

ConnectOne Bancorp, Inc.
Form 10-Q
August 09, 2013

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

S **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2013

or

£ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission file number **001-35812**

CONNECTONE BANCORP, INC.

(Exact name of Registrant as Specified in Its Charter)

NEW JERSEY

(State or other jurisdiction of incorporation or organization)

26-1998619

(I.R.S. Employer Identification Number)

301 Sylvan Avenue

Englewood Cliffs, New Jersey 07632

(Address of Principal Executive Offices)

(201) 816-8900

(Issuer's Telephone Number, including area code)

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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 and 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 S 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 SD-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes S No £

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer or a smaller reporting company. See definition of large accelerated filer, accelerated filer and small reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer £ Accelerated filer £ Non-accelerated filer S 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 S

As of August 9, 2013 there were 5,021,142 shares of common stock, no par value, outstanding.

ConnectOne Bancorp, Inc.
FORM 10-Q

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets as of June 30, 2013 and December 31, 2012 2

Consolidated Statements of Income for the three and six months ended June 30, 2013 and 2012 3

Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2013 and 2012 4

Consolidated Statements of Changes in Stockholders' Equity for the six months ended June 30, 2013 and for the year ended December 31, 2012 5

Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and 2012 6

Notes to Consolidated Financial Statements 7

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 24

Item 3. Quantitative and Qualitative Disclosures About Market Risk 34

Item 4. Controls and Procedures 35

PART II OTHER INFORMATION

Item 1. Legal Proceedings 36

Item 1a. Risk Factors 36

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds 36

Item 3. Defaults Upon Senior Securities 36

Item 4. Mine Safety Disclosures 36

Item 5. Other Information 36

Item 6. Exhibits 36

SIGNATURE 37

CERTIFICATIONS

38

EXHIBIT 32

40

- 1 -

ConnectOne Bancorp, Inc.**CONSOLIDATED BALANCE SHEETS (unaudited)****(dollars in thousands)**

| | June 30, 2013 | December 31, 2012 |
|---|------------------|-------------------------|
| Assets | | |
| Cash and due from banks | \$3,450 | \$3,242 |
| Interest-bearing deposits with banks | 37,130 | 47,387 |
| Cash and cash equivalents | 40,580 | 50,629 |
| Securities available for sale | 24,409 | 19,252 |
| Securities held to maturity, fair value of \$1,481 at 2013 and \$2,084 at 2012 | 1,421 | 1,985 |
| Loans held for sale | 133 | 405 |
| Loans receivable | 955,579 | 848,842 |
| Less: Allowance for loan losses | (13,981) | (13,246) |
| Net loans receivable | 941,598 | 835,596 |
| Investment in restricted stock, at cost | 4,766 | 4,744 |
| Bank premises and equipment, net | 8,049 | 7,904 |
| Accrued interest receivable | 3,509 | 3,361 |
| Other real estate owned | 433 | 433 |
| Goodwill | 260 | 260 |
| Other assets | 5,329 | 5,357 |
| Total assets | \$1,030,487 | \$929,926 |
| Liabilities | | |
| Deposits | | |
| Non-interest-bearing | \$173,188 | \$170,355 |
| Interest-bearing | 650,157 | 598,963 |
| Total deposits | 823,345 | 769,318 |
| Long-term borrowings | 74,065 | 79,568 |
| Accrued interest payable | 2,586 | 2,803 |
| Capital lease obligation | 3,148 | 3,185 |
| Other liabilities | 2,768 | 2,690 |
| Total liabilities | 905,912 | 857,564 |
| Commitments and Contingencies | | |
| Stockholders' Equity | | |
| Common stock, no par value; authorized 10,000,000 shares at June 30, 2013 and December 31, 2012; issued and outstanding 5,021,142 at June 30, 2013 and 3,166,217 at December 31, 2012 | 99,038 | 51,205 |
| Retained earnings | 25,494 | 20,661 |
| Accumulated other comprehensive income | 43 | 496 |

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| | | |
|--|-------------|-----------|
| Total stockholders' equity | 124,575 | 72,362 |
| Total liabilities and stockholders' equity | \$1,030,487 | \$929,926 |

- 2 -

ConnectOne Bancorp, Inc.**CONSOLIDATED STATEMENTS OF INCOME (unaudited)****(dollars in thousands, except per share data)**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|-----------|------------------------------|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| Interest income | | | | |
| Loans receivable, including fees | \$11,139 | \$10,114 | \$21,835 | \$19,120 |
| Securities | 179 | 242 | 373 | 523 |
| Other interest income | 34 | 13 | 55 | 30 |
| Total interest income | 11,352 | 10,369 | 22,263 | 19,673 |
| Interest expense | | | | |
| Deposits | 1,149 | 1,168 | 2,294 | 2,364 |
| Long-term borrowings | 330 | 337 | 664 | 653 |
| Capital lease | 47 | 48 | 95 | 97 |
| Total interest expense | 1,526 | 1,553 | 3,053 | 3,114 |
| Net interest income | 9,826 | 8,816 | 19,210 | 16,559 |
| Provision for loan losses | 950 | 1,140 | 1,875 | 1,890 |
| Net interest income after provision for loan losses | 8,876 | 7,676 | 17,335 | 14,669 |
| Non-interest income | | | | |
| Service fees | 63 | 87 | 98 | 117 |
| Gains on sales of loans | 78 | 113 | 150 | 211 |
| Gains on sales of securities | — | — | — | — |
| Other income | 160 | 77 | 313 | 194 |
| Total non-interest income | 301 | 277 | 561 | 522 |
| Non-interest expenses | | | | |
| Salaries and employee benefits | 2,446 | 2,133 | 4,924 | 4,228 |
| Occupancy and equipment | 761 | 688 | 1,491 | 1,413 |
| Professional fees | 320 | 332 | 590 | 540 |
| Advertising and promotion | 166 | 106 | 269 | 184 |
| Data processing | 444 | 451 | 892 | 859 |
| Other expenses | 788 | 749 | 1,502 | 1,381 |
| Total non-interest expenses | 4,925 | 4,459 | 9,668 | 8,605 |
| Income before income tax expense | 4,252 | 3,494 | 8,228 | 6,586 |
| Income tax expense | 1,755 | 1,418 | 3,395 | 2,666 |
| Net income | 2,497 | 2,076 | 4,833 | 3,920 |
| Dividends on preferred shares | — | 206 | — | 352 |
| Net income available to common stockholders | \$2,497 | \$1,870 | \$4,833 | \$3,568 |
| Earnings per common share: | | | | |
| Basic | \$0.50 | \$0.83 | \$1.06 | \$1.59 |
| Diluted | 0.49 | 0.62 | 1.04 | 1.24 |
| Weighted average common shares outstanding: | | | | |
| Basic | 5,021,142 | 2,245,044 | 4,541,192 | 2,244,392 |

Diluted
- 3 -

5,137,828 3,319,089 4,654,978 3,160,247

ConnectOne Bancorp, Inc.**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)****(in thousands)**

| | Three months ended June 30, | | Six months ended June 30, | |
|-----------------------------------|--------------------------------|---------|------------------------------|---------|
| | 2013 | 2012 | 2013 | 2012 |
| Net income | \$2,497 | \$2,076 | \$4,833 | \$3,920 |
| Net unrealized gains/(losses) | (633) | 83 | (755) | 43 |
| Tax effect | (253) | 33 | (302) | 17 |
| Other comprehensive income (loss) | (380) | 50 | (453) | 26 |
| Comprehensive income | \$2,117 | \$2,126 | \$4,380 | \$3,946 |

- 4 -

ConnectOne Bancorp, Inc.**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (unaudited)**

(dollars in thousands)

| | Common Stock | Preferred Stock, Series A | Preferred Stock, Series B | Preferred Stock Series C | Retained Earnings | Accumulated Other Comprehensive Income | Total |
|--|-----------------|---------------------------------|---------------------------------|--------------------------------|----------------------|---|------------|
| Balance at January 1, 2012 | \$ 27,149 | \$ 2,500 | \$ 14,004 | \$— | \$ 12,594 | \$ 610 | \$ 56,857 |
| Net income | — | — | — | — | 8,421 | — | 8,421 |
| Other comprehensive loss, net of taxes | — | — | — | — | — | (114) | (114) |
| Issuance of convertible preferred stock; Series C, 7,500 shares | — | — | — | 7,500 | — | — | 7,500 |
| Conversion of preferred stock; Series A, Series B, and Series C | 24,004 | (2,500) | (14,004) | (7,500) | — | — | — |
| Cash dividends paid on preferred stock | — | — | — | — | (354) | — | (354) |
| Equity-based compensation | 52 | — | — | — | — | — | 52 |
| Balance at December 31, 2012 | 51,205 | — | — | — | 20,661 | 496 | 72,362 |
| Net income | — | — | — | — | 4,833 | — | 4,833 |
| Other comprehensive loss, net of taxes | — | — | — | — | — | (453) | (453) |
| Issuance of 1,840,000 shares, net of expenses | 47,715 | — | — | — | — | — | 47,715 |
| Grant of 14,925 restricted stock awards | — | — | — | — | — | — | — |
| Equity-based compensation | 118 | — | — | — | — | — | 118 |
| Balance at June 30, 2013 | \$ 99,038 | \$— | \$— | \$— | \$ 25,494 | \$ 43 | \$ 124,575 |

- 5 -

ConnectOne Bancorp, Inc.**CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**

