submit the proposal to approve the merger agreement to its shareholders even if Washington Banking's board of directors has withdrawn, modified or qualified its recommendation?**

A: Yes. Unless the merger agreement is terminated before the Washington Banking special meeting, Washington Banking is required to submit the proposal to approve the merger agreement to its shareholders even if Washington Banking's board of directors has withdrawn or modified its recommendation.

**Q: What are the U.S. federal income tax consequences of the merger to Washington Banking shareholders?**

A:

The merger is intended to qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code, or Code. Assuming the merger qualifies as a reorganization, a U.S. holder of Washington Banking common stock generally will not recognize any gain or loss upon receipt of Heritage common stock in exchange for Washington Banking common stock in the merger, and will recognize gain (but not loss) in an amount not to exceed any cash received as part of the merger consideration (except with respect to any cash received upon exercise of dissenters' rights under Washington law and in lieu of a fractional share of Heritage common stock, as discussed below under Material U.S. Federal Income Tax Consequences of the Merger Receipt of Only Cash Consideration Upon Exercise of Dissenters' Rights and Cash Received Instead of a Fractional Share of Heritage Common Stock on page 118). It is a condition to the completion of the merger that Heritage and Washington Banking receive written opinions from their respective counsel to the effect that the merger will qualify as a reorganization within the meaning of Section 368(a) of the Code.

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**Q: Are Washington Banking shareholders entitled to dissenters' rights?**

A: Yes. If you want to exercise dissenters' rights, you must deliver to Washington Banking, before the vote is taken by Washington Banking shareholders on the approval of the merger agreement, written notice of your intent to exercise your dissenters' rights if the merger is completed. Also, you must vote against, or abstain from voting on, the approval of the merger agreement and follow other procedures, both before and after the Washington Banking special meeting, as described in **Appendix D**. Note that if you return a signed proxy card without voting instructions or with instructions to vote FOR the merger agreement, your shares will be automatically voted in favor of the merger agreement and you will lose all dissenters' rights available under Washington law. For further information, see *The Merger Washington Banking Shareholder Dissenters' Rights* on page 86.

**Q: Are Heritage shareholders entitled to dissenters' rights?**

A: No. Under Washington law Heritage shareholders do not have dissenters' rights.

**Q: If I am a holder of Washington Banking common stock in certificated form, should I send in my Washington Banking stock certificates now?**

A: No. Please do not send in your Washington Banking stock certificates with your proxy. After the merger, an exchange agent will send you instructions for exchanging Washington Banking stock certificates for the merger consideration. See *The Merger Agreement Conversion of Shares; Exchange Procedures* on page 91.

**Q: What should I do if I hold my shares of Washington Banking common stock in book-entry form?**

A: You are not required to take any special additional actions if your shares of Washington Banking common stock are held in book-entry form. After the completion of the merger, an exchange agent will send you instructions for exchanging your shares for the merger consideration. See *The Merger Agreement Conversion of Shares; Exchange Procedures* on page 91.

**Q: Whom may I contact if I cannot locate my Washington Banking stock certificate(s)?**

A: If you are unable to locate your original Washington Banking stock certificate(s), you should contact Computershare, Washington Banking's transfer agent, at (800) 962-4284.

**Q: Should Heritage shareholders do anything with their stock certificates?**

A:

No. Heritage stock certificates will not be exchanged and will remain outstanding after the merger without any action required by Heritage shareholders.

**Q: What should I do if I receive more than one set of voting materials?**

A: Heritage shareholders and Washington Banking shareholders may receive more than one set of voting materials, including multiple copies of this joint proxy statement/prospectus and multiple proxy cards or voting instruction cards. For example, if you hold shares of Heritage and/or Washington Banking common stock in more than one brokerage account, you will receive a separate voting instruction card for each brokerage account in which you hold such shares. If you are a holder of record of Heritage common stock or Washington Banking common stock and your shares are registered in more than one name, you will receive more than one proxy card. In addition, if you are a holder of both Heritage common stock and Washington Banking common stock, you will receive one or more separate proxy cards or voting instruction cards for each company. Please complete, sign, date and return each proxy card and voting instruction card that you receive or otherwise follow the voting instructions set forth in this joint proxy statement/prospectus to ensure that you vote every share of Heritage common stock and/or Washington Banking common stock that you own.

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**Q: When do you expect to complete the merger?**

A: Heritage and Washington Banking expect to complete the merger in the first half of 2014. However, neither Heritage nor Washington Banking can assure you of when or if the merger will be completed. Heritage and Washington Banking must first obtain the approval of Heritage shareholders and Washington Banking shareholders for the merger, as well as obtain necessary regulatory approvals and satisfy certain other closing conditions.

Heritage received approval for the bank merger from the Federal Deposit Insurance Corporation, or the FDIC, and the Washington Department of Financial Institutions, or DFI, on December 23, 2013 and January 3, 2014, respectively. On January 31, 2014, Heritage received a waiver from the Board of Governors of the Federal Reserve System, or the Federal Reserve Board, of its application requirements that would apply to this merger.

**Q: What happens if the merger is not completed?**

A: If the merger is not completed, holders of Washington Banking common stock will not receive any consideration for their shares in connection with the merger. Instead, Washington Banking will remain an independent public company and its common stock will continue to be listed and traded on NASDAQ. In addition, if the merger agreement is terminated in certain circumstances, a termination fee may be required to be paid by either Heritage or Washington Banking. See *The Merger Agreement Termination Fee* beginning on page 102 for a complete discussion of the circumstances under which termination fees will be required to be paid.

**Q: Whom should I call with questions?**

A: *Heritage shareholders:* If you have any questions concerning the merger or this joint proxy statement/prospectus, would like additional copies of this joint proxy statement/prospectus or need help voting your shares of Heritage common stock, please contact Kaylene M. Lahn, Senior Vice President and Corporate Secretary (360) 943-1500, or Heritage's proxy solicitor, Karen Smith of Advantage Proxy, toll-free at (877) 870-8565, or at [ksmith@advantageproxy.com](mailto:ksmith@advantageproxy.com).

*Washington Banking shareholders:* If you have any questions concerning the merger or this joint proxy statement/prospectus, would like additional copies of this joint proxy statement/prospectus or need help voting your shares of Washington Banking common stock, please contact Shelly L. Angus, Senior Vice President and Corporate Secretary, (360) 240-6458, or Washington Banking's proxy solicitor, Karen Smith of Advantage Proxy, toll-free at (877) 870-8565, or at [ksmith@advantageproxy.com](mailto:ksmith@advantageproxy.com).

**Table of Contents****SUMMARY**

*This summary highlights selected information from this joint proxy statement/prospectus and may not contain all of the information that is important to you. You should carefully read this entire document, including the appendices, and the other documents to which this document refers to fully understand the merger and the related transactions. A list of the documents incorporated by reference appears on page 132 under *Where You Can Find More Information*.*

**The Merger and the Merger Agreement (pages 45 and 89)**

The terms and conditions of the merger are contained in the merger agreement, which is attached to this joint proxy statement/prospectus as **Appendix A**. We encourage you to read the merger agreement carefully, as it is the legal document that governs the merger.

Under the terms of the merger agreement, Washington Banking will merge with and into Heritage, with Heritage as the surviving corporation (we refer to this transaction as the *merger*). Immediately following the merger, Washington Banking's wholly owned subsidiary bank, Whidbey Island Bank, will merge with Heritage's wholly owned subsidiary bank, Heritage Bank (we refer to this transaction as the *bank merger*).

**In the Merger, Holders of Washington Banking Common Stock Will Receive Shares of Heritage Common Stock and Cash (page 89)**

If the merger is completed, each outstanding share of Washington Banking common stock will be converted into the right to receive, promptly following the completion of the merger, 0.89000 of a share of Heritage common stock and \$2.75 in cash, which we refer to as the *merger consideration*. Heritage will not issue any fractional shares of Heritage common stock in the merger. Washington Banking shareholders who would otherwise be entitled to a fractional share of Heritage common stock upon completion of the merger will instead receive an amount in cash equal to the fractional share interest multiplied by the average Heritage common stock price. *For example, if you hold 1,001 shares of Washington Banking common stock, then for the stock portion of the merger consideration, you will receive 890 shares of Heritage common stock and a cash payment instead of the 0.89 fractional share of Heritage common stock that you otherwise would have received (1,001 shares × 0.89000 = 890.89 shares), and for the cash portion of the merger consideration, you will receive a cash payment of \$2,752.75 (1,001 × \$2.75).* We refer to the stock and cash consideration described above as the *merger consideration*.

Heritage's and Washington Banking's common stock are listed on NASDAQ under the symbols *HFWA* and *WBCO*, respectively. The following table shows the closing sale prices of Heritage common stock and Washington Banking common stock as reported on NASDAQ on October 23, 2013, immediately prior to the public announcement of the merger agreement, and on March 4, 2014, the last practicable trading day before the printing of this joint proxy statement/prospectus. This table also shows the implied value of the merger consideration payable for each share of Washington Banking common stock, calculated by multiplying the closing price of Heritage common stock on those dates by the exchange ratio of 0.89000 for the stock portion of the merger consideration, and adding to that amount \$2.75 for the cash portion of the merger consideration.

<b>Date</b>	<b>Heritage Closing Price</b>	<b>Washington Banking Closing Price</b>	<b>Implied Value of Merger Consideration for</b>
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**One Share of  
Washington  
Banking  
Common  
Stock**

October 23, 2013	\$	15.89	\$	14.25	\$	16.89
March 4, 2014	\$	18.14	\$	18.81	\$	18.89

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**Heritage Will Hold its Special Meeting on April 14, 2014 (page 35)**

The special meeting of Heritage shareholders will be held on April 14, 2014, at 2:00 p.m. local time, at The DoubleTree Hotel, 415 Capitol Way N., Olympia, Washington. At the Heritage special meeting, Heritage shareholders will be asked to:

approve the merger agreement and the issuance of Heritage common stock in connection with the merger (which we refer to as the Heritage merger proposal ); and

approve a proposal to adjourn the Heritage special meeting, if necessary or appropriate, to solicit additional proxies in favor of the Heritage merger proposal (which we refer to as the Heritage adjournment proposal ). Only holders of record of Heritage common stock at the close of business on February 28, 2014 will be entitled to vote at the Heritage special meeting. Each share of Heritage common stock is entitled to one vote on each proposal to be considered at the Heritage special meeting. As of the record date, there were 16,218,617 shares of Heritage common stock entitled to vote at the Heritage special meeting. As of the record date, the directors and executive officers of Heritage and their affiliates beneficially owned and were entitled to vote 1,090,184 shares of Heritage common stock representing approximately 7% of the shares of Heritage common stock outstanding on that date, which shares are subject to the voting and support agreements described below.

Concurrent with the execution of the merger agreement, each of Heritage s directors and executive officers entered into a voting and support agreement with Washington Banking under which he or she generally has agreed (1) to vote or cause to be voted in favor of the Heritage merger proposal and any other matter required to be approved by the shareholders of Heritage to facilitate the transactions contemplated by the merger agreement, all shares of Heritage common stock over which he or she or a member of his or her immediate family has, directly or indirectly, sole or shared voting power as of the record date for the Heritage special meeting and (2) subject to limited exceptions, not to sell or otherwise dispose of shares of Heritage common stock he or she beneficially owned as of the date of such voting and support agreement until after the approval of the Heritage merger proposal by the shareholders of Heritage. For additional information regarding the voting and support agreements, see The Merger Agreement Voting and Support Agreements on page 103.

To approve the Heritage merger proposal, at least two-thirds of the shares of Heritage common stock outstanding and entitled to vote thereon must be voted in favor of such proposal. The Heritage adjournment proposal will be approved if a majority of the votes cast at the Heritage special meeting are voted in favor of such proposal. If you mark ABSTAIN on your proxy, fail to submit a proxy or fail to vote in person at the Heritage special meeting or fail to instruct your bank or broker how to vote with respect to the Heritage merger proposal, it will have the same effect as a vote AGAINST the proposal. If you mark ABSTAIN on your proxy, fail to submit a proxy or fail to vote in person at the Heritage special meeting or fail to instruct your bank or broker how to vote with respect to the Heritage adjournment proposal, it will have no effect on the proposal.

**Heritage s Board of Directors Unanimously Recommends that Heritage Shareholders Vote FOR the Approval of the Heritage Merger Proposal and FOR the Other Proposal Presented at the Heritage Special Meeting (page 35)**

Heritage s board of directors has determined that the merger, the merger agreement and the transactions contemplated by the merger agreement are advisable and in the best interests of Heritage and its shareholders and has unanimously

approved the merger agreement. Heritage's board of directors unanimously recommends that Heritage shareholders vote FOR the approval of the Heritage merger proposal and FOR the other proposal presented at the Heritage special meeting. For the factors considered by Heritage's board of directors in reaching its decision to approve the merger agreement, see The Merger Heritage's Reasons for the Merger; Recommendation of Heritage's Board of Directors on page 53.

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**Washington Banking Will Hold its Special Meeting on April 15, 2014 (page 40)**

The special meeting of Washington Banking shareholders will be held on April 15, 2014, at 10:00 a.m. local time, at the Best Western Harbor Plaza, 33175 State Route 20, Oak Harbor, Washington. At the Washington Banking special meeting, holders of Washington Banking common stock will be asked to:

approve the merger agreement (which we refer to as the Washington Banking merger proposal );

approve a proposal to adjourn the Washington Banking special meeting, if necessary or appropriate, to solicit additional proxies in favor of the Washington Banking merger proposal (which we refer to as the Washington Banking adjournment proposal ); and

approve, on an advisory (non-binding) basis, the compensation that certain executive officers of Washington Banking may receive in connection with the merger (which we refer to as the Washington Banking compensation proposal ).

Only holders of record of Washington Banking common stock at the close of business on February 28, 2014 will be entitled to vote at the Washington Banking special meeting. Each share of Washington Banking common stock is entitled to one vote on each proposal to be considered at the Washington Banking special meeting. As of the record date, there were 15,587,041 shares of Washington Banking common stock entitled to vote at the Washington Banking special meeting. As of the record date, the directors and executive officers of Washington Banking and their affiliates beneficially owned and were entitled to vote 305,846 shares of Washington Banking common stock representing approximately 2% of the shares of Washington Banking common stock outstanding on that date, which shares are subject to the voting and support agreements described below.

Concurrent with the execution of the merger agreement, each of Washington Banking's directors and executive officers entered into a voting and support agreement with Heritage under which he or she generally has agreed (1) to vote or cause to be voted in favor of the Washington Banking merger proposal and any other matter required to be approved by the shareholders of Washington Banking to facilitate the transactions contemplated by the merger agreement, all shares of Washington Banking common stock over which he or she or a member of his or her immediate family has, directly or indirectly, sole or shared voting power as of the record date for the Washington Banking special meeting and (2) subject to limited exceptions, not to sell or otherwise dispose of shares of Washington Banking common stock he or she beneficially owned as of the date of such voting and support agreement until after the approval of the Washington Banking merger proposal by the shareholders of Washington Banking. For additional information regarding the voting and support agreements, see The Merger Agreement Voting and Support Agreements on page 103.

To approve the Washington Banking merger proposal, at least two-thirds of the shares of Washington Banking common stock outstanding and entitled to vote thereon must be voted in favor of such proposal. The Washington Banking adjournment proposal and the Washington Banking compensation proposal will each be approved if a majority of the of the votes cast at the Washington Banking special meeting are voted in favor of such proposal. If you mark ABSTAIN on your proxy, fail to submit a proxy or fail to vote in person at the Washington Banking special meeting or fail to instruct your bank or broker how to vote with respect to the Washington Banking merger proposal, it will have the same effect as a vote AGAINST the proposal. If you mark ABSTAIN on your proxy, fail to submit a proxy or fail to vote in person at the Washington Banking special meeting or fail to instruct your bank or broker how

to vote with respect to the Washington Banking adjournment proposal or the Washington Banking compensation proposal, it will have no effect on such proposal.

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**Washington Banking's Board of Directors Unanimously Recommends that Washington Banking Shareholders Vote FOR the Approval of the Washington Banking Merger Proposal and the Other Proposals Presented at the Washington Banking Special Meeting (page 40)**

After careful consideration, Washington Banking's board of directors has determined that the merger, the merger agreement and the transactions contemplated by the merger agreement are advisable and in the best interests of Washington Banking and its shareholders and has unanimously approved the merger agreement. Washington Banking's board of directors unanimously recommends that Washington Banking shareholders vote FOR the approval of the Washington Banking merger proposal and FOR the other proposals presented at the Washington Banking special meeting. For the factors considered by Washington Banking's board of directors in reaching its decision to approve the merger agreement, see The Merger Washington Banking's Reasons for the Merger; Recommendation of Washington Banking's Board of Directors on page 55.

**Opinion of Heritage's Financial Advisor (page 59 and Appendix B)**

In connection with its consideration of the merger, the Heritage board of directors received advice and financial presentation from D.A. Davidson & Co. (which we refer to as Davidson), its oral opinion, which opinion was confirmed by delivery of a written opinion, dated October 23, 2013, to the effect that, as of such date and based upon and subject to the various factors, assumptions and limitations set forth in its opinion, the merger consideration payable to holders of Washington Banking common stock was fair, from a financial point of view, to Heritage. The full text of Davidson's written opinion is attached as **Appendix B** to this joint proxy statement/prospectus. You should read the entire opinion for a discussion of, among other things, the assumptions made, procedures followed, matters considered and limitations on the review undertaken by Davidson in rendering its opinion. **Davidson's written opinion is addressed to the Heritage board of directors, is directed only to the merger consideration and does not constitute a recommendation to any Heritage shareholder as to how such shareholder should vote with respect to the merger or any other matter.**

**Opinion of Washington Banking's Financial Advisor (page 69 and Appendix C)**

In connection with its consideration of the merger, on October 23, 2013, the Washington Banking board of directors received financial advice and presentations regarding the financial aspects of the merger from Sandler O'Neill & Partners, L.P. (which we refer to as Sandler), and on October 23, 2013, received Sandler's oral opinion, which opinion was confirmed by delivery of a written opinion, dated October 23, 2013, to the effect that, as of such date and based upon and subject to the various factors, assumptions and limitations set forth in its opinion, the merger consideration was fair, from a financial point of view, to the holders of Washington Banking common stock. The full text of Sandler's written opinion is attached as **Appendix C** to this joint proxy statement/prospectus. You should read the entire opinion for a discussion of, among other things, the assumptions made, procedures followed, matters considered and limitations on the review undertaken by Sandler in rendering its opinion. **Sandler's written opinion is addressed to the Washington Banking board of directors, is directed only to the merger consideration and does not constitute a recommendation to any Washington Banking shareholder as to how such shareholder should vote with respect to the merger or any other matter.**

**What Holders of Washington Banking Stock Options and Restricted Stock Unit Awards Will Receive (page 89)**

*Stock Options.* Each stock option granted by Washington Banking to purchase shares of Washington Banking common stock will automatically be converted into an option to purchase, on the same terms and conditions as were applicable prior to the merger, an option to acquire shares of Heritage common stock. The number of whole shares of Heritage common stock subject to the converted option will be equal to the number of shares of Washington Banking

common stock subject to such Washington Banking option immediately prior to

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the merger multiplied by a fraction having a numerator equal to the sum of (i) \$2.75 plus (ii) the product of 0.89000 multiplied by the average Heritage common stock price, and a denominator equal to the average Heritage common stock price (we refer to this fraction as the option exchange ratio), rounded down to the nearest whole share. The converted option will have an exercise price per share of Heritage common stock equal to the exercise price for each option immediately prior to the merger divided by the option exchange ratio, rounded up to the nearest penny. All outstanding options granted by Washington Banking are fully vested.

For example, assume that an individual holds an option to purchase 100 shares of Washington Banking common stock at an exercise price per share of \$10.00 immediately prior to the merger, and with an expiration date of December 31, 2019. Assume further that the average closing price of a share of Heritage common stock over the 10 trading days immediately prior to the merger is \$20.00. The option exchange ratio in this example would be 1.0275  $((\$2.75 + (0.89000 \times \$20.00)) / \$20.00)$ . As a result, the option will be converted into an option to purchase 102 shares of Heritage common stock (100 x 1.0275, rounded down to the nearest whole share) with an exercise price per share of \$9.74  $(\$10.00 / 1.0275, \text{rounded up to the nearest penny})$  at the time of the merger, and with an expiration date of December 31, 2019. Section 409A of the Internal Revenue Code generally requires that the number of shares covered by the option be rounded down to the next whole share and the exercise price be rounded up to the next whole penny.

*Restricted Stock Unit Awards.* Each restricted stock unit award in respect of a share of Washington Banking common stock will fully vest at the effective time of the merger and will be converted automatically into a restricted stock unit award in respect of shares of Heritage common stock. The number of shares of Heritage common stock subject to the converted restricted stock unit will be equal to the product of the number of shares of Washington Banking common stock subject to the Washington Banking restricted stock unit award and the option exchange ratio, rounded to the nearest whole share. Such converted restricted stock unit award will continue to be subject to the same terms and conditions as were applicable to the restricted stock unit award under the Washington Banking Stock Plan and the applicable award agreement thereunder.

For example, assume that an individual holds a restricted stock unit award that entitles him to receive 100 shares of Washington Banking common stock upon vesting on December 31, 2014. Assume further that the average closing price of a share of Heritage common stock over the 10 trading days immediately prior to the merger is \$20.00. The option exchange ratio in this example would be 1.0275  $((\$2.75 + (0.89000 \times \$20.00)) / \$20.00)$ . As such, the restricted stock unit award will be converted into the right to receive 103 fully vested shares of Heritage common stock (100 x 1.0275, rounded to the nearest whole share) at the time of the merger. Standard rounding conventions are used for conversion of the restricted stock units.

**Material U.S. Federal Income Tax Consequences of the Merger (page 116)**

The merger is intended to qualify as a reorganization within the meaning of Section 368(a) of the Code. Assuming the merger qualifies as a reorganization, a U.S. holder of Washington Banking common stock generally will not recognize any gain or loss upon receipt of Heritage common stock in exchange for Washington Banking common stock in the merger, and will recognize gain (but not loss) in an amount not to exceed any cash received as part of the merger consideration (except with respect to any cash received upon exercise of dissenters' rights under Washington law and in lieu of a fractional share of Heritage common stock, as discussed under Material U.S. Federal Income Tax Consequences of the Merger Receipt of Only Cash Consideration Upon Exercise of Dissenters' Rights and Cash Received Instead of a Fractional Share of Heritage Common Stock) on page 118. It is a condition to the completion of the merger that Heritage and Washington Banking receive written opinions from their respective counsel to the effect that the merger will qualify as a reorganization within the meaning of Section 368(a) of the Code.

For further information, see Material U.S. Federal Income Tax Consequences of the Merger on page 116.



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*The U.S. federal income tax consequences described above may not apply to all holders of Washington Banking common stock. Your tax consequences will depend on your individual situation. Accordingly, we strongly urge you to consult your independent tax advisor for a full understanding of the particular tax consequences of the merger to you.*

**Holders of Washington Banking Common Stock Have Dissenters' Rights in Connection with the Merger (see page 86)**

Under Washington law, Washington Banking shareholders have the right to dissent from the merger and receive cash equal to the fair value of their Washington Banking shares instead of receiving a combination of cash and Heritage common stock. To exercise dissenters' rights, you must strictly follow the procedures established by the Washington Business Corporation Act, RCW Chapter 23B.13, including the delivery to Washington Banking before Washington Banking shareholders vote on the merger proposal at the special meeting of written notice of your intent to demand payment for your shares of Washington Banking common stock if the merger is effected, and you must vote against, or abstain from voting on, the merger proposal. Please read *The Merger* Washington Banking Shareholder Dissenters' Rights on page 86 and **Appendix D** to this joint proxy statement/prospectus for additional information.

Heritage shareholders are not entitled to dissenters' rights in connection with the merger.

**Washington Banking's Executive Officers and Directors Have Financial Interests in the Merger that Differ from Your Interests (page 79)**

Washington Banking shareholders should be aware that some of Washington Banking's directors and executive officers have interests in the merger and have arrangements that are different from, or in addition to, those of Washington Banking shareholders generally. Washington Banking's board of directors was aware of these interests and considered these interests, among other matters, when making its decision to approve the merger agreement, and in recommending that Washington Banking shareholders vote in favor of approving the merger agreement.

These interests include the following:

The six executive officers of Washington Banking may be eligible for severance benefits under existing agreements with, and benefit plans offered by, Washington Banking in an aggregate maximum possible amount of \$2.74 million. The six executive officers of Washington Banking include Mr. John L. Wagner, Mr. Richard A. Shields, Mr. Bryan McDonald, Mr. George W. Bowen, Mr. Edward Eng and Mr. Daniel Kuenzi who will each receive severance benefits of \$137,189, \$544,690, \$577,189, \$475,383, \$468,619 and \$534,150, respectively.

Accelerated vesting of all of the unvested restricted stock unit awards held by Washington Banking directors and executive officers, representing a total of 65,766 shares of common stock.

Bryan McDonald, President and Chief Executive Officer of Whidbey Island Bank, will become Executive Vice President and Chief Lending Officer of Heritage Bank following the bank merger and has entered into an employment agreement with Heritage Bank, to become effective at the effective time of the merger. His employment agreement with Heritage Bank provides for no increase in base salary and, among other benefits, a one-time restricted stock grant with a grant date fair value of \$50,000 and a special bonus of

\$250,000 to be paid in equal installments over 24 months commencing following the effective time of the merger (which payments cease upon termination of Mr. McDonald's employment for any reason).

Edward Eng, Executive Vice President and Chief Administrative Officer of Whidbey Island Bank, will become Executive Vice President and Chief Administrative Officer of Heritage Bank following the

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bank merger and has entered into an employment agreement with Heritage Bank, to become effective at the effective time of the merger. His employment agreement with Heritage Bank provides for no increase in base salary and, among other benefits, a one-time restricted stock grant with a grant date fair value of \$75,000 payable as of the 14-month anniversary of the effective time of the merger, provided he has been continuously employed with Heritage.

John L. Wagner, President and Chief Executive Officer of Washington Banking, will serve as a special advisor to Heritage following the merger and has entered into a consulting agreement with Heritage, to become effective at the effective time of the merger.

Seven current Washington Banking directors, including Anthony B. Pickering, who will serve as chairman of the board of the combined company upon completion of the merger, and Rhoda L. Altom, Mark D. Crawford, Deborah J. Gavin, Jay T. Lien, Gragg E. Miller and Robert T. Severns will be appointed to the board of directors of the combined company.

For a more complete description of these interests, see "The Merger - Interests of Washington Banking's Directors and Executive Officers in the Merger" on page 79.

## **Amendment to Heritage's Bylaws**

At or prior to the closing of the merger, the Bylaws of Heritage will be amended, which we refer to as the "bylaw amendment", to provide for the addition of new provisions addressing certain governance matters in connection with the merger. The bylaw amendment will apply for two years after the completion of the merger and has the following terms:

the combined company's board of directors will be comprised of eight members from Heritage and seven from Washington Banking;

procedures for the appointment of replacement directors by the continuing directors of each company;

reduction in the size of the board in a manner that the proportion of directors from each company remains approximately the same;

Anthony B. Pickering of Washington Banking will serve as chairman of the board of directors and Brian S. Charneski of Heritage will serve as the vice chairman of the board of directors; and

during the two year period these bylaw provisions are in effect they may only be amended by a vote of two thirds of the directors and a majority of the continuing directors from Heritage and the continuing directors from Washington Banking, respectively.

## **Regulatory Approvals**

Under applicable law, the merger must be approved by the Federal Reserve Board, and the bank merger must be approved by the FDIC and the DFI. The U.S. Department of Justice may review the impact of the merger and the bank merger on competition.

We have filed all of the required applications, including requesting a waiver from the Federal Reserve Board of its application requirements that would apply to this merger. We received approval for the bank merger from the FDIC and the DFI, on December 23, 2013 and January 3, 2014, respectively. On January 31, 2014, we received a waiver from the Federal Reserve Board of its application requirements that would apply to this merger. There can be no assurance that the regulatory approvals received will not contain a condition or requirement that results in a failure to satisfy the conditions to closing set forth in the merger agreement. See *The Merger Agreement* Conditions to Complete the Merger on page 100.

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**Conditions that Must be Satisfied or Waived for the Merger to Occur (page 100)**

As more fully described in this joint proxy statement/prospectus and in the merger agreement, the completion of the merger depends on a number of conditions being satisfied or, where legally permitted, waived. These conditions include:

the approval of the Heritage merger proposal by Heritage shareholders and approval of the Washington Banking merger proposal by Washington Banking shareholders;

the authorization for listing on NASDAQ of the shares of Heritage common stock to be issued in the merger;

the receipt of all required regulatory approvals;

the effectiveness of the registration statement on Form S-4 of which this joint proxy statement/prospectus is a part;

the absence of any stop order, injunction or other legal restraint preventing the completion of the merger or the bank merger;

subject to the materiality standards provided in the merger agreement, the accuracy of the representations and warranties of Heritage and Washington Banking;

performance in all material respects by each of Heritage and Washington Banking of its obligations under the merger agreement;

receipt by each of Heritage and Washington Banking of an opinion from its counsel as to certain U.S. federal income tax matters;

receipt by each of Heritage and Washington Banking of a written consent from the FDIC ensuring continuation of loss coverage without adverse change under shared-loss agreements with the FDIC and no other event has occurred that has resulted in, or is likely to result in, the loss of a material amount of loss coverage from the FDIC;

the adoption by Heritage of a bylaw amendment to provide for certain corporate governance provisions, including the composition of the board of directors of the combined company, as provided in Exhibit D to the merger agreement attached as Appendix A to this joint proxy statement/prospectus; and

as an additional condition to Heritage's obligation to complete the merger, the shares of Washington Banking common stock whose holders have perfected dissenters' rights under Washington law shall be less than ten percent of the total number of outstanding shares of Washington Banking common stock.

We expect to complete the merger in the first half of 2014. No assurance can be given, however, as to when, or if, the conditions to the merger will be satisfied or waived, or that the merger will be completed.

**Termination of the Merger Agreement (page 101)**

The merger agreement can be terminated at any time prior to completion of the merger in the following circumstances:

by mutual written consent of Heritage and Washington Banking;

by either Heritage or Washington Banking if any governmental entity that must grant a requisite regulatory approval has denied approval of the merger or bank merger and such denial has become final and non-appealable or any governmental entity of competent jurisdiction has issued a final non-appealable order, injunction or decree permanently enjoining or otherwise prohibiting or making illegal the consummation of the transactions contemplated by the merger agreement, unless the failure to obtain a requisite regulatory approval is due to the failure of the party seeking to terminate the merger agreement to perform or observe its covenants and agreements under the merger agreement;

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by either Heritage or Washington Banking if the merger has not been completed on or before May 31, 2014 (which we refer to as the termination date), unless the failure of the merger to be completed by that date is due to the failure of the party seeking to terminate the merger agreement to perform or observe its covenants and agreements under the merger agreement;

by either Heritage or Washington Banking (provided that the terminating party is not then in material breach of any representation, warranty, covenant or other agreement contained in the merger agreement) if there is a breach of any of the covenants or agreements or any of the representations or warranties set forth in the merger agreement on the part of the other party which either individually or in the aggregate would constitute, if occurring or continuing on the date the merger is completed, the failure of a closing condition of the terminating party and which is not cured within 30 days following written notice to the party committing such breach, or by its nature or timing cannot be cured during such period (or such fewer days as remain prior to the termination date);

by either Heritage or Washington Banking, if (1) the board of directors of the other party fails to recommend in this joint proxy statement/prospectus that its shareholders approve the merger proposal, or withdraws, modifies or qualifies such recommendation in an adverse manner, or resolves to do so, or fails to reaffirm such recommendation within five days after being requested in writing to do so, or fails to recommend against the acceptance of a publicly announced tender offer or exchange offer for its common stock within ten days after the commencement of such offer; or (2) the board of directors of the other party recommends or endorses an acquisition proposal or fails to announce its opposition to an acquisition proposal with ten days after the public announcement of such offer; or (3) the other party materially breaches certain obligations, including with respect to the non-solicitation of acquisition proposals or calling and holding of its meeting of shareholders to vote on its merger proposal; or

by either Heritage or Washington Banking, if either party does not obtain the requisite shareholder vote for approval of the merger proposal, provided that the party terminating the merger agreement shall not have breached in any material respect certain obligations, including with respect to the non-solicitation of acquisition proposals or calling and holding of its meeting of shareholders and recommending that they approve its merger proposal. An acquisition proposal means any offer, proposal or inquiry relating to, or any third-party indication of interest in, (i) any acquisition or purchase, direct or indirect, of more than 25% of the consolidated assets of a party and its subsidiaries or 25% or more of any class of equity or voting securities of a party or its subsidiaries whose assets, individually or in the aggregate, constitute more than a specified percentage of the consolidated assets of the party, (ii) any tender offer (including a self-tender offer) or exchange offer that, if consummated, would result in such third-party beneficially owning 25% or more of any class of equity or voting securities of a party or its subsidiaries whose assets, individually or in the aggregate, constitute more than 25% of the consolidated assets of the party, or (iii) a merger, consolidation, share exchange, business combination, reorganization, recapitalization, liquidation, dissolution or other similar transaction involving a party or its subsidiaries whose assets, individually or in the aggregate, constitute more than 25% of the consolidated assets of the party.

**Termination Fee (page 102)**

If the merger agreement is terminated under certain circumstances, including circumstances involving an acquisition proposal with respect to a party or a change in recommendation by the board of directors of a party, such party may be required to pay to the other party a termination fee equal to \$7.9 million. The percentage referenced in the definition

of acquisition proposal above increases from 25% to 50% for the purpose of determining payment of a termination fee by either party. These termination fees could discourage other companies from seeking to acquire or merge with Washington Banking or Heritage.

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### **The Rights of Washington Banking Shareholders Will Change as a Result of the Merger (page 127)**

The rights of Washington Banking shareholders will change as a result of the merger due to differences in Heritage's and Washington Banking's governing documents. The rights of Washington Banking shareholders and Heritage's shareholders are governed by Washington law and by Washington Banking's and Heritage's respective articles of incorporation and bylaws, each as amended to date. Upon the completion of the merger, Washington Banking shareholders will become shareholders of Heritage, as the continuing legal entity in the merger, and the rights of Washington Banking shareholders will therefore be governed by Washington law and by Heritage's articles of incorporation and bylaws.

For example, Heritage's articles of incorporation authorize 50,000,000 shares of common stock and 2,500,000 shares of preferred stock, and the Heritage board has authority, without shareholder approval, to determine the terms of any preferred stock. Washington Banking's articles of incorporation authorize 35,000,000 shares of common stock and 26,380 shares of preferred stock, but the Washington Banking board does not have authority, without shareholder approval, to determine the terms of any preferred stock. Also, Heritage's articles of incorporation also provide for restrictions on voting rights of shares owned in excess of 10% of any class of Heritage equity security; Washington Banking's articles of incorporation provide for no such restriction on voting rights. See *Comparison of Shareholder Rights* on page 127 for a description of the material differences in shareholder rights under each of the Heritage and Washington Banking governing documents.

### **Heritage's Board of Directors Following the Merger**

Upon completion of the merger, the board of directors of Heritage, as the surviving corporation, will be comprised of 15 directors with eight directors from Heritage and seven directors from Washington Banking. The eight directors from Heritage shall include Brian S. Charneski, who will serve as vice-chairman of the board, David H. Brown, Gary B. Christensen, John A. Clees, Kimberly T. Ellwanger, Jeffrey S. Lyon, Brian L. Vance and Ann Watson. The seven directors from Washington Banking shall include: Anthony B. Pickering, who will serve as chairman of the board, Rhoda L. Altom, Mark D. Crawford, Deborah J. Gavin, Jay T. Lien, Gragg E. Miller and Robert T. Severns.

### **Information About the Companies (page 120)**

#### *Heritage Financial Corporation*

Heritage, headquartered in Olympia, Washington, is a bank holding company for Heritage Bank through which it operates 36 banking offices located primarily in western Washington and the Portland, Oregon area. Through Heritage Bank, Heritage offers a broad range of financial services primarily to small businesses and their owners and attracts deposits from the general public. Heritage Bank also makes real estate construction and land development loans and consumer loans and originates first mortgage loans on residential properties located in western and central Washington State and the greater Portland, Oregon area. Heritage's primary lines of business include commercial banking, retail banking and wealth management. As of September 30, 2013, on a consolidated basis, Heritage had total assets of \$1.67 billion, deposits of \$1.43 billion, and shareholders' equity of \$216.6 million.

Heritage's principal office is located at 201 Fifth Avenue SW, Olympia, Washington 98501, and its telephone number is (360) 943-1500. Heritage's common stock is listed on NASDAQ under the symbol HFWA.

Additional information about Heritage and its subsidiaries is included in documents incorporated by reference in this joint proxy statement/prospectus. See *Where You Can Find More Information* on page 132.



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### *Washington Banking Company*

Washington Banking, headquartered in Oak Harbor, Washington, is a bank holding company for Whidbey Island Bank through which it operates 31 banking offices throughout Northwestern Washington. The business of Whidbey Island Bank consists primarily of attracting deposits from the general public and originating loans. In addition to conducting a full-service, community, commercial banking business, Whidbey Island Bank also offers nondeposit managed investment products and services, which are not FDIC insured. These programs are provided through an unrelated investment advisory company, Elliott Cove Capital Management LLC. At September 30, 2013, on a consolidated basis, Washington Banking had assets of \$1.65 billion, deposits of \$1.43 billion and shareholders' equity of \$181.8 million.

Washington Banking's principal office is located at 450 SW Bayshore Drive, Oak Harbor, Washington 98277, and its telephone number is (360) 240-6458. Washington Banking's common stock is listed on NASDAQ under the symbol WBCO.

Additional information about Washington Banking and its subsidiaries is included in documents incorporated by reference in this joint proxy statement/prospectus. See "Where You Can Find More Information" on page 132.

### **Litigation Relating to the Merger (page 88)**

Washington Banking, its directors and Heritage are named as defendants in two lawsuits pending in the Superior Court for the State of Washington in King County, Washington, which have been consolidated under the caption *In Re Washington Banking Company Shareholder Litigation*, Lead Case No. 13-2-38689-5 SEA. The consolidated litigation generally alleges that Washington Banking's directors breached their fiduciary duties to Washington Banking and its shareholders by agreeing to the proposed merger at an unfair price and without an adequate sales process, because they have interests in the merger different from shareholders and by agreeing to deal protection provisions in the merger agreement that are alleged to prevent bids by third parties. The consolidated litigation also alleges that the disclosures in connection with the merger are misleading in various respects. Heritage is alleged to have aided and abetted the directors' alleged breaches of their fiduciary duties. The consolidated litigation seeks, among other things, an order enjoining the defendants from consummating the proposed merger, as well as attorneys' and experts' fees and certain other damages.

