

HERITAGE FINANCIAL CORP /WA/
Form DEF 14A
March 19, 2013
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**Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934**

Filed by the Registrant ☒ Filed by a Party other than the Registrant ☐

Check the appropriate box:

☐ Preliminary Proxy Statement

☐ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2)).**

☒ Definitive Proxy Statement

☐ Definitive Additional Materials

☐ Soliciting Material Pursuant to Rule 14a-12

HERITAGE FINANCIAL CORPORATION

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

☒ No fee required.

☐ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:
N/A

(2) Aggregate number of securities to which transactions applies:
N/A

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11:
N/A

(4) Proposed maximum aggregate value of transaction:
N/A

(5) Total fee paid:
N/A

.. Fee paid previously with preliminary materials: N/A

.. Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

(1) Amount previously paid:
N/A

(2) Form, Schedule or Registration Statement No.:
N/A

(3) Filing Party:
N/A

(4) Date Filed:
N/A

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March 19, 2013

Dear Shareholder:

On behalf of the Board of Directors and management of Heritage Financial Corporation, we cordially invite you to attend the annual meeting of shareholders. The meeting will be held at 10:30 a.m., Pacific time, on Wednesday, May 1, 2013 at the Phoenix Inn Suites, 417 Capitol Way N., Olympia, Washington. The matters expected to be acted upon at the meeting are described in the attached Proxy Statement. In addition, we will report on our results of operations during the past year and address your questions and comments.

We encourage you to attend the meeting in person. Whether or not you plan to attend, please read the enclosed Proxy Statement and then complete, sign and date the enclosed proxy card and return it in the accompanying postpaid return envelope, or follow the instructions on the proxy card to vote by phone or on the Internet, as promptly as possible. This will save us the additional expense of soliciting proxies and will ensure that your shares are represented at the annual meeting.

Your Board of Directors and management are committed to the continued success of Heritage Financial Corporation and the enhancement of your investment. As President and Chief Executive Officer, I want to express my sincere appreciation for your confidence and support.

We look forward to seeing you at the meeting.

Sincerely,
Brian L. Vance
President and Chief Executive Officer

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NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

Date: Wednesday, May 1, 2013

Time: 10:30 a.m. Pacific time

Place: Phoenix Inn Suites, 417 Capitol Way N., Olympia, Washington

Matters to be voted on:

1. The election of six directors to each serve for a one-year term.
2. An advisory (non-binding) resolution to approve the compensation paid to our named executive officers, as disclosed in this Proxy Statement.
3. The ratification of the Audit and Finance Committee's appointment of Crowe Horwath LLP as our independent registered public accounting firm for the year ending December 31, 2013.

We will also transact other business that may properly come before the meeting, or any adjournment or postponement thereof.

Shareholders of record at the close of business on March 4, 2013 are entitled to receive notice of and to vote at the annual meeting.

Please vote your shares at your earliest convenience. This will ensure the presence of a quorum at the meeting. Promptly voting your shares via the Internet, by telephone, or by signing, dating, and returning the enclosed proxy card, which is solicited by the Board of Directors, will save us the expense and extra work for additional solicitation. If you wish to vote by mail, we have enclosed an addressed envelope, postage prepaid if mailed in the United States. The proxy will not be used if you attend and vote at the annual meeting in person. Regardless of the number of shares you own, your vote is very important. Please act today.

By Order of the Board of Directors

Kaylene M. Lahn

Senior Vice President and Corporate Secretary

Olympia, Washington

March 19, 2013

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**2013 PROXY STATEMENT
ANNUAL MEETING OF SHAREHOLDERS**

HERITAGE FINANCIAL CORPORATION

201 Fifth Avenue S.W.

Olympia, Washington 98501

(360) 943-1500

The Board of Directors of Heritage Financial Corporation is using this Proxy Statement to solicit proxies from our shareholders for use at the annual meeting of shareholders. We are first mailing this Proxy Statement and the enclosed form of proxy to our shareholders on or about March 19, 2013.

The information provided in this Proxy Statement relates to Heritage Financial Corporation and its wholly-owned bank subsidiaries, Heritage Bank and Central Valley Bank. Heritage Financial Corporation may also be referred to as Heritage or the Company. All references in this Proxy Statement to Heritage, we, us and our or similar references means Heritage Financial Corporation and its consolidated subsidiaries and all references to Heritage Financial Corporation means Heritage Financial Corporation excluding its subsidiaries, in each case unless otherwise expressly stated or the context requires otherwise.

INFORMATION ABOUT THE ANNUAL MEETING

Time and Place of the Annual Meeting

Our annual meeting will be held as follows:

Date: Wednesday, May 1, 2013

Time: 10:30 a.m., Pacific time

Place: Phoenix Inn Suites, 417 Capitol Way N., Olympia, Washington

Matters to Be Considered at the Annual Meeting

At the meeting, you will be asked to consider and vote on:

The election of six directors to each serve for a one-year term.

An advisory, non-binding, resolution to approve the compensation paid to our named executive officers, as disclosed in this Proxy Statement.

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The ratification of the Audit and Finance Committee's appointment of Crowe Horwath LLP as our independent registered public accounting firm for the year ending December 31, 2013.

We will also transact any other business that may properly come before the annual meeting. As of the date of this Proxy Statement, we are not aware of any business to be presented for consideration at the annual meeting other than the matters described in this Proxy Statement.

Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting of Shareholders to Be Held on May 1, 2013

Our Proxy Statement and Annual Report to Shareholders are available at www.hf-wa.com. The following materials are available for review:

Proxy Statement;

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Proxy Card;

Annual Report to Shareholders; and

Directions to attend the annual meeting, where you may vote in person.

Who is Entitled to Vote?

We have fixed the close of business on March 4, 2013, as the record date for shareholders entitled to notice of and to vote at our annual meeting. Only holders of record of Heritage's common stock on that date are entitled to notice of and to vote at the annual meeting. You are entitled to one vote for each share of Heritage common stock you own, unless you acquired more than 10% of Heritage's common stock without prior Board approval. As provided in our Articles of Incorporation, for each vote in excess of 10% of the voting power of the outstanding shares of Heritage's voting stock, the record holders in the aggregate will be entitled to cast one-hundredth of a vote, and the aggregate power of these record holders will be allocated proportionately among these record holders. On March 4, 2013, there were 15,113,057 shares of Heritage common stock outstanding and entitled to vote at the annual meeting.

How Do I Vote at the Annual Meeting?

Proxies are solicited to provide all shareholders of record on the voting record date an opportunity to vote on matters scheduled for the annual meeting and described in these materials. You are a shareholder of record if your shares of Heritage common stock are held in your name. If you are a beneficial owner of Heritage common stock held by a broker, bank or other nominee (i.e., in street name), please see the instructions in the following question.

Shares of Heritage common stock can only be voted if the shareholder is present in person or by proxy at the annual meeting. To ensure your representation at the annual meeting, we recommend you vote by proxy even if you plan to attend the annual meeting. You can always change your vote at the meeting if you are a shareholder of record.

