

Cornerstone Financial Corp  
Form 10-Q  
November 10, 2011

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## FORM 10-Q

x Quarterly report pursuant to section 13 or 15 (d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2011

-OR-

Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

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### CORNERSTONE FINANCIAL CORPORATION

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(Exact name of registrant, as specified in its charter)

New Jersey

80-0282551

(State or other jurisdiction of incorporation  
or organization)

(I.R.S. Employer  
Identification No.)

6000 Midlantic Drive, Suite 120 S, Mount Laurel, New Jersey 08054

(Address of principal executive offices)

Zip Code

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Registrant's telephone number, including area code: (856) 439-0300

Securities registered pursuant to Section 12(b) of the Act:

None

(Title of Class)

Securities registered pursuant to Section 12(g) of the Act:

Common stock, no par value

(Title of Class)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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 X 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 X NO \_\_\_

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

Large accelerated filer [ ]

Accelerated filer [ ]

Non-accelerated filer [ ]

Smaller reporting company [X]

(Do not check if a smaller reporting company)

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) YES \_\_\_ NO X

As of November 10, 2011, there were 1,954,428 outstanding shares of the registrant's Common stock.

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**CORNERSTONE FINANCIAL CORPORATION**

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\* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration

statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of

Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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## PART I. FINANCIAL INFORMATION

### Item 1 – Consolidated Financial Statements

#### CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(In thousands, except share data)	<b>September 30, 2011</b>	(unaudited)	<b>December 31, 2010</b>
<b>Assets:</b>			
Cash and due from banks	\$	6,297	\$ 5,331
Federal funds sold		40,400	3,700
Cash and cash equivalents		46,697	9,031
Investment securities:			
Held to maturity (fair value 2011 - \$22,569; 2010 - \$39,520)		21,929	40,435
Available for sale (amortized cost 2011- \$61,440; 2010 - \$47,945)		62,081	44,635
Loans receivable		244,286	242,856
Less allowance for loan losses		2,848	3,826
Loans receivable, net		241,438	239,030
Federal Home Loan Bank stock		1,438	1,435
Premises and equipment, net		7,693	7,806
Accrued interest receivable		1,815	2,152
Bank owned life insurance		4,806	4,685
Deferred taxes		557	2,600
Other real estate owned		830	830
Other assets		1,139	1,378
<b>Total Assets</b>	<b>\$</b>	<b>390,423</b>	<b>\$ 354,017</b>
<b>Liabilities:</b>			
Non-interest bearing deposits	\$	28,651	\$ 40,514
Interest bearing deposits		190,586	148,259
Certificates of deposit		110,506	113,497
Total deposits		329,743	302,270
Advances from the Federal Home Loan Bank		25,000	25,000
Line of credit		5,000	4,877
Subordinated debt		3,000	3,000
Other liabilities		1,388	1,122
Unsettled Security payable		5,250	-
		369,381	336,269



**Total Liabilities**

Commitments and Contingencies (Note 4)

**Stockholders' Equity:**

Preferred stock:

\$0 par value; \$1,000 per share stated value,  
authorized 1,000,000 shares; issued and outstanding  
1,900 at September 30, 2011 and December 31,  
2010, respectively

1,900

1,900

Common stock:

\$0 par value: authorized 10,000,000 shares; issued  
and outstanding 1,954,428 at September 30, 2011  
and December 31, 2010, respectively

-

-

Additional paid-in capital

17,700

16,727

Accumulated other comprehensive income (loss)

385

(1,988)

Retained earnings

1,057

1,109

Total Shareholders' Equity

21,042

17,748

**Total Liabilities and Shareholders' Equity**

\$

390,423

\$

354,017

See accompanying notes to consolidated financial statements.