Washington Banking and Heritage believe the consolidated litigation is without merit and they each intend to vigorously defend against the suits. See "The Merger" *Litigation Relating to the Merger* on page 88.

### **Risk Factors (page 28)**

You should consider all the information contained in or incorporated by reference into this joint proxy statement/prospectus in deciding how to vote for the proposals presented in the joint proxy statement/prospectus. In particular, you should consider the factors under "Risk Factors" on page 28.

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**Selected Historical And Pro Forma Financial Information**

**Selected Historical Financial Data of Heritage and Washington Banking**

The following tables set forth selected historical financial and other data of Heritage and Washington Banking for the periods and at the dates indicated. The information at December 31, 2012 and 2011 and for the years ended December 31, 2012, 2011 and 2010 is derived in part from and should be read together with the audited consolidated financial statements and notes thereto of Heritage and Washington Banking incorporated by reference in this joint proxy statement/prospectus from their Annual Reports on Form 10-K for the year ended December 31, 2012. The information as of December 31, 2010, 2009 and 2008 and for the years ended December 31, 2009 and 2008 is derived in part from audited consolidated financial statements and notes thereto of Heritage and Washington Banking that are not incorporated by reference in this joint proxy statement/prospectus. The information at and for the nine months ended September 30, 2013 and 2012 is derived in part from and should be read together with Heritage's and Washington Banking's unaudited consolidated financial statements and notes thereto incorporated by reference in this document from their Quarterly Reports on Form 10-Q for the quarters ended September 30, 2013 and 2012. In the opinion of management of each of Heritage and Washington Banking, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the results of operations of the respective companies for the unaudited periods have been made. The selected data presented below for the nine months ended September 30, 2013 are not necessarily indicative of the results that may be expected for future periods.

Certain of the selected financial data of Washington Banking in the tables below contain information determined by methods other than in accordance with accounting principles generally accepted in the United States of America (referred to as "GAAP"). This information consists of tangible book value per common share, the efficiency ratio on a fully tax equivalent basis and net interest margin on a fully tax equivalent basis. Washington Banking management believes that it is standard practice in the banking industry to present these values as stated herein, and accordingly believes that providing these measures may be useful for peer comparison purposes. These disclosures should not be viewed as substitutes for the results determined to be in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other companies. See "Reconciliation of Non-GAAP Historical Financial Data of Washington Banking" on page 25 for reconciliations of non-GAAP measures to GAAP measures immediately following Washington Banking's selected financial data table.

**Table of Contents****Selected Historical Financial Data of Heritage**

	As of or for the Nine Months Ended September 30,		As of or for the Year Ended December 31,				2008
	2013	2012	2012	2011	2010	2009	
(Dollars in thousands, except per share data)							
<b>Operations Data:</b>							
Interest income	\$ 52,876	\$ 52,409	\$ 69,109	\$ 74,120	\$ 59,522	\$ 53,341	\$ 56,948
Interest expense	2,818	3,550	4,534	6,582	8,511	11,645	18,606
Net interest income	50,058	48,859	64,575	67,538	51,011	41,696	38,342
Provision for loan losses	3,244	1,317	2,016	14,430	11,990	19,390	7,420
Noninterest income	7,222	5,499	7,272	5,746	18,779	5,988	6,358
Noninterest expense	41,010	37,971	50,392	49,703	38,011	28,216	27,953
Income tax expense (benefit)	4,161	4,843	6,178	2,633	6,435	(503)	2,976
Net income	8,865	10,227	13,261	6,518	13,354	581	6,351
Net income (loss) available to common shareholders	8,865	10,227	13,261	6,518	11,668	(739)	6,208
<b>Common Share Data:</b>							
Earnings (loss) per common share(1)							
Basic	\$ 0.57	\$ 0.67	\$ 0.87	\$ 0.42	\$ 1.05	\$ (0.10)	\$ 0.93
Diluted	0.57	0.67	0.87	0.42	1.04	(0.10)	0.93
Dividend payout ratio to common shareholders(2)	59.6%	62.7%	92.0%	90.5%	%	(100.0)%	60.2%
Cash dividends per common share	\$ 0.34	\$ 0.42	\$ 0.80	\$ 0.38	\$	\$ 0.10	\$ 0.56
<b>Selected Performance Ratios:</b>							
	4.77%	5.09%	5.03%	5.23%	4.56%	4.25%	4.11%

Net interest spread(3)(4)							
Net interest margin(3)(5)	4.88	5.23	5.17	5.41	4.78	4.57	4.59
Efficiency ratio(6)	71.60	69.85	70.14	67.82	54.46	59.17	62.53
Return on average assets(3)	0.79	1.01	0.98	0.48	1.16	0.06	0.71
Return on average common equity(3)	5.74	6.70	6.52	3.17	8.15	(0.72)	6.98
<b>Balance Sheet</b>							
<b>Data:</b>							
Total assets	\$ 1,674,417	\$ 1,366,582	\$ 1,345,540	\$ 1,368,985	\$ 1,367,684	\$ 1,014,859	\$ 946,145
Originated loans receivable, net	944,535	851,426	855,360	815,607	719,957	746,083	793,303
Purchased covered loans receivable, net	63,484	89,005	83,978	105,394	128,715		
Purchased noncovered loans receivable, net	200,063	65,592	59,006	83,479	131,049		
Loans receivable, net	1,208,082	1,006,023	998,344	1,004,480	979,721	746,083	793,303
Loans held for sale		1,411	1,676	1,828	764	825	304
FDIC indemnification asset	4,413	7,480	7,100	10,350	16,071		
Deposits	1,425,985	1,133,700	1,117,971	1,136,044	1,136,276	840,128	824,480
Securities sold under agreement to repurchase	22,655	22,889	16,021	23,091	19,027	10,440	
Shareholders equity	216,595	202,244	198,938	202,520	202,279	158,498	113,147
Book value per common share	13.36	13.34	13.16	13.10	12.99	12.21	13.40
Equity to assets ratio	12.9%	14.8%	14.8%	14.8%	14.8%	15.6%	12.0%

(1) Effective January 1, 2009, Heritage adopted FASB ASC 03-6-1. Earnings per share data for the prior periods have been revised to reflect the retrospective adoption of this standard.

(2) Dividend payout ratio is declared dividends per common share divided by basic earnings (loss) per common share.

(3) Ratios for the nine months ended September 30, 2013 and 2012 are annualized.

(4)

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

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

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

**Table of Contents****Selected Historical Financial Data of Heritage (continued)**

	As of or for the Nine Months Ended September 30,		As of or for the Year Ended December 31,				
	2013	2012	2012	2011	2010	2009	2008(1)
(Dollars in thousands)							
<b>Capital Ratios:</b>							
Capital risk-based capital ratio	16.7%	20.4%	19.9%	20.3%	21.5%	20.7%	13.7%
Tier 1 risk-based capital ratio	15.5	19.1	18.7	19.0	20.2	19.4	12.5
Liquidity coverage ratio	11.6	14.0	13.6	13.8	13.9	14.6	11.0
<b>Asset Quality Ratios:</b>							
Nonperforming originated loans to total originated loans(7)	0.81%	1.57%	1.28%	2.57%	3.14%	4.21%	0.42%
Provision for loan losses on originated loans to total originated loans(7)	1.80	2.35	2.19	2.66	2.97	3.38	1.91
Provision for loan losses on originated loans to nonperforming originated loans(7)	221.68	149.94	170.44	103.52	94.73	79.34	454.02
Provision for loan losses on originated assets to total originated assets(7)	0.83	1.72	1.39	2.14	2.38	3.32	0.57
<b>Other Data:</b>							
Number of banking offices	42	33	33	33	31	20	20
Number of full-time equivalent employees	415	368	363	354	321	222	217

- (7) Nonperforming originated loan balances exclude portions guaranteed by governmental agencies of \$1.9 million and \$2.0 million as of September 30, 2013 and 2012, respectively, and \$1.2 million, \$1.8 million, \$3.2 million and \$2.3 million as of December 31, 2012, 2011, 2010 and 2009, respectively. There were no governmental guarantees on nonperforming originated loans as of December 31, 2008.

**Table of Contents****Selected Historical Financial Data of Washington Banking**

	As of or for the Nine Months Ended September 30,		As of or for the Year Ended December 31,				2008
	2013	2012	2012	2011	2010	2009	
(Dollars in thousands, except per share data)							
<b>Operations data:</b>							
Interest income	\$ 56,805	\$ 68,271	\$ 89,710	\$ 89,707	\$ 75,949	\$ 54,392	\$ 58,782
Interest expense	4,119	5,528	7,113	9,981	11,830	14,019	20,834
Net interest income	52,686	62,743	82,597	79,726	64,119	40,373	37,948
Provision for loan losses	14,239	5,998	9,744	10,050	13,486	10,200	5,050
Noninterest income	19,180	3,643	8,246	9,212	33,531	7,661	6,886
Noninterest expense	39,865	42,427	56,399	55,825	46,797	28,734	27,523
Income tax expense	5,768	5,703	7,856	7,111	11,797	2,886	3,929
Net income before preferred dividends	11,994	12,258	16,844	15,952	25,570	6,214	8,332
Preferred dividends				1,084	1,659	1,600	
Net income available to common shareholders	11,994	12,258	16,844	14,868	23,911	4,614	8,332
<b>Common per share data:</b>							
Earnings per common share							
Basic	\$ 0.77	\$ 0.80	\$ 1.09	\$ 0.97	\$ 1.56	\$ 0.46	\$ 0.88
Diluted	0.77	0.79	1.09	0.97	1.55	0.46	0.88
Dividend payout ratio to common shareholders(1)	50.41%	44.04%	45.81%	20.63%	8.64%	37.23%	29.01%
Cash dividends per common share	\$ 0.39	\$ 0.35	\$ 0.50	\$ 0.20	\$ 0.14	\$ 0.18	\$ 0.26
<b>Selected performance ratios:</b>							
Net interest spread(2)(3)	4.61%	5.55%	5.45%	5.39%	4.76%	4.28%	4.18%
Net interest margin (fully tax-equivalent)(2)(4)(6)	4.71	5.65	5.54	5.47	4.90	4.63	4.60
Efficiency ratio (fully tax-equivalent)(5)(6)	54.98	63.11	61.31	62.06	47.48	59.01	60.63
Return on average assets(2)	0.97	0.98	1.01	0.95	1.72	0.66	0.94
Return on average common equity(2)	8.84	9.38	9.56	9.17	16.87	7.11	10.82

**Balance sheet data:**

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Total assets	\$ 1,648,154	\$ 1,680,126	\$ 1,687,677	\$ 1,670,682	\$ 1,704,939	\$ 1,045,871	\$ 899,631
Non-covered loans	872,636	824,610	853,134	812,830	834,293	813,852	823,068
Covered loans	171,416	232,524	217,339	269,081	366,153		
Allowance for loan losses, non-covered loans	16,942	16,570	17,147	18,032	18,812	16,212	12,250
Allowance for loan losses, covered loans	15,026	1,007	3,252	870	1,336		
Non-covered OREO	4,747	4,080	3,023	1,976	4,122	4,549	2,226
Covered OREO	4,109	18,811	13,460	26,622	29,766		
Deposits	1,429,279	1,458,230	1,462,973	1,466,344	1,492,220	846,671	747,159
Overnight borrowings							11,640
Other borrowed funds						10,000	30,000
Junior subordinated debentures	25,774	25,774	25,774	25,774	25,774	25,774	25,774
Preferred securities					25,334	24,995	
Shareholders equity	181,798	180,967	182,624	170,820	182,098	159,521	80,560
Tangible book value per common share(7)	11.34	11.31	11.41	10.67	9.76	8.79	8.47
Average equity to average assets	11.01%	10.45%	10.54%	9.64%	11.26%	11.86%	8.65%

- (1) Dividend payout ratio is total dividends paid on common stock divided by net income available to common shareholders.
- (2) Ratios for the nine months ended September 30, 2013 and 2012 are annualized.
- (3) Net interest spread is the difference between the average yield on interest earning assets and the average cost of interest bearing liabilities.
- (4) Net interest margin is net interest income divided by average interest earning assets.
- (5) The efficiency ratio is noninterest expense divided by the sum of net interest income and noninterest income.
- (6) A non-GAAP performance measure. The calculation involves grossing up the interest income on tax-exempt loans and investments by an amount that makes it comparable to taxable income. See Reconciliation of Non-GAAP Historical Financial Data of Washington Banking on page 25 for reconciliations of non-GAAP measures to GAAP measures immediately following Washington Banking's selected financial data table.
- (7) Tangible book value is a non-GAAP performance measure. See Reconciliation of Non-GAAP Historical Financial Data of Washington Banking on page 25 for reconciliations of non-GAAP measures to GAAP measures immediately following Washington Banking's selected financial data table.

**Table of Contents****Selected Historical Financial Data of Washington Banking (continued)**

	As of or for the Nine Months Ended September 30,		As of or for the Year Ended December 31,				
	2013	2012	2012	2011	2010	2009	2008
(Dollars in thousands)							
<b>Capital ratios:</b>							
risk-based capital	19.82%	19.59%	19.39%	19.73%	20.96%	22.15%	13.00%
risk-based capital	18.55	18.34	18.13	18.47	19.70	20.89	11.00
coverage ratio	12.56	11.65	11.78	11.16	11.42	18.73	11.00
<b>Quality ratios:</b>							
covered nonperforming loans to total gross non-covered loans	1.14%	2.14%	1.82%	2.72%	3.10%	0.42%	0.00%
provision for loan losses to total gross non-covered loans	1.94	2.01	2.01	2.22	2.25	1.99	1.00
provision for loan losses to total non-covered nonperforming	171.00	93.92	110.26	81.59	72.79	477.53	638.00
covered nonperforming assets to total assets	0.89	1.29	1.10	1.44	1.76	0.76	0.00
loan charge-offs to average non-covered loans outstanding(2)	0.32	1.16	0.97	1.37	1.15	0.76	0.00
<b>Operational data:</b>							
number of banking offices	31	30	31	30	30	18	20
number of full time equivalent employees	464	463	467	450	448	281	200

**Table of Contents****Reconciliation of Non-GAAP Historical Financial Data of Washington Banking**

	As of or for the Nine Months Ended September 30,		As of or for the Year Ended December 31,					2008
	2013	2012	2012	2011	2010	2009		
(Dollars in thousands)								
<b>Net interest margin (fully tax-equivalent):</b>								
GAAP net interest income	\$ 52,686	\$ 62,743	\$ 82,597	\$ 79,726	\$ 64,119	\$ 40,373	\$ 37,948	
Tax-equivalent adjustment(1)	644	837	1,144	1,021	918	658	559	
Tax-equivalent net interest income	\$ 53,330	\$ 63,580	\$ 83,741	\$ 80,747	\$ 65,037	\$ 41,031	\$ 38,507	
Average interest earning assets	\$ 1,515,424	\$ 1,502,903	\$ 1,510,471	\$ 1,475,834	\$ 1,327,871	\$ 887,070	\$ 837,456	
Net interest margin	4.65%	5.58%	5.47%	5.40%	4.83%	4.55%	4.53%	
Net interest margin (fully tax-equivalent)	4.71	5.65	5.54	5.47	4.90	4.63	4.60	
<b>Efficiency Ratio:</b>								
GAAP net interest income	\$ 52,686	\$ 62,743	\$ 82,597	\$ 79,726	\$ 64,119	\$ 40,373	\$ 37,948	
Tax equivalent adjustment(1)	644	837	1,144	1,021	918	658	559	
Tax equivalent net interest income	\$ 53,330	\$ 63,580	\$ 83,741	\$ 80,747	\$ 65,037	\$ 41,031	\$ 38,507	
Efficiency ratio	55.47%	63.91%	62.08%	62.77%	47.92%	59.82%	61.39%	
Efficiency ratio (fully tax-equivalent)	54.98	63.11	61.31	62.06	47.48	59.01	60.63	
<b>Tangible Common Equity:</b>								
	\$ 181,798	\$ 180,967	\$ 182,624	\$ 170,820	\$ 182,098	\$ 159,521	\$ 80,560	

Total shareholders equity								
Less:								
Goodwill and other intangible assets, net	(5,698)	(6,156)	(6,027)	(6,539)	(7,161)			
Less:								
Preferred stock					(25,334)	(24,995)		
Tangible common equity	\$ 176,100	\$ 174,811	\$ 176,597	\$ 164,281	\$ 149,603	\$ 134,526	\$ 80,560	
Common shares outstanding at end of period	15,532,349	15,451,307	15,483,598	15,398,197	15,321,227	15,297,801	9,510,007	
Book value per common share	\$ 11.70	\$ 11.71	\$ 11.79	\$ 11.09	\$ 11.89	\$ 10.43	\$ 8.47	
Tangible book value per common share	11.34	11.31	11.41	10.67	9.76	8.79	8.47	

(1) Tax-equivalent adjustment relates to non-taxable investment interest income. Interest and rates are presented on a fully taxable equivalent basis using a tax rate of 34%.

**Table of Contents****Selected Unaudited Consolidated Pro Forma Financial Data of Heritage and Washington Banking**

The following table shows selected unaudited consolidated pro forma financial data reflecting the merger of Washington Banking with Heritage, assuming the companies had been combined at the dates and for the periods shown. The pro forma amounts reflect certain purchase accounting adjustments, which are based on estimates that are subject to change depending on fair values as of the merger completion date. These adjustments are described in the notes to unaudited pro forma combined condensed consolidated financial information contained elsewhere in this document under the heading Unaudited Pro Forma Combined Condensed Consolidated Financial Information, beginning on page 104. The pro forma financial data in the table below does not include any projected cost savings, revenue enhancements or other possible financial benefits of the merger to the combined company and does not attempt to suggest or predict future results. This information also does not necessarily reflect what the historical financial condition or results of operations of the combined company would have been had Heritage and Washington Banking been combined as of the dates and for the periods shown.

	<b>At or for the Nine Months Ended September 30, 2013</b>	<b>For the Year Ended December 31, 2012</b>
	(In thousands)	
<b>Statement of Operations Data:</b>		
Interest income	\$ 110,376	\$ 159,978
Interest expense	7,022	11,735
Net interest income	103,354	148,243
Provision for loan losses, excluding covered loans	3,409	8,670
Provision for loan losses on covered loans	14,074	3,090
Net interest income after provision for loan losses	85,871	136,483
Noninterest income	26,471	14,896
Noninterest expense	81,367	107,567
Income before income taxes	30,975	43,812
Income tax expense	9,994	13,920
Net income	\$ 20,981	\$ 29,892
	<b>At September 30, 2013</b> (In thousands)	
<b>Financial Condition Data:</b>		

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Total assets	\$ 3,365,817
Investment securities available for sale and held to maturity	602,615
Loans, excluding covered loans, net of allowance of \$22,783	1,987,714
Covered loans, net of allowance of \$5,972	205,985
Total loans receivable, net of allowance of \$28,755	2,193,699
Total deposits	2,855,264
Securities sold under agreement to repurchase	22,655
Junior subordinated debentures	17,578
Accrued expenses and other liabilities	19,663
Total shareholders equity	450,657

**Table of Contents****Comparative Unaudited Pro Forma Per Share Data**

The table below sets forth the book value per common share, cash dividends per common share, and basic and diluted earnings per common share data for each of Heritage and Washington Banking on a historical basis, for Heritage on a pro forma combined basis and on a pro forma combined basis per Washington Banking equivalent share. The pro forma combined and pro forma combined per equivalent share information gives effect to the merger as if the merger occurred on September 30, 2013 or December 31, 2012, in the case of the book value data, and as if the merger occurred on January 1, 2012, in the case of the cash dividends and earnings per common share data. The Pro Forma Combined Amounts for Heritage data reflect certain purchase accounting adjustments, which are based on estimates that are subject to change depending on fair values as of the merger completion date. These adjustments are described in the notes to unaudited pro forma combined condensed consolidated financial information contained elsewhere in this document under the heading Unaudited Pro Forma Combined Condensed Consolidated Financial Information, beginning on page 104. The Pro Forma Combined Per Washington Banking Equivalent Share data shows the effect of the merger from the perspective of an owner of Washington Banking common stock. The pro forma financial data in the table below is provided for illustrative purposes, does not include any projected cost savings, revenue enhancements or other possible financial benefits of the merger to the combined company and does not attempt to suggest or predict future results. This information also does not necessarily reflect what the historical financial condition or results of operations of the combined company would have been had Heritage and Washington Banking been combined as of the dates and for the periods shown.

	<b>Heritage Historical</b>	<b>Washington Banking Historical</b>	<b>Pro Forma Combined Amounts for Heritage</b>	<b>Pro Forma Combined Per Washington Banking Equivalent Share(1)</b>
Book value per common share at September 30, 2013(3)	\$ 13.36	\$ 11.70	\$ 14.92	\$ 16.03
Book value per common share at December 31, 2012(3)	13.16	11.79	14.90	16.01
Cash dividends per common share for the nine months ended September 30, 2013(2)	0.34	0.39	0.34	0.30
Cash dividends per common share for the year ended December 31, 2012(2)	0.80	0.50	0.80	0.71
Basic earnings per common share for the nine months ended September 30, 2013	0.57	0.77	0.71	0.63
Basic earnings per common share for the year ended December 31, 2012	0.87	1.09	1.02	0.91
Diluted earnings per common share for the nine months ended September 30, 2013	0.57	0.77	0.71	0.63
Diluted earnings per common share for the year ended December 31, 2012	0.87	1.09	1.02	0.91

- (1) Calculated by multiplying the Pro Forma Combined Amounts for Heritage by 0.89000, which is the exchange ratio for the stock portion of the merger consideration payable to the holders of Washington Banking common stock, and, solely in the case of the book value per common share at September 30, 2013, and December 31, 2012, adding to that result, \$2.75, which is the per share cash merger consideration payable to holders of Washington Banking common stock. See *The Merger Agreement Merger Consideration* on page 89.
- (2) The pro forma combined cash dividends per common share for the nine months ended September 30, 2013 and the year ended December 31, 2012 represent the actual cash dividends per share declared by Heritage for those periods.
- (3) The pro forma combined book value and common shares as of September 30, 2013 was \$450.7 million and 30,210,000, respectively. See the calculation for these amounts included in the section *Unaudited Pro Forma Combined Condensed Consolidated Financial Information* on page 104 and *Note 2 Purchase Price* on page 109. The pro forma combined book value and common shares as of December 31, 2012 was estimated to be \$433.8 million and 29,117,000, respectively.

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**RISK FACTORS**

*In addition to general investment risks and the other information contained in or incorporated by reference into this joint proxy statement/prospectus, including the matters addressed under the section Cautionary Statement Regarding Forward-Looking Statements on page 33, you should carefully consider the following risk factors in deciding how to vote for the proposals presented in this joint proxy statement/prospectus. You should also consider the other documents incorporated by reference into this joint proxy statement/prospectus. See Where You Can Find More Information on page 132.*

**Because the market price of Heritage common stock will fluctuate, holders of Washington Banking common stock cannot be certain of the market value of the stock portion of the merger consideration they will receive.**

Upon completion of the merger, each outstanding share of Washington Banking common stock will be converted into the right to receive 0.89000 of a share of Heritage common stock and \$2.75 in cash. The market value of the stock portion of the merger consideration will vary from the closing price of Heritage common stock on the date Heritage and Washington Banking announced the merger, on the date that this joint proxy statement/prospectus is mailed to Washington Banking shareholders, on the date of the special meeting of the Washington Banking shareholders and on the date the merger is completed and thereafter. Any change in the market price of Heritage common stock prior to the completion of the merger will affect the market value of the stock portion of the merger consideration that holders of Washington Banking common stock will receive upon completion of the merger, and there will be no adjustment to the merger consideration for changes in the market price of either shares of Heritage common stock or shares of Washington Banking common stock. Stock price changes may result from a variety of factors that are beyond the control of Heritage and Washington Banking, including, but not limited to, general market and economic conditions, changes in our respective businesses, operations and prospects and regulatory considerations. Therefore, if you are a holder of Washington Banking common stock, you will not know at the time of the Washington Banking special meeting the precise market value of the merger consideration you will receive at the effective time of the merger. You should obtain current market quotations for shares of Heritage common stock and for shares of Washington Banking common stock.

**The market price of Heritage common stock after the merger may be affected by factors different from those affecting the shares of Washington Banking or Heritage currently.**

Upon completion of the merger, holders of Washington Banking common stock will become holders of Heritage common stock. Heritage's business differs in important respects from that of Washington Banking, and, accordingly, the results of operations of the combined company and the market price of Heritage common stock after the completion of the merger may be affected by factors different from those currently affecting the independent results of operations of each of Heritage and Washington Banking. For a discussion of the businesses of Heritage and Washington Banking and of some important factors to consider in connection with those businesses, see the documents incorporated by reference in this joint proxy statement/prospectus and referred to under Where You Can Find More Information on page 132.

**Regulatory approvals may not be received, may take longer than expected or may impose conditions that are not presently anticipated or that could have an adverse effect on the combined company following the merger.**

Before the merger and the bank merger may be completed, Heritage and Washington Banking must obtain approvals from the Federal Reserve Board (or a waiver), the FDIC and the DFI. Heritage received approval for the bank merger from the FDIC and the DFI, on December 23, 2013 and January 3, 2014, respectively. On January 31, 2014, Heritage received a waiver from the Federal Reserve Board of its application requirements that would apply to this merger.

Other approvals, waivers or consents from regulators may also be required. An adverse development in either party's regulatory standing or other factors could result in an inability to obtain approvals or delay their receipt. These regulators may impose conditions on the completion of the merger or the

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bank merger or require changes to the terms of the merger or the bank merger. Such conditions or changes could have the effect of delaying or preventing completion of the merger or the bank merger or imposing additional costs on or limiting the revenues of the combined company following the merger and the bank merger, any of which might have an adverse effect on the combined company following the merger. See *The Merger Regulatory Approvals* on page 85.

### **Combining the two companies may be more difficult, costly or time consuming than expected and the anticipated benefits and cost savings of the merger may not be realized.**

Heritage and Washington Banking have operated and, until the completion of the merger, will continue to operate, independently. The success of the merger, including anticipated benefits and cost savings, will depend, in part, on our ability to successfully combine the businesses of Heritage and Washington Banking. To realize these anticipated benefits and cost savings, after the completion of the merger, Heritage expects to integrate Washington Banking's business into its own. It is possible that the integration process could result in the loss of key employees, the disruption of each company's ongoing businesses or inconsistencies in standards, controls, procedures and policies that adversely affect the combined company's ability to maintain relationships with clients, customers, depositors and employees or to achieve the anticipated benefits and cost savings of the merger. The loss of key employees could adversely affect Heritage's ability to successfully conduct its business, which could have an adverse effect on Heritage's financial results and the value of its common stock. If the combined company experiences difficulties with the integration process, the anticipated benefits of the merger may not be realized fully or at all, or may take longer to realize than expected. As with any merger of financial institutions, there also may be business disruptions that cause Heritage and/or Washington Banking to lose customers or cause customers to remove their accounts from Heritage and/or Washington Banking and move their business to competing financial institutions. Integration efforts between the two companies will also divert management attention and resources. These integration matters could have an adverse effect on each of Washington Banking and Heritage during this transition period and for an undetermined period after completion of the merger on the combined company. In addition, the actual cost savings of the merger could be less than anticipated.

### **The fairness opinions obtained by Heritage and Washington Banking from their respective financial advisors will not reflect changes in circumstances between signing the merger agreement and the completion of the merger.**

Heritage has not obtained an updated opinion as of the date of this joint proxy statement/prospectus from Davidson, Heritage's financial advisor. Changes in the operations and prospects of Heritage or Washington Banking, general market and economic conditions and other factors which may be beyond the control of Heritage and Washington Banking, and on which the fairness opinions were based, may alter the value of Heritage or Washington Banking or the prices of shares of Heritage common stock or Washington Banking common stock by the time the merger is completed. The opinions do not speak as of the time the merger will be completed or as of any date other than the dates of such opinions. Because Heritage and Washington Banking currently do not anticipate asking their respective financial advisors to update their opinions, the October 23, 2013 opinions do not address the fairness of the merger consideration, from a financial point of view, at the time the merger is completed. For a description of the opinions that Heritage and Washington Banking received from their respective financial advisors, please refer to *The Merger Opinion of D.A. Davidson & Co. Financial Advisor to Heritage* on page 59 and *The Merger Opinion of Sandler O'Neill & Partners, L.P. Financial Advisor to Washington Banking* on page 69. For a description of the other factors considered by the boards of directors of Heritage and Washington Banking in determining to approve the merger agreement, please refer to *The Merger Heritage's Reasons for the Merger; Recommendation of Heritage's Board of Directors* on page 53 and *The Merger Washington Banking's Reasons for the Merger; Recommendation of Washington Banking's Board of Directors* on page 55.

**Certain of Washington Banking s directors and executive officers have interests in the merger that may differ from the interests of Washington Banking s shareholders.**

Washington Banking s shareholders should be aware that some of Washington Banking s directors and executive officers have interests in the merger and have arrangements that are different from, or in addition to,

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those of Washington Banking's shareholders generally. These interests and arrangements may create potential conflicts of interest. Washington Banking's board of directors was aware of these interests and considered these interests, among other matters, when making its decision to approve the merger agreement, and in recommending that Washington Banking's shareholders vote in favor of approving the merger agreement.

These interests include the following:

Certain executive officers of Washington Banking may be eligible for severance benefits under existing agreements with, and benefit plans offered by, Washington Banking.

Accelerated vesting of all of the unvested restricted stock unit awards held by Washington Banking directors and executive officers.

Bryan McDonald, President and Chief Executive Officer of Whidbey Island Bank, will become Executive Vice President and Chief Lending Officer of Heritage Bank following the bank merger and has entered into an employment agreement with Heritage Bank, to become effective at the effective time of the merger.

Edward Eng, Executive Vice President and Chief Administrative Officer of Whidbey Island Bank, will become Executive Vice President and Chief Administrative Officer of Heritage Bank following the bank merger and has entered into an employment agreement with Heritage Bank, to become effective at the effective time of the merger.

John L. Wagner, President and Chief Executive Officer of Washington Banking, will serve as a special advisor to Heritage following the merger and has entered into a consulting agreement with Heritage, to become effective at the effective time of the merger.

Seven current Washington Banking directors, including Anthony B. Pickering, who will serve as chairman of the board of Heritage upon completion of the merger, and Rhoda L. Altom, Mark D. Crawford, Deborah J. Gavin, Jay T. Lien, Gragg E. Miller and Robert T. Severns will be appointed to the board of directors of Heritage.

For a more complete description of these interests, see "The Merger" Interests of Washington Banking's Directors and Executive Officers in the Merger on page 79.

**Termination of the merger agreement could negatively impact Washington Banking or Heritage.**

If the merger agreement is terminated, there may be various consequences. For example, Washington Banking's or Heritage's businesses may have been impacted adversely by the failure to pursue other beneficial opportunities due to the focus of management on the merger, without realizing any of the anticipated benefits of completing the merger. Additionally, if the merger agreement is terminated, the market price of Washington Banking's or Heritage's common stock could decline to the extent that the current market prices reflect a market assumption that the merger will be completed. If the merger agreement is terminated under certain circumstances, Washington Banking or Heritage may

be required to pay to the other party a termination fee of \$7.9 million.

**Washington Banking and Heritage will be subject to business uncertainties and contractual restrictions while the merger is pending.**

Uncertainty about the effect of the merger on employees and customers may have an adverse effect on Washington Banking, Heritage and the combined company. These uncertainties may impair Washington Banking's or Heritage's ability to attract, retain and motivate key personnel until the merger is completed, and could cause customers and others that deal with Washington Banking or Heritage to seek to change existing business relationships with Washington Banking or Heritage. Retention of certain employees by Washington Banking or Heritage may be challenging while the merger is pending, as certain employees may experience uncertainty about their future roles with Washington Banking, Heritage or the combined company. If key employees depart because of issues relating to the uncertainty and difficulty of integration or a desire not to

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remain with Washington Banking, Heritage or the combined company, Washington Banking's or Heritage's business or the business of the combined company following the merger could be harmed. In addition, both companies have agreed to operate their businesses in the ordinary course prior to closing and are subject to other agreed upon contractual operating restrictions prior to closing. See The Merger Agreement Covenants and Agreements-Conduct of Businesses Prior to Completion of the Merger on page 93.

### **If the merger is not completed, Heritage and Washington Banking will have incurred substantial expenses without realizing the expected benefits of the merger.**

Each of Heritage and Washington Banking has incurred and will incur substantial expenses in connection with the due diligence, negotiation and completion of the transactions contemplated by the merger agreement, as well as the costs and expenses of preparing, filing, printing and mailing this joint proxy statement/prospectus and all filing fees paid to the SEC in connection with the merger. If the merger is not completed, Heritage and Washington Banking would have to recognize these expenses without realizing the expected benefits of the merger.

### **The merger agreement limits Heritage's and Washington Banking's ability to pursue acquisition proposals and requires each company to pay a termination fee of \$7.9 million under certain circumstances, including circumstances relating to acquisition proposals.**

The merger agreement prohibits Heritage and Washington Banking from initiating, soliciting, knowingly encouraging or knowingly facilitating certain third-party acquisition proposals. See The Merger Agreement Agreement Not to Solicit Other Offers on page 99. The merger agreement also provides that Heritage or Washington Banking must pay a termination fee in the amount of \$7.9 million in the event that the merger agreement is terminated under certain circumstances, including involving such party's failure to abide by certain obligations not to solicit acquisition proposals. See The Merger Agreement Termination Fee on page 102. These provisions might discourage a potential competing acquirer that might have an interest in acquiring all or a significant part of Washington Banking or Heritage from considering or proposing such an acquisition.

### **The shares of Heritage common stock to be received by holders of Washington Banking common stock for the stock portion of the merger consideration will have different rights from the shares of Washington Banking common stock.**

Upon completion of the merger, Washington Banking shareholders will become Heritage shareholders and their rights as shareholders will continue to be governed by the Washington Business Corporation Act and will also be governed by Heritage's articles of incorporation and bylaws. The rights associated with Washington Banking common stock are different from the rights associated with Heritage common stock. See Comparison of Shareholder Rights on page 127 for a discussion of the different rights associated with Heritage common stock.

### **Pending litigation against Washington Banking and Heritage could result in an injunction preventing the completion of the merger or a judgment resulting in the payment of damages.**

In connection with the merger, certain purported Washington Banking shareholders have filed putative shareholder class action lawsuits against Washington Banking, the members of the Washington Banking board of directors and Heritage. Among other remedies, the plaintiffs seek to enjoin the merger. The outcome of any such litigation is uncertain. If the cases are not resolved, these lawsuits could prevent or delay completion of the merger and result in substantial costs to Heritage and Washington Banking, including any costs associated with the indemnification of directors and officers. Additional lawsuits may be filed against Heritage, Washington Banking and/or the directors and officers of either company in connection with the merger. The defense or settlement of any lawsuit or claim that

remains unresolved at the time the merger is completed may adversely affect the combined company's business, financial condition, results of operations and cash flows following the merger. See "The Merger - Litigation Relating to the Merger" on page 88.

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**Sales of substantial amounts of Heritage's common stock in the open market by former Washington Banking shareholders could depress Heritage's stock price.**

Shares of Heritage common stock that are issued to shareholders of Washington Banking in the merger will be freely tradable without restrictions or further registration under the Securities Act of 1933. As of the record date, Heritage had 16,218,617 shares of common stock outstanding, and 184,535 shares of Heritage common stock were reserved for issuance under Heritage equity plans. Based on the shares of Washington Banking common stock, the outstanding Washington Banking options, and the Washington Banking restricted stock units outstanding as of the record date, the maximum number of shares of common stock Heritage will issue in the merger is approximately 14.1 million shares.

If the merger is completed and if Washington Banking's former shareholders sell substantial amounts of Heritage common stock in the public market following completion of the merger, the market price of Heritage common stock may decrease. These sales might also make it more difficult for Heritage to sell equity or equity-related securities at a time and price that it otherwise would deem appropriate.

**The unaudited pro forma combined condensed consolidated financial information included in this document is illustrative only and the actual financial condition and results of operations after the merger may differ materially.**

The unaudited pro forma combined condensed consolidated financial information in this document is presented for illustrative purposes only and is not necessarily indicative of what Heritage's actual financial condition or results of operations would have been had the merger been completed on the dates indicated. The unaudited pro forma combined condensed consolidated financial information reflects adjustments, which are based upon preliminary estimates, to record the Washington Banking identifiable tangible and intangible assets to be acquired and liabilities to be assumed at fair value and the resulting goodwill to be recognized. The purchase price allocation reflected in this document is preliminary and final allocation of the purchase price will be based upon the actual purchase price and the fair value of the consolidated assets and liabilities of Washington Banking as of the date of the completion of the merger. Accordingly, the final acquisition accounting adjustments may differ materially from the pro forma adjustments reflected in this document. For more information, please see the section entitled "Unaudited Pro Forma Combined Condensed Consolidated Financial Information" beginning on page 104.

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**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

Some of the statements contained or incorporated by reference in this joint proxy statement/prospectus are forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 giving Heritage's or Washington Banking's expectations or predictions of future financial or business performance or conditions.

Forward-looking statements are typically identified by words such as believe, expect, anticipate, intend, target, estimate, continue, positions, prospects or potential, by future conditional verbs such as will, would, show, may, or by variations of such words or by similar expressions. Such forward-looking statements include, but are not limited to, statements about the benefits of the business combination transaction involving Washington Banking and Heritage, including future financial and operating results, the combined company's plans, objectives, expectations and intentions and other statements that are not historical facts. These forward-looking statements are subject to numerous assumptions, risks and uncertainties which change over time. In addition to the risk factors set forth above and those previously disclosed in Heritage's and Washington Banking's reports filed with the Securities and Exchange Commission, the following factors, among others, could cause actual results to differ materially from forward-looking statements:

expected revenues, cost savings, synergies and other benefits from the merger and Heritage's recent acquisitions of Northwest Commercial Bank and Valley Community Bancshares, Inc. and its subsidiary Valley Bank, might not be realized within the expected time frames or at all and costs or difficulties relating to integration matters, including but not limited to customer and employee retention, might be greater than expected;

the requisite shareholder and regulatory approvals for the merger might not be obtained;

the credit risks of lending activities, including changes in the level and direction of loan delinquencies and write-offs and changes in estimates of the adequacy of the allowance for loan losses, which could necessitate additional provisions for loan losses, resulting both from loans originated and loans acquired from other financial institutions;

results of examinations by regulatory authorities, including the possibility that any such regulatory authority may, among other things, require increases in the allowance for loan losses or writing down of assets;

changes in liquidity of the combined company;

competitive pressures among depository institutions;

interest rate movements and their impact on customer behavior and net interest margin;

the impact of repricing and competitors' pricing initiatives on loan and deposit products;

fluctuations in real estate values;

changes in both companies' businesses during the period between now and the completion of the merger may have adverse impacts on the combined company;

the ability to adapt successfully to technological changes to meet customers' needs and developments in the market place;

the ability to access cost-effective funding;

changes in financial markets;

changes in economic conditions in general and in Western Washington and the Pacific Northwest in particular;

the costs, effects and outcomes of litigation;

new legislation or regulatory changes, including but not limited to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act) and regulations adopted thereunder, changes in capital requirements pursuant to the Dodd-Frank Act and the implementation of the

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Basel III capital standards, other governmental initiatives affecting the financial services industry and changes in federal and/or state tax laws or interpretations thereof by taxing authorities;

changes in accounting principles, policies or guidelines;

future acquisitions by Heritage of other depository institutions or lines of business; and

future goodwill impairment due to changes in Heritage's business, changes in market conditions, or other factors.

