

ConnectOne Bancorp, Inc.
Form 10-Q
May 12, 2014

**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

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 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 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 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

As of May 12, 2014 there were 5,122,047 shares of common stock, no par value, outstanding.

ConnectOne Bancorp, Inc.
FORM 10-Q

TABLE OF CONTENTS

<u>PART I FINANCIAL INFORMATION</u>	2
<u>Item 1. Financial Statements</u>	2
<u>Consolidated Balance Sheets as of March 31, 2014 and December 31, 2013</u>	2
<u>Consolidated Statements of Income for the three months ended March 31, 2014 and 2013</u>	4
<u>Consolidated Statements of Comprehensive Income for the three months ended March 31, 2014 and 2013</u>	5
<u>Consolidated Statements of Changes in Stockholders' Equity for the three months ended March 31, 2014 and for the year ended December 31, 2013</u>	6
<u>Consolidated Statements of Cash Flows for the three months ended March 31, 2014 and 2013</u>	7
<u>Notes to Consolidated Financial Statements</u>	8
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	26
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	37
<u>Item 4. Controls and Procedures</u>	38
<u>PART II OTHER INFORMATION</u>	39
<u>Item 1. Legal Proceedings</u>	
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	39
<u>Item 3. Defaults Upon Senior Securities</u>	39
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	39
<u>Item 5. Other Information</u>	39
<u>Item 6. Exhibits</u>	39
<u>SIGNATURES</u>	40
<u>CERTIFICATIONS</u>	

EXHIBIT 32

- 1 -

PART I – FINANCIAL INFORMATION**Item 1. Financial Statements****ConnectOne Bancorp, Inc.****CONSOLIDATED BALANCE SHEETS****(in thousands)**

	March 31, 2014 (unaudited)	December 31, 2013
Assets		
Cash and due from banks	\$3,005	\$2,907
Interest-bearing deposits with banks	42,325	31,459
Cash and cash equivalents	45,330	34,366
Securities available for sale	27,199	27,589
Securities held to maturity, fair value of \$943 at 2014 and \$1,077 at 2013	898	1,027
Loans held for sale	792	575
Loans receivable	1,245,363	1,151,904
Less: Allowance for loan losses	(17,035)	(15,979)
Net loans receivable	1,228,328	1,135,925
Investment in restricted stock, at cost	9,411	7,622
Bank premises and equipment, net	7,385	7,526
Accrued interest receivable	4,235	4,102
Other real estate owned	870	1,303
Goodwill	260	260
Bank-owned life insurance	15,334	15,191
Deferred taxes	7,539	7,614
Other assets	142	128
Total assets	\$1,347,723	\$1,243,228

(continued)

See accompanying notes to unaudited consolidated financial statements.

ConnectOne Bancorp, Inc.**CONSOLIDATED BALANCE SHEETS****(in thousands, except share data)**

	March 31, 2014	December 31, 2013
	(unaudited)	
Liabilities		
Deposits		
Noninterest-bearing	\$236,872	\$216,804
Interest-bearing	790,884	749,003
Total deposits	1,027,756	965,807
FHLB Borrowings	177,301	137,558
Accrued interest payable	2,836	2,762
Capital lease obligation	3,081	3,107
Other liabilities	3,741	3,866
Total liabilities	1,214,715	1,113,100
 Commitments and Contingencies		
 Stockholders' Equity		
Preferred stock (Series A), no par value; \$20 liquidation value; authorized 125,000 shares; no shares issued and outstanding at March 31, 2014 and December 31, 2013	—	—
Preferred stock (Series B), no par value; \$20 liquidation value; authorized 875,000 shares; no shares issued and outstanding at March 31, 2014 and December 31, 2013	—	—
Preferred stock (Series C), no par value; \$1,000 liquidation value; authorized 7,500 shares; no shares issued and outstanding at March 31, 2014 and December 31, 2013	—	—
Common stock and surplus, no par value; authorized 10,000,000 shares at March 31, 2014 and December 31, 2013; issued and outstanding 5,122,047 at March 31, 2014 and 5,106,455 at December 31, 2013	99,466	99,315
Retained earnings	33,539	30,931
Accumulated other comprehensive income/(loss)	3	(118)
Total stockholders' equity	133,008	130,128
Total liabilities and stockholders' equity	\$1,347,723	\$1,243,228

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended March 31,	
	2014	2013
Interest income		
Loans receivable, including fees	\$13,455	\$10,696
Securities	227	195
Other interest income	22	21
Total interest income	13,704	10,912
Interest expense		
Deposits	1,401	1,146
FHLB borrowings	561	334
Capital lease	47	48
Total interest expense	2,009	1,528
Net interest income	11,695	9,384
Provision for loan losses	1,300	925
Net interest income after provision for loan losses	10,395	8,459
Non-interest income		
Service fees	87	100
Gains on sales of loans	41	83
Income on bank owned life insurance	144	—
Other income	77	76
Total non-interest income	349	259
Non-interest expenses		
Salaries and employee benefits	3,091	2,480
Occupancy and equipment	829	729
Professional fees	378	271
Advertising and promotion	99	103
Data processing	517	447
Merger related expenses	923	—
Other expenses	835	711
Total non-interest expenses	6,672	4,741
Income before income tax expense	4,072	3,977
Income tax expense	1,464	1,641
Net income	\$2,608	\$2,336
Earnings per common share:		
Basic	\$0.52	\$0.58
Diluted	0.50	0.56
Weighted average common shares outstanding:		

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

Basic	5,035,521	4,055,908
Diluted	5,216,599	4,178,214

See accompanying notes to unaudited consolidated financial statements.

- 4 -

ConnectOne Bancorp, Inc.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

(in thousands)

	Three Months Ended March 31,	
	2014	2013
Net income	\$2,608	\$2,336
Unrealized holding (losses)/gains on securities available for sale arising during the period	202	(122)
Tax effect	81	(49)
Other comprehensive loss	121	(73)
Comprehensive income	\$2,729	\$2,263

See accompanying notes to unaudited consolidated financial statements.

