CASS INFORMATION SYSTEMS INC
Form 10-Q
August 07, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2018

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 No. 000-20827

CASS INFORMATION SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Missouri	**43-1265338**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
12444 Powerscourt Drive, Suite 550	
St. Louis, Missouri	**63131**
(Address of principal executive offices)	(Zip Code)

(314) 506-5500
(Registrant's telephone number, including area code)

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 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 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 S-T (§ 232.405 of this chapter) 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer X Accelerated Filer

Non-Accelerated Filer Smaller Reporting Company Emerging Growth Company
(Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. _____

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No X

The number of shares outstanding of the registrant's only class of common stock as of July 27, 2018: Common stock, par value $.50 per share – 12,294,422 shares outstanding.

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Forward-looking Statements - Factors That May Affect Future Results

This report may contain or incorporate by reference forward-looking statements made pursuant to the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Although we believe that, in making any such statements, our expectations are based on reasonable assumptions, forward-looking statements are not guarantees of future performance and involve risks, uncertainties, and other factors beyond our control, which may cause future performance to be materially different from expected performance summarized in the forward-looking statements. These risks, uncertainties and other factors are discussed in Part I, Item 1A, "Risk Factors" of the Company's 2017 Annual Report on Form 10-K, filed with the Securities and Exchange Commission ("SEC"), which may be updated from time to time in our future filings with the SEC. We undertake no obligation to publicly update or revise any forward-looking statements to reflect changed assumptions, the occurrence of anticipated or unanticipated events, or changes to future results over time.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CASS INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands except Share and Per Share Data)

	June 30, 2018 (Unaudited)	December 31, 2017
Assets		
Cash and due from banks	$13,064	$17,422
Interest-bearing deposits in other financial institutions	111,244	152,056
Federal funds sold and other short-term investments	1,895	58,632
Cash and cash equivalents	126,203	228,110
Securities available-for-sale, at fair value	440,863	470,523
Loans	714,861	686,231
Less: Allowance for loan losses	10,215	10,205
Loans, net	704,646	676,026
Premises and equipment, net	22,466	21,586
Investment in bank-owned life insurance	17,155	16,927
Payments in excess of funding	153,836	139,103
Goodwill	12,569	12,569
Other intangible assets, net	1,775	1,996
Other assets	90,792	90,369
Total assets	$1,570,305	$1,657,209
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Noninterest-bearing	$265,356	$281,541
Interest-bearing	360,381	396,547
Total deposits	625,737	678,088
Accounts and drafts payable	673,704	715,888
Other liabilities	44,251	38,145
Total liabilities	1,343,692	1,432,121
Shareholders' Equity:		
Preferred stock, par value $.50 per share; 2,000,000 shares authorized and no shares issued	–	–
Common stock, par value $.50 per share; 40,000,000 shares authorized and 13,047,997 shares issued at June 30, 2018 and December 31, 2017	6,524	6,524
Additional paid-in capital	204,687	204,631
Retained earnings	68,771	59,314
Common shares in treasury, at cost (754,435 shares at June 30, 2018 and 760,962 shares at December 31, 2017)	(32,243)	(32,061)
Accumulated other comprehensive loss	(21,126)	(13,320)
Total shareholders' equity	226,613	225,088
Total liabilities and shareholders' equity	$1,570,305	$1,657,209

See accompanying notes to unaudited consolidated financial statements.

CASS INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(Dollars in Thousands except Per Share Data)

	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Fee Revenue and Other Income:				
Information services payment and processing revenue	$25,221	$23,282	$50,048	$45,571
Bank service fees	359	389	694	671
Losses on sales of securities	(55)	–	(42)	–
Other	115	129	314	329
Total fee revenue and other income	25,640	23,800	51,014	46,571
Interest Income:				
Interest and fees on loans	7,923	7,104	15,465	14,057
Interest and dividends on securities:				
Taxable	489	84	810	161
Exempt from federal income taxes	2,332	2,659	4,897	5,260
Interest on federal funds sold and other short-term investments	769	485	1,629	853
Total interest income	11,513	10,332	22,801	20,331
Interest Expense:				
Interest on deposits	794	470	1,473	950
Net interest income	10,719	9,862	21,328	19,381
Provision for loan losses	–	–	–	–
Net interest income after provision for loan losses	10,719	9,862	21,328	19,381
Total net revenue	36,359	33,662	72,342	65,952
Operating Expense:				
Personnel	21,589	19,162	41,971	37,961
Occupancy	925	889	1,779	1,731
Equipment	1,408	1,200	2,716	2,504
Amortization of intangible assets	111	108	221	207
Other operating expense	3,430	3,542	6,958	6,816
Total operating expense	27,463	24,901	53,645	49,219
Income before income tax expense	8,896	8,761	18,697	16,733
Income tax expense	1,387	2,248	3,096	3,913
Net income	$7,509	$6,513	$15,601	$12,820
Basic earnings per share	$.61	$.53	$1.27	$1.05
Diluted earnings per share	.60	.52	1.25	1.03

See accompanying notes to unaudited consolidated financial statements.

CASS INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(Dollars in Thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	**2017**	**2018**	**2017**
Comprehensive Income:				
Net income	$ 7,509	$ 6,513	$ 15,601	$ 12,820
Other comprehensive income:				
Net unrealized (loss) gain on securities available-for-sale	(420)	5,832	(10,194)	8,345
Tax effect	100	(2,167)	2,426	(3,100)
Reclassification adjustments for losses included in net income	55	–	42	–
Tax effect	(13)	–	(10)	–
Foreign currency translation adjustments	(109)	94	(70)	102
Total comprehensive income	$ 7,122	$ 10,272	$ 7,795	$ 18,167

See accompanying notes to unaudited consolidated financial statements.