(in thousands)

| | Six Months Ended June 30, | |
|--|------------------------------|-----------------|
| | 2013 | 2012 |
| Cash flows from operating activities | | |
| Net income | \$4,833 | \$3,920 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 1,875 | 1,890 |
| Depreciation and amortization | 571 | 645 |
| Net amortization of securities discounts and premiums | 37 | 22 |
| Stock compensation earned | 118 | — |
| Amortization of intangible assets | — | 5 |
| Proceeds from sale of loans | 7,572 | 10,149 |
| Origination of loans held for sale | (7,150) | (10,919) |
| Gain on sales of loans | (150) | (211) |
| Increase in accrued interest receivable | (148) | (131) |
| Increase (decrease) in accrued interest payable | (217) | 152 |
| Increase (decrease) in other liabilities | 78 | (165) |
| Decrease in other assets | 330 | 755 |
| Net cash provided by operating activities | 7,749 | 6,112 |
| Cash flows from investing activities | | |
| Net increase in loans | (107,877) | (99,563) |
| Purchases of securities available for sale | (9,902) | — |
| Maturities, calls and principal repayments of securities held to maturity and available for sale | 4,517 | 4,926 |
| Net increase in investments in restricted stock, at cost | (22) | (1,389) |
| Purchases of premises and equipment | (716) | (256) |
| Net cash used in investing activities | (114,000) | (96,282) |
| Cash flows from financing activities | | |
| Net increase in deposits | 54,027 | 57,011 |
| Proceeds from long-term borrowings | 5,000 | 60,000 |
| Repayments of long-term borrowings | (10,503) | (35,492) |
| Net proceeds from initial public offering | 47,715 | — |
| Proceeds from sale of preferred stock | — | 7,500 |
| Decrease in capital lease obligation | (37) | (35) |
| Preferred stock dividends | — | (352) |
| Net cash provided by financing activities | 96,202 | 88,632 |
| Net decrease in cash and cash equivalents | (10,049) | (1,538) |
| Cash and cash equivalents – beginning | 50,629 | 59,176 |
| Cash and cash equivalents – ending | \$40,580 | \$57,638 |

Supplementary cash flows information:

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| | | |
|-------------------|---------|---------|
| Interest paid | \$3,270 | \$2,962 |
| Income taxes paid | \$4,130 | \$2,927 |

- 6 -

ConnectOne Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Principles of Consolidation: The consolidated financial statements include ConnectOne Bancorp, Inc. and its wholly owned subsidiary, ConnectOne Bank (“the Bank”), together referred to as “the Company.” Intercompany transactions and balances are eliminated in consolidation.

The Company provides financial services through its offices in Bergen, Hudson, and Monmouth counties, New Jersey. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are residential mortgage, commercial, and installment loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Commercial loans are expected to be repaid from cash flow from business operations. There are no significant concentrations of loans to any one industry or customer. However, the customers’ ability to repay their loans is dependent on the cash flows, real estate and general economic conditions in the area.

The consolidated financial information included herein as of and for the periods ended June 30, 2013 and 2012 is unaudited. The accompanying unaudited consolidated financial statements included herein have been prepared by the Company in accordance with U.S. generally accepted accounting principles and pursuant to the rules and regulations of the Securities and Exchange Commission and reflect all adjustments which, in the opinion of management, are considered necessary for a fair presentation of the financial condition and results of operations for the periods presented. All adjustments made were of a normal and recurring nature. Operating results for the three months and six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ended December 31, 2013. These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto, included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

Adoption of New Accounting Guidance: In February 2013, the FASB amended existing guidance to require an entity to provide information about amounts reclassified out of other comprehensive income by component. In addition, an entity is required to present, either on the face of the income statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under United States generally accepted accounting principles to be reclassified to net income in its entirety in the same reporting period. For all other amounts, an entity is required to cross-reference to other disclosures that provide additional details about these amounts. The guidance is effective for all interim and annual reporting periods beginning after December 15, 2012. The adoption of the guidance did not have a material impact on the Company’s results of operation or financial position.

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)****NOTE 2 - SECURITIES**

The amortized cost, gross unrealized gains and losses and fair value of securities available for sale at June 30, 2013 and December 31, 2012, are as follows (dollars in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|-------------------|------------------------------|-------------------------------|---------------|
| <u>June 30, 2013</u> | | | | |
| Securities available for sale: | | | | |
| U.S. Treasury securities | \$ 1,932 | \$ — | \$ (59) |) \$1,873 |
| U.S. government sponsored agencies States and political subdivisions | — | — | — | — |
| | 2,923 | — | (61) |) 2,862 |
| Asset-backed securities: | | | | |
| Residential mortgages | 10,962 | 374 | (98) |) 11,238 |
| Student loans | 2,516 | — | (52) |) 2,464 |
| Equity securities | 6,000 | — | (28) |) 5,972 |
| | \$ 24,333 | \$ 374 | \$ (298) |) \$24,409 |
| <u>December 31, 2012</u> | | | | |
| Securities available for sale: | | | | |
| U.S. Treasury securities | \$ — | \$ — | \$ — | \$— |
| U.S. government sponsored agencies States and political subdivisions | 1,000 | 5 | — | 1,005 |
| | — | — | — | — |
| Asset-backed securities: | | | | |
| Residential mortgages | 11,421 | 608 | — | 12,029 |
| Student loans | — | — | — | — |
| Equity securities | 6,000 | 218 | — | 6,218 |
| | \$ 18,421 | \$ 831 | \$ — | \$19,252 |

The amortized cost, gross unrecognized gains and losses and fair value of securities held to maturity at June 30, 2013 and December 31, 2012, are as follows (dollars in thousands):

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| | Amortized Cost | Gross Unrecognized Gains | Gross Unrecognized Losses | Fair Value |
|--|-------------------|--------------------------------|---------------------------------|---------------|
| June 30, 2013 | | | | |
| Securities held to maturity: | | | | |
| Asset-backed securities – residential mortgages | \$ 1,421 | \$ 60 | \$ — | \$1,481 |
| December 31, 2012 | | | | |
| Securities held to maturity: | | | | |
| Asset-backed securities – residential mortgages | \$ 1,985 | \$ 99 | \$ — | \$2,084 |

- 8 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)****NOTE 2 - SECURITIES**

(continued)

The amortized cost and fair value of debt securities available for sale and held to maturity at June 30, 2013, by contractual maturity, are shown below (dollars in thousands). Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities do not have a specific maturity and are shown separately.

| | Available for Sale | | Held to Maturity | |
|---|--------------------|------------|------------------|------------|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| <u>June 30, 2013</u> | | | | |
| Due in one year or less | \$1,006 | \$1,006 | \$— | \$— |
| Due after one year through five years | — | — | — | — |
| Due after five years through ten years | 3,849 | 3,729 | — | — |
| Due after ten years | 2,516 | 2,464 | — | — |
| Asset-backed securities – residential mortgages | 10,962 | 11,238 | 1,421 | 1,481 |
| | \$18,333 | \$18,437 | \$1,421 | \$1,481 |

There were no sales of available for sale securities for the six months ended June 30, 2013 and 2012.

Securities with a carrying value of \$236,342 and \$322,272 at June 30, 2013 and December 31, 2012, respectively, were pledged to secure public deposits, securities sold under agreements to repurchase and for other purposes as required or permitted by law.

The following table summarizes securities with unrealized losses at June 30, 2013, aggregated by major security type and length of time in a continuous unrealized loss position:

| | Less than 12 Months | | 12 Months or Longer | | Total | |
|-----------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| <u>June 30, 2013</u> | | | | | | |
| Available-for-Sale | | | | | | |
| U.S. Treasury securities | \$1,873 | \$ 59 | \$ — | \$ — | \$1,873 | \$ 59 |
| States and political subdivisions | 2,862 | 61 | — | — | 2,862 | 61 |
| Asset-backed securities – | | | | | | |
| Residential mortgages | 4,797 | 98 | — | — | 4,797 | 98 |
| Student loans | 2,464 | 52 | — | — | 2,464 | 52 |
| Equity securities | 5,972 | 28 | — | — | 5,972 | 28 |
| | \$17,968 | \$ 298 | \$ — | \$ — | \$17,968 | \$ 298 |

Unrealized losses on available for sale securities have not been recognized into income because the securities are of high credit quality, management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates. The fair value is expected to recover as the securities approach maturity.

There were no held to maturity securities in an unrealized loss position at June 30, 2013. There were no securities in an unrealized loss position at December 31, 2012.

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)****NOTE 3 – LOANS RECEIVABLE**

The composition of loans receivable (which excludes loans held for sale) at June 30, 2013 and December 31, 2012 are as follows (dollars in thousands):

| | June 30, 2013 | December 31, 2012 |
|---|------------------|-------------------------|
| Commercial | \$ 193,231 | \$ 147,455 |
| Commercial real estate | 597,126 | 549,218 |
| Commercial construction | 42,261 | 36,872 |
| Residential real estate | 90,465 | 82,962 |
| Home equity | 31,574 | 30,961 |
| Consumer | 1,556 | 1,801 |
| Gross loans | 956,213 | 849,269 |
| Unearned net origination fees and costs | (634) | (427) |
| Loans receivable | 955,579 | 848,842 |
| Less: Allowance for loan losses | (13,981) | (13,246) |
| Net loans receivable | \$ 941,598 | \$ 835,596 |

The portfolio classes in the above table have unique risk characteristics with respect to credit quality:

The repayment of commercial loans is generally dependent on the creditworthiness and cash flow of borrowers, and if applicable, guarantors, which may be negatively impacted by adverse economic conditions. While the majority of these loans are secured, collateral type, marketing, coverage, valuation and monitoring is not as uniform as in other portfolio classes and recovery from liquidation of such collateral may be subject to greater variability.

Payment on commercial real estate loans is driven principally by operating results of the managed properties or underlying business and secondarily by the sale or refinance of such properties. Both primary and secondary sources of repayment, and value of the properties in liquidation, may be affected to a greater extent by adverse conditions in the real estate market or the economy in general.

Properties underlying commercial construction loans often do not generate sufficient cash flows to service debt and thus repayment is subject to the ability of the borrower and, if applicable, guarantors, to complete development or construction of the property and carry the project, often for extended periods of time until the property can be sold. As a result, the performance of these loans is contingent upon future events whose probability at the time of origination is uncertain.

The ability of borrowers to service debt in the residential, home equity and consumer loan portfolios is generally subject to personal income which may be impacted by general economic conditions, such as increased unemployment levels. These loans are predominately collateralized by first and/or second liens on single family properties. If a borrower cannot maintain the loan, the Company's ability to recover against the collateral in a sufficient amount and in a timely manner may be significantly influenced by market, legal and regulatory conditions.