**CORNERSTONE FINANCIAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

Three Months Ended

(In thousands, except per share data)	September 30, 2011 (Unaudited)	September 30, 2010 (Unaudited)
<b>Interest Income</b>		
Interest and fees on loans	\$ 3,295	\$ 3,460
Interest on investment securities	956	593
Interest on federal funds	3	16
<b>Total interest income</b>	4,254	4,069
<b>Interest Expense</b>		
Interest on deposits	915	991
Interest on borrowings	176	171
<b>Total interest expense</b>	1,091	1,162
Net interest income	3,163	2,907
Provision for loan losses	207	235
<b>Net interest income after loan loss provision</b>	2,956	2,672
<b>Non-Interest Income</b>		
Service charges on deposit accounts	46	50
Bank owned life insurance income	42	41
Gain on sale of loan	18	291
Gain on sale of securities	44	-
Miscellaneous fee income	44	30
<b>Total non-interest income</b>	194	412
<b>Non-Interest Expense</b>		
Salaries and employee benefits	1,453	1,231
Net occupancy	384	298
Data processing and other service costs	127	115
Professional services	173	322
Advertising and promotion	41	26
Other real estate owned expense	22	10
FDIC expense	31	131
Other operating expenses	188	161
<b>Total non-interest expense</b>	2,419	2,294
Income before income taxes	731	790
Income tax expense	282	311
<b>Net income</b>	449	479
Preferred stock dividends	33	33
Net income available to common shareholders		

Interest Income

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\$ 416 \$ 446

***Earnings per share***

Basic	\$ 0.21	\$ 0.23(1)
Diluted	\$ 0.21	\$ 0.23(1)

***Weighted average shares outstanding***

Basic	1,954	1,954(1)
Diluted	1,954	1,978(1)

(1) All share and per share amounts have been restated to reflect the 8.0% common stock dividend paid on May 16, 2011 to

common shareholders of record as of April 15, 2011.

See accompanying notes to consolidated financial statements.

**CORNERSTONE FINANCIAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

Nine Months Ended

(In thousands, except per share data)	September 30, 2011 (Unaudited)	September 30, 2010 (Unaudited)
<b>Interest Income</b>		
Interest and fees on loans	\$ 9,939	\$ 10,248
Interest on investment securities	2,729	1,781
Interest on federal funds	9	24
<b>Total interest income</b>	12,677	12,053
<b>Interest Expense</b>		
Interest on deposits	2,752	2,932
Interest on borrowings	530	523
<b>Total interest expense</b>	3,282	3,455
Net interest income	9,395	8,598
Provision for loan losses	1,378	382
<b>Net interest income after loan loss provision</b>	8,017	8,216
<b>Non-Interest Income</b>		
Service charges on deposit accounts	136	148
Bank owned life insurance income	121	123
Gain on sale of loans	174	330
Gain on sale of securities	44	-
Miscellaneous fee income	161	85
<b>Total non-interest income</b>	636	686
<b>Non-Interest Expense</b>		
Salaries and employee benefits	4,191	3,648
Net occupancy	1,113	925
Data processing and other service costs	368	352
Professional services	501	609
Advertising and promotion	119	99
Other real estate owned expense	89	24
FDIC expense	286	355
Other operating expenses	506	476
<b>Total non-interest expense</b>	7,173	6,488
Income before income taxes	1,480	2,414
Income tax expense	563	939
<b>Net income</b>	917	1,475

Interest Income

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Preferred stock dividends	100	99
Net income available to common shareholders		
	\$ 817	\$ 1,376
<b><i>Earnings per share</i></b>		
Basic	\$ 0.42	\$ 0.70(1)
Diluted	\$ 0.42	\$ 0.70(1)
<b><i>Weighted average shares outstanding</i></b>		
Basic	1,954	1,954(1)
Diluted	1,958	1,967(1)

(1) All share and per share amounts have been restated to reflect the 8.0% common stock dividend paid on May 16, 2011 to

common shareholders of record as of April 15, 2011.

See accompanying notes to consolidated financial statements.