For any forward-looking statements made in this joint proxy statement/prospectus or in any documents incorporated by reference into this joint proxy statement/prospectus, Heritage and Washington Banking claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You are cautioned not to place undue reliance on these statements, which speak only as of the date of this joint proxy statement/prospectus or the date of the applicable document incorporated by reference in this joint proxy statement/prospectus. Heritage and Washington Banking do not undertake to update forward-looking statements to reflect facts, circumstances, assumptions or events that occur after the date the forward-looking statements are made.

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**THE HERITAGE SPECIAL MEETING**

This section contains information for Heritage shareholders about the special meeting that Heritage has called to allow its shareholders to consider and vote on the merger agreement and other related matters. Heritage commenced the mailing of this joint proxy statement/prospectus to its shareholders on or about March 14, 2014. This joint proxy statement/prospectus is accompanied by a notice of the special meeting of Heritage shareholders and a form of proxy card that Heritage's board of directors is soliciting for use at the Heritage special meeting and at any adjournments or postponements of the Heritage special meeting.

**Date, Time and Place of Meeting**

The Heritage special meeting will be held on April 14, 2014 at 2:00 p.m., local time, at The DoubleTree Hotel, 415 Capitol Way N., Olympia, Washington.

**Matters to Be Considered**

At the Heritage special meeting, Heritage shareholders will be asked to consider and vote on the following matters:

a proposal to approve the merger agreement and the issuance of Heritage common stock in connection with the merger (which is referred to as the Heritage merger proposal); and

a proposal to adjourn the Heritage special meeting, if necessary or appropriate, to solicit additional proxies in favor of the Heritage merger proposal (which is referred to as the Heritage adjournment proposal).

**Recommendation of Heritage's Board of Directors**

Heritage's board of directors has determined that the merger agreement and the transactions contemplated thereby, including the merger, are advisable and in the best interests of Heritage and its shareholders, has unanimously approved the merger agreement and unanimously recommends that Heritage shareholders vote FOR the Heritage merger proposal, and FOR the Heritage adjournment proposal. See The Merger Heritage's Reasons for the Merger; Recommendation of Heritage's Board of Directors on page 53 for a more detailed discussion of Heritage's board of directors' recommendation.

**Record Date and Quorum**

The Heritage board of directors has fixed the close of business on February 28, 2014 as the record date for determining the holders of shares of Heritage common stock entitled to receive notice of and to vote at the Heritage special meeting. Only holders of record of shares of Heritage common stock as of the close of business on that date will be entitled to vote at the Heritage special meeting and at any adjournment or postponement of that meeting. At the close of business on the record date, there were 16,218,617 shares of Heritage common stock outstanding, held by 1,440 holders of record.

Each holder of shares of Heritage common stock outstanding as of the close of business on the record date will be entitled to one vote for each share held of record upon each matter properly submitted at the Heritage special meeting and at any adjournment or postponement of that meeting; provided, however, that pursuant to Heritage's articles of incorporation, no person who beneficially owns more than 10.0% of the shares of Heritage common stock outstanding

as of the record date may vote shares in excess of this limit. The presence at the Heritage special meeting, in person or by proxy, of holders of a majority of the outstanding shares of Heritage common stock entitled to vote at the special meeting will constitute a quorum for the transaction of business. All shares of Heritage common stock present in person or represented by proxy, including abstentions and broker non-votes, will be treated as present for purposes of determining the presence or absence of a quorum for all matters voted on at the Heritage special meeting.

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### **Vote Required; Treatment of Abstentions and Failure to Vote**

To approve the Heritage merger proposal, two-thirds of the shares of Heritage common stock outstanding and entitled to vote thereon must be voted in favor of such proposal. The Heritage adjournment proposal will be approved if a majority of the votes cast at the Heritage special meeting are voted in favor of such proposal. If you mark **ABSTAIN** on your proxy or fail to submit a proxy or vote in person at the Heritage special meeting with respect to the Heritage merger proposal, it will have the same effect as a vote **AGAINST** the proposal. If you mark **ABSTAIN** on your proxy or fail to submit a proxy or vote in person at the Heritage special meeting with respect to the Heritage adjournment proposal, it will have no effect on the proposal.

### **Shares Held by Directors and Executive Officers; Voting and Support Agreements**

As of the record date for the Heritage special meeting, Heritage directors and executive officers and their affiliates owned and were entitled to vote, and have agreed to vote in favor of the merger proposal pursuant to the voting and support agreements described below, 1,090,184 shares of Heritage common stock, representing approximately 7% of the outstanding shares of Heritage common stock. As of the record date for the Heritage special meeting, Washington Banking directors and executive officers and their affiliates did not own any shares of Heritage common stock. Washington Banking owns no shares of Heritage common stock.

Concurrent with the execution of the merger agreement, each of the directors and executive officers of Heritage entered into a voting and support agreement with Washington Banking under which he or she generally has agreed (1) to vote or cause to be voted in favor of the Heritage merger proposal and any other matter required to be approved by the shareholders of Heritage to facilitate the transactions contemplated by the merger agreement, all shares of Heritage common stock over which he or she or a member of his or her immediate family has, directly or indirectly, sole or shared voting power as of the record date for the Heritage special meeting and (2) subject to limited exceptions, not to sell or otherwise dispose of shares of Heritage common stock he or she beneficially owned as of the date of such voting and support agreement until after the approval of the Heritage merger proposal by the shareholders of Heritage.

### **Voting of Proxies; Incomplete Proxies**

Each copy of this joint proxy statement/prospectus mailed to holders of Heritage common stock is accompanied by a form of proxy card with instructions for voting. If you hold shares of Heritage common stock in your name as a shareholder of record, you should complete and return the proxy card accompanying this joint proxy statement/prospectus, regardless of whether you plan to attend the special meeting. You may also vote your shares through the Internet or by telephone. Information and applicable deadlines for voting through the Internet or by telephone are set forth in the enclosed proxy card instructions.

If you hold shares of Heritage common stock in street name through a bank, broker or other nominee, you must direct your bank, broker or other nominee how to vote in accordance with the instructions you have received from your bank, broker or other nominee. See **Shares Held in Street Name; Broker Non-Votes** on page 37.

All shares represented by valid proxies that Heritage receives through this solicitation, and that are not revoked, will be voted at the Heritage special meeting in accordance with your instructions on the proxy card. If you make no specification on your proxy card as to how you want your shares voted before signing and returning it, your proxy will be voted **FOR** the Heritage merger proposal and **FOR** the Heritage adjournment proposal. No matters other than the matters described in this joint proxy statement/prospectus are anticipated to be presented for action at the Heritage special meeting or at any adjournment or postponement of the Heritage special meeting. However, if other business

properly comes before the Heritage special meeting, the proxy agents will, in their discretion, vote upon such matters in their best judgment.

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### **Shares Held in Street Name; Broker Non-Votes**

If you are a Heritage shareholder and your shares are held in street name through a bank, broker or other nominee, you must provide the record holder of your shares with instructions on how to vote the shares. Please follow the voting instructions provided by the bank, broker or other nominee. You may not vote shares held in street name by returning a proxy card directly to Heritage or by voting in person at the Heritage special meeting unless you provide a legal proxy, which you must obtain from your bank, broker or other nominee. Further, because each of the proposals to be considered at the Heritage special meeting is a non-routine matter, under stock exchange rules, banks, brokers or other nominees who hold shares of Heritage common stock on behalf of their customers may not give a proxy to Heritage to vote those shares with respect to any of these proposals without specific voting instructions from their customers. Therefore, if you are a Heritage shareholder and you do not instruct your bank, broker or other nominee on how to vote your shares:

your bank, broker or other nominee may not vote your shares on the Heritage merger proposal, which will have the same effect as a vote **AGAINST** this proposal; and

your bank, broker or other nominee may not vote your shares on the Heritage adjournment proposal, which will have no effect on the vote count for this proposal.

Broker non-votes are shares held by a broker, bank or other nominee that are represented at the Heritage special meeting, but with respect to which the broker or nominee is not instructed by the beneficial owner of such shares to vote on the particular proposal and the broker does not have discretionary voting power on such proposal.

### **Revocability of Proxies and Changes to a Heritage Shareholder's Vote**

If you hold shares of Heritage common stock in your name as a shareholder of record, you may revoke any proxy at any time before it is voted at the Heritage special meeting by (1) signing and returning a proxy card with a later date, (2) delivering a written revocation to Heritage's Corporate Secretary, (3) attending the Heritage special meeting in person, notifying the Corporate Secretary and voting by ballot at the Heritage special meeting or (4) voting by telephone or the Internet at a later time.

Any shareholder entitled to vote in person at the Heritage special meeting may vote in person regardless of whether a proxy has been previously given, but the mere presence (without notifying Heritage's Corporate Secretary of revocation) of a shareholder at the Heritage special meeting will not constitute revocation of a previously given proxy.

Written notices of revocation and other communications about revoking your proxy card should be addressed to: Heritage Financial Corporation, Attn: Corporate Secretary, 201 Fifth Avenue SW, Olympia, Washington 98501.

If your shares are held in street name by a bank, broker or other nominee, you must follow the instructions of your bank, broker or other nominee regarding changes in voting instructions.

### **Solicitation of Proxies**

Heritage will bear the entire cost of soliciting proxies from Heritage shareholders. In addition to solicitation of proxies by mail, Heritage will request that banks, brokers and other record holders send proxy materials to the beneficial owners of Heritage common stock and secure their voting instructions. Heritage will reimburse the record holders for

their reasonable expenses in taking those actions. If necessary, Heritage may use its directors and several of its regular employees, who will not be specially compensated, to solicit proxies from the Heritage shareholders, either personally or by telephone, facsimile, letter or electronic means. Heritage has also made arrangements with Advantage Proxy to assist it in soliciting proxies and has agreed to pay Advantage Proxy approximately \$7,500 plus reasonable expenses for these services.

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**Attending the Heritage Special Meeting**

All holders of Heritage common stock, including shareholders of record and shareholders who hold their shares through banks, brokers, nominees or any other holder of record, are invited to attend the Heritage special meeting. If you hold your Heritage shares in an account at a brokerage firm or bank, your name will not appear on Heritage's shareholder list. Please bring an account statement or a letter from your broker showing your holdings of Heritage common stock. You may be asked to provide this documentation and picture identification at the meeting registration desk to attend the Heritage special meeting.

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**HERITAGE PROPOSALS**

**Heritage Merger Proposal**

As discussed elsewhere in this joint proxy statement/prospectus, Heritage is asking its shareholders to approve the Heritage merger proposal. Holders of Heritage common stock should read carefully this joint proxy statement/prospectus in its entirety, including the appendices, for more detailed information concerning the merger agreement and the merger. In particular, holders of Heritage common stock are directed to the merger agreement, a copy of which is attached as **Appendix A** to this joint proxy statement/prospectus.

The affirmative vote of the holders of at least two-thirds of the outstanding shares of Heritage common stock entitled to vote is required to approve the Heritage merger proposal.

**The Heritage board of directors unanimously recommends that Heritage shareholders vote FOR the Heritage merger proposal.**

Each of the directors and executive officers of Heritage has entered into a voting and support agreement with Washington Banking, pursuant to which each has agreed to vote FOR the Heritage merger proposal. For more information regarding the voting and support agreements, see The Merger Agreement Voting and Support Agreements on page 103.

**Heritage Adjournment Proposal**

The Heritage special meeting may be adjourned to another time or place, if necessary or appropriate, to permit, among other things, further solicitation of proxies if necessary to obtain additional votes in favor of the Heritage merger proposal.

If, at the Heritage special meeting, the number of shares of Heritage common stock present or represented and voting in favor of the Heritage merger proposal is insufficient to approve the Heritage merger proposal, Heritage intends to move to adjourn the Heritage special meeting in order to enable the Heritage board of directors to solicit additional proxies for approval of the Heritage merger proposal.

In this proposal, Heritage is asking its shareholders to authorize the holder of any proxy solicited by the Heritage board of directors on a discretionary basis to vote in favor of adjourning the Heritage special meeting to another time and place for the purpose of soliciting additional proxies, including the solicitation of proxies from Heritage shareholders who have previously voted.

The affirmative vote of the holders of a majority of the votes cast on the Heritage adjournment proposal is required to approve the Heritage adjournment proposal.

**The Heritage board of directors unanimously recommends that Heritage shareholders vote FOR the Heritage adjournment proposal.**

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**THE WASHINGTON BANKING SPECIAL MEETING**

This section contains information for Washington Banking shareholders about the special meeting that Washington Banking has called to allow its shareholders to consider and vote on the merger agreement and other related matters. Washington Banking commenced the mailing of this joint proxy statement/prospectus to holders of Washington Banking common stock on or about March 14, 2014. This joint proxy statement/prospectus is accompanied by a notice of the special meeting of Washington Banking shareholders and a form of proxy card that Washington Banking's board of directors is soliciting for use at the Washington Banking special meeting and at any adjournments or postponements of the Washington Banking special meeting.

**Date, Time and Place of Meeting**

The Washington Banking special meeting will be held on April 15, 2014 at 10:00 a.m., local time, at the Best Western Harbor Plaza, 33175 State Route 20, Oak Harbor, Washington.

**Matters to Be Considered**

At the Washington Banking special meeting, holders of Washington Banking common stock will be asked to consider and vote on the following matters:

a proposal to approve the merger agreement (which is referred to as the Washington Banking merger proposal );

a proposal to adjourn the Washington Banking special meeting, if necessary or appropriate, to solicit additional proxies in favor of the Washington Banking merger proposal (which is referred to as the Washington Banking adjournment proposal ); and

a proposal to approve, on an advisory (non-binding) basis, the compensation that certain executive officers of Washington Banking may receive that is based on or otherwise relates to the merger (which is referred to as the Washington Banking compensation proposal ).

**Recommendation of Washington Banking's Board of Directors**

After careful consideration, Washington Banking's board of directors has determined that the merger agreement and the transactions contemplated thereby, including the merger, are advisable and in the best interests of Washington Banking and its shareholders, has unanimously approved the merger agreement and unanimously recommends that Washington Banking shareholders vote FOR the Washington Banking merger proposal, FOR the Washington Banking adjournment proposal and FOR the Washington Banking compensation proposal. See The Merger Washington Banking's Reasons for the Merger; Recommendation of Washington Banking's Board of Directors on page 55 for a more detailed discussion of Washington Banking's board of directors' recommendation.

**Record Date and Quorum**

The Washington Banking board of directors has fixed the close of business on February 28, 2014 as the record date for determining the holders of shares of Washington Banking common stock entitled to receive notice of and to vote at

the Washington Banking special meeting. Only holders of record of shares of Washington Banking common stock as of the close of business on that date will be entitled to vote at the Washington Banking special meeting and at any adjournment or postponement of that meeting. At the close of business on the record date, there were 15,587,041 shares of Washington Banking common stock outstanding, held by 428 holders of record.

Each holder of shares of Washington Banking common stock outstanding as of the close of business on the record date will be entitled to one vote for each share held of record upon each matter properly submitted at the

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Washington Banking special meeting and at any adjournment or postponement of that meeting. The presence at the Washington Banking special meeting, in person or by proxy, of holders of a majority of the outstanding shares of Washington Banking common stock entitled to vote at the special meeting will constitute a quorum for the transaction of business. All shares of Washington Banking common stock present in person or represented by proxy, including abstentions and broker non-votes, will be treated as present for purposes of determining the presence or absence of a quorum for all matters voted on at the Washington Banking special meeting.

### **Vote Required; Treatment of Abstentions and Failure to Vote**

To approve the Washington Banking merger proposal, the affirmative vote of two-thirds of the shares of Washington Banking common stock outstanding and entitled to vote thereon must be voted in favor of such proposal. The Washington Banking adjournment proposal and the Washington Banking compensation proposal will each be approved if a majority of the votes cast at the Washington Banking special meeting are voted in favor of such proposal. If you mark **ABSTAIN** on your proxy or fail to submit a proxy or vote in person at the Washington Banking special meeting with respect to the Washington Banking merger proposal, it will have the same effect as a vote **AGAINST** the proposal. If you mark **ABSTAIN** on your proxy or fail to submit a proxy or vote in person at the Washington Banking special meeting with respect to the Washington Banking adjournment proposal or the Washington Banking compensation plan proposal, it will have no effect on the proposal.

### **Shares Held by Directors and Executive Officers; Voting and Support Agreements**

As of the record date for the Washington Banking special meeting, Washington Banking directors and executive officers and their affiliates owned and were entitled to vote, and have agreed to vote in favor of the merger proposal pursuant to the voting and support agreements described below, 305,846 shares of Washington Banking common stock, representing approximately 2% of the outstanding shares of Washington Banking common stock, and Heritage directors and executive officers and their affiliates owned and were entitled to vote approximately 5,000 shares of Washington Banking common stock, representing less than one percent of the outstanding shares of Washington Banking common stock. Heritage owns no shares of Washington Banking common stock.

Concurrent with the execution of the merger agreement, each of the directors and executive officers of Washington Banking entered into a voting and support agreement with Heritage under which he or she generally has agreed (1) to vote or cause to be voted in favor of the Washington Banking merger proposal and any other matter required to be approved by the shareholders of Washington Banking to facilitate the transactions contemplated by the merger agreement, all shares of Washington Banking common stock over which he or she or a member of his or her immediate family has, directly or indirectly, sole or shared voting power as of the record date for the Washington Banking special meeting and (2) subject to limited exceptions, not to sell or otherwise dispose of shares of Washington Banking common stock he or she beneficially owned as of the date of such voting and support agreement until after the approval of the Washington Banking merger proposal by the shareholders of Washington Banking. For additional information regarding the voting and support agreements, see **The Merger Agreement Voting and Support Agreements** on page 103.

### **Voting of Proxies; Incomplete Proxies**

Each copy of this joint proxy statement/prospectus mailed to holders of Washington Banking common stock is accompanied by a form of proxy card with instructions for voting. If you hold shares of Washington Banking common stock in your name as a shareholder of record, you should complete and return the proxy card accompanying this joint proxy statement/prospectus, regardless of whether you plan to attend the special meeting. You may also vote your shares through the Internet or by telephone. Information and applicable deadlines for voting through the Internet or by

telephone are set forth in the enclosed proxy card instructions.

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If you hold shares of Washington Banking common stock in street name through a bank, broker or other nominee, you must direct your bank, broker or other nominee how to vote in accordance with the instructions you have received from your bank, broker or other nominee. See Shares Held in Street Name; Broker Non-Votes on this page 42.

All shares represented by valid proxies that Washington Banking receives through this solicitation, and that are not revoked, will be voted at the Washington Banking special meeting in accordance with your instructions on the proxy card. If you make no specification on your proxy card as to how you want your shares voted before signing and returning it, your proxy will be voted FOR the Washington Banking merger proposal, FOR the Washington Banking adjournment proposal and FOR the Washington Banking compensation proposal. No matters other than the matters described in this joint proxy statement/ prospectus are anticipated to be presented for action at the Washington Banking special meeting or at any adjournment or postponement of the Washington Banking special meeting. However, if other business properly comes before the Washington Banking special meeting, the proxy agents will, in their discretion, vote upon such matters in their best judgment.

### **Shares Held in Street Name; Broker Non-Votes**

If you are a Washington Banking shareholder and your shares are held in street name through a bank, broker or other nominee, you must provide the record holder of your shares with instructions on how to vote the shares. Please follow the voting instructions provided by the bank, broker or other nominee. You may not vote shares held in street name by returning a proxy card directly to Washington Banking or by voting in person at the Washington Banking special meeting unless you provide a legal proxy, which you must obtain from your bank, broker or other nominee. Further, because each of the proposals to be considered at the Washington Banking special meeting is a non-routine matter, under stock exchange rules, banks, brokers or other nominees who hold shares of Washington Banking common stock on behalf of their customers may not give a proxy to Washington Banking to vote those shares with respect to any of these proposals without specific voting instructions from their customers. Therefore, if you are a holder of Washington Banking common stock and you do not instruct your bank, broker or other nominee on how to vote your shares:

your bank, broker or other nominee may not vote your shares on the Washington Banking merger proposal, which will have the same effect as a vote **AGAINST** this proposal; and

your bank, broker or other nominee may not vote your shares on the Washington Banking adjournment proposal or the Washington Banking compensation proposal, which will have no effect on the vote counts for these proposals.

Broker non-votes are shares held by a broker, bank or other nominee that are represented at the Washington Banking special meeting, but with respect to which the broker or nominee is not instructed by the beneficial owner of such shares to vote on the particular proposal and the broker does not have discretionary voting power on such proposal.

### **Revocability of Proxies and Changes to a Washington Banking Shareholder's Vote**

If you hold shares of Washington Banking common stock in your name as a shareholder of record, you may revoke any proxy at any time before it is voted at the Washington Banking special meeting by (1) signing and returning a proxy card with a later date, (2) delivering a written revocation to Washington Banking's Corporate Secretary, (3) attending the Washington Banking special meeting in person, notifying the Corporate Secretary and voting by ballot at the Washington Banking special meeting or (4) voting by telephone or the Internet at a later time.

Any shareholder entitled to vote in person at the Washington Banking special meeting may vote in person regardless of whether a proxy has been previously given, but the mere presence (without notifying Washington Banking's Corporate Secretary of revocation) of a shareholder at the Washington Banking special meeting will not constitute revocation of a previously given proxy.

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Written notices of revocation and other communications about revoking your proxy card should be addressed to: Washington Banking Company, Attn: Corporate Secretary, 450 SW Bayshore Drive, Oak Harbor, Washington 98277.

If your shares are held in street name by a bank, broker or other nominee, you must follow the instructions of your bank, broker or other nominee regarding changes in voting instructions.

## **Solicitation of Proxies**

Washington Banking will bear the entire cost of soliciting proxies from Washington Banking shareholders. In addition to solicitation of proxies by mail, Washington Banking will request that banks, brokers and other record holders send proxies and proxy material to the beneficial owners of Washington Banking common stock and secure their voting instructions. Washington Banking will reimburse the record holders for their reasonable expenses in taking those actions. If necessary, Washington Banking may use its directors and several of its regular employees, who will not be specially compensated, to solicit proxies from the Washington Banking shareholders, either personally or by telephone, facsimile, letter or electronic means. Washington Banking has also made arrangements with Advantage Proxy to assist it in soliciting proxies and has agreed to pay Advantage Proxy approximately \$7,500 plus reasonable expenses for these services.

## **Attending the Washington Banking Special Meeting**

All holders of Washington Banking common stock, including shareholders of record and shareholders who hold their shares through banks, brokers, nominees or any other holder of record, are invited to attend the Washington Banking special meeting. If you hold your Washington Banking shares in an account at a brokerage firm or bank, your name will not appear on Washington Banking's shareholder list. Please bring an account statement or a letter from your broker showing your holdings of Washington Banking common stock. You may be asked to provide this documentation and picture identification at the meeting registration desk to attend the Washington Banking special meeting.

## **WASHINGTON BANKING PROPOSALS**

### **Washington Banking Merger Proposal**

As discussed elsewhere in this joint proxy statement/prospectus, Washington Banking is asking its shareholders to approve the Washington Banking merger proposal. Holders of Washington Banking common stock should read carefully this joint proxy statement/prospectus in its entirety, including the appendices, for more detailed information concerning the merger agreement and the merger. In particular, holders of Washington Banking common stock are directed to the merger agreement, a copy of which is attached as **Appendix A** to this joint proxy statement/prospectus.

The affirmative vote of the holders of two-thirds of the outstanding shares of Washington Banking common stock entitled to vote is required to approve the Washington Banking merger proposal.

**The Washington Banking board of directors unanimously recommends that Washington Banking shareholders vote FOR the Washington Banking merger proposal.**

Each of the directors and executive officers of Washington Banking has entered into a voting and support agreement with Heritage, pursuant to which each has agreed to vote FOR the Washington Banking merger proposal. For more information regarding the voting and support agreements, see The Merger Agreement Voting and Support Agreements on page 103.

Under Washington law, shareholders are not entitled to bring any other proposals before the Washington Banking special meeting.

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### **Washington Banking Adjournment Proposal**

The Washington Banking special meeting may be adjourned to another time or place, if necessary or appropriate, to permit, among other things, further solicitation of proxies if necessary to obtain additional votes in favor of the Washington Banking merger proposal.

If, at the Washington Banking special meeting, the number of shares of Washington Banking common stock present or represented and voting in favor of the Washington Banking merger proposal is insufficient to approve the Washington Banking merger proposal, Washington Banking intends to move to adjourn the Washington Banking special meeting in order to enable the Washington Banking board of directors to solicit additional proxies for approval of the Washington Banking merger proposal.

In this proposal, Washington Banking is asking its shareholders to authorize the holder of any proxy solicited by the Washington Banking board of directors on a discretionary basis to vote in favor of adjourning the Washington Banking special meeting to another time and place for the purpose of soliciting additional proxies, including the solicitation of proxies from Washington Banking shareholders who have previously voted.

The affirmative vote of the holders of a majority of the votes cast on the Washington Banking adjournment proposal is required to approve the Washington Banking adjournment proposal.

**The Washington Banking board of directors unanimously recommends that Washington Banking shareholders vote FOR the Washington Banking adjournment proposal.**

### **Washington Banking Compensation Proposal**

In accordance with Section 14A of the Securities Exchange Act of 1934, as amended, (the Exchange Act ) Washington Banking is providing its shareholders with the opportunity to cast an advisory (non-binding) vote on certain compensation that may become payable to its named executive officers that is based on or otherwise relates to the merger, the value of which is set forth in the table included in the section of this joint proxy statement/prospectus entitled The Merger Merger-Related Compensation for Washington Banking s Named Executive Officers on page 84. As required by Section 14A of the Exchange Act, and the applicable SEC rules issued thereunder, Washington Banking is asking its shareholders to vote on the adoption of the following resolution:

RESOLVED, that the compensation that may be paid or become payable to Washington Banking s named executive officers that is based on or otherwise relates to the merger, as disclosed in the table and associated narrative discussion in the section of the joint proxy statement/prospectus statement entitled The Merger Merger-Related Compensation for Washington Banking s Named Executive Officers on page 84, is hereby APPROVED.

The affirmative vote of the holders of a majority of the votes cast on the Washington Banking compensation proposal is required to approve the Washington Banking compensation proposal. The vote on named executive officer merger-related compensation is a vote separate and apart from the vote on the Washington Banking merger proposal. Accordingly, a Washington Banking shareholder may vote to approve the Washington Banking merger proposal and vote not to approve the Washington Banking compensation proposal and vice versa.

Because the vote on named executive officer merger-related compensation is advisory in nature only, it will not be binding on either Washington Banking or Heritage. Accordingly, because Washington Banking is contractually obligated to pay the compensation described in the section of this joint proxy statement/prospectus entitled The Merger Merger-Related Compensation for Washington Banking s Named Executive Officers on page 84, such

compensation will be payable, subject only to the conditions applicable thereto, if the merger is approved and the merger is completed, regardless of the outcome of the advisory vote.

**The Washington Banking board of directors unanimously recommends that Washington Banking shareholders vote FOR the Washington Banking compensation proposal.**

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### **THE MERGER**

*The following discussion contains certain material information about the merger. We urge you to read carefully this entire joint proxy statement/prospectus, including the merger agreement attached as **Appendix A** to this joint proxy statement/prospectus, for a more complete understanding of the merger.*

#### **Terms of the Merger**

Each of Heritage's and Washington Banking's respective boards of directors has approved the merger agreement. The merger agreement provides for the merger of Washington Banking with and into Heritage, with Heritage continuing as the surviving corporation. Immediately following the completion of the merger, Washington Banking's wholly owned bank subsidiary, Whidbey Island Bank, will merge with and into Heritage Bank, with Heritage Bank continuing as the resulting institution in the bank merger.

In the merger, each share of Washington Banking common stock, no par value per share, issued and outstanding immediately prior to the completion of the merger, except for specified shares of Washington Banking common stock held by Washington Banking or Heritage and dissenting shares, will be converted into the right to receive 0.89000 shares of Heritage common stock, no par value per share, and \$2.75 in cash per share. No fractional shares of Heritage common stock will be issued in connection with the merger, and holders of Washington Banking common stock will be entitled to receive cash in lieu thereof.

Washington Banking shareholders and Heritage shareholders are being asked to approve the merger agreement. See The Merger Agreement on page 89 for additional and more detailed information regarding the legal documents that govern the merger, including information about the conditions to the completion of the merger and the provisions for terminating or amending the merger agreement.

#### **Background of the Merger**

As part of their ongoing consideration and evaluation of their respective long-term prospects and strategies, each of Washington Banking's and Heritage's board of directors and senior management have regularly reviewed and assessed their respective business strategies and objectives, including strategic opportunities and challenges, and have considered various strategic options potentially available to them, all with the goal of enhancing value for their respective shareholders. The strategic discussions have focused on, among other things, the business and regulatory environment facing financial institutions generally and Washington Banking and Heritage, respectively, in particular, as well as conditions and ongoing consolidation in the financial services industry.

Heritage continually seeks potential merger and acquisition candidates to enhance the value of its franchise. Heritage's most recent acquisitions consisted of two FDIC-assisted transactions during 2010 involving failed banking institutions in its primary market area; the acquisition of Northwest Commercial Bank, a Washington chartered commercial bank headquartered in Lakewood, Washington on January 9, 2013; and the acquisition of Valley Community Bancshares, Inc. and its subsidiary financial institution, Valley Bank on July 15, 2013. Following these acquisitions, Heritage was particularly interested in a transformative strategic transaction of significant size that would both enhance Heritage's competitive position in the commercial banking business and further diversify its loan portfolio and revenue stream. Washington Banking was well-known to Heritage, and the strength of its business lines, similar customer base and market area appeared to make it a good strategic fit with Heritage.

Over the past four years, Washington Banking, consistent with the strategic plan adopted by its board of directors, has actively sought potential merger and acquisition and other growth opportunities to enhance shareholder value.

Washington Banking's recent acquisitions consisted of two FDIC-assisted transactions in 2010 involving failed banking institutions. The FDIC-assisted acquisition of City Bank expanded Washington Banking's footprint into King County, Washington. From July 2012 to August 2013, Washington Banking continued to review and pursue acquisition opportunities, including conducting due diligence on three acquisition targets in Washington state and two branch purchase opportunities in Washington Banking's markets. During the

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summer of 2013 Washington Banking negotiated a potential non-binding letter of intent for the acquisition of a financial institution headquartered in Washington state and approximately half the size of Whidbey Island Bank, which we refer to as Project X. On September 6, 2013, the board of directors determined to discontinue discussions with respect to Project X to focus on the opportunity with Heritage, which the board of directors believed offered the opportunity to more significantly grow the franchise and was a more attractive opportunity than Project X due to the larger size, more complementary geographic fit and overall profile of the combined institution. In connection with Washington Banking's strategic planning, the board of directors and management stressed the importance of enhancing shareholder value through mergers or acquisitions in order to remain competitive in the challenging economic, regulatory and interest rate climate, and to address potentially increased operating costs and declining revenues with the projected runoff of covered loans from FDIC-assisted transactions. The board of directors focused on identifying strong complementary franchises that shared Washington Banking's values and approach to community banking.

Over the years, Brian L. Vance, President and Chief Executive Officer of Heritage, and John L. Wagner, President and Chief Executive Officer of Washington Banking, have engaged in informal discussions regarding general industry and business matters. Mr. Vance and Mr. Wagner, separately, discussed with various investment bankers a potential strategic business combination between the two companies; however, subsequent discussions between the individuals had not occurred.

In early August 2013, Mr. Vance telephoned Mr. Wagner to suggest that they have an informal meeting to discuss various merger opportunities, and they agreed to meet in Seattle on August 27, 2013. At the meeting, Mr. Vance and Mr. Wagner initiated an informal dialogue about a possible strategic combination of Heritage and Washington Banking.

Between August 13, 2013 and August 22, 2013, representatives of Heritage met with its financial advisor, Davidson, to discuss potential structures, terms and pricing of a proposed transaction between Heritage and Washington Banking.

Between August 13, 2013 and August 23, 2013, Washington Banking's management, along with Sandler, participated in discussions regarding the potential Project X acquisition, the strategic opportunities and merger and acquisition possibilities for Washington Banking that had been considered over the previous year, the general state of potential merger and acquisition opportunities and strategic partners in the Pacific Northwest. Mr. Wagner informed board members of the pending meeting with Mr. Vance and was asked to report back to the board.

At the August 27, 2013 meeting, Messrs. Vance and Wagner initially engaged in a broad-ranging conversation, including discussion of general business and financial services industry matters and an exchange of their respective business philosophies. Mr. Vance and Mr. Wagner also discussed the topic of a possible strategic business combination of Heritage and Washington Banking. Mr. Vance inquired as to whether Washington Banking would be interested in engaging in a discussion about a possible transaction. Mr. Wagner confirmed that under the right terms he believed Washington Banking would be interested in further discussions with Heritage about a possible strategic business combination. Messrs. Vance and Wagner acknowledged that this strategic business combination would require careful consideration of structural issues including organizational structure, shared leadership by both management teams, as well as financial metrics, including stock and cash mix, accretion/dilution to existing Heritage shareholders and pro forma ownership of the combined company, capital and capital ratios of the resulting institution, and returns in order to be acceptable to both Washington Banking and Heritage. Following the meeting, Mr. Wagner informed Washington Banking board members and senior management of his initial discussions with Mr. Vance.

On August 28, 2013, Mr. Wagner contacted Washington Banking's legal counsel, Lane Powell PC (which we refer to as Lane Powell), to discuss the proposed transaction. Lane Powell reviewed with Mr. Wagner the various items that

would need to be addressed in connection with the proposed transaction including structure

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and pricing considerations, as well as social issues such as the combined company's corporate headquarters and subsidiary bank name.

On August 29, 2013, at Washington Banking's regularly scheduled board meeting, Mr. Wagner gave a report of his meeting with Mr. Vance and Heritage's desire to have further discussions regarding a potential strategic business combination with Washington Banking. Sandler participated in the meeting. After discussion and at the conclusion of the meeting, Washington Banking's board authorized management to have further discussions with Heritage about a possible strategic business combination.

On August 30, 2013, Heritage's management, Heritage's legal counsel, Breyer & Associates PC and Silver, Freedman, Taff & Tiernan, L.L.P. (together, referred to as Heritage's legal counsel), and Davidson participated in initial discussions of the proposed strategic business combination of Heritage and Washington Banking by telephone. That same day, Davidson provided a nondisclosure agreement that had been signed by Heritage to Washington Banking.

On September 3, 2013, Heritage's legal counsel, Lane Powell, Davidson and Sandler participated in a telephone call to discuss the structure of the proposed strategic business combination in preparation for the special board meeting scheduled for that day.

On September 3, 2013, Heritage's management and its board of directors, along with Davidson and Heritage's legal counsel participated in a special board meeting to discuss the proposed transaction. Management and Heritage's legal counsel responded to questions from the board regarding the proposed transaction. In addition, Heritage's legal counsel reviewed with the board of directors the various items that would need to be addressed in connection with the proposed transaction including structure and pricing. Davidson presented detailed financial analysis concerning Washington Banking and information concerning the combined company. In connection with the financial analysis provided by Davidson, there was a discussion among management and the board regarding a potential strategic partnership with Washington Banking with Mr. Vance suggesting a proposal to Washington Banking of \$15.75 per share with 80% of the total consideration comprised of Heritage stock and 20% in cash. Heritage wanted to use the cash consideration to leverage the resulting company's capital ratios, improve return on equity, improve earnings per share and minimize dilution to Heritage shareholders.

On September 4, 2013, Messrs. Wagner and Vance met in Seattle along with Sandler and Davidson to discuss the proposed strategic business combination. This was the initial discussion between Heritage and Washington Banking and their respective financial advisors regarding the structure and pricing of the proposed transaction. At that meeting, Mr. Vance distributed a list of discussion items regarding the structure of the strategic business transaction and the potential combined company, including deal structure, pricing, governance and operational issues including participation in the combined company by board members of Heritage and Washington Banking and management team roles for individuals from both institutions, and the logistical issues of the combined company's name and the location of its headquarters. In addition to these discussion items, the parties present also discussed the size of the proposed board of the combined company as compared to select publicly traded peers. Following the meeting, Davidson distributed a summary of the framework of the strategic business combination, including the specific items discussed at the meeting as outlined above. These items included the establishment of a combined board of 12 to 15 members with a majority of the board consisting of Heritage directors and up to five Washington Banking directors; the appointment of the board chair from Washington Banking for a term of up to two years; and the chief executive officer and chief operating officer from Heritage continuing in their respective roles in the combined company. In connection with these discussions, Mr. Vance proposed to Mr. Wagner a price of \$15.80 per share with 80% of the total consideration comprised of Heritage stock and 20% in cash. Following these discussions, Mr. Wagner executed the nondisclosure agreement so the two banks could begin to share more detailed and confidential information. After the meeting Mr. Vance provided Mr. Wagner with a summary of the discussion items that reflected the matters

discussed at the meeting that occurred that day.

On September 6, 2013, Heritage's board of directors held a special meeting to discuss the status of the proposed strategic business combination with Washington Banking, and management updated the board of additional developments regarding preliminary discussions with Washington Banking at the September 4, 2013

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meeting. In particular, Mr. Vance apprised the Heritage board of the results of the discussions with Washington Banking on September 4, 2013 regarding the composition of the board of directors of the resulting company, the appointment of the board chair from Washington Banking and the appointment of the chief executive officer and chief operating officer from Heritage. There was a general consensus among the board regarding the number of directors of the resulting company and the appointment of the board chair, chief executive officer and chief operating officer. Discussion followed regarding the materials provided by Davidson and the board determined and provided management with a price of \$15.80 to \$16.00 to use as a guideline for negotiation with Washington Banking for the proposed transaction.

