



**2002  
annual  
report**



**STRENGTH IN NUMBERS**  
**Heritage Financial**  
**Corporation**  
Continuously improving...



## Strength in Commitment

To Our Shareholders:

During the year 2002 we continued our commitment to continuously improve customer satisfaction, employee empowerment and shareholder value. Groundwork prepared during our Vision 2001 project last year combined with sharply lower interest rates this year led to very positive financial results for the fiscal year ended December 31, 2002.

Earnings of \$9.424 million were up 35.4% over 2001. Earnings per diluted share of \$1.271 represented a 48.5% increase over the \$.856 per share earned during 2001. Return on average equity increased to 12.18% for the year, up from 8.52% last year, another important step toward our previously announced target of achieving a 15% return on average equity by the end of 2005. Both our earnings per diluted share and return on average equity benefited from our stock repurchase program. In 2002, we completed our fourth 10% stock repurchase program and initiated our fifth 10% program—the latter program being 73.5 % completed as of December 31, 2002.

Our efficiency ratio, which measures the cost of generating a dollar of revenue, improved to 55.67 from 63.35 in the previous year. Asset quality also improved during the year. Nonperforming assets as of December 31, 2002 amounted to 0.38 percent of total assets (\$2,283,000), well below the 1.11 percent average for West Coast publicly traded commercial banks as monitored by D.A. Davidson and Company. These and other financial highlights, which were outlined in our January 23, 2003 press release, are fully discussed in this annual report. You can also follow our progress by accessing our website at [www.HF-WA.com](http://www.HF-WA.com).

We continue to execute, and believe we have substantially achieved, the strategies developed five years ago to increase growth through product and geographic expansion, diversify our balance sheet to reflect the successful community bank we have become, and further develop relationship banking while maintaining asset quality.

Corporate governance was a major topic in the business and the regulatory worlds during 2002. The Board of Directors has sought the advice of legal and accounting professionals to ensure that the company's governance practices meet the highest possible standards. I'm pleased to report that only minimal changes were recommended to the corporate governance process already in practice at Heritage Financial Corporation.



Custom-fit solutions for every customer

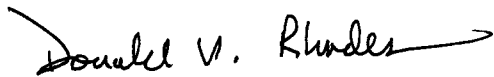
## OUR MISSION

We are committed to continuously improving customer satisfaction, employee empowerment, and shareholder value.

The year of 2002 also represented a historical milestone for each of Heritage Financial's subsidiary banks. Heritage Bank, under the leadership of Brian Vance celebrated its 75th year of continuous operations while Central Valley Bank, led by Mike Broadhead, celebrated its 40th Anniversary.

Please join our Board of Directors and other members of our Heritage Financial Corporation family at our annual meeting of shareholders to be held in Olympia at the Phoenix Inn on April 30, at 10:30 a.m. Details are included in the proxy statement which accompanies this report. We welcome your questions and comments and appreciate your interest in Heritage Financial Corporation.

Sincerely,



Donald V. Rhodes  
Chairman and Chief Executive Officer





## OUR MISSION

We are committed to continuously improving customer satisfaction, employee empowerment, and shareholder value.

## Strength in Fundamentals

Heritage Bank's record-setting performance in 2002 is a direct result of our strong ability to focus on the fundamentals of business so critical to successful community banking. During the year we were able to substantially improve net interest margin, non-interest income and our efficiency ratio. We were also able to maintain and improve overall credit quality during challenging economic conditions. Interest rate management was another challenge throughout the year. However, we were able to improve our overall cost of funds by continuing to focus on no interest and low interest deposit accounts. That, along with our staff's continued focus on expense control led to our record year.

Our Retail Division performed strongly in 2002, deepening existing relationships and adding valuable new relationships through the use of custom-tailored banking solutions, a hallmark of banking with Heritage Bank. Early in 2002 we introduced Business Cash Manager Online, a powerful internet based cash management tool for businesses, to widespread acceptance. We improved our already strong community relationships system-wide and increased our exposure in Pierce County where we see strong potential for our style of banking.

We also capitalized on our year long 75th anniversary celebration with open houses at each branch and the recognition of our stellar staff with many activities throughout the year, culminating with an Employee Appreciation Month in December. Across the company in 2002 Heritage employees embraced our mission and we were truly committed to continuously improving. The record-setting 2002 financial results demonstrate their success and I commend them for it.

