

HERITAGE FINANCIAL CORP /WA/  
Form 10-Q  
May 11, 2009  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**  
**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended March 31, 2009

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
Commission File Number 0-29480

**HERITAGE FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

**Washington**  
(State or other jurisdiction of incorporation or organization)

**91-1857900**  
(I.R.S. Employer Identification No.)

**201 Fifth Avenue SW, Olympia, WA**  
(Address of principal executive office)

**98501**  
(ZIP Code)

**(360) 943-1500**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date:

As of April 10, 2009 there were 6,705,954 common shares outstanding, with no par value, of the registrant.

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**HERITAGE FINANCIAL CORPORATION**

**FORM 10-Q**

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(Dollars in thousands, except for per share amounts)

(Unaudited)

	March 31, 2009	December 31, 2008
<b>Assets</b>		
Cash on hand and in banks	\$ 19,187	\$ 31,478
Interest earning deposits	73,107	29,156
Investment securities available for sale	34,837	31,922
Investment securities held to maturity (market value of \$10,123 and \$11,079)	11,470	12,081
Loans held for sale	1,402	304
Loans receivable	786,797	808,726
Less: Allowance for loan losses	(20,155)	(15,423)
Loans receivable, net	766,642	793,303
Other real estate owned	2,022	2,031
Premises and equipment, at cost, net	16,594	15,721
Federal Home Loan Bank stock, at cost	3,566	3,566
Accrued interest receivable	3,765	4,168
Prepaid expenses and other assets	6,071	4,453
Deferred federal income taxes, net	4,267	4,526
Intangible assets, net	404	424
Goodwill	13,012	13,012
Total assets	\$ 956,346	\$ 946,145
<b>Liabilities and Stockholders Equity</b>		
Deposits	\$ 839,747	\$ 824,480
Accrued expenses and other liabilities	4,733	8,518
Total liabilities	844,480	832,998
Stockholders equity:		
Preferred stock, \$1,000 per share liquidation preference, 24,000 shares authorized and outstanding at March 31, 2009 and December 31, 2008	23,396	23,367
Common stock, no par, 15,000,000 shares authorized; 6,705,954 and 6,699,550 shares outstanding at March 31, 2009 and December 31, 2008, respectively	26,667	26,546
Unearned compensation ESOP and other	(336)	(358)
Retained earnings	61,647	63,240
Accumulated other comprehensive gain, net	492	352
Total stockholders equity	111,866	113,147
Total liabilities and stockholders equity	\$ 956,346	\$ 946,145

See Notes to Condensed Consolidated Financial Statements.



**Table of Contents****ITEM 1. HERITAGE FINANCIAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF INCOME (LOSS)**

(Dollars in thousands, except for per share amounts)

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>INTEREST INCOME:</b>		
Interest and fees on loans	\$ 12,895	\$ 14,168
Taxable interest on investment securities	447	392
Nontaxable interest on investment securities	55	45
Interest on federal funds sold and interest bearing deposits	44	88
Dividends on Federal Home Loan Bank stock		8
<b>Total interest income</b>	<b>13,441</b>	<b>14,701</b>
<b>INTEREST EXPENSE:</b>		
Deposits	3,363	5,540
Other borrowings		97
<b>Total interest expense</b>	<b>3,363</b>	<b>5,637</b>
<b>Net interest income</b>	<b>10,078</b>	<b>9,064</b>
Provision for loan losses	5,250	360
<b>Net interest income after provision for loan losses</b>	<b>4,828</b>	<b>8,704</b>
<b>NON-INTEREST INCOME:</b>		
Gains on sales of loans, net	97	42
Brokered mortgage income	39	88
Service charges on deposits	989	990
Rental income	36	83
Merchant visa income	682	700
Other income	194	343
<b>Total non-interest income</b>	<b>2,037</b>	<b>2,246</b>
<b>NON-INTEREST EXPENSE:</b>		
Salaries and employee benefits	3,831	3,721
Occupancy and equipment	1,033	988
Data processing	409	384
Marketing	226	103
Merchant visa	565	562
Professional services	141	163
State and local taxes	195	237
Federal deposit insurance	145	37
Impairment loss on investment securities	175	
Other expense	1,160	775
<b>Total non-interest expense</b>	<b>7,880</b>	<b>6,970</b>
<b>Income (loss) before federal income taxes</b>	<b>(1,015)</b>	<b>3,980</b>
Federal income taxes	(421)	1,320

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Net income (loss)	\$ (594)	\$ 2,660
Net income (loss) applicable to common shareholders	\$ (923)	\$ 2,660
Earnings (loss) per common share:		
Basic	\$ (0.14)	\$ 0.40
Diluted	\$ (0.14)	\$ 0.40
Dividends declared per common share:	\$ 0.10	\$ 0.21

See Notes to Condensed Consolidated Financial Statements.

**Table of Contents****HERITAGE FINANCIAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY FOR THE THREE MONTHS ENDED  
MARCH 31, 2009 AND COMPREHENSIVE INCOME (LOSS) FOR THE THREE MONTHS ENDED****MARCH 31, 2009 AND 2008**

(Dollars and shares in thousands)

(Unaudited)

	Number of preferred stock shares	Preferred stock	Number of common shares	Common stock	Unearned Compensation- ESOP and other	Retained earnings	Accumulated other comprehensive income, net	Total stockholders equity
Balance at December 31, 2008	24,000	\$ 23,367	6,700	\$ 26,546	\$ (358)	\$ 63,240	\$ 352	\$ 113,147
Stock option compensation expense				44				44
Exercise of stock options (including tax benefits from nonqualified stock options)			4	42				42
Share based payment and earned ESOP			2	120	22			142
Tax benefit (provision) associated with share based payment and unallocated ESOP				(85)				(85)
Accretion of preferred stock		29				(29)		
Net loss						(594)		(594)
Change in fair value of securities available for sale, net of reclassification adjustments							140	140
Cash dividends accrued on preferred stock						(300)		(300)
Cash dividends declared on common stock						(670)		(670)
Balance at March 31, 2009	24,000	\$ 23,396	6,706	\$ 26,667	\$ (336)	\$ 61,647	\$ 492	\$ 111,866

<b>Comprehensive Income (Loss)</b>	<b>Three months ended March 31,</b>	
	<b>2009</b>	<b>2008</b>
Net income (loss)	\$ (594)	\$ 2,660
Change in fair value of securities available for sale, net of tax of \$73 and \$90	134	167
Reclassification adjustment of net gain from sale of available for sale securities included in income, net of tax of \$3 and \$0	6	
Comprehensive income (loss)	\$ (454)	\$ 2,827

See Notes to Condensed Consolidated Financial Statements.



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**HERITAGE FINANCIAL CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**For the three months ended March 31, 2009 and 2008**

(Dollars in thousands)

(Unaudited)

	2009	2008
Cash flows from operating activities:		
Net income (loss)	\$ (594)	\$ 2,660
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	255	313
Deferred loan fees, net of amortization	(135)	(207)
Provision for loan losses	5,250	360
Net change in accrued interest receivable, prepaid expenses and other assets, accrued expenses and other liabilities	(5,101)	(2,850)
Recognition of compensation related to ESOP shares and share based payment	142	118
Stock option compensation expense	44	54
Tax (benefit) provision realized from stock options exercised, share based payment and dividends on unallocated ESOP shares	84	(20)
Amortization of intangible assets	20	19
Deferred federal income tax	183	