- 10 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)****NOTE 3 – LOANS RECEIVABLE**

(continued)

The following table represents the allocation of allowance for loan losses and the related loans by loan portfolio segment disaggregated based on the impairment methodology at June 30, 2013 and December 31, 2012 (dollars in thousands):

| | Commercial | Commercial | Commercial | Residential | Home | Consumer | Unallocated | Total |
|---------------------------------------|-------------------|-------------------|------------------|------------------|------------------|-----------------|---------------|-------------------|
| | Commercial | Real | Construction | Real | Equity | Lines of | | |
| | Estate | Estate | | Estate | Lines of | Credit | | |
| June 30, 2013 | | | | | | | | |
| Allowance for loan losses: | | | | | | | | |
| Individually evaluated for impairment | \$ 759 | \$ 89 | \$ — | \$ 200 | \$ — | \$ — | \$ — | \$ 1,048 |
| Collectively evaluated for impairment | 2,952 | 7,132 | 531 | 1,431 | 627 | 35 | 225 | 12,933 |
| Total | \$ 3,711 | \$ 7,221 | \$ 531 | \$ 1,631 | \$ 627 | \$ 35 | \$ 225 | \$ 13,981 |
| Loans receivable: | | | | | | | | |
| Individually evaluated for impairment | \$ 3,542 | \$ 6,511 | \$ — | \$ 3,643 | \$ 232 | \$ — | \$ — | \$ 13,928 |
| Collectively evaluated for impairment | 189,689 | 590,615 | 42,261 | 86,822 | 31,342 | 1,556 | — | 942,285 |
| Total | \$ 193,231 | \$ 597,126 | \$ 42,261 | \$ 90,465 | \$ 31,574 | \$ 1,556 | \$ — | \$ 956,213 |
| December 31, 2012 | | | | | | | | |
| Allowance for loan losses: | | | | | | | | |
| Individually evaluated for impairment | \$ 165 | \$ 1,006 | \$ 27 | \$ — | \$ — | \$ — | \$ — | \$ 1,198 |
| Collectively evaluated for impairment | 2,237 | 6,712 | 633 | 1,542 | 617 | 41 | 266 | 12,048 |

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| | | | | | | | | |
|--|------------|------------|-----------|-----------|-----------|----------|--------|------------|
| Total | \$ 2,402 | \$ 7,718 | \$ 660 | \$ 1,542 | \$ 617 | \$ 41 | \$ 266 | \$ 13,246 |
| Loans receivable: | | | | | | | | |
| Individually evaluated for impairment | \$ 3,124 | \$ 4,697 | \$ 395 | \$ 2,995 | \$ 119 | \$ — | \$ — | \$ 11,330 |
| Collectively evaluated for impairment | 144,331 | 544,521 | 36,477 | 79,967 | 30,842 | 1,801 | — | 837,939 |
| Total | \$ 147,455 | \$ 549,218 | \$ 36,872 | \$ 82,962 | \$ 30,961 | \$ 1,801 | \$ — | \$ 849,269 |

- 11 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

NOTE 3 – LOANS RECEIVABLE

(continued)

The following tables present information related to impaired loans by class (dollars in thousands):

| | Unpaid Principal Balance | Recorded Investment (1) | Allowance for Loan Losses Allocated | Average Recorded Investment (1) | Interest Income Recognized | Cash Basis Interest Recognized |
|-------------------------------------|--------------------------------|-------------------------------|---|--|----------------------------------|--------------------------------------|
| June 30, 2013 | | | | | | |
| With no related allowance recorded: | | | | | | |
| Commercial | \$ 804 | \$ 698 | — | \$ 699 | \$ 10 | \$ — |
| Commercial real estate | 5,589 | 4,998 | — | 5,484 | 33 | — |
| Commercial construction | — | — | — | — | — | — |
| Residential real estate | 1,291 | 1,330 | — | 1,311 | 24 | — |
| Home equity lines of credit | 233 | 238 | — | 236 | 3 | — |
| Consumer | — | — | — | — | — | — |
| | 7,917 | 7,264 | — | 7,730 | 70 | — |
| With an allowance recorded: | | | | | | |
| Commercial | 2,862 | 2,862 | 759 | 2,895 | — | 60 |
| Commercial real estate | 1,980 | 2,040 | 89 | 2,069 | 27 | — |
| Commercial construction | — | — | — | — | — | — |
| Residential real estate | 2,357 | 2,438 | 200 | 2,438 | — | — |
| Home equity lines of credit | — | — | — | — | — | — |
| Consumer | — | — | — | — | — | — |
| | 7,199 | 7,340 | 1,048 | 7,402 | 27 | 60 |
| Total | \$ 15,116 | \$ 14,604 | \$ 1,048 | \$ 15,132 | \$ 97 | \$ 60 |
| December 31, 2012 | | | | | | |
| With no related allowance recorded: | | | | | | |
| Commercial | \$ 273 | \$ 291 | — | \$ 285 | \$ — | \$ — |
| Commercial real estate | 1,705 | 1,738 | — | 1,354 | 46 | — |
| Commercial construction | — | — | — | — | — | — |
| Residential real estate | 2,995 | 3,196 | — | 3,047 | 119 | — |

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| | | | | | | |
|-----------------------------|-----------|-----------|----------|-----------|--------|-------|
| Home equity lines of credit | 119 | 125 | — | 121 | 7 | — |
| Consumer | — | — | — | — | — | — |
| | 5,092 | 5,350 | — | 4,807 | 172 | — |
| With an allowance recorded: | | | | | | |
| Commercial | 2,851 | 2,984 | 165 | 2,895 | 135 | 33 |
| Commercial real estate | 2,992 | 3,206 | 1,006 | 3,200 | 26 | — |
| Commercial construction | 395 | 424 | 27 | 414 | 29 | — |
| Residential real estate | — | — | — | — | — | — |
| Home equity lines of credit | — | — | — | — | — | — |
| Consumer | — | — | — | — | — | — |
| | 6,238 | 6,614 | 1,198 | 6,509 | 190 | 33 |
| Total | \$ 11,330 | \$ 11,964 | \$ 1,198 | \$ 11,316 | \$ 362 | \$ 33 |

(1) The recorded investment in loans include accrued interest receivable and other capitalized costs such as real estate taxes paid on behalf of the borrower and loan origination fees, net.

- 12 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

NOTE 3 – LOANS RECEIVABLE

(continued)

The following table presents nonaccrual and loans past due 90 days or greater and still accruing by class of loans (dollars in thousands):

| | Nonaccrual | | Loans Past Due 90 Days or Greater Still Accruing | |
|-----------------------------|---------------|-------------------|--|-------------------|
| | June 30, 2013 | December 31, 2012 | June 30, 2013 | December 31, 2012 |
| Commercial | \$3,542 | \$ 3,124 | \$— | \$ — |
| Commercial real estate | 2,781 | 2,446 | 1,189 | — |
| Commercial construction | — | — | — | — |
| Residential real estate | 2,990 | 2,369 | — | — |
| Home equity lines of credit | 232 | — | — | — |
| Consumer | — | — | — | — |
| Total | \$9,545 | \$ 7,939 | \$1,189 | \$ — |

The following tables present past due and current loans by the loan portfolio class (dollars in thousands):

| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or Greater Past Due | Total Past Due | Current | Total Gross Loans |
|-------------------------|---------------------|---------------------|-----------------------------|----------------|-----------|-------------------|
| June 30, 2013 | | | | | | |
| Commercial | \$— | \$— | \$ 680 | \$680 | \$192,551 | \$193,231 |
| Commercial real estate | — | — | 3,970 | 3,970 | 593,156 | 597,126 |
| Commercial construction | — | — | — | — | 42,261 | 42,261 |

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| | | | | | | |
|-----------------------------|-------|-------|---------|---------|-----------|-----------|
| Residential real estate | — | — | 2,990 | 2,990 | 87,475 | 90,465 |
| Home equity lines of credit | 114 | 539 | 232 | 885 | 30,689 | 31,574 |
| Consumer | 2 | 22 | — | 24 | 1,532 | 1,556 |
| Total | \$116 | \$561 | \$7,872 | \$8,549 | \$947,664 | \$956,213 |

December 31, 2012

| | | | | | | |
|-----------------------------|---------|-------|---------|---------|-----------|-----------|
| Commercial | \$— | \$— | \$273 | \$273 | \$147,182 | \$147,455 |
| Commercial real estate | — | 142 | 2,446 | 2,588 | 546,630 | 549,218 |
| Commercial construction | — | — | — | — | 36,872 | 36,872 |
| Residential real estate | 1,769 | — | 2,369 | 4,138 | 78,824 | 82,962 |
| Home equity lines of credit | 35 | — | — | 35 | 30,926 | 30,961 |
| Consumer | — | — | — | — | 1,801 | 1,801 |
| Total | \$1,804 | \$142 | \$5,088 | \$7,034 | \$842,235 | \$849,269 |

- 13 -

ConnectOne Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

NOTE 3 – LOANS RECEIVABLE

(continued)

There were no troubled debt restructurings that occurred during the quarters ended June 30, 2013 and 2012. There were no troubled debt restructurings for which there was a payment default within twelve months following the modification during the quarters ended June 30, 2013 and 2012. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

Credit Quality Indicators

The Bank categorizes loans into risk categories based on relevant information about the quality and realizable value of collateral, if any, and the ability of borrowers to service their debts such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Bank analyzes loans individually by classifying the loans as to credit risk. This analysis is performed whenever a credit is extended, renewed or modified, or when an observable event occurs indicating a potential decline in credit quality, and no less than annually for large balance loss. The Bank used the following definitions for risk ratings:

Special Mention: Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or the Bank's credit position at some future date.

Substandard: Loans classified as substandard are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the repayment and liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Normal payment from the borrower is in jeopardy, although loss of principal, while still possible, is not imminent.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as Substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions, and values, highly questionable and improbable.