On September 6, 2013, Washington Banking's board of directors held a special meeting to discuss the status of the proposed strategic business combination and management informed the board of additional development regarding preliminary discussions with Heritage from September 4, 2013. Washington Banking's management and Sandler responded to questions about the discussions and possible next steps. Based on the information from the September 4, 2013, meeting, Sandler presented detailed financial analysis concerning the strategic business combination. Washington Banking's board of directors determined that in order to proceed with discussions with Heritage, the proposed merger consideration to Washington Banking's shareholders would need to be increased to approximately \$16.80 per share, and an increase in the amount of stock consideration to approximately 90% of the overall consideration, and additional governance and operational changes, including the proposed board and management composition, would need to be made to the proposed merger terms in order to reflect Washington Banking's contribution to the combined company. Washington Banking wanted the stock component increased from 80% to 90% so that Washington Banking shareholders would retain a meaningful ownership interest in the resulting company. The Washington Banking board indicated that they would prefer to have a balance of Heritage and Washington Banking senior leaders in the resulting organizational structure and a board of directors that represented the pro forma ownership of the combined company with just over 50% of the directors from the current Heritage board, and confirmation that the board chair would be from Washington Banking for two years. Washington Banking's board of directors instructed Mr. Wagner to provide this feedback to Mr. Vance. Following the special board meeting, Mr. Wagner contacted Mr. Vance to share the board's feedback.

On September 9, 2013, Mr. Vance communicated to Mr. Wagner an updated approach to the proposed strategic business combination, including a revised approach to certain social and operational issues and reflecting greater involvement from Washington Banking in the potential combined company. In particular, these discussions centered around board composition, the board chair, the appointment of the chief executive officer and chief operating officer, and other key management positions including the chief lending officer and chief administrative officer. In particular, Mr. Vance proposed to Mr. Wagner a combined board of 15 members with eight members from Heritage and seven members from Washington Banking, the appointment of the board chair from Washington Banking and the appointment of the chief executive officer and chief operating officer from Heritage. Mr. Vance told Mr. Wagner that Heritage would consider revising the merger consideration of \$15.80 per share with 80% of the total consideration comprised of Heritage stock and 20% in cash, but that Heritage needed more definitive direction from Washington Banking. Mr. Vance also indicated to Mr. Wagner that in order for Heritage to move forward with due diligence and drafting a merger agreement, Heritage and Washington Banking would need to enter into a period of mutual exclusivity for purposes of their negotiations. The parties entered into an exclusivity arrangement to induce each other to spend the time, effort and cost to complete due diligence which is costly and time consuming and to protect the integrity of good faith negotiations.

On September 12, 2013, at a special meeting of the Heritage board, the Heritage board received an update on the proposed strategic business combination. Discussion continued on the price and consideration mix to be offered to Washington Banking in the proposed transaction. The board determined that negotiations should continue regarding the proposed transaction and authorized Mr. Vance to have the ability to negotiate a price of up to \$16.50 per share

with a mix of up to 90% stock and 10% cash.

On September 13, 2013, at a special meeting of the Washington Banking board, directors discussed the proposed merger consideration and social issues, including the board composition and executive management team of the combined company. During that discussion, the Washington Banking board noted the importance of ensuring an appropriate balance of directors and executives of Washington Banking in the oversight, strategic

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direction and management of the combined company whose familiarity with Washington Banking's business, customers and employees would help minimize integration risk, which in turn would maximize the opportunity for Washington Banking's shareholders to participate in the synergies of the strategic business combination as continuing shareholders of the potential combined company. The Washington Banking board also discussed the opportunities and risks associated with a strategic business combination with Heritage. Sandler and Lane Powell participated in the meeting. Sandler presented certain financial analysis and data regarding Washington Banking and Heritage. Lane Powell reviewed with the Washington Banking board the fiduciary duties of Washington Banking directors applicable to their consideration of the proposed strategic business combination. Washington Banking's board directed Mr. Wagner and Sandler to inform Mr. Vance and Davidson that Washington Banking would proceed with due diligence and a reasonable period of exclusivity, authorized by the board not to exceed six weeks in order to complete due diligence and prepare a merger agreement, provided that the cash consideration to be received by Washington Banking shareholders was increased. After reviewing the materials presented by Sandler, the Washington Banking board proposed a 0.89000 exchange ratio and directed Mr. Wagner and Sandler to negotiate for additional cash consideration in the range of \$2.75 to \$3.00 per share, reflecting total merger consideration of approximately \$16.80 per share. The parties had been discussing a transaction with a stock consideration mix of up to 90% of the total consideration. The 0.89000 exchange ratio was within this amount based on the current price of Heritage's common stock.

On September 14, 2013, Heritage verbally presented to Washington Banking a revised proposal agreeing with an exchange ratio of 0.89000 per share and proposing cash consideration of \$2.50 per share and recommended an exclusivity period until the end of October 2013.

On September 14 and 15, 2013, Davidson and Sandler had a series of discussions regarding the terms of the proposed strategic business combination, primarily the exchange ratio and cash consideration per share.

On September 15, 2013, after further discussion between Heritage and Washington Banking and their respective financial advisors, Heritage and Washington Banking agreed to proceed with negotiations of a definitive merger agreement with cash consideration of \$2.75 per share and an exchange ratio of 0.89000, subject to completion of satisfactory due diligence, a period of mutual exclusivity and approval from their respective boards. By agreeing to a fixed exchange ratio of 0.89000, the number of shares to be issued became fixed, thereby limiting the dilutive impact of the issuance of shares. The cash component of \$2.75 was also fixed. After the exchange ratio and cash per share was agreed upon, the composition of stock and cash as a percentage of the total deal consideration would fluctuate based on the market price of Heritage's shares.

On September 16, 2013, Heritage's board of directors held a special meeting to discuss the status of the negotiations. Discussion followed regarding the proposed cash consideration of \$2.75 per share and an exchange ratio of 0.89000. In connection with the discussion it was noted that including cash consideration of \$2.75 would result in consideration of \$16.50 per share based on Heritage's most recent 10 day average trading price. Following discussion, the board approved the merger consideration and also approved an engagement letter with Davidson, which was then executed. On that same day, Heritage provided a draft of the exclusivity agreement to Washington Banking, proposing an exclusivity period ending October 31, 2013.

On September 16, 2013, Mr. Wagner informed the Washington Banking directors and senior management of the Heritage board's approval to proceed with the preparation of a definitive agreement and the due diligence process.

On September 17, 2013, Heritage provided Washington Banking access to Heritage due diligence information. On that same day, Washington Banking entered into an engagement letter with Sandler.

On September 18, 2013, Lane Powell proposed revisions to the exclusivity agreement and Lane Powell, with input from Sandler and Washington Banking management, and Heritage's legal counsel, with input from Davidson and Heritage management, finalized a form of exclusivity agreement with an exclusivity period ending October 24, 2013.

On September 19, 2013, Mr. Vance and Jeff Deuel, Executive Vice President of Heritage, had a meeting with the Washington Banking management team in Burlington, Washington. Introductions of the parties in

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attendance were made and a discussion of the general operating processes of Heritage and Washington Banking followed. On that same day, Mr. Vance and Mr. Wagner exchanged signature pages to the exclusivity agreement which was dated September 18, 2013.

From September 21, 2013 through September 30, 2013, Heritage's legal counsel prepared the merger agreement and the related transaction documents, with the assistance of Heritage's management and Davidson.

On September 23, 2013, the Heritage management team met in Seattle, Washington with the Washington Banking management team, Davidson and Sandler also attended the meeting. Introductions of the parties in attendance were made and a discussion followed regarding the general operating processes of the potential combined company as well as discussion on a due diligence process.

On September 24, 2013 Washington Banking provided Heritage with access to Washington Banking due diligence information.

From September 25, 2013 through September 27, 2013 Heritage and an outside third party conducted credit due diligence of Washington Banking.

On September 26, 2013, at Washington Banking's regularly scheduled board meeting, Mr. Wagner, Sandler and Lane Powell provided updates on the status of the proposed strategic business combination. Lane Powell presented an overview of the timeline for the potential business combination and the key approvals required by the banking regulators and filings with the SEC.

On September 30, 2013, management of Heritage had a call with management of Washington Banking to discuss credit trends, and from September 30, 2013 through October 2, 2013, Washington Banking and an outside third party conducted on site credit due diligence of Heritage.

On October 1, 2013 the Heritage board had a telephone conference call in order to provide a general update on transaction status.

On October 1, 2013, Heritage's legal counsel provided the initial draft of the merger agreement and related transaction documents to Washington Banking, Lane Powell and Sandler.

On October 2, 2013, the management teams from Heritage and Washington Banking, along with Davidson and Sandler, met in Seattle to discuss process, procedures, human resources, facilities, locations of respective operations, and organizational structures. as to the potential integration of the combined company. Lane Powell participated in due diligence discussions and reviewed documents. Mr. Vance and Mr. Deuel met individually with members of Washington Banking's senior management team. Later that day, the Washington Banking board traveled to Seattle to be introduced to Mr. Vance. The purpose of the meeting was to make general introductions and terms of the proposed transaction were not discussed.

On October 8, 2013, Heritage received comments on the merger agreement and related transaction documents from Lane Powell.

On October 11, 2013, Heritage's board of directors held a special meeting to discuss the comments on the merger agreement and related transaction documents received from Lane Powell with Heritage's legal counsel. Following that discussion, Heritage's legal counsel provided Lane Powell with a revised draft of the merger agreement.

On October 14, 2013, Messrs. Vance and Wagner met to discuss Mr. Wagner's role in the potential combined company. Mr. Vance urged Mr. Wagner to continue his involvement with the combined company in order to ensure an orderly and successful transition. Mr. Vance further proposed that Mr. Wagner once again consider the role of Chairman of the Board of Directors which Mr. Wagner declined.

On October 15, 2013, the Washington Banking board of directors held a special meeting in order to receive an update on the status of the negotiation of the merger agreement and potential strategic business combination with Heritage. Sandler reviewed with the board the key business terms of the transaction as then currently proposed. The discussion included a review of possible strategic alternatives. Sandler and Lane Powell reviewed with the board additional information regarding the proposed transaction and certain of the key terms and open

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issues in the current draft of the merger agreement. Further, management reported on the status of Washington Banking's due diligence of Heritage. In addition, Lane Powell reviewed with the board the legal standards and duties applicable to the board's process, decisions and actions with respect to the proposed transaction. Following questions from and discussions among those in attendance, Washington Banking's board authorized management to continue their negotiations with Heritage regarding the possible transaction.

On October 16, 2013, Messrs. Vance and Wagner further discussed by telephone personnel issues and responsibilities in the potential combined company. In addition, there was further discussion regarding Mr. Wagner's continued involvement with the combined company, and the various alternatives in which this could be accomplished.

On October 17, 2013, Lane Powell provided comments on the merger agreement to Heritage's legal counsel.

On October 18, 2013, Washington Banking's board of directors held a special meeting to review the merger agreement and related open items. Lane Powell reviewed in detail the merger agreement and open items. Following a discussion, the board authorized management to continue discussions with Heritage management concerning the resolution of these open items.

Also on October 18, 2013, Heritage provided Washington Banking with a revised draft of the merger agreement and related documents.

On October 20, 2013, Heritage's board of directors held a special meeting to discuss the open items with respect to the merger agreement. On that same date, Heritage management discussed with Washington Banking management the proposed bylaw amendments concerning the composition of the combined company's board of directors, including the procedures for the appointment of replacement directors, the term of the directors of the combined company, the appointment of the chairman and vice-chairman of the combined company, and the amendment of the proposed bylaw amendment.

As a result of continuing discussions and negotiations, the parties agreed to recommend to their respective boards of directors a transaction in which Washington Banking would merge with and into Heritage in a stock and cash transaction, with Washington Banking shareholders receiving 0.89000 shares of Heritage common stock and \$2.75 in cash in exchange for each share of Washington Banking common stock. The transaction would provide that Mr. Vance would serve as President and Chief Executive Officer of the combined company and Chief Executive Officer of Heritage Bank, Mr. Deuel would serve as Executive Vice President of the combined company and President and Chief Operating Officer of Heritage Bank, Mr. Hinson would serve as Executive Vice President and Chief Financial Officer of the combined company and Heritage Bank, Mr. David A. Spurling would serve as Senior Vice President and Chief Credit Officer of Heritage Bank; Mr. Bryan McDonald would serve as Executive Vice President and Chief Lending Officer of Heritage Bank, and Mr. Edward Eng would serve as Executive Vice President and Chief Administrative Officer of Heritage Bank. The boards of directors of the combined company and the combined banks would each consist of 15 directors, eight of which would be ongoing Heritage directors (including Mr. Vance and Mr. Brian S. Charneski, the current Vice Chairman of Heritage, who would serve as Vice-Chairman of the Board of Heritage and Heritage Bank) and seven of which would be former Washington Banking directors, including Mr. Anthony B. Pickering, the current Washington Banking Chairman of the Board, who would serve as Chairman of the Board of Heritage and Heritage Bank.

On October 21, 2013, Messrs. Wagner and Vance spoke by telephone with the FDIC Western Regional Director about the proposed transaction. Heritage legal counsel provided to Lane Powell the Heritage disclosure schedules. Mr. Wagner telephoned Mr. Vance to inform him that, although he was enthusiastic about the proposed transaction, he had determined that he did not want to serve on the board of the combined company. During their discussion,

Mr. Wagner agreed to enter into a consulting agreement with the potential combined company, which would provide that Mr. Wagner assist in the maintenance and retention of important customer and employee relationships with Washington Banking and Heritage.

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Also on October 21, 2013, Heritage's legal counsel provided a revised draft of the merger agreement and plan of bank merger to Lane Powell.

On October 21 and 22, 2013, Mr. McDonald, President and Chief Executive Officer of Whidbey Island Bank, entered into an employment agreement with Heritage Bank to serve as Executive Vice President and Chief Lending Officer of Heritage Bank; and Mr. Eng, Chief Administrative Officer of Whidbey Island Bank entered into an employment agreement with Heritage Bank to serve as Executive Vice President and Chief Administrative Officer of Heritage Bank. Each agreement was entered into subject to Heritage and Washington Banking entering into the merger agreement, and each such agreement would be effective only if the merger is completed.

On October 22, 2013, Davidson distributed to all parties drafts of a joint press release announcing the transaction and investor presentation. Heritage's board of directors convened a special meeting to review the merger agreement, voting agreements, the proposed bylaw amendment and plan of merger. At the meeting, Davidson presented its financial analysis, oral fairness opinion and information on the public announcements for the proposed merger. Following these discussions, and review and discussion among the members of the Heritage board of directors, including consideration of the factors described under Heritage's Reasons for the Merger; Recommendation of Heritage's Board of Directors on page 53, the Heritage board of directors determined that the merger agreement and the transactions contemplated thereby, including the merger, are advisable and in the best interests of Heritage and its shareholders, and the directors voted unanimously to approve the merger agreement and the transactions contemplated thereby and recommended that Heritage's shareholders approve the merger agreement. On that same day, Lane Powell provided Heritage legal counsel and Heritage with drafts of the Washington Banking disclosure schedules to the merger agreement. Following the Heritage board meeting, Messrs. Vance and Wagner contacted the Federal Reserve Bank of San Francisco and the Washington State Department of Financial Institutions, Division of Banks to notify them of the announcement of a strategic business combination between Washington Banking and Heritage.

On October 23, 2013, Heritage provided its final disclosure schedules to Washington Banking. On that same day, the Washington Banking board of directors held a special meeting to consider the proposed merger in accordance with the terms of the draft merger agreement. At the meeting, the board of directors received an update from Washington Banking's management on the status of negotiations with Heritage and received due diligence reports on aspects of Heritage's operations and financial condition. Also at this meeting Sandler reviewed with Washington Banking's board of directors its financial analysis of the proposed merger consideration and delivered to Washington Banking's board of directors an oral opinion, which was confirmed by delivery of a written opinion dated October 23, 2013, to the effect that, as of such date and based on and subject to various factors, assumptions and limitations set forth in its opinion, the proposed merger consideration was fair, from a financial point of view, to the holders of Washington Banking common stock. A representative of Lane Powell again reviewed with the board the legal standards applicable to the board's process, decisions and actions on the proposed merger. In addition, representatives of Lane Powell reviewed the most recent draft of the proposed merger agreement and related agreements. Washington Banking's senior management and outside legal and financial advisors responded to questions from the directors throughout the meeting and there were discussions among the directors and management.

Following these discussions, and review and discussion among the members of Washington Banking's board of directors, including consideration of the factors described under Washington Banking's Reasons for the Merger; Recommendation of Washington Banking's Board of Directors on page 55, the Washington Banking board of directors determined that the merger agreement and the transactions contemplated thereby, including the merger, were advisable and in the best interests of Washington Banking and its shareholders, and the directors voted unanimously to approve the merger agreement and the transactions contemplated thereby and recommended that Washington Banking's shareholders approve the merger agreement.

Following the completion of the October 23, 2013 Washington Banking board meeting, the parties and their respective legal and financial advisors completed final negotiations covering the remaining open items in the

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merger agreement. Following these final negotiations, Mr. Wagner executed a consulting agreement with Heritage to serve as a special advisor to Heritage following the merger. The consulting agreement for Mr. Wagner, and the employment agreements for Messrs. McDonald and Eng become effective as of the closing of the merger and the bank merger. The merger agreement and the related agreements were then finalized, executed and delivered, and the proposed transaction was announced in the afternoon of October 23, 2013, in a press release issued jointly by Heritage and Washington Banking.

### **Heritage's Reasons for the Merger; Recommendation of Heritage's Board of Directors**

After careful consideration, at a meeting held on October 22, 2013, Heritage's board of directors unanimously determined that the merger agreement, including the merger and the other transactions contemplated thereby, is in the best interests of Heritage and its shareholders. Accordingly, Heritage's board of directors unanimously approved the merger agreement and recommends that Heritage's shareholders vote FOR the Heritage merger proposal and FOR the Heritage adjournment proposal.

In reaching its decision to approve the merger agreement, the merger and the other transactions contemplated by the merger agreement and recommend that its shareholders vote FOR the Heritage merger proposal, the Heritage board of directors consulted with Heritage management, as well as its independent financial and legal advisors, and considered a number of factors, including the following material factors:

its knowledge of Heritage's business, operations, financial condition, earnings and prospects and of Washington Banking's business, operations, financial condition, earnings and prospects, taking into account the results of Heritage's due diligence review of Washington Banking, including Heritage's assessments of Washington Banking's credit policies, asset quality, adequacy of loan loss reserves, interest rate risk and litigation;

its understanding of the current and prospective environment in which Heritage and Washington Banking operate, including national and local economic conditions, the interest rate environment, increasing operating costs resulting from regulatory initiatives and compliance mandates, the competitive environment for financial institutions generally, and the likely effect of these factors on Heritage both with and without the proposed transaction;

the broader product offering for its customer base and the additional cross-selling opportunities in certain segments, including consumer lending, auto lending, mortgages and small business administration;

the enhancement of the combined company's competitive position expected to result from the merger, including the fact that the combined company is expected to have the 11th largest deposit market share in Washington and third in deposit market share among Washington-based institutions, with corporate headquarters in the state of Washington, in the combined footprint (based on data as of June 30, 2013 provided by SNL Financial);

the locations of Washington Banking's branch offices and the potential opportunity to double the branch footprint of the combined company along the I-5 corridor;

the strength of Washington Banking's management team;

the anticipated pro forma impact of the merger on the combined company, including potential synergies, and the expected impact on financial metrics such as earnings and tangible equity per share, as well as on regulatory capital levels;

the expanded possibilities, including organic growth and future acquisitions, expected to be available to the combined company, given its larger size, asset base and capital position;

the likelihood of a successful integration of Washington Banking's business, operations and workforce with those of Heritage and of successful operation of the combined company despite the challenges of such integration, and the belief that customer disruption in the transition phase would not be significant due to the complementary nature of the markets served by Heritage and Washington Banking;

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the financial and other terms of the merger agreement, including the fixed exchange ratio for the stock portion of the merger consideration and the fixed per share amount for the cash portion of the merger consideration, tax treatment and mutual deal protection and termination fee provisions, which the Heritage board reviewed with its outside financial and legal advisors;

the written opinion of Davidson, Heritage's financial advisor, dated as of October 23, 2013, delivered to the Heritage board of directors to the effect that, as of that date, and subject to and based on the various assumptions, considerations, qualifications and limitations set forth in the opinion, the merger consideration payable to holders of Washington Banking common stock was fair, from a financial point of view, to Heritage; and

the interests of Washington Banking's directors and executive officers in the merger, in addition to their interests generally as shareholders, as described under "Interests of Washington Banking's Directors and Executive Officers in the Merger" on page 79.

The Heritage board of directors also considered a number of potential risks and uncertainties associated with the merger in connection with its deliberation of the proposed transaction, including, without limitation, the following:

the potential risk of diverting management attention and resources from the operation of Heritage's business towards the completion of the merger;

the restrictions on the conduct of Heritage's business prior to the completion of the merger, which are customary for public company merger agreements involving financial institutions, but which, subject to specific exceptions, could delay or prevent Heritage from undertaking business opportunities that may arise or any other action it would otherwise take with respect to the operations of Heritage absent the pending merger;

the potential risks associated with achieving anticipated cost synergies and savings and successfully integrating Washington Banking's business, operations and workforce with those of Heritage;

the fact that, because the stock portion of the merger consideration consists of a fixed exchange ratio of shares of Heritage common stock, there will be no reduction in the number of shares of Heritage common stock to be issued in connection with the merger even if the price of Heritage common stock increases prior to completion of the merger;

the fact that, while Heritage expects that the merger will be consummated, there can be no assurance that all conditions to the parties' obligations to complete the merger agreement will be satisfied, including the risk that necessary regulatory or shareholder approvals might not be obtained and, as a result, the merger may not be consummated;

the risk of potential employee attrition and/or adverse effects on business and customer relationships as a result of the pending merger;

the outcome of litigation in connection with the merger;

the fact that: (i) the merger agreement includes a force the vote provision that would obligate Heritage to hold a shareholders meeting to consider the merger agreement even if the Heritage board of directors withdraws its favorable recommendation of the merger agreement after determining in good faith that it would be inconsistent with its fiduciary duties to continue to recommend the merger agreement; (ii) Heritage would be prohibited from affirmatively soliciting acquisition proposals after execution of the merger agreement; and (iii) Heritage would be obligated to pay to Washington Banking a termination fee of \$7.9 million if the merger agreement is terminated under certain circumstances, all of which may discourage other parties potentially interested in a strategic transaction with Heritage from pursuing such a transaction;

Washington Banking's ratio of loan loss reserves to non-performing loans was significantly below the comparable group median results for nationwide and Western United States transactions; and

the other risks described under the heading Risk Factors on page 28.

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The foregoing discussion of the information and factors considered by the Heritage board of directors is not intended to be exhaustive, but includes the material factors considered by the Heritage board of directors. In reaching its decision to approve the merger agreement, the merger and the other transactions contemplated by the merger agreement, the Heritage board of directors did not quantify or assign any relative weights to the factors considered, and individual directors may have given different weights to different factors. The Heritage board of directors considered all these factors as a whole, including discussions with, and questioning of, Heritage's management and Heritage's independent financial and legal advisors, and overall considered the factors to be favorable to, and to support, its determination.

Heritage's board of directors unanimously approved the merger agreement and recommends that Heritage's shareholders vote FOR the approval of the Heritage merger proposal and FOR the Heritage adjournment proposal.

This summary of the reasoning of Heritage's board of directors and other information presented in this section is forward-looking in nature and, therefore, should be read in light of the factors discussed under the heading Cautionary Statement Regarding Forward-Looking Statements on page 33.

## **Washington Banking's Reasons for the Merger; Recommendation of Washington Banking's Board of Directors**

After careful consideration, at a meeting held on October 23, 2013, Washington Banking's board of directors unanimously determined that the merger agreement, including the merger and the other transactions contemplated thereby, is in the best interests of Washington Banking and its shareholders. Accordingly, Washington Banking's board of directors unanimously approved the merger agreement and recommends that Washington Banking's shareholders vote FOR the Washington Banking merger proposal, FOR the Washington Banking adjournment proposal and FOR the Washington Banking compensation proposal.

In reaching its decision to approve the merger agreement, the merger and the other transactions contemplated by the merger agreement and recommend that its shareholders vote FOR the Washington Banking merger proposal, the Washington Banking board of directors consulted with Washington Banking management, as well as its independent financial and legal advisors, and considered a number of factors, including the following material factors:

its knowledge of Washington Banking's business, operations, financial condition, asset quality, earnings, covered loan portfolio, capital and prospects both as an independent organization, as an acquirer executing its strategic plan and as a part of a combined company with Heritage, as well as under various other alternative scenarios;

its understanding of Heritage's business, operations, regulatory and financial condition, asset quality, earnings, capital and prospects taking into account presentations by senior management of the results of due diligence review and information from Sandler and Lane Powell;

its belief that the merger will result in a premier, locally-operated commercial banking franchise with a diversified revenue stream, strong capital ratios, a well-balanced loan portfolio and an attractive funding base that has the potential to deliver a higher value to Washington Banking's shareholders than the alternatives to the merger;

the complementary nature of the cultures and product mix of Washington Banking and Heritage, including with respect to strategic focus, target markets and client service, which management believes should facilitate integration and implementation of the transaction;

the expanded possibilities, including organic growth and future acquisitions, that would be available to the combined company, given its larger size, asset base, capital, market capitalization and trading liquidity and footprint;

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the anticipated pro forma impact of the merger on the combined company, including potential synergies, and the expected impact on financial metrics such as earnings and tangible equity per share, as well as on regulatory capital levels;

the fact that the value of the merger consideration for holders of Washington Banking common stock at \$16.89 per share, represents a premium of approximately 18.5% over the \$14.25 closing price of Washington Banking common stock on NASDAQ on October 23, 2013 (the last trading day prior to the execution and announcement of the merger agreement), and the board's review of similar transactions and belief that the transaction is likely to provide substantial future value to Washington Banking's shareholders;

the financial analyses of Sandler and the written opinion of Sandler, Washington Banking's independent financial advisor, dated as of October 23, 2013, delivered to the Washington Banking board of directors to the effect that, as of that date, and subject to and based on the various assumptions, considerations, qualifications and limitations set forth in the opinion, the merger consideration was fair, from a financial point of view, to Washington Banking's shareholders;

the familiarity of Washington Banking's management team with Heritage's management team and the belief of Washington Banking's management that the management and employees of Washington Banking and Heritage possess complementary skills and expertise;

the anticipated continued participation of certain members of Washington Banking's board of directors and management team in the combined company, which enhances the likelihood that the strategic benefits that Washington Banking expects to achieve as a result of the merger will be realized and that the benefits and talents that Washington Banking brings to the combined institution will be appropriately valued and effectively utilized including the appointment of seven current Washington Banking directors to the board of directors of Heritage with Washington Banking's current Chairman of the Board, Anthony B. Pickering, to serve as Chairman of the Board of Heritage and Heritage Bank, the appointment of Whidbey Island Bank's President and Chief Executive Officer, Bryan McDonald, as Executive Vice President and Chief Lending Officer of Heritage Bank, the appointment of Whidbey Island Bank's Executive Vice President and Chief Administrative Officer, Edward Eng, as Executive Vice President and Chief Administrative Officer of Heritage Bank, and the continuing leadership of Washington Banking's President and Chief Executive Officer, John L. Wagner, as a special advisor to Heritage following the merger, and the expected participation of other Washington Banking officers in management positions of the combined company;

the effects of the merger on other Washington Banking employees, including the prospects for continued employment and various benefits agreed to be provided to Washington Banking employees;

the board's understanding of the current and prospective environment in which Washington Banking and Heritage operate, including national and local economic conditions, the interest rate environment, increasing operating costs resulting from regulatory initiatives and compliance mandates, the competitive environment for financial institutions generally, and the likely effect of these factors on Washington Banking both with and without the proposed transaction;

the limited availability of FDIC-assisted and traditional acquisition opportunities that met, or would meet going forward, the strategic goals of Washington Banking, including growth in the current environment;

the effects of the run-off of the covered loan portfolio, including declining revenue and lower net interest margin, and the prospects, and impact on financial performance, of a prolonged low interest rate environment, which emphasized the importance of seeking merger and acquisition opportunities with community banks that share similar business models;

the merger is consistent with Washington Banking's strategic plan, including achieving strong earnings growth, providing the opportunity to replace the covered loan portfolio, improving customer attraction and retention and focusing on expense control;

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the complementary fit of Washington Banking and Heritage because of the nature of the markets served and the products offered by the two institutions;

the enhancement of the combined company's competitive position expected to result from the merger, including that the combined company is expected to have the 11th largest deposit market share in Washington and third in deposit market share among Washington-based institutions, with corporate headquarters in the state of Washington, in the combined footprint (based on data as of June 30, 2013 provided by SNL Financial);

the ability of Heritage to complete the merger from a financial and regulatory perspective;

the structure of the transaction as a strategic business combination in which, among other things, Washington Banking's board and management would have substantial participation in the combined company;

the equity interest in the combined company that Washington Banking's existing shareholders will receive in the merger, which allows such shareholders to continue to participate in the future success of the combined company;

the greater market capitalization and trading liquidity of Heritage common stock in the event that Washington Banking shareholders desired to sell the shares of Heritage common stock to be received by them following completion of the merger;

the proximity of Mr. Wagner to retirement and the effect of his retirement on the management team and Washington Banking's prospects;

the board's understanding that the merger will qualify as a reorganization under Section 368(a) of the Code, providing favorable tax consequences to Washington Banking's shareholders in the merger on the stock portion of the merger consideration; and

the board's review with its independent legal advisor, Lane Powell, of the material terms of the merger agreement, including the board's ability, under certain circumstances, to withhold, withdraw, qualify or modify its recommendation to Washington Banking's shareholders and to consider an acquisition proposal in certain circumstances, subject to the potential payment by Washington Banking of a termination fee of \$7.9 million to Heritage, which the board of directors concluded was reasonable in the context of termination fees in comparable transactions and in light of the overall terms of the merger agreement, as well as the reciprocal nature of the covenants, representations and warranties and termination provisions in the merger agreement.

The Washington Banking board of directors also considered a number of potential risks and uncertainties associated with the merger in connection with its deliberation of the proposed transaction, including, without limitation, the following:

the potential risk of diverting management attention and resources from the operation of Washington Banking's business and towards the completion of the merger;

the restrictions on the conduct of Washington Banking's business prior to the completion of the merger, which are customary for public company merger agreements involving financial institutions, but which, subject to specific exceptions, could delay or prevent Washington Banking from undertaking business opportunities that may arise or any other action it would otherwise take with respect to the operations of Washington Banking absent the pending merger;

the potential risks associated with achieving anticipated cost synergies and savings and successfully integrating Washington Banking's business, operations and workforce with those of Heritage;

the merger-related costs;

the fact that the interests of certain of Washington Banking's directors and executive officers may be different from, or in addition to, the interests of Washington Banking's other shareholders as described

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under the heading "Interests of Washington Banking's Directors and Executive Officers in the Merger" on page 79;

the fact that, because the stock portion of the merger consideration consists of a fixed exchange ratio of shares of Heritage common stock, Washington Banking shareholders could be adversely affected by a decrease in the trading price of Heritage common stock during the pendency of the merger;

the fact that, while Washington Banking expects that the merger will be consummated, there can be no assurance that all conditions to the parties' obligations to complete the merger agreement will be satisfied, including the risk that necessary regulatory or shareholder approvals might not be obtained and, as a result, the merger may not be consummated;

the risk of potential employee attrition and/or adverse effects on business and customer relationships as a result of the pending merger;

the outcome of litigation in connection with the merger;

the dividend history of Heritage and possible dividend amounts following the merger;

the fact that: (i) the merger agreement includes a "force the vote" provision that would obligate Washington Banking to hold a shareholders' meeting to consider the merger agreement even if the Washington Banking board of directors withdraws its favorable recommendation of the merger agreement after determining in good faith that it would be inconsistent with its fiduciary interests to recommend the merger agreement; (ii) Washington Banking would be prohibited from affirmatively soliciting acquisition proposals after execution of the merger agreement; and (iii) Washington Banking would be obligated to pay to Heritage a termination fee of \$7.9 million if the merger agreement is terminated under certain circumstances, all of which may discourage other parties potentially interested in a strategic transaction with Washington Banking from pursuing such a transaction; and

the other risks described under the heading "Risk Factors" on page 28.

The foregoing discussion of the information and factors considered by the Washington Banking board of directors is not intended to be exhaustive, but includes the material factors considered by the Washington Banking board of directors. In reaching its decision to approve the merger agreement, the merger and the other transactions contemplated by the merger agreement, the Washington Banking board of directors did not quantify or assign any relative weights to the factors considered, and individual directors may have given different weights to different factors. The Washington Banking board of directors considered all these factors as a whole, including discussions with, and questioning of Washington Banking's management and Washington Banking's independent financial and legal advisors, and overall considered the factors to be favorable to, and to support, its determination.

Washington Banking's board of directors unanimously approved the merger agreement and recommends that Washington Banking's shareholders vote "FOR" the approval of the Washington Banking merger proposal, "FOR" the

Washington Banking adjournment proposal and FOR the Washington Banking compensation proposal. Washington Banking shareholders should be aware that Washington Banking's directors and executive officers have interests in the merger that are different from, or in addition to, those of other Washington Banking shareholders. The board of directors was aware of and considered these interests, among other matters, in evaluating and negotiating the merger agreement, and in recommending that the merger agreement be approved by the shareholders of Washington Banking. See Interests of Washington Banking's Directors and Executive Officers in the Merger on page 79.

This summary of the reasoning of Washington Banking's board of directors and other information presented in this section is forward-looking in nature and, therefore, should be read in light of the factors discussed under the heading Cautionary Statement Regarding Forward-Looking Statements on page 33.

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**Opinion of D.A. Davidson & Co. Financial Advisor to Heritage**

On September 16, 2013, Heritage entered into an engagement agreement with Davidson to render financial advisory and investment banking services to Heritage. As part of its engagement, Davidson agreed to assist Heritage in analyzing, structuring, negotiating and, if appropriate, effecting a transaction between Heritage and Washington Banking. Davidson also agreed to provide Heritage's board of directors with an opinion as to the fairness, from a financial point of view, to Heritage of the merger consideration in the proposed strategic business combination. Heritage engaged Davidson because Davidson is a nationally recognized investment banking firm with substantial experience in transactions similar to the merger and is familiar with Heritage and its business. As part of its investment banking business, Davidson is continually engaged in the valuation of financial institutions and their securities in connection with mergers and acquisitions and other corporate transactions.

On October 22, 2013, the Heritage board of directors held a meeting to evaluate the proposed strategic business combination. At this meeting, Davidson reviewed the financial aspects of the proposed strategic business combination and rendered an opinion to the Heritage board that, as of such date and based upon and subject to factors and assumptions set forth therein, the merger consideration was fair, from a financial point of view, to Heritage.

The full text of Davidson's written opinion, dated October 22, 2013, which sets forth the assumptions made, procedures followed, matters considered and limitations on the review undertaken in connection with the opinion, is attached as **Appendix B** to this joint proxy statement/prospectus and is incorporated herein by reference. Heritage's shareholders are urged to read the opinion in its entirety.

Davidson's opinion speaks only as of the date of the opinion and Davidson undertakes no obligation to revise or update its opinion. The opinion does not address, and Davidson expresses no view or opinion with respect to, (i) the underlying business decision of Heritage to engage in or proceed with the merger, (ii) the relative merits or effect of the merger as compared to any strategic alternatives or business strategies or combinations that may be or may have been available to or contemplated by Heritage or Heritage's board of directors, or (iii) any legal, regulatory, accounting, tax or similar matters relating to Heritage, its shareholders or relating to or arising out of the merger. The opinion expresses no view or opinion as to any terms or other aspects of the merger. Heritage and Washington Banking determined the merger consideration through the negotiation process. The opinion does not constitute a recommendation to any Heritage shareholder as to how such shareholder should vote with respect to the merger or with respect to any other matter. The opinion does not express any view as to the fairness of the amount or nature of the compensation to any of Heritage's or Washington Banking's officers, directors or employees, or any class of such persons, relative to the merger consideration. The opinion has been reviewed and approved by Davidson's Fairness Opinion Committee in conformity with its policies and procedures established under the requirements of Rule 5150 of the Financial Industry Regulatory Authority.

Davidson has reviewed the registration statement on Form S-4 of which this joint proxy statement/prospectus is a part and consented to the inclusion of its opinion to the Heritage board of directors as **Appendix B** to this joint proxy statement/prospectus and to the references to Davidson and its opinion contained herein. A copy of the consent of Davidson is attached as Exhibit 99.3 to the registration statement on Form S-4.

In connection with rendering its opinion, Davidson reviewed, analyzed and relied upon material bearing upon the merger and the financial and operating condition of Heritage and Washington Banking, including among other things, the following:

a draft of the merger agreement dated October 22, 2013;

certain financial statements and other historical financial and business information about Heritage and Washington Banking made available to Davidson from published sources and/or from the internal records of Heritage and Washington Banking that Davidson deemed relevant;

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certain publicly available analyst earnings estimates for Heritage for the years ending December 31, 2013 and December 31, 2014 and estimated long-term growth rate for the years thereafter, in each case as discussed with, and confirmed by, senior management of Heritage;

certain publicly available analyst earnings estimates for Washington Banking for the years ending December 31, 2013 and December 31, 2014 and estimated long-term growth rate for the years thereafter, in each case as discussed with, and confirmed by, senior management of Heritage;

the current market environment generally and the banking environment in particular;

the financial terms of certain other transactions in the financial institutions industry, to the extent publicly available;

the market and trading characteristics of public companies, and bank holding companies and/or savings and loan holding companies in particular;

the relative contributions of Heritage and Washington Banking to the combined company;

the pro forma financial impact of the merger, taking into consideration the amounts and timing of the transaction costs and cost savings;

the net present value of Washington Banking with consideration of projected financial results;

the net present value of Heritage with consideration of projected financial results;

the net present value of Heritage, on a pro forma basis with the pro forma financial impact of the merger, with consideration of projected financial results; and

such other financial studies, analyses and investigations and financial, economic and market criteria and other information as Davidson considered relevant including discussions with management and other representatives and advisors of Heritage and Washington Banking concerning the business, financial condition, results of operations and prospects of Heritage and Washington Banking.