Voting instructions are included on your proxy card. Shares of Heritage common stock represented by properly executed proxies will be voted by the individuals named on the proxy card in accordance with the shareholder's instructions. Where properly executed proxies are returned to us with no specific instruction as to how to vote at the annual meeting, the persons named in the proxy will vote the shares FOR the election of each of our director nominees, FOR advisory approval of the compensation of our named executive officers as disclosed in this Proxy Statement and FOR ratification of the appointment of Crowe Horwath LLP as our independent registered public accounting firm for the year ending December 31, 2013. If any other matters are properly presented at the annual meeting for action, the persons named in the enclosed proxy and acting thereunder will have the discretion to vote on these matters in accordance with their best judgment. We do not currently expect that any other matters will be properly presented for action at the annual meeting.

You may receive more than one proxy card depending on how your shares are held. For example, you may hold some of your shares individually, some jointly with your spouse and some in trust for your children. In this case, you will receive three separate proxy cards to vote.

What if My Shares Are Held in Street Name by a Broker?

If you are the beneficial owner of shares held in street name by a broker, your broker, as the record holder of the shares, is required to vote the shares in accordance with your instructions. If you do not give instructions to your broker, your broker may nevertheless vote the shares with respect to discretionary items, but will not be permitted to vote your shares with respect to non-discretionary items, pursuant to current industry practice. In the case of non-discretionary items, the shares not

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voted will be treated as broker non-votes. The proposal to elect directors and the advisory vote on executive compensation are considered non-discretionary items; therefore, you must provide instructions to your broker in order to have your shares voted on these proposals.

If your shares are held in street name, you will need proof of ownership to be admitted to the annual meeting. A recent brokerage statement or letter from the record holder of your shares are examples of proof of ownership. If you want to vote your shares of common stock held in street name in person at the annual meeting, you will have to get a written proxy in your name from the broker, bank or other nominee who holds your shares.

How Will My Shares of Common Stock Held in the 401(k) Employee Stock Ownership Plan Be Voted?

We maintain a 401(k) employee stock ownership plan (KSOP) which owned 387,780 shares or 2.57% of Heritage's common stock as of the record date. Our 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 26, 2013.

How Many Shares Must Be Present to Hold the Meeting?

A quorum must be present at the meeting for any business to be conducted. The presence at the meeting, in person or by proxy, of at least a majority of the shares of Heritage common stock entitled to vote at the annual meeting as of the record date will constitute a quorum. Proxies received but marked as abstentions or broker non-votes will be included in the calculation of the number of shares considered to be present at the meeting.

What if a Quorum Is Not Present at the Meeting?

If a quorum is not present at the scheduled time of the meeting, a majority of the shareholders present or represented by proxy may adjourn the meeting until a quorum is present. The time and place of the adjourned meeting will be announced at the time the adjournment is taken, and no other notice will be given unless a new record date for the meeting is set. An adjournment will have no effect on the business that may be conducted at the meeting.

Vote Required to Approve Proposal 1: Election of Directors

Directors are elected by a plurality of the votes cast, in person or by proxy, at the annual meeting by holders of Heritage common stock. Accordingly, the six nominees for election as directors who receive the highest number of votes actually cast will be elected. Pursuant to our Articles of Incorporation, shareholders are not permitted to cumulate their votes for the election of directors. Votes may be cast for or withheld from each nominee. Votes that are withheld and broker non-votes will have no effect on the outcome of the election because the six nominees receiving the greatest number of votes will be elected. **Our Board of Directors unanimously recommends that you vote FOR the election of each of its director nominees.**

Vote Required to Approve Proposal 2: Advisory Vote on Executive Compensation

Approval of the advisory (non-binding) vote on executive compensation requires the affirmative vote of the majority of the shares of Heritage common stock present, in person or by proxy, at the annual

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meeting. Abstentions are not affirmative votes and, therefore, will have the same effect as a vote against the proposal. Broker non-votes do not constitute votes cast and therefore will have no effect on the approval of the proposal. **Our Board of Directors unanimously recommends that you vote FOR the adoption of an advisory resolution to approve our executive compensation as disclosed in this Proxy Statement.**

Vote Required to Approve Proposal 3: Ratification of the Appointment of Our Independent Registered Public Accounting Firm

Ratification of the Audit and Finance Committee's appointment of Crowe Horwath LLP as our independent registered public accounting firm for the year ending December 31, 2013, requires the affirmative vote of the majority of the shares of Heritage common stock present, in person or by proxy, at the annual meeting by holders of Heritage common stock. Abstentions are not affirmative votes and, therefore, will have the same effect as a vote against the proposal. **Our Board of Directors unanimously recommends that you vote FOR the proposal to ratify the selection of Crowe Horwath LLP as our independent registered public accounting firm for the year ending December 31, 2013.**

May I Revoke My Proxy?

You may revoke your proxy before it is voted by:

submitting a new proxy with a later date;

notifying the Corporate Secretary of Heritage in writing before the annual meeting that you have revoked your proxy; or

voting in person at the annual meeting.

If you plan to attend the annual meeting and wish to vote in person, we will give you a ballot at the annual meeting. However, if your shares are held in street name, you must bring a validly executed proxy from the nominee indicating that you have the right to vote the shares.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following tables set forth, as of March 4, 2013, information regarding share ownership of:

those persons or entities (or groups of affiliated persons or entities) known by management to beneficially own more than five percent of Heritage's common stock other than directors and executive officers;

each director and director nominee of Heritage;

each executive officer of Heritage named in the Summary Compensation Table appearing under "Executive Compensation" below (known as "named executive officers"); and

all current directors and executive officers of Heritage as a group.

Persons and groups who beneficially own in excess of five percent of Heritage's common stock are required to file with the Securities and Exchange Commission ("SEC"), and provide a copy to Heritage, reports disclosing their ownership pursuant to the Securities Exchange Act of 1934. To our knowledge, no other person or entity, other than the ones set forth below, beneficially owned more than five percent of the outstanding shares of Heritage's common stock as of the close of business on the voting record date.

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Beneficial ownership is determined in accordance with the rules and regulations of the SEC. In accordance with Rule 13d-3 of the Securities Exchange Act, a person is deemed to be the beneficial owner of any shares of common stock if he or she has voting and/or investment power with respect to those shares. Therefore, the table below includes shares owned by spouses, other immediate family members in trust, shares held in retirement accounts or funds for the benefit of the named individuals, and other forms of ownership, over which shares the persons named in the table may possess voting and/or investment power. In addition, in computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares of common stock subject to outstanding options that are currently exercisable or exercisable within 60 days after the voting record date are included in the number of shares beneficially owned by the person and are deemed outstanding for the purpose of calculating the person's percentage ownership. These shares, however, are not deemed outstanding for the purpose of computing the percentage ownership of any other person.

