

CASS INFORMATION SYSTEMS INC

Form 10-Q

November 02, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

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, 2012

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

(State or other jurisdiction of incorporation or organization)

43-1265338

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

13001 Hollenberg Drive

Bridgeton, Missouri

(Address of principal executive offices)

63044

(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

Edgar Filing: CASS INFORMATION SYSTEMS INC - Form 10-Q

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	☐

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 registrant's only class of stock as of October 26, 2012: Common stock, par value \$.50 per share 10,397,885 shares outstanding.

TABLE OF CONTENTS

PART I	Financial Information	
Item 1.	FINANCIAL STATEMENTS	
	Consolidated Balance Sheets September 30, 2012 (unaudited) and December 31, 2011	3
	Consolidated Statements of Income Three and Nine Months Ended September 30, 2012 and 2011 (unaudited)	4
	Consolidated Statements of Comprehensive Income Three and Nine Months Ended September 30, 2012 and 2011 (unaudited)	5
	Consolidated Statements of Cash Flows Nine Months Ended September 30, 2012 and 2011 (unaudited)	6
	Notes to Consolidated Financial Statements (unaudited)	7
Item 2.	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	18
Item 3.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	30
Item 4.	CONTROLS AND PROCEDURES	30
PART II	Other Information	Items 1. - 6. 30
	SIGNATURES	32

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 the section Part I, Item 1A, "Risk Factors" of the Company's 2011 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)

	September 30, 2012 (Unaudited)	December 31, 2011
Assets		
Cash and due from banks	\$ 9,667	\$ 12,579
Interest-bearing deposits in other financial institutions	124,039	123,551
Federal funds sold and other short-term investments	86,100	99,832
Cash and cash equivalents	219,806	235,962
Securities available-for-sale, at fair value	367,519	310,612
Loans	681,174	671,565
Less: Allowance for loan losses	12,321	12,954
Loans, net	668,853	658,611
Premises and equipment, net	9,326	9,587
Investment in bank-owned life insurance	14,774	14,375
Payments in excess of funding	74,031	61,378
Goodwill	11,590	7,471
Other intangible assets, net	3,905	161
Other assets	21,431	21,144
Total assets	\$ 1,391,235	\$ 1,319,301
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Noninterest-bearing	\$ 140,677	\$ 131,956
Interest-bearing	407,657	416,412
Total deposits	548,334	548,368
Accounts and drafts payable	648,944	595,201
Other liabilities	19,382	15,184
Total liabilities	1,216,660	1,158,753
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; 20,000,000 shares authorized and 10,890,163 shares issued at September 30, 2012 and December 31, 2011	5,445	5,445
Additional paid-in capital	80,973	80,971
Retained earnings	102,517	89,853
Common shares in treasury, at cost (492,278 shares at September 30, 2012 and 532,233 shares at December 31, 2011)	(12,241)	(12,968)
Accumulated other comprehensive loss	(2,119)	(2,753)
Total shareholders' equity	174,575	160,548
Total liabilities and shareholders' equity	\$ 1,391,235	\$ 1,319,301

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 September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Fee Revenue and Other Income:				
Information services payment and processing revenue	\$ 16,600	\$ 15,806	\$ 49,712	\$ 45,372
Bank service fees	299	302	908	1,036
Gains on sales of securities	267		2,401	48
Other	135	339	400	606
Total fee revenue and other income	17,301	16,447	53,421	47,062
Interest Income:				
Interest and fees on loans	8,819	9,827	26,721	30,209
Interest and dividends on securities:				
Taxable	16	6	39	24
Exempt from federal income taxes	2,435	2,475	7,388	7,450
Interest on federal funds sold and other short-term investments	125	186	366	510
Total interest income	11,395	12,494	34,514	38,193
Interest Expense:				
Interest on deposits	785	1,060	2,383	3,391
Net interest income	10,610	11,434	32,131	34,802
Provision for loan losses		550	800	1,850
Net interest income after provision for loan losses	10,610	10,884	31,331	32,952
Total net revenue	27,911	27,331	84,752	80,014
Operating Expense:				
Salaries and employee benefits	15,919	14,425	46,978	42,277
Occupancy	497	581	1,588	1,786
Equipment	879	886	2,626	2,581
Amortization of intangible assets	147	26	433	80
Other operating	2,487	2,995	8,885	8,958
Total operating expense	19,929	18,913	60,510	55,682
Income before income tax expense	7,982	8,418	24,242	24,332
Income tax expense	1,890	2,358	6,280	6,814
Net Income	\$ 6,092	\$ 6,060	\$ 17,962	\$ 17,518
Basic earnings per share	.59	.59	1.74	1.70
Diluted earnings per share	.58	.58	1.71	1.68

See accompanying notes to unaudited consolidated financial statements.

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

(Unaudited)
(Dollars in Thousands)

<i>(In thousands)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Comprehensive income:				
Net income	\$ 6,092	\$ 6,060	\$ 17,962	\$ 17,518
Other comprehensive income:				
Net unrealized gain on securities available-for-sale, net of tax	1,763	3,778	2,212	4,783
Reclassification adjustments for gains included in net income, net of tax	(173)		(1,560)	(31)
Foreign currency translation adjustments	10		(18)	
Total comprehensive income	\$ 7,692	\$ 9,838	\$ 18,596	\$ 22,270

See accompanying notes to unaudited consolidated financial statements.

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

(Unaudited)
(Dollars in Thousands)

	Nine Months Ended September 30, 2012	2011
Cash Flows From Operating Activities:		
Net income	\$ 17,962	\$ 17,518
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,940	3,295
Gains on sales of securities	(2,401)	(48)
Provision for loan losses	800	1,850
Stock-based compensation expense	1,050	1,043
Increase in income tax liability	1,194	531
Increase in pension liability	624	286
Other operating activities, net	826	(1,447)
Net cash provided by operating activities	24,995	23,028
Cash Flows From Investing Activities:		
Proceeds from sales of securities available-for-sale	33,234	5,405
Proceeds from maturities of securities available-for-sale	6,920	10,185
Purchase of securities available-for-sale	(96,704)	(19,974)
Net (increase) decrease in loans	(11,042)	15,517
Increase in payments in excess of funding	(12,653)	(30,222)
Purchases of premises and equipment, net	(1,198)	(1,765)
Acquisition of waste expense management service company's assets	(7,798)	
Net cash used in investing activities	(89,241)	(20,854)
Cash Flows From Financing Activities:		
Net increase in noninterest-bearing demand deposits	8,721	12,883
Net (decrease) increase in interest-bearing demand and savings deposits	(6,413)	31,804
Net decrease in time deposits	(2,342)	(13,485)
Net increase in accounts and drafts payable	53,743	167,132
Cash dividends paid	(5,298)	(4,519)
Distribution of stock awards, net	(321)	(249)
Other financing activities, net		114
Net cash provided by financing activities	48,090	193,680
Net (decrease) increase in cash and cash equivalents	(16,156)	195,854
Cash and cash equivalents at beginning of period	235,962	138,929
Cash and cash equivalents at end of period	\$ 219,806	\$ 334,783
Supplemental information:		
Cash paid for interest	\$ 2,401	\$ 3,386
Cash paid for income taxes	4,966	6,211

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, 2011. 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, 2011.

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, 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.

In January 2012, the Company acquired the assets of Waste Reduction Consultants, Inc. (WRC), and recorded intangible assets of \$3,183,000 for the customer list, \$261,000 for two non-compete agreements and software of \$234,000.

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

<i>(In thousands)</i>	September 30, 2012		December 31, 2011	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Assets eligible for amortization:				
Customer lists	\$ 3,933	\$ (908)	\$ 750	\$ (589)
Non-compete agreements	261	(39)	750	(39)
Software	234	(59)		
Other	500	(17)		
Unamortized intangible assets:				
Goodwill	11,817	(227)	7,698	(227)
Total intangible assets	\$ 16,745	\$ (1,250)	\$ 8,448	\$ (816)

The customer lists are amortized over seven and ten years; the non-compete agreements over five years; software over three years and other intangible assets over 15 years. Amortization of intangible assets amounted to \$433,000 and \$80,000 for the nine-month periods ended September 30, 2012 and 2011, respectively. Estimated amortization of intangibles over the next five years is as follows: \$581,000 in 2012, \$535,000 in 2013, \$482,000 in 2014 and \$404,000 in 2015 and 2016.