- 5 -

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

(dollars in thousands)

	Common Stock and Surplus	Preferred Stock, Series A	Preferred Stock, Series B	Preferred Stock, Series C	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance at January 1, 2013	\$ 51,205	\$ —	\$ —	\$ —	\$ 20,661	\$ 496	\$ 72,362
Net income	—	—	—	—	10,270	—	10,270
Other comprehensive loss, net of taxes	—	—	—	—	—	(614)	(614)
Issuance of 1,840,000 shares, net of expenses	47,715	—	—	—	—	—	47,715
Grant of 100,238 restricted stock awards and performance units	—	—	—	—	—	—	—
Equity-based compensation	395	—	—	—	—	—	395
Balance at December 31, 2013	99,315	—	—	—	30,931	(118)	130,128
Net income	—	—	—	—	2,608	—	2,608
Other comprehensive income, net of taxes	—	—	—	—	—	121	121
Grant of 15,592 restricted stock awards	—	—	—	—	—	—	—
Equity-based compensation	151	—	—	—	—	—	151
Balance at March 31, 2014 (unaudited)	\$ 99,466	\$ —	\$ —	\$ —	\$ 33,539	\$ 3	\$ 133,008

See accompanying notes to unaudited consolidated financial statements.

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

	Three months ended March 31,	
	2014	2013
Cash flows from operating activities		
Net income	\$2,608	\$2,336
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,300	925
Depreciation and amortization	305	297
Net amortization of securities discounts and premiums	4	20
Equity-based compensation	151	99
Proceeds from sale of loans	2,246	4,352
Originations of loans held for sale	(2,422)	(4,149)
Gain on sales of loans	(41)	(83)
Increase in bank-owned life insurance	(144)	—
Increase in accrued interest receivable	(133)	(157)
Increase (decrease) in accrued interest payable	74	(126)
Increase (decrease) in other liabilities	(125)	1,314
(Increase) decrease in other assets	(13)	205
Net cash provided by operating activities	3,810	5,033
Cash flows from investing activities		
Net increase in loans	(93,703)	(52,978)
Maturities, calls and principal repayments of securities held to maturity and available for sale	711	1,851
Proceeds from sale of other real estate owned	433	—
Net (increase) decrease in investments in restricted stock, at cost	(1,789)	228
Purchases of bank premises and equipment	(164)	(701)
Net cash used in investing activities	(94,512)	(51,600)
Cash flows from financing activities		
Net increase in deposits	61,949	29,760
Proceeds from FHLB borrowings	40,000	5,000
Repayment of FHLB borrowings	(257)	(10,162)
Net proceeds from initial public offering	—	47,715
Decrease in capital lease obligation	(26)	(18)
Net cash provided by financing activities	101,666	72,295
Net increase in cash and cash equivalents	10,964	25,728
Cash and cash equivalents - beginning	34,366	50,629
Cash and cash equivalents - ending	\$45,330	\$76,357
Supplementary cash flows information:		
Interest paid	\$1,935	\$1,654
Income taxes paid	\$1,275	\$900

See accompanying notes to unaudited consolidated financial statements.

- 7 -

ConnectOne Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Principles of Consolidation: The consolidated financial statements include ConnectOne Bancorp, Inc. (“The Parent Corporation”) and its wholly owned subsidiary, ConnectOne Bank (“the Bank” and, collectively with the Parent Corporation and the Parent Corporation’s other direct subsidiaries, “the Company.”)

The Company provides financial services through its offices in Bergen, Hudson, Monmouth, and Essex 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 March 31, 2014 and 2013 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 ended March 31, 2014 are not necessarily indicative of the results that may be expected for the year ended December 31, 2014. 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, 2013.

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

NOTE 2 - SECURITIES

The amortized cost, gross unrealized gains and losses and fair value of securities available for sale at March 31, 2014 and December 31, 2013, are as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<u>March 31, 2014</u>				
Securities available for sale:				
U.S. Treasury securities	\$ 1,937	\$ —	\$ (84)	) \$ 1,853
States and political subdivisions	4,412	2	(32)	) 4,382
Asset-backed securities:				
Residential mortgages	9,038	333	(87)	) 9,284
Student loans	4,451	7	(11)	) 4,447
Small business loans	1,356	—	(12)	) 1,344
Equity securities	6,000	—	(111)	) 5,889
	\$ 27,194	\$ 342	\$ (337)	) \$ 27,199

December 31, 2013

Securities available for sale:				
U.S. Treasury securities	\$ 1,935	\$ —	\$ (132)	) \$ 1,803
States and political subdivisions	4,415	—	(80)	) 4,335
Asset-backed securities:				
Residential mortgages	9,452	333	(128)	) 9,657
Student loans	4,568	—	(20)	) 4,548
Small business loans	1,414	—	(23)	) 1,391
Equity securities	6,000	—	(145)	) 5,855
	\$ 27,784	\$ 333	\$ (528)	) \$ 27,589

The amortized cost, gross unrecognized gains and losses and fair value of securities held to maturity at March 31, 2014 and December 31, 2013, are as follows (dollars in thousands):

	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
<u>March 31, 2014</u>				
Securities held to maturity:				

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

Asset-backed securities:

Residential mortgages	\$ 898	\$ 45	\$ —	\$943
-----------------------	--------	-------	------	-------

December 31, 2013

Securities held to maturity:

Asset-backed securities:

Residential mortgages	\$ 1,985	\$ 99	\$ —	\$2,084
-----------------------	----------	-------	------	---------

- 9 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

NOTE 2 - SECURITIES

(continued)

The amortized cost and fair value of debt securities available for sale and held to maturity at March 31, 2014, 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. Asset-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>March 31, 2014</u>				
Due in one year or less	\$1,001	\$1,002	\$—	\$—
Due after one year through five years	—	—	—	—
Due after five years through ten years	3,849	3,733	—	—
Due after ten years	1,499	1,500	—	—
Asset-backed securities:				
Residential mortgages	9,038	9,284	898	943
Student loans	4,451	4,447	—	—
Small business loans	1,356	1,344	—	—
	\$21,194	\$21,310	\$898	\$943

There were no sales of available for sale securities for the quarters ended March 31, 2014 and 2013.

Securities with a carrying value of \$204,000 and \$215,000 at March 31, 2014 and December 31, 2013, 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 March 31, 2014 and December 31, 2013, aggregated by major security type and length of time in a continuous unrealized loss position (in thousands).

Less than 12 Months

Total

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

	Fair	Unrealized	12 Months or Longer	Fair	Unrealized	Fair	Unrealized
	Value	Losses	Valu	Losses	Value	Losses	
March 31, 2014							
Securities available for sale:							
U.S. Treasury securities	\$1,853	\$ (84)	\$ —	\$ —	\$1,853	\$ (84)	
States and political subdivisions	1,880	(32)	—	—	1,880	(32)	
Asset-backed securities:							
Residential mortgages	2,275	(87)	—	—	2,275	(87)	
Student loans	2,495	(11)	—	—	2,495	(11)	
Small business loans	1,344	(12)	—	—	1,344	(12)	
Equity securities	5,889	(111)	—	—	5,889	(111)	
	\$15,736	\$ (337)	\$ —	\$ —	\$15,736	\$ (337)	

- 10 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

NOTE 2 - SECURITIES

(continued)

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<u>December 31, 2013</u>						
Securities available for sale:						
U. S. Treasury securities	\$1,803	\$ (132)	\$ —	\$ —	\$1,803	\$ (132)
States and political subdivisions	3,412	(80)	—	—	3,412	(80)
Asset-backed securities:						
Residential mortgages	4,284	(128)	—	—	4,284	(128)
Student loans	4,548	(20)	—	—	4,548	(20)
Small business loans	1,391	(23)	—	—	1,391	(23)
Equity securities	5,855	(145)	—	—	5,855	(145)
	\$21,293	\$ (528)	\$ —	\$ —	\$21,293	\$ (528)

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.

