

Continuously Improving



**HERITAGE
FINANCIAL
CORPORATION**

In 2001, as part of our transformation into a thriving commercial banking company, we pledged to deliver a 15% return on average equity to our shareholders within five years.

We did it in four.

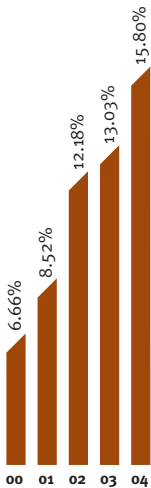
For your review, we present an overview of our final strides toward that goal, and a snapshot of a company never content with the status quo.





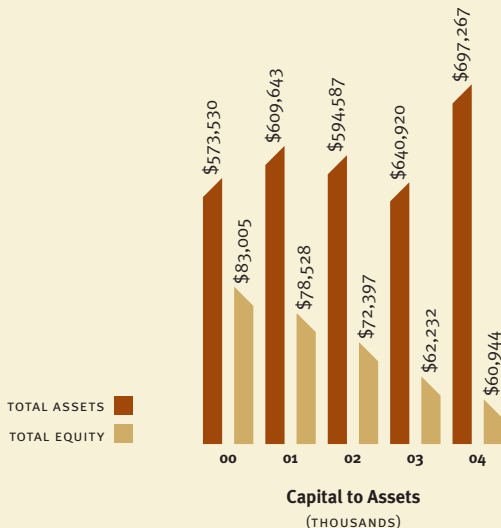
Knowledgeable investors know that a 15% return on average equity (ROAE) is the measure of a sound, well-run company. That's why we made achieving that goal our number one priority. In just four years, we've increased our ROAE from 6.7% to 15.8%. We met that goal by steadily doing what we think we do best: exceeding expectations of customers and shareholders alike.

15.8% ROAE



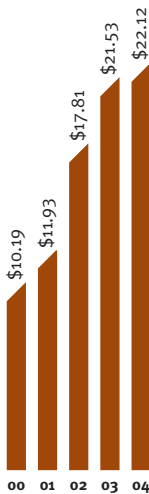
Return on Average Equity
(PERCENT)

Heritage Bank has operated as a commercial bank for years. **Now, it's official.** But it probably won't be news to our commercial customers. We've been finding new ways to exceed their expectations for a long time—with products, services, and solid relationships.

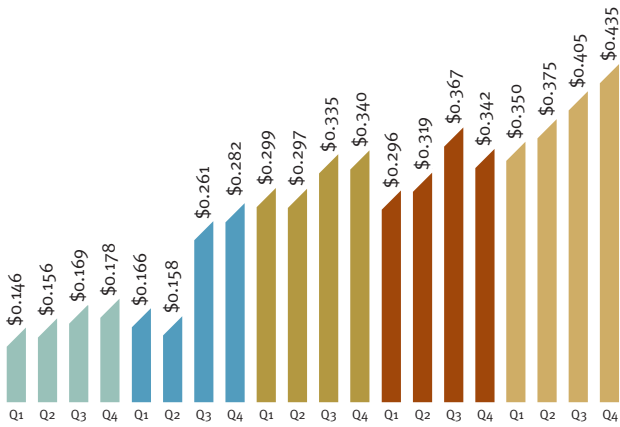




On September 1, 2004, the State of Washington approved the conversion of Heritage Bank's savings bank charter to a commercial bank charter. This final affirmation of our successful transformation to a total commercial banking company is good news for our shareholders, since investors typically assign a higher market premium to commercial banks.



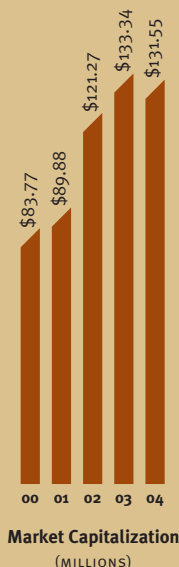
Closing Price
(DECEMBER 31)