In arriving at its opinion, Davidson has assumed and relied upon the accuracy and completeness of all information supplied or otherwise made available to Davidson, discussed with or reviewed by or for Davidson, or publicly available, and Davidson has not assumed responsibility for independently verifying such information or undertaken an independent evaluation or appraisal of any of the assets or liabilities (contingent or otherwise) of Heritage or Washington Banking, nor did Davidson make an independent appraisal or analysis on Heritage or Washington Banking with respect to the merger. In addition, Davidson has not assumed any obligation to conduct, nor has

Davidson conducted any physical inspection of the properties or facilities of Heritage or Washington Banking. Davidson has further relied on the assurances of management of Heritage and Washington Banking that they are not aware of any facts or circumstances that would make any of such information inaccurate or misleading. Davidson did not make an independent evaluation or appraisal of the specific assets or liabilities including the amount of any fair value adjustments per FASB Accounting Standards Codification ( ASC ) No. 805, *Business Combinations*. Davidson did not make an independent evaluation of the adequacy of the allowance for loan losses of Heritage or Washington Banking nor has Davidson reviewed any individual credit files relating to Heritage or Washington Banking. Davidson has assumed that the respective allowances for loan losses for both Heritage and Washington Banking are adequate to cover such losses and will be adequate on a pro forma basis for the combined entity. Davidson has assumed that there has been no material adverse change in Heritage s or Washington Banking s assets, financial condition, results of operations, business or prospects since the date of the most recent financial statements provided. Davidson has assumed in all respects material to its analysis that Heritage and Washington Banking will remain as going concerns for all periods relevant to its analysis. Davidson has also assumed in all respects material to its analysis that all of the representations and warranties contained in the merger agreement and all related agreements are true and correct, that each party to such agreements will perform all of the covenants required to be performed by such party under such agreements and that the conditions precedent in the merger agreement are not waived. Davidson has assumed that in the course of obtaining necessary regulatory or other consents or approvals (contractual or otherwise) for the merger, no restrictions, including any divestiture requirements or amendment or modifications, will be imposed that will

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have a material adverse effect on the contemplated benefits of the merger. Davidson's opinion is necessarily based upon information available to Davidson and economic, market, financial and other conditions as they exist and can be evaluated on the date the fairness opinion letter was delivered to Heritage's board of directors.

Set forth below is a summary of the material financial analyses performed by Davidson in connection with rendering its opinion. The summary of the analyses of Davidson set forth below is not a complete description of the analysis underlying its opinion, and the order in which these analyses are described below is not indicative of any relative weight or importance given to those analyses by Davidson. The following summaries of financial analyses include information presented in tabular format. You should read these tables together with the full text of the summary financial analyses, as the tables alone are not a complete description of the analyses.

Unless otherwise indicated, the following quantitative information, to the extent it is based on market data, is based on market data as of October 18, 2013 and is not necessarily indicative of market conditions after such date.

**Summary of Proposal**

Davidson reviewed the financial terms of the proposed transaction. As described in the merger agreement, each share of the common stock, no par value per share, of Washington Banking issued and outstanding immediately prior to the effective time, except for cancelled shares and dissenting shares, shall be converted into the right to receive a fraction of a share of Heritage's common stock equal to 0.89000 and \$2.75 in cash. The terms and conditions of the merger are more fully described in the merger agreement.

Based upon financial information as of or for the twelve month period ended September 30, 2013, Davidson calculated the following transaction ratios:

<b>Transaction Ratios</b>	
Transaction Price / Last Twelve Months Earnings Per Share	15.8x
Transaction Price / Book Value Per Share	144.3%
Transaction Price / Tangible Book Value Per Share	149.0%
Transaction Price / Book Value (Aggregate)	145.8%
Transaction Price / Tangible Book Value (Aggregate)	150.5%
Tangible Book Premium / Core Deposits(1)	7.1%
Transaction Price / Washington Banking's Closing Price as of 10/18/2013(2)	17.0%
Transaction Price / Washington Banking's 20-Day Average Price as of 10/18/2013(3)	19.4%

(1) Core deposits exclude time deposits with account balances greater than \$100,000. Tangible book premium / core deposits calculated by dividing the excess or deficit of the aggregate transaction value over tangible book value by core deposits

(2) Based on Washington Banking's Closing Price price as of 10/18/2013 of \$14.44

(3) Based on Washington Banking's 20-Day Average Price price as of 10/18/2013 of \$14.14

**Stock Trading History of Heritage and Washington Banking**

Davidson reviewed the history of the reported trading prices and volume of Heritage and Washington Banking common stock and the relationship between the movements in the prices of Heritage and Washington Banking common stock to movements in certain stock indices, including the Standard & Poor's 500 Index and the SNL Bank Index.

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<b>One Year Stock Performance</b>		
	<b>Beginning Index Value on October 18, 2012</b>	<b>Ending Index Value on October 18, 2013</b>
Washington Banking	100.0%	106.0%
Heritage	100.0%	113.6%
Standard & Poor's 500 Index	100.0%	119.7%
SNL Bank Index	100.0%	129.7%

<b>Three Year Stock Performance</b>		
	<b>Beginning Index Value on October 18, 2010</b>	<b>Ending Index Value on October 18, 2013</b>
Washington Banking	100.0%	103.0%
Heritage	100.0%	106.0%
Standard & Poor's 500 Index	100.0%	147.3%
SNL Bank Index	100.0%	144.5%

**Comparable Companies Analysis for Heritage and Washington Banking**

Davidson used publicly available information to compare selected financial and market trading information for Heritage, Washington Banking and two separate groups of financial institutions selected by Davidson. The two groups of comparable companies consisted of (1) Pacific Northwest Companies which included eight bank holding companies and/or savings and loan holding companies headquartered in Washington or Oregon with common stock listed on NASDAQ and market capitalization greater than \$100.0 million; and (2) Western U.S. Companies which consisted of 17 bank holding companies and/or savings and loan holding companies headquartered in Arizona, California, Colorado, Montana, Oregon, and Washington with total assets between \$1.0 billion and \$10.0 billion as set forth below:

**Pacific Northwest Companies**

Banner Corporation	HomeStreet, Inc.
Cascade Bancorp	Pacific Continental Corporation
Columbia Banking System, Inc.	Umpqua Holdings Corporation
First Financial Northwest, Inc.	Washington Federal, Inc.

**Western U.S. Companies**

Banc of California, Inc.	Glacier Bancorp, Inc.
Bank of Marin Bancorp	Guaranty Bancorp
Banner Corporation	Heritage Commerce Corp

Cascade Bancorp

Heritage Oaks Bancorp

CoBiz Financial Inc.

Pacific Continental Corporation

Columbia Banking System, Inc.

TriCo Bancshares

CU Bancorp

Westamerica Bancorporation

CVB Financial Corp.

Western Alliance Bancorporation

First Interstate BancSystem, Inc.

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The analysis compared publicly available financial and market trading information for Heritage, Washington Banking and the median data for the comparable companies as of and for the most recently reported three month period available. The table below compares the data for Heritage, Washington Banking and the median data for the comparable companies, with pricing data as of October 18, 2013. The 2013 and 2014 Earnings Per Share estimates used in the table below were based on FactSet Research Systems, Inc. mean estimates for Heritage, Washington Banking and the comparable companies.

**Financial Condition and Performance**

	<b>Heritage</b>	<b>Washington Banking</b>	<b>Comparable Group Pacific NW</b>	<b>Median Result Western U.S.</b>
Total Assets (in millions)	\$ 1,674.4	\$ 1,648.2	\$ 3,506.2	\$ 2,587.9
Non-Performing Assets / Total Assets	0.81%	0.89%	2.67%	1.89%
Texas Ratio(1)	16.4%	21.4%	18.2%	14.3%
Tangible Common Equity Ratio	11.29%	10.72%	11.56%	9.75%
Net Interest Margin	4.67%	4.59%	3.98%	4.01%
Cost of Deposits	0.27%	0.34%	0.29%	0.21%
Efficiency Ratio	70.9%	63.8%	66.5%	64.3%
Return on Average Equity	6.05%	10.03%	8.93%	8.98%
Return on Average Assets	0.80%	1.10%	1.21%	1.03%

**Market Performance Multiples**

	<b>Heritage</b>	<b>Washington Banking</b>	<b>Comparable Group Pacific NW</b>	<b>Median Result Western U.S.</b>
Market Capitalization (in millions)	\$ 266.0	\$ 224.3	\$ 515.8	\$ 382.3
Price / Tangible Book Value Per Share	138.9%	127.4%	147.5%	171.5%
Price / LTM Earnings Per Share	20.9x	13.2x	15.8x	16.2x
Price / 2013 Est. Earnings Per Share(2)	20.2x	14.4x	16.5x	16.6x
Price / 2014 Est. Earnings Per Share(2)	15.7x	14.0x	15.1x	15.6x

- (1) Texas ratio is calculated as the sum of non-performing assets and loans 90 days or more past due divided by the sum of tangible common equity and loan loss reserves
- (2) Earnings per share estimates based on FactSet Research Systems, Inc. mean estimates

**Table of Contents****Precedent Transactions Analysis**

Davidson reviewed two sets of comparable merger and acquisition transactions. The sets of mergers and acquisitions included: (1) Nationwide Transactions which included 14 transactions announced from January 1, 2011 through October 18, 2013 involving bank holding companies and/or savings and loan holding companies headquartered nationwide where the merger transaction value was between \$100.0 million and \$500.0 million, the merger transaction value included stock consideration, and the target company's total assets were between \$500.0 million and \$4.0 billion, non-performing assets to total assets ratio was less than 3.00%, and return on average assets over the preceding twelve months was greater than 0.70%; and (2) Western U.S. Transactions which included five transactions announced from January 1, 2011 through October 18, 2013 involving bank holding companies and/or savings and loan holding companies headquartered in California, Idaho, Oregon and Washington where the target company's total assets were between \$1.0 billion and \$10.0 billion, non-performing assets to total assets ratio was less than 4.00% and return on average assets over the preceding twelve months was greater than 0.00%, as set forth below:

**Nationwide Transactions**

Announcement Date	Acquirer	Target
9/18/2013*	East West Bancorp, Inc.	MetroCorp Bancshares, Inc.
9/10/2013*	Old National Bancorp	Tower Financial Corporation
8/15/2013*	Mercantile Bank Corporation	Firstbank Corporation
8/13/2013*	Cullen/Frost Bankers, Inc.	WNB Bancshares, Inc.
7/01/2013*	Prosperity Bancshares, Inc.	FVNB Corp.
7/01/2013*	First Federal Bancshares of Arkansas, Inc.	First National Security Company
6/28/2013*	Peoples Financial Services Corp.	Penseco Financial Services Corporation
6/10/2013*	Union First Market Bankshares Corporation	StellarOne Corporation
4/04/2013*	Provident New York Bancorp	Sterling Bancorp
2/20/2013	SCBT Financial Corporation	First Financial Holdings, Inc.
12/10/2012	Prosperity Bancshares, Inc.	Coppermark Bancshares, Inc.
10/08/2012	NBT Bancorp Inc.	Alliance Financial Corporation
4/28/2011	Valley National Bancorp	State Bancorp, Inc.
3/11/2011	IBERIABANK Corporation	Cameron Bancshares, Inc.

\*Indicates the transaction was pending as of October 18, 2013

**Western U.S. Transactions**

Announcement Date	Acquirer	Target
9/24/2013*	Banner Corporation	Home Federal Bancorp, Inc.
9/11/2013*	Umpqua Holdings Corporation	Sterling Financial Corporation
11/06/2012	PacWest Bancorp	First California Financial Group, Inc.
9/26/2012	Columbia Banking System, Inc.	West Coast Bancorp
3/12/2012	Mitsubishi UFJ Financial Group, Inc.	Pacific Capital Bancorp

*\*Indicates the transaction was pending as of October 18, 2013*

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Davidson reviewed the following multiples for both sets of comparable mergers and acquisitions: transaction price to last twelve months earnings per share, transaction price to tangible book value per share, and tangible book premium to core deposits. As illustrated in the following table, Davidson compared the proposed merger multiples to the median multiples of the comparable transaction groups and other operating financial data where relevant. The table below sets forth the median data for the comparable transaction groups as of the last twelve months ended prior to the transaction announcement and Washington Banking data for the last twelve months ended September 30, 2013.

**Financial Condition and Performance**

	<b>Washington Banking</b>	<b>Comparable Group Nationwide Transactions</b>	<b>Comparable Group Median Results Western U.S. Transactions</b>
Total Assets (in millions)	\$ 1,648.2	\$ 1,439.9	\$ 2,408.4
Return on Average Assets (Last Twelve Months)	1.00%	0.89%	1.08%
Return on Average Equity (Last Twelve Months)	9.14%	8.71%	8.23%
Tangible Common Equity Ratio	10.72%	8.44%	11.71%
Efficiency Ratio (Last Twelve Months)	63.8%	64.8%	70.7%
Non-Performing Assets / Total Assets	0.89%	1.44%	1.70%
Loan Loss Reserves / Non-Performing Loans	39.3%	120.1%	77.4%

**Transaction Multiples**

	<b>Washington Banking</b>	<b>Comparable Group Nationwide Transactions</b>	<b>Comparable Group Median Results Western U.S. Transactions</b>
Transaction Price / Last Twelve Months Earnings Per Share	15.8x	15.3x	19.5x
Transaction Price / Tangible Book Value Per Share	149.0%	167.6%	167.1%
Tangible Book Premium / Core Deposits(1)	7.1%	8.5%	11.0%

- (1) Core deposits exclude time deposits with account balances greater than \$100,000. Tangible book premium / core deposits calculated by dividing the excess or deficit of the aggregate transaction value over tangible book value by core deposits.

***Net Present Value Analysis - Washington Banking***

Davidson performed an analysis that estimated the net present value per share of Washington Banking common stock under various circumstances. The analysis assumed Washington Banking performed in accordance with publicly available analyst earnings estimates for the years ending December 31, 2013 and December 31, 2014 and an estimated long-term growth rate for the years thereafter and the dividend payout ratio, as discussed with and confirmed by Heritage senior management. To approximate the terminal value of Washington Banking common stock at

December 31, 2018, Davidson applied price to forward earnings multiples of 12.0x to 22.0x and multiples of tangible book value ranging from 120.0% to 190.0%. The terminal values were then discounted to present values using different discount rates ranging from 9.00% to 15.00% chosen to reflect different assumptions regarding required rates of return of holders or prospective buyers of Washington Banking's common stock. In evaluating the discount rate, Davidson used the industry standard methods of adding the current risk-free rate, which is based on the 10-year Treasury yield, plus the published Ibbotson Equity Risk Premium, plus the published Ibbotson Size Premium, plus the published Ibbotson Industry Premium.

At the October 22, 2013 Heritage board of directors meeting, Davidson noted that the net present value analysis is a widely used valuation methodology, but the results of such methodology are highly dependent upon the numerous assumptions that must be made, and the results thereof are not necessarily indicative of actual values or future results.

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As illustrated in the following tables, the analysis indicates an imputed range of values per share of Washington Banking common stock of \$7.83 to \$18.97 when applying the price to earnings multiples to the financial forecasts and \$8.25 to \$17.28 when applying the multiples of tangible book value to the financial forecasts.

**Earnings Per Share Multiples****Discount**

Rate	12.0x	14.0x	16.0x	18.0x	20.0x	22.0x
9.00%	\$ 10.38	\$ 12.10	\$ 13.81	\$ 15.53	\$ 17.25	\$ 18.97
10.00%	\$ 9.89	\$ 11.53	\$ 13.17	\$ 14.80	\$ 16.44	\$ 18.07
11.00%	\$ 9.43	\$ 10.99	\$ 12.55	\$ 14.11	\$ 15.67	\$ 17.23
12.00%	\$ 9.00	\$ 10.49	\$ 11.97	\$ 13.46	\$ 14.95	\$ 16.43
13.00%	\$ 8.59	\$ 10.01	\$ 11.43	\$ 12.84	\$ 14.26	\$ 15.68
14.00%	\$ 8.20	\$ 9.55	\$ 10.91	\$ 12.26	\$ 13.62	\$ 14.97
15.00%	\$ 7.83	\$ 9.12	\$ 10.42	\$ 11.71	\$ 13.00	\$ 14.30

**Tangible Book Value Multiples****Discount**

Rate	120.0%	130.0%	140.0%	150.0%	160.0%	170.0%	180.0%	190.0%
9.00%	\$ 10.94	\$ 11.85	\$ 12.75	\$ 13.66	\$ 14.56	\$ 15.47	\$ 16.38	\$ 17.28
10.00%	\$ 10.43	\$ 11.29	\$ 12.15	\$ 13.02	\$ 13.88	\$ 14.74	\$ 15.61	\$ 16.47
11.00%	\$ 9.94	\$ 10.77	\$ 11.59	\$ 12.41	\$ 13.23	\$ 14.06	\$ 14.88	\$ 15.70
12.00%	\$ 9.49	\$ 10.27	\$ 11.05	\$ 11.84	\$ 12.62	\$ 13.41	\$ 14.19	\$ 14.97
13.00%	\$ 9.05	\$ 9.80	\$ 10.55	\$ 11.30	\$ 12.04	\$ 12.79	\$ 13.54	\$ 14.29
14.00%	\$ 8.64	\$ 9.36	\$ 10.07	\$ 10.78	\$ 11.50	\$ 12.21	\$ 12.93	\$ 13.64
15.00%	\$ 8.25	\$ 8.94	\$ 9.62	\$ 10.30	\$ 10.98	\$ 11.66	\$ 12.35	\$ 13.03

**Net Present Value Analysis Heritage**

Davidson performed an analysis that estimated the net present value per share of Heritage common stock under various circumstances. The analysis assumed Heritage performed in accordance with publicly available analyst earnings estimates for the years ending December 31, 2013 and December 31, 2014 and an estimated long-term growth rate for the years thereafter and the dividend payout ratio, as discussed with and confirmed by Heritage senior management. To approximate the terminal value of Heritage common stock at December 31, 2018, Davidson applied price to forward earnings multiples of 12.0x to 22.0x and multiples of tangible book value ranging from 120.0% to 190.0%. The terminal values were then discounted to present values using different discount rates ranging from 9.00% to 15.00% chosen to reflect different assumptions regarding required rates of return of holders or prospective buyers of Heritage's common stock. In evaluating the discount rate, Davidson used the industry standard methods of adding the current risk-free rate, which is based on the 10-year Treasury yield, plus the published Ibbotson Equity Risk Premium, plus the published Ibbotson Size Premium, plus the published Ibbotson Industry Premium.

At the October 22, 2013 Heritage board of directors meeting, Davidson noted that the net present value analysis is a widely used valuation methodology, but the results of such methodology are highly dependent upon the numerous

assumptions that must be made, and the results thereof are not necessarily indicative of actual values or future results.

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As illustrated in the following tables, the analysis indicates an imputed range of values per share of Heritage common stock of \$7.72 to \$18.76 when applying the price to earnings multiples to the financial forecasts and \$8.74 to \$18.18 when applying the multiples of tangible book value to the financial forecasts.

**Earnings Per Share Multiples****Discount**

Rate	12.0x	14.0x	16.0x	18.0x	20.0x	22.0x
9.00%	\$ 10.25	\$ 11.96	\$ 13.67	\$ 15.38	\$ 17.07	\$ 18.76
10.00%	\$ 9.77	\$ 11.39	\$ 13.02	\$ 14.65	\$ 16.27	\$ 17.88
11.00%	\$ 9.31	\$ 10.86	\$ 12.41	\$ 13.96	\$ 15.52	\$ 17.05
12.00%	\$ 8.88	\$ 10.36	\$ 11.84	\$ 13.32	\$ 14.80	\$ 16.27
13.00%	\$ 8.47	\$ 9.88	\$ 11.29	\$ 12.70	\$ 14.11	\$ 15.53
14.00%	\$ 8.08	\$ 9.43	\$ 10.78	\$ 12.12	\$ 13.47	\$ 14.82
15.00%	\$ 7.72	\$ 9.00	\$ 10.29	\$ 11.58	\$ 12.86	\$ 14.15

**Tangible Book Value Multiples****Discount**

Rate	120.0%	130.0%	140.0%	150.0%	160.0%	170.0%	180.0%	190.0%
9.00%	\$ 11.55	\$ 12.50	\$ 13.45	\$ 14.39	\$ 15.34	\$ 16.29	\$ 17.23	\$ 18.18
10.00%	\$ 11.02	\$ 11.92	\$ 12.82	\$ 13.72	\$ 14.62	\$ 15.53	\$ 16.43	\$ 17.33
11.00%	\$ 10.51	\$ 11.37	\$ 12.23	\$ 13.09	\$ 13.95	\$ 14.81	\$ 15.67	\$ 16.53
12.00%	\$ 10.03	\$ 10.85	\$ 11.67	\$ 12.49	\$ 13.31	\$ 14.13	\$ 14.95	\$ 15.77
13.00%	\$ 9.58	\$ 10.36	\$ 11.14	\$ 11.92	\$ 12.71	\$ 13.49	\$ 14.27	\$ 15.05
14.00%	\$ 9.15	\$ 9.90	\$ 10.64	\$ 11.39	\$ 12.13	\$ 12.88	\$ 13.63	\$ 14.37
15.00%	\$ 8.74	\$ 9.46	\$ 10.17	\$ 10.88	\$ 11.59	\$ 12.31	\$ 13.02	\$ 13.73

**Net Present Value Analysis Pro Forma Heritage**

Davidson performed an analysis that estimated the net present value per share of Heritage common stock on a pro forma basis, including the pro forma impact with the merger transaction, under various circumstances. In performing this analysis, Davidson assumed Heritage and Washington Banking performed in accordance with publicly available analyst earnings estimates for the years ending December 31, 2013 and December 31, 2014 and an estimated long-term growth rate for the years thereafter and pro forma financial impact of cost savings estimates, purchase accounting adjustments, transaction expenses and the dividend payout ratio, as discussed with and confirmed by Heritage senior management. To approximate the terminal value of Heritage common stock at December 31, 2018, Davidson applied price to forward earnings multiples of 12.0x to 22.0x and multiples of tangible book value ranging from 120.0% to 190.0%. The terminal values were then discounted to present values using different discount rates ranging from 9.00% to 15.00% chosen to reflect different assumptions regarding required rates of return of holders or prospective buyers of Heritage's common stock. In evaluating the discount rate, Davidson used the industry standard methods of adding the current risk-free rate, which is based on the 10-year Treasury yield, plus the published Ibbotson Equity Risk Premium, plus the published Ibbotson Size Premium, plus the published Ibbotson Industry Premium.

At the October 22, 2013 Heritage board of directors meeting, Davidson noted that the net present value analysis is a widely used valuation methodology, but the results of such methodology are highly dependent upon the numerous assumptions that must be made, and the results thereof are not necessarily indicative of actual values or future results.

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As illustrated in the following tables, the analysis indicates an imputed range of values per share of Heritage common stock of \$9.51 to \$23.01 when applying the price to earnings multiples to the financial forecasts and \$8.45 to \$17.67 when applying the multiples of tangible book value to the financial forecasts.

**Earnings Per Share Multiples****Discount**

Rate	12.0x	14.0x	16.0x	18.0x	20.0x	22.0x
9.00%	\$ 12.60	\$ 14.68	\$ 16.77	\$ 18.85	\$ 20.93	\$ 23.01
10.00%	\$ 12.01	\$ 13.99	\$ 15.98	\$ 17.96	\$ 19.95	\$ 21.93
11.00%	\$ 11.45	\$ 13.34	\$ 15.23	\$ 17.13	\$ 19.02	\$ 20.91
12.00%	\$ 10.93	\$ 12.73	\$ 14.53	\$ 16.34	\$ 18.14	\$ 19.94
13.00%	\$ 10.43	\$ 12.15	\$ 13.87	\$ 15.59	\$ 17.31	\$ 19.03
14.00%	\$ 9.96	\$ 11.60	\$ 13.24	\$ 14.88	\$ 16.52	\$ 18.17
15.00%	\$ 9.51	\$ 11.08	\$ 12.65	\$ 14.21	\$ 15.78	\$ 17.35

**Tangible Book Value Multiples****Discount**

Rate	120.0%	130.0%	140.0%	150.0%	160.0%	170.0%	180.0%	190.0%
9.00%	\$ 11.20	\$ 12.12	\$ 13.05	\$ 13.97	\$ 14.89	\$ 15.82	\$ 16.74	\$ 17.67
10.00%	\$ 10.67	\$ 11.55	\$ 12.43	\$ 13.31	\$ 14.20	\$ 15.08	\$ 15.96	\$ 16.84
11.00%	\$ 10.18	\$ 11.02	\$ 11.86	\$ 12.70	\$ 13.54	\$ 14.37	\$ 15.21	\$ 16.05
12.00%	\$ 9.71	\$ 10.51	\$ 11.31	\$ 12.11	\$ 12.91	\$ 13.71	\$ 14.51	\$ 15.31
13.00%	\$ 9.27	\$ 10.03	\$ 10.80	\$ 11.56	\$ 12.32	\$ 13.09	\$ 13.85	\$ 14.61
14.00%	\$ 8.85	\$ 9.58	\$ 10.31	\$ 11.04	\$ 11.76	\$ 12.49	\$ 13.22	\$ 13.95
15.00%	\$ 8.45	\$ 9.15	\$ 9.85	\$ 10.54	\$ 11.24	\$ 11.93	\$ 12.63	\$ 13.32

**Financial Impact Analysis**

Davidson performed pro forma merger analyses that combined projected income statement and balance sheet information of Heritage and Washington Banking. Assumptions regarding the accounting treatment, purchase accounting adjustments and cost savings were used to calculate the financial impact that the merger would have on certain projected financial results of Heritage. In the course of this analysis, Davidson used the FactSet Research Systems, Inc. mean consensus earnings estimates for Heritage and Washington Banking for years ending December 31, 2013 and December 31, 2014 and an estimated long-term growth rate for the years thereafter, as discussed with and confirmed by Heritage senior management. This analysis indicated that the merger is expected to be accretive to Heritage's estimated earnings per share for the years ending December 31, 2014 and December 31, 2015, excluding the impact of transaction expenses. The analysis also indicated that the merger is expected to be dilutive to tangible book value per share for Heritage and that Heritage would maintain capital ratios in excess of those required for Heritage to be considered well-capitalized under existing regulations. For all of the above analyses, the actual results achieved by Heritage and Washington Banking following the merger will vary from the projected results, and the variations may be material.

Davidson prepared its analyses for purposes of providing its opinion to Heritage's board of directors as to the fairness, from a financial point of view to Heritage, of the merger consideration and to assist Heritage's board of directors in analyzing the proposed merger. The analyses do not purport to be appraisals or necessarily reflect the prices at which businesses or securities actually may be sold. Analyses based upon forecasts of future results are not necessarily indicative of actual future results, which may be significantly more or less favorable than those suggested by these analyses. Because these analyses are inherently subject to uncertainty, being based upon numerous factors or events beyond the control of the parties and their respective advisors, none of Heritage, Washington Banking or Davidson or any other person assumes responsibility if future results are materially different from those forecasted.

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Davidson's opinion was one of many factors considered by Heritage's board of directors in its evaluation of the merger and should not be viewed as determinative of the views of the board of directors of Heritage or management with respect to the merger or the merger consideration.

Davidson and its affiliates, as part of their investment banking business, are continually engaged in performing financial analyses with respect to businesses and their securities in connection with mergers and acquisitions, negotiated underwritings, competitive biddings, secondary distributions of listed and unlisted securities, private placements and other transactions. Davidson acted as financial advisor to Heritage in connection with, and participated in certain of the negotiations leading to the merger. Davidson is a full service securities firm engaged, either directly or through its affiliates, in securities trading, investment management, financial planning and benefits counseling, financing and brokerage activities for both companies and individuals. In the ordinary course of these activities, Davidson and its affiliates may provide such services to Heritage, Washington Banking and their respective affiliates, may actively trade the debt and equity securities (or related derivative securities) of Heritage and Washington Banking for their own account and for the accounts of their customers and may at any time hold long and short positions of such securities. Heritage selected Davidson as its financial advisor because it is a recognized investment banking firm that has substantial experience in transactions similar to the merger. Pursuant to a letter agreement dated September 16, 2013, Heritage engaged Davidson as its financial advisor in connection with the contemplated transaction. Pursuant to the terms of the engagement letter, Heritage agreed to pay Davidson a cash fee of \$250,000 concurrently with the rendering of its opinion. Heritage will pay to Davidson at the time of closing of the merger a contingent cash fee equal to 0.65% of the aggregate consideration payable in the merger (which consideration shall be calculated in part based on the average price of Heritage's stock for the ten days up to and including the closing date; and which fee would be approximately \$1.8 million if the merger had closed on the date of this joint proxy statement/prospectus). Heritage has also agreed to reimburse Davidson for all reasonable out-of-pocket expenses, including fees of counsel, and to indemnify Davidson and certain related persons against specified liabilities, including liabilities under the federal securities laws, relating to or arising out of its engagement.

Davidson has, in the past, provided certain investment banking services to Heritage and its affiliates, has had a material relationship with Heritage and its affiliates and has received compensation and reimbursement of out-of-pocket expenses for such services. During the two years preceding the date of the opinion, Davidson received \$150,000 in connection with Heritage's acquisition of Northwest Commercial Bank in January 2013. Additionally, Davidson served as an underwriter for Heritage's follow-on offering of equity securities in 2009 and 2010. Davidson may provide investment banking services to the combined company in the future and may receive future compensation. In the two years prior to the execution of the merger agreement, Davidson has not provided investment banking services to, or received fees for such services from, Washington Banking.

## **Opinion of Sandler O'Neill & Partners, L.P. Financial Advisor to Washington Banking**

By letter dated September 17, 2013, Washington Banking retained Sandler to act as financial advisor to Washington Banking's board of directors in connection with a possible business combination with Heritage. Sandler is a nationally recognized investment banking firm whose principal business specialty is financial institutions. In the ordinary course of its investment banking business, Sandler is regularly engaged in the valuation of financial institutions and their securities in connection with mergers and acquisitions and other corporate transactions.

Sandler acted as financial advisor to Washington Banking's board of directors in connection with the proposed transaction and participated in certain of the negotiations leading to the execution of the merger agreement. At the October 23, 2013 meeting at which Washington Banking's board of directors considered and approved the merger agreement, Sandler delivered to the board its oral opinion, which was subsequently followed up in writing, that, as of such date, the merger consideration was fair to the holders of Washington Banking's common stock from a financial

point of view. **The full text of Sandler's opinion is attached as Appendix C to this proxy statement/prospectus. The opinion outlines the procedures followed, assumptions made, matters considered and qualifications and limitations on the review undertaken by Sandler in**

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**rendering its opinion. Holders of Washington Banking common stock are urged to read the entire opinion carefully in connection with their consideration of the proposed merger.**

**Sandler's opinion speaks only as of the date of the opinion. The opinion was directed to Washington Banking's board and is directed only to the fairness of the merger consideration to the holders of Washington Banking's common stock from a financial point of view. It does not address the underlying business decision of Washington Banking to engage in the merger or any other aspect of the merger and is not a recommendation to any holder of Washington Banking common stock as to how such holder of Washington Banking common stock should vote at the special meeting with respect to the merger or any other matter.**

In connection with rendering its opinion on October 23, 2013, Sandler reviewed and considered, among other things:

the merger agreement;

certain financial statements and other historical financial information of Washington Banking that Sandler deemed relevant;

certain financial statements and other historical financial information of Heritage that Sandler deemed relevant;

publicly available earnings estimates for the years ending December 31, 2013 and December 31, 2014 and an estimated long term growth rate for the years thereafter in each instance as discussed with the senior management of Washington Banking;

publicly available earnings estimates for the years ending December 31, 2013 and December 31, 2014 and an estimated long term growth rate for the years thereafter in each instance as discussed with the senior management of Heritage;

the pro forma financial impact of the merger on Heritage based on assumptions relating to transaction expenses, purchase accounting adjustments, cost savings and other synergies as provided by Heritage;

comparison of certain financial and other information for Washington Banking and Heritage, including relevant stock trading information, with similar publicly available information for certain other commercial banks, the securities of which are publicly traded and the relative contributions of certain assets, liabilities, equity and earnings of Washington Banking and Heritage to the combined institution;

the terms and structures of other recent mergers and acquisition transactions in the commercial banking sector;

the current market environment generally and in the commercial banking sector in particular; and

such other information, financial studies, analyses and investigations and financial, economic and market criteria as Sandler considered relevant.

Sandler also discussed with certain members of the senior management of Washington Banking the business, financial condition, results of operations and prospects of Washington Banking and held similar discussions with the senior management of Heritage regarding the business, financial condition, results of operations and prospects of Heritage.

In performing its reviews and analyses and in rendering its opinion, Sandler relied upon the accuracy and completeness of all of the financial and other information that was available to Sandler from public sources, that was provided to Sandler by Washington Banking or Heritage or their respective representatives or that was otherwise reviewed by Sandler and Sandler assumed such accuracy and completeness for purposes of rendering its opinion. Sandler further relied on the assurances of the senior management of each of Washington Banking and Heritage that they were not aware of any facts or circumstances that would make any of such information inaccurate or misleading in a material respect. Sandler did not make an independent evaluation or appraisal of the specific assets, the collateral securing assets or the liabilities (contingent or otherwise) of Washington Banking or

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Heritage or any of their respective subsidiaries. Sandler did not make an independent evaluation of the adequacy of the allowance for loan losses of Washington Banking and Heritage and Sandler did not review any individual credit files relating to Washington Banking and Heritage. Sandler assumed that the respective allowances for loan losses for Washington Banking and Heritage are adequate to cover such losses.

Sandler used publicly available earnings estimates for Washington Banking and Heritage for the years ending December 31, 2013 and December 31, 2014 and a long-term earnings per share growth rate for the years thereafter in both cases as discussed with the respective senior management of Washington Banking and Heritage. The information provided to Sandler by Heritage included a forecast of earnings per share that was not materially different than the publicly available earnings estimates used by Sandler. Sandler also received and used in its analyses certain projections of transaction costs, purchase accounting adjustments, expected cost savings and other synergies which were provided by Heritage. Sandler expresses no opinion as to such estimates or the assumptions on which they are based. Sandler has assumed that there has been no material adverse change in the respective assets, financial condition, results of operations, business or prospects of Washington Banking and Heritage since the date of the most recent financial data made available to Sandler. Sandler has also assumed in all respects material to its analysis that Washington Banking and Heritage would remain as a going concern for all the periods relevant to its analyses. Sandler expresses no opinion as to any of the legal, accounting and tax matters relating to the merger and any other transaction contemplated in connection therewith.

Sandler's opinion was necessarily based on financial, economic, regulatory, market and other conditions as in effect on, and the information made available to Sandler as of, the date of its opinion. Events occurring after the date thereof could materially affect its opinion. Sandler has not undertaken to update, revise, reaffirm or withdraw its opinion or otherwise comment upon events occurring after the date of its opinion. Washington Banking's board of directors retains the right to request an update to Sandler's opinion, pursuant to the terms of its engagement letter with Sandler, at no additional cost to Washington Banking. Sandler expressed no opinion as to the trading values at which the common stock of Washington Banking or Heritage may trade at any time or what the value of Heritage common stock will be once it is actually received by the holders of Washington Banking common stock. Sandler's opinion was approved by Sandler's fairness opinion committee. Sandler did not express any opinion as to the fairness of the amount or nature of the compensation to be received in the merger by Washington Banking's officers, directors, or employees, or class of such persons, relative to the merger consideration to be received by Washington Banking's shareholders.

In rendering its October 23, 2013 opinion, Sandler performed a variety of financial analyses. The following is a summary of the material analyses performed by Sandler, but is not a complete description of all the analyses underlying Sandler's opinion. The summary includes information presented in tabular format. **In order to fully understand the financial analyses, these tables must be read together with the accompanying text. The tables alone do not constitute a complete description of the financial analyses.** The preparation of a fairness opinion is a complex process involving subjective judgments as to the most appropriate and relevant methods of financial analysis and the application of those methods to the particular circumstances. The process, therefore, is not necessarily susceptible to a partial analysis or summary description. Sandler believes that its analyses must be considered as a whole and that selecting portions of the factors and analyses to be considered without considering all factors and analyses, or attempting to ascribe relative weights to some or all such factors and analyses, could create an incomplete view of the evaluation process underlying its opinion. Also, no company included in Sandler's comparative analyses described below is identical to Washington Banking or Heritage and no transaction is identical to the merger. Accordingly, an analysis of comparable companies or transactions involves complex considerations and judgments concerning differences in financial and operating characteristics of the companies and other factors that could affect the public trading values or merger transaction values, as the case may be, of Washington Banking and Heritage and the companies to which they are being compared.

In performing its analyses, Sandler also made numerous assumptions with respect to industry performance, business and economic conditions and various other matters, many of which cannot be predicted and are beyond the control of Washington Banking, Heritage and Sandler. The analysis performed by Sandler is not necessarily indicative of actual values or future results, both of which may be significantly more or less favorable than suggested by such analyses. Sandler prepared its analyses solely for purposes of rendering its opinion and

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provided such analyses to the Washington Banking board of directors at the board of directors' meeting on October 23, 2013. Estimates on the values of companies do not purport to be appraisals or necessarily reflect the prices at which companies or their securities may actually be sold. Such estimates are inherently subject to uncertainty and actual values may be materially different. Accordingly, Sandler's analyses do not necessarily reflect the value of Washington Banking's common stock or the prices at which Washington Banking's common stock may be sold at any time. The analyses of Sandler and its opinion were among a number of factors taken into consideration by Washington Banking's board of directors in making its determination to approve of Washington Banking's entry into the merger agreement and the analyses described below should not be viewed as determinative of the decision made by Washington Banking's board of directors with respect to the fairness of the merger.

In arriving at its opinion Sandler did not attribute any particular weight to any analysis or factor that it considered. Rather it made qualitative judgments as to the significance and relevance of each analysis and factor. Sandler did not form an opinion as to whether any individual analysis or factor (positive or negative) considered in isolation supported or failed to support its opinions; rather Sandler made its determination as to the fairness of the merger consideration on the basis of its experience and professional judgment after considering the results of all its analyses taken as a whole.