As of December 31, 2012, the following shareholders beneficially owned more than 5% of the outstanding shares of Heritage common stock.

Beneficial Owners of More Than 5%	Number of Shares Beneficially Owned	Percent of Common Stock Outstanding
Wellington Management Company, LLP ⁽¹⁾ 75 State Street, Boston, MA 02108	972,855	6.42%
BlackRock Inc. ⁽²⁾ 40 East 52 nd Street, New York, NY 10022	873,324	5.76%
Woodmen of the World Life Insurance Society and/or Omaha Woodmen Life Insurance Company ⁽³⁾ 1700 Farnam Street, Omaha, NE 68102	828,080	5.48%

(1) According to a Schedule 13G filed with the SEC on February 14, 2013, Wellington Management Company, LLP has shared voting power and dispositive power over the shares reported.

(2) According to a Schedule 13G filed with the SEC on February 8, 2013, BlackRock Inc. has sole voting and dispositive power over the shares reported.

(3) According to a Schedule 13G filed with the SEC on February 4, 2013, Woodmen of the World Life Insurance Society and/or Omaha Woodmen Life Insurance Company has sole voting and dispositive power over the shares reported.

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The following table shows, as of March 4, 2013, the amount of Heritage common stock owned (unless otherwise indicated) by each director, director nominee, the named executive officers and all of our directors and executive officers as a group. On March 4, 2013, there were 15,113,057 shares of Heritage common stock outstanding and entitled to vote at the annual meeting.

Name	Number of Shares Beneficially Owned	Percent of Common Stock Outstanding
Directors		
Brian S. Charneski ⁽¹⁾	38,883	*
Gary B. Christensen ⁽²⁾	61,209	*
John A. Clees ⁽³⁾	83,425	*
Kimberly T. Ellwanger ⁽⁴⁾	17,213	*
Peter N. Fluetsch ⁽⁵⁾	47,844	*
Daryl D. Jensen ⁽⁶⁾	186,670	1.24%
Jeffrey S. Lyon ⁽⁷⁾	36,549	*
Donald V. Rhodes ⁽⁸⁾	328,350	2.17%
Ann Watson ⁽⁹⁾	-	
Philip S. Weigand ⁽¹⁰⁾	134,817	*
Named Executive Officers		
Brian L. Vance ⁽¹¹⁾	151,330	1.00%
Jeffrey J. Deuel ⁽¹²⁾	43,561	*
Donald J. Hinson ⁽¹³⁾	27,767	*
D. Michael Broadhead ⁽¹⁴⁾	53,519	*
David A. Spurling ⁽¹⁵⁾	29,802	*
Directors and Executive Officers as a group (15 persons)	1,240,939	8.21%

* Less than one percent of shares outstanding

- (1) Includes 5,500 shares issuable upon exercise of options, 18,494 shares held jointly with his spouse, 8,675 shares owned by an entity controlled by Mr. Charneski and 420 shares held in trust.
- (2) Includes 7,675 shares issuable upon exercise of options, 30,157 shares held jointly with his spouse and 21,400 shares owned by entities controlled by Mr. Christensen.
- (3) Includes 6,025 shares issuable upon exercise of options, 65,122 shares held jointly with his spouse, 1,050 shares owned solely by his spouse and 2,500 shares owned by an entity controlled by Mr. Clees.
- (4) Includes 4,000 shares issuable upon exercise of options and 11,859 shares held jointly with her spouse.
- (5) Includes 4,000 shares issuable upon exercise of options and 42,250 shares held jointly with his spouse.
- (6) Includes 7,150 shares issuable upon exercise of options, 128,455 shares held jointly with his spouse, 10,000 shares held in an indirect trust whereby he has voting power and 39,088 shares held in trust.
- (7) Includes 5,500 shares issuable upon exercise of options and 3,150 shares held as custodian for a minor.
- (8) Includes 7,150 shares issuable upon exercise of options and 22,193 vested shares in the KSOP.
- (9) It is expected that Ms. Watson will be in compliance with our stock ownership guidelines in the allotted time frame.
- (10) Includes 7,050 shares issuable upon exercise of options, 15,960 shares held solely by his spouse and 49,920 shares held jointly with his spouse.
- (11) Mr. Vance is also a director. Includes 7,001 shares issuable upon exercise of options, 78,055 shares held jointly with his spouse and 18,073 vested shares in the KSOP.
- (12) Includes 20,000 shares issuable upon exercise of options and 380 vested shares in the KSOP.
- (13) Includes 6,596 shares issuable upon exercise of options and 1,664 vested shares in the KSOP.
- (14) Includes 10,048 shares issuable upon exercise of options, 20,414 shares owned jointly with his spouse, 649 shares owned by a family partnership and 2,589 vested shares in the KSOP.
- (15) Includes 6,294 shares issuable upon exercise of options, 10,875 shares held jointly with his spouse and 4,728 vested shares in the KSOP.

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Our Board of Directors currently consists of eleven members and historically has been divided into three classes, with directors elected for three-year terms. At the 2011 annual meeting of shareholders, shareholders approved an amendment to our Articles of Incorporation which eliminated our classified Board prospectively. The terms of current members Brian S. Charneski, Gary B. Christensen, John A. Clees, Kimberly T. Ellwanger, Peter N. Fluetsch, Philip S. Weigand and Brian L. Vance expire at the 2013 annual meeting. Upon recommendation of the Governance and Nominating Committee, each of these incumbent directors, with the exception of Messrs. Fluetsch and Weigand who are retiring due to our retirement policy, has been nominated by the Board to serve a one-year term ending at the 2014 annual meeting, or when their respective successors have been duly elected and qualified. Ann Watson was newly appointed to the Board of Directors in October 2012 and has also been nominated by the Board to serve a one-year term. Ms. Watson was recommended as a director by a third party search firm. The third party search firm performed interviews with the directors and certain executive officers to determine a consensus profile for the director search. Due diligence of the candidates was performed by the third party search firm prior to the candidate meeting with the Board for final interviews, selection and nomination to the Board.

The table below sets forth information regarding each director of Heritage and each nominee for director, including his or her age, position and term of office. Each nominee has consented to being named in this Proxy Statement and has agreed to serve if elected. If a nominee is unable to stand for election, the Board of Directors may either reduce the number of directors to be elected or select a substitute nominee. If a substitute nominee is selected, the proxy holders will vote your shares for the substitute nominee, unless you have withheld authority. At this time, we are not aware of any reason why a nominee might be unable to serve if elected.

The Board of Directors recommends you vote FOR the election of Brian S. Charneski, Gary B. Christensen, John A. Clees, Kimberly T. Ellwanger, Brian L. Vance and Ann Watson.