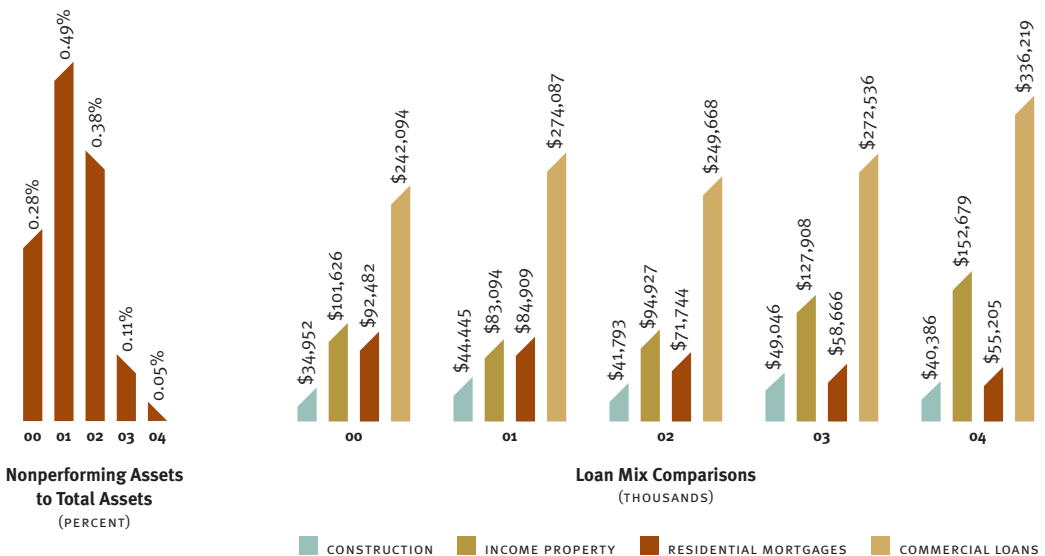
Quarterly Earnings per Diluted Share
(DOLLARS)

Heritage Financial Corporation is the holding company for two banks: Heritage Bank, which serves the south Puget Sound region, and Central Valley Bank, serving central Washington's Yakima and Kittitas Valleys.

While both banks have developed **expertise** in serving their particular customer bases—agricultural around Yakima and an emphasis on commercial business and real estate interests in urban Puget Sound—our company **prosper**s when the banks draw on one another's **strengths** and capitalize on their **synergies**.



In the last quarter of 2004, as part of an ongoing effort to align the two banks, we completed the conversion of Central Valley Bank's accounting and data processing systems to the same systems that Heritage Bank employs. The move, which enables all accounting functions for both banks to be performed by the holding company, will immediately save human resource and data processing costs. Further, the conversion will enable both banks to more efficiently align their products and services.





We can compete with the larger banks. Our new technology enables us to offer ‘big bank’ services with a personal touch. That’s good for our bottom line, good for our community, and good for our shareholders.”



D. MICHAEL BROADHEAD PRESIDENT, CENTRAL VALLEY BANK

In Washington’s Yakima and Kittitas Counties, success in banking means sharing in a strong sense of community and honoring longstanding relationships with your neighbors. That’s a lesson Central Valley Bank learned long ago, and it paid dividends for the bank again in 2004.

Central Valley Bank posted record earnings this year, despite the cost of converting to technology that will align the bank’s data processing and accounting systems with those of Heritage Bank. In addition to creating cost- and time-saving efficiencies, the conversion will enable Central Valley Bank to leverage its well-established presence in the marketplace in offering new Internet banking and cash management services in 2005.

Among Central Valley Bank’s achievements in 2004:

- Posted total assets of \$107.1 million, up 6.4% over 2003
- Increased total loans 14.9% to \$71.7 million; increased deposits 5.8% to \$98.1 million
- Continued its “Discover Excellence” campaign, which promotes the bank’s commercial services by profiling business partners in print, outdoor, and cable television advertising
- Maintained its commitment to community involvement through cash donations and volunteerism on the part of bank management and staff



“A five-year plan is only meaningful if you execute it, and your execution is only as good as your team. There is a strong culture at Heritage Bank and Heritage Financial Corporation of performing to the goals we set. We reach them through a series of individual decisions that all of our employees make daily. Everything we do, every day, makes a difference.”