**Summary of Proposal.** Sandler reviewed the financial terms of the proposed transaction. As described in the merger agreement, Washington Banking shareholders will receive consideration consisting of 0.89000 shares of Heritage common stock and \$2.75 in cash in exchange for each share of Washington Banking's common stock. Based upon Heritage's closing price of \$15.85 as of October 22, 2013, Sandler calculated merger consideration value of \$16.86 per Washington Banking share. Based upon 15,533,186 common shares outstanding, 128,575 restricted stock units outstanding, 100,650 in-the-money options outstanding with a weighted-average strike price of \$11.57 and using Heritage's closing price of \$15.85 as of October 22, 2013, Sandler calculated aggregate consideration value of \$265 million. Based upon financial information as of or for the twelve month period ended September 30, 2013, Sandler calculated the following transaction ratios:

	Washington Banking/ Heritage
Transaction Value / Book Value Per Share	144%
Transaction Value / Tangible Book Value Per Share	149%
Transaction Value / Last Twelve Months' Earnings Per Share	15.6x
Transaction Value / Mean Estimated 2013 Earnings Per Share	16.9x
Transaction Value / Mean Estimated 2014 Earnings Per Share	16.4x
Tangible Book Premium to Core Deposits	6.8%
Premium to Washington Banking Stock Price (Oct. 22, 2013)	18.1%
Premium to Washington Banking 52 Week High Price	7.7%
Premium to Washington Banking 52 Week Low Price	28.9%
Premium to Washington Banking 30 Day Average Closing Price	18.7%

**Comparable Company Analysis.** Sandler used publicly available information to compare selected financial information for Washington Banking and Heritage and a group of financial institutions as selected by Sandler. The peer group consisted of publicly traded commercial banks headquartered in the Western Region of the United States with total assets as of the most recently reported period between \$1 billion and \$3 billion and nonperforming assets / total assets less than 4%. The group excluded thrifts, merger targets and ethnic-focused banks.

Bank of Marin Bancorp

Cascade Bancorp

CU Bancorp

Heritage Commerce Corp

Heritage Oaks Bancorp

Northrim BanCorp, Inc.

Pacific Continental Corporation

Pacific Premier Bancorp, Inc.

TriCo Bancshares

The analysis compared publicly available financial information for Washington Banking, Heritage and the financial and market trading data for the peer group. The peer group data is as of or for the period ended June 30, 2013, with the exception of Pacific Continental Corporation, Bank of Marin, Washington Banking and Heritage

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whose data is as of or for the period ending September 30, 2013. Pricing data for all companies is as of October 22, 2013. The table below sets forth the data for Washington Banking, Heritage and the mean and median data for the peer group.

	Washington Banking	Heritage	Comparable Group Median	Comparable Group Mean
Total Assets (in millions)	\$ 1,648	\$ 1,674	\$ 1,400	\$ 1,488
Last Twelve Months Return on Average Assets <sup>1</sup>	1.0%	0.8%	1.0%	0.9%
Last Twelve Months Return on Average Tangible Equity <sup>1</sup>	9.4%	6.4%	9.6%	9.0%
Non-Performing Assets / Total Assets	2.4%	2.0%	1.2%	1.8%
Tangible Equity / Tangible Assets <sup>1</sup>	10.7%	11.3%	10.9%	10.9%
Stock Price	\$ 14.28	\$ 15.85		
Market Capitalization (in millions)	\$ 222	\$ 257	\$ 241	\$ 246
Price / Tangible Book Value	126%	139%	153%	153%
Price / Last Twelve Months Earnings Per Share <sup>1</sup>	13.2x	20.6x	16.9x	18.5x
Price / Estimated 2013 Earnings Per Share	14.3x	20.1x	15.7x	17.2x
Price / Estimated 2014 Earnings Per Share	13.9x	15.7x	14.7x	15.3x
Dividend Yield	2.5%	2.0%	1.6%	1.2%
3 Months Total Return	-7.8%	0.3%	1.9%	0.2%
1 Year Total Return	11.1%	19.6%	22.9%	30.6%

Notes:

<sup>1</sup>LTM profitability for Pacific Premier Bancorp, Inc., Pacific Continental Corporation, CU Bancorp and Heritage Oaks Bancorp adjusted for one-time items

**Stock Price Performance.** Sandler reviewed the history of the publicly reported trading prices of Washington Banking and Heritage's common stock for the one-year and three-year periods ended October 22, 2013. Sandler then compared the relationship between the movements in the price of Washington Banking and Heritage's common stock against the movements in the prices of the peer group, S&P 500 Index and NASDAQ Bank Index.

	One-Year Comparative Stock Performance	
	Beginning Index Value	Ending Index Value
	October 19, 2012	October 22, 2013
Washington Banking	100%	107%
Heritage	100%	114%
Peer Group	100%	128%
S&P 500	100%	122%
NASDAQ Bank	100%	131%

Three-Year Comparative Stock Performance		
	Beginning Index Value	Ending Index Value
	October 22, 2010	October 22, 2013
Washington Banking	100%	104%
Heritage	100%	111%
Peer Group	100%	146%
S&P 500	100%	148%
NASDAQ Bank	100%	146%

**Washington Banking Net Present Value Analysis.** Sandler performed an analysis that estimated the net present value per share of Washington Banking common stock under various circumstances. The analysis assumed that Washington Banking performed in accordance with the publicly available analyst estimated earnings for the years ending December 31, 2013 and December 31, 2014 and an estimated long-term growth rate for the years thereafter, in each case as discussed with, and confirmed by, senior management of Washington Banking. To approximate the terminal value of Washington Banking common stock at December 31, 2018,

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Sandler applied price to earnings multiples ranging from 12.0x to 22.0x and multiples of tangible book value ranging from 115% to 190%. The terminal values were then discounted to present values using different discount rates ranging from 9.5% to 15.5% chosen to reflect different assumptions regarding required rates of return of holders or prospective buyers of Washington Banking's common stock.

As illustrated in the following tables, the analysis indicates an imputed range of values per share of Washington Banking common stock of \$9.77 to \$21.19 when applying multiples of earnings to the applicable amounts indicated in the Washington Banking projections and \$9.86 to \$19.52 when applying multiples of tangible book value to the applicable amounts indicated in the Washington Banking projections.

Discount		Earnings Per Share Multiples				
Rate	12.0x	14.0x	16.0x	18.0x	20.0x	22.0x
9.50%	\$ 12.62	\$ 14.34	\$ 16.05	\$ 17.76	\$ 19.47	\$ 21.19
10.50%	\$ 12.08	\$ 13.71	\$ 15.35	\$ 16.98	\$ 18.61	\$ 20.24
11.50%	\$ 11.57	\$ 13.12	\$ 14.68	\$ 16.24	\$ 17.80	\$ 19.35
12.50%	\$ 11.08	\$ 12.57	\$ 14.05	\$ 15.54	\$ 17.02	\$ 18.51
13.50%	\$ 10.62	\$ 12.04	\$ 13.46	\$ 14.87	\$ 16.29	\$ 17.71
14.50%	\$ 10.18	\$ 11.54	\$ 12.89	\$ 14.25	\$ 15.60	\$ 16.95
15.50%	\$ 9.77	\$ 11.06	\$ 12.36	\$ 13.65	\$ 14.94	\$ 16.24

Discount		Tangible Book Value Multiples				
Rate	115%	130%	145%	160%	175%	190%
9.50%	\$ 12.75	\$ 14.10	\$ 15.46	\$ 16.81	\$ 18.17	\$ 19.52
10.50%	\$ 12.20	\$ 13.49	\$ 14.78	\$ 16.07	\$ 17.37	\$ 18.66
11.50%	\$ 11.68	\$ 12.91	\$ 14.14	\$ 15.37	\$ 16.61	\$ 17.84
12.50%	\$ 11.19	\$ 12.36	\$ 13.54	\$ 14.71	\$ 15.89	\$ 17.07
13.50%	\$ 10.72	\$ 11.84	\$ 12.97	\$ 14.09	\$ 15.21	\$ 16.33
14.50%	\$ 10.28	\$ 11.35	\$ 12.42	\$ 13.49	\$ 14.57	\$ 15.64
15.50%	\$ 9.86	\$ 10.88	\$ 11.91	\$ 12.93	\$ 13.96	\$ 14.98

Sandler also considered and discussed with the Washington Banking board of directors how this analysis would be affected by changes in the underlying assumptions, including variations with respect to net income. To illustrate this impact, Sandler performed a similar analysis assuming Washington Banking net income varied from 25% above projections to 25% below projections. This analysis resulted in the following range of per share values for Washington Banking common stock, using the same price to earnings multiples of 12.0x to 22.0x and a discount rate of 12.5% (which represents the midpoint of the range of discount rates used).

Annual		Earnings Per Share Multiples				
Budget						
Variance	12.0x	14.0x	16.0x	18.0x	20.0x	22.0x
-25.0%	\$ 8.85	\$ 9.97	\$ 11.08	\$ 12.19	\$ 13.31	\$ 14.42

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-20.0%	\$ 9.30	\$ 10.49	\$ 11.67	\$ 12.86	\$ 14.05	\$ 15.24
-15.0%	\$ 9.74	\$ 11.01	\$ 12.27	\$ 13.53	\$ 14.79	\$ 16.06
-10.0%	\$ 10.19	\$ 11.53	\$ 12.86	\$ 14.20	\$ 15.54	\$ 16.87
-5.0%	\$ 10.63	\$ 12.05	\$ 13.46	\$ 14.87	\$ 16.28	\$ 17.69
0.0%	\$ 11.08	\$ 12.57	\$ 14.05	\$ 15.54	\$ 17.02	\$ 18.51
5.0%	\$ 11.53	\$ 13.09	\$ 14.65	\$ 16.21	\$ 17.77	\$ 19.33
10.0%	\$ 11.97	\$ 13.61	\$ 15.24	\$ 16.87	\$ 18.51	\$ 20.14
15.0%	\$ 12.42	\$ 14.13	\$ 15.83	\$ 17.54	\$ 19.25	\$ 20.96
20.0%	\$ 12.86	\$ 14.65	\$ 16.43	\$ 18.21	\$ 20.00	\$ 21.78
25.0%	\$ 13.31	\$ 15.17	\$ 17.02	\$ 18.88	\$ 20.74	\$ 22.60

During the Washington Banking board of directors meeting on October 23, 2013, Sandler noted that the terminal value analysis is a widely used valuation methodology, but the results of such methodology are highly dependent upon the numerous assumptions that must be made, and the results thereof are not necessarily indicative of actual values or future results.

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**Heritage Net Present Value Analysis.** Sandler also performed an analysis that estimated the net present value per share of Heritage common stock under various circumstances. The analysis assumed that Heritage performed in accordance with publicly available analyst earnings estimates for the years ending December 31, 2013 and December 31, 2014 and an estimated long-term earnings growth rate for the years thereafter, in each case as discussed with, and confirmed by, senior management of Heritage.

To approximate the terminal value of Heritage common stock at December 31, 2018, Sandler applied price to earnings multiples ranging from 12.0x to 22.0x and multiples of tangible book value ranging from 115% to 190%. The terminal values were then discounted to present values using different discount rates ranging from 9.5% to 15.5% chosen to reflect different assumptions regarding required rates of return of holders or prospective buyers of Heritage's common stock.

As illustrated in the following tables, the analysis indicates an imputed range of values per share of Heritage common stock of \$9.13 to \$20.23 when applying multiples of earnings to the applicable amounts indicated in the Heritage projections and \$9.69 to \$19.62 when applying multiples of tangible book value to the applicable amounts indicated in the Heritage projections.

Discount	Earnings Per Share Multiples					
	12.0x	14.0x	16.0x	18.0x	20.0x	22.0x
9.50%	\$ 11.86	\$ 13.53	\$ 15.20	\$ 16.88	\$ 18.55	\$ 20.23
10.50%	\$ 11.34	\$ 12.93	\$ 14.53	\$ 16.13	\$ 17.72	\$ 19.32
11.50%	\$ 10.85	\$ 12.37	\$ 13.89	\$ 15.41	\$ 16.94	\$ 18.46
12.50%	\$ 10.38	\$ 11.84	\$ 13.29	\$ 14.74	\$ 16.19	\$ 17.65
13.50%	\$ 9.94	\$ 11.33	\$ 12.72	\$ 14.10	\$ 15.49	\$ 16.88
14.50%	\$ 9.53	\$ 10.85	\$ 12.18	\$ 13.50	\$ 14.82	\$ 16.15
15.50%	\$ 9.13	\$ 10.40	\$ 11.66	\$ 12.93	\$ 14.19	\$ 15.46

Discount	Tangible Book Value Multiples					
	115%	130%	145%	160%	175%	190%
9.50%	\$ 12.59	\$ 14.00	\$ 15.40	\$ 16.81	\$ 18.21	\$ 19.62
10.50%	\$ 12.04	\$ 13.38	\$ 14.72	\$ 16.06	\$ 17.40	\$ 18.74
11.50%	\$ 11.52	\$ 12.80	\$ 14.07	\$ 15.35	\$ 16.63	\$ 17.91
12.50%	\$ 11.02	\$ 12.24	\$ 13.46	\$ 14.68	\$ 15.90	\$ 17.12
13.50%	\$ 10.55	\$ 11.72	\$ 12.88	\$ 14.05	\$ 15.21	\$ 16.37
14.50%	\$ 10.11	\$ 11.22	\$ 12.33	\$ 13.45	\$ 14.56	\$ 15.67
15.50%	\$ 9.69	\$ 10.75	\$ 11.81	\$ 12.88	\$ 13.94	\$ 15.00

Sandler also considered and discussed with the Washington Banking board of directors how this analysis would be affected by changes in the underlying assumptions, including variations with respect to net income. To illustrate this impact, Sandler performed a similar analysis assuming Heritage net income varied from 25% above projections to 25% below projections. This analysis resulted in the following range of per share values for Heritage common stock, using the same price to earnings multiples of 12.0x to 22.0x and a discount rate of 12.5% (which represents the midpoint of the range of discount rates used).

## Annual Budget

## Earnings Per Share Multiples

Variance	12.0x	14.0x	16.0x	18.0x	20.0x	22.0x
-25.0%	\$ 8.21	\$ 9.29	\$ 10.38	\$ 11.47	\$ 12.56	\$ 13.65
-20.0%	\$ 8.64	\$ 9.80	\$ 10.97	\$ 12.13	\$ 13.29	\$ 14.45
-15.0%	\$ 9.08	\$ 10.31	\$ 11.55	\$ 12.78	\$ 14.02	\$ 15.25
-10.0%	\$ 9.51	\$ 10.82	\$ 12.13	\$ 13.43	\$ 14.74	\$ 16.05
-5.0%	\$ 9.95	\$ 11.33	\$ 12.71	\$ 14.09	\$ 15.47	\$ 16.85
0.0%	\$ 10.38	\$ 11.84	\$ 13.29	\$ 14.74	\$ 16.19	\$ 17.65
5.0%	\$ 10.82	\$ 12.34	\$ 13.87	\$ 15.39	\$ 16.92	\$ 18.44
10.0%	\$ 11.26	\$ 12.85	\$ 14.45	\$ 16.05	\$ 17.65	\$ 19.24
15.0%	\$ 11.69	\$ 13.36	\$ 15.03	\$ 16.70	\$ 18.37	\$ 20.04
20.0%	\$ 12.13	\$ 13.87	\$ 15.61	\$ 17.36	\$ 19.10	\$ 20.84
25.0%	\$ 12.56	\$ 14.38	\$ 16.19	\$ 18.01	\$ 19.82	\$ 21.64

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At the October 23, 2013 Washington Banking board of directors meeting, Sandler noted that the net present value analysis is a widely used valuation methodology, but the results of such methodology are highly dependent upon the numerous assumptions that must be made, and the results thereof are not necessarily indicative of actual values or future results.

**Analysis of Selected Merger Transactions.** Sandler reviewed two groups of comparable mergers and acquisitions. The first group of mergers and acquisitions included: 12 transactions announced during the last twelve month period as of October 22, 2013 involving nationwide commercial banks with total assets between \$500 million and \$4 billion with nonperforming assets / total assets less than 4% and tangible equity / equity greater than 8%. Group one was composed of the following transactions:

**Buyer/Seller**

Banner Corporation/ Home Federal Bancorp, Inc.  
 East West Bancorp, Inc./ MetroCorp Bancshares, Inc.  
 Old National Bancorp/ Tower Financial Corporation  
 CenterState Banks, Inc./ Gulfstream Bancshares, Inc.  
 Wilshire Bancorp, Inc./ Saehan Bancorp  
 First Fed. Bancshares of AR, Inc./ First National Security Co.  
 F.N.B. Corporation/ BCSB Bancorp, Inc.  
 Union First Market Bankshares Corporation/ StellarOne Corp.  
 Home BancShares, Inc./ Liberty Bancshares, Inc.  
 SCBT Financial Corporation/ First Financial Holdings, Inc.  
 United Bankshares, Inc./ Virginia Commerce Bancorp, Inc.  
 PacWest Bancorp/ First California Financial Group, Inc.

The second group of mergers and acquisitions included: six transactions announced during the last twelve month period as of October 22, 2013 involving nationwide commercial banks with total assets greater than \$500 million and target ownership greater than 40% in the combined company. Group two was composed of the following transactions:

**Buyer/Seller**

Umpqua Holdings Corp./ Sterling Financial Corp.  
 Mercantile Bank Corp./ Firstbank Corp.  
 PacWest Bancorp/ CapitalSource Inc.  
 Union First Market Bankshares Corp./ StellarOne Corp.  
 Peoples Financial Services Corp./ Penseco Financial Services Corp.  
 Provident New York Bancorp/ Sterling Bancorp

Sandler then reviewed the following multiples for each of the transactions: transaction price to book value, transaction price to tangible book value, transaction price to last twelve months earnings per share, transaction price to estimated current year earnings per share, tangible book premium to core deposits and transaction price to seller's stock price one day before transaction announcement. As illustrated in the following table, Sandler compared the proposed merger multiples to the multiples of the comparable transactions.

Group One

Group Two

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	Washington Banking / Heritage	Median	Mean	Median	Mean
Transaction Value / Book Value Per Share	144%	131%	134%	134%	133%
Transaction Value / Tangible Book Value Per Share	149%	153%	153%	163%	159%
Transaction Value / Last Twelve Months Earnings Per Share <sup>1</sup>	15.6x	15.9x	18.4x	17.5x	17.6x
Transaction Value / Estimated 2013 Earnings Per Share	16.9x	17.8x	18.5x	18.8x	17.2x
Tangible Book Premium to Core Deposits	6.8%	6.3%	7.4%	7.8%	12.8%
Premium to Stock Price:	18.1%	17.6%	20.7%	17.0%	16.6%

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<sup>1</sup>LTM EPS for Gulfstream Bancshares, Inc., First Financial Holdings, Inc., Virginia Commerce Bancorp, Inc., First California Financial Group, Inc., Sterling Financial Corp. and CapitalSources, Inc. adjusted for one-time items.

**Relative Contribution.** Sandler performed a contribution analysis comparing the September 30, 2013 financial information of Heritage and Washington Banking and each company's relative financial contribution to the pro forma entity, prior to any purchase accounting or other transaction related adjustments. Heritage will own 54% and Washington Banking will own 46% of the pro forma entity. The results of Sandler's analysis are set forth in the following table:

<i>(Dollars in thousands)</i>	Washington Banking		Pro Forma	Heritage	
Total Net Loans	\$ 1,208,082	54.4%	\$ 2,220,166	45.6%	\$ 1,012,084
Total Net Portfolio Loans (ex FDIC covered)	\$ 1,144,598	57.2%	\$ 2,000,292	42.8%	\$ 855,694
Assets	\$ 1,674,417	50.4%	\$ 3,322,571	49.6%	\$ 1,648,154
Core Deposits (excluding CDs)	\$ 1,105,867	51.3%	\$ 2,154,129	48.7%	\$ 1,048,262
Noninterest Bearing Deposits	\$ 361,743	57.3%	\$ 630,954	42.7%	\$ 269,211
Tangible Common Equity	\$ 185,458	51.3%	\$ 361,558	48.7%	\$ 176,100
Mean Analyst Est. 2014 Net Income	\$ 16,419	50.7%	\$ 32,366	49.3%	\$ 15,947
Market Cap (10/22/13)	\$ 256,942	53.7%	\$ 478,742	46.3%	\$ 221,800
		57.3%	High	49.6%	
		50.4%	Low	42.7%	
		53.3%	Mean	46.7%	
		52.5%	Median	47.5%	

**Pro Forma Results and Capital Ratios.** Sandler analyzed certain potential pro forma effects of the merger, assuming the following: (i) the merger closes March 31, 2014; (ii) per share merger consideration value of \$16.86, based on Heritage's closing stock price on October 22, 2013 of \$15.85; (iii) Heritage would be able to achieve cost savings of approximately 20% of Washington Banking projected operating expense and such savings would be 50% realized in 2014 and fully realized in 2015; (iv) pretax transaction costs and expenses would total approximately \$14.9 million, with 50% of the expenses phased-in at closing and the remaining 50% recognized post-closing; (v) a core deposit intangible of approximately \$14.5 million (10 year, sum-of-years-digits amortization method); (vi) Washington Banking's performance was calculated in accordance with publicly available analyst estimated earnings per share for the years ending December 31, 2013 and December 31, 2014, and an estimated long-term growth rate for the years thereafter; (vii) Heritage's performance was calculated in accordance with publicly available analyst earnings estimates for the years ending December 31, 2013 and December 31, 2014 and an estimated long-term growth rate for the years thereafter; and (viii) various purchase accounting adjustments, including credit and interest rate mark-to-market adjustments and other accounting adjustments on Washington Banking's loan portfolio, other real estate owned, borrowings and other liabilities. The analyses indicated that for the year ending December 31, 2014, the merger (excluding transaction expenses) would be accretive to Heritage's projected earnings per share and, as of March 31, 2014 the merger would be dilutive to Heritage's tangible book value per share. The actual results achieved by the combined company, however, may vary from projected results and the variations may be material.

**Sandler's Relationship.** Sandler acted as the financial advisor to Washington Banking's board of directors in connection with the merger. Pursuant to the terms of the letter agreement with Sandler, Washington Banking has agreed to pay Sandler a cash fee equal to 1.20% of the aggregate consideration payable in the merger (which shall be

calculated in part based on the average last sales prices of Heritage's common stock on the five trading days ending five calendar days prior to the effective date of the merger; and which fee would be approximately \$3.4 million if the merger had closed on the date of this joint proxy statement/prospectus), payable at, and contingent upon, the closing of the merger. Washington Banking paid \$250,000 to Sandler, which will be credited towards any fee payable at the closing the merger, in connection with Sandler's opinion. Washington

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Banking may request an update to Sandler's opinion at no additional cost. Washington Banking has also agreed to reimburse Sandler for reasonable out-of-pocket expenses incurred in connection with its engagement and to indemnify Sandler and its affiliates and their respective partners, directors, officers, employee and agents against certain expenses and liabilities, including liabilities under the securities laws.

Sandler has, in the past, provided certain investment banking services to Washington Banking and its affiliates, has had a material relationship with Washington Banking and its affiliates and has received compensation and reimbursement of out-of-pocket expenses for such services. During the two years preceding the date of the Sandler opinion, Sandler did not receive any fees from Washington Banking. Sandler may provide investment banking services to the combined company in the future and may receive future compensation. In the two years prior to the execution of the merger agreement, Sandler has not provided investment banking services to, or received fees for such services from, Heritage.

In the ordinary course of its respective broker and dealer businesses, Sandler may purchase securities from and sell securities to Washington Banking and Heritage and their respective affiliates. Sandler may also actively trade the debt and/or equity securities of Washington Banking or Heritage or their respective affiliates for their own accounts and for the accounts of their customers and, accordingly may at any time hold a long or short position in such securities.

## **Combined Company Board of Directors Following Completion of the Merger**

In accordance with the merger agreement, upon completion of the merger, the number of directors constituting the board of directors of the combined company will be increased by four to 15 members, and it is seven current Washington Banking directors, including Anthony B. Pickering, who will serve as chairman of the board of the combined company upon completion of the merger, and Rhoda L. Altom, Mark D. Crawford, Deborah J. Gavin, Jay T. Lien, Gragg E. Miller and Robert T. Severns who are expected to be appointed to the board of directors of the combined company. Eight current Heritage directors, including Mr. Brian S. Charneski, the current Vice Chairman of Heritage, who will serve as vice-chairman of the board of the combined company upon completion of the merger, and Brian L. Vance, David H. Brown, Gary B. Christensen, John A. Clees, Kimberly T. Ellwanger, Jeffrey S. Lyon and Ann Watson will continue to serve on the board of directors of the combined company upon completion of the merger.

## **Amendment to Heritage's Bylaws**

At or prior to the closing of the merger, the Bylaws of Heritage will be amended, which we refer to as the bylaw amendment, to provide for the addition of new provisions to the Bylaws addressing certain governance matters in connection with the merger. The bylaw amendment will apply for two years after the completion of the merger and has the following terms:

the combined company's board of directors will be comprised of eight members from Heritage and seven from Washington Banking;

procedures for the appointment of replacement directors by the continuing directors of each company;

reduction in the size of the board in a manner that the proportion of directors from each company remains approximately the same;

Anthony B. Pickering of Washington Banking will serve as chairman of the board of directors and Brian S. Charneski of Heritage will serve as the vice chairman of the board of directors; and

during the two year period these bylaw provisions are in effect they may only be amended by a vote of two thirds of the directors and a majority of the continuing directors from Heritage and the continuing directors from Washington Banking, respectively.

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**Interests of Washington Banking's Directors and Executive Officers in the Merger**

Washington Banking shareholders should be aware that some of Washington Banking's directors and executive officers have interests in the merger and have arrangements that are different from, or in addition to, those of Washington Banking shareholders generally. Washington Banking's board of directors was aware of these interests and considered these interests, among other matters, when making its decision to approve the merger agreement, and in recommending that Washington Banking shareholders vote in favor of adopting the merger agreement.

These interests include the following:

The six executive officers of Washington Banking may be eligible for severance benefits under existing agreements with, and benefit plans offered by, Washington Banking in an aggregate maximum possible amount of \$2.74 million. The six executive officers of Washington Banking include Mr. John L. Wagner, Mr. Richard A. Shields, Mr. Bryan McDonald, Mr. George W. Bowen, Mr. Edward Eng and Mr. Daniel Kuenzi who will each receive severance benefits of \$137,189, \$544,690, \$577,189, \$475,383, \$468,619 and \$534,150, respectively.

Accelerated vesting of all of the unvested restricted stock unit awards held by Washington Banking directors and executive officers, representing a total of 65,766 shares of common stock.

Bryan McDonald, President and Chief Executive Officer of Whidbey Island Bank, will become Executive Vice President and Chief Lending Officer of Heritage Bank following the bank merger and has entered into an employment agreement with Heritage Bank, to become effective at the effective time of the merger. His employment agreement with Heritage Bank provides for no increase in base salary and, among other benefits, a one-time restricted stock grant with a grant date fair value of \$50,000 and a special bonus of \$250,000 to be paid in equal installments over 24 months commencing following the effective time of the merger (which payments cease upon termination of Mr. McDonald's employment for any reason).

Edward Eng, Executive Vice President and Chief Administrative Officer of Whidbey Island Bank, will become Executive Vice President and Chief Administrative Officer of Heritage Bank following the bank merger and has entered into an employment agreement with Heritage Bank, to become effective at the effective time of the merger. His employment agreement with Heritage bank provides for no increase in base salary and, among other benefits, a one-time restricted stock grant with a grant date fair value of \$75,000 payable as of the 14-month anniversary of the effective time of the merger, provided he has been continuously employed with Heritage.

John L. Wagner, President and Chief Executive Officer of Washington Banking, will serve as a special advisor to Heritage following the merger and has entered into a consulting agreement with Heritage, to become effective at the effective time of the merger.

Seven current Washington Banking directors, including Anthony B. Pickering, who will serve as chairman of the board of the combined company upon completion of the merger, and Rhoda L. Altom, Mark D. Crawford, Deborah J. Gavin, Jay T. Lien, Gragg E. Miller and Robert T. Severns will be appointed to the board of directors of the combined company.

*Equity Interests of Directors and Executive Officers*

*Stock Options.* Each Washington Banking stock option issued under the Washington Banking 1998 Stock Option and Restricted Stock Award Plan and the Washington Banking 2005 Stock Incentive Plan (together, the Washington Banking Stock Plans ) that is outstanding immediately prior to the merger will automatically be converted into an option to purchase the number of whole shares of Heritage common stock that is equal to the number of shares of Washington Banking common stock subject to such Washington Banking stock option immediately prior to the merger multiplied by a fraction having a numerator equal to the sum of (i) \$2.75 plus

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(ii) the product of 0.89000 multiplied by the average of the Heritage common stock price and a denominator equal to the average Heritage common stock price (we refer to this fraction as the option exchange ratio), rounded down to the nearest whole share, at an exercise price per share of Heritage common stock (rounded up to the nearest penny) equal to the exercise price for each option immediately prior to the merger divided by the option exchange ratio. Each outstanding stock option held by Washington Banking directors and executive officers is fully vested.

*Restricted Stock Unit Awards.* Each Washington Banking restricted stock unit award granted under the Washington Banking Stock Plans that is outstanding and subject to vesting, repurchase or other lapse restriction immediately prior to the merger will fully vest upon the effective time of the merger and will be converted automatically into a restricted stock unit award in respect of the number of shares of Heritage common stock, rounded to the nearest whole share, equal to the product of the number of shares of Washington Banking common stock subject to the Washington Banking restricted stock unit award and the option exchange ratio, with such converted restricted stock unit award to continue to be subject to the same terms and conditions as were applicable to the restricted stock unit award under the Washington Banking Stock Plan and the applicable award agreement thereunder.

The following table sets forth the number of Washington Banking stock options and restricted stock units held by each director and executive officer of Washington Banking as of February 28, 2014. The following table assumes that Washington Banking's directors and executive officers will not sell, acquire or forfeit any shares of Washington Banking common stock or equity awards following such date. As described below, directors and executive officers of Washington Banking may be eligible to receive new equity awards prior to the effective time of the merger.

Name	Stock Options(1)	Restricted Stock Units(1)
John L. Wagner	15,123(2)	12,417(7)
Richard A. Shields	17,623(3)	6,500(8)
Bryan McDonald	6,194(4)	8,000(9)
George W. Bowen	0	6,000(10)
Edward Eng	0	5,766(11)
Daniel E. Kuenzi	3,717(5)	4,000(12)
Rhoda L. Altom	0	1,250(13)
Mark D. Crawford	0	3,583(14)
Deborah J. Gavin	0	1,250(13)
Jay T. Lien	2,925(6)	4,250(15)
Gragg E. Miller	0	4,250(15)
Anthony B. Pickering	2,925(6)	4,250(15)
Robert T. Severns	0	4,250(15)

- (1) All stock options are fully vested and all restricted stock units (RSUs) vest upon completion of the merger.
- (2) Option exercise prices equal \$14.60 (496 shares), \$15.98 (2,627 shares) and \$9.11 (12,000 shares).
- (3) Option exercise prices equal \$14.60 (496 shares), \$15.98 (2,627 shares) and \$9.11 (14,500 shares).
- (4) Option exercise prices equal \$15.98 (1,194 shares) and \$9.11 (5,000 shares).
- (5) Option exercise prices equal \$15.77 (1,000 shares), \$15.98 (717 shares) and \$9.11 (2,000 shares).
- (6) Option exercise prices equal \$14.60 (1,162 shares) and \$15.98 (1,763 shares).
- (7)

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- 1,667 RSUs scheduled to vest on 6/23/14; 2,000 RSUs scheduled to vest on 2/23/15; 3,750 RSUs scheduled to vest on 1/21/15; 2,500 RSUs scheduled to vest on 1/24/15; and 2,500 RSUs scheduled to vest on 1/24/16.
- (8) 834 RSUs scheduled to vest on 6/23/14; 1,000 RSUs scheduled to vest on 2/23/15; 2,000 RSUs scheduled to vest on 1/21/15; 1,333 RSUs scheduled to vest on 1/24/15; and 1,333 RSUs scheduled to vest on 1/24/16.
- (9) 834 RSUs scheduled to vest on 6/23/14; 1,333 RSUs scheduled to vest on 2/23/15; 2,500 RSUs scheduled to vest on 1/21/15; 1,666 RSUs scheduled to vest on 1/24/15; and 1,667 RSUs scheduled to vest on 1/24/16.

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- (10) 334 RSUs scheduled to vest on 6/23/14; 1,000 RSUs scheduled to vest on 2/23/15; 2,000 RSUs scheduled to vest on 1/21/15; 1,333 RSUs scheduled to vest on 1/24/15; and 1,333 RSUs scheduled to vest on 1/24/16.
- (11) 100 RSUs scheduled to vest on 6/23/14; 1,000 RSUs scheduled to vest on 2/23/15; 2,000 RSUs scheduled to vest on 1/21/15; 1,333 RSUs scheduled to vest on 1/24/15; and 1,333 RSUs scheduled to vest on 1/24/16.
- (12) 334 RSUs scheduled to vest on 6/23/14; 1,000 RSUs scheduled to vest on 2/23/15; 1,333 RSUs scheduled to vest on 1/24/15; and 1,333 RSUs scheduled to vest on 1/24/16.
- (13) 1,250 RSUs scheduled to vest on 1/21/15.
- (14) 666 RSUs scheduled to vest on 2/23/15; 1,250 RSUs scheduled to vest on 1/21/15; 833 RSUs scheduled to vest on 1/24/15; and 833 RSUs scheduled to vest on 1/24/16.
- (15) 667 RSUs scheduled to vest on 6/23/14; 667 RSUs scheduled to vest on 2/23/15; 1,250 RSUs scheduled to vest on 1/21/15; 833 RSUs scheduled to vest on 1/24/15; and 833 RSUs scheduled to vest on 1/24/16.

*New Consulting and Employment Agreements*

In connection with the execution of the merger agreement, Heritage entered into a consulting agreement with Mr. Wagner and employment agreements with Messrs. Eng and McDonald, executive officers of Washington Banking. As described below, these agreements set forth the terms and conditions of each such individual's employment or consulting relationship with Heritage following the effective time of the merger and will be effective upon and subject to the completion of the merger. When effective, the employment agreements will also supersede and replace any prior employment, retention, pre-existing change of control or other similar agreement with Messrs. Eng and McDonald, including their Washington Banking employment agreements. Mr. Wagner's consulting agreement sets forth the terms and conditions of his consulting relationship with Heritage commencing at the effective time of the merger.

*Consulting Agreement with Mr. Wagner.* Mr. Wagner's consulting agreement, which expires as of the third anniversary of the effective date of the merger, provides that he will assist in the maintenance and retention of important customer and employee relationships with Washington Banking and Heritage and assist in advising on Heritage's merger and acquisition activities following the effective time of the merger. Under the consulting agreement, Mr. Wagner will receive a fee of \$500,000, payable in three installments in the amount of \$250,000 immediately following the effective time of the merger, \$150,000 as of the first anniversary of the effective time of the merger and \$100,000 as of the second anniversary of the effective time of merger, in each case provided that Mr. Wagner has not violated confidentiality, non-competition and non-solicitation covenants in the consulting agreement.

If Mr. Wagner terminates the consulting agreement, Heritage has no further obligation to make payments. If Heritage terminates the consulting agreement or Mr. Wagner dies during the term of the consulting agreement, Heritage must pay the balance of the consulting fees that would have been paid through the end of the term of the consulting agreement.

*Employment Agreements with Other Executive Officers.* The employment agreements with Messrs. Eng and McDonald have initial terms from effective time of the merger through June 30, 2016. The terms of the employment agreements will be automatically extended for an additional year beginning on July 1, 2015, and on each July 1 thereafter, unless either party gives at least 90 days prior notice of non-renewal. Mr. Eng will serve as Heritage Bank's Executive Vice President and Chief Administrative Officer and Mr. McDonald will serve as Heritage Bank's Executive Vice President and Chief Lending Officer.

The employment agreements provide for annual base salaries of \$250,000 for Mr. McDonald and \$202,000 for Mr. Eng. The base salaries will be reviewed annually and may be increased at the discretion of the board of directors of Heritage Bank. The agreements provide that the executives will be eligible to receive performance-based annual incentive bonuses, in accordance with Heritage Bank's annual incentive plan with initial target bonuses of 30% of

annual base salary, and also to receive employee benefits on as favorable a basis as other similarly situated and performing senior executives of Heritage Bank, provided that each executive will have an

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initial target equity compensation plan award of 25% of annual base salary. Mr. McDonald will also be entitled to a special bonus of \$250,000 to be paid in equal installments over 24 months commencing following the effective time of the merger (which payments cease upon termination of Mr. McDonald's employment for any reason), the use of an automobile provided by Heritage Bank and a one-time restricted stock grant with a grant date fair value of \$50,000, subject to Heritage's standard award agreement and terms. Mr. Eng will be entitled to receive, as of the 14-month anniversary of the effective time of the merger, provided he has been continuously employed by Heritage Bank through such date, a one-time grant of restricted stock with a grant date fair value of \$75,000, subject to Heritage's standard award agreement and terms, with vesting over two years. Messrs. Eng and McDonald will be entitled to reimbursement for up to \$50,000 and \$75,000, respectively, of relocation expenses incurred associated with relocating to the Olympia, Washington area and, for Mr. McDonald, such amounts will be grossed-up for Federal, Washington State and employment taxes via a single iteration calculation. Mr. McDonald will also be provided a housing allowance of \$2,000 per month following executive's leasing of an apartment in Olympia, Washington, for a maximum of two years from the effective date of the merger.

The employment agreements provide for severance benefits in the event the executive's employment is terminated by Heritage Bank (other than for cause or as a result of the executive's death or disability) or if the employment is terminated by the executive for good reason (referred to as a Termination). For a Termination during the first 12 months of the term of the employment agreement, or during the six months before or within 24 months after a change in control of Heritage (such period referred to as the Covered Period), Messrs. Eng and McDonald would be entitled to receive a lump sum payment equal to 200% of the sum of: (i) his then-current annual base salary or, if greater, his annual base salary one day prior to the applicable change in control, plus (ii) the average of his annual performance-based bonuses for the immediately preceding three completed fiscal year performance periods (or, if the Termination occurs during the 12-month period beginning on the effective date of the merger, the highest bonus paid by Washington Banking for 2011, 2012 or 2013 will be used) (collectively referred to as Base Compensation). Mr. Eng would also be entitled to receive such amount for a voluntary resignation during the 30-day period beginning on the 13-month anniversary of the effective time of the merger. Except as noted in the previous sentence, for a Termination that occurs other than during a Covered Period and other than during the 12-month period beginning at the effective time of the merger, Messrs. Eng and McDonald would be entitled to receive a payment equal to 100% of Base Compensation, paid in 24 monthly installments. The executives and their eligible dependents would also be entitled to continued coverage under the medical and dental plans of Heritage (12 months' coverage for Termination that does not occur during a Covered Period and 18 months' coverage for Termination during a Covered Period). The employment agreements also provide that any equity awards granted to the executive and subject to vesting, performance or target requirements will be treated as having satisfied the applicable requirements in the case of any Termination other than a Termination during the 12-month period beginning at the effective time of the merger.