			Director	Term to
Name	Age (1)	Position(s) Held with Heritage	Since	Expire
Nominees				
Brian S. Charneski	51	Director, Vice Chairman	2000	2014 ⁽²⁾
Gary B. Christensen	64	Director	2005	2014 ⁽²⁾
John A. Clees	65	Director	2005	2014 ⁽²⁾
Kimberly T. Ellwanger	53	Director	2006	2014 ⁽²⁾
Brian L. Vance	58	Director, President & CEO	2002	2014 ⁽²⁾
Ann Watson	51	Director	2012	2014 ⁽²⁾
Directors Continuing in Office ⁽³⁾				
Daryl D. Jensen	73	Director	1985	2014
Jeffrey S. Lyon	60	Director	2000	2014
Donald V. Rhodes	76	Chairman	1989	2014

(1) As of December 31, 2012.

(2) Assuming election or re-election.

(3) Messrs. Jensen, Lyon and Rhodes will complete the last year of their three-year staggered term.

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Business Experience of Nominees for Election or Re-Election

The business experience of each nominee of Heritage for at least the past five years and the experience, qualifications, attributes, skills and areas of expertise of each director that led to the conclusion that the person should serve as a director of Heritage is set forth below. All nominees have held their present positions for at least five years unless otherwise indicated.

Brian S. Charneski is the President of L&E Bottling Company in Olympia, Washington and is Chairman of Pepsi Northwest Beverages, LLC, a regional beverage manufacturing joint venture with PepsiCo, Inc. headquartered in Tumwater, Washington. Mr. Charneski is a director of Spyglass Capital Partners, LLC, a private equity investment company and chairs its operating committee. Mr. Charneski is a director of Shadow Beverages and Snacks, LLC, a developer and innovator in the snack and beverage industry, headquartered in Phoenix, Arizona. Mr. Charneski is a director of the American Beverage Association and is also a member of the Board of Directors of the Pepsi-Cola Bottlers Association, having chaired the Association from 2005 to 2007. Mr. Charneski serves on the Board of Trustees of Saint Martin's University and has been a past director of the Washington Center for Performing Arts and The Community Foundation of the South Sound. Mr. Charneski is a 1985 graduate of Seattle University with a Bachelor of Arts in Economics. Mr. Charneski provides a depth of knowledge in corporate and regulatory matters as he is a strong advocate for the beverage industry. He brings significant financial, economic and merger and acquisition expertise to the Board.

Gary B. Christensen is the President, Chief Executive Officer and Chairman of the Board of Powell Christensen Inc., a fuel, lubricant and propane distributorship headquartered in Grandview, Washington. Mr. Christensen is also the Chief Executive Officer and Chairman of the Board of MidValley Chrysler, Jeep, Dodge Inc., the Chief Executive Officer of Christensen West LLC and the Chief Executive Officer of Seaport Petroleum. In 2004, R.E. Powell Distributing (a subsidiary of Powell Christensen Inc.) was named one of five inductees into the University of Washington sponsored Leadership Circle at the Annual University of Washington Minority Business of the Year Awards dinner. Mr. Christensen is a current member of the Chevron Oil Company National Wholesale Council, serves on the Board of Ambassadors for the University of Washington Business and Economic Development Program and is a founding director and a former President of the Central Washington Chapter of Safari Club International. Mr. Christensen serves as a director for Central Valley Bank and recently retired from serving as the Chairman of the Board of Directors for Yakima County Development Association. Mr. Christensen provides significant knowledge in corporate matters with his proven leadership in the success of his multiple companies. He also provides extensive knowledge of the Yakima Valley real estate market, where our subsidiary bank, Central Valley Bank, is located.

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John A. Clees is an attorney at Worth Law Group with a practice emphasis in estate and business succession planning for closely held companies and their owners. Formerly, Mr. Clees was the Tax Services Director at the consulting and accounting firm of RSM McGladrey and McGladrey & Pullen LLP in Olympia, Washington. Prior to this, Mr. Clees was the President of Clees Miles CPA Group, Olympia, Washington until the Group was sold to RSM McGladrey. Prior to that time, he was the managing partner of Gattis, Clees and Company, an accounting firm with offices in Seattle and Olympia, Washington. Mr. Clees is a graduate of the University of Washington with a Bachelor of Arts in Economics and a graduate of the University of Washington School of Law. Mr. Clees is licensed as a Certified Public Accountant, an attorney and mediator in the State of Washington. Mr. Clees served on Heritage's Board of Directors from 1990 to 2000 and served as a non-voting consultant to Heritage's Board of Directors and Audit Committee from 2000 until June 2005. Mr. Clees provides important tax and accounting expertise to the Board. He also brings a legal perspective to the Board, with a solid understanding of corporate governance matters.

Kimberly T. Ellwanger was Senior Director of Corporate Affairs and Associate General Counsel at Microsoft Corporation of Redmond, Washington from 1991 until her retirement in October 1999. She led Microsoft in developing a corporate presence in government, industry and community affairs, including opening a Washington, D.C. office and developing a network of state and local government affairs representation. Prior to joining Microsoft, Ms. Ellwanger was a Partner at Perkins Coie in Seattle, Washington from 1985 to 1991, where her practice included state and local tax planning, tax litigation, bankruptcy, general business and corporate advice and transactions. She has been involved in numerous civic and professional activities including currently serving on the Board of the South Sound YMCA and the University of Washington Law Alumni Magazine Editorial Board. She is past Chair of the Washington Council on International Trade and past Vice President of the Business Software Alliance and past Board member of the American Electronics Association. Ms. Ellwanger graduated with high honors from the University of Washington School of Law and graduated Phi Beta Kappa from Vassar College with an honors degree in economics. She has participated in a number of director education programs, including the DirectWomen Board Institute and has been a panelist at state and national compensation conferences. Ms. Ellwanger brings significant legal expertise, which is complemented with her knowledge and experience in corporate and government matters.

Brian L. Vance became President and Chief Executive Officer of Heritage and Heritage Bank, and Vice Chairman and Chief Executive Officer of Central Valley Bank in 2006. In September 2012, Mr. Vance resigned as President of Heritage Bank upon the promotion of Jeffrey J. Deuel. In 2003, Mr. Vance was appointed President and Chief Executive Officer of Heritage Bank and in 1998, Mr. Vance was named President and Chief Operating Officer of Heritage Bank. Mr. Vance joined Heritage Bank in 1996 as its Executive Vice President and Chief Credit Officer. Prior to joining Heritage Bank, Mr. Vance was employed for 24 years with West One Bank, a bank with offices in Idaho, Utah, Oregon and Washington. Prior to leaving West One, he was Senior Vice President and Regional Manager of Banking Operations for the south Puget Sound region. Mr. Vance serves as trustee of the South Puget Sound Community College and as a director of the University of Washington Tacoma Milgard School of Business Foundation and the Community Foundation. He is also the past President of the Washington Financial League. Mr. Vance's experience with the financial services industry, which includes credit administration, management and strategic forecasting, brings valuable management and financial analysis skills to the Board.