NOTE 3 – LOANS RECEIVABLE

The composition of loans receivable (which excludes loans held for sale) at March 31, 2014 and December 31, 2013 are as follows (dollars in thousands):

	March 31, 2014	December 31, 2013
Commercial	\$223,324	\$ 203,690
Commercial real estate	835,169	769,121
Commercial construction	69,420	59,877
Residential real estate	83,243	85,568
Home equity	32,665	32,504

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

Consumer	2,348	2,340
Gross loans	1,246,169	1,153,100
Unearned net origination fees and costs	(806)	(1,196)
Loans receivable	1,245,363	1,151,904
Less: Allowance for loan losses	(17,035)	(15,979)
Net loans receivable	\$1,228,328	\$ 1,135,925

- 11 -

ConnectOne Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 – LOANS RECEIVABLE

(continued)

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 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 sufficient amount and in a timely manner may be significantly influenced by market, legal and regulatory conditions.

- 12 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****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 March 31, 2014 and December 31, 2013 (dollars in thousands):

	Commercial	Commercial	Commercial	Residential	Home	Consumer	Unallocated	Total
	Commercial	Real	Commercial	Real	Home	Consumer	Unallocated	Total
	Estate	Estate	Construction	Estate	Equity	Consumer	Unallocated	Total
					Lines of	Consumer	Unallocated	Total
					Credit	Consumer	Unallocated	Total
March 31, 2014								
Allowance for loan losses:								
Individually evaluated for impairment	\$ 1,456	\$ 80	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 1,536
Collectively evaluated for impairment	3,267	9,259	740	1,217	701	52	263	15,499
Total	\$ 4,723	\$ 9,339	\$ 740	\$ 1,217	\$ 701	\$ 52	\$ 263	\$ 17,035
Gross loans:								
Individually evaluated for impairment	\$ 5,743	\$ 6,106	\$ —	\$ 2,784	\$ 765	\$ —	\$ —	\$ 15,398
Collectively evaluated for impairment	217,581	829,063	69,420	80,459	31,900	2,348	—	1,230,771
Total	\$ 223,324	\$ 835,169	\$ 69,420	\$ 83,243	\$ 32,665	\$ 2,348	\$ —	\$ 1,246,169
December 31, 2013								
Allowance for loan losses:								
Individually evaluated for impairment	\$ 1,440	\$ 122	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 1,562
Collectively evaluated for impairment	2,998	8,622	639	1,248	698	52	160	14,417
Total	\$ 4,438	\$ 8,744	\$ 639	\$ 1,248	\$ 698	\$ 52	\$ 160	\$ 15,979

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

Gross loans:								
Individually evaluated for impairment	\$ 5,813	\$ 6,137	\$ —	\$ 3,029	\$ 767	\$ —	\$ —	\$ 15,746
Collectively evaluated for impairment	197,877	762,984	59,877	82,539	31,737	2,340	—	1,137,354
Total	\$ 203,690	\$ 769,121	\$ 59,877	\$ 85,568	\$ 32,504	\$ 2,340	\$ —	\$ 1,153,100

- 13 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

NOTE 3 – LOANS RECEIVABLE

(continued)

The following tables present information related to impaired loans by class as of March 31, 2014, December 31, 2013 and March 31, 2013 and for the quarters ended March 31, 2014 and 2013 and for the year ended December 31, 2013 (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
<u>March 31, 2014</u>						
With no related allowance recorded:						
Commercial	\$ 929	\$ 801	—	\$ 819	\$ —	\$ —
Commercial real estate	5,244	4,870	—	4,955	22	—
Commercial construction	—	—	—	—	—	—
Residential real estate	3,641	2,817	—	3,202	8	—
Home equity lines of credit	770	765	—	771	—	—
Consumer	—	—	—	—	—	—
	10,584	9,253	—	9,747	30	—
With an allowance recorded:						
Commercial	5,018	4,949	1,456	5,077	17	—
Commercial real estate	1,394	1,403	80	1,447	21	—
Commercial construction	—	—	—	—	—	—
Residential real estate	—	—	—	—	—	—
Home equity lines of credit	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
	6,412	6,352	1,536	6,524	38	—
Total	\$ 16,996	\$ 15,605	\$ 1,536	\$ 16,271	\$ 68	\$ —
<u>December 31, 2013</u>						
With no related allowance recorded:						
Commercial	\$ 934	\$ 809	—	\$ 830	\$ 15	\$ —
Commercial real estate	4,712	4,348	—	4,479	63	—
Commercial construction	—	—	—	—	—	—

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

Residential real estate	3,643	3,055	—	3,510	36	—
Home equity lines of credit	771	768	—	567	7	—
Consumer	—	—	—	—	—	—
	10,060	8,980	—	9,386	121	—
With an allowance recorded:						
Commercial	5,057	5,016	1,440	5,192	122	60
Commercial real estate	1,950	1,959	122	2,042	119	—
Commercial construction	—	—	—	—	—	—
Residential real estate	—	—	—	—	—	—
Home equity lines of credit	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
	7,007	6,975	1,562	7,234	241	60
Total	\$ 17,067	\$ 15,955	\$ 1,562	\$ 16,620	\$ 362	\$ 60

March 31, 2013

With no related allowance recorded:

Commercial	\$ 273	\$ 276	—	\$ 286	\$ —	\$ —
Commercial real estate	2,392	2,434	—	1,666	16	—
Commercial construction	—	—	—	—	—	—
Residential real estate	3,023	3,068	—	3,058	—	—
Home equity lines of credit	119	121	—	121	1	—
Consumer	—	—	—	—	—	—
	5,807	5,899	—	5,131	17	—

With an allowance recorded:

Commercial	2,862	2,862	648	2,895	32	32
Commercial real estate	3,274	3,326	612	3,442	35	—
Commercial construction	—	—	—	—	—	—
Residential real estate	639	647	45	660	8	—
Home equity lines of credit	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
	6,775	6,835	1,305	6,997	75	32
Total	\$ 12,582	\$ 12,734	\$ 1,305	\$ 12,128	\$ 92	\$ 32

(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.