CASS INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in Thousands)

	Six Months Ended June 30, 2018	2017
Cash Flows From Operating Activities:		
Net income	$ 15,601	$ 12,820
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,822	5,471
Net losses on sales of securities	42	–
Stock-based compensation expense	1,477	1,097
Increase in income tax liability	1,637	748
Increase in pension liability	2,463	2,310
Decrease in accounts receivable	3,473	793
Other operating activities, net	(5,419)	(1,771)
Net cash provided by operating activities	25,096	21,468
Cash Flows From Investing Activities:		
Proceeds from sales of securities available-for-sale	58,520	–
Proceeds from maturities of securities available-for-sale	17,374	25,694
Purchase of securities available-for-sale	(60,108)	(62,279)
Net increase in loans	(28,620)	(6,796)
Increase in payments in excess of funding	(14,733)	(6,088)
Purchases of premises and equipment, net	(2,800)	(1,935)
Net cash used in investing activities	(30,367)	(51,404)
Cash Flows From Financing Activities:		
Net decrease in noninterest-bearing demand deposits	(16,185)	(12,714)
Net decrease in interest-bearing demand and savings deposits	(40,588)	(1,077)
Net increase (decrease) in time deposits	4,422	(3,131)
Net (decrease) increase in accounts and drafts payable	(36,538)	87,116
Cash dividends paid	(6,144)	(5,151)
Purchase of common shares for treasury	(1,408)	–
Other financing activities, net	(195)	(790)
Net cash (used in) provided by financing activities	(96,636)	64,253
Net (decrease) increase in cash and cash equivalents	(101,907)	34,317
Cash and cash equivalents at beginning of period	228,110	266,743
Cash and cash equivalents at end of period	$ 126,203	$ 301,060
Supplemental information:		
Cash paid for interest	$ 1,459	$ 956
Cash paid for income taxes	1,445	3,152

See accompanying notes to unaudited consolidated financial statements.

CASS INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included. All share and per share data have been restated to give effect to the 10% stock dividend issued on December 15, 2017. Certain amounts in prior-period financial statements have been reclassified to conform to the current period's presentation. For further information, refer to the audited consolidated financial statements and related footnotes included in Cass Information System, Inc.'s (the "Company" or "Cass") Annual Report on Form 10-K for the year ended December 31, 2017.

On January 1, 2018, the Company adopted accounting standard ASC 606, Revenue from Contracts with Customers, and selected the modified retrospective transition method. The adoption of this new standard did not impact the Company's results of operations or balance sheet and there was no cumulative effect of initially applying this new revenue standard to the opening balance of retained earnings. Since interest income on loans and securities are both excluded from this topic, a significant portion of the Company's revenues are not subject to the new guidance. The services that fall within the scope of ASC 606 are presented within fee revenue and other income in the Consolidated Statements of Income and are recognized as revenue as the obligation to the customer is satisfied. Services within the scope of ASC 606 include transportation and facility payment and processing fees, bank service fees, and other real estate owned ("OREO").

Invoice processing and payment fees – The Company earns fees on a per-item basis for the services rendered on behalf of customers. Fees are earned over the course of a month, representing the period over with the performance obligation is satisfied.

Bank service fees – Revenue from service fees consists of service charges and fees on deposit accounts under depository agreements with customers to provide access to deposited funds and, when applicable, pay interest on deposits. Service charges on deposit accounts are primarily all charges that are recognized on a monthly basis representing the period over which the performance obligation is satisfied.

OREO – The Company currently does not have any OREO and has not in recent years. Net gains or losses would be recorded when other real estate is sold to a third party and substantially all of the consideration for the transfer of property is received.

Note 2 – Intangible Assets

The Company accounts for intangible assets in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 350, "Goodwill and Other Intangible Assets," ("FASB ASC 350"), which requires that intangibles with indefinite useful lives be tested annually for impairment and those with finite useful lives be amortized over their useful lives.

Details of the Company's intangible assets are as follows:

	June 30, 2018		December 31, 2017	
(In thousands)	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Assets eligible for amortization:				
Customer lists	$ 4,288	$ (2,887)	$ 4,288	$ (2,702)
Patents	72	(14)	72	(12)
Non-compete agreements	332	(308)	332	(291)
Software	234	(234)	234	(234)
Other	500	(208)	500	(191)
Unamortized intangible assets:				
Goodwill[1]	12,796	(227)	12,796	(227)
Total intangible assets	$ 18,222	$ (3,878)	$ 18,222	$ (3,657)

[1]Amortization through December 31, 2001 prior to adoption of FASB ASC 350.

The customer lists are amortized over seven and ten years; the patents over 18 years; the non-compete agreements over two and five years; software over three years; and other intangible assets over 15 years. Amortization of intangible assets amounted to $221,000 and $207,000 for the six-month periods ended June 30, 2018 and 2017, respectively. Estimated annual amortization of intangibles is as follows: $442,000 in 2018, $412,000 in 2019, $406,000 in each of 2020 and 2021, and $88,000 in 2022.