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Ann Watson was appointed to the board in October 2012. Ms. Watson is a graduate of Whitman College with a Bachelor of Arts in Economics and a graduate of Columbia University with a Masters of Business Administration. Ms. Watson previously served in executive leadership roles at Russell Investments where she played an integral part in the company's successful expansion spanning a 15 year period. In these leadership roles, she served as Chief Human Resources Officer, as a Management Committee Member, a Russell Mellon Board Member and as a Director in the Corporate Finance Group. Prior to joining Russell Investments she had a seven year career with Chemical Bank/Manufacturers Hanover in New York and abroad whereby she held multiple global roles including strategic planning, loan workouts, client relationship management and credit analysis. Ms. Watson is an active community leader in the Seattle area. She currently serves on the Board of the Seattle Foundation and is active in Social Venture Partners and Thrive by Five. Previously she served on the board of the Washington Economic Development Finance Authority and on the Executive Committee of the Washington State China Relations Council. Ms Watson brings extensive financial services industry and corporate financial knowledge to the Board, including merger and acquisition experience. Her significant leadership, compensation and human resources experience add to the Board's perspective.

Business Experience of Directors Continuing in Office

The business experience of each director continuing in office of Heritage for at least the past five years and the experience, qualifications, attributes, skills and areas of expertise of each director that led to the conclusion that the person should serve as a director of Heritage is set forth below. All directors have held their present positions for at least five years unless otherwise indicated.

Daryl D. Jensen served as President of Sunset Life Insurance Company of America from 1973 until his retirement in 1999. He was a member of the Sunset Life Board from 1971 to 2010. He came out of retirement and served as the Chief Financial Officer of Western Institutional Review Board, located in Olympia, Washington, from 2001 until 2010. He served as a director of Kansas City Life Insurance Company from 1978 to 2011 and was a member of its Audit Committee from 2004 to 2011. Mr. Jensen is also a director of Panorama Corporation, a large retirement community located in Lacey, Washington. Mr. Jensen has served as a director of Central Valley Bank since 1989. Mr. Jensen is a member of the American Academy of Actuaries. Mr. Jensen brings significant financial services industry and accounting expertise to the Board. His management and financial operations experience broaden the Board's perspective on insurance and financial services matters.

Jeffrey S. Lyon is the Chairman and Chief Executive Officer of Kidder Mathews, headquartered in Seattle, Washington. Mr. Lyon serves as a director for Kidder Mathews Segner Inc. Mr. Lyon is a member of the Real Estate Advisory Board of Washington State University, the Business Advisory Board for the Milgard School of Business at the University of Washington, Tacoma and is also on the Tacoma-Pierce County Economic Development Board. Mr. Lyon has over 35 years of experience in the commercial real estate industry in the Puget Sound area. Mr. Lyon provides expertise in the commercial real estate industry and has excellent entrepreneurial and leadership skills, which are beneficial to the Board.

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Donald V. Rhodes currently serves as Chairman of Heritage Financial Corporation and Heritage Bank, and since 1986, Chairman of Central Valley Bank, a subsidiary of Heritage Financial Corporation which was acquired in March 1999. Mr. Rhodes joined Heritage Bank in 1989 as President and Chief Executive Officer and was elected Chairman in 1990. Mr. Rhodes served as a director of the Federal Home Loan Bank of Seattle from August 2005 to December 2012. Mr. Rhodes' significant experience in the financial services industry provides a broad depth of knowledge and judgment to the Board. He provides the management and leadership skills required of the Chairman of the Company.

Director Qualifications and Experience

The following table includes the qualifications and experience of each director that led the Board to conclude that the director is qualified to serve on the Board.

Summary of Director Qualifications

and Experience	Charneski	Christensen	Clees	Ellwanger	Jensen	Lyon	Rhodes	Watson	Vance
Academia/Education is valued because it evidences a disciplined approach to enhancing the individual's knowledge in their trade/business which provides for a broader perspective.	ü	ü	ü	ü	ü	ü	ü	ü	ü
Attorney - provides legal focus which assists with regulatory compliance.			ü	ü					
Business Operations experience gives directors a practical understanding of developing, implementing and assessing our operating plan and business strategy.	ü	ü	ü	ü	ü	ü	ü	ü	ü
Corporate Governance experience supports our goals of strong Board and management accountability, transparency and protection of shareholder interests.	ü	ü	ü	ü	ü	ü	ü	ü	ü
Financial Expertise assists our directors in understanding the financial reporting and internal controls.	ü	ü	ü	ü	ü	ü	ü	ü	ü
Financial Services (specifically, banking or insurance) experience provides an in-depth knowledge of our business operations.					ü		ü	ü	ü
Real Estate expertise is important in understanding our lending business.	ü					ü	ü		ü

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The Board of Directors of Heritage conducts its business through meetings of the Board and through its committees. The Board meets on a monthly basis, holding special meetings as necessary. After each regular Board meeting, the directors meet in executive session, outside of the presence of the Chief Executive Officer. In addition, the outside directors hold separate meetings on a regular basis. During the year ended December 31, 2012, the Board of Directors held 12 meetings. No director attended fewer than 75% of the total meetings of the Board and committees on which the director served during this period.

Committees and Committee Charters

Our Board of Directors has standing Audit and Finance, Governance and Nominating, Compensation and Risk Committees and has adopted written charters for each of these committees. You may obtain a copy of the Audit and Finance, Governance and Nominating, and Compensation Committee charters, free of charge, by writing to: Kaylene M. Lahn, Corporate Secretary, Heritage Financial Corporation, 201 Fifth Avenue S.W., Olympia, Washington, 98501, or by calling (360) 943-1500. These charters are also available on our website at www.hf-wa.com.

The following table shows the membership of the various committees as of the mailing date of this proxy statement, as well as the number of meetings held by each committee in 2012.

Committee Membership

Name	Audit and Finance	Compensation	Governance and Nominating	Risk
Brian S. Charneski	ü		ü *	
Gary B. Christensen	ü	ü	ü	
John A. Clees	ü			ü *
Kimberly T. Ellwanger		ü *	ü	
Peter N. Fluetsch		ü	ü	ü
Daryl D. Jensen	ü *			ü
Jeffrey S. Lyon	ü	ü	ü	
Donald V. Rhodes	ü		ü	ü
Brian L. Vance				ü
Ann Watson	ü	ü		
Philip S. Weigand	ü	ü		ü
Total Meetings in 2012	6	6	7	4

* Committee Chair

Audit and Finance Committee

The Audit and Finance Committee is composed of eight members, each of whom is independent in accordance with the requirements for companies listed on The NASDAQ Stock Market and applicable SEC rules. Director Jensen has been designated by the Board of Directors as the audit committee financial expert, as defined by the SEC. The Committee meets quarterly and on an as-needed basis to evaluate the effectiveness of Heritage's internal controls for safeguarding its assets and ensuring the

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integrity of the financial reporting. The Committee also appoints the independent registered public accounting firm and reviews the audit reports prepared by the independent registered public accounting firm.