## CORNERSTONE FINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS'

## EQUITY

(Unaudited)

(In thousands, except per share data)

	Comprehensive Income	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance at							
December 31, 2010		\$ 1,900	\$-	\$ 16,727	\$ 1,109	\$ (1,988)	\$ 17,748
Comprehensive income							
Net income	\$ 917	-	-	-	917	-	917
Unrealized gain on securities available for sale, net of tax	2,373					2,373	2,373
Comprehensive income	\$ 3,290						
Stock based compensation		-	-	104	-	-	104
7 % Preferred stock dividend		-	-	-	(100)	-	(100)
Declaration of 8% common stock dividend		-	-	869	(869)	-	-
Balance at	\$	1,900	\$-	\$ 17,700	\$ 1,057	\$ 385	\$ 21,042

September 30,  
2011

See accompanying notes to consolidated financial statements.

**CORNERSTONE FINANCIAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Nine Months Ended

(In thousands)	September 30, 2011 (Unaudited)	September 30, 2010 (Unaudited)
<b>Cash flows from operating activities:</b>		
Net Income	\$ 917	\$ 1,475
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,378	382
Depreciation	328	293
Amortization of premiums and discounts, net	(120)	39
Stock option expense	104	101
Gain on sale of loans	(174)	-
Gain on sale of securities	(44)	-
Deferred tax expense(benefit)	465	(54)
Income on bank owned life Insurance	(121)	(123)
Decrease in accrued interest receivable and other assets	577	94
Increase in other liabilities	266	197
Net cash provided by operating activities	3,576	2,404
<b>Cash flows from investing activities:</b>		
Purchases of investments held to maturity	-	(44,509)
Purchases of securities available for sale	(26,309)	(28,519)
Repayment of investments available for sale	8,178	-
Repayment of investments held to maturity	18,511	48,320
Sale of investments available for sale	10,044	-
(Purchase) redemption of FHLB stock	(3)	137
Net increase in loans	(3,612)	(3,851)
Purchases of premises and equipment	(215)	(159)
Net cash provided (used) in investing activities	6,594	(28,581)
<b>Cash flows from financing activities:</b>		
Net increase in deposits	27,473	60,340
Proceeds from borrowings	10,123	242,753
Principal payments on borrowings	(10,000)	(247,483)
Cash dividend paid for preferred stock	(100)	(99)
Net cash provided by financing activities	27,496	55,511
Net increase in cash and cash equivalents	37,666	29,334
Cash and cash equivalents at the beginning of the period	9,031	4,742
Cash and cash equivalents at the end of the period	46,697	\$ 34,076
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid during the period for interest	\$ 3,296	\$ 3,466



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Cash paid during the period for income taxes		96		991
Net change in unrealized gain on securities, net of tax		2,373		101
<b>Supplemental non-cash investing and financing activities:</b>				
Unsettled securities payable	\$	5,250	\$	4,000

See accompanying notes to consolidated financial statements.

**CORNERSTONE FINANCIAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 1 - BASIS OF PRESENTATION**

The consolidated financial statements include the accounts of Cornerstone Financial Corporation and its wholly owned subsidiary, Cornerstone Bank (together, the “Company”). These interim statements, which are unaudited, were prepared in accordance with instructions for Form 10-Q. In the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for fair presentation of the interim financial statements have been included.

Cornerstone Financial Corporation was formed in 2008 at the direction of the Board of Directors of Cornerstone Bank to serve as a holding company for the Bank. The holding company reorganization was completed in January 2009. The statement of financial condition as of December 31, 2010 has been derived from audited financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in Cornerstone Financial Corporation’s Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the United States Securities and Exchange Commission.

**NOTE 2 – USE OF ESTIMATES**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the allowance for loan losses and the evaluation of deferred taxes.

**NOTE 3 - CONTINGENCIES**

The Company, from time to time, is a party to routine litigation that arises in the normal course of business. Management does not believe the resolution of this litigation, either any individual case or in the aggregate, would have a material adverse effect on the Company's financial condition or results of operations. However, the ultimate outcome of any such matter, as with litigation generally, is inherently uncertain and it is possible that some of these matters may be resolved in a manner that is materially adverse to the Company.