Growth will be our focus in 2003. We plan to continue to increase our market penetration in Pierce County as well as all the communities we serve. We know that customer satisfaction drives every aspect of our success and we will continue to provide the training, support, and personal customer attention that are the foundations of our 75 years of community banking.

Brian L. Vance  
President and Chief Operating Officer  
Heritage Bank



Sharing our customers' commitment to quality

**SUPPORTING OUR COMMUNITIES** Each year Heritage Bank and Central Valley Bank demonstrate their support to the communities they serve through volunteer commitment and corporate contributions. A partial list of the organizations we supported in 2002 include:

**HERITAGE BANK**

**MASON COUNTY**

Economic Development Council  
 Forest Heritage Festival  
 Habitat for Humanity  
 Mason County General  
 Foundation-Fantasy Forest  
 Shelton Chamber of Commerce  
 Shelton Clock Tower  
 United Way

**PIERCE COUNTY**

American Cancer Society  
 American Heart Association  
 American Red Cross  
 Asia Pacific Cultural Center  
 Assoc. of Washington Business  
 Boys & Girls Club  
 Business Leaders of the Year  
 Economic Development Board  
 Emergency Food Network  
 Fantasy Lights  
 Franciscan Foundation  
 Greater Lakes Mental  
 Health Clinic  
 Junior Achievement  
 Korean American Association  
 Korean Womens Association  
 Martin Luther King Housing  
 Development Association  
 Multicare Health Foundation  
 Pierce County Community  
 Action Agency  
 Rotary  
 South Tacoma Business District  
 Tacoma Art Museum

Tacoma Pierce County  
 Chamber of Commerce  
 Tacoma Rescue Mission  
 United Way  
 World Trade Center  
 WWEE  
 YMCA and YWCA

**THURSTON COUNTY**

American Cancer Society  
 American Heart Association  
 American Red Cross  
 Arts Walk  
 Big Brothers, Big Sisters  
 Boys & Girls Club  
 Community Foundation  
 Economic Development  
 Council  
 Exploring Business  
 Family Support Center  
 Girl Scouts  
 Habitat for Humanity  
 Hands On Children's Museum  
 Junior League  
 Lacey Chamber  
 March of Dimes  
 Music in the Park  
 Olympia Chamber of Commerce  
 Olympia Downtown Assoc.  
 Olympia Farmers Market  
 Olympia Master Builders  
 Rotary  
 Senior Services for South Sound  
 South Puget Sound  
 Intertribal Planning

South Puget Sound  
 Community College  
 St. Peter Health Foundation  
 Together  
 Tumwater Chamber  
 of Commerce  
 United Way  
 YMCA and YWCA

**CENTRAL VALLEY BANK**

Coats for Kids Campaign  
 Chambers of Commerce  
 (Toppenish, Wapato, Yakima,  
 Ellensburg)  
 Ellensburg Rodeo  
 New Vision Economic  
 Development Group  
 Rotary Clubs (Toppenish,  
 Yakima, Ellensburg)  
 Yakima Valley Visitor and  
 Convention Center  
 Casting for Kids  
 Yakima Wine and Visitors Center  
 Yakima Symphony  
 Farmers Market, Yakima  
 Downtown Association  
 Sun Kings CBA Basketball  
 Toppenish Mural Society  
 Wapato Harvest Festival  
 Junior Livestock Shows  
 (Ellensburg, Toppenish,  
 West Valley)  
 Boy Scouts  
 United Way  
 Tri County Workforce Council  
 Toppenish PowWow and Rodeo  
 Toppenish Western Art Show





## OUR MISSION

We are dedicated to the long-term success of our customers, employees, and our community. We provide high-quality products and services focused on the development of long-term relationships with those we serve. Through integrity and leadership we maintain an acceptable level of financial performance to ensure our mission will continue.

## Strength in Teamwork

Central Valley Bank completed its 40th year in business with strong performances across many important areas. Earnings increased 22% and average core deposits grew 12% over last year. Total assets grew as well, increasing by 14%. These achievements were attained in spite of a sluggish economic environment, making them even more significant as well as testimony to the professional work of our staff.