Edgar Filing: CASS INFORMATION SYSTEMS INC - Form 10-Q

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-month and nine-month periods ended September 30, 2012 and 2011. The calculations of basic and diluted earnings per share are as follows:

<i>(In thousands except share and per share data)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Basic				
Net income	\$ 6,092	\$ 6,060	\$ 17,962	\$ 17,518
Weighted-average common shares outstanding	10,345,497	10,299,213	10,337,401	10,296,131
Basic earnings per share	\$.59	\$.59	\$ 1.74	\$ 1.70
Diluted				
Net income	\$ 6,092	\$ 6,060	\$ 17,962	\$ 17,518
Weighted-average common shares outstanding	10,345,497	10,299,213	10,337,401	10,296,131
Effect of dilutive restricted stock, stock options and stock appreciation rights	161,363	126,585	162,680	136,090
Weighted-average common shares outstanding assuming dilution	10,506,860	10,425,798	10,500,081	10,432,221
Diluted earnings per share	\$.58	\$.58	\$ 1.71	\$ 1.68

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 330,000 shares of the Company's common stock. The Company did not repurchase any shares during the nine-month periods ended September 30, 2012 and 2011. As of September 30, 2012, 330,000 shares remained available for repurchase under the program. Repurchases are 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, processing and capital requirements.

The Information Services segment provides freight, utility, telecommunication and environmental invoice processing and payment services primarily to large corporations. The Banking Services segment provides banking services primarily to privately-held businesses and churches.

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, 2011. Management evaluates segment performance based on net income after allocations for corporate expenses and income taxes. 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 North America, and no revenue from any customer of any segment exceeds 10% of the Company's consolidated revenue.

Assets represent actual assets owned by Information Services and there is no allocation methodology used. Loans are sold by Banking Services to Information Services to create liquidity when the loan-to-deposit ratio of the Company's bank subsidiary, Cass Commercial Bank (the Bank) is greater than 100%. Segment interest from customers is the actual interest earned on the loans owned by Information Services and Banking Services, respectively.

Edgar Filing: CASS INFORMATION SYSTEMS INC - Form 10-Q

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

<i>(In thousands)</i>	Information Services	Banking Services	Corporate, Eliminations and other	Total
<i>Three Months Ended September 30, 2012</i>				
Total Net Revenues:				
Revenue from customers	\$ 21,727	\$ 6,184	\$	\$ 27,911
Intersegment revenue	2,842	408	(3,250)	
Net income	5,889	2,367	(2,164)	6,092
Goodwill	11,454	136		11,590
Other intangible assets, net	3,905			3,905
Total assets	774,476	634,564	(17,805)	1,391,235
<i>Three Months Ended September 30, 2011</i>				
Total Net Revenues:				
Revenue from customers	\$ 21,414	\$ 5,917	\$	\$ 27,331
Intersegment revenue	2,539	466	(3,005)	
Net income	3,968	2,092		6,060
Goodwill	7,335	136		7,471
Other intangible assets, net	187			187
Total assets	794,998	623,706	(13,046)	1,405,658
<i>Nine Months Ended September 30, 2012</i>				
Total Net Revenues:				
Revenue from customers	\$ 66,448	\$ 18,304	\$	\$ 84,752
Intersegment revenue	8,126	1,251	(9,377)	
Net income	17,437	6,611	(6,086)	17,962
Goodwill	11,454	136		11,590
Other intangible assets, net	3,905			3,905
Total assets	774,476	634,564	(17,805)	1,391,235
<i>Nine Months Ended September 30, 2011</i>				
Total Net Revenues:				
Revenue from customers	\$ 61,950	\$ 18,064	\$	\$ 80,014
Intersegment revenue	7,638	1,407	(9,045)	
Net income	11,230	6,288		17,518
Goodwill	7,335	136		7,471
Other intangible assets, net	187			187
Total assets	794,998	623,706	(13,046)	1,405,658

Note 6 Loans by Type

A summary of loan categories is as follows:

<i>(In thousands)</i>	September 30, 2012	December 31, 2011
Commercial and industrial	\$ 158,050	\$ 136,916
Real estate		
Commercial:		
Mortgage	138,088	140,848
Construction	10,133	9,067
Church, church-related:		
Mortgage	360,013	347,726
Construction	14,748	36,497
Other	142	511
Total loans	\$ 681,174	\$ 671,565

Edgar Filing: CASS INFORMATION SYSTEMS INC - Form 10-Q

The following table presents the aging of loans by loan categories at September 30, 2012 and December 31, 2011:

(In thousands)	Performing			Nonperforming		Total Loans
	Current	30-59 Days	60-89 Days	90 Days and Over	Non Accrual	
<i>September 30, 2012</i>						
Commercial and industrial	\$ 158,009	\$	\$	\$	\$ 41	\$ 158,050
Real estate						
Commercial:						
Mortgage	133,417	19			4,652	138,088
Construction	10,133					10,133
Church, church-related:						
Mortgage	358,629	1,184			200	360,013
Construction	14,748					14,748
Other	142					142
Total	\$ 675,078	\$ 1,203	\$	\$	\$ 4,893	\$ 681,174
<i>December 31, 2011</i>						
Commercial and industrial	\$ 136,850	\$	\$ 10	\$	\$ 56	\$ 136,916
Real estate						
Commercial:						
Mortgage	139,249	137		29	1,433	140,848
Construction	9,067					9,067
Church, church-related:						
Mortgage	347,506				220	347,726
Construction	36,497					36,497
Other	511					511
Total	\$ 669,680	\$ 137	\$ 10	\$ 29	\$ 1,709	\$ 671,565

The following table presents the credit exposure of the loan portfolio by internally assigned credit grade as of September 30, 2012 and December 31, 2011:

(In thousands)	Loans Subject to Normal Monitoring ¹	Performing Loans Subject to Special Monitoring ²	Nonperforming Loans Subject to Special Monitoring ²	Total Loans
<i>September 30, 2012</i>				
Commercial and industrial	\$ 153,816	\$ 4,193	\$ 41	\$ 158,050
Real estate				
Commercial:				
Mortgage	126,473	6,963	4,652	138,088
Construction	10,133			10,133
Church, church-related:				
Mortgage	357,594	2,219	200	360,013
Construction	14,748			14,748
Other	142			142
Total	\$ 662,906	\$ 13,375	\$ 4,893	\$ 681,174
<i>December 31, 2011</i>				
Commercial and industrial	\$ 132,475	\$ 4,385	\$ 56	\$ 136,916
Real estate				
Commercial:				
Mortgage	125,850	13,536	1,462	140,848
Construction	9,067			9,067
Church, church-related:				
Mortgage	336,727	10,779	220	347,726

Edgar Filing: CASS INFORMATION SYSTEMS INC - Form 10-Q

Construction		36,497				36,497
Other		511				511
Total	\$	641,127	\$	28,700	\$	1,738
					\$	671,565

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 obligation.

² Loans subject to special monitoring possess some credit deficiency or potential weakness which requires a high level of management attention.

-10-

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. At September 30, 2012 and December 31, 2011, all impaired loans were evaluated based on the fair value of the collateral. The fair value of the collateral is based upon an observable market price or current appraised value and therefore, the Company classifies these assets as nonrecurring Level 2. Loans delinquent 90 days or more and still accruing interest at September 30, 2012 and December 31, 2011 were \$0 and \$29,000, respectively. Loans classified as troubled debt restructuring were \$0 and \$4,479,000 at September 30, 2012 and December 31, 2011, respectively.

There are two foreclosed loans with a book value of \$1,322,000 which have been recorded as other real estate owned (included in other assets) as of September 30, 2012 and there were two foreclosed loans with a book value of \$1,689,000 as of December 31, 2011. During the three months ended September 30, 2012, one property located in St. Louis County, Missouri, was sold resulting in a net gain of \$2,000 and a property relating to a loan secured by commercial real estate, also located in St. Louis County, Missouri, was added through foreclosure.