Note 3 – Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding. Diluted earnings per share is computed by dividing net income by the sum of the weighted-average number of common shares outstanding and the weighted-average number of potential common shares outstanding. There were no anti-dilutive shares in the three and six months ended June 30, 2018 and 2017. The calculations of basic and diluted earnings per share are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands except share and per share data)	2018	2017	2018	2017
Basic				
Net income	$ 7,509	$ 6,513	$ 15,601	$ 12,820
Weighted-average common shares outstanding	12,239,901	12,268,481	12,236,478	12,260,515
Basic earnings per share	$ .61	$ .53	$ 1.27	$ 1.05
Diluted				
Net income	$ 7,509	$ 6,513	$ 15,601	$ 12,820
Weighted-average common shares outstanding	12,239,901	12,268,481	12,236,478	12,260,515
Effect of dilutive restricted stock and stock appreciation rights	205,281	181,009	197,227	180,180
Weighted-average common shares outstanding assuming dilution	12,445,182	12,449,490	12,433,705	12,440,695
Diluted earnings per share	$ .60	$ .52	$ 1.25	$ 1.03

Note 4 – Stock Repurchases

The Company maintains a treasury stock buyback program pursuant to which the Board of Directors has authorized the repurchase of up to 500,000 shares of the Company's common stock. As restored by the Board of Directors on October 24, 2017, the program provides that the Company may repurchase up to an aggregate of 500,000 shares of common stock and has no expiration date. The Company repurchased 6,000 and 0 shares during the three-month periods and 15,547 and 0 shares for the six-month periods ended June 30, 2018 and 2017, respectively. As of June 30, 2018, 484,453 shares remained available for repurchase under the program. Repurchases may be made in the open market or through negotiated transactions from time to time depending on market conditions.

Note 5 – Industry Segment Information

The services provided by the Company are classified into two reportable segments: Information Services and Banking Services. Each of these segments provides distinct services that are marketed through different channels. They are managed separately due to their unique service and processing requirements.

The Information Services segment provides transportation, energy, telecommunication, and environmental invoice processing and payment services to large corporations. The Banking Services segment provides banking services primarily to privately held businesses and churches as well as supporting the banking needs of the Information Services segment.

The Company's accounting policies for segments are the same as those described in the summary of significant accounting policies in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. Management evaluates segment performance based on tax-equivalized (as defined in the footnote to the chart on the following table) pre-tax income after allocations for corporate expenses. Transactions between segments are accounted for at what management believes to be fair value.

Substantially all revenue originates from, and all long-lived assets are located within the United States, and no revenue from any customer of any segment exceeds 10% of the Company's consolidated revenue.

Funding sources represent average balances and deposits generated by Information Services and Banking Services and there is no allocation methodology used. Segment interest income is a function of the relative share of average funding sources generated by each segment multiplied by the following rates:

Information Services – one or more fixed rates depending upon the specific characteristics of the funding source, and

Banking Services – a variable rate that is based upon the overall performance of the Company's earning assets.

Any difference between total segment interest income and overall total Company interest income is included in Corporate, Eliminations, and Other.

Summarized information about the Company's operations in each industry segment is as follows:

(In thousands)	Information Services	Banking Services	Corporate, Eliminations and Other	Total
Three Months Ended June 30, 2018				
Fee income from customers	$ 25,262	$ 318	$ 60	$ 25,640
Interest income*	5,334	5,735	1,068	12,137
Interest expense	–	794	–	794
Intersegment income (expense)	–	486	(486)	
Tax-equivalized pre-tax income*	6,068	2,851	601	9,520
Goodwill	12,433	136		12,569
Other intangible assets, net	1,775			1,775
Total Assets	807,571	806,560	(43,826)	1,570,305
Funding Sources	617,287	553,237	–	1,170,524
Three Months Ended June 30, 2017				
Fee income from customers	$ 23,321	$ 355	$ 124	$ 23,800
Interest income*	5,043	5,823	916	11,782
Interest expense	–	470		470
Intersegment income (expense)	–	323	(323)	
Tax-equivalized pre-tax income*	6,360	3,286	565	10,211
Goodwill	12,433	136		12,569
Other intangible assets, net	2,217			2,217
Total Assets	863,562	742,659	(12,939)	1,593,282
Funding Sources	594,102	579,705	–	1,173,807
Six Months Ended June 30, 2018				
Fee income from customers	$ 50,134	$ 694	$ 186	$ 51,014
Interest income*	10,850	11,486	1,777	24,113
Interest expense		1,473		1,473
Intersegment income (expense)		948	(948)	
Tax-equivalized pre-tax income*	12,802	6,276	930	20,008
Goodwill	12,433	136		12,569
Other intangible assets, net	1,775			1,775
Total Assets	807,571	806,560	(43,826)	1,570,305
Funding Sources	631,022	574,419		1,205,441
Six Months Ended June 30, 2017				
Fee income from customers	$ 45,645	$ 679	$ 247	$ 46,571
Interest income*	9,772	11,708	1,722	23,202
Interest expense		950		950
Intersegment income (expense)		623	(623)	
Tax-equivalized pre-tax income*	11,816	6,742	1,046	19,604
Goodwill	12,433	136		12,569
Other intangible assets, net	2,217			2,217
Total Assets	863,562	742,659	(12,939)	1,593,282
Funding Sources	579,321	589,823		1,169,144

* Presented on a tax-equivalent basis assuming a tax rate of 21% for 2018 and 35% for 2017. The tax-equivalent adjustment was approximately $624,000 and $1,450,000 for the Second Quarter of 2018 and 2017, respectively, and $1,311,000 and $2,871,000 for the First Half of 2018 and 2017, respectively.