Throughout the year we celebrated our 40th anniversary in every branch, using that milestone as a way to thank our existing customers and build relationships with new customers. Every branch met or exceeded its growth goals for the year, a direct result of our employees ongoing commitment to our organization. That same commitment also enabled us to improve our efficiency ratio, bringing Central Valley Bank more closely in line with, and in some cases ahead of, other banks in our peer group. In 2002 the bank also received national recognition from VISA for our outstanding 38% increase in the issuance of VISA debit cards.

In 2003 our goal is to gain even greater efficiencies with investment in new technology to help us work smarter and with greater ease and speed. While technology is important to our future, it is our family of employees who are the cornerstone of our success and who will enable us to again deliver positive results and reach our goals in 2003. In each of our communities we will continue to capitalize on our strengths in customer service with personal attention, ongoing employee training and the right product mix. While our local economy will continue to lag behind any general recovery, we plan to be even more visible in our marketplace through community service, sponsorships and marketing initiatives to bring in new customers and deepen relationships with existing customers. We are looking forward to another successful year for our customers, our employees and our shareholders.

D. Michael Broadhead  
President  
Central Valley Bank



Taking a real interest in our customers

## Strength in Leadership

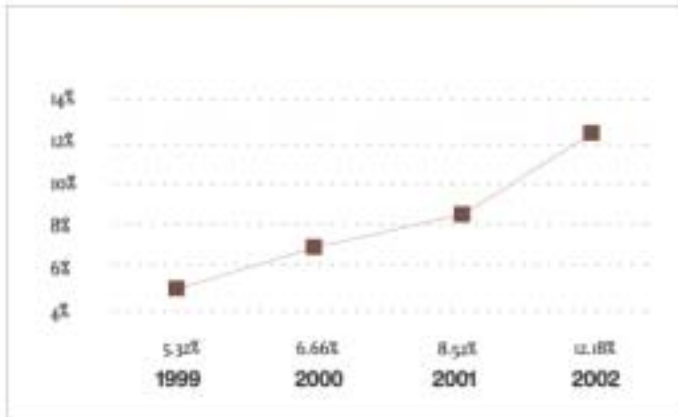
With a broad range of successful business and community leadership backgrounds, the Board of Directors of Heritage Financial Corporation brings unique individual perspectives to their leadership and guidance role. Each director has a strong continuing interest in the corporation and its future success, as well as a high level of community involvement. Their diversity of experience and their community knowledge are important assets to the overall vision and strength of the corporation. The Board maintains several sub-committees. Of particular importance in the successful corporate governance of Heritage is the Audit and Finance Committee chaired by Daryl Jensen. The Audit and Finance Committee meets at least once each quarter with management and representatives of our outside auditing firm KPMG LLP. These meetings also include direct reports from our internal auditing firm, RSM McGladrey, as well as from other quality audits such as compliance and third party credit reviews. Other important functioning committees include the compensation committee chaired by Peter Fluetsch, the Nominating Committee chaired by Daryl Jensen, and the Contribution Committee chaired by Lynn Brunton. The Board of Directors provides important oversight of your company.

*Back Row (l-r)*  
Brian Charneski  
Jim Senna  
Daryl Jensen  
Brian Vance  
Don Rhodes  
Mel Lewis  
Ed Odegard  
Phil Weigand

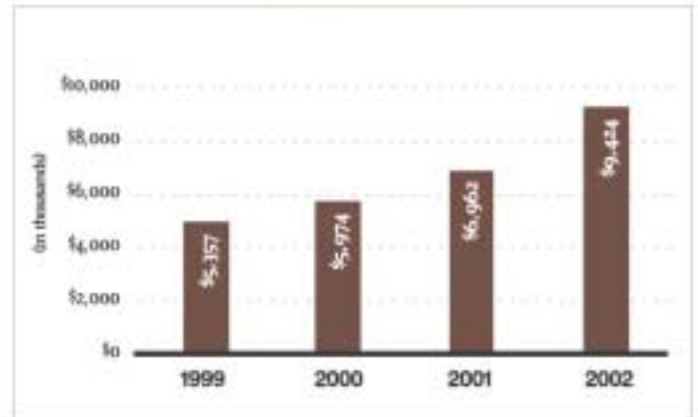
*Front Row (l-r):*  
Peter Fluetsch  
John Clees  
(consultant to Board)  
Jeff Lyon  
Lynn Brunton