The following table presents the recorded investment and unpaid principal balance for impaired loans at September 30, 2012 and December 31, 2011:

	Recorded Investment	Unpaid Principal Balance	Related Allowance for Loan Losses
<i>(In thousands)</i>			
<i>September 30, 2012</i>			
Commercial and industrial:			
Nonaccrual	\$ 41	\$ 41	\$ 21
Troubled debt restructurings still accruing			
Real estate			
Commercial Mortgage:			
Nonaccrual	4,652	4,652	465
Past due 90 days or more and still accruing			
Troubled debt restructurings still accruing			
Church Mortgage:			
Nonaccrual	200	200	115
Total impaired loans	\$ 4,893	\$ 4,893	\$ 601
<i>December 31, 2011</i>			
Commercial and industrial:			
Nonaccrual	\$ 56	\$ 56	\$ 28
Troubled debt restructurings still accruing	83	83	8
Real estate			
Commercial Mortgage:			
Nonaccrual	1,433	1,433	149
Past due 90 days or more and still accruing	29	29	
Troubled debt restructurings still accruing	4,396	4,396	766
Church Mortgage:			
Nonaccrual	220	220	115
Total impaired loans	\$ 6,217	\$ 6,217	\$ 1,066

Edgar Filing: CASS INFORMATION SYSTEMS INC - Form 10-Q

A summary of the activity in the allowance for loan losses from December 31, 2011 to September 30, 2012 is as follows:

<i>(In thousands)</i>	December 31, 2011	Charge- Offs	Recoveries	Provision	September 30, 2012
Commercial and industrial	\$ 2,594	\$	\$ 109	\$ (126)	\$ 2,577
Real estate					
Commercial:					
Mortgage	4,776	1,542		1,076	4,310
Construction	167			39	206
Church, church-related:					
Mortgage	4,797			107	4,904
Construction	616			(294)	322
Other	4			(2)	2
Total	\$ 12,954	\$ 1,542	\$ 109	\$ 800	\$ 12,321

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 September 30, 2012 and December 31, 2011, 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 September 30, 2012, the balance of unused loan commitments, standby and commercial letters of credit were \$12,046,000, \$13,594,000 and \$4,203,000, 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 September 30, 2012:

<i>(In thousands)</i>	Amount of Commitment Expiration per Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	Over 5 Years
Operating lease commitments	\$ 8,263	\$ 1,009	\$ 2,096	\$ 1,665	\$ 3,493
Time deposits	128,739	121,005	6,278	1,456	
Total	\$ 137,002	\$ 122,014	\$ 8,374	\$ 3,121	\$ 3,493

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.

Edgar Filing: CASS INFORMATION SYSTEMS INC - Form 10-Q

Note 8 Stock-Based Compensation

The 2007 Omnibus Incentive Stock Plan (the "Omnibus Plan") permits the issuance of up to 968,000 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 issues shares out of treasury stock for these awards. During the Nine Months Ended September 30, 2012, 25,805 restricted shares and 83,968 SARs were granted under the Omnibus Plan.

The Company also continues to maintain its other stock-based incentive plans for the restricted common stock previously awarded and the options previously issued and still outstanding. These plans have been superseded by the Omnibus Plan and accordingly, any available restricted stock and stock option grants not yet issued have been cancelled.

Restricted Stock

Restricted shares are amortized to expense over the three-year vesting period. As of September 30, 2012, the total unrecognized compensation expense related to non-vested common stock was \$1,270,000, and the related weighted-average period over which it is expected to be recognized is approximately 1.1 years.

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

	Nine Months Ended September 30, 2012	
	Shares	Fair Value
Balance at December 31, 2011	52,470	\$ 29.86
Granted	25,805	\$ 37.43
Vested	(28,154)	\$ 28.02
Balance at September 30, 2012	50,121	\$ 34.79

Stock Options

Stock options vest and expire over a period not to exceed seven years. As of September 30, 2012, the total unrecognized compensation expense related to non-vested stock options was \$4,000, and the related weighted-average period over which it is expected to be recognized is approximately .3 years. Following is a summary of the activity of the stock options during the nine-month period ended September 30, 2012:

	Shares	Weighted-Average Exercise Price	Average Remaining Contractual Term Years	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2011	30,628	\$ 17.79	.84	\$ 545
Exercised	13,192	\$ 16.47		
Outstanding at September 30, 2012	17,436	\$ 18.79	.26	\$ 404
Exercisable at September 30, 2012	17,436	\$ 18.79	.26	\$ 404

The total intrinsic value of options exercised was \$283,000 and \$156,000 for the nine-month periods ended September 30, 2012 and 2011, respectively. Following is a summary of the activity of the non-vested stock options during the nine-month period ended September 30, 2012:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested at December 31, 2011	3,674	\$ 2.69
Vested	(3,674)	\$ 2.69
Non-vested at September 30, 2012		\$ 0.00

SARs

SARs vest over a three-year period, with one-third of the shares vesting and becoming exercisable each year on the anniversary date of the grant, and they expire 10 years from the original grant date. As of September 30, 2012, the total unrecognized compensation expense was \$3,645,000, and the related weighted-average period over which it is expected to be recognized is 1.7 years. Following is a summary of the activity of the Company's SARs program for the nine-month period ended September 30, 2012:

	Shares	Weighted-Average Exercise Price	Average Remaining Contractual Term Years	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2011	332,586	\$ 26.87	7.42	\$ 3,166
Granted	83,968	\$ 36.92		
Exercised	(49,344)	\$ 24.64		
Outstanding at September 30, 2012	367,210	\$ 29.47	7.39	4,590
Exercisable at September 30, 2012	219,679	\$ 25.83	6.33	3,545

Following is a summary of the activity of the non-vested SARs during the nine-month period ended September 30, 2012:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested at December 31, 2011	144,321	\$ 29.35
Granted	83,968	\$ 36.92
Vested	(80,758)	\$ 27.49
Non-vested at September 30, 2012	147,531	\$ 34.89

The Company uses the Black-Scholes pricing model to determine the fair value of the SARs at the date of grant. Following are the assumptions used to estimate the per-share fair value of SARs granted:

	Nine Months Ended September 30,	
	2012	2011
Risk-free interest rate	1.38%	2.70 %
Expected life	7 yrs.	7 yrs.
Expected volatility	29.39%	27.86 %
Expected dividend yield	1.84%	1.77 %

The risk-free interest rate is based on the zero-coupon U.S. Treasury yield for the period equal to the expected life of the SARs at the time of the grant. The expected life was derived using the historical exercise activity. The Company uses historical volatility for a period equal to the expected life of the rights using average monthly closing market prices of the Company's stock as reported on The Nasdaq Global Market. The expected dividend yield is based on the Company's current rate of annual dividends.

Note 9 Defined Pension Plans

The Company has a noncontributory defined benefit pension plan, which covers most of its employees. 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:

Estimated Actual

Edgar Filing: CASS INFORMATION SYSTEMS INC - Form 10-Q

<i>(In thousands)</i>		2012	2011
Service cost	benefits earned during the year	\$ 2,986	\$ 2,073
Interest cost on projected benefit obligation		2,588	2,423
Expected return on plan assets		(3,967)	(3,314)
Net amortization and deferral		1,504	603
Net periodic pension cost		\$ 3,111	\$ 1,785

Pension costs recorded to expense were \$1,011,000 and \$415,000 for the three-month periods ended September 30, 2012 and 2011, respectively, and totaled \$2,341,000 and \$1,347,000 for the nine-month periods ended September 30, 2012 and 2011, respectively. The Company made a contribution of \$750,000 to the plan during the three-month period ended September 30, 2012, for a total of \$2,250,000 for the nine-month period ending September 30, 2012, and expects to contribute at least an additional \$750,000 in 2012.

Edgar Filing: CASS INFORMATION SYSTEMS INC - Form 10-Q

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 2011 and an estimate for 2012:

		Estimated	Actual
		2012	2011
<i>(In thousands)</i>			
Service cost	benefits earned during the year	\$ 134	\$ 89
Interest cost on projected benefit obligation		329	295
Net amortization		422	250
Net periodic pension cost		\$ 885	\$ 634

Pension costs recorded to expense were \$224,000 and \$159,000 for the three-month periods ended September 30, 2012 and 2011, respectively, and were \$671,000 and \$476,000 for the nine-month periods ended September 30, 2012 and 2011, respectively.

Note 10 Income Taxes

As of September 30, 2012, the Company's unrecognized tax benefits were approximately \$2,348,000, of which \$1,683,000 would, if recognized, affect the Company's effective tax rate. As of December 31, 2011, the Company's unrecognized tax benefits were approximately \$2,069,000, of which \$1,496,000 would, if recognized, affect the Company's effective tax rate. During the next twelve months, the Company may realize a reduction of its unrecognized tax benefits of approximately \$485,000 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 \$144,000 and \$95,000 of gross interest accrued as of September 30, 2012 and December 31, 2011, respectively. There were no penalties for unrecognized tax benefits accrued at September 30, 2012 and December 31, 2011.

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 2009 through 2011 remain subject to examination by the Internal Revenue Service. In addition, the Company is subject to state tax examinations for the tax years 2008 through 2011.