Note 6 – Loans by Type

A summary of loan categories is as follows:

(In thousands)	June 30, 2018	December 31, 2017
Commercial and industrial	$ 257,236	$ 236,394
Real estate		
Commercial:		
Mortgage	88,887	94,675
Construction	21,347	9,359
Church, church-related:		
Mortgage	310,402	316,073
Construction	35,212	25,948
Industrial revenue bonds	1,739	3,374
Other	38	408
Total loans	$ 714,861	$ 686,231

The following table presents the aging of loans by loan categories at June 30, 2018 and December 31, 2017:

	Performing			Nonperforming		
(In thousands)	Current	30-59 Days	60-89 Days	90 Days and Over	Non-accrual	Total Loans
June 30, 2018						
Commercial and industrial	$ 257,236	$ —	$ —	$ —	$ —	$ 257,236
Real estate						
Commercial:						
Mortgage	88,887	—	—	—	—	88,887
Construction	21,347	—	—	—	—	21,347
Church, church-related:						
Mortgage	310,402	—	—	—	—	310,402
Construction	35,212	—	—	—	—	35,212
Industrial revenue bonds	1,739	—	—	—	—	1,739
Other	38	—	—	—	—	38
Total	$ 714,861	$ —	$ —	$ —	$ —	$ 714,861
December 31, 2017						
Commercial and industrial	$ 236,394	$ —	$ —	$ —	$ —	$ 236,394
Real estate						
Commercial:						
Mortgage	94,675	—	—	—	—	94,675
Construction	9,359	—	—	—	—	9,359
Church, church-related:						
Mortgage	316,073	—	—	—	—	316,073
Construction	25,948	—	—	—	—	25,948
Industrial revenue bonds	3,374	—	—	—	—	3,374
Other	408	—	—	—	—	408
Total	$ 686,231	$ —	$ —	$ —	$ —	$ 686,231

The following table presents the credit exposure of the loan portfolio by internal credit grade as of June 30, 2018 and December 31, 2017:

(In thousands)	Loans Subject to Normal Monitoring[1]	Performing Loans Subject to Special Monitoring[2]	Nonperforming Loans Subject to Special Monitoring[2]	Total Loans
June 30, 2018				
Commercial and industrial	$ 256,231	$ 1,005	$ —	$ 257,236
Real estate				
Commercial:				
Mortgage	88,715	172	—	88,887
Construction	21,347	—	—	21,347
Church, church-related:				
Mortgage	310,315	87	—	310,402
Construction	35,212	—	—	35,212
Industrial revenue bonds	1,739	—	—	1,739
Other	38	—	—	38
Total	$ 713,597	$ 1,264	$ —	$ 714,861
December 31, 2017				
Commercial and industrial	$ 234,271	$ 2,123	$ —	$ 236,394
Real estate				
Commercial:				
Mortgage	93,788	887	—	94,675
Construction	9,359	—	—	9,359
Church, church-related:				
Mortgage	316,042	31	—	316,073
Construction	25,948	—	—	25,948
Industrial revenue bonds	3,374	—	—	3,374
Other	408	—	—	408
Total	$ 683,190	$ 3,041	$ —	$ 686,231

1 Loans subject to normal monitoring involve borrowers of acceptable-to-strong credit quality and risk, who have the apparent ability to satisfy their loan obligations.
2 Loans subject to special monitoring possess some credit deficiency or potential weakness which requires a high level of management attention.

Impaired loans consist primarily of nonaccrual loans, loans greater than 90 days past due and still accruing interest and troubled debt restructurings, both performing and nonperforming. Troubled debt restructuring involves the granting of a concession to a borrower experiencing financial difficulty resulting in the modification of terms of the loan, such as changes in payment schedule or interest rate. Management measures impairment in accordance with FASB ASC 310, "Allowance for Credit Losses." There were no impaired loans, loans delinquent 90 days or more and still accruing, or loans classified as troubled debt restructuring at June 30, 2018 and December 31, 2017.

There were no foreclosed loans recorded as other real estate owned as of June 30, 2018 and December 31, 2017.

A summary of the activity in the allowance for loan losses from December 31, 2017 to June 30, 2018 is as follows:

(In thousands)	December 31, 2017	Charge-Offs	Recoveries	Provision	June 30, 2018
Commercial and industrial	$ 3,652	$ —	$ 10	$ 311	$ 3,973
Real estate					
Commercial:					
Mortgage	1,394	—	—	(80)	1,314
Construction	70	—	—	90	160
Church, church-related:					
Mortgage	3,962	—	—	(71)	3,891
Construction	196	—	—	68	264
Industrial revenue bonds	52	—	—	(25)	27
Other	879	—	—	(293)	586
Total	$ 10,205	$ —	$ 10	$ —	$ 10,215

A summary of the activity in the allowance for loan losses from December 31, 2016 to June 30, 2017 is as follows:

(In thousands)	December 31, 2016	Charge-Offs	Recoveries	Provision	June 30, 2017
Commercial and industrial	$ 3,261	$ —	$ 21	$ 144	$ 3,426
Real estate					
Commercial:					
Mortgage	1,662	—	—	(164)	1,498
Construction	47	—	—	16	63
Church, church-related:					
Mortgage	4,027	—	—	61	4,088
Construction	85	—	—	8	93
Industrial revenue bonds	101	—	—	(25)	76
Other	992	—	—	(40)	952
Total	$ 10,175	$ —	$ 21	$ —	$ 10,196