Compensation Committee

The Compensation Committee is composed of six members, each of whom is an independent director as defined by NASDAQ listing standards and applicable SEC and Internal Revenue Service rules. The Compensation Committee meets on an as-needed basis regarding the personnel, compensation and benefits related matters of Heritage. For more information on the responsibilities and activities of the Compensation Committee, including the Committee's processes for determining executive compensation, see the Compensation Discussion and Analysis section below.

Governance and Nominating Committee

The Governance and Nominating Committee is composed of six members, each of whom is an independent director. The Governance and Nominating Committee and its Chair are appointed annually by the Board of Directors. The Committee meets annually and on an as-needed basis, and is responsible for selecting qualified individuals to fill expiring directors' terms and vacancies on the Board of Directors. Final approval of director nominees is determined by the full Board, based on the recommendations of the Committee. The Committee's role includes oversight of our corporate governance program. The Committee's duties include the development and administration of Heritage's corporate governance standards.

Risk Committee

The Risk Committee is composed of six members. The Committee meets quarterly and on an as needed basis to review risks inherent in our business such as credit risk, market and liquidity risk, operational risk and the regulatory component of compliance risk. During the year, the Company developed an Enterprise Risk Management model for the Committee and full Board to utilize in managing risks of the Company.

CORPORATE GOVERNANCE

Heritage is committed to good corporate governance and acts in a manner that best serves the interests of the Company and its shareholders. The Board reviews the Company's policies and business strategies and advises executive management who manage and implement the Company's business model and operations. The Board has adopted Corporate Governance Guidelines, Committee Charters, Stock Ownership Guidelines and various Policies including the Code of Ethics Policy and Whistleblower Policy to provide a framework for effective governance practices. The full text of these documents can be found at www.hf-wa.com. Governance is a continuing focus at the Company and in this section we describe our key governance policies, guidelines and practices.

Corporate Governance Guidelines

The Corporate Governance Guidelines outline the Company's governance framework by addressing such items as responsibilities of directors, adherence to conflict of interest rules; the selection process for director candidates, required meeting attendance, stock ownership guidelines, the annual completion of Board performance assessments, director compensation, retirement age of directors, director education, succession planning and other important governance matters.

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Process for Selecting Directors

In its deliberations for selecting candidates for nomination as director, the Governance and Nominating Committee Charter requires the Committee to consider: each candidate's business and occupational background and experience; integrity and reputation; education; knowledge of and contacts in our market area and ties to the community; ability to commit adequate time and attention to serve as a director in light of other commitments; ability to work effectively in a group; independence and potential conflicts of interest; tenure on the Board; specialized knowledge or skills; and any other factors that the Committee deems appropriate. In selecting nominees, the Committee must consider these criteria, and any other criteria established by the Board, in the context of an assessment of the operation and needs of the Board as a whole and the Board's goal of maintaining a diversity of backgrounds among its members. In searching for qualified director candidates to fill vacancies on the Board, the Committee solicits its current Board for names of potentially qualified candidates. Additionally, the Committee may request that members of the Board pursue their own business contacts for the names of potentially qualified candidates, or the Committee may use the services of a search firm. The Committee would then consider the potential pool of director candidates, select the top candidate based on the candidates' qualifications and the Board's needs, and conduct an investigation of the proposed candidate's background to ensure there is no past history that would cause the candidate not to be qualified to serve as a director of Heritage. The Committee will consider director candidates recommended by Heritage's shareholders. If a shareholder has submitted a proposed nominee, the Committee would consider the proposed nominee, along with any other proposed nominees recommended by members of the Board of Directors, in the same manner in which the Committee would evaluate its nominees for director. For a description of the proper procedure for a shareholder to submit a nomination, see Shareholder Proposals in this Proxy Statement.

Board Leadership

The Board annually elects the Chairman of the Board. The Chairman leads the Board and presides at all Board meetings, and is responsible for delivery of information to enable the Board to make informed decisions. In December 2012, the Board named Mr. Charneski as Vice Chairman of the Board and he now leads the Board meetings in the absence of the Chairman of the Board. The positions of Board Chairman and of President and Chief Executive Officer have been separately held since 2006. The Board believes this structure is appropriate for Heritage because it provides segregation of duties between managing Heritage and leadership of the Board.

Board Risk Oversight

The Board has the ultimate responsibility and authority for overseeing risk management at Heritage. The Board assesses risks facing Heritage and the subsidiary banks. On a regular basis, the Board reviews operational and regulatory reports provided by management to assess credit risk, liquidity risk, and operational risk.

The Board also delegates the oversight of risk to various committees. The Audit and Finance Committee oversees the financial, accounting and internal control risk management. The Compensation Committee oversees the management of risks that may be posed by our compensation practices and programs. The Compensation Committee is responsible for reviewing compensation policies and practices for all employees to ensure that they do not create or encourage risks that are reasonably likely to have a material adverse effect on Heritage. The Risk Committee oversees the risks inherent in our businesses in the following categories: credit risk, market and liquidity risk, operational risk and the regulatory component of compliance risk. The Audit and Finance Committee and Risk Committee hold a joint meeting annually to review the annual audit plan and risk assessment. The Compensation Committee Chair also attends the joint Audit and Finance and Risk Committee meeting to ensure that compensation risks are also reviewed as part of the annual risk assessment process. The Senior Risk Officer reports directly to the Risk Committee Chair and Audit and Finance Committee Chair.

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Director Independence

Our common stock is listed on the NASDAQ Global Select Market. In accordance with NASDAQ requirements, at least a majority of our directors must be independent. The Board of Directors has determined that as of December 31, 2012 ten of our eleven directors were independent. Directors Charneski, Christensen, Clees, Ellwanger, Fluetsch, Jensen, Lyon, Rhodes, Watson and Weigand are all independent. The Board determined that effective September 1, 2012, Mr. Rhodes, who formerly served as the Chief Executive Officer of the Company, became independent. Only Brian L. Vance, who serves as President and Chief Executive Officer of Heritage Financial Corporation and Chief Executive Officer of Heritage Bank, was not independent.

Code of Ethics

The Board of Directors has adopted a written Code of Ethics Policy that applies to our directors, officers and employees.

Stock Ownership Guidelines

Heritage has adopted Stock Ownership Guidelines for directors, the Chief Executive Officer, the Presidents of our subsidiary banks and the Chief Financial Officer. The guidelines were established to promote a long-term perspective in managing the Company, and to help align the interests of our shareholders, directors and top executives. The stock ownership goal for each person is determined on an individual basis, first in dollars as a multiple as follows: three times each director's annual cash compensation, 2.5 times the Chief Executive Officer's base salary and 1.5 times each subsidiary bank President's and the Chief Financial Officer's base salary; and then by converting such amount to a fixed number of shares. The guidelines were revised in December 2012 and gave directors three years to comply and the executives five years to comply. As of December 31, 2012 all directors and executive officers covered by the Guidelines were in compliance, or are within the time frame to come into compliance, with the Stock Ownership Guidelines.