- 14 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

NOTE 3 – LOANS RECEIVABLE

(continued)

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

	Nonaccrual Loans		Loans Past Due Over 90 Days Still Accruing	
	March 31, 2014	December 31 2013	March 31, 2014	December 31 2013
Commercial	\$3,512	\$ 3,582	\$ —	\$ —
Commercial real estate	2,434	2,445	—	—
Commercial construction	—	—	—	—
Residential real estate	2,137	2,381	—	—
Home equity lines of credit	765	767	—	—
Consumer	—	—	—	—
Total	\$8,848	\$ 9,175	\$ —	\$ —

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

	30-59	60-89	90 Days	Total	Current	Total Gross Loans
	Days	Days	or Greater			
March 31, 2014	Past Due	Past Due	Past Due	Past Due		
Commercial	\$—	\$—	\$ 628	\$628	\$222,696	\$223,324
Commercial real estate	1,928	—	1,394	3,322	831,847	835,169
Commercial construction	—	—	—	—	69,420	69,420
Residential real estate	647	321	1,524	2,492	80,751	83,243
Home equity lines of credit	—	—	651	651	32,014	32,665
Consumer	—	—	—	—	2,348	2,348

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

Total	\$2,575	\$321	\$4,197	\$7,093	\$1,239,076	\$1,246,169
December 31, 2013						
Commercial	\$—	\$—	\$634	\$634	\$203,056	\$203,690
Commercial real estate	—	—	1,394	1,394	767,727	769,121
Commercial construction	—	—	—	—	59,877	59,877
Residential real estate	—	431	1,763	2,194	83,374	85,568
Home equity lines of credit	—	—	653	653	31,851	32,504
Consumer	—	19	—	19	2,321	2,340
Total	\$—	\$450	\$4,444	\$4,894	\$1,148,206	\$1,153,100

- 15 -

ConnectOne Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 – LOANS RECEIVABLE

(continued)

There were no troubled debt restructurings that occurred during the quarters ended March 31, 2014 and 2013. There were no troubled debt restructurings for which there was a payment default within twelve months following the modification during the quarters ended March 31, 2014 and 2013. 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 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.

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

The following table presents the risk category of loans by class of loans based on the most recent analysis performed as of March 31, 2014 and December 31, 2013 (dollars in thousands):

Credit Risk Profile by Internally Assigned Grades	Pass	Special Mention	Substandard	Doubtful	Total
March 31, 2014					
Commercial	\$204,463	\$13,969	\$4,892	\$—	\$223,324
Commercial real estate	821,711	1,934	11,524	—	835,169
Commercial construction	69,420	—	—	—	69,420
Total	\$1,095,594	\$15,903	\$16,416	\$—	\$1,127,913
December 31, 2013					
Commercial	\$184,340	\$14,377	\$4,973	\$—	\$203,690
Commercial real estate	755,533	1,947	11,641	—	769,121
Commercial construction	59,877	—	—	—	59,877
Total	\$999,750	\$16,324	\$16,614	\$—	\$1,032,688

- 16 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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	Commercial	Real	Equity			
	Estate	Estate	Construction	Estate	Lines			
					of			
					Credit			
Allowance for loan losses:								
Beginning balance at January 1, 2014	\$ 4,438	\$ 8,744	\$ 639	\$ 1,248	\$ 698	\$ 52	\$ 160	\$ 15,979
Charge-offs	—	—	—	(239)	—	(5)	—	(244)
Recoveries	—	—	—	—	—	—	—	—
Provision for loan losses	285	595	101	208	3	5	103	1,300
Total ending balance at March 31, 2014	\$ 4,723	\$ 9,339	\$ 740	\$ 1,217	\$ 701	\$ 52	\$ 263	\$ 17,035
Allowance for loan losses:								
Beginning balance at January 1, 2013	\$ 2,402	\$ 7,745	\$ 633	\$ 1,542	\$ 617	\$ 41	\$ 266	\$ 13,246
Charge-offs	—	(452)	—	—	(79)	(3)	—	(534)
Recoveries	—	—	—	—	—	—	—	—
Provision for loan losses	842	283	(290)	22	87	(5)	(14)	925
Total ending balance at March 31, 2013	\$ 3,244	\$ 7,576	\$ 343	\$ 1,564	\$ 625	\$ 33	\$ 252	\$ 13,637

NOTE 4 - STOCK OPTION PLANS AND EQUITY COMPENSATION PLAN

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

At March 31, 2014, there were 91,393 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 three months ended March 31, 2014 are as follows:

	Shares	Weighted Average Exercised Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2014	300,438	\$ 12.32		
Granted	—	—		
Exercised	—	—		
Forfeited	(606)	18.18		
Expired	—	—		
Outstanding at March 31, 2014	299,832	\$ 12.31	\$ 3.16	\$11,008,412
Fully vested and expected to vest	299,832	\$ 12.31	\$ 3.16	\$11,008,412
Exercisable at March 31, 2014	298,416	\$ 12.28	\$ 3.12	\$10,946,236

- 17 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****NOTE 4 - STOCK OPTION PLANS AND EQUITY COMPENSATION PLAN**

(continued)

As of March 31, 2014 and December 31, 2013, there were no material unrecognized compensation costs related to nonvested stock options granted under the Company's plans. Aggregate intrinsic value is based on a fair value share price of \$48.96, which is derived from the closing price of our common stock at March 31, 2014. There were no stock options granted during the first quarter of 2014.

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 granted was based on the closing market price of our common stock as of the grant date. 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 March 31, 2014 is as follows:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at December 31, 2013	19,275	\$ 21.90
Awarded	15,592	38.81
Vested	(7,188)	21.57
Expired	—	—
Nonvested at March 31, 2014	26,679	\$ 31.51

As of March 31, 2014, there was \$811,000 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 26.3 months. The total fair value of shares vested during the quarter ended March 31, 2014 was \$321,000.

On August 7, 2013, the Company granted to various key employees performance unit awards, with each unit entitling the holder to one share of the Company's common stock contingent upon the Company meeting or exceeding certain return on asset targets over the course of a three-year period commencing July 1, 2013. Under the agreement, and assuming the Company has met or exceeded the applicable targets, grants of performance unit awards will vest one-third, each, on the third, fourth and fifth anniversaries of the grant date or an earlier date, in the event of a change in control, as defined in the agreement. At March 31, 2014, the specific number of shares related to performance unit awards that were expected to vest was 85,313, determined by actual performance in consideration of the established range of the performance targets, which is consistent with the level of expense currently being recognized over the vesting period. Should this expectation change, additional compensation expense could be recorded in future periods or previously recognized expense could be reversed. The maximum amount of performance unit awards is 102,375.