The following table presents the risk category of loans by class of loans based on the most recent analysis performed as of June 30, 2013 and December 31, 2012 (dollars in thousands):

| Credit Risk Profile by Internally Assigned Grades | Pass | Special Mention | Substandard | Doubtful | Total |
|---|-----------|-----------------|-------------|----------|-----------|
| June 30, 2013 | | | | | |
| Commercial | \$171,115 | \$15,437 | \$6,679 | \$— | \$193,231 |
| Commercial real estate | 580,229 | 3,800 | 13,097 | — | 597,126 |
| Commercial construction | 41,193 | — | 1,068 | — | 42,261 |
| Total | \$792,537 | \$19,237 | \$20,844 | \$— | \$832,618 |
| December 31, 2012 | | | | | |
| Commercial | \$131,887 | \$11,733 | \$3,835 | \$— | \$147,455 |
| Commercial real estate | 529,453 | 6,602 | 13,163 | — | 549,218 |
| Commercial construction | 35,985 | — | 887 | — | 36,872 |
| Total | \$697,325 | \$18,335 | \$17,885 | \$— | \$733,545 |

- 14 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

NOTE 3 – LOANS RECEIVABLE

(continued)

Residential real estate, home equity lines of credit, and consumer loans are not rated. The Company evaluates credit quality of those loans by aging status of the loan and by payment activity, which was previously presented.

The following table presents the activity in the Company's allowance for loan losses by class of loans (dollars in thousands):

| | Commercial | Commercial | Commercial | Residential | Home | Consumer | Unallocated | Total |
|---------------------------------|------------|------------|--------------|-------------|--------|----------|-------------|----------|
| | Commercial | Real | Construction | Real | Equity | | | |
| | Estate | Estate | | Estate | Lines | | | |
| | | | | | of | | | |
| | | | | | Credit | | | |
| Six Months Ended June 30, 2013: | | | | | | | | |
| Allowance for loan losses: | | | | | | | | |
| Beginning balance at 1/1/13 | \$ 2,402 | \$ 7,718 | \$ 660 | \$ 1,542 | \$ 617 | \$ 41 | \$ 266 | \$13,246 |
| Charge-offs | — | (1,059) | — | — | (79) | (3) | — | (1,141) |
| Recoveries | — | — | — | — | — | 1 | — | 1 |
| Provision for loan losses | 1,309 | 562 | (129) | 89 | 89 | (4) | (41) | 1,875 |
| Total ending balance | \$ 3,711 | \$ 7,221 | \$ 531 | \$ 1,631 | \$ 627 | \$ 35 | \$ 225 | \$13,981 |
| Six Months Ended June 30, 2012: | | | | | | | | |
| Allowance for loan losses: | | | | | | | | |
| Beginning balance at 1/1/12 | \$ 653 | \$ 5,658 | \$ 447 | \$ 2,517 | \$ 339 | \$ 3 | \$ — | \$9,617 |
| Charge-offs | (225) | — | (15) | — | — | — | — | (240) |
| Recoveries | — | 1 | — | — | — | 30 | — | 31 |
| Provision for loan losses | 1,648 | 539 | 493 | (810) | 42 | (22) | — | 1,890 |
| Total ending balance | \$ 2,076 | \$ 6,198 | \$ 925 | \$ 1,707 | \$ 381 | \$ 11 | \$ — | \$11,298 |
| | Commercial | | | | | Consumer | Unallocated | Total |

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| | Commercial Real Estate | Commercial Construction | Residential Real Estate | Home Equity Lines of Credit | | | | |
|-----------------------------------|------------------------------|----------------------------|-------------------------------|---|--------|-------|--------|----------|
| Three Months Ended June 30, 2013: | | | | | | | | |
| Allowance for loan losses: | | | | | | | | |
| Beginning balance at 4/1/13 | \$ 3,244 | \$ 7,549 | \$ 370 | \$ 1,564 | \$ 625 | \$ 33 | \$ 252 | \$13,637 |
| Charge-offs | — | (607) | — | — | — | — | — | (607) |
| Recoveries | — | — | — | — | — | 1 | — | 1 |
| Provision for loan losses | 467 | 279 | 161 | 67 | 2 | 1 | (27) | 950 |
| Total ending balance | \$ 3,711 | \$ 7,221 | \$ 531 | \$ 1,631 | \$ 627 | \$ 35 | \$ 225 | \$13,981 |
| Three Months Ended June 30, 2012: | | | | | | | | |
| Allowance for loan losses: | | | | | | | | |
| Beginning balance at 4/1/12 | \$ 1,641 | \$ 5,592 | \$ 988 | \$ 1,789 | \$ 364 | \$ 8 | \$ — | \$10,382 |
| Charge-offs | (224) | — | — | — | — | — | — | (224) |
| Recoveries | — | — | — | — | — | — | — | — |
| Provision for loan losses | 659 | 606 | (63) | (82) | 17 | 3 | — | 1,140 |
| Total ending balance | \$ 2,076 | \$ 6,198 | \$ 925 | \$ 1,707 | \$ 381 | \$ 11 | \$ — | \$11,298 |

- 15 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
(unaudited)

NOTE 4 - STOCK OPTION PLANS AND EQUITY COMPENSATION PLAN

At June 30, 2013, there were 216,906 shares available for awards under the Company's equity plans. Awards may be in the form of options, restricted stock or other equity awards. A summary of the stock option activity in the Company's equity plans for the six months ended June 30, 2013 are as follows:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|-----------------------------------|---------|--|--|---------------------------------|
| Outstanding at January 1, 2013 | 300,438 | \$ 12.32 | | |
| Granted | — | — | | |
| Exercised | — | — | | |
| Forfeited | — | — | | |
| Expired | — | — | | |
| Outstanding at June 30, 2013 | 300,438 | \$ 12.32 | 3.91 | \$5,534,431 |
| Fully vested and expected to vest | 300,438 | \$ 12.32 | 3.91 | \$5,534,431 |
| Exercisable at June 30, 2013 | 286,687 | \$ 12.04 | 3.69 | \$5,364,235 |

As of June 30, 2013 and December 31, 2012, there was \$26,000 and \$4,200, respectively, of total unrecognized compensation cost related to nonvested stock options granted under the Company's plan. The cost is expected to be recognized over a weighted-average period of less than six months. Aggregate intrinsic value is based on a fair value share price of \$30.74, which is derived from the closing price of our common stock at June 30, 2013.

In conjunction with the Company's equity plans, the Company granted restricted shares to certain executive officers. Compensation expense is recognized over the vesting period of the awards based on the fair value of the stock at issue date. The fair value of the stock was based on the book value of stock on the date of the award. Generally, grants of restricted shares vest one-third, each, on the first, second and third anniversaries of the grant date.

A summary of changes in the Company's nonvested restricted shares for the quarter ended June 30, 2013 is as follows:

| <u>Nonvested Shares</u> | Shares | Weighted- Average Grant-Date Fair Value |
|--------------------------------|----------|--|
| Nonvested at December 31, 2012 | 10,075 | \$ 18.26 |
| Granted | 14,925 | |
| Vested | (4,891) | |
| Forfeited | — | |
| Nonvested at June 30, 2013 | 20,109 | \$ 21.92 |

As of June 30, 2013, there was \$356,857 of total unrecognized compensation cost related to nonvested shares granted under the plans. The cost is expected to be recognized over a weighted average period of 2.3 years. The total fair value of shares vested during the quarter ended June 30, 2013 was \$35,516.

- 16 -

ConnectOne Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 5 - FAIR VALUE MEASUREMENTS AND FAIR VALUE OF FINANCIAL INSTRUMENTS

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. The estimated fair value amounts have been measured as of June 30, 2013 and December 31, 2012, and have not been re-evaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year end.

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate fair value:

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

Investment Securities: The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Discounted cash flows are calculated using spread to swap and LIBOR curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at June 30, 2013 and December 31, 2012 are as follows (dollars in thousands):

- 17 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

NOTE 5 - FAIR VALUE MEASUREMENTS AND FAIR VALUE OF FINANCIAL INSTRUMENTS

(continued)

Assets and Liabilities Measured on a Recurring Basis

| | Fair Value Measurements Using Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|------------------------------------|--|---|--|
| June 30, 2013 | | | |
| Securities: | | | |
| U.S. Treasury securities | \$— | \$ 1,873 | \$ — |
| U.S. government sponsored agencies | — | — | — |
| State and political subdivisions | — | 2,862 | — |
| Asset-backed securities: | | | |
| Residential mortgages | — | 11,238 | — |
| Student loans | — | 2,464 | — |
| Equity securities | — | 5,972 | — |
| December 31, 2012 | | | |
| Securities: | | | |
| U.S. Treasury securities | \$— | \$ — | \$ — |
| U.S. government sponsored agencies | — | 1,005 | — |
| State and political subdivisions | — | — | — |
| Asset-backed securities: | | | |
| Residential mortgages | — | 12,029 | — |
| Student loans | — | — | — |
| Equity securities | — | 6,218 | — |

Assets and Liabilities Measured on a Non-recurring Basis

Assets measured at fair value on a non-recurring basis are summarized below (dollars in thousands):

| | Fair Value Measurements Using | | |
|-------------------------|-------------------------------|-------------|--------------|
| | Quoted | | |
| | Prices | | |
| | In | Significant | Significant |
| | Active | Other | Unobservable |
| | Markets | Observable | Inputs |
| | for | Inputs | (Level 3) |
| | Identical | (Level 2) | |
| | Assets | | |
| | (Level | | |
| | 1) | | |
| June 30, 2013 | | | |
| Impaired loans: | | | |
| Commercial | \$— | \$— | \$— |
| Commercial real estate | — | — | 1,891 |
| Commercial construction | — | — | — |
| Residential real estate | — | — | 2,157 |

- 18 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)****NOTE 5 - FAIR VALUE MEASUREMENTS AND FAIR VALUE OF FINANCIAL INSTRUMENTS**

(continued)

December 31, 2012

Impaired loans:

| | | | |
|-------------------------|-----|-----|-------|
| Commercial | \$— | \$— | \$— |
| Commercial real estate | — | — | 1,986 |
| Commercial construction | — | — | 368 |
| Residential real estate | — | — | — |

June 30, 2012

Impaired loans:

| | | | |
|-------------------------|-----|-----|-------|
| Commercial | \$— | \$— | \$876 |
| Commercial real estate | — | — | 640 |
| Commercial construction | — | — | — |
| Residential real estate | — | — | — |

As of June 30, 2013, impaired loans, which have a specific reserve and are measured for impairment using the fair value of the collateral, had an unpaid principal balance of \$4,338,000 with a valuation allowance of \$289,000, resulting in an additional provision for loan losses of \$216,000 and \$185,000 for the second quarter and first half of 2013, respectively.

