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

FORM 10-Q

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

For the quarterly period ended September 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______________ to ______________

Commission File No. 000-20827

CASS INFORMATION SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes X No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes X No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer X Accelerated Filer

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

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

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

The number of shares outstanding of the registrant's only class of common stock as of October 30, 2018: Common stock, par value $.50 per share – 12,289,377 shares outstanding.

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Forward-looking Statements - Factors That May Affect Future Results

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

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 2018 (Unaudited)	December 31, 2017
Assets		
Cash and due from banks	$ 11,835	$ 17,422
Interest-bearing deposits in other financial institutions	145,803	152,056
Federal funds sold and other short-term investments	22,409	58,632
Cash and cash equivalents	180,047	228,110
Securities available-for-sale, at fair value	446,440	470,523
Loans	726,239	686,231
Less: Allowance for loan losses	10,220	10,205
Loans, net	716,019	676,026
Premises and equipment, net	22,615	21,586
Investment in bank-owned life insurance	17,270	16,927
Payments in excess of funding	161,080	139,103
Goodwill	12,569	12,569
Other intangible assets, net	1,664	1,996
Other assets	120,543	90,369
Total assets	$ 1,678,247	$ 1,657,209
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 270,395	$ 281,541
Interest-bearing	364,329	396,547
Total deposits	634,724	678,088
Accounts and drafts payable	769,638	715,888
Other liabilities	44,543	38,145
Total liabilities	1,448,905	1,432,121
Shareholders' Equity:		
Preferred stock, par value $.50 per share; 2,000,000 shares authorized and no shares issued	–	–
Common stock, par value $.50 per share; 40,000,000 shares authorized and 13,047,997 shares issued at September 30, 2018 and December 31, 2017	6,524	6,524
Additional paid-in capital	204,971	204,631
Retained earnings	73,183	59,314
Common shares in treasury, at cost (746,260 shares at September 30, 2018 and 760,962 shares at December 31, 2017)	(32,029)	(32,061)
Accumulated other comprehensive loss	(23,307)	(13,320)
Total shareholders' equity	229,342	225,088
Total liabilities and shareholders' equity	$ 1,678,247	$ 1,657,209

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
Fee Revenue and Other Income:				
Information services payment and processing revenue	$ 26,020	$ 23,761	$ 76,068	$ 69,332
Bank service fees	300	327	994	998
Losses on sales of securities	—	—	(42)	—
Other	115	119	429	448
Total fee revenue and other income	26,435	24,207	77,449	70,778
Interest Income:				
Interest and fees on loans	8,367	7,209	23,832	21,266
Interest and dividends on securities:				
Taxable	618	107	1,428	268
Exempt from federal income taxes	2,111	2,605	7,008	7,865
Interest on federal funds sold and other short-term investments	1,119	744	2,748	1,597
Total interest income	12,215	10,665	35,016	30,996
Interest Expense:				
Interest on deposits	1,029	571	2,502	1,521
Net interest income	11,186	10,094	32,514	29,475
Provision for loan losses	—	—	—	—
Net interest income after provision for loan losses	11,186	10,094	32,514	29,475
Total net revenue	37,621	34,301	109,963	100,253
Operating Expense:				
Personnel	21,747	19,423	63,718	57,384
Occupancy	975	903	2,754	2,634
Equipment	1,434	1,242	4,150	3,746
Amortization of intangible assets	110	110	331	317
Other operating expense	4,264	3,364	11,222	10,180
Total operating expense	28,530	25,042	82,175	74,261
Income before income tax expense	9,091	9,259	27,788	25,992
Income tax expense	1,481	2,396	4,577	6,309
Net income	$ 7,610	$ 6,863	$ 23,211	$ 19,683
Basic earnings per share	$ .62	$ .56	$ 1.90	$ 1.61
Diluted earnings per share	.61	.55	1.87	1.58

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
Comprehensive income:				
Net income	$ 7,610	$ 6,863	$ 23,211	$ 19,683
Other comprehensive income:				
Net unrealized (loss) gain on securities available-for-sale	(2,835)	(99)	(13,029)	8,246
Tax effect	675	37	3,101	(3,063)
Reclassification adjustments for losses included in net income	—	—	42	—
Tax effect	—	—	(10)	—
Foreign currency translation adjustments	(21)	41	(91)	143
Total comprehensive income	$ 5,429	$ 6,842	$ 13,224	$ 25,009