- 18 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****NOTE 4 - STOCK OPTION PLANS AND EQUITY COMPENSATION PLAN**

(continued)

A summary of the status of unearned performance unit awards and the change during the period is presented in the table below:

	Shares	Weighted-Average Grant-Date Fair Value
Unearned at December 31, 2013	85,313	\$ 32.35
Awarded	—	—
Forfeited	—	—
Expired	—	—
Unearned at March 31, 2014	85,313	\$ 32.35

The company recognized \$184,000 in stock-based compensation expenses for services rendered for the quarter ended March 31, 2014. At March 31, 2014, compensation cost of \$2,323,000 related to nonvested awards not yet recognized is expected to be recognized over a weighted-average period of 3.2 years.

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 March 31, 2014 and December 31, 2013, 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 period 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.

- 19 -

ConnectOne Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

(continued)

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

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 March 31, 2014 and December 31, 2013 are as follows (dollars in thousands):

Assets and Liabilities Measured on a Recurring Basis

	Fair Value Measurements Using	
	Quoted	Significant
	Prices	
	in	Other
	Active	Significant

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

	Markets for Identical Assets (Level 1)	Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
March 31, 2014			
Securities:			
U.S. Treasury securities	\$1,853	\$ —	\$ —
States and political subdivisions	—	4,382	—
Asset-backed securities:			
Residential mortgages	—	9,284	—
Student loans	—	4,447	—
Small business loans	—	1,344	—
Equity securities	—	5,889	—
December 31, 2013			
Securities:			
U.S. Treasury securities	\$1,803	\$ —	\$ —
States and political subdivisions	—	4,335	—
Asset-backed securities:			
Residential mortgages	—	9,657	—
Student loans	—	4,548	—
Small business loans	—	1,391	—
Equity securities	—	5,855	—

- 20 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

(continued)

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 Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
March 31, 2014			
Impaired loans:			
Commercial real estate	\$—	\$ —	\$ 1,828
Commercial	—	—	1,865
December 31, 2013			
Impaired loans:			
Commercial real estate	\$—	\$ —	\$ 1,828
Commercial	—	—	1,865

As of March 31, 2014, 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 \$4,106,000 with a valuation allowance of \$977,000, resulting in an additional provision for loan losses of \$39,000 for the quarter ended March 31, 2014.

As of March 31, 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 \$3,913,000 with a valuation allowance of \$657,000,

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

resulting in an additional provision for loan losses of \$76,000 for the quarter ended March 31, 2013.

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 March 31, 2014 (dollars in thousands):

	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Discount Range	Weighted Average
<u>Impaired loans:</u>					
Commercial real estate	\$1,313	Sales comparison	Adjustments for differences between the comparable sales.	5% - 14 %	7 %
Commercial	\$1,816	Sales comparison	Adjustments for differences between the comparable sales.	39 %	39 %

- 21 -

ConnectOne Bancorp, Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****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, 2013 (dollars in thousands):

	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Discount Range	Weighted Average
<u>Impaired loans:</u>					
Commercial real estate	\$1,828	Sales comparison	Adjustments for differences between the comparable sales.	5% - 15 %	8 %
		Income approach	Adjustments for differences in net operating income expectations.	4 %	4 %
Commercial	\$1,865	Sales comparison	Adjustments for differences between the comparable sales.	39 %	39 %

The carrying value and estimated fair value of financial instruments as of March 31, 2014 and December 31, 2013 are summarized below (dollars in thousands):

	Carrying Value	Fair Value Measurements at March 31, 2014 Using		
		Quoted 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	\$3,005	\$3,005	\$—	\$—
Interest bearing deposits	42,325	42,325	—	—

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

Securities available for sale	27,199	1,853	25,346	—
Securities held to maturity	898	—	943	—
FHLB stock	9,411	n/a	n/a	n/a
Loans held for sale	792	—	792	—
Loans receivable	12,45,363	—	—	12,43,636
Accrued interest receivable	4,235	—	77	4,158

Financial liabilities:

Deposits

Demand, NOW, money market and savings	\$5,78,045	\$5,78,045	\$—	\$—
Certificates of deposit	4,49,711	—	4,52,129	—
FHLB Borrowings	1,77,301	—	1,81,851	—
Accrued interest payable	2,836	—	2,836	—

- 22 -

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

(continued)

	Carrying Value	Fair Value Measurements at December 31, 2013 Using		
		Quoted 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	\$2,907	\$2,907	\$—	\$—
Interest bearing deposits	31,459	31,459	—	—
Securities available for sale	27,589	1,803	25,786	—
Securities held to maturity	1,027	—	1,077	—
FHLB stock	4,744	n/a	n/a	n/a
Loans held for sale	575	—	583	—
Loans receivable, gross	11,51,904	—	—	11,51,870
Accrued interest receivable	4,102	—	99	4,003
Financial liabilities:				
Deposits				
Demand, NOW, money market and savings	\$5,50,096	\$5,50,096	\$—	\$—
Certificates of deposit	4,15,711	—	4,19,467	—
FHLB Borrowings	1,37,558	—	1,41,902	—
Accrued interest payable	2,762	—	2,762	—

The methods and assumptions, not previously presented, used to estimate fair values for the periods ended March 31, 2014 and December 31, 2013, are described as follows:

Cash and due from banks and interest bearing deposits: 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 repriced 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.

FHLB Stock: It is not practical to determine the fair value of FHLB Stock due to restrictions placed on its transferrability.

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.

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

(continued)

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.