As of December 31, 2012, impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had an unpaid principal balance of \$3,387,000, with a valuation allowance of \$1,033,000, resulting in an additional provision for loan losses of \$558,000 for the year ended December 31, 2012.

As of June 30, 2012, impaired loans, which have a specific reserve and are measured for impairment using the fair value of the collateral, had an unpaid principal balance of \$2,510,000 with a valuation allowance of \$994,000, resulting in an additional provision for loan losses of \$175,000 and \$439,000 for the second quarter and first half of 2012, respectively.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at June 30, 2013 (dollars in thousands):

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| | Fair Value | Valuation Technique(s) | Unobservable Input(s) | Discount Range | Weighted Average |
|-------------------------|------------|---------------------------------------|--|----------------|------------------|
| <u>Impaired loans:</u> | | | | | |
| Commercial real estate | \$1,891 | Sales comparison and income approach. | Adjustments for maintenance, selling, legal costs and taxes. | 7%-14% | 9% |
| Residential real estate | \$2,157 | Sales comparison approach. | Adjustments for selling and other costs. | 10% | 10% |

- 19 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)****NOTE 5 - FAIR VALUE MEASUREMENTS AND FAIR VALUE OF FINANCIAL INSTRUMENTS**

(continued)

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2012 (dollars in thousands):

| | Fair Value | Valuation Technique(s) | Unobservable Input(s) | Discount Range | Weighted Average |
|-------------------------|------------|---------------------------------------|---|----------------|------------------|
| <u>Impaired loans:</u> | | | | | |
| Commercial real estate | \$ 1,986 | Sales comparison and income approach. | Adjustments for maintenance, property type, selling, legal costs and date of appraisal. | 10%-65% | 32% |
| Commercial construction | \$ 368 | Sales comparison and income approach. | Adjustments for maintenance, selling and legal costs. | 7% | 7% |

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at June 30, 2012 (dollars in thousands):

| | Fair Value | Valuation Technique(s) | Unobservable Input(s) | Discount Range | Weighted Average |
|------------------------|------------|---------------------------------------|--|----------------|------------------|
| <u>Impaired loans:</u> | | | | | |
| Commercial real estate | \$ 640 | Sales comparison and income approach. | Adjustments for maintenance, selling, legal costs and taxes and date of appraisal. | 17% | 17% |
| Commercial | \$ 876 | Sales comparison and income approach. | Adjustments for maintenance, selling, legal costs, taxes and date of appraisal. | 6% | 6% |

The carrying value and estimated fair value of financial instruments as of June 30, 2013 and December 31, 2012 are summarized below (dollars in thousands):

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| | Fair Value Measurements at June 30, 2013 Using | | | |
|-------------------------------|---|---|---|--|
| | Quoted Prices | | | |
| | Carrying Value | In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| | | | | |
| <u>Financial assets:</u> | | | | |
| Cash and due from banks | \$3,450 | \$3,450 | \$ — | \$ — |
| Interest bearing deposits | 37,130 | 37,130 | — | — |
| Securities available for sale | 24,409 | — | 24,409 | — |
| Securities held to maturity | 1,421 | — | 1,481 | — |
| Loans held for sale | 133 | — | 133 | — |
| Loans receivable, gross | 955,579 | — | — | 967,512 |
| Accrued interest receivable | 3,509 | — | 72 | 3,437 |

- 20 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)****NOTE 5 - FAIR VALUE MEASUREMENTS AND FAIR VALUE OF FINANCIAL INSTRUMENTS**

(continued)

Financial liabilities:

Deposits:

| | | | | |
|---------------------------------------|-----------|-----------|---------|-----|
| Demand, NOW, money market and savings | \$501,671 | \$501,671 | \$— | \$— |
| Certificates of deposit | 321,674 | — | 323,783 | — |
| Long-term borrowings | 74,065 | — | 78,238 | — |
| Accrued interest payable | 2,586 | — | 2,586 | — |

Fair Value Measurements at December
31, 2012 Using

Quoted

| | | | |
|----------------|---|---|--|
| Carrying Value | Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|----------------|---|---|--|

Financial assets:

| | | | | |
|-------------------------------|---------|---------|--------|---------|
| Cash and due from banks | \$3,242 | \$3,242 | \$— | \$— |
| Interest bearing deposits | 47,387 | 47,387 | — | — |
| Securities available for sale | 19,252 | — | 19,252 | — |
| Securities held to maturity | 1,985 | — | 2,084 | — |
| Loans held for sale | 405 | — | 414 | — |
| Loans receivable, gross | 849,269 | — | — | 874,438 |
| Accrued interest receivable | 3,361 | — | 68 | 3,293 |

Financial liabilities:

Deposits:

| | | | | |
|---------------------------------------|-----------|-----------|---------|-----|
| Demand, NOW, money market and savings | \$505,264 | \$505,264 | \$— | \$— |
| Certificates of deposit | 264,054 | — | 277,614 | — |
| Long-term borrowings | 79,568 | — | 81,703 | — |
| Accrued interest payable | 2,803 | — | 2,803 | — |

The methods and assumptions, not previously presented, used to estimate fair values for the periods ended June 30, 2013 and December 31, 2012, are described as follows:

Cash and due from banks: The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

Loans: Fair value of loans, excluding loans held for sale, is estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously.

The methods utilized to estimate the fair value of loans do not necessarily represent an exit price. The fair value of loans held for sale is estimated based upon binding contracts and quotes from third party investors resulting in a Level 2 classification.

- 21 -

ConnectOne Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

NOTE 5 - FAIR VALUE MEASUREMENTS AND FAIR VALUE OF FINANCIAL INSTRUMENTS

(continued)

Deposits: The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 1 classification. The carrying amounts of variable rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date resulting in a Level 1 classification. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Long-term borrowings: Long-term borrowings consist of Federal Home Loan Bank of New York borrowings which are estimated using a discounted cash flow calculation that applies interest rates currently being offered to a schedule of aggregated expected monthly Federal Home Loan borrowings maturities.

Accrued interest receivable/payable: The carrying amounts of accrued interest approximate the fair value resulting in a Level 2 or Level 3 classification.

- 22 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)****NOTE 6 – EARNINGS PER SHARE**

The factors used in the earnings per share computation follow (in thousands, except per share data):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|---------|------------------------------|---------|
| | 2013 | 2012 | 2013 | 2012 |
| Basic: | | | | |
| Net income available to common stockholders | \$2,497 | \$1,870 | \$4,833 | \$3,568 |
| Weighted average common shares outstanding | 5,021 | 2,245 | 4,541 | 2,244 |
| Basic earnings per common share | \$0.50 | \$0.83 | \$1.06 | \$1.59 |
| Diluted: | | | | |
| Net income available to common stockholders | \$2,497 | \$1,870 | \$4,833 | \$3,568 |
| Add: Preferred dividends | — | 206 | — | 352 |
| Net Income | \$2,497 | \$2,076 | \$4,833 | \$3,920 |
| Weighted average common shares outstanding for basic earnings per common share | 5,021 | 2,245 | 4,541 | 2,244 |
| Add: Dilutive effects of assumed exercises of stock options | 117 | 90 | 114 | 86 |
| Add: Dilutive effects of assumed conversion of preferred stock | — | 984 | — | 830 |
| Average shares and dilutive potential common shares | 5,138 | 3,319 | 4,655 | 3,160 |
| Diluted earnings per common share | \$0.49 | \$0.62 | \$1.04 | \$1.24 |

There were no stock options that resulted in anti-dilution for the periods presented.

NOTE 7 – INITIAL PUBLIC OFFERING OF CONNECTONE BANCORP, INC.

On February 11, 2013, ConnectOne Bancorp, Inc. (“The Company”) priced 1,600,000 common shares in its IPO at \$28.00 per share, and on February 12, 2013, ConnectOne Bancorp common shares began trading on the Nasdaq Stock

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Market (ticker symbol: CNOB). The Company issued a total of 1,840,000 common shares in its IPO, which included 240,000 common shares issued pursuant to the underwriters' exercise of their option to purchase additional common shares, on February 21, 2013.

The net proceeds from the IPO were approximately \$47.7 million, after deducting the underwriting discount of approximately \$3.4 million and approximately \$457,000 of expenses.

- 23 -

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Some of the statements in this document discuss future expectations, contain projections or results of operations or financial conditions or state other "forward-looking" information. Those statements are subject to known and unknown risk, uncertainties and other factors that could cause the actual results to differ materially from those contemplated by the statements. We based the forward-looking statements on various factors and using numerous assumptions. Important factors that may cause actual results to differ from those contemplated by forward-looking statements include those disclosed under Item 1A – Risk Factors included in the Company's Annual Report Form 10K filed for the year ended December 31, 2012 and the following:

• The success or failure of our efforts to implement our business strategy;

• The effect of changing economic conditions and, in particular, changes in interest rates;

• Changes in government regulations, tax rates and similar matters;

• Our ability to attract and retain quality employees; and

• Other risks which may be described in our future filings with the SEC

We do not promise to update forward-looking information to reflect actual results or changes in assumptions or other factors that could affect those statements.

Critical Accounting Policies and Estimates

"Management's Discussion and Analysis of Financial Condition and Results of Operations," is based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to our audited consolidated financial statements included in our Annual Report on Form 10-K contains a summary of our significant accounting policies. Management believes our policy with respect to the methodology for the determination of the allowance for loan losses involves a higher degree of complexity and requires management to make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. This critical policy and its application are periodically reviewed with the Audit Committee and our Board of Directors.