Note 7 – Commitments and Contingencies

In the normal course of business, the Company is party to activities that contain credit, market and operational risks that are not reflected in whole or in part in the Company's consolidated financial statements. Such activities include traditional off-balance sheet credit-related financial instruments and commitments under operating leases. These financial instruments include commitments to extend credit, commercial letters of credit and standby letters of credit. The Company's maximum potential exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, commercial letters of credit and standby letters of credit is represented by the contractual amounts of those instruments. At June 30, 2018 and December 31, 2017, no amounts have been accrued for any estimated losses for these instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commercial and standby letters of credit are conditional commitments issued by the Company or its subsidiaries to guarantee the performance of a customer to a third party. These off-balance sheet financial instruments generally have fixed expiration dates or other termination clauses and may require payment of a fee. At June 30, 2018, the balance of unused loan commitments, standby and commercial letters of credit were $65,586,000, $13,088,000, and $3,836,000, respectively. Since some of the financial instruments may expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. Commitments to extend credit and letters of credit are subject to the same underwriting standards as those financial instruments included on the consolidated balance sheets. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of the credit, is based on management's credit evaluation of the borrower. Collateral held varies, but is generally accounts receivable, inventory, residential or income-producing commercial property or equipment. In the event of nonperformance, the Company or its subsidiaries may obtain and liquidate the collateral to recover amounts paid under guarantees on these financial instruments.

The following table summarizes contractual cash obligations of the Company related to operating lease commitments and time deposits at June 30, 2018:

		Amount of Commitment Expiration per Period			
(In thousands)	Total	Less than 1 Year	1-3 Years	3-5 Years	Over 5 Years
Operating lease commitments	$ 10,420	$ 1,603	$ 3,517	$ 2,744	$ 2,556
Time deposits	56,920	46,227	8,235	2,458	—
Total	$ 67,340	$ 47,830	$ 11,752	$ 5,202	$ 2,556

The Company and its subsidiaries are involved in various pending legal actions and proceedings in which claims for damages are asserted. Management, after discussion with legal counsel, believes the ultimate resolution of these legal actions and proceedings will not have a material effect upon the Company's consolidated financial position or results of operations.

Note 8 – Stock-Based Compensation

The Amended and Restated Omnibus Stock and Performance Compensation Plan (the "Omnibus Plan") permits the issuance of up to 1,500,000 shares of the Company's common stock in the form of stock options, stock appreciation rights ("SARs"), restricted stock, restricted stock units and performance awards. The Company may issue shares out of treasury stock for these awards. During the six months ended June 30, 2018, 27,037 restricted shares, 28,388 performance-based restricted shares, and 0 SARs were granted under the Omnibus Plan.

Restricted Stock

Beginning on April 16, 2013, restricted shares granted to Company employees are amortized to expense over a three-year vesting period whereas restricted shares granted to members of the Board of Directors are amortized to expense over a one-year service period, with the exception of those shares granted in lieu of cash payments for retainer fees which are expensed in the period earned. Beginning on February 2, 2017, restricted shares granted to Company employees are amortized to expense over the three-year cliff vesting period. As of June 30, 2018, the total unrecognized compensation expense related to non-vested restricted shares was $2,082,000, and the related weighted-average period over which it is expected to be recognized is approximately 1.07 years.

Following is a summary of the activity of the restricted stock:

	Six Months Ended June 30, 2018	
	Shares	**Fair Value**
Balance at December 31, 2017	78,166	$ 50.30
Granted	27,037	59.27
Vested	(23,758)	46.83
Balance at June 30, 2018	81,445	$ 54.29

Performance-Based Restricted Stock

In February of 2017, the Company granted three-year performance based restricted stock ("PBRS") awards which are contingent upon the Company's achievement of pre-established financial goals over the period from January 1, 2017 through December 31, 2019. The PBRS awards cliff vest on the three year anniversary of their grant date at levels ranging from 0% to 150% of the target opportunity based on the actual achievement of financial goals for the three-year performance period. The aggregate target number of PBRS shares granted was 25,342 with an average grant date fair value of $59.20 per share. The 2018 expense related to these grants is currently estimated to be $690,000 and is based on the grant date fair value of the awards and the Company's achievement of 132% of the target financial goals. The estimated expense for 2018 and each future period through the vesting date is subject to prospective adjustment based upon changes in the expected achievement of the financial goals.

In February of 2018, the Company granted three-year PBRS awards which are contingent upon the Company's achievement of pre-established financial goals over the period from January 1, 2018 through December 31, 2020. The PBRS awards cliff vest on the three year anniversary of their grant date at levels ranging from 0% to 150% of the target opportunity based on the actual achievement of financial goals for the three-year performance period. The aggregate target number of PBRS shares granted was 28,388 with an average grant date fair value of $58.35 per share. The 2018 expense related to these grants is currently estimated to be $729,000 and is based on the grant date fair value of the awards and the Company's achievement of 144% of the target financial goals. The estimated expense for 2018 and each future period through the vesting date is subject to prospective adjustment based upon changes in the expected achievement of the financial goals.