Shareholder Communication with the Board of Directors

The Board of Directors maintains a process for shareholders to communicate with the Board of Directors. Shareholders wishing to communicate with the Board of Directors should send any communication to Kaylene M. Lahn, Corporate Secretary, Heritage Financial Corporation, 201 Fifth Avenue S.W., Olympia, Washington 98501. Any such communication should state the number of shares beneficially owned by the shareholder making the communication.

Annual Meeting Attendance

Directors are encouraged to attend the annual meeting of shareholders and all directors attended the 2012 annual meeting of shareholders.

Related Party Transactions

We have followed a policy of granting loans to our executive officers and directors, which fully comply with all applicable federal regulations, including those governing loans and other transactions with affiliated persons of Heritage. Loans to our directors and executive officers are made in the ordinary course of business and on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with all customers, and do not involve more than the normal risk of collectability or present other unfavorable features.

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All loans and aggregate loans to individual directors and executive officers, without regard to loan amount, are completely documented and underwritten using the same underwriting policies, procedures, guidelines and documentation requirements as are used for non-director and non-employee customers of Heritage. Following the normal underwriting approvals by underwriting personnel, all such loans are then presented for review and approval by the Board of Directors of Heritage Bank or Central Valley Bank, as the case may be, pursuant to Regulation O of the Federal Reserve Board, and the requirements of the Federal Deposit Insurance Corporation and the Washington State Department of Financial Institutions, Division of Banks. There are no exceptions to these procedures and all approvals are documented in the Board meeting minutes. There were \$8.4 million in loan balances outstanding to directors and executive officers at December 31, 2012.

DIRECTOR COMPENSATION

The following table shows the compensation paid to Heritage's directors for the year ended December 31, 2012, with the exception of Brian L. Vance, who is the President and Chief Executive Officer of Heritage, and whose compensation is included in the section below entitled Executive Compensation.

Name	Fees Earned or Paid In Cash (\$)	Stock Awards (\$)⁽¹⁾	Total (\$)
Brian S. Charneski	39,700	17,507	57,207
Gary B. Christensen	40,600 ⁽²⁾	19,255	59,855
John A. Clees	38,920	17,507	56,427
Kimberly T. Ellwanger	41,700	17,507	59,207
Peter N. Fluetsch	32,850	17,507	50,357
Daryl D. Jensen	47,450 ⁽²⁾	19,255	66,705
Jeffrey S. Lyon	37,150	17,507	54,657
Donald V. Rhodes	60,000	19,255	79,255
Ann Watson	4,500 ⁽³⁾	-	4,500
Philip S. Weigand	35,100	17,507	52,607

(1) Reflects the aggregate grant date fair value of awards, computed in accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 718, Compensation Stock Compensation (FASB ASC Topic 718). For a discussion of valuation assumptions, please see footnotes to the financial statements of Heritage's Annual Report on Form 10-K for the year ended December 31, 2012. The stock awards include grants for service at Central Valley Bank as well. Outstanding awards are discussed below under Equity Compensation.

(2) Includes \$5,400 for service on the Board of Central Valley Bank.

(3) Ms. Watson was appointed to the Board on October 30, 2012.

2012 Director Compensation Highlights

The Compensation Committee retained McLagan, the independent compensation consultant, to review total director compensation and assist with updating the Company's compensation peer group (see Compensation Discussion and Analysis below for additional discussion about the peer group). As a result of McLagan's review, the Compensation Committee and the full Board determined that Board fees and equity as a percentage of total compensation should each be increased to more closely align the directors with the 50th percentile of the peer group. The cash compensation program was revised to shift more compensation to a retainer structure for committee chairs and the full Board due to ongoing work performed by the directors between meetings. Per meeting committee fees were also adjusted.

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Equity compensation became a larger percentage of total compensation to encourage long-term ownership in the Company as well as to more closely align our Board compensation program with the programs of our peer group.

Cash Compensation

In 2012, each non-employee director, other than the Chairman of the Board, was paid an annual cash retainer of \$24,000 plus committees fees for service as a director. The Chairman of the Board received an annual cash retainer of \$60,000 in lieu of the standard annual retainer and committee fees. Chairs of the Audit and Finance; Compensation; and Governance and Nominating Committees are paid a quarterly cash retainer of \$2,500 and the Chair of the Risk Committee is paid a quarterly cash retainer of \$1,250 to serve as Chairs of the respective committees. Members and Chairs of the Audit and Finance, Compensation and Governance and Nominating Committees receive an additional per meeting attendance fee of \$500. Members and the Chair of the Risk Committee receive an additional per meeting fee of \$400. Mr. Vance does not receive any compensation for service as a director or Board committee member.

Equity Compensation

In June 2012, each non-employee director with the exception of Ms. Watson, who was not yet appointed to the Board, received an award of 1,232 shares of Company restricted stock, which vest 10 months from the date of grant. Directors Jensen, Christensen, and Rhodes each received an additional award of 123 shares for their service as directors of Central Valley Bank. Directors also received Company restricted stock awards in 2011 and 2010, which vest ratably over the two-year period from the grant date. As of December 31, 2012, Directors Charneski, Clees, Ellwanger, Fluetsch, Lyon and Weigand each had 1,354 shares of restricted stock outstanding and Directors Christensen, Jensen and Rhodes each had 1,512 shares of restricted stock outstanding.

Prior to 2010, non-employee directors historically received annual grants of non-qualified stock options. As of December 31, 2012, the non-employee directors had unexercised nonqualified stock options in the following amounts: Mr. Charneski, 5,500 shares; Mr. Christensen, 7,675 shares; Mr. Clees, 6,025 shares; Ms. Ellwanger, 4,000 shares; Mr. Fluetsch, 4,000 shares; Mr. Jensen, 7,150 shares; Mr. Lyon, 5,500 shares; Mr. Rhodes, 7,150 shares; and Mr. Weigand, 5,500 shares.

COMPENSATION DISCUSSION AND ANALYSIS

In this section we discuss our executive compensation philosophy and programs at Heritage. The Committee refers to the Compensation Committee. Following this discussion, we disclose compensation for our named executive officers in the 2012 Summary Compensation Table and other compensation tables. The following individuals are our 2012 named executive officers:

Brian L. Vance Chief Executive Officer of Heritage Bank and Central Valley Bank; President and Chief Executive Officer of Heritage Financial Corporation

Jeffrey J. Deuel President and Chief Operating Officer of Heritage Bank and Executive Vice President of Heritage Financial Corporation

Donald J. Hinson Executive Vice President and Chief Financial Officer of Heritage Bank and Heritage Financial Corporation

D. Michael Broadhead President of Central Valley Bank

In August 2018, the FASB issued new authoritative guidance on customer's accounting for implementation costs incurred in a cloud computing arrangement that is a service contract, which will require customers to apply internal-use software guidance to determine the implementation costs that are able to be capitalized. Capitalized implementation costs will be required to be amortized over the term of the arrangement, beginning when the module or component of the hosting arrangement is ready for its intended use. The standard is effective for us in our first quarter of fiscal 2021 and will be applied on either a prospective or retrospective basis. Early adoption is permitted.