The allowance for loan losses is based upon management's evaluation of the adequacy of the allowance, including an assessment of known and probable incurred losses included in the portfolio, including giving consideration to the size and composition of the loan portfolio, actual loan loss experience, level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions. Although management uses the best information available, the level of the allowance for loan losses remains an estimate which is subject to significant judgment and short-term change. Various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the majority of our loans are secured by real estate in the State of New Jersey. Accordingly, the collectability of a substantial portion of the carrying value of our loan portfolio is susceptible to changes in local market conditions and may be adversely affected by declines in real estate values, or if the Central or Northern areas of New Jersey experience an adverse economic shock. Future adjustments to the allowance for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond our control.

- 24 -

Operating Results Overview

Net income for the second quarter of 2013 was \$2.5 million, an increase of \$0.4 million, or 20.3%, compared to net income of \$2.1 million in the second quarter of 2012. Net income available to common shareholders for the second quarter of 2013 was \$2.5 million, an increase of \$0.6 million, or 33.5%, compared to net income available to common shareholders of \$1.9 million in the second quarter of 2012. Diluted earnings per share were \$0.49 for the second quarter of 2013, a decline from \$0.62 for the second quarter of 2012. Net income for the first half of 2013 was \$4.8 million, an increase of \$0.9 million, or 18.9%, compared to net income of \$3.9 million in the first half of 2012. Net income available to common shareholders for the first half of 2013 was \$4.8 million, an increase of \$1.3 million, or 35.5%, compared to net income available to common shareholders of \$3.6 million in the first half of 2012. Diluted earnings per share were \$1.04 for the first half of 2013, a decline from \$1.24 for the first half of 2012.

Net income available to common shareholders and diluted earnings per share in 2012 were impacted by three series of convertible preferred stock issued at various times between 2009 and 2012. During 2012, all three series of preferred stock were converted into common shares and, as of December 31, 2012, stockholders' equity was comprised solely of common equity. In addition, earnings per share in 2013 were impacted by the issuance of 1.8 million shares in the first quarter of 2013 as part of our initial public offering.

The increases in net income and net income available to common shareholders were primarily attributable to significant increases in net interest income due to the Company's rapid growth in loans and deposits, and in its customer base. Partially offsetting the revenue increases were higher noninterest expenses, largely staff-related, commensurate with the Company's growing infrastructure. Credit costs have kept pace with both loan growth and a changing mix in the loan portfolio, while benefitting from an improving economy and overall sound credit quality.

Net Interest Income

Net interest income for the second quarter of 2013 was \$9.8 million, an increase of \$1.0 million, or 11.5%, compared to net interest income of \$8.8 million in the second quarter of 2012. Net interest income for the first half of 2013 was \$19.2 million, an increase of \$2.7 million, or 16.0%, compared to net interest income of \$16.6 million in the first half of 2012. The increase in net interest income was largely attributable to growth in average interest-earning assets, principally loans, which increased by 27.9% and 27.6% in the second quarter and first half of 2013, respectively, from prior period amounts, and was partially offset by a 65 basis point contraction in the net interest margin, from 4.54% in the second quarter of 2012 to 3.89% in the second quarter of 2013 and by a 50 basis point contraction from 4.45% in the first half of 2012 to 3.95% in the first half of 2013. Although the Bank's cost of interest-bearing funds has declined, from 1.04% in the second quarter of 2012 to 0.86% in the second quarter of 2013, and from 1.07% in the first half 2012 to 0.88% in the first half 2013, the rate earned on interest-earning assets has declined to a greater degree, from 5.34% in last year's second quarter to 4.50% in the second quarter of 2013, and from 5.28% in the first half of 2012 to 4.58% in the first half of 2013. The Bank's net interest income has increased due to volume growth, despite continue margin compression resulting from the maturity, prepayment or contractual re-pricing of loans and securities in this extended period of low interest rates.

Average Balance Sheets

The following table sets forth certain information relating to our average assets and liabilities for the three months and six months ended June 30, 2013 and 2012, and reflect the average yield on assets and average cost of liabilities for the periods indicated. Such yields are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown.

| | For the Three Months Ended | | | | | | |
|---|----------------------------|----------|------------------|---------------|-----------------|----------|------------------|
| | June 30, 2013 | | | June 30, 2012 | | | |
| | Average Balance | Interest | Average Rate (5) | | Average Balance | Interest | Average Rate (5) |
| Interest-earning assets: | | | | | | | |
| Investment securities (1) | \$25,460 | \$179 | 2.82 % | | \$30,752 | \$242 | 3.17 % |
| Loans receivable (2) (3) | 923,841 | 11,139 | 4.84 % | | 715,710 | 10,114 | 5.68 % |
| Federal funds sold and interest-bearing deposits with banks | 63,061 | 34 | 0.22 % | | 34,677 | 13 | 0.15 % |
| Total interest-earning assets | 1,012,362 | 11,352 | 4.50 % | | 781,139 | 10,369 | 5.34 % |
| Allowance for loan losses | (13,936) | | | | (10,598) | | |
| Non-interest earning assets | 21,270 | | | | 26,421 | | |
| Total assets | \$1,019,696 | | | | \$796,962 | | |
| Interest-bearing liabilities: | | | | | | | |
| Savings, NOW, Money Market, Interest Checking | \$330,289 | 257 | 0.31 % | | \$306,516 | 369 | 0.48 % |
| Time deposits | 304,429 | 892 | 1.18 % | | 213,744 | 799 | 1.50 % |
| Total interest-bearing deposits | 634,718 | 1,149 | 0.73 % | | 520,260 | 1,168 | 0.90 % |
| Borrowings | 74,287 | 330 | 1.78 % | | 77,871 | 337 | 1.74 % |
| Capital lease obligation | 3,160 | 47 | 5.97 % | | 3,233 | 48 | 5.97 % |
| Total interest-bearing liabilities | 712,165 | 1,526 | 0.86 % | | 601,364 | 1,553 | 1.04 % |
| Noninterest-bearing deposits | 179,084 | | | | 125,723 | | |
| Other liabilities | 4,119 | | | | 3,230 | | |
| Stockholders' equity | 124,328 | | | | 66,645 | | |
| Total liabilities and stockholders' equity | \$1,019,696 | | | | \$796,962 | | |
| Net interest income/interest rate spread | | \$9,826 | 3.64 % | | | \$8,816 | 4.30 % |
| Net interest margin (4) | | | 3.89 % | | | | 4.54 % |

(1) Average balances are calculated on amortized cost.

(2) Includes loan fee income.

(3) Loans receivable include non-accrual loans.

(4) Represents net interest income divided by average total interest-earning assets.

(5) Rates are annualized.

- 26 -

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| | For the Six Months Ended | | | | | | |
|---|--------------------------|------------------|------------------|---------------|-----------------|------------------|------------------|
| | June 30, 2013 | | | June 30, 2012 | | | |
| | Average Balance | Average Interest | Average Rate (5) | | Average Balance | Average Interest | Average Rate (5) |
| Interest-earning assets: | | | | | | | |
| Investment securities (1) | \$24,962 | \$373 | 3.01 % | | \$33,044 | \$523 | 3.18 % |
| Loans receivable (2) (3) | 898,830 | 21,835 | 4.90 % | | 683,304 | 19,120 | 5.63 % |
| Federal funds sold and interest-bearing deposits with banks | 57,278 | 55 | 0.19 % | | 32,749 | 30 | 0.18 % |
| Total interest-earning assets | 981,070 | 22,263 | 4.58 % | | 749,097 | 19,673 | 5.28 % |
| Allowance for loan losses | (13,733) | | | | (10,249) | | |
| Non-interest earning assets | 19,725 | | | | 34,692 | | |
| Total assets | \$987,062 | | | | \$773,540 | | |
| Interest-bearing liabilities: | | | | | | | |
| Savings, NOW, Money Market, Interest Checking | \$330,099 | 516 | 0.32 % | | \$307,227 | 790 | 0.52 % |
| Time deposits | 291,228 | 1,778 | 1.23 % | | 199,757 | 1,574 | 1.58 % |
| Total interest-bearing deposits | 621,327 | 2,294 | 0.74 % | | 506,984 | 2,364 | 0.94 % |
| Borrowings | 76,484 | 664 | 1.75 % | | 75,083 | 653 | 1.75 % |
| Capital lease obligation | 3,169 | 95 | 6.05 % | | 3,242 | 97 | 6.02 % |
| Total interest-bearing liabilities | 700,980 | 3,053 | 0.88 % | | 585,309 | 3,114 | 1.07 % |
| Noninterest-bearing deposits | 180,807 | | | | 122,091 | | |
| Other liabilities | 4,267 | | | | 3,294 | | |
| Stockholders' equity | 101,008 | | | | 62,846 | | |
| Total liabilities and stockholders' equity | \$987,062 | | | | \$773,540 | | |
| Net interest income/interest rate spread | | \$19,210 | 3.70 % | | | \$16,559 | 4.21 % |
| Net interest margin (4) | | | 3.95 % | | | | 4.45 % |

(1) Average balances are calculated on amortized cost.

(2) Includes loan fee income.

(3) Loans receivable include non-accrual loans.

(4) Represents net interest income divided by average total interest-earning assets.

(5) Rates are annualized.

Provision for Loan Losses

In determining the provision for loan losses, management considers national and local economic trends and conditions; trends in the portfolio including orientation to specific loan types or industries; experience, ability and depth of lending management in relation to the complexity of the portfolio; effects of changes in lending policies, trends in volume and terms of loans; levels and trends in delinquencies, impaired loans and net charge-offs and the results of independent third party loan and lease review.

The provision for loan losses for the second quarter and first half of 2013 was \$1.0 million and \$1.9 million, respectively, compared to the provision for loan losses of \$1.1 million and \$1.9 million in the comparable 2012 periods. The provision for loan losses for all periods presented was largely related to loan growth and, to a lesser degree, specific reserves for impaired credits. In addition, 2013 provision for loan losses benefited from improving economic factors.