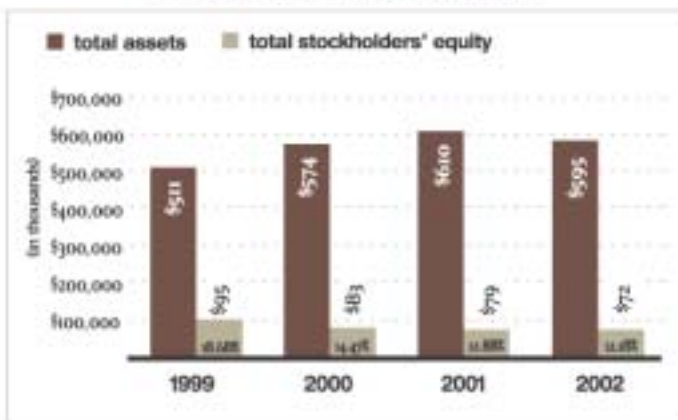
Return on Average Equity



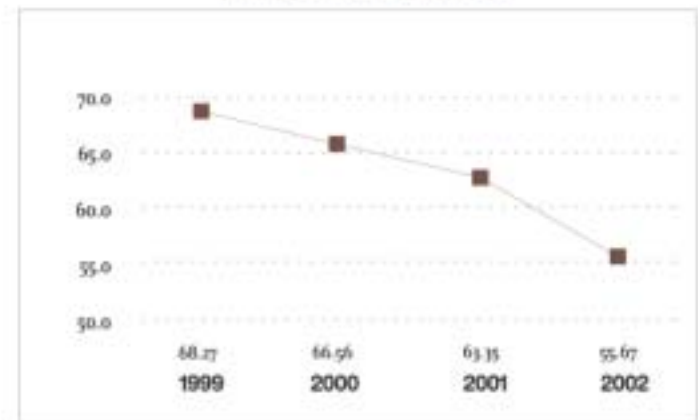
Net Income



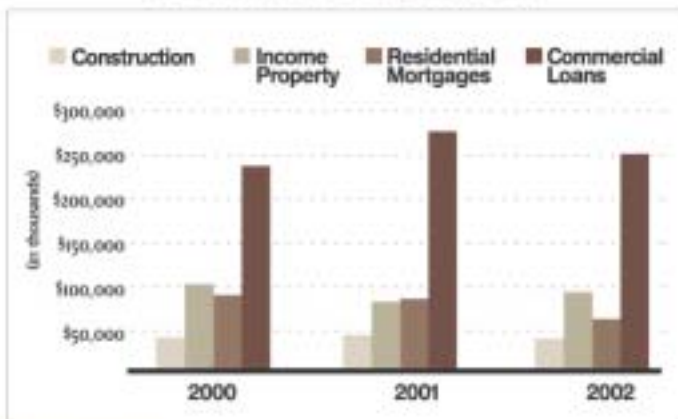
Capital to Total Assets\*