NOTE 6 – EARNINGS PER SHARE

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

	Three Months Ended March 31,	
	2014	2013
Basic		
Net income available to common stockholders	\$2,608	\$2,336
Weighted average common shares outstanding	5,036	4,056
Basic earnings per common share	\$0.52	\$0.58
Diluted		
Net income	\$2,608	\$2,336
Weighted average common shares outstanding for basic earnings per common share	5,036	4,056
Add: Dilutive effects of assumed exercises of stock options and stock awards	181	122
Average shares and dilutive potential common shares	5,217	4,178
Diluted earnings per common share	\$0.50	\$0.56

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

NOTE 7 – PENDING MERGER

On January 20, 2014, the Company, entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Center Bancorp, Inc. (NASDAQ: “CNBC”) (“Center Bancorp”). The Merger Agreement provides that, upon the terms and subject to the conditions set forth therein, the Company will merge with and into Center Bancorp, with Center Bancorp continuing as the surviving entity (the “Merger”). The Merger Agreement also provides that, immediately following the consummation of the Merger, Union Center National Bank, a commercial bank chartered pursuant to the laws of the United States (“Union Center”) and a wholly-owned subsidiary of Center Bancorp, will merge with and into the Bank, with the Bank continuing as the surviving bank. Upon completion of the Merger, each share of common stock of the Company will be converted into and become the right to receive 2.6 shares of common stock, no par value per share, of Center Bancorp. Immediately after consummation of the transaction, the directors of the resulting corporation and the resulting bank shall consist of six individuals who previously served as Center Bancorp Directors and six Directors who previously served as Directors of the Company, each to hold office in accordance with the Amended and Restated Certificate of Incorporation and the by-laws of the surviving corporation until their respective successors are duly elected or appointed and qualified. The officers of the surviving corporation shall consist of (i) Frank S. Sorrentino III as Chairman, President and Chief Executive Officer; (ii) William S. Burns, Chief Financial Officer; and (iii) Anthony Weagley, current President and Chief Executive Officer of Center Bancorp, as Chief Operating Officer.

- 24 -

ConnectOne Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7 – PENDING MERGER

(continued)

Completion of the Merger is subject to various conditions, including, among others, (i) approval by shareholders of Center Bancorp and the Company of the Merger Agreement and the transactions contemplated thereby, (ii) the receipt of all necessary approvals and consents of governmental entities required to consummate the transactions contemplated by the Merger Agreement, (iii) the absence of any order or proceeding which prohibits the Merger or the Bank Merger and (iv) the receipt by each of Center Bancorp and ConnectOne Bancorp of an opinion to the effect that the Merger will be treated as a reorganization qualifying under Section 368(a) of the Internal Revenue Code of 1986, as amended. Each party's obligation to consummate the Merger is also subject to certain customary conditions, including (i) subject to certain exceptions, the accuracy of the representations and warranties of the other party, (ii) performance in all material respects of its agreements, covenants and obligations and (iii) the delivery of certain certificates and other documents.

The Company expects the Merger to be completed in either the second or third quarter of 2014.

- 25 -

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, 2013 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 10K 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.

- 26 -

Operating Results Overview

Net income for the first quarter of 2014 was \$ \$2.6 million, or \$0.50 per diluted share, compared with net income of \$2.3 million, or \$0.56 per diluted share, for the prior year period. The first quarter 2014 results include \$0.7 million in after-tax merger expenses related to the pending merger-of-equals with Center Bancorp, Inc., announced during the first quarter of 2014.

The increases in net income, excluding merger charges, 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 overall sound credit quality.

Net Interest Income

Fully taxable equivalent ("FTE") net interest income for the first quarter of 2014 totaled \$11.7 million, an increase of \$2.3 million, or 24.6%, from the year ago period. The increase in net interest income was primarily due to a 33.9% increase in average interest-earning assets, which grew to \$1.3 billion in the first quarter of 2014. This was partially offset by a 28 basis points contraction in the net interest margin, from 4.01% in the first quarter of 2013 to 3.73% in the first quarter of 2014. Average total loans increased by 35.9% to \$1.2 billion in the first quarter of 2014 from the prior year period. Prepayment fees contributed 10 basis points to the net interest margin for the first quarter of 2014, and 7 basis points to the net interest margin for the first quarter of 2013. Management expects net interest income to continue expanding as a result of solid loan growth, while margin compression is likely to moderate in future periods as the Company's loan origination mix changes and the loan portfolio fully re-prices.

Average Balance Sheets

The following table sets forth certain information relating to our average assets and liabilities for the three months ended March 31, 2014 and 2013, and reflects 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					
	March 31, 2014			March 31, 2013		
	Average Balance	Interest	Average Rate (7)	Average Balance	Interest	Average Rate (7)
Interest-earning assets:						
Investment securities (1) (2)	\$37,122	\$233	2.55 %	\$25,216	\$195	3.14 %
Loans receivable (3) (4)	1,186,847	13,455	4.60 %	873,557	10,696	4.97 %
Federal funds sold and interest-bearing deposits with banks	48,463	22	0.18 %	51,431	21	0.17 %
Total interest-earning assets	1,272,432	13,710	4.37 %	950,204	10,912	4.66 %
Allowance for loan losses	(16,450)			(13,545)		
Non-interest earning assets	37,977			19,364		
Total assets	\$1,293,959			\$956,023		
Interest-bearing liabilities:						
Savings, NOW, Money Market, Interest Checking	\$340,125	225	0.27 %	\$329,906	259	0.32 %
Time deposits	436,820	1,176	1.09 %	277,882	887	1.29 %
Total interest-bearing deposits	776,945	1,401	0.73 %	607,788	1,146	0.76 %
Borrowings	166,226	561	1.37 %	76,019	334	1.78 %
Capital lease obligation	3,098	47	6.15 %	3,172	48	6.14 %
Total interest-bearing liabilities	946,269	2,009	0.86 %	686,979	1,528	0.90 %
Noninterest-bearing deposits	209,303			164,403		
Other liabilities	5,897			7,706		
Stockholders' equity	132,490			96,935		
Total liabilities and stockholders' equity	\$1,293,959			\$956,023		
Net interest income/interest rate spread (5)		\$11,701	3.51 %		\$9,384	3.76 %
Tax equivalent effect		(6)			—	
Net interest income as reported		\$11,695			\$9,384	
Net interest margin (6)			3.73 %			4.01 %

(1) Average balances are calculated on amortized cost.

(2) Interest income is presented on a tax equivalent basis using 35 percent federal tax rate.

(3) Includes loan fee income.

(4) Loans receivable include non-accrual loans.

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

- (5) Represents difference between the average yield on interest earning assets and the average cost of interest bearing liabilities and is presented on a fully tax equivalent basis.
- (6) Represents net interest income divided by average total interest-earning assets.
- (7) Rates are annualized.

- 28 -

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 first quarter of 2014 was \$1.3 million, an increase of \$0.4 million, compared to the provision for loan losses of \$0.9 million in the first quarter of 2013. A majority of the provision for loan losses in both periods was attributable to loan growth.

Non-Interest Income

Non-interest income represents a relatively small portion of the Bank's total revenue as management has historically made a strategic decision to de-emphasize fee income, focusing instead on customer growth and retention.

Non-interest income totaled \$0.3 million in each of the first quarters of 2014 and 2013. Bank owned life insurance ("BOLI") income in 2014 (there was no BOLI outstanding during the first quarter of 2013) was largely offset by declines in gains on sale of residential mortgage loans.