All severance benefits under the employment agreements for Messrs. Eng and McDonald are contingent upon the executive's execution and non-revocation of a general release and waiver of claims. The agreements are subject to certain banking regulatory provisions and include a clawback provision should any severance payment require recapture under any applicable statute, law, regulation or regulatory interpretation or guidance. Further, the agreements provide for an automatic reduction of severance payments if the reduction would result in a better net-after-tax result for the respective executive after taking into account the impact of the golden parachute payment restrictions of Section 280G of the Internal Revenue Code.

The employment agreements for the executives contain restrictive covenants prohibiting the unauthorized disclosure of confidential information of Heritage by the executives during and after their employment, prohibiting Mr. McDonald from competing with Heritage and prohibiting the executives from soliciting Heritage's employees or customers during employment and, in certain circumstances, after termination of employment. The non-solicitation provisions, and for Mr. McDonald the non-competition provisions, apply for a period of 18 months following any

termination not during a Covered Period or within the 12 months of the effective date of the merger, and apply for a period of 12 months following any termination that occurs during a

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Covered Period or within 12 months of the effective date of the merger. For Mr. McDonald, in the event of delivery of a notice of non-renewal of his employment agreement by Heritage Bank, the restricted period, in all cases, ends as of the expiration of the employment agreement pursuant to such non-renewal notice; and in the event of delivery of a notice of non-renewal of the employment agreement by Mr. McDonald, if delivered to Heritage Bank after the second anniversary of the effective date of the merger and he continues to be employed through the expiration of the employment agreement pursuant to such notice, the restricted period, in all cases, ends as of the expiration of the employment agreement.

### *Washington Banking Employment Agreements*

Washington Banking is party to employment agreements with Messrs. Bowen, Eng, Kuenzi, McDonald, Shields and Wagner, the terms of which are substantially the same, except as described below. The employment agreements with Messrs. Eng and McDonald will be superseded at the effective time of the merger by their Heritage employment agreements described immediately above.

Mr. Wagner's employment agreement provides that, following termination of his employment by Washington Banking without cause or by Mr. Wagner for good reason, he is entitled to employer-paid health and dental insurance benefits for a maximum period of 18 months or, if earlier, until such time that he becomes eligible for comparable group insurance coverage in connection with new employment. Mr. Wagner is subject to a provision prohibiting him from soliciting the customers or employees of Washington Banking for a period of 18 months following his employment termination.

Messrs. Bowen, Kuenzi and Shields are eligible for certain payments and benefits under their respective employment agreements if the executive officer's employment is terminated without cause or the executive officer terminates employment for good reason. The termination benefits under the employment agreements are calculated based on an amount equal to two times the executive officer's highest annual base salary over the prior three years, plus an amount equal to two times the greater of the annual bonus last paid to the executive under the employment or two times the average bonus paid over the prior three years. Payment of the benefits commences on the 60th day following the executive officer's termination of employment, provided that the executive officer has executed a release of claims, and continues with regular equal payments on the employer's payroll schedule until two years after termination of employment. In addition, the employment agreements provide that, following termination of employment by Washington Banking without cause or by the executive for good reason, the executive officer is entitled to health and dental insurance benefits until such time that the executive officer becomes eligible for comparable group insurance coverage in connection with new employment for a maximum period of 18 months except that, with respect to Mr. Bowen, such benefits are not payable for a termination of employment within two years following a change in control. The employment agreements contain a covenant not to compete with Washington Banking's business for a period of 18 months (or 12 months in the event of a termination within 12 months following a change in control, which the merger constitutes for purposes of the agreements) following employment termination, and not to solicit Washington Banking's employees or customers for a period of 18 months following employment termination. Each of the agreements provides for reduction of the executive officer's payments and benefits to the maximum amount that does not trigger the Internal Revenue Code Section 280G excise tax unless the executive would be better off (on an after-tax basis) receiving all payments and benefits due and paying all excise and income taxes.

### *Washington Banking Retirement Agreements for Mr. Wagner*

Washington Banking and Whidbey Island Bank are each party to a Salary Continuation Agreement with Mr. Wagner dated December 10, 2010 (we refer to these collectively as the SCAs and individually as the Bank SCA and the Washington Banking SCA). The SCAs provide for a fixed schedule of retirement benefits to be paid to Mr. Wagner.

Benefits under the Bank SCA commenced on August 24, 2012, when Mr. Wagner reached age 69. Benefits under the Washington Banking SCA commence upon his retirement on or after August 24, 2015, when Mr. Wagner reaches age 72. The Bank SCA normal retirement benefit is an initial lump

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sum payment of \$100,000 plus \$50,000 per year for five years from age 69, and the Washington Banking SCA normal retirement benefit provides an additional \$25,000 per year for five years from age 72. If Mr. Wagner terminates employment prior to age 72 and prior to a change in control, the Washington Banking SCA generally provides for a lump sum payment of the vested, GAAP-accrued amount under the Washington Banking SCA, in addition to the normal retirement payments under the Bank SCA. For a termination following a change in control (which the merger constitutes for purposes of the SCAs), the Washington Banking SCA provides for a lump sum payment of \$125,000 and the Bank SCP provides for a lump sum payment of the vested, GAAP-accrued amount. If Mr. Wagner dies while receiving payments, his estate will receive the remainder of the scheduled payments under both the Bank SCA and the Washington Banking SCA.

**Merger-Related Compensation for Washington Banking s Named Executive Officers**

This section sets forth the information required by Item 402(t) of Regulation S-K regarding the compensation that will or may become payable to Washington Banking s named executive officers (as defined under SEC rules) that is based on or otherwise relates to the merger. Washington Banking shareholders are being asked to approve, on a non-binding, advisory basis, such compensation for these executive officers (see Washington Banking Proposals Washington Banking Compensation Proposal on page 44). Because the vote to approve such compensation is advisory only, it will not be binding on either Heritage or Washington Banking. Accordingly, if the merger is completed, the compensation will be paid (or payable) regardless of the outcome of the vote to approve such compensation, subject only to the conditions applicable thereto, which are described below. Except as noted in the footnotes to the table, the amounts indicated below are estimates of amounts that would be payable if the merger were consummated on March 31, 2014 and assuming that the employment of the named executive officers were terminated immediately thereafter on a basis entitling them to severance payments. Some of these assumptions are based on information not currently available and, as a result, the actual amounts, if any, to be received by the named executive officers may differ in material respects from the amounts set forth below. See the footnotes to the table for additional information.

Name	Cash(1)	Equity(2)	Pension/ NQDC(3)	Perquisites / benefits(4)	Tax reimbursement(5)	Other(6)	Total
John Wagner	\$ 500,000	\$ 148,223	\$ 33,347				\$ 681,570
Richard Shields		\$ 76,959					\$ 76,959
Bryan McDonald		\$ 144,061		\$ 131,125	\$ 22,500	\$ 250,000	\$ 547,686
George Bowen		\$ 68,408					\$ 68,408
Daniel Kuenzi		\$ 68,408					\$ 68,408

- (1) As further described under The Merger Interests of Washington Banking s Directors and Executive Officers in the Merger New Consulting and Employment Agreements on page 81, in the event Mr. Wagner s consulting agreement is terminated by Heritage during the term of the agreement, he would be entitled to receive the unpaid amounts due under the Consulting Agreement in a lump sum payment equal to a maximum of \$500,000, and in the event Mr. McDonald is terminated without cause or resigns for good reason following the merger and during the term of his employment agreement with Heritage, subject to the execution of a release of claims and compliance with certain restrictive covenants, he would be entitled to severance benefits up to 200% of the sum of: (i) his then-current annual base salary or, if greater, his annual base salary one day prior to the effective time of the merger, plus (ii) the highest bonus paid by Washington Banking for 2011, 2012 or 2013. However, the amount reflected in this column for Mr. McDonald does not reflect any payments he would have been owed under his current employment agreement with Washington Banking as a result of a similar termination of

employment irrespective of the occurrence of the merger, because these payments are not considered based on or otherwise related to the merger. As further described under "The Merger Interests of Washington Banking's Directors and Executive Officers in the Merger Washington Banking Employment Agreements" on page 83, if Messrs. Bowen, Kuenzi or Shields, is involuntarily terminated by Heritage without cause or resigns for good reason within 24 months following the merger, subject to the execution of a release of claims and compliance with certain restrictive covenants, he would receive an amount equal to two times his

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- highest annual base salary over the prior three years, plus an amount equal to the greater of two times the most recent annual bonus or two times the average bonus paid over the prior three years. This payment would be made in equal monthly installments commencing on the 60th day following termination of employment and continuing until two years after termination of employment. However, the amounts reflected in this column for Messrs. Bowen, Kuenzi and Shields do not reflect any payments they would have been owed under their current employment agreements as a result of a similar termination of employment irrespective of the occurrence of the merger, because these payments are not considered based on or otherwise related to the merger.
- (2) Pursuant to the terms of Washington Banking's equity plans and award agreements, Washington Banking stock options and restricted stock units fully vest at the effective time of the merger. The value above reflects the value of restricted stock units for which vesting would be accelerated as a result of the merger, based on a price per share of Washington Banking common stock of \$17.10 (the average closing market price of Washington Banking common stock over the first five business days following the first public announcement of the merger). All stock options held by the named executive officers are fully vested. For Mr. McDonald, the amount also reflects the vesting of the \$50,000 grant date fair value restricted stock award granted pursuant to his employment agreement with Heritage, which vesting would occur if Mr. McDonald is terminated without cause or resigns for good reason following the merger and during the term of the employment agreement.
  - (3) Represents the additional benefit payable to Mr. Wagner under his salary continuation agreement with Washington Banking as a result of termination following a change in control as compared to termination prior to age 72.
  - (4) For Mr. McDonald, reflects the following benefits pursuant to the terms of his employment agreement with Heritage (which benefits are not conditioned upon Mr. McDonald's termination of employment): (a) \$75,000 for relocation expenses; (b) \$48,000 for a housing allowance (\$2,000 per month payable for up to two years); (c) \$2,500 in legal fees incurred in connection with the negotiation of the employment agreement; and (d) \$5,625 for the cost of a company-provided automobile (\$2,500 per year) through June 30, 2016 (the end of the initial term of the employment agreement).
  - (5) For Mr. McDonald, reflects a tax gross up for the relocation expenses he is entitled to pursuant to the terms of his employment agreement with Heritage (which gross up is not conditioned upon Mr. McDonald's termination of employment).
  - (6) For Mr. McDonald, reflects a special bonus pursuant to the terms of his employment agreement with Heritage, to be paid in equal installments over 24 months commencing following the effective time of the merger (which payments cease upon termination of Mr. McDonald's employment for any reason).

**Regulatory Approvals**

Under applicable law, the merger must be approved by the Federal Reserve Board, and the bank merger must be approved by the FDIC and the DFI. The U.S. Department of Justice may review the impact of the merger and the bank merger on competition.

We have filed all of the required applications, including requesting a waiver from the Federal Reserve Board of its application requirements that would apply to this merger. We received approval for the bank merger from the FDIC and the DFI, on December 23, 2013 and January 3, 2014, respectively. On January 31, 2014 we received a waiver from the Federal Reserve Board of its application requirements that would apply to this merger. There can be no assurance that the regulatory approvals received will not contain a condition or requirement that results in a failure to satisfy the conditions to closing set forth in the merger agreement. See "The Merger Agreement - Conditions to Complete the Merger" on page 100.

**Accounting Treatment**

In accordance with current accounting guidance, the merger will be accounted for using the acquisition method. The result of this is that the recorded assets and liabilities of Heritage will be carried forward at their

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recorded amounts, the historical operating results will be unchanged for the prior periods being reported on and that the assets and liabilities of Washington Banking will be adjusted to fair value at the date of the merger. In addition, all identified intangibles will be recorded at fair value and included as part of the net assets acquired. To the extent that the purchase price, consisting of cash plus the number of shares of Heritage common stock to be issued to former Washington Banking shareholders, at fair value, exceeds the fair value of the net assets including identifiable intangibles of Washington Banking at the merger date, that amount will be reported as goodwill. In accordance with current accounting guidance, goodwill will not be amortized but will be evaluated for impairment annually. Identified intangibles will be amortized over their estimated lives. Further, the acquisition method of accounting results in the operating results of Washington Banking being included in the operating results of Heritage beginning from the date of completion of the merger.

## **Washington Banking Shareholder Dissenters' Rights**

In connection with the merger, record holders of Washington Banking common stock who comply with the requirements of the Washington Business Corporation Act, as set forth in Chapter 23B.13 of the Revised Code of Washington (which we will refer to as RCW Chapter 23B.13), which is summarized below, will be entitled to dissenters' rights if the merger is completed.

Washington Banking shareholders electing to exercise dissenters' rights must comply with the provisions of RCW Chapter 23B.13 in order to perfect their rights. The following is intended as a brief summary of the material provisions of the Washington statutory procedures required to be followed by a Washington Banking shareholder in order to dissent from the merger and perfect the shareholder's dissenters' rights. We urge you to read carefully the copy of RCW Chapter 23B.13, which is attached as Appendix D to this joint proxy statement/prospectus.

A shareholder who wishes to assert dissenters' rights must (i) deliver to Washington Banking, before the vote is taken by Washington Banking shareholders, notice of the shareholder's intent to demand payment for the shareholder's shares if the merger is effected, and (ii) not vote such shares in favor of the merger. A shareholder wishing to deliver such notice should hand deliver or mail such notice to Washington Banking at the following address before the vote on the merger agreement is taken:

### **Washington Banking Company**

450 SW Bayshore Drive

Oak Harbor, Washington 98277

Attention: Shelly L. Angus

or deliver such notice at the special meeting of shareholders prior to the vote being taken by Washington Banking shareholders.

A shareholder who wishes to exercise dissenters' rights generally must dissent with respect to all the shares the shareholder owns or over which the shareholder has power to direct the vote. However, if a record shareholder is a nominee for more than one beneficial shareholder, some of whom wish to dissent and some of whom do not, then the record holder may dissent with respect to all the shares beneficially owned by any one person by delivering to Washington Banking a notice of the name and address of each person on whose behalf the record shareholder asserts dissenters' rights. A beneficial shareholder may assert dissenters' rights directly by submitting to Washington Banking the record shareholder's written consent to the dissent not later than the time the beneficial shareholder asserts

dissenters' rights and by dissenting with respect to all the shares of which such shareholder is the beneficial shareholder or over which such shareholder has power to direct the vote.

A shareholder who does not deliver a notice of the shareholder's intent to demand payment for the fair value of the shares to Washington Banking prior to the vote being taken by Washington Banking shareholders will lose the right to exercise dissenters' rights. In addition, shares must either not be voted at the special meeting or must be voted against, or must abstain from voting on, the Washington merger proposal. Submitting a properly signed

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proxy card that is received prior to the vote at the special meeting (and is not properly revoked) that does not direct how the shares of Washington Banking common stock represented by proxy are to be voted will, for purposes of dissenters' rights constitute a vote in favor of the merger agreement and, therefore, a waiver of such shareholder's statutory dissenters' rights.

If the merger is effected, Heritage, as the surviving corporation, is required, within ten days after the effective date of the merger, to deliver a written notice to all shareholders who properly perfected their dissenters' rights in accordance with RCW Chapter 23B.13. Such notice must, among other things: (i) state where the payment demand must be sent and where and when certificates for certificated shares must be deposited; (ii) inform holders of uncertificated shares to what extent transfer of the shares will be restricted after the payment demand is received; (iii) supply a form for demanding payment that includes the date of the first announcement to news media or to shareholders of the terms of the proposed merger and requires that the person asserting dissenters' rights certify whether or not the person acquired beneficial ownership of the shares before that date; and (iv) set a date by which Heritage must receive the payment demand, which date must be between 30 and 60 days after notice is delivered.

A shareholder wishing to exercise dissenters' rights must timely file the payment demand and deposit share certificates as required in the notice. Failure to do so will cause such person to lose his or her dissenters' rights.

Within 30 days after the merger occurs or receipt of the payment demand, whichever is later, Heritage is required to pay each dissenter with properly perfected dissenters' rights Heritage's estimate of the fair value of the shareholder's shares, plus accrued interest from the effective date of the merger until the payment date. With respect to a dissenter who did not beneficially own Washington Banking shares prior to the public announcement of the merger, Heritage may elect to withhold payment. After the effective date of the merger, however, Heritage must estimate the fair value of the shares, plus accrued interest from the effective date of the merger until the date of payment, and then send an offer to the dissenting shareholder to whom Heritage withheld payment explaining how it estimated the fair value of the shares, an explanation of how the interest was calculated, and a statement of the dissenter's right to demand payment under RCW Section 23B.13.280. Heritage must pay the estimated fair value to dissenting shareholders that agree to accept the payment of the estimated fair value in full satisfaction of their demand for payment. In all instances in which Heritage is required to pay accrued interest on the fair value of shares, the rate of interest is generally required to be the average rate Heritage currently pays on its principal bank loans or, if none, a rate that is fair and equitable. For purposes of RCW Chapter 23B.13, fair value with respect to dissenters' shares means the value of the shares of Washington Banking common stock immediately before the effective date of the merger, excluding any appreciation or depreciation in anticipation of the merger, unless that exclusion would be inequitable. The procedures for dissenting shareholders are as set forth in **Appendix D**.

In view of the complexity of RCW Chapter 23B.13 and the requirement that shareholders must strictly comply with the provisions of RCW Chapter 23B.13, shareholders of Washington Banking who may wish to dissent from the merger and pursue dissenters' rights should consult their legal advisors.

**The foregoing is a brief summary of RCW Chapter 23B.13 that sets forth the procedures for exercising dissenters' rights. We urge you to read carefully RCW Chapter 23B.13, which is attached as Appendix D to this joint proxy statement/prospectus. Failure to comply with all the procedures set forth in RCW Chapter 23B.13 will result in the loss of a shareholder's dissenters' rights. Consequently, if you desire to exercise your dissenters' rights you are urged to consult a legal advisor before attempting to exercise these rights.**

## **Heritage's Dividend Policy**

The holders of Heritage common stock receive cash dividends if and when declared by the Heritage board of directors out of legally available funds. The timing and amount of cash dividends depends on Heritage s

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earnings, capital requirements, financial condition and other relevant factors. The primary source for dividends paid to Heritage shareholders is dividends paid to Heritage from its bank subsidiary, Heritage Bank, and cash on hand. There are regulatory restrictions on the ability of Heritage Bank to pay dividends. As a bank holding company, Heritage's ability to pay dividends is subject to the guidelines of the Federal Reserve Board regarding capital adequacy and dividends and limitations under Washington law. No assurances can be given that any cash dividends will be paid by Heritage on its common stock or that any such dividends, if paid, will not be reduced or eliminated in future periods. For additional information, see "Comparative Market Prices and Dividends on Common Stock" on page 125.

## **Public Trading Markets**

Heritage's common stock and Washington Banking's common stock are listed on NASDAQ under the symbols HFWA and WBCO, respectively. Upon completion of the merger, Washington Banking common stock will be delisted from NASDAQ and thereafter will be deregistered under the Exchange Act. The shares of Heritage common stock issuable in the merger for shares of Washington Banking common stock will be listed on NASDAQ.

## **Litigation Relating to the Merger**

Washington Banking, its directors and Heritage are named as defendants in two lawsuits pending in the Superior Court for the State of Washington in King County, Washington, which have been consolidated under the caption In Re Washington Banking Company Shareholder Litigation, Lead Case No. 13-2-38689-5 SEA. The consolidated litigation generally alleges that Washington Banking's directors breached their fiduciary duties to Washington Banking and its shareholders by agreeing to the proposed merger at an unfair price and without an adequate sales process, because they have interests in the merger different from shareholders and by agreeing to deal protection provisions in the merger agreement that are alleged to prevent bids by third parties. The consolidated litigation also alleges that the disclosures in connection with the merger are misleading in various respects. Heritage is alleged to have aided and abetted the directors' alleged breaches of their fiduciary duties. The consolidated litigation seeks, among other things, an order enjoining the defendants from consummating the proposed merger, as well as attorneys' and experts' fees and certain other damages.

Washington Banking and its directors believe the claims and allegations lack merit. Heritage believes that the aiding and abetting claim against it also lacks merit. Washington Banking and its directors and Heritage separately filed motions to dismiss the claims against them.

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**THE MERGER AGREEMENT**

*The following describes certain aspects of the merger, including certain material provisions of the merger agreement. We urge you to read the merger agreement carefully and in its entirety, as it is the legal document governing the merger. A copy of the merger agreement is attached to this joint proxy statement/prospectus as **Appendix A**.*

**Structure of the Merger**

Each of Heritage's and Washington Banking's respective boards of directors has approved the merger agreement. The merger agreement provides for the merger of Washington Banking with and into Heritage, with Heritage continuing as the surviving corporation. Immediately following the completion of the merger, Washington Banking's wholly owned subsidiary bank, Whidbey Island Bank, will merge with Heritage's wholly owned subsidiary bank, Heritage Bank.

Prior to the completion of the merger, Washington Banking and Heritage may, by mutual agreement, change the method or structure of effecting the combination of Washington Banking and Heritage, except that no such change may (1) alter or change in any way the type or amount of merger consideration payable to the holders of Washington Banking common stock, (2) adversely affect the tax treatment of Washington Banking's shareholders, (3) adversely affect the tax treatment of Washington Banking or Heritage or (4) materially impede or delay the consummation of the transactions contemplated by the merger agreement in a timely manner.

**Merger Consideration**

*Consideration for Holders of Washington Banking Common Stock*

If the merger is completed, each share of Washington Banking common stock that is issued and outstanding immediately prior to the completion of the merger, excluding shares held by persons who have perfected their dissenters' rights under Washington law (see *The Merger Washington Banking Shareholder Dissenters' Rights* on page 86) and excluding shares of Washington Banking common stock that are owned by Washington Banking or Heritage (other than shares held in a fiduciary or agency capacity for third parties and other than shares held in respect of a debt previously contracted), will be converted into the right to receive, promptly following the completion of the merger: (1) 0.89000 of a share of Heritage common stock and (2) \$2.75 in cash. Heritage will not issue any fractional shares of Heritage common stock in the merger. Washington Banking shareholders who would otherwise be entitled to a fractional share of Heritage common stock upon completion of the merger will instead receive an amount in cash equal to such fractional share interest multiplied by the average of the volume weighted price (rounded to the nearest one ten thousandth) of Heritage common stock on NASDAQ for the ten trading days ending on the trading day immediately prior to the date on which the merger is completed (which we refer to as the *average Heritage common stock price*). We refer to this stock and cash consideration described above as the *merger consideration*.

For example, if you hold 1,001 shares of Washington Banking common stock, then for the stock portion of the merger consideration, you will receive 890 shares of Heritage common stock and a cash payment instead of the 0.89 fractional share of Heritage common stock that you otherwise would have received (1,001 shares  $\times$  0.89000 = 890.89 shares), and for the cash portion of the merger consideration, you will receive a cash payment of \$2,752.75 (1,001  $\times$  \$2.75).

**Treatment of Washington Banking Stock Options and Restricted Stock Unit Awards**

*Stock Options.* Each Washington Banking stock option issued under the Washington Banking 1998 Stock Option and Restricted Stock Award Plan and the Washington Banking 2005 Stock Incentive Plan (together, the *Washington*

Banking Stock Plans ) that is outstanding immediately prior to the merger will automatically be

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converted into an option to purchase shares of Heritage common stock. The number of whole shares of Heritage common stock subject to the converted option will be equal to the number of shares of Washington Banking common stock subject to such Washington Banking stock option immediately prior to the merger multiplied by a fraction having a numerator equal to the sum of (i) \$2.75 plus (ii) the product of 0.89000 multiplied by the average Heritage common stock price, and a denominator equal to the average Heritage common stock price (we refer to this fraction as the option exchange ratio), rounded down to the nearest whole share. The converted option will have an exercise price per share of Heritage common stock equal to the exercise price for each option immediately prior to the merger divided by the option exchange ratio, rounded up to the nearest penny. Each option is subject to the terms and conditions of the Washington Banking Stock Plan pursuant to which the option was granted and any associated award agreement. All outstanding options granted by Washington Banking are fully vested.

For example, assume that an individual holds an option to purchase 100 shares of Washington Banking common stock at an exercise price per share of \$10.00 immediately prior to the merger, and with an expiration date of December 31, 2019. Assume further that the average closing price of a share of Heritage common stock over the 10 trading days immediately prior to the merger is \$20.00. The option exchange ratio in this example would be 1.0275  $((\$2.75 + (0.89000 \times \$20.00)) / \$20.00)$ . As a result, the option will be converted into an option to purchase 102 shares of Heritage common stock  $(100 \times 1.0275, \text{rounded down to the nearest whole share})$  with an exercise price per share of \$9.74  $(\$10.00 / 1.0275, \text{rounded up to the nearest penny})$  at the time of the merger, and with an expiration date of December 31, 2019. Section 409A of the Internal Revenue Code generally requires that the number of shares covered by the option be rounded down to the next whole share and the exercise price be rounded up to the next whole penny.

*Restricted Stock Unit Awards.* Each Washington Banking restricted stock unit award granted under the Washington Banking Stock Plans that is outstanding and subject to vesting, repurchase or other lapse restriction immediately prior to the merger will fully vest upon the effective time of the merger and will be converted automatically into a restricted stock unit award in respect of shares of Heritage common stock. The number of shares of Heritage common stock subject to the converted restricted stock unit will be equal to the product of the number of shares of Washington Banking common stock subject to the Washington Banking restricted stock unit award and the option exchange ratio, rounded to the nearest whole share. Such converted restricted stock unit award will continue to be subject to the same terms and conditions as were applicable to the restricted stock unit award under the Washington Banking Stock Plan and the applicable award agreement thereunder.

For example, assume that an individual holds a restricted stock unit award that entitles him to receive 100 shares of Washington Banking common stock upon vesting on December 31, 2014. Assume further that the average closing price of a share of Heritage common stock over the 10 trading days immediately prior to the merger is \$20.00. The option exchange ratio in this example would be 1.0275  $((\$2.75 + (0.89000 \times \$20.00)) / \$20.00)$ . As such, the restricted stock unit award will be converted into the right to receive 103 fully vested shares of Heritage common stock  $(100 \times 1.0275, \text{rounded to the nearest whole share})$  at the time of the merger. Standard rounding conventions are used for conversion of the restricted stock units.

**Closing and Effective Time of the Merger**

The merger will be completed only if all conditions to the merger set forth in the merger agreement are either satisfied or waived. See **Conditions to Complete the Merger** on page 100.

The merger will become effective as set forth in the articles of merger to be filed with the Secretary of State of the State of Washington. The closing of the merger will occur on a date that is no later than fifteen business days after the satisfaction or waiver of the conditions to closing, unless extended by the mutual agreement of the parties. It currently is anticipated that the closing of the merger will occur in the first half of 2014, subject to the receipt of regulatory

approvals and other customary closing conditions. No assurances can be given as to when or if the merger will be completed.

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### **Conversion of Shares; Exchange Procedures**

The conversion of Washington Banking stock into the right to receive the merger consideration will occur automatically at the effective time of the merger. Prior to the effective time of the merger, Heritage will appoint its transfer agent or an unrelated bank or trust company, as is reasonably acceptable to Washington Banking, to act as exchange agent for the exchange of Washington Banking securities for the merger consideration.

#### *Letter of Transmittal*

Within ten days after completion of the merger, the exchange agent will mail to each holder of record of shares of Washington Banking common stock immediately prior to the effective time of the merger: (1) a letter of transmittal and instructions on how to surrender such shares in exchange for the merger consideration the holder is entitled to receive under the merger agreement; and (2) instructions for surrendering each certificate in exchange for the merger consideration, any cash in lieu of a fractional share of Heritage common stock and any dividends or distributions to which such holder is entitled.

If a certificate for Washington Banking common stock has been lost, stolen or destroyed, the exchange agent will issue the merger consideration upon receipt of (1) an affidavit of that fact by the claimant and (2) if required by Heritage, the posting of a bond in an amount as Heritage may determine is reasonably necessary as indemnity against any claim that may be made against it with respect to such certificate.

After completion of the merger, there will be no further transfers on the stock transfer books of Washington Banking of shares of Washington Banking stock that were issued and outstanding immediately prior to the effective time of the merger.

#### *Withholding*

Heritage or the exchange agent will be entitled to deduct and withhold from any cash consideration payable under the merger agreement to any holder of Washington Banking common stock, from any cash payments made to holders of Washington Banking stock options and restricted stock unit awards, the amounts it is required to deduct and withhold under the Code or any provision of state, local or foreign tax law. If any such amounts are withheld and paid over to the appropriate governmental authority, these amounts will be treated for all purposes of the merger agreement as having been paid to the persons from whom they were withheld.

#### *Dividends and Distributions*

No dividends or other distributions declared with respect to Heritage common stock will be paid to the holder of any unsurrendered shares of Washington Banking common stock until the holder surrenders such shares in accordance with the merger agreement. After the surrender of a share in accordance with the merger agreement, the record holder of the share will be entitled to receive any such dividends or other distributions, with a record date after the effective time of the merger, without any interest, which had previously become payable with respect to the whole shares of Heritage common stock which the Washington Banking common stock have been converted into the right to receive under the merger agreement.

### **Representations and Warranties**

The representations, warranties and covenants described below and included in the merger agreement were made only for purposes of the merger agreement and as of specific dates, are solely for the benefit of Heritage and Washington

Banking, may be subject to limitations, qualifications or exceptions agreed upon by the parties, including those included in confidential disclosures made for the purposes of, among other things, allocating contractual risk between Heritage and Washington Banking rather than establishing matters as facts, and may be subject to standards of materiality that differ from those standards relevant to shareholders. You should not rely on the representations, warranties, covenants or any description thereof as characterizations of the actual state of facts or condition of Heritage, Washington Banking or any of their respective subsidiaries or affiliates. Moreover,

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information concerning the subject matter of the representations, warranties and covenants may change after the date of the merger agreement, which subsequent information may or may not be fully reflected in public disclosures by Heritage or Washington Banking. The representations and warranties and other provisions of the merger agreement should not be read alone, but instead should be read only in conjunction with the information provided elsewhere in this joint proxy statement/prospectus and in the documents incorporated by reference into this joint proxy statement/prospectus. See [Where You Can Find More Information](#) on page 132.

The merger agreement contains customary representations and warranties of each of Heritage and Washington Banking relating to their respective businesses. The representations and warranties in the merger agreement do not survive the effective time of the merger.

The representations and warranties made by each of Washington Banking and Heritage in the merger agreement relate to a number of matters, including the following:

corporate matters, including due organization and qualification and subsidiaries;

capitalization;

authority relative to execution and delivery of the merger agreement and the absence of conflicts with, or violations of, organizational documents or other obligations as a result of the merger or bank merger;

required governmental and other regulatory filings and consents and approvals in connection with the merger and the bank merger;

reports to regulatory authorities;

financial statements, internal controls, books and records, and absence of undisclosed liabilities;

broker's fees payable in connection with the merger;

the absence of certain changes or events;

legal proceedings;

tax matters;

employee benefit matters;

SEC reports;

compliance with applicable laws;

certain contracts;

absence of agreements with regulatory authorities;

derivative instruments and transactions;

environmental matters;

investment securities, commodities and bank owned life insurance;

real property;

intellectual property;

related party transactions;

inapplicability of takeover statutes;

absence of action or circumstance that would prevent the merger or the bank merger from qualifying as a reorganization under Section 368(a) of the Code;

receipt of an opinion from the investment advisor and the absence of any amendment or rescission thereof;

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the accuracy of information supplied for inclusion in this joint proxy statement/prospectus and other documents;

loan matters;

insurance matters; and

payments under the FDIC shared-loss agreements.

Certain representations and warranties of Heritage and Washington Banking are qualified as to materiality or material adverse effect. For purposes of the merger agreement, a material adverse effect, when used in reference to either Heritage, Washington Banking or the combined company, means:

- (1) a material adverse effect on the business, properties, results of operations or financial condition of such party and its subsidiaries taken as a whole (provided that a material adverse effect will not be deemed to include the impact of (A) changes, after the date of the merger agreement, in GAAP or applicable regulatory accounting requirements, (B) changes, after the date of the merger agreement, in laws, rules or regulations of general applicability to companies in the industries in which such party and its subsidiaries operate, or interpretations thereof by courts or governmental entities, (C) changes, after the date of the merger agreement, in global, national or regional political conditions (including the outbreak of war or acts of terrorism) or in economic or market (including equity, credit and debt markets, as well as changes in interest rates) conditions affecting the financial services industry generally, (D) public disclosure of the transactions contemplated by the merger agreement or actions or inactions expressly required by the merger agreement or that are taken with the prior written consent of the other party in contemplation of the transactions contemplated by the merger agreement, or (E) a decline in the trading price of a party's common stock or the failure, in and of itself, to meet earnings projections, but not, in either case, including the underlying causes thereof; except, with respect to subclauses (A), (B), or (C), to the extent that the effects of such change are materially disproportionately adverse to the business, properties, assets, liabilities, results of operations or financial condition of such party and its subsidiaries, taken as a whole, as compared to other companies in the industry in which such party and its subsidiaries operate); or
- (2) a material adverse effect on the ability of such party to timely consummate the transactions contemplated by the merger agreement.

## **Covenants and Agreements**

### *Conduct of Businesses Prior to the Completion of the Merger*

Each of Heritage and Washington Banking has agreed that, prior to the effective time of the merger (or earlier termination of the merger agreement), subject to specified exceptions, it will, and will cause each of its subsidiaries to, (a) conduct its business in the ordinary course in all material respects, (b) use reasonable best efforts to maintain and preserve intact its business organization, employees and advantageous business relationships, and (c) take no action that would reasonably be expected to adversely affect or materially delay the ability of either Heritage, Washington Banking or any of their respective subsidiaries to obtain any necessary approvals of any regulatory agency or

governmental entity required for the transactions contemplated by the merger agreement or to perform its covenants and agreements under the merger agreement or to consummate the transactions contemplated by the merger agreement on a timely basis.

Additionally, prior to the effective time of the merger (or earlier termination of the merger agreement), subject to specified exceptions, Washington Banking and Heritage will not, and will not permit any of their respective subsidiaries to, without the prior written consent of the other party (which consent may not be unreasonably withheld), undertake the following actions:

other than in the ordinary course of business, incur any indebtedness for borrowed money (other than indebtedness of Washington Banking or any of its wholly owned subsidiaries to Washington Banking

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or any of its subsidiaries, on the one hand, or of Heritage or any of its wholly owned subsidiaries to Heritage or any of its subsidiaries, on the other hand), assume, guarantee, endorse or otherwise as an accommodation become responsible for the obligations of any other individual, corporation or other entity;

adjust, split, combine or reclassify any capital stock;

make, declare or pay any dividend, or make any other distribution on, or directly or indirectly redeem, purchase or otherwise acquire, any shares of its capital stock or any securities or obligations convertible (whether currently convertible or convertible only after the passage of time or the occurrence of certain events) into or exchangeable for any shares of its capital stock, except for (A) regular quarterly cash dividends, including both the basic and variable portions under the Washington Banking two-tiered approach to determine the amount of quarterly dividends by Washington Banking at a rate not in excess of the greater of (1) 50% of the net income of Washington Banking for the most recent completed quarter or (2) \$0.07 per share of Washington Banking common stock, (B) regular quarterly cash dividends by Heritage at a rate not in excess of the greater of (1) 50% of the net income of Heritage for the most recent completed quarter or (2) \$0.08 per share of Heritage common stock, (C) dividends paid by any of the subsidiaries of each of Heritage and Washington Banking to Heritage or Washington Banking or any of their wholly owned subsidiaries, respectively, (D) regular distributions on Washington Banking's trust preferred securities, or (E) the acceptance of shares of Washington Banking common stock or Heritage common stock, as the case may be, as payment for the exercise price of stock options or for withholding taxes incurred in connection with the exercise of stock options or the vesting or settlement of equity compensation awards, in each case in accordance with past practice and the terms of the applicable award agreements;

in the case of Washington Banking and its subsidiaries, other than up to 92,400 restricted stock units under the 2005 Washington Banking Stock Incentive Plan, grant any stock options, stock appreciation rights, performance shares, restricted stock units, restricted shares or other equity-based awards, interests or compensation, or grant any individual, corporation or other entity any right to acquire any shares of its capital stock and, in the case of Heritage and its subsidiaries, grant any stock option, stock appreciation right, performance share, restricted stock unit, restricted share or other equity based award, interests or compensation other than pursuant to and in accordance with Heritage stock plans and in the ordinary course of business consistent with past practice, or grant any individual, corporation or other entity any other right to acquire any shares of its capital stock;

issue, sell or otherwise permit to become outstanding any additional shares of capital stock or securities convertible or exchangeable into, or exercisable for, any shares of its capital stock, except pursuant to the exercise of stock options or the settlement of equity compensation awards including, without limitation, restricted stock units, in accordance with their terms;

sell, transfer, mortgage, encumber or otherwise dispose of any of its material properties or assets to any individual, corporation or other entity other than a wholly-owned subsidiary, or cancel, release or assign any indebtedness to any such person or any claims held by any such person, in each case other than in the ordinary course of business consistent with past practice or pursuant to contracts or agreements in force at the date of the merger agreement;

except for transactions in the ordinary course of business consistent with past practice or pursuant to contracts or agreements in force at the date of the merger agreement, make any material investment either by purchase of stock or securities, contributions to capital, property transfers, or purchase of any property or assets of any other individual, corporation or other entity other than a wholly-owned subsidiary of Washington Banking or Heritage, as applicable;

except for transactions in the ordinary course of business, terminate, materially amend, or waive any material provision of, any material contract, or make any change in any instrument or agreement governing the terms of any of its securities, material leases or contracts, other than normal renewals of

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contracts and leases without material adverse changes of terms or enter into any contract that would constitute a material contract, as the case may be, if it were in effect on the date of the merger agreement;

subject to certain exceptions, including as required under applicable law or the terms of any Washington Banking or Heritage benefit plans existing as of the date of the merger agreement (and except for annual renewal of insurance coverage relating to employee benefit or compensation plans, programs, policies or arrangements in the ordinary course of business), (i) enter into, adopt or terminate any employee benefit or compensation plan, program, policy or arrangement for the benefit or welfare of any current or former employee, officer, director or consultant, (ii) amend (whether in writing or through the interpretation of) any employee benefit or compensation plan, program, policy or arrangement for the benefit or welfare of any current or former employee, officer, director or consultant, (iii) materially increase the compensation or benefits payable to any current or former employee, officer, director or consultant (other than in connection with a promotion or change in responsibilities, or any annual salary, wage or benefit increases or an equitable increase to market wages in the ordinary course of business consistent with past practices as to timing and amount), (iv) pay or award, or commit to pay or award, any bonuses or incentive compensation above levels in effect on the date of the merger agreement other than up to an aggregate of \$1.5 million under Washington Banking's annual discretionary bonus plan, (v) accelerate the vesting of any equity-based awards or other compensation, (vi) enter into any new, or amend any existing, employment, severance, change in control, retention, bonus guarantee, or similar agreement or arrangement, (vii) fund any rabbi trust or similar arrangement, (viii) terminate the employment or services of any officer or any employee whose target annual compensation is greater than \$150,000, other than for cause, without providing notice thereof to the other party within 10 days of the date of termination or (ix) hire any officer, employee, independent contractor or consultant who has target annual compensation greater than \$150,000 without providing notice thereof to the other party within 10 days of the hire date;

settle any material claim, suit, action or proceeding, except (i) in the ordinary course of business in an amount and for consideration not in excess of \$250,000 and that would not impose any material restriction on the business of it or its subsidiaries or the combined company, or (ii) in connection with a loan restructuring or workout (excluding in connection with a loan that is a covered asset under an FDIC shared-loss agreement) not in excess of \$500,000 in net loss not inclusive of federal income taxes;

take any action or knowingly fail to take any action where such action or failure to act would reasonably be expected to prevent the merger from qualifying as a reorganization within the meaning of Section 368(a) of the Code;

amend its articles of incorporation, its bylaws, or comparable governing documents of its subsidiaries;

materially restructure or materially change its investment securities or derivatives portfolio or its interest rate exposure, through purchases, sales or otherwise or the manner in which the portfolio is classified or reported or purchase any security rated below investment grade (other than in prior consultation with the other party);

take any action that is intended or expected to result in any of its representations and warranties in the merger agreement being or becoming untrue in any material respect, or in any of the conditions to the merger not being satisfied or in a violation of any provision of the merger agreement, except as may be required by applicable law;

implement or adopt any change in its accounting principles, practices or methods, other than as required by GAAP;

other than in prior consultation with the other party, enter into any new line of business or, other than in the ordinary course of business consistent with past practice, change in any material respect its lending, investment, underwriting, risk and asset liability management and other banking and operating, securitization and servicing policies (including any change in the maximum ratio or similar limits as a percentage of its capital exposure applicable with respect to its loan portfolio or any segment thereof), except as required by applicable law, regulation or policies imposed by any governmental entity;

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other than in the ordinary course of business consistent with past practice, make any material changes in its policies and practices with respect to (i) underwriting, pricing, originating, acquiring, selling, servicing, or buying or selling rights to service loans or (ii) its hedging practices and policies, in each case except as required by law or requested by a regulatory agency;

make any new loans to new borrowers in excess of \$7.5 million, (except for (i) loan renewals and (ii) loans or commitments for loans that have been made prior to the date of the merger agreement) without providing notice to the other party within ten days following the closing of such loan;

make application for the opening, relocation or closing of any, or open, relocate or close any, branch office, loan production office or other significant office or operations facility of it or its subsidiaries; or

agree to take, make any commitment to take, or adopt any resolutions of its board of directors or similar governing body in support of, any of the foregoing.