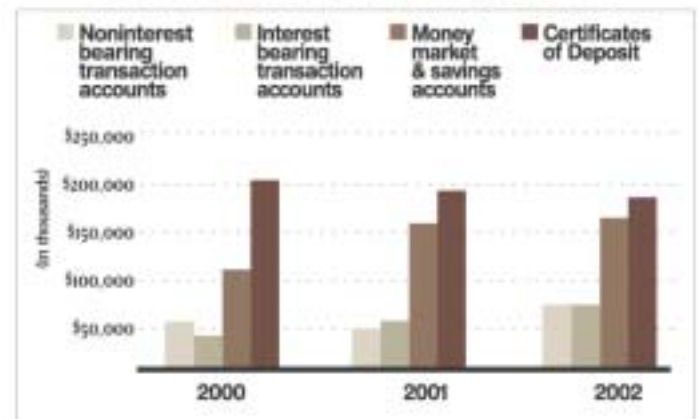
Efficiency Ratio



Loan Mix Comparison\*



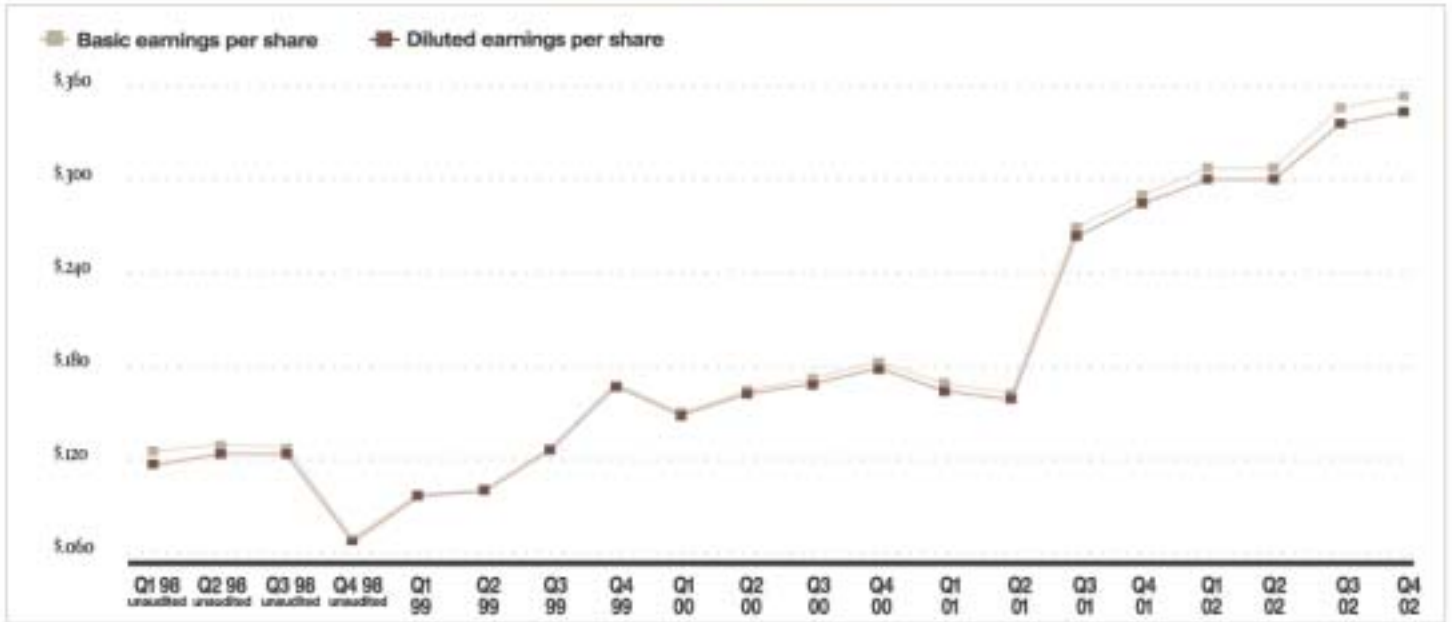
Core Deposit Mix Comparison\*



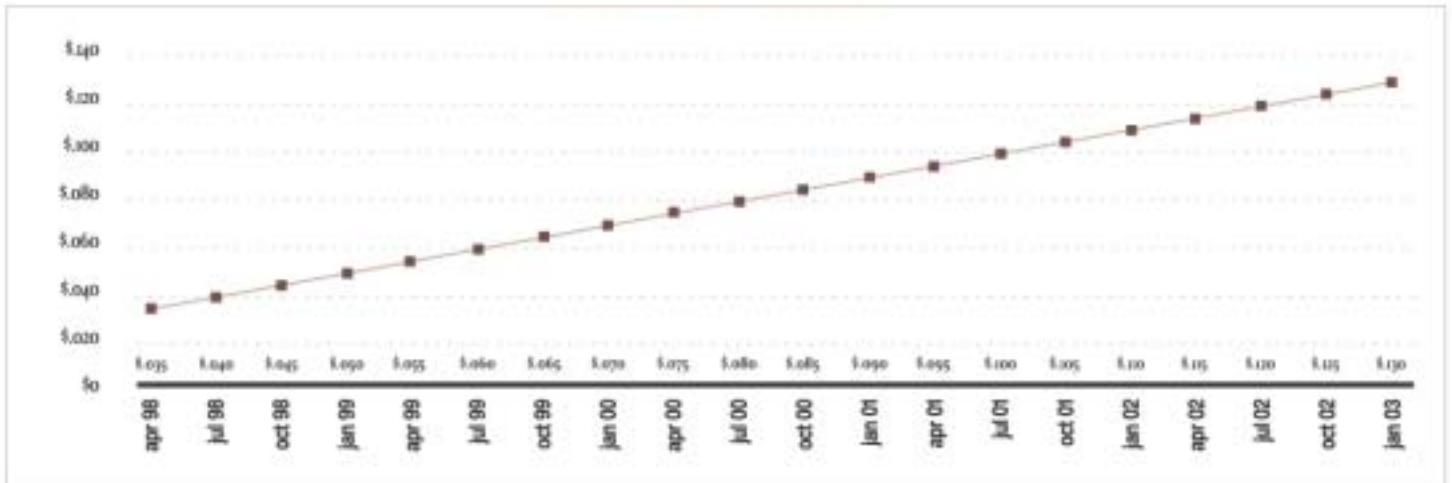
\*as of December 31.