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 falls into the Level 2 category. The amortized cost, gross unrealized gains, gross unrealized losses and fair value of investment securities are summarized as follows:

September 30, 2012				
		Amortized	Gross	Gross
		Cost	Unrealized	Unrealized
			Gains	Losses
				Fair Value
<i>(In thousands)</i>				
State and political subdivisions		\$ 333,855	\$ 20,834	\$ 52
Certificates of deposit		12,882		
Total		\$ 346,737	\$ 20,834	\$ 52
				\$ 367,519

December 31, 2011				
		Amortized	Gross	Gross
		Cost	Unrealized	Unrealized
			Gains	Losses
				Fair Value
<i>(In thousands)</i>				
State and political subdivisions		\$ 287,585	\$ 19,797	\$ 20
Certificates of deposit		3,250		
Total		\$ 290,835	\$ 19,797	\$ 20
				\$ 310,612

Edgar Filing: CASS INFORMATION SYSTEMS INC - Form 10-Q

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

	September 30, 2012		12 months or more		Total	
	Less than 12 months	Unrealized	Estimated	Unrealized	Estimated	Unrealized
	Estimated fair value	losses	Estimated fair value	losses	Estimated Fair value	Losses
<i>(In thousands)</i>						
State and political subdivisions	\$ 21,181	\$ 52	\$	\$	\$ 21,181	\$ 52
Certificates of deposit						
Total	\$ 21,181	\$ 52	\$	\$	\$ 21,181	\$ 52

	December 31, 2011		12 months or more		Total	
	Less than 12 months	Unrealized	Estimated	Unrealized	Estimated	Unrealized
	Estimated fair value	losses	Estimated fair value	losses	Estimated Fair value	Losses
<i>(In thousands)</i>						
State and political subdivisions	\$ 4,362	\$ 20	\$	\$	\$ 4,362	\$ 20
Certificates of deposit						
Total	\$ 4,362	\$ 20	\$	\$	\$ 4,362	\$ 20

There were 23 securities (none greater than 12 months) in an unrealized loss position as of September 30, 2012. There were seven securities (none greater than 12 months) in an unrealized loss position as of December 31, 2011. 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 the Company has the ability and intent to hold these securities until maturity.

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.

	September 30, 2012	
	Amortized Cost	Fair Value
<i>(In thousands)</i>		
Due in 1 year or less	\$ 18,898	\$ 19,036
Due after 1 year through 5 years	62,453	66,994
Due after 5 years through 10 years	180,082	190,378
Due after 10 years	85,304	91,111
Total	\$ 346,737	\$ 367,519

Proceeds from sales of investment securities classified as available for sale were \$3,485,000 and \$0 for the three months ended September 30, 2012 and 2011, respectively, and were \$33,234,000 and \$5,405,000 for the nine months ended September 30, 2012 and 2011, respectively. Gross realized gains were \$267,000 and \$0 for the three months ended September 30, 2012 and 2011, respectively, and were \$2,401,000 and \$48,000 for the nine months ended September 30, 2012 and 2011, respectively. There was one security for \$3,250,000 pledged to secure public deposits and for other purposes at September 30, 2012.

Note 12 Fair Value of Financial Instruments

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

(In thousands)	September 30, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Balance sheet assets:				
Cash and cash equivalents	\$ 219,806	\$ 219,806	\$ 235,962	\$ 235,962
Investment securities	367,519	367,519	310,612	310,612
Loans, net	668,853	671,757	658,611	665,348
Accrued interest receivable	6,168	6,168	6,125	6,125
Total	\$ 1,262,346	\$ 1,265,250	\$ 1,211,310	\$ 1,218,047
Balance sheet liabilities:				
Deposits	\$ 548,334	\$ 548,837	\$ 548,368	\$ 548,985
Accounts and drafts payable	648,944	648,944	595,201	595,201
Accrued interest payable	142	142	159	159
Total	\$ 1,197,420	\$ 1,197,923	\$ 1,143,728	\$ 1,144,345

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 Other Short-term Instruments For cash and cash equivalents, accrued interest receivable, accounts and drafts payable and accrued interest payable, the carrying amount is a reasonable estimate of fair value because of the demand nature or short maturities of these instruments.

Investment Securities The fair value is measured using Level 2 valuations.

Loans The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

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. 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.

There were no transfers between Levels 1 and 2 of the fair value hierarchy for the nine months ended September 30, 2012 and 2011. No financial instruments are measured using Level 3 inputs for the Nine Months Ended September 30, 2012 and 2011.

Note 13 Subsequent Events

On October 15, 2012, the Company's board of directors declared a 10% stock dividend payable December 14, 2012 to shareholders of record December 5, 2012. Shareholders will receive one additional share of Cass stock for each 10 shares owned. No fractional shares will be issued. Shareholders will receive cash for any fractional shares owned based on the share price reported by NASDAQ at the close of trading December 5, 2012.

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 and Breda, Netherlands. The Company's services include freight invoice rating, payment processing, auditing, and the generation of accounting and transportation information. Cass also processes and pays utility invoices, which include electricity, gas, environmental and telecommunications expenses, and is a provider of telecom expense management solutions. Cass extracts, stores, and presents information from freight, utility, telecommunication and environmental invoices, assisting its customers' transportation, energy, environmental and information technology managers in making decisions that will enable them to improve operating performance. The Company receives data from multiple sources, electronic and otherwise, and processes the data to accomplish the specific operating requirements of its customers. It then provides the data in a central repository for access and archiving. The data is finally transformed into information through the Company's databases that allow client interaction as required and provide Internet-based tools for analytical processing. The Company also, through Cass Commercial Bank, its St. Louis, Missouri based bank subsidiary, provides banking/loan services in the St. Louis metropolitan area, Orange County, California, 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 churches and church-related 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, 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, utility, 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 2011 Annual Report on Form 10-K, a decline in the general level of interest rates can have a negative impact on net interest income.

In January 2011, Cass opened an office in Breda, Netherlands, to support the Company's multinational information processing clients. The revenues, expenditures and assets related to this office did not account for a significant portion of the Company's business during the nine months ended September 30, 2011 and 2012, and the current activities are not significant enough to pose substantial risk.

In January 2012, the Company acquired the assets of WRC, a provider of environmental expense management services. This acquisition positions the Company to expand its portfolio of services for controlling facility-related expenses and accelerates Cass' leadership position as a back-office business processor. The results of operations for this new service are included in the Information Services business segment.

In September 2012, the Company entered into a 10-year lease for office space in St. Louis County, Missouri, to relocate the Company's headquarters and the Bank's headquarters from 13001 Hollenberg Drive in Bridgeton, Missouri. The Company's headquarters will occupy 13,991 square feet in the Manchester/270 Office Center at 12444 Powerscourt Drive and the Bank's headquarters will occupy 10,564 square feet in the same center at 12412 Powerscourt Drive. The vacated 18,000 square feet at 13001 Hollenberg Drive will support the expansion of the transportation processing activities which are currently performed in 42,000 square feet of the building. The Bank branch will continue to occupy the remaining 1,500 square feet. The physical move is expected to occur in the first quarter of 2013.

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 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 our 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, we expect to continue to utilize the present processes.

Impairment of Assets. The Company periodically evaluates certain long-term assets such as intangible assets including goodwill, foreclosed assets and assets held for sale for impairment. Generally, these assets are initially recorded at cost, and recognition of impairment is required when events and circumstances indicate that the carrying amounts of these assets will not be recoverable in the future. If impairment occurs, various methods of measuring impairment may be called for depending on the circumstances and type of asset, including quoted market prices, estimates based on similar assets, and estimates based on valuation techniques such as discounted projected cash flows. The Company had no impairment of goodwill and intangible assets for the three or nine-month periods ended September 30, 2012 or for the fiscal year ended December 31, 2011, and management does not anticipate any future impairment loss. Investment securities available-for-sale are measured at fair value as calculated by an independent research firm. The market evaluation utilizes several sources which include observable inputs rather than significant unobservable inputs. These policies affect both segments of the Company and require significant management assumptions and estimates that could result in materially different results if conditions or underlying circumstances change.

Income Taxes. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in addressing the future tax consequences of events that have been recognized in the Company's financial statements or tax returns such as the realization of deferred tax assets or changes in tax laws or interpretations thereof. In addition, the Company is subject to the continuous examination of its income tax returns by the Internal Revenue Service and other taxing authorities. In accordance with FASB ASC 740, Income Taxes, the Company has unrecognized tax benefits related to tax positions taken or expected to be taken. See Note 10 to the consolidated financial statements contained herein.