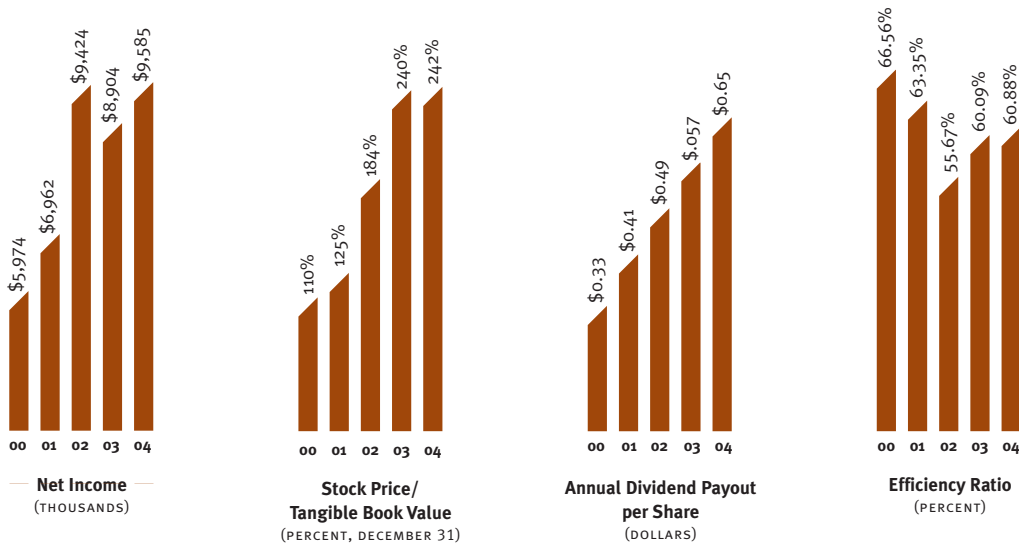
BRIAN L. VANCE PRESIDENT AND CHIEF EXECUTIVE OFFICER, HERITAGE BANK
PRESIDENT, HERITAGE FINANCIAL CORPORATION

In 2004, Heritage Bank experienced strong loan growth while maintaining asset quality, and met its financial goals despite the costs of an IT upgrade and measures to comply with the Sarbanes-Oxley Act. With 12 branches in three counties, Heritage Bank has succeeded by focusing on “total relationships” with customers—particularly its business customers.

The Heritage Bank team is proud of its contribution toward helping Heritage Financial Corporation achieve its goal of 15% return on average equity. Now the team is ready to do its part to meet the company’s new objectives of reaching \$1 billion in total assets and \$14 million in net income by the end of 2009. Heritage Bank will help to achieve these goals by continuing to execute on its community bank guiding principal of “exceeding your expectations”. Heritage Bank’s new strategic plan calls for continued alignment of all business units to further emphasize business relationships; a branching strategy to improve market position; increased training and development for all employees; and new business relationship products.

Among Heritage Bank’s achievements in 2004:

- ◆ Increased total assets 9.3% to \$589.9 million
- ◆ Increased total loans 15.0% to \$528.1 million; increased deposits 8.2% to \$490.1 million
- ◆ Continued to expand products and services, including a new free business checking account that performed strongly. In 2005, Heritage Bank will introduce a business debit card and other cash management products in high demand among its business customers
- ◆ Continued its long tradition of exemplary corporate citizenship and community involvement by our bank staff



To the Shareholders of Heritage Financial Corporation

DONALD V. RHODES CHAIRMAN AND CHIEF EXECUTIVE OFFICER, HERITAGE FINANCIAL CORPORATION

For years, “Continuously Improving” has been more than a slogan on the cover of our annual reports. It is our deeply held mission, an ethic we live by daily.

This year, I am proud to present you with the most compelling evidence yet of our commitment to continuous improvement: the achievement of our original five-year plan, one year early.

In 2001, we promised to improve all aspects of our performance to reach a return on average equity (ROAE) of 15% within five years. This year—just four years into our plan—we posted an ROAE of 15.8%.

That wasn’t the only positive news. Earnings per diluted share increased more than 18%, from \$1.32 to \$1.57. Net income for 2004 was \$9.6 million, up 7.9% from 2003. Our total assets at year’s end stood at \$697.3 million, up 8.8% over last year.

All told, we have made key strides in the process we began when we went public in 1998: that of turning a well-regarded, small-town thrift into a thriving regional commercial bank. We’ve succeeded through an unshakable focus on those simple-but-crucial things we think we do well: serving the business and real estate communities through longstanding relationships; offering the best products available; and operating as efficiently as we can.

Reaching this milestone doesn’t mean our work is finished. Our board of directors has adopted a new five-year strategic plan calling for continuing steady growth in earnings per



“The gains we’ve made in four short years are proof of what is possible in our unending mission to create greater value for our shareholders and the communities we serve.”