SARs

There were no SARs granted and no expense recognized during the six months ended June 30, 2018. Following is a summary of the activity of the Company's SARs program for the six-month period ended June 30, 2018:

	Shares	Weighted-Average Exercise Price	Average Remaining Contractual Term Years	Aggregate Intrinsic Value *(In thousands)*
Outstanding at December 31, 2017	234,236	$ 34.97	5.03	$ 7,291
Exercised	(15,271)	22.73		
Outstanding at June 30, 2018	218,965	35.83	3.94	6,629
Exercisable at June 30, 2018	218,965	$ 35.83	3.94	$ 6,629

There were no non-vested SARs at June 30, 2018.

Note 9 – Defined Pension Plans

The Company has a noncontributory defined-benefit pension plan, which covers most of its employees. Effective December 31, 2016, the Plan was closed to all new participants. The Company accrues and makes contributions designed to fund normal service costs on a current basis using the projected unit credit with service proration method to amortize prior service costs arising from improvements in pension benefits and qualifying service prior to the establishment of the plan over a period of approximately 30 years. Disclosure information is based on a measurement date of December 31 of the corresponding year. The following table represents the components of the net periodic pension costs:

(In thousands)	Estimated 2018	Actual 2017
Service cost – benefits earned during the year	$ 4,294	$ 3,733
Interest cost on projected benefit obligations	3,655	3,621
Expected return on plan assets	(5,206)	(4,681)
Net amortization and deferral	1,409	1,382
Net periodic pension cost	$ 4,152	$ 4,055

Pension costs recorded to expense were $1,049,000 and $1,017,000 for the three-month periods ended June 30, 2018 and 2017, respectively and $2,098,000 and $2,037,000 for the six-month periods ended June 30, 2018 and 2017, respectively. Pension costs increased in 2018 primarily due to a decrease in the discount rate. The Company made no contribution to the plan during the six-month period ended June 30, 2018 and is evaluating the amount of additional contributions, if any, in the remainder of 2018.

In addition to the above funded benefit plan, the Company has an unfunded supplemental executive retirement plan which covers key executives of the Company. This is a noncontributory plan in which the Company and its subsidiaries make accruals designed to fund normal service costs on a current basis using the same method and criteria as its defined benefit plan. The following table represents the components of the net periodic pension costs for 2017 and an estimate for 2018:

(In thousands)	Estimated 2018	Actual 2017
Service cost – benefits earned during the year	$ 92	$ 143
Interest cost on projected benefit obligation	348	360
Net amortization	581	324
Net periodic pension cost	$ 1,021	$ 827

Pension costs recorded to expense were $256,000 and $209,000 for the three-month periods ended June 30, 2018 and 2017, respectively, and were $511,000 and $418,000 for the six-month periods ended June 30, 2018 and 2017, respectively.

Note 10 – Income Taxes

As of June 30, 2018, the Company's unrecognized tax benefits were approximately $1,836,000, of which $1,669,000 would, if recognized, affect the Company's effective tax rate. As of December 31, 2017, the Company's unrecognized tax benefits were approximately $1,632,000, of which $1,464,000 would, if recognized, affect the Company's effective tax rate. During the next 12 months, the Company may realize a reduction of its unrecognized tax benefits of approximately $313,000 due to the lapse of federal and state statutes of limitations.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. The Company had $173,000 and $139,000 of gross interest accrued as of June 30, 2018 and December 31, 2017, respectively. There were no penalties for unrecognized tax benefits accrued at June 30, 2018 and December 31, 2017.

The Company is subject to income tax in the U.S. federal jurisdiction and numerous state jurisdictions. U.S. federal income tax returns for tax years 2014 through 2016 remain subject to examination by the Internal Revenue Service. In addition, the Company is subject to state tax examinations for the tax years 2013 through 2016.

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was enacted. Among other things, the new law (i) establishes a new, flat corporate federal statutory income tax rate of 21% beginning January 1, 2018; (ii) eliminates the corporate alternative minimum tax and allows the use of any such carryforwards to offset regular tax liability for any taxable year; (iii) limits the deduction for net interest expense incurred by U.S. corporations; (iv) allows businesses to immediately expense, for tax purposes, the cost of new investments in certain qualified depreciable assets; (v) eliminates or reduces certain deductions related to meals and entertainment expenses; (vi) modifies the limitation on excessive employee remuneration to eliminate the exception for performance-based compensation and clarifies the definition of a covered employee; and (vii) limits the deductibility of deposit insurance premiums. The TCJA also significantly changes U.S. tax law related to foreign operations, though, such changes do not currently impact the Company on a significant level.

Note 11 – Investment in Securities

Investment securities available-for-sale are recorded at fair value on a recurring basis. The Company's investment securities available-for-sale are measured at fair value using Level 2 valuations. The market evaluation utilizes several sources which include "observable inputs" rather than "significant unobservable inputs" and therefore fall into the Level 2 category. The amortized cost, gross unrealized gains, gross unrealized losses and fair value of investment securities are summarized as follows:

	June 30, 2018			
(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
State and political subdivisions	$ 343,850	$ 3,276	$ 3,441	$ 343,685
U.S. government agencies	91,778	8	1,848	89,938
Certificates of deposit	7,240			7,240
Total	$ 442,868	$ 3,284	$ 5,289	$ 440,863

	December 31, 2017			
(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
State and political subdivisions	$ 408,165	$ 9,528	$ 661	$ 417,032
U.S. government agencies	46,222		722	45,500
Certificates of deposit	7,991			7,991
Total	$ 462,378	$ 9,528	$ 1,383	$ 470,523

The fair values of securities with unrealized losses are as follows:

	June 30, 2018					
	Less than 12 months		**12 months or more**		**Total**	
(In thousands)	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**
State and political subdivisions	$ 156,545	$ 2,140	$ 30,194	$ 1,301	$ 186,739	$ 3,441
U.S. government agencies	71,861	1,245	10,322	603	82,183	1,848
Total	$ 228,406	$ 3,385	$ 40,516	$ 1,904	$ 268,922	$ 5,289

	December 31, 2017					
	Less than 12 months		12 months or more		Total	
(In thousands)	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
State and political subdivisions	$ 34,755	$ 123	$ 31,251	$ 538	$ 66,006	$ 661
U.S. government agencies	34,183	376	11,317	346	45,500	722
Total	$ 68,938	$ 499	$ 42,568	$ 884	$ 111,506	$ 1,383

There were 163 securities, or 49% of the total (24 greater than 12 months), in an unrealized loss position as of June 30, 2018. There were 64 securities, or 17% of the total (24 greater than 12 months), in an unrealized loss position as of December 31, 2017. All unrealized losses were reviewed to determine whether the losses were other than temporary. Management believes that all unrealized losses are temporary since they were market driven, and it is more likely than not that the Company will not be required to sell prior to recovery of the amortized basis.

The amortized cost and fair value of investment securities by contractual maturity are shown in the following table. Expected maturities may differ from contractual maturities because borrowers have the right to prepay obligations with or without prepayment penalties.

	June 30, 2018	
(In thousands)	Amortized Cost	Fair Value
Due in 1 year or less	$ 16,570	$ 16,678
Due after 1 year through 5 years	102,182	102,497
Due after 5 years through 10 years	216,399	217,126
Due after 10 years	107,717	104,562
Total	$ 442,868	$ 440,863

Proceeds from sales of investment securities classified as available-for-sale were $48,977,000 and $0 for the three months ended June 30, 2018 and 2017, respectively, and were $58,520,000 and $0 for the six months ended June 30, 2018 and 2017, respectively. Gross realized losses were $55,000 and $0 for the three months ended June 30, 2018 and 2017, respectively, and were $42,000 and $0 for the six months ended June 30, 2018 and 2017, respectively. There was one security totaling $3,750,000 pledged to secure public deposits and for other purposes at June 30, 2018.

Note 12 – Fair Value of Financial Instruments

Following is a summary of the carrying amounts and fair values of the Company's financial instruments:

	June 30, 2018		December 31, 2017	
(In thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Balance sheet assets:				
Cash and cash equivalents	$ 126,203	$ 126,203	$ 228,110	$ 228,110
Investment securities	440,863	440,863	470,523	470,523
Loans, net	704,646	697,745	676,026	675,020
Accrued interest receivable	6,834	6,834	7,413	7,413
Total	$ 1,278,546	$ 1,271,645	$ 1,382,072	$ 1,381,066
Balance sheet liabilities:				
Deposits	$ 625,737	$ 622,973	$ 678,088	$ 678,346
Accounts and drafts payable	673,704	673,704	661,888	661,888
Accrued interest payable	70	70	55	55
Total	$ 1,299,511	$ 1,296,747	$ 1,340,031	$ 1,340,289

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Cash Equivalents – The carrying amount approximates fair value.

Investment in Securities – The fair value is measured on a recurring basis using Level 2 valuations. Refer to Note 11, "Investment in Securities," for fair value and unrealized gains and losses by investment type.

Loans – The fair value is estimated using present values of future cash flows discounted at risk-adjusted interest rates for each loan category designated by management and is therefore a Level 3 valuation. Management believes that the risk factor embedded in the interest rates along with the allowance for loan losses result in a fair valuation. The estimated fair values of loans disclosed above as of June 30, 2018 follow the guidance in ASU 2016-01 which prescribes an exit price approach in estimating and disclosing fair value.

Impaired loans are valued using the expected cash flow method or fair value of the collateral which is based upon an observable market price or a current appraised value and therefore, the fair value is a nonrecurring Level 3 valuation.

Accrued Interest Receivable – The carrying amount approximates fair value.

Deposits – The fair value of demand deposits, savings deposits and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities and therefore, is a Level 2 valuation. The fair value estimates above do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market or the benefit derived from the customer relationship inherent in existing deposits.

Accounts and Drafts Payable – The carrying amount approximates fair value.

Accrued Interest – The carrying amount approximates fair value.

There were no transfers between Levels 1 and 2 of the fair value hierarchy for the six months ended June 30, 2018 and 2017. No financial instruments are measured using Level 3 inputs for the six months ended June 30, 2018 and 2017.

Note 13 – Subsequent Events

In accordance with FASB ASC 855, “Subsequent Events,” the Company has evaluated subsequent events after the consolidated balance sheet date of June 30, 2018, and there were no events identified that would require additional disclosures to prevent the Company’s unaudited consolidated financial statements from being misleading.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
Overview

Cass provides payment and information processing services to large manufacturing, distribution and retail enterprises from its offices/locations in St. Louis, Missouri, Columbus, Ohio, Boston, Massachusetts, Greenville, South Carolina, Wellington, Kansas, Jacksonville, Florida, Breda, Netherlands, Basingstoke, United Kingdom, and Singapore. The Company's services include freight invoice rating, payment processing, auditing, and the generation of accounting and transportation information. Cass also processes and pays energy invoices, which include electricity and gas as well as waste and telecommunications expenses and is a provider of telecom expense management solutions. The Company also, through Cass Commercial Bank, its St. Louis, Missouri-based bank subsidiary provides banking services in the St. Louis metropolitan area, Orange County, California, Colorado Springs, Colorado, and other selected cities in the United States. In addition to supporting the Company's payment operations, the Bank provides banking services to its target markets, which include privately-owned businesses and faith-based ministries.