Pension Plans. The amounts recognized in the consolidated financial statements related to pension plans are determined from actuarial valuations. Inherent in these valuations are assumptions, including expected return on plan assets, discount rates at which the liabilities could be settled at December 31, 2011, rate of increase in future compensation levels and mortality rates. These assumptions are updated annually and are disclosed in Note 10 to the consolidated financial statements filed with the Company's Annual Report on Form 10-K for the year ended December 31, 2011. There have been no significant changes in the Company's long-term rate of return assumptions for the past three fiscal years ended December 31, and management believes they are not reasonably likely to change in the future. Pursuant to FASB ASC 715,

Compensation Retirement Benefits, the Company has recognized the funded status of its defined benefit postretirement plan in its balance sheet and has recognized changes in that funded status through comprehensive income. The funded status is measured as the difference between the fair value of the plan assets and the projected benefit obligation as of the date of its fiscal year-end.

Results of Operations

The following paragraphs more fully discuss the results of operations and changes in financial condition for the three-month period ended September 30, 2012 (Third Quarter of 2012) compared to the three-month period ended September 30, 2011 (Third Quarter of 2011) and the nine-month period ended September 30, 2012 (Nine Months Ended 2012) compared to the nine-month period ended September 30, 2011 (Nine Months Ended 2011). The following discussion and analysis should be read in conjunction with the 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 2011 Annual Report on Form 10-K. Results of operations for the Third Quarter of 2012 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:

	Third Quarter of			Nine Months Ended		
			%			%
(In thousands except per share data)	2012	2011	Change	2012	2011	Change
Net income	\$ 6,092	\$ 6,060	.5%	\$ 17,962	\$ 17,518	2.5%
Diluted earnings per share	\$.58	\$.58		\$ 1.71	\$ 1.68	1.8%
Return on average assets	1.76%	1.79%		1.79%	1.83%	
Return on average equity	14.29%	15.52%		14.50%	15.75%	

Fee Revenue and Other Income

The Company's fee revenue is derived mainly from transportation and utility processing and payment 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 related to fees and accounts and drafts payable were as follows:

	Third Quarter of			Nine Months Ended		
			%			%
(In thousands except per share data)	2012	2011	Change	2012	2011	Change
Transportation core invoice transaction volume*	7,302	7,482	(2.4)%	21,470	21,281	.9%
Transportation invoice dollar volume	\$ 5,599,551	\$ 5,443,972	2.9%	\$ 16,647,242	\$ 15,273,046	9.0%
Utility transaction volume	3,443	3,410	1.0%	10,472	10,108	3.6%
Utility transaction dollar volume	\$ 2,783,505	\$ 2,936,417	(5.2)%	\$ 7,829,235	\$ 8,184,747	(4.3)%
Payment and processing fees	\$ 16,600	\$ 15,806	5.0%	\$ 49,712	\$ 45,372	9.6%

*Core invoices exclude parcel shipments.

Third Quarter of 2012 compared to Third Quarter of 2011:

Transportation transaction volume was down 2.4% primarily due to the current sluggish economic environment and utility transaction volume was up only 1.0% for the quarter. Transportation dollar volumes were up 2.9%. Utility dollar volumes were down 5.2% due to lower rates for electricity and natural gas.

Bank service fees decreased \$3,000, or less than 1%, due to a decrease in letter of credit fees. There were \$267,000 gains on sales of securities in the Third Quarter of 2012.

Edgar Filing: CASS INFORMATION SYSTEMS INC - Form 10-Q

Nine Months Ended 2012 compared to Nine Months Ended 2011:

Transportation and utility transaction volumes were up .9% and 3.6%, respectively. Transportation dollar volumes were up 9.0% due to new business and improved activity for existing customers. Utility dollar volumes were down 4.3% due to lower rates for electricity and natural gas.

Bank service fees decreased \$128,000, or 12.4%, due to decreased letter of credit fees. There were \$2,401,000 gains on sales of securities in the Nine Months Ended 2012.

Net Interest Income

Net interest income is the difference between interest earned on loans, investments, and other earning assets and interest expense on deposits and other interest-bearing liabilities. Net interest income is a significant source of the Company's revenues. The following table summarizes the changes in net interest income and related factors:

	Third Quarter of			Nine Months Ended		
			%			%
(In thousands)	2012	2011	Change	2012	2011	Change
Average earnings assets	\$ 1,229,687	\$ 1,219,184	.9%	\$ 1,199,950	\$ 1,172,182	2.4%
Average interest-bearing liabilities	406,604	407,067	(.1)%	400,533	403,902	(.8)%
Net interest income*	11,922	12,768	(6.6)%	36,111	38,818	(7.0)%
Net interest margin*	3.86%	4.15%		4.02%	4.43%	
Yield on earning assets*	4.11%	4.50%		4.29%	4.81%	
Rate on interest-bearing liabilities	.77%	1.03%		.79%	1.12%	

*Presented on a tax-equivalent basis assuming a tax rate of 35%.

Third Quarter of 2012 compared to Third Quarter of 2011:

Third Quarter 2012 average earning assets increased .9% compared to the same period in the prior year (see discussion in the following paragraphs). The yield on earning assets and the tax equivalent net interest margin both decreased in 2012 as the general level of interest rates remained low.

Total average loans decreased \$8,109,000, or 1.2%, to \$679,043,000 for the Third Quarter of 2012 as compared to the Third Quarter of 2011. This decrease was attributable to intense competition from other lenders and several large pay-offs. Average investment securities increased \$63,922,000, or 24.9%, to \$321,076,000, as the Company took advantage of buying opportunities in the market.

Total average interest-bearing deposits for the Third Quarter of 2012 decreased \$463,000, or less than 1%, to \$406,604,000 compared to the Third Quarter of 2011. Average accounts and drafts payable decreased \$537,000, or less than 1%, as freight and utility payment processing activities remained steady in the current sluggish economic environment.

Nine Months Ended 2012 compared to Nine Months Ended 2011:

Nine Months Ended 2012 average earning assets increased 2.4% compared to the same period in the prior year (see discussion in the following paragraphs). The yield on earning assets and the tax equivalent net interest margin both decreased in 2012 as the general level of interest rates remained low.

Total average loans decreased \$15,818,000, or 2.3%, to \$685,198,000 for the Nine Months Ended 2012 as compared to the Nine Months Ended 2011. This decrease was attributable to the intense competition from other lenders. Average investment securities increased \$45,907,000, or 17.8%, to \$303,639,000, as the Company took advantage of buying opportunities in the market.

Total average interest-bearing deposits for the Nine Months Ended 2012 decreased \$3,368,000, or less than 1%, to \$400,533,000 compared to the Nine Months Ended 2011. Average accounts and drafts payable increased \$31,142,000, or 5.3%, as freight and utility payment processing activities increased.

For more information on the changes in net interest income, please refer to the tables that follow.

-21-

Distribution of Assets, Liabilities and Shareholders' Equity; Interest Rate and Interest Differential

The following tables show the condensed average balance sheets for each of the periods reported, the tax-equivalent interest income and expense on each category of interest-earning assets and interest-bearing liabilities, and the average yield on such categories of interest-earning assets and the average rates paid on such categories of interest-bearing liabilities for each of the periods reported.

(In thousands)	Third Quarter of 2012			Third Quarter of 2011		
	Average Balance	Interest Income/Expense	Yield/Rate	Average Balance	Interest Income/Expense	Yield/Rate
Assets¹						
Earning assets						
Loans ^{2, 3} :						
Taxable	\$ 678,377	\$ 8,819	5.17%	\$ 686,324	\$ 9,825	5.68%
Tax-exempt ⁴	666	1	.60	828	4	1.92
Investment securities ⁵ :						
Taxable	1,030	1	.39	1,029	5	1.93
Tax-exempt ⁴	309,885	3,746	4.81	256,125	3,808	5.90
Certificates of deposit	10,161	15	.59			
Interest-bearing deposits in other financial institutions	99,678	25	.10	118,275	94	.32
Federal funds sold and other short-term investments	129,890	100	.31	156,603	92	.23
Total earning assets	1,229,687	12,707	4.11	1,219,184	13,828	4.50
Non-earning assets						
Cash and due from banks	12,597			12,618		
Premise and equipment, net	9,444			9,897		
Bank-owned life insurance	14,688			14,263		
Goodwill and other intangibles	15,582			7,674		
Other assets	104,588			94,032		
Allowance for loan losses	(12,586)			(13,295)		
Total assets	\$ 1,374,000			\$ 1,344,373		
Liabilities and Shareholders' Equity						
Interest-bearing liabilities						
Interest-bearing demand deposits	\$ 256,390	\$ 444	.69%	\$ 239,288	\$ 538	.89%
Savings deposits	26,018	46	.70	25,073	52	.82
Time deposits >= \$100	38,882	99	1.01	52,080	171	1.30
Other time deposits	85,314	196	.91	90,626	299	1.31
Total interest-bearing deposits	406,604	785	.77	407,067	1,060	1.03
Short-term borrowings & other						
Total interest bearing liabilities	406,604	785	.77	407,067	1,060	1.03
Non-interest bearing liabilities						
Demand deposits	138,808			132,757		
Accounts and drafts payable	639,467			640,004		
Other liabilities	19,496			9,664		
Total liabilities	1,204,375			1,189,492		
Shareholders' equity	169,625			154,881		
Total liabilities and shareholders' equity	\$ 1,374,000			\$ 1,344,373		
Net interest income		\$ 11,922			\$ 12,768	
Net interest margin			3.86%			4.15%
Interest spread			3.34			3.47

1. Balances shown are daily averages.

2.