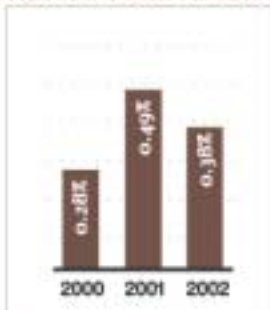
### Earnings per Share



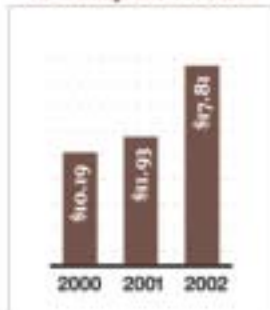
### Dividend Payout



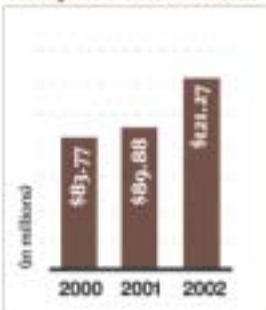
### Nonperforming Assets/Total Assets\*



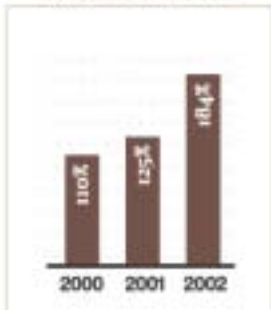
### Stock Price Comparison\*



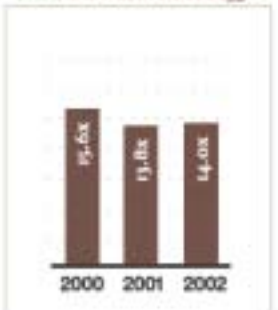
### Market Capitalization\*



### Price/Tangible Book Value\*



### Price/Earnings\*



\*as of December 31.