The specific payment and information processing services provided to each customer are developed individually to meet each customer's requirements, which can vary greatly. In addition, the degree of automation such as electronic data interchange, imaging, work flow, and web-based solutions varies greatly among customers and industries. These factors combine so that pricing varies greatly among the customer base. In general, however, Cass is compensated for its processing services through service fees and investment of account balances generated during the payment process. The amount, type, and calculation of service fees vary greatly by service offering, but generally follow the volume of transactions processed. Interest income from the balances generated during the payment processing cycle is affected by the amount of time Cass holds the funds prior to payment and the dollar volume processed. Both the number of transactions processed and the dollar volume processed are therefore key metrics followed by management. Other factors will also influence revenue and profitability, such as changes in the general level of interest rates, which have a significant effect on net interest income. The funds generated by these processing activities are invested in overnight investments, investment grade securities, and loans generated by the Bank. The Bank earns most of its revenue from net interest income, or the difference between the interest earned on its loans and investments and the interest paid on its deposits and other borrowings. The Bank also assesses fees on other services such as cash management services.

Industry-wide factors that impact the Company include the willingness of large corporations to outsource key business functions such as freight, energy, telecommunication and environmental payment and audit. The benefits that can be achieved by outsourcing transaction processing, and the management information generated by Cass' systems can be influenced by factors such as the competitive pressures within industries to improve profitability, the general level of transportation costs, deregulation of energy costs, and consolidation of telecommunication providers. Economic factors that impact the Company include the general level of economic activity that can affect the volume and size of invoices processed, the ability to hire and retain qualified staff, and the growth and quality of the loan portfolio. The general level of interest rates also has a significant effect on the revenue of the Company. As discussed in greater detail in Item 7A, "Quantitative and Qualitative Disclosures about Market Risk," in the Company's 2017 Annual Report on Form 10-K, a decline in the general level of interest rates can have a negative impact on net interest income and conversely, a rise in the general level of interest rates can have a positive impact on net interest income. The cost of fuel is another factor that has a significant impact on the transportation sector. As the price of fuel goes up or down, the Company's earnings increase or decrease with the dollar amount of transportation invoices.

Currently, management views Cass' major opportunity as the continued expansion of its payment and information processing service offerings and customer base. Management intends to accomplish this by maintaining the Company's leadership position in applied technology, which when combined with the security and processing controls of the Bank, makes Cass unique in the industry.

Critical Accounting Policies

The Company has prepared the consolidated financial statements in this report in accordance with the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC"). In preparing the consolidated financial statements, management makes estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. These estimates have been generally accurate in the past, have been consistent and have not required any material changes. There can be no assurances that actual results will not differ from those estimates. Certain accounting policies that require significant management estimates and are deemed critical to the Company's results of operations or financial position have been discussed with the Audit Committee of the Board of Directors and are described below.

Allowance for Loan Losses. The Company performs periodic and systematic detailed reviews of its loan portfolio to assess overall collectability. The level of the allowance for loan losses reflects management's estimate of the collectability of the loan portfolio. Although these estimates are based on established methodologies for determining allowance requirements, actual results can differ significantly from estimated results. These policies affect both segments of the Company. The impact and associated risks related to these policies on the Company's business operations are discussed in the "Provision and Allowance for Loan Losses" section of this report. The Company's estimates have been materially accurate in the past, and accordingly, the Company expects to continue to utilize the present processes.

Results of Operations

The following paragraphs more fully discuss the results of operations and changes in financial condition for the three-month period ended June 30, 2018 ("Second Quarter of 2018") compared to the three-month period ended June 30, 2017 ("Second Quarter of 2017") and the six-month period ended June 30, 2018 ("First Half of 2018") compared to the six-month period ended June 30, 2017 ("First Half of 2017"). The following discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and related notes and with the statistical information and financial data appearing in this report, as well as in the Company's 2017 Annual Report on Form 10-K. Results of operations for the Second Quarter and First Half of 2018 are not necessarily indicative of the results to be attained for any other period.

Net Income

The following table summarizes the Company's operating results:

	Second Quarter of			**First Half of**		
			%			**%**
(In thousands except per share data)	**2018**	**2017**	**Change**	**2018**	**2017**	**Change**
Net income	$ 7,509	$ 6,513	15.3	$ 15,601	$ 12,820	21.7
Diluted earnings per share	$ .60	$ .52	15.4	$ 1.25	$ 1.03	21.4
Return on average assets	1.90 %	1.70 %	—	1.96 %	1.70 %	—
Return on average equity	13.66 %	12.13 %	—	14.29 %	12.24 %	—

Fee Revenue and Other Income

The Company's fee revenue is derived mainly from transportation and facility payment and processing fees. As the Company provides its processing and payment services, it is compensated by service fees which are typically calculated on a per-item basis and by the accounts and drafts payable balances generated in the payment process which can be used to generate interest income. Processing volumes, fee revenue, and other income were as follows:

	Second Quarter of			**First Half of**		
			%			**%**
(In thousands)	**2018**	**2017**	**Change**	**2018**	**2017**	**Change**
Transportation invoice volume	9,628	9,248	4.1 %	18,819	17,623	6.8 %
Transportation invoice dollar volume						