Edgar Filing: CASS INFORMATION SYSTEMS INC - Form 10-Q

For purposes of these computations, nonaccrual loans are included in the average loan amounts outstanding. Interest on nonaccrual loans is recorded when received as discussed further in Note 1 to the Company's 2011 consolidated financial statements, filed with the Company's 2011 Annual Report on Form 10-K.

3. Interest income on loans includes net loan fees of \$70,000 and \$96,000 for the Third Quarter of 2012 and 2011, respectively.
4. Interest income is presented on a tax-equivalent basis assuming a tax rate of 35%. The tax-equivalent adjustment was approximately \$1,312,000 and \$1,334,000 for the Third Quarter of 2012 and 2011, respectively.
5. For purposes of these computations, yields on investment securities are computed as interest income divided by the average amortized cost of the investments.

-22-

	Nine Months Ended 2012			Nine Months Ended 2011		
	Average	Interest	Yield/	Average	Interest	Yield/
(In thousands)	Balance	Income/ Expense	Rate	Balance	Income/ Expense	Rate
Assets¹						
Earning assets						
Loans ^{2, 3} :						
Taxable	\$ 684,512	\$ 26,719	5.21%	\$ 700,122	\$ 30,199	5.77%
Tax-exempt ⁴	686	4	.78	894	15	2.24
Investment securities ⁵ :						
Taxable	1,009	16	2.12	987	24	3.25
Tax-exempt ⁴	296,755	11,366	5.12	256,745	11,461	5.97
Certificates of deposit	5,875	23	.52			
Interest-bearing deposits in other financial institutions	117,319	272	.31	89,572	242	.36
Federal funds sold and other short-term investments	93,794	94	.13	123,862	268	.29
Total earning assets	1,199,950	38,494	4.29	1,172,182	42,209	4.81
Non-earning assets						
Cash and due from banks	12,361			12,283		
Premise and equipment, net	9,472			9,774		
Bank-owned life insurance	14,558			14,302		
Goodwill and other intangibles	14,814			7,701		
Other assets	101,480			79,226		
Allowance for loan losses	(12,841)			(12,640)		
Total assets	\$ 1,339,794			\$ 1,282,828		
Liabilities and Shareholders' Equity						
Interest-bearing liabilities						
Interest-bearing demand deposits	\$ 252,938	\$ 1,293	.68%	\$ 225,929	\$ 1,646	.97%
Savings deposits	23,456	122	.69	24,496	174	.95
Time deposits >= \$100	41,252	357	1.16	52,906	532	1.34
Other time deposits	82,887	611	.98	100,570	1,039	1.38
Total interest-bearing deposits	400,533	2,383	.79	403,901	3,391	1.12
Short-term borrowings & other				1		
Total interest bearing liabilities	400,533	2,383	.79	403,902	3,391	1.12
Non-interest bearing liabilities						
Demand deposits	136,101			130,191		
Accounts and drafts payable	619,349			588,207		
Other liabilities	18,386			11,793		
Total liabilities	1,174,369			1,134,093		
Shareholders' equity	165,425			148,735		
Total liabilities and shareholders' equity	\$ 1,339,794			\$ 1,282,828		
Net interest income		\$ 36,111			\$ 38,818	
Net interest margin			4.02%			4.43%
Interest spread			3.50			3.69

- Balances shown are daily averages.
- For purposes of these computations, nonaccrual loans are included in the average loan amounts outstanding. Interest on nonaccrual loans is recorded when received as discussed further in Note 1 to the Company's 2011 consolidated financial statements, filed with the Company's 2011 Annual Report on Form 10-K.
- Interest income on loans includes net loan fees of \$219,000 and \$474,000 for the Nine Months Ended 2012 and 2011, respectively.
- Interest income is presented on a tax-equivalent basis assuming a tax rate of 35%. The tax-equivalent adjustment was approximately \$3,980,000 and \$4,016,000 for the Nine Months Ended 2012 and 2011, respectively.
- For purposes of these computations, yields on investment securities are computed as interest income divided by the average amortized cost of the investments.

Analysis of Net Interest Income Changes

The following tables present the changes in interest income and expense between periods due to changes in volume and interest rates. That portion of the change in interest attributable to the combined rate/volume variance has been allocated to rate and volume changes in proportion to the absolute dollar amounts of the change in each.

<i>(In thousands)</i>	Third Quarter of 2012 Over Third Quarter of 2011		
	Volume	Rate	Total
Increase (decrease) in interest income:			
Loans ^{1, 2} :			
Taxable	\$ (115)	\$ (891)	\$ (1,006)
Tax-exempt ³	(1)	(2)	(3)
Investment securities:			
Taxable		(4)	(4)
Tax-exempt ³	715	(777)	(62)
Certificates of deposit	15		15
Interest-bearing deposits in other financial institutions	(13)	(56)	(69)
Federal funds sold and other short-term investments	(18)	26	8
Total interest income	583	(1,704)	(1,121)
Interest expense on:			
Interest-bearing demand deposits	36	(130)	(94)
Savings deposits	2	(8)	(6)
Time deposits of >=\$100	(38)	(34)	(72)
Other time deposits	(17)	(86)	(103)
Total interest expense	(17)	(258)	(275)
Net interest income	\$ 600	\$ (1,446)	\$ (846)

1. Average balances include nonaccrual loans.
2. Interest income includes net loan fees.
3. Interest income is presented on a tax-equivalent basis assuming a tax rate of 35%.

<i>(In thousands)</i>	Nine Months Ended 2012 Over Nine Months Ended 2011		
	Volume	Rate	Total
Increase (decrease) in interest income:			
Loans ^{1, 2} :			
Taxable	\$ (657)	\$ (2,823)	\$ (3,480)
Tax-exempt ³	(3)	(8)	(11)
Investment securities:			
Taxable	1	(9)	(8)
Tax-exempt ³	1,665	(1,760)	(95)
Certificates of deposit	23		23
Interest-bearing deposits in other financial institutions	68	(38)	30
Federal funds sold and other short-term investments	(54)	(120)	(174)
Total interest income	1,043	(4,758)	(3,715)
Interest expense on:			
Interest-bearing demand deposits	181	(534)	(353)
Savings deposits	(7)	(45)	(52)
Time deposits of >= \$100	(107)	(68)	(175)
Other time deposits	(163)	(265)	(428)
Total interest expense	(96)	(912)	(1,008)
Net interest income	\$ 1,139	\$ (3,846)	\$ (2,707)

1. Average balances include nonaccrual loans.
2. Interest income includes net loan fees.
3. Interest income is presented on a tax-equivalent basis assuming a tax rate of 35%.

Provision and Allowance for Loan Losses

A significant determinant of the Company's operating results is the provision for loan losses. Provision for loan losses during the Third Quarter of 2012 and Third Quarter of 2011, were \$0 and \$550,000, respectively. During the Nine Months Ended 2012 and the Nine Months Ended 2011, the provision for loan losses were \$800,000 and \$1,850,000, respectively. As discussed below, the Company continually analyzes the outstanding loan portfolio based on the performance, financial condition and collateralization of the credits. There were net loan charge-offs of \$302,000 in the Third Quarter of 2012 compared to net loan charge-offs of \$768,000 for the same period in 2011. There were \$1,433,000 net loan charge-offs in the Nine Months Ended 2012 and \$731,000 in net loan charge-offs in the Nine Months Ended 2011.

The allowance for loan losses at September 30, 2012 was \$12,321,000 and at December 31, 2011 was \$12,954,000. The ratio of allowance for loan losses to total loans outstanding at September 30, 2012 was 1.81% compared to 1.93% at December 31, 2011. Nonperforming loans were \$4,893,000, or .72%, of total loans at September 30, 2012 compared to \$1,738,000, or .26%, of total loans at December 31, 2011. These loans, which are also considered impaired, consisted of five nonaccrual loans at September 30, 2012. Nonperforming loans at December 31, 2011 also consisted of five nonaccrual loans. Total nonaccrual loans increased \$2,968,000 from September 30, 2011 to September 30, 2012, primarily due to the addition of two loans offset by the charge-off of one loan.