- 27 -

Non-Interest Income

Non-interest income represents a relatively small portion of the Bank's total revenue as management has made a strategic decision to de-emphasize fee income, focusing instead on customer growth and retention. Non-interest income totaled \$301,000 and \$561,000 for the second quarter and first half of 2013, respectively, up slightly from \$277,000 and \$522,000 in the comparable 2012 periods. Growth in service and card-related fees were partially offset by a decline in gains of sale of residential mortgage loans.

Non-Interest Expense

Non-interest expenses have increased significantly since inception of the Bank as we have expanded our geographic reach and invested in our infrastructure to support our strong asset growth. Non-interest expenses for the second quarter of 2013 were \$4.9 million, a \$0.5 million, or 10.5%, increase from \$4.6 million in the second quarter of 2012, and were \$9.7 million for the first six months of 2013, a \$1.1 million, or 12.4%, increase from \$8.6 million in the first half of 2012. The largest factor contributing to the increase was salaries and employee benefits expense, which increased by \$0.3 and \$0.7 million to \$2.4 and \$4.9 million in the second quarter and first half of 2013, respectively. This increase was primarily due to an approximately 10% increase in our staff, which consisted of 97 full-time employees at June 30, 2013. Also contributing to higher non-interest expenses were increased costs associated with being a publicly-traded entity and a general increase in other operating expenses related to a significantly increased volume of business.

Management continues to focus efforts on supporting growth primarily by adding to staff, investing in technology, and by enhancing risk controls. At the same time, management seeks to contain costs whenever prudent. Our success in this regard is evident in the recent improvements in our efficiency ratio, a widely-followed metric in the banking industry which measures operating expenses as a percentage of net revenue. The ratio is computed by dividing total noninterest expense by the sum of net interest income and noninterest income less securities gains/(losses). The Company's efficiency ratio improved to 48.6% in the second quarter of 2013 from 49.0% in the second quarter of 2012.

Income Taxes

Income tax expense was \$1.8 million for the second quarter 2013 and \$3.4 million for the first half of 2013 versus \$1.4 million for the second quarter 2012 and \$2.7 million for the first half 2012. The effective tax rate, which is derived from both federal and New Jersey statutory income tax rates, was approximately 41.3% for 2013, an increase from 40.5% for 2012, as the Company's growth and increase in earnings has placed it into the 35% federal bracket. Management has thus far taken a conservative approach to the Company's tax position and is currently exploring various strategies to maximize the tax efficiency of operations.

Financial Condition Overview

At June 30, 2013, total assets were \$1.0 billion, a \$100.6 million increase from December 31, 2012. The increase in total assets was due primarily to a \$106.7 million increase, to \$955.6 million, in loans receivable and a \$4.6 million increase, to \$25.8 million, in securities, partially offset by a \$10.1 million decline in cash and cash equivalents. The growth in assets was funded by a \$54.0 million increase in deposits and \$47.8 million in net proceeds from our first quarter 2013 initial public equity offering.

Stockholders' Equity

Stockholders' equity totaled \$124.6 million as of June 30, 2013, an increase of \$52.2 million from \$72.4 million as of year-end 2012, due primarily to the Company's first quarter IPO. As of June 30, 2013, the tangible common equity ratio and tangible book value per share were 12.07% and \$24.76, respectively. As of December 31, 2012, the Company's tangible common equity ratio and tangible book value per share were 7.76.% and \$22.77, respectively. The tangible common equity ratio is calculated by dividing common equity, less goodwill by total assets less, goodwill. Tangible book value per share is calculated by dividing common equity, less goodwill, by common shares outstanding.

- 28 -

Capital

The following table summarizes the risk-based and leverage capital ratios for the Company and the Bank as well as the required minimum regulatory capital ratios for the following periods:

| | June 30, 2013 | | | | December 31, 2012 | | | |
|----------------------------------|---------------|---------------------|------------------------------|------------------------------|-------------------|---------------------|------------------------------|------------------------------|
| | Actual Ratio | Minimum Requirement | Well Capitalized Requirement | Well Capitalized Requirement | Actual Ratio | Minimum Requirement | Well Capitalized Requirement | Well Capitalized Requirement |
| The Company: | | | | | | | | |
| Leverage ratio | 12.19% | 4.00 | % | n/a | 7.84 % | 4.00 | % | n/a |
| Tier 1 Risk-based capitalization | 13.69% | 4.00 | % | n/a | 9.26 % | 4.00 | % | n/a |
| Total Risk-based capitalization | 15.11 % | 8.00 | % | n/a | 10.52 % | 8.00 | % | n/a |
| The Bank: | | | | | | | | |
| Leverage ratio | 12.18% | 4.00 | % | 5.00 | % 7.84 % | 4.00 | % | 5.00 % |
| Tier 1 Risk-based capitalization | 13.68% | 4.00 | % | 6.00 | % 9.26 % | 4.00 | % | 6.00 % |
| Total Risk-based capitalization | 15.10% | 8.00 | % | 10.00 | % 10.51 % | 8.00 | % | 10.00 % |

On July 2, 2013, the Federal Reserve approved final rules that substantially amend the regulatory risk-based capital rules applicable to the Company and the Bank. On July 9, 2013, the FDIC also approved, as an interim final rule, the regulatory capital requirements for U.S. banks, following the actions of the Federal Reserve. The final rules implement the “Basel III” regulatory capital reforms, as well as certain changes required by the Dodd-Frank Act.

The final rules include new risk-based capital and leverage ratios that will be phased in from 2015 to 2019. The rules include a new common equity Tier 1 capital to risk-weighted assets ratio of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets, which is in addition to the Tier 1 and Tier 2 risk-based capital requirements. The final rules also raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% and require a minimum leverage ratio of 4.0%. The required minimum ratio of total capital to risk-weighted assets will remain 8.0%. The new risk-based capital requirements (except for the capital conservation buffer) will become effective for the Company on January 1, 2015. The capital conservation buffer will be phased in over four years beginning on January 1, 2016, with a maximum buffer of 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. Failure to maintain the required capital conservation buffer will result in limitations on capital distributions and on discretionary bonuses to executive officers.

The following chart compares the risk-based capital ratios required under existing Federal Reserve rules to those prescribed under the new final rules under the phase-in period described above:

Current Rules Final Rules

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| | | | | |
|-----------------------------|-----|---|-----|---|
| Common Equity Tier 1 | n/a | | 4.5 | % |
| Additional Tier 1 | n/a | | 1.5 | % |
| Tier 1 | 4.0 | % | n/a | |
| Tier 2 | 4.0 | % | 2.0 | % |
| Common Equity Tier 1 | | | | |
| Capital Conservation Buffer | n/a | | 2.5 | % |

The final rules also implement revisions and clarifications consistent with Basel III regarding the various components of Tier 1 capital, including common equity, unrealized gains and losses and instruments that will no longer qualify as Tier 1 capital. The final rules provide that depository holding companies with less than \$15 billion in total assets as of December 31, 2009, such as the Company, may permanently include trust preferred securities and certain other non-qualifying instruments issued and included in Tier 1 or Tier 2 capital before May 19, 2010 in additional Tier 1 (subject to a maximum of 25% of Tier 1 capital) or Tier 2 capital until maturity or redemption.

- 29 -

The final rules also set forth certain changes for the calculation of risk-weighted assets that the Company will be required to implement beginning January 1, 2015. Management is currently evaluating the provisions of the final rules and their expected impact on the Company. Based on the Company's current capital composition and levels, management does not presently anticipate that the final rules present a material risk to the Company's financial condition or results of operations.

Except as set forth above, management is not aware of any other events or uncertainties that are reasonably likely to have a material effect on the Company's liquidity, capital resources or operations.

Loan Portfolio

The Bank's lending activities are generally oriented to small-to-medium sized businesses, high net worth individuals, professional practices and consumer and retail customers living and working in the Bank's market area of Hudson, Bergen and Monmouth Counties, New Jersey. The Bank has not made loans to borrowers outside of the United States. The Bank believes that its strategy of high-quality customer service, competitive rate structures and selective marketing have enabled it to gain market entry.

Commercial loans are loans made for business purposes and are primarily secured by collateral such as cash balances with the Bank, marketable securities held by or under the control of the Bank, business assets including accounts receivable, taxi medallions, inventory and equipment and liens on commercial and residential real estate. Commercial construction loans are loans to finance the construction of commercial or residential properties secured by first liens on such properties. Commercial real estate loans include loans secured by first liens on completed commercial properties, including multi-family properties, to purchase or refinance such properties. Residential mortgages include loans secured by first liens on residential real estate, and are generally made to existing customers of the Bank to purchase or refinance primary and secondary residences. Home equity loans and lines of credit include loans secured by first or second liens on residential real estate for primary or secondary residences. Consumer loans are made to individuals who qualify for auto loans, cash reserve, credit cards and installment loans.

The following table sets forth the classification of our gross loans held for investment by loan portfolio class as of the periods indicated:

| (dollars in thousands) | June 30, 2013 | | At December 31, 2012 | |
|-------------------------|---------------|------------------|----------------------|------------------|
| | Amount | Percent of Total | Amount | Percent of Total |
| Commercial | \$ 193,231 | 20.2 % | \$ 147,455 | 17.4 % |
| Commercial real estate | 597,126 | 62.4 % | 549,218 | 64.7 % |
| Commercial construction | 42,261 | 4.4 % | 36,872 | 4.3 % |

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| | | | | | | |
|-------------------------|-----------|-------|---|-----------|-------|---|
| Residential real estate | 90,465 | 9.5 | % | 82,962 | 9.8 | % |
| Home equity | 31,574 | 3.3 | % | 30,961 | 3.6 | % |
| Consumer | 1,556 | 0.2 | % | 1,801 | 0.2 | % |
| Total gross loans | \$956,213 | 100.0 | % | \$849,269 | 100.0 | % |

Asset Quality

Nonperforming assets totaled \$10.0 million, or 0.97% of total assets, at June 30, 2013, up from \$8.4 million, or 0.90% of total assets, at year-end 2012. The allowance for loan losses was \$14.0 million, representing 1.46% of loans receivable and 146.5% of nonaccrual loans at June 30, 2013. At year-end 2012, the allowance was \$13.2 million representing 1.56% of loans receivable and 166.8% of nonaccrual loans. There were \$0.6 million and \$1.1 million in net charge-offs recorded during the second quarter and first half of 2013, representing an annualized rate of 0.26% and 0.25% for the second quarter and first half of 2013, respectively.