DONALD V. RHODES CHAIRMAN AND CHIEF EXECUTIVE OFFICER
HERITAGE FINANCIAL CORPORATION

share and setting two ambitious goals: to increase net income to \$14 million by fiscal year-end 2009 and to reach \$1 billion in total assets. In short, our objective is to continue to be a high-performing community banking company serving our market areas with competitive, fairly priced products and services while continuing to meet our shareholder expectations.

Of course, effective leadership is essential to reaching any objective, so it is my pleasure to announce that Brian Vance, president and chief executive officer of Heritage Bank, was named president of Heritage Financial Corporation by our directors on February 17, 2005. I will remain as chief executive officer of the holding company, confident in Brian’s ability to execute our strategic plan on a day-to-day basis.

With the proven effectiveness of our board and management team matched with the demonstrated commitment of our employees at Heritage and Central Valley Banks, I’m confident we can meet our new objectives. The gains we’ve made in four short years are proof of what is possible in our unending mission to create greater value for our shareholders and the communities we serve.

Thank you for your interest and investment in our company.

Sincerely,

A handwritten signature in dark ink that reads "Donald V. Rhodes" with a horizontal line extending to the right.

DONALD V. RHODES
CHAIRMAN AND CHIEF EXECUTIVE OFFICER



Board of Directors

Standing from left to right:

Brian S. Charneski
President, L&E Bottling Company

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

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

Brian L. Vance
*President, Heritage Financial Corporation
President & Chief Executive Officer, Heritage Bank*

Donald V. Rhodes
Chairman & Chief Executive Officer, Heritage Financial Corporation

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

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

Philip S. Weigand
Real Estate Agent, Virgil Adams Real Estate

Seated from left to right:

Peter N. Fluetsch
Chief Executive Officer, Sunset Air Inc.

John A. Clees
*(Consultant to Board)
Owner, RSM McGladrey*

Jeffrey S. Lyon
President & Chief Executive Officer, GVA Kidder Matthews

Lynn M. Brunton
Community Volunteer

Corporate Officers

HERITAGE FINANCIAL
CORPORATION

Donald V. Rhodes
Chairman & Chief Executive Officer

Brian L. Vance
President

Edward D. Cameron
*Senior Vice President
Corporate Secretary & Treasurer*

Lisa A. Welander
Vice President & Chief Information Officer

HERITAGE BANK

Donald V. Rhodes
Chairman

Brian L. Vance
President & Chief Executive Officer

Gregory D. Patjens
Executive Vice President

Edward D. Cameron
Senior Vice President & Treasurer

Ronald H. Goodwin
Senior Vice President & Senior Credit Officer

Lisa A. Welander
Senior Vice President & Chief Information Officer

CENTRAL VALLEY BANK

Donald V. Rhodes
Chairman & Chief Executive Officer

D. Michael Broadhead
President

Bruce Lyman
Senior Vice President & Senior Credit Officer

Janet St. Clair
Senior Vice President & Cashier

**2004
Form 10-K**

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

Central Valley Bank

YAKIMA COUNTY

Toppenish

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

Wapato

507 W. First St.
Wapato, WA 98951
509 877 6161

Union Gap

2205 S. First St.
Yakima, WA 98909
509 576 0424

Downtown Yakima

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

PIERCE COUNTY

Spanaway

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

Lakewood

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 South Tacoma Way

5448 South Tacoma Way
Tacoma, WA 98409
253 472 3333

88th and South Tacoma Way

8801 South Tacoma Way
Lakewood, WA 98499
253 584 8600

Downtown Tacoma

1119 Pacific Ave.
Tacoma, WA 98402
253 572 5772

www.HeritageBankWA.com

Nob Hill

3919 W. Nob Hill Blvd.
Yakima, WA 98907
509 972 9510

KITTITAS COUNTY

Ellensburg

100 N. Main
Ellensburg, WA 98926
509 925 5444

Corporate Information

TRANSFER AGENT & REGISTRAR

U.S. Stock Transfer Corporation
1745 Gardena Ave.
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

WEBSITE

www.HF-WA.com

STOCKHOLDER/ INVESTOR INFORMATION

The annual meeting will be held Thursday, April 28, 2005, 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
Senior Vice President,
Corporate Secretary & Treasurer

Heritage Financial Corporation
P.O. Box 1578
Olympia, WA 98507
360 705 9172

email: HFWA@HeritageBankWA.com

All charts contained in this annual report pertain to Heritage Financial Corporation.