**NOTE 4 - EARNINGS PER SHARE**

Basic earnings per share is calculated on the basis of net income divided by the weighted average number of shares outstanding. Diluted earnings per share includes dilutive potential common shares as computed under the treasury stock method using average common stock prices.

All share and per share amounts have been restated to reflect the 8.0% common stock dividend, declared on March 17, 2011, and paid on May 16, 2011 to common shareholders of record as of April 15, 2011. This stock dividend resulted in the issuance of 144,772 additional shares and resulted in \$869 thousand being transferred from retained earnings to additional paid in capital.

## NOTE 5 – STOCK OPTIONS

The Company accounts for stock options in accordance with FASB Accounting Standards Codification (ASC) 718 *Stock Compensation*. The Company recognizes the grant-date fair-value of stock options and other equity-based compensation issued to employees in the statement of operations. The Company had \$159 thousand in unrecognized compensation costs relating to non-vested stock based compensation awards at September 30, 2011.

On July 16, 2009, options to purchase a total of 48,600 shares of common stock were granted with an exercise price of \$4.63 per share. These options will expire ten years from the date of the grant and vest on a one-third per year basis beginning on July 16, 2010, with vesting accelerating in certain circumstances such as change in control of the Company. The exercise price of each option equals the market price of the common stock on the date of the grant.

On January 16, 2010, options to purchase a total of 119,880 shares of common stock were granted with an exercise price of \$4.17 per share. These options will expire ten years from the date of the grant and vest on a one-third per year basis beginning on January 21, 2011, with vesting accelerating in certain circumstances such as change in control of the Company. The exercise price of each option equals the market price of the common stock on the date of the grant.

## NOTE 6 - INVESTMENT SECURITIES

A comparison of amortized cost and approximate fair value of investment securities held to maturity at September 30, 2011 and December 31, 2010 is as follows (in thousands):

	September 30, 2011			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Investments held to maturity:</b>				
Government agency obligations \$	14,982	\$ 163	\$ (10)	\$ 15,135
Mortgage backed securities	6,947	487	-	7,434
Total	\$ 21,929	\$ 650	\$ (10)	\$ 22,569

**Investments available for sale:**

Government agency obligations	\$	61,440		650	\$	(9)	\$	62,081
Total	\$	61,440	\$	650	\$	(9)	\$	62,081

December 31, 2010

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Investments held to maturity:</b>				
Government agency obligations	\$ 32,706	\$ 68	\$ (1,131)	\$ 31,643
Mortgage backed securities	7,729	148	-	7,877
Total	\$ 40,435	\$ 216	\$ (1,131)	\$ 39,520

**Investments available for sale:**

Government agency obligations	\$	38,056	\$	-	\$	(2,496)	\$	35,560
US Treasury Securities		9,889		-		(814)		9,075
Total	\$	47,945	\$	-	\$	(3,310)	\$	44,635

The following table sets forth information regarding the fair value and unrealized losses on the Company's temporarily impaired

investment securities at September 30, 2011 and December 31, 2010 for the time periods shown (in thousands):

September 30, 2011						
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>Investments held to maturity:</b>						
Government agency obligations	\$ 3,680	\$ (10)	\$ -	\$ -	\$ 3,680	\$ (10)
<b>Investments available for sale:</b>						
Government agency obligations	4,825	(9)	-	-	4,825	(9)
Total temporarily impaired investment securities	\$ 8,505	\$ ( 19)	\$ -	\$ -	\$ 8,505	\$ (19)
December 31, 2010						
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>Investments held to maturity:</b>						
Government agency obligations	\$ 27,132	\$ (1,131)	\$ -	\$ -	\$ 27,132	\$ (1,131)
<b>Investments available for sale:</b>						
Government agency obligations	35,560	( 2,496)	-	-	35,560	( 2,496)
US Treasury Securities	9,075	(814)				