- 30 -

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The following table sets forth information concerning our non-performing assets, TDRs, and past-due accruing loans as of the periods indicated:

| (dollars in thousands) | June 30, 2013 | December 31, 2012 | | |
|--|---------------|-------------------|----------|---|
| Nonaccrual loans | 9,545 | | 7,939 | |
| Other real estate owned | 433 | | 433 | |
| Total non-performing assets | \$ 9,978 | | \$ 8,372 | |
| Loans past due 90 days and still accruing | \$ 1,189 | | \$ — | |
| Performing troubled debt restructured loans | \$ 2,947 | | \$ 2,996 | |
| Nonaccrual loans to loans receivable | 1.00 | % | 0.93 | % |
| Nonperforming assets to total assets | 0.97 | % | 0.90 | % |
| Allowance for loan losses to loans receivable | 1.46 | % | 1.56 | % |
| Allowance for loan losses to non-accrual loans | 146.5 | % | 166.8 | % |
| Net loan charge-offs to average loans | 0.26 | % | 0.05 | % |

Allowance for Loan Losses

The following is a summary of the reconciliation of the allowance for loan losses for the periods indicated:

| (dollars in thousands) | Three Months Ended June 30, 2013 | Three Months Ended June 30, 2012 | Six Months Ended June 30, 2013 | Six Months Ended June 30, 2012 |
|--|----------------------------------|----------------------------------|--------------------------------|--------------------------------|
| Balance at beginning of period | \$ 13,637 | \$ 10,382 | \$ 13,246 | \$ 9,617 |
| Provision charged to operating expenses | 950 | 1,140 | 1,875 | 1,890 |
| Recoveries of loans previously charged-off: | | | | |
| Commercial | — | — | — | 1 |
| Consumer | 1 | — | 1 | 30 |
| Residential real estate | — | — | — | — |
| Total recoveries | — | — | — | 31 |
| Loans charged-off: | | | | |
| Commercial | (607) | (224) | (1,059) | (240) |
| Consumer | — | — | (82) | — |
| Residential real estate | — | — | — | — |
| Total charge-offs | (607) | (224) | (1,140) | (240) |
| Net (charge-offs)/recoveries | (607) | (224) | (1,140) | (209) |
| Balance at end of period | \$ 13,981 | \$ 11,298 | \$ 13,981 | \$ 11,298 |
| Net charge-offs to average loans outstanding | 0.26 | % 0.13 | % 0.26 | % 0.07 |
| Allowance for loan losses to total loans | 1.46 | % 1.55 | % 1.46 | % 1.55 |

Liquidity

Liquidity is a measure of a bank's ability to fund loans, withdrawals or maturities of deposits, and other cash outflows in a cost-effective manner. Our principal sources of funds are deposits, scheduled amortization and prepayments of loan principal, maturities of investment securities, and funds provided by operations. While scheduled loan payments and maturing investments are relatively predictable sources of funds, deposit flow and loan prepayments are greatly influenced by general interest rates, economic conditions and competition.

At June 30, 2013, the amount of liquid assets remained at a level management deemed adequate to ensure that, on a short and long-term basis, contractual liabilities, depositors' withdrawal requirements, and other operational and customer credit needs could be satisfied. As of June 30, 2013, liquid assets (cash and due from banks, interest-bearing deposits with banks and unencumbered investment securities) were \$66.2 million, which represented 6.4% of total assets and 8.0% of total deposits and borrowings, compared to \$71.5 million at December 31, 2012, which represented 7.7% of total assets and 9.3% of total deposits and borrowings on such date.

The Bank is a member of the Federal Home Loan Bank of New York and, based on available qualified collateral as of June 30, 2013, had the ability to borrow \$376.6 million. In addition, at June 30, 2013, the Bank had in place additional borrowing capacity of \$18.0 million through correspondent banks. The Bank also has a credit facility established with the Federal Reserve Bank of New York for direct discount window borrowings, although no collateral was pledged at year-end 2012. At June 30, 2013, the Bank had aggregate available and unused credit of \$317.5 million, which represents the aforementioned facilities totaling \$391.6 million net of \$74.1 million in outstanding borrowings. At June 30, 2013, outstanding commitments for the Bank to extend credit were \$155.1 million.

Cash and cash equivalents totaled \$40.6 million on June 30, 2013, decreasing by \$10.0 million or 19.8%, from \$50.6 million at December 31, 2012. Operating activities provided \$7.7 million in net cash. Investing activities used \$114.0 million in net cash, primarily reflecting an increase in loans. Financing activities provided \$96.2 million in net cash, primarily reflecting a net increase of \$54.0 million in deposits and net proceeds of \$47.8 million from our initial public offering, partially offset by net repayments of \$10.5 million long-term borrowings.

Interest Rate Sensitivity Analysis

The principal objective of our asset and liability management function is to evaluate the interest-rate risk included in certain balance sheet accounts; determine the level of risk appropriate given our business focus, operating environment, and capital and liquidity requirements; establish prudent asset concentration guidelines; and manage the risk consistent with Board approved guidelines. We seek to reduce the vulnerability of our operations to changes in interest rates, and actions in this regard are taken under the guidance of the Bank's Asset Liability Committee (the "ALCO"). The ALCO generally reviews our liquidity, cash flow needs, maturities of investments, deposits and borrowings, and current market conditions and interest rates.

We currently utilize net interest income simulation and economic value of portfolio equity (“EVPE”) models to measure the potential impact to the Bank of future changes in interest rates. As of June 30, 2013 and December 31, 2012 the results of the models were within guidelines prescribed by our Board of Directors. If model results were to fall outside prescribed ranges, action, including additional monitoring and reporting to the Board, would be required by the ALCO and Bank’s management.

The net interest income simulation model attempts to measure the change in net interest income over the next one-year period, and the next three-year period on a cumulative basis, assuming certain changes in the general level of interest rates.

- 32 -

In our model, which was run as of June 30, 2013, we estimated that, over the next one-year period, a 200 basis-point increase in the general level of interest rates will decrease our net interest income by 1.9%, while a 100 basis-point decrease in interest rates will increase net interest income by 0.1%. As of December 31, 2012, we estimated that, over the next one-year period, a 200 basis-point increase in the general level of interest rates will decrease our net interest income by 1.6%, while a 100 basis-point decrease in the general level of interest rates will decrease our interest rates by 0.5%.

In our model, which was run as of June 30, 2013, we estimated that, over the next three years on a cumulative basis, a 200 basis-point increase in the general level of interest rates will decrease our net interest income by 2.0%, while a 100 basis-point decrease in interest rates will also decrease net interest income by 1.3%. As of December 31, 2012, we estimated that, over the next three years on a cumulative basis, a 200 basis-point increase in the general level of interest rates will decrease our net interest income by 0.9%, while a 100 basis-point decrease in interest rates will decrease net interest income by 2.8%.

An EVPE analysis is also used to dynamically model the present value of asset and liability cash flows with rate shocks of up 200 basis points and down 100 basis points. The economic value of equity is likely to be different as interest rates change. Our EVPE as of June 30, 2013, would decline by 13.50% with a rate shock of up 200 basis points, and increase by 10.73% with a rate shock of down 100 basis points. Our EVPE as of December 31, 2012, would decline by 19.37% with a rate shock of up 200 basis points, and increase by 9.73% with a rate shock of down 100 basis points.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk Management

Interest rate risk management is our primary market risk. See Item 2—“Management’s Discussion and Analysis—Interest Rate Sensitivity Analysis” herein for a discussion of our management of our interest rate risk.

Inflation Risk Management

Inflation has an important impact on the growth of total assets in the banking industry and causes a need to increase equity capital higher than normal levels in order to maintain an appropriate equity-to-assets ratio. We cope with the effects of inflation by managing our interest rate sensitivity position through our asset/liability management program, and by periodically adjusting our pricing of services and banking products to take into consideration current costs.

- 34 -

Item 4. Controls and Procedures

(a) **Evaluation of disclosure controls and procedures:**

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period reported on in this report, the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings.

(b) **Changes in internal controls:**

There has been no change in the Company's internal controls over financial reporting during the quarter that has materially affected, or is reasonably likely to affect, the Company's internal control over financial reporting.

- 35 -

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

The Company and the Bank are periodically involved in various legal proceedings as a normal incident to their businesses. In the opinion of management, no material loss is expected from any such pending lawsuit.

Item 1a. Risk Factors

See Item 1A to our Annual Report on Form 10-K for the year ended December 31, 2012 for the information required by this item.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

Exhibits

Exhibit 31.1 – Certification of Frank Sorrentino III pursuant to SEC Rule 13a-14(a)

Exhibit 31.2 – Certification of William S. Burns pursuant to SEC Rule 13a-14(a)

Exhibit 32 - Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

The following materials from ConnectOne Bancorp, Inc.'s Quarterly Report on Form 10-Q for the period ended June 30, 2013, formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Stockholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) Notes to Consolidated Financial Statements.

101.INS**

XBRL Instance Document

101.SCH**

XBRL Taxonomy Extension Schema

101.CAL**

XBRL Taxonomy Extension Calculation Linkbase

101.DEF**

XBRL Taxonomy Extension Definition Linkbase

101.LAB**

XBRL Taxonomy Extension Label Linkbase

101.PRE**

XBRL Taxonomy Extension Presentation Linkbase

** Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**CONNECTONE
BANCORP, INC.**

Date: August 9, 2013 By: /s/ William S. Burns

William S. Burns
Executive Vice President
and
Chief Financial Officer

- 37 -