In addition to the loans discussed above, at September 30, 2012, loans totaling \$13,375,000 not included in the table below were identified by management as subject to special monitoring. These loans possess some credit deficiency or potential weakness which requires a high level of management attention.

The allowance for loan losses has been established and is maintained to absorb probable losses in the loan portfolio. An ongoing assessment of risk of loss is performed to determine if the current balance of the allowance is adequate to cover probable losses in the portfolio. A charge or credit is made to expense to cover any deficiency or reduce any excess. The current methodology employed to determine the appropriate allowance consists of two components, specific and general. The Company develops specific allowances on commercial, commercial real estate, and construction loans based on individual review of these loans and an estimate of the borrower's ability to repay the loan given the availability of collateral, other sources of cash flow and collection options available. The general component relates to all other loans, which are evaluated based on loan grade. The loan grade assigned to each loan is typically evaluated on an annual basis, unless circumstances require interim evaluation. The Company assigns an allowance amount consistent with each loan's rating category. The allowance amount is based on derived loss experience over prescribed periods. In addition to the amounts derived from the loan grades, a portion is added to the general allowance to take into account other factors including national and local economic conditions; downturns in specific industries including loss in collateral value; trends in credit quality at the Company and in the banking industry; and trends in risk rating changes. As part of their examination process, federal and state agencies review the Company's methodology for maintaining the allowance for loan losses and the related balance. These agencies may require the Company to increase the allowance for loan losses based on their judgments and interpretations about information available to them at the time of their examination.

Summary of Asset Quality

The following table presents information on the Company's provision for loan losses and analysis of the allowance for loan losses:

(In thousands)	Third Quarter of		Nine Months Ended	
	2012	2011	2012	2011
Allowance at beginning of period	\$ 12,623	\$ 13,228	\$ 12,954	\$ 11,891
Provision charged to expense		550	800	1,850
Loans charged off	(303)	(769)	(1,542)	(769)
Recoveries on loans previously charged off	1	1	109	38
Net loans charged off	(302)	(768)	(1,433)	(731)
Allowance at end of period	\$ 12,321	\$ 13,010	\$ 12,321	\$ 13,010
Loans outstanding:				
Average	\$ 679,043	\$ 687,152	\$ 687,151	\$ 701,016
September 30	681,174	692,385	681,174	692,385
Ratio of allowance for loan losses to loans outstanding:				
Average	1.81%	1.89%	1.80%	1.86%
September 30	1.81	1.88	1.81	1.88
Impaired loans:				
Nonaccrual loans	\$ 4,893	\$ 1,925	\$ 4,893	\$ 1,925
Loans past due 90 days or more				
Troubled debt restructurings		4,483		4,483
Total impaired loans	\$ 4,893	\$ 6,408	\$ 4,893	\$ 6,408
Foreclosed assets	1,322	1,910	1,322	1,910
Impaired loans as percentage of average loans	.72%	.93%	.71%	.91%

The Bank had two properties carried as other real estate owned of \$1,322,000 as of September 30, 2012 and two properties carried as other real estate owned of \$1,910,000 as of September 30, 2011.

Operating Expenses

Total operating expenses for the Third Quarter of 2012 were up 5.4%, or \$1,016,000, compared to the Third Quarter of 2011 and for the Nine Months Ended 2012 were up 8.7%, or \$4,828,000, from the Nine Months Ended 2011, primarily due to costs related to the integration of the Company's new environmental expense service line following its acquisition of WRC in January 2012.

Salaries and benefits expense for the Third Quarter of 2012 increased \$1,494,000 to \$15,919,000 compared to the Third Quarter of 2011 and increased \$4,701,000 to \$46,978,000 for the Nine Months Ended 2012 compared to the Nine Months Ended 2011 due to higher payroll and pension expense.

Occupancy expense for the Third Quarter of 2012 decreased \$84,000 to \$497,000 from the Third Quarter of 2011 and decreased \$198,000, or 11.1%, for the Nine Months Ended 2012 from the Nine Months Ended 2011 due to lower rent, maintenance and repairs expenses associated with the consolidation of bank branches.

Equipment expense for the Third Quarter of 2012 decreased \$7,000, or less than 1%, compared to the Third Quarter of 2011. Equipment expense increased \$45,000, or 1.7%, for the Nine Months Ended 2012 from the Nine Months Ended 2011 due to increased software license and maintenance expenses.

Amortization of intangible assets increased \$121,000 for the Third Quarter of 2012 and \$353,000 for the Nine Months Ended 2012 as compared to the prior year periods due to the purchase of the assets of WRC.

Other operating expenses for the Third Quarter of 2012 decreased \$508,000, or 17.0%, compared to the Third Quarter of 2011. Primary decreases were due to the receipt of state escheatment refunds for uncashed checks and decreased legal expenses. Other operating expense decreased \$73,000 for the Nine Months Ended 2012 compared to the Nine Months Ended 2011 due to decreases in FDIC insurance and the receipt of state escheatment refunds, offset by increases in promotional expenses.

Edgar Filing: CASS INFORMATION SYSTEMS INC - Form 10-Q

Income tax expense for the Third Quarter of 2012 decreased \$468,000, or 19.9%, compared to the Third Quarter of 2011 and decreased \$534,000 for the Nine Months Ended 2012 compared to the Nine Months Ended 2011. The effective tax rate was 23.7% and 28.0% for the Third Quarters of 2012 and 2011, respectively, and was 25.9% and 28.0% for the nine months ended September 30, 2012 and 2011, respectively, primarily due to reductions in state income taxes.

-26-

Financial Condition

Total assets at September 30, 2012 were \$1,391,235,000, an increase of \$71,934,000, or 5.5%, from December 31, 2011. The most significant change in asset balances during this period was an increase of \$56,907,000 in securities. Changes in cash and cash equivalents reflect the Company's daily liquidity position and are affected by the changes in the other asset balances and changes in deposit and accounts and drafts payable balances.

Total liabilities at September 30, 2012 were \$1,216,660,000, an increase of \$57,907,000, or 5.0%, from December 31, 2011. Total deposits at September 30, 2012 were \$548,334,000, a decrease of \$34,000, or less than 1%, from December 31, 2011. Accounts and drafts payable at September 30, 2012 were \$648,944,000, an increase of \$53,743,000, or 9.0%, from December 31, 2011. Total shareholders' equity at September 30, 2012 was \$174,575,000, a \$14,027,000, or 8.7%, increase from December 31, 2011.

Accounts and drafts payable will fluctuate from period-end to period-end due to the payment processing cycle, which results in lower balances on days when checks clear and higher balances on days when checks are issued. For this reason, average balances are a more meaningful measure of accounts and drafts payable (for average balances refer to the tables under the Distribution of Assets, Liabilities and Shareholders Equity; Interest Rate and Interest Differential section of this report).

The increase in total shareholders' equity of \$14,027,000 resulted from net income of \$17,962,000, stock-based compensation expense of \$729,000 and \$634,000 in other comprehensive income offset by dividends paid of \$5,298,000.

Liquidity and Capital Resources

The balance of liquid assets consists of cash and cash equivalents, which include cash and due from banks, interest-bearing deposits in other financial institutions, federal funds sold and money market funds, and was \$219,806,000 at September 30, 2012, a decrease of \$16,156,000, or 6.8%, from December 31, 2011. At September 30, 2012, these assets represented 15.8% of total assets. These funds are the Company's and its subsidiaries' primary source of liquidity to meet future expected and unexpected loan demand, depositor withdrawals or reductions in accounts and drafts payable.

Secondary sources of liquidity include the investment portfolio and borrowing lines. Total investment in securities was \$367,519,000 at September 30, 2012, an increase of \$56,907,000 from December 31, 2011. These assets represented 26.4% of total assets at September 30, 2012. Of this total, 96% were state and political subdivision securities. Of the total portfolio, 5.2% mature in one year, 18.2% mature in one to five years, and 76.6% mature in five or more years.

The Bank has unsecured lines of credit at correspondent banks to purchase federal funds up to a maximum of \$88,000,000 at the following banks: Bank of America, \$20,000,000; US Bank, \$20,000,000; Wells Fargo Bank, \$15,000,000; Frost National Bank, \$10,000,000; PNC Bank, \$12,000,000; UMB Bank, \$5,000,000; and JPM Chase Bank, \$6,000,000. The Bank also had secured lines of credit with the Federal Home Loan Bank of \$127,361,000 collateralized by commercial mortgage loans. There were no amounts outstanding under any line of credit as of September 30, 2012 or December 31, 2011.