*Regulatory Matters*

Heritage and Washington Banking have agreed to promptly prepare and file all necessary documentation no later than forty-five days after the date of the merger agreement, to effect all applications, notices, petitions and filings, to obtain as promptly as practicable all permits, consents, approvals and authorizations of all governmental entities which are necessary or advisable to consummate the transactions contemplated by the merger agreement. However, in no event will Heritage or Washington Banking be required to take any action, or commit to take any action, or agree to any condition or restriction, in connection with obtaining the required permits, consents, approvals and authorizations of governmental entities that would reasonably be expected to have a material adverse effect on or impose a materially adverse, non-standard condition (a materially burdensome regulatory condition ) on Heritage (as the surviving corporation of the merger) and its subsidiaries, taken as a whole, after giving effect to the merger. Heritage and Washington Banking have also agreed to furnish each other with all information reasonably necessary or advisable in connection with any statement, filing, notice or application to any governmental entity in connection with the merger, as well as to keep each other apprised of the status of matters related to the completion of the transactions contemplated by the merger agreement or any materially burdensome regulatory condition.

*Employee Benefit Plan Matters*

Following the effective time of the merger, Heritage shall maintain or cause to be maintained employee benefit plans and compensation opportunities for the benefit of employees (as a group) who are employees of Washington Banking and its subsidiaries on the merger closing date (referred to below as covered employees ) which, in the aggregate, provide employee benefits and compensation programs that are substantially comparable to the employee benefits and compensation programs that are made available to similarly situated employees of Heritage or its subsidiaries, as applicable. Until such time as Heritage causes covered employees to participate in the benefit plans that are made available to similarly situated employees of Heritage or its subsidiaries, a covered employee's continued participation in employee benefit plans of Washington Banking and its subsidiaries will be deemed to satisfy this provision of the merger agreement. In no event will any covered employee be eligible to participate in any closed or frozen plan of Heritage or its subsidiaries.

To the extent that a covered employee becomes eligible to participate in a Heritage benefit plan, Heritage shall cause the plan to recognize years of prior service from the date of the most recent hire of such covered employee with

Washington Banking, its subsidiaries or their predecessors, for purposes of eligibility, participation, vesting and, except under any plan that determines benefits on an actuarial basis, for benefit accrual, but only to the extent such service was recognized immediately prior to the merger closing date under a comparable Washington Banking benefit plan in which such covered employee was eligible to participate immediately prior to the effective time of the merger. This recognition of service will not duplicate any benefits of a covered employee with respect to the same period of service.

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With respect to any Heritage benefit plan that is a health, dental, vision or similar plan, Heritage or a subsidiary of Heritage shall use commercially reasonable best efforts to:

cause the waiver of all limitations as to pre-existing conditions and waiting periods with respect to participation and coverage requirements applicable to the covered employees, to the extent such pre-existing condition was or would have been covered under a Washington Banking benefit plan maintained for such covered employees immediately prior to the merger closing date;

recognize expenses incurred by a covered employee in the year that includes the closing date (or, if later, the year in which the covered employee is first eligible to participate) for purposes of any applicable deductible and annual out-of-pocket expense requirements; and

credit each covered employee for the purpose of determining eligibility under Heritage's vacation or paid time off benefits plan, with service accrued with Washington Banking from the most recent hire date with Washington Banking, its subsidiaries or their predecessors, taking into consideration any vacation or paid time off used by such covered employee prior to the merger closing date.

Washington Banking has agreed to take, and cause its subsidiaries to take, all actions reasonably requested by Heritage that may be necessary or appropriate to (i) cause the continuation on and after the effective time of the merger, of any contract, arrangement or insurance policy relating to any Washington Banking benefit plan for such period as may be requested by Heritage, (ii) facilitate the merger of any Washington Banking benefit plan into any employee benefit plan maintained by Heritage or a Heritage subsidiary, and/or (iii) terminate any Washington Banking benefit plan (to the extent permitted by the terms thereof and Section 409A of the Code) immediately prior to the effective time of the merger.

Heritage has agreed that it or one of its subsidiaries will honor the obligations of Washington Banking and/or Whidbey Island Bank for certain employees identified by Washington Banking under existing employment, change in control or severance agreements and benefits under the Washington Banking benefit plans that do not enter into similar agreements with Heritage or Heritage Bank following the effective time of the merger. Concurrent with the execution of the merger agreement and to become effective at the effective time of the merger, Heritage entered into a consulting agreement with John L. Wagner, President and Chief Executive Officer of Washington Banking, pursuant to which Mr. Wagner will serve as a special advisor to Heritage following the merger; Heritage Bank entered into employment agreements with Bryan McDonald, President and Chief Executive Officer of Whidbey Island Bank, who will serve as Executive Vice President and Chief Lending Officer of Heritage Bank, and Edward Eng, Executive Vice President and Chief Administrative Officer of Whidbey Island Bank, who will serve as Executive Vice President and Chief Administrative Officer of Heritage Bank. These employment agreements will replace and supersede any existing agreement with Washington Banking and Whidbey Island Bank. For additional information, see *The Merger* Interests of Washington Banking's Directors and Executive Officers in the Merger on page 79.

### *Director and Officer Indemnification and Insurance*

The merger agreement provides that for a period of six years from and after the effective time of the merger, Heritage will indemnify and hold harmless all present and former directors, officers and employees of Washington Banking and its subsidiaries against all costs and liabilities arising out of the fact that such person is or was a director, officer or employee of Washington Banking or its subsidiaries and pertaining to matters existing or occurring at or prior to the

effective time of the merger, to the same extent as such persons are indemnified as of the date of the merger agreement by Washington Banking pursuant to its articles of incorporation or bylaws or the governing or organizational documents of any subsidiary of Washington Banking and will also provide indemnification under certain identified indemnification agreements in existence as of the date of the merger agreement or which provide for indemnification in an amount up to \$25,000, and will also advance expenses to such persons to the same extent as they are entitled to advancement of expenses by Washington Banking or its subsidiaries as of the date of the merger agreement, provided that such person provides an undertaking to repay such advances if it is ultimately determined that such person is not entitled to indemnification.

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The merger agreement requires Heritage to maintain for a period of six years after completion of the merger Washington Banking's existing directors' and officers' liability insurance policy, or policies with a substantially comparable insurer of at least the same coverage and amounts and containing terms and conditions that are no less advantageous to the insured, with respect to claims arising from facts or events that occurred at or prior to the effective time of the merger. However, Heritage is not required to spend annually more than 150% of the current annual premium paid as of the date of the merger agreement by Washington Banking for such insurance (which we refer to as the "premium cap"), and if such premiums for such insurance would at any time exceed the premium cap, then Heritage must maintain policies of insurance which, in its good faith determination, provide the maximum coverage available at an annual premium equal to the premium cap. Alternatively, Heritage, or Washington Banking at the request of Heritage, may obtain at or prior to the effective time of the merger a six-year "tail" policy under Washington Banking's existing directors and officers insurance policy providing single limit (not annual) coverage equivalent to the aggregate coverage described in the preceding sentence if such a policy can be obtained for an amount that does not exceed in the aggregate 400% of the current annual premium paid as of the date of the merger agreement by Washington Banking for such insurance.

*Trust Preferred Securities*

The merger agreement provides that upon completion of the merger, Heritage will assume the performance and observance of the covenants to be performed by Washington Banking under an indenture relating to \$25 million in trust preferred securities issued in 2007 and the due and punctual payment of the principal of and premium and interest on such trust preferred securities. In connection with such assumption, Heritage has agreed to enter into any supplemental indentures or other documents as necessary to make such assumption effective.

*Dividends*

The merger agreement provides that Heritage and Washington Banking shall coordinate with each other regarding the declaration of any common stock dividends and the record dates and payment dates relating thereto, to ensure that holders of Washington Banking common stock shall not receive two dividends, or fail to receive one dividend, in any quarter with respect to their shares of Washington Banking common stock and any shares of Heritage common stock received in the merger. Starting with the first quarter of 2014, the Board of Directors of Washington Banking shall cause its regular quarterly dividend record date and payment date for Washington Banking common stock to be similar to the regular quarterly dividend record date and payment date for Heritage common stock (*i.e.*, Washington Banking shall move its dividend record and payment dates for the first quarter of 2014 to approximately February 10 and February 20, respectively) and Heritage shall continue to pay dividends on Heritage common stock on substantially the same record and payment dates schedule as has been utilized in the past.

**Shareholder Meetings and Recommendation of Heritage's and Washington Banking's Boards of Directors**

Each of Heritage and Washington Banking has agreed to hold a meeting of its shareholders for the purpose of voting upon the Heritage merger proposal and the Washington Banking merger and compensation proposals as soon as reasonably practicable. The board of directors of each of Heritage and Washington Banking has agreed to use its reasonable best efforts to obtain from its shareholders the vote required to approve the Heritage merger proposal and the Washington Banking merger proposal, including by communicating to its shareholders its recommendation (and including such recommendation in this joint proxy statement/prospectus) that they adopt and approve the merger agreement and the transactions contemplated thereby. However, if the board of directors of Washington Banking or Heritage, after receiving the advice of its outside counsel and, with respect to financial matters, its financial advisors, determines in good faith that it would be inconsistent with its fiduciary duties under applicable law to continue to recommend the merger agreement, then it may submit the merger agreement to its shareholders without

recommendation and may communicate the basis for its lack of a recommendation to its shareholders, provided that (1) it gives the other party at least three business days prior written notice of its intention to take such action and a reasonable description of the event or circumstances giving rise to its determination to take such action (including, in the event such action is taken in response to an

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acquisition proposal, the latest material terms and conditions and the identity of the third-party in any such acquisition proposal, or any amendment or modification thereof, or describe in reasonable detail such other event or circumstances) and (2) at the end of such notice period, the board of directors takes into account any amendment or modification to the merger agreement proposed by the other party and after receiving the advice of its outside counsel and, with respect to financial matters, its financial advisors, determines in good faith that it would nevertheless be inconsistent with its fiduciary duties under applicable law to continue to recommend the merger agreement. Any material amendment to any acquisition proposal will require a new notice period.

Notwithstanding any change in recommendation by the board of directors of Heritage or Washington Banking, unless the merger agreement has been terminated in accordance with its terms, each party is required to convene a meeting of its shareholders and to submit the merger agreement to a vote of such shareholders. Heritage and Washington Banking will adjourn or postpone such meeting if there are insufficient shares of Heritage common stock or Washington Banking common stock, as the case may be, represented (either in person or by proxy) to constitute a quorum necessary to conduct the business of such meeting.

### **Agreement Not to Solicit Other Offers**

Each of Heritage and Washington Banking has agreed that it will not, and will cause its subsidiaries and its and their officers, directors, agents, advisors and representatives not to, directly or indirectly, (i) initiate, solicit, knowingly encourage or knowingly facilitate inquiries or proposals with respect to, (ii) engage or participate in any negotiations with any person concerning, or (iii) provide any confidential or nonpublic information or data to, or have or participate in any discussions with, any person relating to, any acquisition proposal. For purposes of the merger agreement, an acquisition proposal means, other than the transactions contemplated by the merger agreement, any offer, proposal or inquiry relating to, or any third-party indication of interest in, (i) any acquisition or purchase, direct or indirect, of more than the 25% of the consolidated assets of a party and its subsidiaries or 25% or more of any class of equity or voting securities of a party or its subsidiaries whose assets, individually or in the aggregate, constitute more than the 25% or more of the consolidated assets of the party, (ii) any tender offer (including a self-tender offer) or exchange offer that, if consummated, would result in such third-party beneficially owning 25% or more of any class of equity or voting securities of a party or its subsidiaries whose assets, individually or in the aggregate, constitute more than 25% of the consolidated assets of the party, or (iii) a merger, consolidation, share exchange, business combination, reorganization, recapitalization, liquidation, dissolution or other similar transaction involving a party or its subsidiaries whose assets, individually or in the aggregate, constitute more than 25% of the consolidated assets of the party.

However, in the event either Heritage or Washington Banking receives an unsolicited bona fide written acquisition proposal, it may, and may permit its subsidiaries and its and its subsidiaries officers, directors, agents, advisors and representatives to, furnish or cause to be furnished nonpublic information or data and participate in negotiations or discussions to the extent that its board of directors concludes in good faith (after receiving the advice of its outside counsel, and with respect to financial matters, its financial advisors) that failure to take such actions would be inconsistent with its fiduciary duties under applicable law, provided that, prior to providing any such nonpublic information, such party enters into a confidentiality agreement with such third-party on terms no less favorable to it than the confidentiality agreement between Heritage and Washington Banking, and which confidentiality agreement does not provide such person with any exclusive right to negotiate with such party.

Each party has agreed to (1) promptly (and within seventy-two hours) advise the other party following receipt of any acquisition proposal or any inquiry which could reasonably be expected to lead to an acquisition proposal, and the substance thereof (including the terms and conditions of and the identity of the person making such inquiry or acquisition proposal), and to keep the other party apprised of any related developments, discussions and negotiations

on a current basis, including any amendments to or revisions of the terms of such inquiry or acquisition proposal, and (2) use its reasonable best efforts to enforce any existing confidentiality or standstill agreements to which it or any of its subsidiaries is a party.

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**Conditions to Complete the Merger**

Heritage's and Washington Banking's respective obligations to complete the merger are subject to the satisfaction or, to the extent legally permitted, waiver of the following conditions:

the approval of the Heritage merger proposal by Heritage's shareholders and the approval of the Washington Banking merger proposal by Washington Banking's shareholders;

the authorization for listing on NASDAQ, subject to official notice of issuance, of the shares of Heritage common stock to be issued in the merger;

the receipt of necessary regulatory approvals, including from the Federal Reserve Board, the FDIC and the DFI and other approvals necessary to consummate the transactions contemplated by the merger agreement, or those the failure of which to be obtained would reasonably be expected to have, individually or in the aggregate, a material adverse effect on the combined company, and the expiration of all statutory waiting periods in respect thereof, without the imposition of any condition or restriction that would reasonably be expected to have a material adverse effect on, or impose a materially adverse non-standard condition on, Heritage (as the surviving corporation of the merger) and its subsidiaries, taken as a whole, after giving effect to the merger;

the effectiveness of the registration statement of which this joint proxy statement/prospectus is a part, and the absence of any stop order (or proceedings for that purpose initiated or threatened and not withdrawn);

the absence of any order, injunction, or decree by any court or agency of competent jurisdiction or other legal restraint or prohibition preventing the completion of the merger or the other transactions contemplated by the merger agreement, and the absence of any statute, rule, regulation, order, injunction or decree that prohibits or makes illegal consummation of the merger;

the accuracy of the representations and warranties of the other party contained in the merger agreement subject to the closing standards for accuracy and the receipt by each party of an officers' certificate from the other party to that effect;

the performance by the other party in all material respects of all obligations required to be performed by it under the merger agreement and the receipt by each party of an officers' certificate from the other party to that effect;

receipt by each party of an opinion of its legal counsel to the effect that on the basis of facts, representations and assumptions set forth or referred to in such opinion, the merger will qualify as a reorganization within the meaning of Section 368(a) of the Code;

as an additional condition to Heritage's obligation to complete the merger, the shares of Washington Banking common stock whose holders have perfected dissenters' rights under Washington law represent less than ten percent of the total number of outstanding shares of Washington Banking common stock;

as an additional condition to Heritage's obligation to complete the merger, receipt by Washington Banking of all designated third party consents in form and substance reasonably satisfactory to Heritage;

receipt by each of Heritage and Washington Banking of a written consent from the FDIC ensuring no adverse change or loss of a material amount of loss coverage from the FDIC under the other party's shared-loss agreements with the FDIC will occur as a result of the merger; and

as an additional condition to Washington Banking's obligation to complete the merger, Heritage's adoption of amendments to its bylaws provided in the merger agreement.

Neither Heritage nor Washington Banking can provide assurance as to when or if all of the conditions to the merger can or will be satisfied or waived by the appropriate party.

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**Termination of the Merger Agreement**

The merger agreement can be terminated at any time prior to completion of the merger in the following circumstances:

by mutual written consent of Heritage and Washington Banking;

by either Heritage or Washington Banking if any governmental entity that must grant a requisite regulatory approval has denied approval of the merger or the bank merger and such denial has become final and non-appealable or any governmental entity of competent jurisdiction has issued a final non-appealable order permanently enjoining or otherwise prohibiting or making illegal the consummation of the transactions contemplated by the merger agreement, unless the failure to obtain a requisite regulatory approval is due to the failure of the party seeking to terminate the merger agreement to perform or observe its covenants and agreements under the merger agreement;

by either Heritage or Washington Banking if the merger has not been completed on or before May 31, 2014 (which we refer to as the termination date), unless the failure of the merger to be completed by that date is due to the failure of the party seeking to terminate the merger agreement to perform or observe its covenants and agreements under the merger agreement;

by either Heritage or Washington Banking (provided that the terminating party is not then in material breach of any representation, warranty, covenant or other agreement contained in the merger agreement) if there is a breach of any of the covenants or agreements or any of the representations or warranties set forth in the merger agreement on the part of the other party which either individually or in the aggregate would constitute, if occurring or continuing on the date the merger is completed, the failure of a closing condition of the terminating party and which is not cured within 30 days following written notice to the party committing such breach, or by its nature or timing cannot be cured during such period (or such fewer days as remain prior to the termination date);

by either Heritage or Washington Banking if (1) the board of directors of the other party fails to recommend in this joint proxy statement/prospectus that the shareholders of such party approve the merger agreement, or withdraws, modifies or qualifies such recommendation in an adverse manner, or resolves to do so, or fails to reaffirm such recommendation within five days after being requested in writing to do so, or fails to recommend against the acceptance of a tender offer or an exchange offer for its common stock that has been publicly disclosed within ten business days after the commencement of such tender or exchange offer; (2) the board of directors of the other party (A) recommends or endorses an acquisition proposal, or (B) fails to issue a press release announcing its opposition to a publicly announced acquisition proposal within ten business days after an acquisition proposal is publically announced; or (3) the other party materially breaches certain obligations, including with respect to the non-solicitation of acquisition proposals or calling and holding a meeting of its shareholders; or

by either Heritage or Washington Banking if the shareholder meeting of a party has been held (including any postponement or adjournment thereof) and the required vote to approve the merger proposal has not been obtained; provided that the party seeking to terminate the merger agreement has complied in all material respects with its obligations under the merger agreement, including with respect to the non-solicitation of acquisition proposals or calling and holding a meeting of its shareholders.

**Effect of Termination**

If the merger agreement is terminated, it will become void and have no effect, except that (1) both Heritage and Washington Banking will remain liable for any liabilities or damages arising out of its willful and material breach of any provision of the merger agreement and (2) designated provisions of the merger agreement will survive the termination, including those relating to payment of fees and expenses and the treatment of confidential information.

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### **Termination Fee**

In the event that a bona fide acquisition proposal with respect to a party shall have been made or known to its senior management or has been made directly to its shareholders generally or any person shall have publicly announced (and not withdrawn) an acquisition proposal, then such party shall pay the other party a termination fee of \$7.9 million if the merger agreement is terminated under the following circumstances:

due to the breach by such party of certain specified obligations under the merger agreement, in which case the termination fee is payable by such party upon termination of the merger agreement;

due to such party's board of directors recommending or endorsing an acquisition proposal, in which case 75% of the termination fee is payable upon termination of the merger agreement, and the remaining 25% is payable upon such party entering into a definitive agreement or consummating a transaction involving an acquisition proposal within twelve months after the merger agreement is terminated; or

due to the willful breach by such party of the merger agreement, such party's shareholders fail to approve the merger agreement, or the board of directors of such party fails to recommend or reaffirm approval of the merger agreement by such party's shareholders, or withdraws or adversely changes such favorable recommendation, or fails to publicly announce its opposition to an acquisition proposal, then in any such event, such party shall pay the termination fee if it enters into a definitive agreement or consummates a transaction involving an acquisition proposal within twelve months after the merger agreement is terminated.

In the event of a willful and material breach of the merger agreement by a party that would entitle the other party to the termination fee, such other party is not required to accept the termination fee from the breaching party and may pursue alternate relief against the breaching party.

### **Expenses and Fees**

All costs and expenses incurred in connection with the merger agreement and the transactions contemplated thereby will be paid by the party incurring such expense, except that the costs and expenses of printing and mailing this joint proxy statement/prospectus and all filing and other fees paid to the SEC in connection with the merger will be borne equally by Heritage and Washington Banking.

### **Amendment, Waiver and Extension of the Merger Agreement**

Subject to compliance with applicable law, the merger agreement may be amended by the parties at any time before or after approval of the merger agreement by the shareholders of Heritage and Washington Banking, except that after approval of the merger agreement by the respective shareholders of Heritage or Washington Banking, there may not be, without further approval of such shareholders, any amendment of the merger agreement that requires further approval of such shareholders under applicable law.

At any time prior to the effective time of the merger, the parties may, to the extent legally allowed, extend the time for the performance of any of the obligations or other acts of the other party, waive any inaccuracies in the representations and warranties contained in the merger agreement or in any document delivered pursuant to the merger agreement, and waive compliance with any of the agreements or satisfaction of any conditions contained in the merger agreement,

except that after approval or adoption of the merger agreement by the respective shareholders of Heritage or Washington Banking, there may not be, without further approval of such shareholders, any extension or waiver of the merger agreement or any portion of the merger agreement that requires further approval under applicable law.

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**Voting and Support Agreements**

As an inducement to each of Heritage and Washington Banking to enter into the merger agreement, the directors and executive officers of Heritage each entered into a voting and support agreement with Washington Banking with respect to the shares of Heritage common stock they own, and the directors and executive officers of Washington Banking each entered into a voting and support agreement with Heritage with respect to the shares of Washington Banking common stock they own. We urge you to read the form of voting and support agreement, a copy of which is attached as Exhibit A to the merger agreement, which is attached as **Appendix A** to this joint proxy statement/prospectus.

Pursuant to the voting and support agreements, each director and executive officer of Heritage, in his or her capacity as a shareholder of Heritage, and each director and executive officer of Washington Banking, in his or her capacity as a shareholder of Washington Banking, has agreed:

to vote, or cause to be voted, in favor of approval of the Heritage merger proposal or the Washington Banking merger proposal, as applicable, and any other matter required to be approved by shareholders to facilitate the transactions contemplated by the merger agreement, all shares of Heritage common stock or Washington Banking common stock, as applicable, over which he or she, or a member of his or her immediate family (meaning any child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, and including adoptive relationships) has, directly or indirectly, sole or shared voting power as of the voting record date for the Heritage special meeting or Washington Banking special meeting, as applicable, using reasonable efforts to cause shares beneficially held by immediate family members to be so voted; and

not to sell, transfer or otherwise dispose of shares of Heritage common stock or Washington Banking common stock, as applicable, he or she beneficially held as of the date of the voting and support agreement until after shareholder approval of the Heritage merger proposal or Washington Banking merger proposal, as applicable, excluding (i) dispositions of shares in connection with the exercise of stock options and warrants in order to pay the exercise price or to satisfy tax withholding obligations in connection with the exercise of stock options or the vesting of equity awards, and (ii) transfers to a lineal descendant or his or her spouse, or to a trust or other entity for the benefit of one or more of the foregoing persons, provided that the transferee agrees in writing to be bound by the terms of the voting and support agreement.

The obligations under each voting and support agreement will terminate concurrently with any termination of the merger agreement.

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**UNAUDITED PRO FORMA COMBINED CONDENSED  
CONSOLIDATED FINANCIAL INFORMATION**

The following is the unaudited pro forma combined condensed consolidated financial information for Heritage and Washington Banking, giving effect to the merger. The unaudited pro forma combined condensed consolidated statement of financial condition as of September 30, 2013 gives effect to the merger as if it occurred on that date. The unaudited pro forma combined condensed consolidated statements of income for the nine months ended September 30, 2013 and the year ended December 31, 2012 give effect to the merger as if it occurred on January 1, 2012.

The unaudited pro forma combined condensed consolidated financial information has been prepared using the acquisition method of accounting for business combinations under GAAP. Heritage is the acquirer for accounting purposes.

A final determination of the fair values of Washington Banking's assets and liabilities, which cannot be made prior to the completion of the merger, will be based on the actual net tangible and intangible assets of Washington Banking that exist as of the date of completion of the transaction. Consequently, fair value adjustments and amounts preliminarily allocated to goodwill and identifiable intangibles could change significantly from those allocations used in the unaudited pro forma combined condensed consolidated financial information presented herein and could result in a material change in amortization of acquired intangible assets. In addition, the value of the final purchase price of the merger will be based on the closing price of Heritage common stock on the closing date of the merger. For purposes of the accompanying pro forma financial information, the closing price of Heritage common stock as of December 20, 2013, the date of the filing of this joint proxy statement/prospectus with the SEC, was used for purposes of presenting the pro forma combined condensed consolidated statement of financial condition as of September 30, 2013.

In connection with the plan to integrate the operations of Heritage and Washington Banking following the completion of the merger, Heritage anticipates that nonrecurring charges, such as costs associated with systems implementation, severance and other costs related to exit or disposal activities, will be incurred. Heritage is not able to determine the timing, nature and amount of these charges as of the date of this document. However, these charges will affect the results of operations of Heritage and Washington Banking, as well as those of the combined company following the completion of the merger, in the period in which they are recorded. The unaudited pro forma combined condensed consolidated statements of income do not include the effects of the non-recurring costs associated with any restructuring or integration activities resulting from the merger, as they are nonrecurring in nature and not factually supportable at this time. Additionally, the unaudited pro forma adjustments do not give effect to any nonrecurring or unusual restructuring charges that may be incurred as a result of the integration of the two companies or any anticipated disposition of assets that may result from such integration.

The actual amounts recorded as of the completion of the merger may differ materially from the information presented in the unaudited pro forma combined condensed consolidated financial information as a result of:

changes in the trading price for Heritage's common stock;

capital used or generated in Washington Banking's operations between the signing of the merger agreement and completion of the merger;

changes in the fair values of Washington Banking's assets and liabilities;

other changes in Washington Banking's net assets that occur prior to the completion of the merger, which could cause material changes in the information presented below; and

the actual financial results of the combined company.

The unaudited pro forma combined condensed consolidated financial information is provided for informational purposes only. The unaudited pro forma combined condensed consolidated financial information is

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not necessarily, and should not be assumed to be, an indication of the results that would have been achieved had the transaction been completed as of the dates indicated or that may be achieved in the future. The preparation of the unaudited pro forma combined condensed consolidated financial information and related adjustments required management to make certain assumptions and estimates. The unaudited pro forma combined condensed consolidated financial information is based on, and should be read together with, the historical consolidated financial statements and related notes of Heritage incorporated into this document by reference from its Quarterly Report on Form 10-Q for the quarter ended September 30, 2013 and its Annual Report on Form 10-K for the year ended December 31, 2012, and of Washington Banking incorporated into this document by reference from its Quarterly Report on Form 10-Q for the quarter ended September 30, 2013 and its Annual Report on Form 10-K for the year ended December 31, 2012.

**Table of Contents****HERITAGE FINANCIAL CORPORATION AND WASHINGTON BANKING COMPANY****UNAUDITED PRO FORMA COMBINED CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL  
CONDITION**

As of September 30, 2013

(In thousands)

	Heritage	Washington Banking	Pro Forma Adjustments	Notes	Pro Forma
<b>ASSETS</b>					
Cash and cash equivalents	\$ 135,123	\$ 111,505	\$ (42,714)	<b>A</b>	\$ 203,914
Investment securities available for sale	167,226	400,276			567,502
Investment securities held to maturity	35,113				35,113
Loans, excluding covered loans, net of unearned income	1,167,381	872,636	(29,520)	<b>B</b>	2,010,497
Less: Allowance for loan losses	(22,783)	(16,942)	16,942	<b>C</b>	(22,783)
Loans, excluding covered loans, net	1,144,598	855,694	(12,578)		1,987,714
Covered loans	69,456	171,416	(28,915)	<b>B</b>	211,957
Less: Allowance for loan losses	(5,972)	(15,026)	15,026	<b>C</b>	(5,972)
Covered loans, net	63,484	156,390	(13,889)		205,985
Total loans receivable, net	1,208,082	1,012,084	(26,467)		2,193,699
FDIC indemnification asset	4,413	25,439	14,181	<b>D</b>	44,033
Other real estate owned	4,129	8,856			12,985
Other intangible assets, net	1,772	1,208	13,069	<b>E</b>	16,049
Goodwill	29,365	4,490	90,181	<b>F</b>	124,036
Other assets	89,194	84,296	(5,004)	<b>G</b>	168,486
<b>Total assets</b>	<b>\$ 1,674,417</b>	<b>\$ 1,648,154</b>	<b>\$ 43,246</b>		<b>\$ 3,365,817</b>

**LIABILITIES AND STOCKHOLDERS****EQUITY****LIABILITIES**

Deposits	\$ 1,425,985	\$ 1,429,279	\$		\$ 2,855,264
Securities sold under agreement to repurchase	22,655				22,655
Junior subordinated debentures		25,774	(8,196)	<b>H</b>	17,578
Accrued expenses and other liabilities	9,182	11,303	(822)	<b>I</b>	19,663
<b>Total liabilities</b>	<b>1,457,822</b>	<b>1,466,356</b>	<b>(9,018)</b>		<b>2,915,160</b>

**STOCKHOLDERS EQUITY**

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Common stock	138,426	86,447	147,615	<b>J</b>	372,488
Retained earnings	78,851	98,182	(98,182)	<b>K</b>	78,851
Accumulated other comprehensive (loss) income, net	(682)	(2,831)	2,831	<b>L</b>	(682)
<b>Total stockholders equity</b>	<b>216,595</b>	<b>181,798</b>	<b>52,264</b>		<b>450,657</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 1,674,417</b>	<b>\$ 1,648,154</b>	<b>\$ 43,246</b>		<b>\$ 3,365,817</b>

*See accompanying Notes to Unaudited Pro Forma Combined Condensed Consolidated Financial Information*

Table of Contents**HERITAGE FINANCIAL CORPORATION AND WASHINGTON BANKING COMPANY****UNAUDITED PROFORMA COMBINED CONDENSED CONSOLIDATED****STATEMENT OF INCOME****For the Nine Months Ended September 30, 2013****(In thousands, except per share data)**

	<b>Heritage</b>	<b>Washington Banking</b>	<b>Pro Forma Adjustments</b>	<b>Notes</b>	<b>Pro Forma</b>
<b>Interest income:</b>					
Interest and fees on loans	\$ 50,252	\$ 51,416	\$ 695	<b>M</b>	\$ 102,363
Taxable interest on investment securities	1,296	4,090			5,386
Nontaxable interest on investment securities	1,108	1,157			2,265
Other	220	142			362
<b>Total interest income</b>	<b>52,876</b>	<b>56,805</b>	<b>695</b>		<b>110,376</b>
<b>Interest expense:</b>					
Deposits	2,786	3,760			6,546
Junior subordinated debenture		359	85	<b>N</b>	444
Other borrowings	32				32
<b>Total interest expense</b>	<b>2,818</b>	<b>4,119</b>	<b>85</b>		<b>7,022</b>
<b>Net interest income</b>	<b>50,058</b>	<b>52,686</b>	<b>610</b>		<b>103,354</b>
Provision for loan losses on loans, excluding covered loans	1,584	1,825			3,409
Provision for loan losses on covered loans	1,660	12,414			14,074
<b>Net interest income after provision for loan losses</b>	<b>46,814</b>	<b>38,447</b>	<b>610</b>		<b>85,871</b>
<b>Noninterest income:</b>					
Service charges and other fees	4,395	5,428			9,823
Income from sale of mortgage loans		2,798			2,798
Change in FDIC indemnification asset	(336)	6,298	276	<b>O</b>	6,238
Other income	3,163	4,449			7,612
<b>Total noninterest income</b>	<b>7,222</b>	<b>18,973</b>	<b>276</b>		<b>26,471</b>
<b>Noninterest expense:</b>					
Compensation and employee benefits	23,220	22,481			45,701
Occupancy and equipment	6,105	5,843	(133)	<b>P</b>	11,815
Data processing	2,809	1,558			4,367
Professional services	2,532	637	(439)	<b>Q</b>	2,730

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Other real estate owned, net	(260)	1,918			1,658
Other expense	6,604	7,221	1,271	<b>R</b>	15,096
<b>Total noninterest expense</b>	<b>41,010</b>	<b>39,658</b>	<b>699</b>		<b>81,367</b>
Income before income taxes	13,026	17,762	187		30,975
Income tax expense (benefit)	4,161	5,768	65	<b>S</b>	9,994
Net income	\$ 8,865	\$ 11,994	\$ 122		\$ 20,981
<b>Earnings per Common Share:</b>					
Basic	\$ 0.57	\$ 0.77		<b>T</b>	\$ 0.71
Diluted	0.57	0.77		<b>T</b>	0.71
<b>Average Common Shares Outstanding:</b>					
Basic	15,297	15,491	(1,492)	<b>U</b>	29,296
Diluted	15,309	15,538	(1,539)	<b>U</b>	29,308
<i>See accompanying Notes to Unaudited Pro Forma Combined Condensed Consolidated Financial Information</i>					

Table of Contents**HERITAGE FINANCIAL CORPORATION AND WASHINGTON BANKING COMPANY****UNAUDITED PRO FORMA COMBINED CONDENSED CONSOLIDATED****STATEMENT OF INCOME****For the Year Ended December 31, 2012****(In thousands, except per share data)**

	<b>Heritage</b>	<b>Washington Banking</b>	<b>Pro Forma Adjustments</b>	<b>Notes</b>	<b>Pro Forma</b>
<b>Interest income:</b>					
Interest and fees on loans	\$ 65,588	\$ 82,948	\$ 1,159	<b>M</b>	\$ 149,695
Taxable interest on investment securities	2,195	5,333			7,528
Nontaxable interest on investment securities	1,097	1,178			2,275
Other	229	251			480
<b>Total interest income</b>	<b>69,109</b>	<b>89,710</b>	<b>1,159</b>		<b>159,978</b>
<b>Interest expense:</b>					
Deposits	4,469	6,581			11,050
Junior subordinated debenture		532	88	<b>N</b>	620
Other borrowings	65				65
<b>Total interest expense</b>	<b>4,534</b>	<b>7,113</b>	<b>88</b>		<b>11,735</b>
<b>Net interest income</b>	<b>64,575</b>	<b>82,597</b>	<b>1,071</b>		<b>148,243</b>
Provision for loan losses on loans, excluding covered loans	1,570	7,100			8,670
Provision for loan losses on covered loans	446	2,644			3,090
<b>Net interest income after provision for loan losses</b>	<b>62,559</b>	<b>72,853</b>	<b>1,071</b>		<b>136,483</b>
<b>Noninterest income:</b>					
Service charges and other fees	5,516	7,231			12,747
Income from sale of mortgage loans		3,848			3,848
Change in FDIC indemnification asset	(1,033)	(9,126)	368	<b>O</b>	(9,791)
Other income	2,789	5,303			8,092
<b>Total noninterest income</b>	<b>7,272</b>	<b>7,256</b>	<b>368</b>		<b>14,896</b>
<b>Noninterest expense:</b>					
Compensation and employee benefits	29,020	30,248			59,268
Occupancy and equipment	7,365	7,418	(177)	<b>P</b>	14,606
Data processing	2,555	2,022			4,577
Professional services	2,543	904		<b>Q</b>	3,447
Other real estate owned, net	316	2,791			3,107

Other expense	8,593	12,026	1,943	<b>R</b>	22,562
<b>Total noninterest expense</b>	50,392	55,409	&nbsp;		