

CASS INFORMATION SYSTEMS INC  
Form 10-Q  
May 08, 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 March 31, 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. \_\_\_\_\_

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The number of shares outstanding of the registrant's only class of common stock as of April 25, 2018: Common stock, par value \$.50 per share – 12,287,374 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)

	<b>March 31, 2018 (Unaudited)</b>	<b>December 31, 2017</b>
<b>Assets</b>		
Cash and due from banks	\$ 10,251	\$ 17,422
Interest-bearing deposits in other financial institutions	178,104	152,056
Federal funds sold and other short-term investments	11,227	58,632
Cash and cash equivalents	199,582	228,110
Securities available-for-sale, at fair value	454,981	470,523
Loans	702,000	686,231
Less: Allowance for loan losses	10,210	10,205
Loans, net	691,790	676,026
Premises and equipment, net	22,012	21,586
Investment in bank-owned life insurance	17,040	16,927
Payments in excess of funding	157,557	139,103
Goodwill	12,569	12,569
Other intangible assets, net	1,885	1,996
Other assets	93,386	90,369
Total assets	\$ 1,650,802	\$ 1,657,209
<b>Liabilities and Shareholders' Equity</b>		
<u>Liabilities:</u>		
Deposits:		
Noninterest-bearing	\$ 257,915	\$ 281,541
Interest-bearing	381,328	396,547
Total deposits	639,243	678,088
Accounts and drafts payable	747,455	715,888
Other liabilities	41,682	38,145
Total liabilities	1,428,380	1,432,121
<u>Shareholders' Equity:</u>		
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 13,047,858 shares issued at March 31, 2018 and December 31, 2017	6,524	6,524
Additional paid-in capital	204,479	204,631
Retained earnings	64,458	59,314
Common shares in treasury, at cost (760,193 shares at March 31, 2018 and 760,962 shares at December 31, 2017)	(32,301)	(32,061)
Accumulated other comprehensive loss	(20,738)	(13,320)
Total shareholders' equity	222,422	225,088
Total liabilities and shareholders' equity	\$ 1,650,802	\$ 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)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2018</b>	<b>2017</b>
<b>Fee Revenue and Other Income:</b>		
Information services payment and processing revenue	\$ 24,827	\$ 22,289
Bank service fees	335	282
Gains on sales of securities	13	—
Other	199	200
Total fee revenue and other income	25,374	22,771
<b>Interest Income:</b>		
Interest and fees on loans	7,542	6,953
Interest and dividends on securities:		
Taxable	321	77
Exempt from federal income taxes	2,565	2,601
Interest on federal funds sold and other short-term investments	860	368
Total interest income	11,288	9,999
<b>Interest Expense:</b>		
Interest on deposits	679	480
Net interest income	10,609	9,519
Provision for loan losses	—	—
Net interest income after provision for loan losses	10,609	9,519
Total net revenue	35,983	32,290
<b>Operating Expense:</b>		
Salaries and employee benefits	20,382	18,799
Occupancy	854	842
Equipment	1,308	1,304
Amortization of intangible assets	110	99
Other operating expense	3,528	3,274
Total operating expense	26,182	24,318
Income before income tax expense	9,801	7,972
Income tax expense	1,709	1,665
Net income	\$ 8,092	\$ 6,307
Basic earnings per share	\$ .66	\$ .51
Diluted earnings per share	.65	.51

See accompanying notes to unaudited consolidated financial statements.

**CASS INFORMATION SYSTEMS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited)

(Dollars in Thousands)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2018</b>	<b>2017</b>
<b>Comprehensive Income:</b>		
Net income	\$ 8,092	\$ 6,307
Other comprehensive income:		
Net unrealized (loss) gain on securities available-for-sale	(9,774)	2,513
Tax effect	2,326	(933)
Reclassification adjustments for gains included in net income	(13)	—
Tax effect	3	—
Foreign currency translation adjustments	39	8
Total comprehensive income	\$ 673	\$ 7,895
See accompanying notes to unaudited consolidated financial statements.		

**CASS INFORMATION SYSTEMS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

(Dollars in Thousands)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2018</b>	<b>2017</b>
<b>Cash Flows From Operating Activities:</b>		
Net income	\$ 8,092	\$ 6,307
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,018	2,704
Net gains on sales of securities	(13)	—
Stock-based compensation expense	638	537
Increase in income tax liability	1,352	467
Increase in pension liability	1,231	1,155
Decrease in accounts receivable	6,410	1,655
Other operating activities, net	(2,569)	(7,204)
Net cash provided by operating activities	18,159	5,621
<b>Cash Flows From Investing Activities:</b>		
Proceeds from sales of securities available-for-sale	9,543	—
Proceeds from maturities of securities available-for-sale	11,030	17,623
Purchase of securities available-for-sale	(16,752)	(52,599)
Net increase in loans	(15,764)	(10,498)
Increase in payments in excess of funding	(18,454)	(16,428)
Purchases of premises and equipment, net	(1,387)	(887)
Net cash used in investing activities	(31,784)	(62,789)
<b>Cash Flows From Financing Activities:</b>		
Net decrease in noninterest-bearing demand deposits	(23,626)	(18,796)
Net decrease in interest-bearing demand and savings deposits	(15,149)	(24,994)
Net (decrease) increase in time deposits	(69)	185
Net increase (decrease) in accounts and drafts payable	27,825	(19,064)
Cash dividends paid	(2,948)	(2,575)
Purchase of common shares for treasury	(1,030)	—
Other financing activities, net	94	(761)
Net cash used in financing activities	(14,903)	(66,005)
Net decrease in cash and cash equivalents	(28,528)	(123,173)
Cash and cash equivalents at beginning of period	228,110	266,743
Cash and cash equivalents at end of period	\$ 199,582	\$ 143,570
<b>Supplemental information:</b>		
Cash paid for interest	\$ 667	\$ 476
Cash paid for income taxes	263	1,198
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").