The deposits of the Company's banking subsidiary have historically been stable, consisting of a sizable volume of core deposits related to customers that utilize other commercial products of the Bank. The accounts and drafts payable generated by the Company has also historically been a stable source of funds. The Company is part of the Certificate of Deposit Account Registry Service (CDARS). Time deposits include \$91,989,000 of CDARS deposits which offer the Bank's customers the ability to maximize FDIC insurance coverage. The Company uses this program to retain or attract deposits from existing customers.

Net cash flows provided by operating activities were \$24,995,000 for the Nine Months Ended 2012, compared with \$23,028,000 for the Nine Months Ended 2011, an increase of \$1,967,000. This increase is attributable to the increase in net income of \$444,000, the increase in depreciation and amortization of \$1,645,000 offset by the increase in gains on sales of securities of \$2,353,000 plus the other normal fluctuations in asset and liability accounts. Net cash flows from investing and financing activities fluctuate greatly as the Company actively manages its investment and loan portfolios and customer activity influences changes in deposit and accounts and drafts payable balances. Other causes for the changes in these account balances are discussed earlier in this report. Due to the daily fluctuations in these account balances, the analysis of changes in average balances, also discussed earlier in this report, can be more indicative of underlying activity than the period-end balances used in the statements of cash flows. Management anticipates that cash and cash equivalents, maturing investments and cash from operations will continue to be sufficient to fund the Company's operations and capital expenditures in 2012, which are estimated to be less than \$3,000,000.

The Company faces market risk to the extent that its net interest income and fair market value of equity are affected by changes in market interest rates. For information regarding the market risk of the Company's financial instruments, see Item 3, Quantitative and Qualitative Disclosures about Market Risk.

There are several trends and uncertainties that may impact the Company's ability to generate revenues and income at the levels that it has in the past. In addition, these trends and uncertainties may impact available liquidity. Those that could significantly impact the Company include the general levels of interest rates, business activity, and energy costs as well as new business opportunities available to the Company.

As a financial institution, a significant source of the Company's earnings is generated from net interest income. Therefore, the prevailing interest rate environment is important to the Company's performance. A major portion of the Company's funding sources are the non-interest bearing accounts and drafts payable generated from its payment and information processing services. Accordingly, higher levels of interest rates will generally allow the Company to earn more net interest income. Conversely, a lower interest rate environment will generally tend to depress net interest income. The Company actively manages its balance sheet in an effort to maximize net interest income as the interest rate environment changes. This balance sheet management impacts the mix of earning assets maintained by the Company at any point in time. For example, in the lower interest rate environment currently faced by the Company, short-term, relatively lower rate liquid investments are reduced in favor of longer-term relatively higher yielding investments and loans.

The overall level of economic activity can have a significant impact on the Company's ability to generate revenues and income, as the volume and size of customer invoices processed may increase or decrease. Higher levels of economic activity increase both fee income (as more invoices are processed) and balances of accounts and drafts payable.

The relative level of energy costs can impact the Company's earnings and available liquidity. Higher levels of energy costs will tend to increase transportation and utility invoice amounts resulting in a corresponding increase in accounts and drafts payable. Increases in accounts and drafts payable generate higher interest income and improve liquidity.

New business opportunities are an important component of the Company's strategy to grow earnings and improve performance. Generating new customers allows the Company to leverage existing systems and facilities and grow revenues faster than expenses.

Risk-based capital guidelines require the Company to meet a minimum total capital ratio of 8.0%, of which at least 4.0% must consist of Tier 1 capital. Tier 1 capital generally consists of (a) common shareholders' equity (excluding the unrealized market value adjustments on the available-for-sale securities), (b) qualifying perpetual preferred stock and related surplus subject to certain limitations specified by the FDIC, (c) minority interests in the equity accounts of consolidated subsidiaries less (d) goodwill, (e) mortgage servicing rights within certain limits, and (f) any other intangible assets and investments in subsidiaries that the FDIC determines should be deducted from Tier 1 capital. The FDIC also requires a minimum leverage ratio of 3.0%, defined as the ratio of Tier 1 capital less purchased mortgage servicing rights to total assets, for banking organizations deemed the strongest and most highly rated by banking regulators. A higher minimum leverage ratio is required of less highly-rated banking organizations. Total capital, a measure of capital adequacy, includes Tier 1 capital, allowance for loan losses, and debt considered equity for regulatory capital purposes.

Edgar Filing: CASS INFORMATION SYSTEMS INC - Form 10-Q

The Company and the Bank continue to exceed all regulatory capital requirements, as evidenced by the following capital amounts and ratios:

<i>(In thousands)</i>	September 30, 2012		December 31, 2011	
	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)				
Cass Information Systems, Inc.	\$ 172,440	19.11%	\$ 166,605	19.03%
Cass Commercial Bank	73,586	13.73%	66,851	12.71%
Tier I capital (to risk-weighted assets)				
Cass Information Systems, Inc.	\$ 161,149	17.86%	\$ 155,638	17.78%
Cass Commercial Bank	66,860	12.47%	60,248	11.46%
Tier I capital (to average assets)				
Cass Information Systems, Inc.	\$ 161,149	11.86%	\$ 155,638	11.53%
Cass Commercial Bank	66,860	10.47%	60,248	9.49%

Inflation

The Company's assets and liabilities are primarily monetary, consisting of cash, cash equivalents, securities, loans, payables and deposits. Monetary assets and liabilities are those that can be converted into a fixed number of dollars. The Company's consolidated balance sheet reflects a net positive monetary position (monetary assets exceed monetary liabilities). During periods of inflation, the holding of a net positive monetary position will result in an overall decline in the purchasing power of a company. Management believes that replacement costs of equipment, furniture, and leasehold improvements will not materially affect operations. The rate of inflation does affect certain expenses, such as those for employee compensation, which may not be readily recoverable in the price of the Company's services.

Impact of New and Not Yet Adopted Accounting Pronouncements

None.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As described in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, the Company manages its interest rate risk through measurement techniques that include gap analysis and a simulation model. As part of the risk management process, asset/liability management policies are established and monitored by management. The policy objective is to limit the change in annualized net interest income to 15% from an immediate and sustained parallel change in interest rates of 200 basis points. Based on the Company's most recent evaluation, management does not believe the Company's risk position at September 30, 2012 has changed materially from that at December 31, 2011.

ITEM 4. CONTROLS AND PROCEDURES

The Company's management, under the supervision and with the participation of the principal executive officer and the principal financial officer, evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report and concluded that, as of such date, these controls and procedures were effective.

There were no changes in the Third Quarter of 2012 in the Company's internal control over financial reporting identified by the Company's principal executive officer and principal financial officer in connection with their evaluation that materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended).

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company has included in Part I, Item 3 of its Annual Report on Form 10-K for the year ended December 31, 2011 disclosure regarding certain legal proceedings. There were no material developments with regard to these disclosed proceedings during the three-month period ended September 30, 2012. All other legal proceedings and actions involving the Company are of an ordinary and routine nature and are incidental to the operations of the Company. Management believes the outcome of all proceedings will not have a material effect on the businesses or financial conditions of the Company or its subsidiaries.

ITEM 1A. RISK FACTORS

The Company has included in Part I, Item 1A of its Annual Report on Form 10-K for the year ended December 31, 2011, a description of certain risks and uncertainties that could affect the Company's business, future performance or financial condition (the "Risk Factors"). There are no material changes to the Risk Factors as disclosed in the Company's 2011 Annual Report on Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

- (a) None.
- (b) There have been no material changes to the procedures by which security holders may recommend nominees to the Company's Board of Directors implemented in the Third Quarter of 2012.

ITEM 6. EXHIBITS

Cass Information Systems, Inc. 401(k) Plan (filed as Exhibit 10.1 to the Registration Statement on Form S-8 filed with the Commission on May 30, 2012 and incorporated herein by reference).

Exhibit 31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 31.2 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit 32.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit 101.INS XBRL Instance Document

Exhibit 101.SCH XBRL Taxonomy Extension Schema Document

Exhibit 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

Exhibit 101.LAB XBRL Taxonomy Extension Label Linkbase Document

Exhibit 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

Exhibit 101.DEF XBRL Taxonomy Extension Definition Linkbase Document

-31-

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CASS INFORMATION SYSTEMS, INC.

DATE: November 2, 2012

By /s/ Eric H. Brunngraber
Eric H. Brunngraber
President and Chief Executive Officer
(Principal Executive Officer)

DATE: November 2, 2012

By /s/ P. Stephen Appelbaum
P. Stephen Appelbaum
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)