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

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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

Total stockholders’ equity	124,575	72,362
Total liabilities and stockholders’ equity	$1,030,487	$929,926

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	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

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

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 borrowing	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:

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

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
June 30, 2013				
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
December 31, 2012				
Securities available for sale:				
U.S. Treasury securities	$ —	$ —	$ —	$ —
U.S. government sponsored agencies	1,000	5	—	1,005
States and political subdivisions	—	—	—	—
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):

	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

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
June 30, 2013				
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
June 30, 2013						
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.

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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.

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 Real Estate	Commercial Construction	Residential Real Estate	Home Equity Lines of Credit	Consumer	Unallocated	Total
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

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

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	—

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.

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

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

ConnectOne Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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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

ConnectOne Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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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 Real Estate	Commercial Construction	Residential Real Estate	Home Equity Lines of Credit	Consumer	Unallocated	Total
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

		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

ConnectOne Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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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:

Nonvested Shares	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.

ConnectOne Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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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):

ConnectOne Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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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 Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2013			
Impaired loans:			
Commercial	$—	$ —	$ —
Commercial real estate	—	—	1,891
Commercial construction	—	—	—
Residential real estate	—	—	2,157

ConnectOne Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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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