Non-Interest Expense

Non-interest expenses for the first quarter of 2014 increased by \$1.9 million to \$6.7 million, from \$4.7 million in the prior year period. Non-interest expenses, excluding merger-related expenses, totaled \$5.7 million, representing a \$1.0 million or 21.3% increase from 2013, and was essentially flat from the linked fourth quarter of 2013. The primary factor contributing to the increases in total non-interest expenses from last year was salaries and employee benefits expense, which increased by \$0.6 million to \$3.1 million in the first quarter of 2014 from \$2.5 million in the first quarter of 2013. The increase was primarily due an increase in the number of full-time equivalent employees and higher incentive-based compensation. Also contributing to higher non-interest expenses were increased costs associated with being a publicly-traded entity, higher professional fees, snow-removal costs and a general increase in other operating expenses related to a significantly increased volume of business. Management continues to focus on expense control, balancing its investment in infrastructure with prudent and sustainable growth.

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 47.7% in the first quarter of 2014 from 49.2% in the first quarter of 2013. The Company uses this ratio because it believes that the ratio provides a good comparison of period-to-period performance and because the ratio is widely accepted in the banking industry.

- 29 -

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

The following table shows the calculation of the efficiency ratio for the periods presented:

	Three Months	
	Ended	
	March	March
	31,	31,
	2014	2013
Efficiency Ratio		
Non-interest expense	\$6,672	\$4,741
Less: merger related expenses	(923)	—
Adjusted non-interest expense (numerator)	\$5,749	\$4,741
Net interest income	11,695	9,384
Non-interest income	349	259
Operating revenue (denominator)	\$12,044	\$9,643
Efficiency Ratio	47.7 %	49.2 %

Income Taxes

Income tax expense was \$1.5 million for the first quarter of 2014 compared with \$1.6 million for the first quarter of 2013. The effective tax rates were 36.0% and 41.3% for the first quarters of 2014 and 2013, respectively. The effective tax rate for 2014 reflects a reorganized operating structure effective October 1, 2013. The Company's effective tax rate is projected to be approximately 36% in future periods, although it is likely to fluctuate depending upon future levels of taxable and non-taxable revenue.

Financial Condition Overview

At March 31, 2014, the Company's total assets were \$1.35 billion, a \$104.5 million increase from December 31, 2013. The increase in total assets was primarily due to a \$93.5 million increase, to \$1.25 billion, in loans receivable, and \$11.0 million increase, to \$45.3 million, in cash and cash equivalents. The growth in assets was funded by a \$61.9 million increase in deposits, a \$39.7 million increase in Federal Home Loan Bank borrowings, and a \$2.6 million increase in retained earnings.

Stockholders' Equity

Stockholders' equity totaled \$133.0 million as of March 31, 2014, an increase of \$2.9 million from \$130.1 million as of December 31, 2013, primarily due to the retention of earnings. As of March 31, 2014, the tangible common equity

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

ratio and tangible book value per share were 9.85% and \$25.92, respectively. As of December 31, 2013, the Company's tangible common equity ratio and tangible book value per share were 10.45% and \$25.43, respectively. Tangible common equity ratio and tangible book value per share are non-GAAP financial measures. The following table shows the calculation of these ratios for the periods presented:

- 30 -

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

	As of	
	March 31, 2014	December 31, 2013
Tangible Common Equity and Tangible Common Equity/Tangible Assets		
Common equity	\$ 133,008	\$ 130,128
Less: intangible assets	(260)	(260)
Tangible common equity	\$ 132,748	\$ 129,868
Total assets	\$ 1,347,723	\$ 1,243,228
Less: intangible assets	(260)	(260)
Tangible assets	\$ 1,347,463	\$ 1,242,968
Tangible Common Equity/Tangible Assets	9.85 %	10.45 %
Tangible Book Value per Common Share		
Book value per common share	\$25.97	\$25.48
Less: effects of intangible assets	(0.05)	(0.05)
Tangible Book Value per Common Share	\$25.92	\$25.43

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:

	March 31, 2014				December 31, 2013			
	Actual Ratio	Minimum Requirement	Well Capitalized Requirement		Actual Ratio	Minimum Requirement	Well Capitalized Requirement	
The Company:								
Leverage ratio	10.25 %	4.00	% n/a		10.74 %	4.00	% n/a	
Tier 1 Risk-based capitalization	10.94 %	4.00	% n/a		11.68 %	4.00	% n/a	
Total Risk-based capitalization	12.20 %	8.00	% n/a		12.91 %	8.00	% n/a	
The Bank:								
Leverage ratio	10.25 %	4.00	% 5.00	%	10.71 %	4.00	% 5.00	%
Tier 1 Risk-based capitalization	10.95 %	4.00	% 6.00	%	11.65 %	4.00	% 6.00	%
Total Risk-based capitalization	12.19 %	8.00	% 10.00	%	12.88 %	8.00	% 10.00	%

The Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, adopted Basel III in September 2010, which constitutes a set of capital reform measures designed to

strengthen the regulation, supervision and risk management of banking organizations worldwide. In order to implement Basel III and certain additional capital changes required by the Dodd-Frank Act, on July 9, 2013, the Federal banking agencies, including the FDIC the Federal Reserve and the Office of the Comptroller of the Currency, approved, as an interim final rule, the regulatory capital requirements for U.S. insured depository institutions and their holding companies.

The interim final rule includes new risk-based capital and leverage ratios that will be phased-in from 2015 to 2019. The rule includes 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 Total risk-based capital requirements. The interim final rule also raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% and requires 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 on January 1, 2015. The capital conservation buffer will be phased in over four years beginning on

- 31 -

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

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 required under existing rules to those prescribed under the interim final rule under the phase-in period described above:

	Current Rules		Final Rules	
Common Equity Tier 1 Capital Conservation Buffer	—		2.5	%
Tier 2	4.0	%	2.0	%
Additional Tier 1 Tier 1	—		1.5	%
Common Equity Tier 1	4.0	%	—	
	—		4.5	%

The interim final rule also implements 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 interim final rule also sets forth certain changes for the calculation of risk-weighted assets that we will be required to implement beginning January 1, 2015. Management is currently evaluating the provisions of the interim final rule and its expected impact. Based on our current capital composition and levels, management does not presently anticipate that the interim final rule presents a material risk to our financial condition or results of operations.

These provisions, as well as any other aspects of current or proposed regulatory or legislative changes to laws applicable to the financial industry, may impact the profitability of our business activities and may change certain of our business practices, including the ability to offer new products, obtain financing, attract deposits, make loans, and achieve satisfactory interest spreads, and could expose us to additional costs, including increased compliance costs. These changes also may require us to invest significant management attention and resources to make any necessary changes to operations in order to comply, and could therefore also materially and adversely affect our business, financial condition and results of 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.