*Transportation and facility payment and processing 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 which 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:

	March 31, 2018		December 31, 2017	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
<i>(In thousands)</i>				
Assets eligible for amortization:				
Customer lists	\$ 4,288	\$ (2,795)	\$ 4,288	\$ (2,702)
Patent	72	(13)	72	(12)
Non-compete agreements	332	(299)	332	(291)
Software	234	(234)	234	(234)
Other	500	(200)	500	(191)
Unamortized intangible assets:				
Goodwill <sup>1</sup>	12,796	(227)	12,796	(227)
Total intangible assets	\$ 18,222	\$ (3,768)	\$ 18,222	\$ (3,657)

<sup>1</sup>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 \$110,000 and \$99,000 for the three-month periods ended March 31, 2018 and 2017, respectively. Estimated annual amortization of intangibles is as follows: \$442,000 in 2018, and \$412,000 in 2019, \$406,000 each of 2020 and 2021, and \$88,000 in 2022.





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### 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 months ended March 31, 2018 and 2017. The calculations of basic and diluted earnings per share are as follows:

<i>(In thousands except share and per share data)</i>	<b>Three Months Ended March 31,</b>	
	<b>2018</b>	<b>2017</b>
<b>Basic</b>		
Net income	\$ 8,092	\$ 6,307
Weighted-average common shares outstanding	12,233,016	12,252,461
Basic earnings per share	\$ .66	\$ .51
<b>Diluted</b>		
Net income	\$ 8,092	\$ 6,307
Weighted-average common shares outstanding	12,233,016	12,252,461
Effect of dilutive restricted stock and stock appreciation rights	189,084	179,341
Weighted-average common shares outstanding assuming dilution	12,422,100	12,431,802
Diluted earnings per share	\$ .65	\$ .51

### 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 9,547 shares during the three-month period ended March 31, 2018 and no shares during the three-month period ended March 31, 2017. As of March 31, 2018, 490,453 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\* 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.



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

<i>(In thousands)</i>	<b>Information Services</b>	<b>Banking Services</b>	<b>Corporate, Eliminations and Other</b>	<b>Total</b>
<i>Three Months Ended March 31, 2018</i>				
Fee income from customers	\$ 24,872	\$ 376	\$ 126	\$ 25,374
Interest income*	5,516	5,750	709	11,975
Interest expense	—	679	—	679
Intersegment income (expense)	—	462	(462)	—
Tax-equivalized pre-tax income*	6,734	3,425	329	10,488
Goodwill	12,433	136	—	12,569
Other intangible assets, net	1,885	—	—	1,885
Total Assets	878,199	858,283	(85,680)	1,650,802
Funding Sources	644,909	595,837	—	1,240,746
<i>Three Months Ended March 31, 2017</i>				
Fee income from customers	\$ 22,324	\$ 324	\$ 123	\$ 22,771
Interest income*	4,728	5,886	806	11,420
Interest expense	—	480	—	480
Intersegment income (expense)	—	300	(300)	—
Tax-equivalized pre-tax income*	5,455	3,457	481	9,393
Goodwill	11,454	136	—	11,590
Other intangible assets, net	2,099	—	—	2,099
Total Assets	747,301	715,753	(16,048)	1,447,006
Funding Sources	564,376	600,054	—	1,164,430

\* Presented on a tax-equivalent basis assuming a tax rate of 21% for 2018 and 35% for 2017. The tax-equivalent adjustment was approximately \$687,000 and \$1,421,000 for the First Quarter of 2018 and 2017, respectively.

### Note 6 – Loans by Type

A summary of loan categories is as follows:

<i>(In thousands)</i>	<b>March 31, 2018</b>	<b>December 31, 2017</b>
Commercial and industrial	\$ 256,381	\$ 236,394
Real estate		
Commercial:		
Mortgage	90,742	94,675
Construction	15,708	9,359
Church, church-related:		
Mortgage	307,654	316,073
Construction	28,932	25,948
Industrial Revenue Bonds	2,557	3,374
Other	26	408
Total loans	\$ 702,000	\$ 686,231

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

<i>(In thousands)</i>	Performing			Nonperforming		Total Loans
	Current	30-59 Days	60-89 Days	90 Days and Over	Non- accrual	
<i>March 31, 2018</i>						
Commercial and industrial	\$ 256,381	\$ —	\$ —	\$ —	\$ —	\$ 256,381
Real estate						
Commercial:						
Mortgage	90,742	—	—	—	—	90,742
Construction	15,708	—	—	—	—	15,708
Church, church-related:						
Mortgage	307,654	—	—	—	—	307,654
Construction	28,932	—	—	—	—	28,932
Industrial Revenue Bonds	2,557	—	—	—	—	2,557
Other	26	—	—	—	—	26
Total	\$ 702,000	\$ —	\$ —	\$ —	\$ —	\$ 702,000
<i>December 31, 2017</i>						
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

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The following table presents the credit exposure of the loan portfolio by internally assigned credit grade as of March 31, 2018 and December 31, 2017:

	<b>Loans Subject to Normal Monitoring<sup>1</sup></b>	<b>Performing Loans Subject to Special Monitoring<sup>2</sup></b>	<b>Nonperforming Loans Subject to Special Monitoring<sup>2</sup></b>	<b>Total Loans</b>
<i>(In thousands)</i>				
<i>March 31, 2018</i>				
Commercial and industrial	\$ 254,932	\$ 1,449	\$ —	\$ 256,381
Real estate				
Commercial:				
Mortgage	89,882			