We are currently evaluating adoption timing and whether this standard will have a material impact on our condensed consolidated financial statements.

Financial Instruments - Credit Losses

In June 2016, the FASB issued new authoritative guidance on the accounting for credit losses on most financial assets and certain financial instruments. The standard replaces the existing incurred loss model with an expected credit loss model for financial assets measured at amortized cost, including trade receivables, and requires that credit losses on available-for-sale debt securities be presented as an allowance rather than as a write-down. The standard is effective for us in our first quarter of fiscal 2021 and will be applied on a modified retrospective basis. Early adoption is permitted beginning our first quarter of fiscal 2020. We are currently evaluating adoption timing and whether this standard will have a material impact on our condensed consolidated financial statements.

Leases

In February 2016, the FASB issued new authoritative guidance on lease accounting. Among its provisions, the standard requires lessees to recognize right-of-use assets and lease liabilities on the balance sheet for operating leases and also requires additional qualitative and quantitative disclosures about lease arrangements. The standard is effective for us in our first quarter of fiscal 2020 and will be applied on a modified retrospective basis, with the option to elect certain practical expedients. Early adoption is permitted; however, we plan to adopt the new standard in our first quarter of fiscal 2020. Upon adoption, we will recognize right-of-use assets and operating lease liabilities on our condensed consolidated balance sheets, which will increase our total assets and total liabilities. We are currently evaluating the accounting, transition, and disclosure requirements of this standard, including its impact on our accounting policies and processes.

2. Revenue

Revenue Recognition

Our revenue consists of product revenue and subscription and support revenue. Revenue is recognized when control of promised products, subscriptions and support services are transferred to customers with the expected consideration in exchange for those products and services. Depending on who the contract is with, our customers are either our channel partners or our end-customers.

We determine revenue recognition through the following steps:

1. Identification of the contract, or contracts, with a customer.

2. Identification of the performance obligations in the contract.

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Determination of the transaction price.

Allocation of the transaction price to the performance obligations in the contract.

Recognition of revenue when, or as, we satisfy a performance obligation.

Revenues are reported net of sales taxes. Shipping charges billed to channel partners are included in revenues and related costs are included in cost of revenue.

Product Revenue

Product revenue is derived primarily from sales of our appliances. Product revenue also includes revenue derived from software licenses of Panorama and the VM-Series. We recognize product revenue at the time of hardware shipment or delivery of software license.

Subscription and Support Revenue

Subscription and support revenue is derived primarily from sales of our subscription and support offerings. We recognize subscription and support revenue over time as the services are performed. Our contractual subscription and support contracts are typically one to five years.

Contracts with Multiple Performance Obligations

The majority of our contracts with our customers include various combinations of our products and subscriptions and support which are distinct and accounted for as separate performance obligations. We account for multiple agreements with a single customer as a single contract if the contractual terms and/or substance of those agreements indicate that they may be so closely related that they are, in effect, parts of a single contract. The amount of consideration we expect to receive in exchange for delivering on the contract is allocated to each performance obligation based on its relative standalone selling price. If a contract contains a single performance obligation, no allocation is required. We establish standalone selling price using the prices charged for a deliverable when sold separately. If the standalone selling price is not observable through past transactions, we estimate the standalone selling price based on our pricing model and our go-to-market strategy, which include factors such as type of sales channel (reseller, distributor, or end-customer), the geographies in which our offerings were sold (domestic or international), and offering type (products, subscriptions, or support).

Deferred Revenue

We record deferred revenue when cash payments are received or due in advance of our performance. Our payment terms typically require payment within 30 to 45 days of the date we issue an invoice. The current portion of deferred revenue represents the amounts that are expected to be recognized as revenue within one year of the condensed consolidated balance sheet date. During the three months ended October 31, 2018, we recognized approximately \$370.0 million of revenue pertaining to amounts that were deferred as of July 31, 2018.

Remaining Performance Obligations

Revenue expected to be recognized from remaining performance obligations was \$2.5 billion as of October 31, 2018, of which we expect to recognize approximately \$1.3 billion over the next 12 months and the remainder thereafter.

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Disaggregation of Revenue

The following table presents revenue by geographic theater (in millions):

	Three Months Ended October 31,	
	2018	2017
	(As Adjusted)	
Revenue:		
Americas		
United States	\$415.9	\$ 326.0
Other Americas	34.3	23.3
Total Americas	450.2	349.3
Europe, the Middle East, and Africa ("EMEA")	127.7	94.7
Asia Pacific and Japan ("APAC")	78.1	57.8
Total revenue	\$656.0	\$ 501.8

The following table presents revenue for groups of similar products and services (in millions):

	Three Months Ended October 31,	
	2018	2017
	(As Adjusted)	
Revenue:		
Product	\$240.5	\$ 184.8
Subscription and support		
Subscription	231.3	169.0
Support	184.2	148.0
Total subscription and support	415.5	317.0
Total revenue	\$656.0	\$ 501.8

3. Fair Value Measurements

We categorize assets and liabilities recorded or disclosed at fair value on our condensed consolidated balance sheets based upon the level of judgment associated with inputs used to measure their fair value. The categories are as follows:

Level 1—Inputs are unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2—Inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the assets or liabilities, either directly or indirectly through market corroboration, for substantially the full term of the financial instruments.

Level 3—Inputs are unobservable inputs based on our own assumptions used to measure assets and liabilities at fair value. The inputs require significant management judgment or estimation.

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The following table presents the fair value of our financial assets and liabilities measured at fair value on a recurring basis using the above input categories as of October 31, 2018 and July 31, 2018 (in millions):

	October 31, 2018				July 31, 2018			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Cash equivalents:								
Money market funds	\$904.4	\$ —	—\$	—\$904.4	\$1,512.3	\$ —	—\$	—\$1,512.3
Commercial paper	—	5.0	—	5.0	—	52.0	—	52.0
Corporate debt securities	—	2.5	—	2.5	—	—	—	—
U.S. government and agency securities	—	210.3	—	210.3	—	397.3	—	397.3
Total cash equivalents	904.4	217.8	—	1,122.2	1,512.3	449.3	—	1,961.6
Short-term investments:								
Certificates of deposit	—	5.4	—	5.4	—	5.4	—	5.4
Non-U.S. government securities	—	20.0	—	20.0	—	20.0	—	20.0
Commercial paper	—	97.3	—	97.3	—	22.3	—	22.3
Corporate debt securities	—	188.9	—	188.9	—	139.8	—	139.8
U.S. government and agency securities	—	1,107.8	—	1,107.8	—	709.0	—	709.0
Total short-term investments	—	1,419.4	—	1,419.4	—	896.5	—	896.5
Long-term investments:								
Corporate debt securities	—	191.2	—	191.2				