## Branch Locations

### HERITAGE BANK

#### THURSTON COUNTY

OLYMPIA MAIN OFFICE  
201 5th Ave. SW  
Olympia, WA 98501  
360/ 943-1500

#### LACEY

4400 Pacific Ave. SE  
Lacey, WA 98503  
360/ 491-4350

#### TUMWATER

5301 Capitol Blvd. S.  
Tumwater, WA 98501  
360/ 943-5100

#### WEST OLYMPIA

900 Cooper Point Rd. SW  
Olympia, WA 98502  
360/ 705-3500

#### INDIAN SUMMER

5800 Rainier Lp. SE  
Lacey, WA 98513  
360/ 438-2000

#### MASON COUNTY

##### SHELTON

301 E. Wallace Kneeland Blvd.  
Shelton, WA 98584  
360/ 426-4431

#### PIERCE COUNTY

##### SPANAWAY

15211 Pacific Ave. W.  
Tacoma, WA 98444  
253/ 531-4360

#### LAKESWOOD

9802 Gravelly Lake Dr. SW  
Lakewood, WA 98499  
253/ 588-9866

#### 80TH AND PACIFIC

8002 Pacific Ave.  
Tacoma, WA 98408  
253/ 473-4945

#### 56TH AND S. TACOMA WAY

5448 South Tacoma Way  
Tacoma, WA 98499  
253/ 472-3333

#### 88TH AND S. TACOMA WAY

8801 South Tacoma Way  
Lakewood, WA 98499  
253/ 584-8600

#### DOWNTOWN TACOMA

1201 Pacific Ave.  
Tacoma, WA 98402  
253/ 572-5772

### CENTRAL VALLEY BANK

#### YAKIMA COUNTY

##### Toppenish

537 W. Second Ave.  
Toppenish, WA 98948  
509/ 865-2511

##### WAPATO

507 W. First Street  
Wapato, WA 98951  
509/ 877-6161

#### UNION GAP

2205 S. First Street  
Yakima, WA 98909  
509/ 576-0424

#### DOWNTOWN YAKIMA

301 W. Yakima Ave.  
Yakima, WA 98901  
509/ 453-1172

#### NOB HILL

3919 W. Nob Hill Blvd.  
Yakima, WA 98907  
509/ 972-9510  
Mortgage Center:  
509/ 576-8440

#### KITTITAS COUNTY

##### ELLENSBURG

100 N. Main  
Ellensburg, WA 98926  
509/ 925-5444



Taking the time to learn about our customers' businesses

# Corporate Directory

## DIRECTORS

Donald V. Rhodes  
Chairman

Lynn M. Brunton  
Community Volunteer

Brian Charneski  
President,  
L & E Bottling Co.

Peter Fluetsch  
President, Chief Executive Officer  
Sunset Air Inc.

Daryl D. Jensen  
Vice President, Administration  
Western Institutional Review Board  
Former President  
Sunset Life Insurance Company

Jeffrey S. Lyon  
President, Chief Executive Officer  
Insignia Kidder Mathews and  
Segner, Inc.

Melvin R. Lewis  
Broker, Former President  
Terril, Lewis and Wilke  
Insurance, Inc.

H. Edward Odegard  
Former Co-Owner  
The Valley Athletic Club

James P. Senna  
Former President and  
Chief Executive Officer  
Shee Atika, Inc.

Philip S. Weigand  
Real Estate Agent  
Virgil Adams Real Estate

Brian L. Vance  
President, Chief Operating Officer  
Heritage Bank

## CONSULTANT

John A. Clees  
Owner,  
RSM McGladrey

## CORPORATE OFFICERS

### HERITAGE FINANCIAL CORPORATION

Donald V. Rhodes  
Chairman, President  
and Chief Executive Officer

Brian L. Vance  
Executive Vice President

Edward D. Cameron  
Senior Vice President, Corporate  
Secretary and Treasurer

Lisa Welander  
Vice President and CIO

### HERITAGE BANK

Donald V. Rhodes  
Chairman and CEO

Brian L. Vance  
President and  
Chief Operating Officer

Gregory D. Patjens  
Executive Vice President

Edward D. Cameron  
Senior Vice President  
and Treasurer

Ron Goodwin  
Senior Vice President and  
Senior Credit Officer

Lisa Welander  
Senior Vice President and CIO

### CENTRAL VALLEY BANK

Donald V. Rhodes  
Chairman and CEO

D. Michael Broadhead  
President

Dale Loveland  
Senior Vice President and  
Senior Credit Officer

Janet St. Clair  
Senior Vice President  
and Cashier

## TRANSFER AGENT AND REGISTRAR

U.S. Stock Transfer Corporation  
1745 Gardena Avenue  
Glendale, CA 91204  
818/ 502-1404

## INDEPENDENT AUDITOR

KPMG LLP  
801 2nd Ave., Suite 900  
Seattle, WA 98104  
206/ 913-4000

## STOCK LISTING

NASDAQ® Stock Market  
Symbol: HFWA  
Common Stock

## STOCKHOLDER/INVESTOR INFORMATION

The annual meeting will be held  
Wednesday, April 30, 2003  
at 10:30 a.m. at The Phoenix Inn,  
417 Capitol Way N., Olympia, WA.  
All shareholders are invited to attend.

Shareholders and investors interested  
in additional information about  
Heritage Financial Corporation  
or receiving a copy of the Company's  
Annual Report to the Securities and  
Exchange Commission on Form  
10-K may contact:

Edward D. Cameron  
Treasurer and  
Corporate Secretary  
Heritage Financial Corporation  
PO Box 1578  
Olympia, WA 98507  
360/ 705-9172

e-mail:  
HFWA@HeritageBankWA.com





**nasdaq: hfwa**  
**[www.hf-wa.com](http://www.hf-wa.com)**