- 32 -

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

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)	March 31, 2014		December 31, 2013	
	Amount	Percent of Total	Amount	Percent of Total
Commercial	\$223,324	17.9 %	\$147,455	17.4 %
Commercial real estate	835,169	67.0 %	549,218	64.7 %
Commercial construction	69,420	5.6 %	36,872	4.3 %
Residential real estate	83,243	6.7 %	82,962	9.8 %
Home equity	32,665	2.6 %	30,961	3.6 %
Consumer	2,348	0.2 %	1,801	0.2 %
Total gross loans	\$1,246,169	100.0 %	\$849,269	100.0 %

Asset Quality

Nonperforming assets, which includes nonaccrual loans and other real estate owned, totaled \$9.7 million at March 31, 2014, down from \$10.5 million at December 31, 2013 and up from \$7.9 million at March 31, 2013. Nonperforming assets as a percent of total assets declined to 0.72% at March 31, 2014 from 0.84% at December 31, 2013 and from 0.79% at March 31, 2013. The allowance for loan losses was \$17.0 million, representing 1.37% of loans receivable and 192.5% of nonaccrual loans at March 31, 2014. At December 31, 2013, the allowance was \$16.0 million representing 1.39% of loans receivable and 174.2% of nonaccrual loans, and at March 31, 2013 the allowance was \$13.6 million representing 1.51% of loans receivable and 181.9% of nonaccrual loans. The provision for loan losses was \$1.3 million for the first quarter of 2014, \$1.4 million for the fourth quarter of 2013, and \$0.9 million for the first quarter 2013. The provision for loan losses has remained relatively constant, although the level is contingent upon many factors including, but not limited to, loan growth, the Company's historical loss experience, macroeconomic conditions and reserves required for specific credits. The annualized rate of net loan charge-offs was 0.08% for the first quarter of 2014, 0.03% for the fourth quarter of 2013 and 0.25% for the first quarter of 2013.

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

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

(dollars in thousands)	March 31, 2014	December 31, 2013		
Nonaccrual loans:				
Commercial	\$3,512	\$ 3,582		
Commercial real estate	2,434	2,445		
Commercial construction	—	—		
Residential real estate	2,137	2,381		
Home equity	765	767		
Consumer	—	—		
Nonaccrual loans	8,848	9,175		
Other real estate owned	870	1,303		
Total non-performing assets	\$9,718	\$ 10,478		
Loans past due 90 days and still accruing	\$—	\$—		
Performing troubled debt restructured loans	\$2,925	\$ 2,934		
Nonaccrual loans to loans receivable	0.71 %	0.80 %		
Nonperforming assets to total assets	0.72 %	0.84 %		
Allowance for loan losses to loans receivable	1.37 %	1.39 %		
Allowance for loan losses to non-accrual loans	192.5 %	174.2 %		
Net loan charge-offs to average loans	0.08 %	0.19 %		

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			
	March 31, 2014	March 31, 2013		
Balance at beginning of period	\$15,979	\$13,246		
Provision charged to operating expenses	1,300	925		
Recoveries of loans previously charged-off:				
Commercial	—	—		
Consumer	—	—		
Residential real estate	—	—		
Total recoveries	—	—		
Loans charged-off:				
Commercial	—	(452)		
Consumer	(5)	(82)		
Residential real estate	(239)	—		
Total charge-offs	(244)	(534)		
Net charge-offs	(244)	(534)		
Balance at end of period	\$17,035	\$13,637		
Net charge-offs to average loans outstanding	0.08 %	0.25 %		

Edgar Filing: ConnectOne Bancorp, Inc. - Form 10-Q

Allowance for loan losses to loans receivable 1.37 % 1.51 %

- 34 -

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 March 31, 2014, 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 March 31, 2014, liquid assets (cash and due from banks, interest-bearing deposits with banks and unencumbered investment securities) were \$73.2 million, which represented 5.4% of total assets and 7.1% of total deposits and borrowings, compared to \$65.7 million at December 31, 2013, which represented 5.3% of total assets and 6.8% 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 March 31, 2014, had the ability to borrow \$524.5 million. In addition, at March 31, 2014, 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 as of March 31, 2014. At March 31, 2014, the Bank had aggregate available and unused credit of \$365.2 million, which represents the aforementioned facilities totaling \$542.5 million net of \$177.3 million in outstanding borrowings. At March 31, 2014, outstanding commitments for the Bank to extend credit were \$271.4million.

Cash and cash equivalents totaled \$45.3 million on March 31, 2014, increasing by \$11.0 million or 31.9%, from \$34.4 million at December 31, 2013. Operating activities provided \$3.8 million in net cash. Investing activities used \$94.5 million in net cash, primarily reflecting an increase in loans. Financing activities provided \$101.7 million in net cash, primarily reflecting a net increase of \$61.9 million in deposits and \$40.0 million increase in FHLB 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 March 31, 2014 and December 31, 2013 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 over the next three-year period on a cumulative basis, assuming certain changes in the general level of interest rates.

In our model, which was run as of March 31, 2014, 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 3.1%, while a 100 basis-point decrease in interest rates will also decrease net interest income by 1.0%. As of December 31, 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 3.5%, while a 100 basis-point decrease in the general level of interest rates will decrease our interest rates by 1.9%.

In our model, which was run as of March 31, 2014, 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 3.6%, while a 100 basis-point decrease in interest rates will decrease net interest income by 2.1%. As of December 31, 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 4.2%, while a 100 basis-point decrease in interest rates will decrease net interest income by 1.9%.

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 March 31, 2014, would decline by 19.43% with a rate shock of up 200 basis points, and increase by 12.07% with a rate shock of down 100 basis points. Our EVPE as of December 31, 2013, would decline by 20.62% with a rate shock of up 200 basis points, and increase by 12.84% with a rate shock of down 100 basis points.

- 36 -

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.

- 37 -

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

- 38 -

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. As previously disclosed, in the first quarter of 2014, several complaints were filed against the Company and members of its Board of Directors in the Superior Court of New Jersey seeking class action status and asserting that the Company and the members of its Board violated their duties to the Company's shareholders in connection with the proposed merger with Center Bancorp, Inc. On April 24th, these complaints were voluntarily dismissed by the plaintiffs.

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 March 31, 2014, 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.

- 39 -

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: May 12, 2014 By: /s/ William S. Burns

William S. Burns
Executive Vice President
and
Chief Financial Officer

- 40 -