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,	
	2018	**2017**
Cash Flows From Operating Activities:		
Net income	$ 23,211	$ 19,683
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,524	8,361
Net losses on sales of securities	42	—
Stock-based compensation expense	2,238	1,658
Increase in income tax liability	773	551
Increase in pension liability	3,688	3,476
Decrease (increase) in accounts receivable	4,027	(3,637)
Other operating activities, net	(3,707)	(2,156)
Net cash provided by operating activities	38,796	27,936
Cash Flows From Investing Activities:		
Proceeds from sales of securities available-for-sale	58,520	—
Proceeds from maturities of securities available-for-sale	26,041	33,856
Purchase of securities available-for-sale	(78,772)	(97,473)
Net (increase) decrease in loans	(39,993)	6,803
Net increase in payments in excess of funding	(21,977)	(14,455)
Purchases of premises and equipment, net	(3,956)	(2,780)
Net cash used in investing activities	(60,137)	(74,049)
Cash Flows From Financing Activities:		
Net decrease in noninterest-bearing demand deposits	(11,146)	(3,243)
Net decrease in interest-bearing demand and savings deposits	(35,988)	(6,504)
Net increase (decrease) in time deposits	3,771	(2,984)
Net increase in accounts and drafts payable	27,849	44,946
Cash dividends paid	(9,342)	(7,725)
Purchase of common shares for treasury	(1,409)	(2,270)
Other financing activities, net	(457)	(752)
Net cash (used in) provided by financing activities	(26,722)	21,468
Net decrease in cash and cash equivalents	(48,063)	(24,645)
Cash and cash equivalents at beginning of period	228,110	266,743
Cash and cash equivalents at end of period	$ 180,047	$ 242,098
Supplemental information:		
Cash paid for interest	$ 2,459	$ 1,520
Cash paid for income taxes	3,776	5,758

See accompanying notes to unaudited consolidated financial statements.

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

Note 1 - Basis of Presentation

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

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

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

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

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

Note 2 – Intangible Assets

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

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

	September 30, 2018		**December 31, 2017**	
(In thousands)	**Gross Carrying Amount**	**Accumulated Amortization**	**Gross Carrying Amount**	**Accumulated Amortization**
Assets eligible for amortization:				
Customer lists	$ 4,288	$ (2,979)	$ 4,288	$ (2,702)
Patents	72	(15)	72	(12)
Non-compete agreements	332	(317)	332	(291)
Software	234	(234)	234	(234)
Other	500	(217)	500	(191)
Unamortized intangible assets:				
Goodwill[1]	12,796	(227)	12,796	(227)
Total intangible assets	$ 18,222	$ (3,989)	$ 18,222	$ (3,657)

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

The customer lists are amortized over seven and ten years; the patents over 18 years; the non-compete agreements over two and five years; software over three years; and other intangible assets over 15 years. Amortization of intangible assets amounted to $331,000 and $317,000 for the nine-month periods ended September 30, 2018 and 2017, respectively. Estimated annual amortization of intangibles is as follows: $442,000 in 2018, $412,000 in 2019, $406,000 in each of 2020 and 2021, and $88,000 in 2022.

Note 3 – Earnings Per Share

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

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
(In thousands except share and per share data)	**2018**	**2017**	**2018**	**2017**
Basic:				
Net income	$ 7,610	$ 6,863	$ 23,211	$ 19,683
Weighted-average common shares outstanding	12,245,975	12,251,084	12,239,678	12,257,337
Basic earnings per share	$ .62	$ .56	$ 1.90	$ 1.61
Diluted:				
Net income	$ 7,610	$ 6,863	$ 23,211	$ 19,683
Weighted-average common shares outstanding	12,245,975	12,251,084	12,239,678	12,257,337
Effect of dilutive restricted stock and stock appreciation rights	206,388	176,767	200,315	179,029
Weighted-average common shares outstanding assuming dilution assuming dilution	12,452,363	12,427,851	12,439,993	12,436,366
Diluted earnings per share	$ .61	$ .55	$ 1.87	$ 1.58

Note 4 – Stock Repurchases

The Company maintains a treasury stock buyback program pursuant to which the Board of Directors has authorized the repurchase of up to 500,000 shares of the Company's common stock. As restored by the Board of Directors on October 24, 2017, the program provides that the Company may repurchase up to an aggregate of 500,000 shares of common stock and has no expiration date. The Company repurchased 0 and 41,846 shares during the three-month periods and 15,547 and 41,846 during the nine-month periods ended September 30, 2018 and 2017, respectively. As of September 30, 2018, 484,453 shares remained available for repurchase under the program. Repurchases may be made in the open market or through negotiated transactions from time to time depending on market conditions.

Note 5 – Industry Segment Information

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

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

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

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

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

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

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

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

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

(In thousands)	Information Services	Banking Services	Corporate, Eliminations and Other	Total
Three Months Ended September 30, 2018				
Fee income from customers	$ 26,263	$ 253	$ (81)	$ 26,435
Interest income*	5,703	5,856	1,219	12,778
Interest expense	—	1,029	—	1,029
Intersegment income (expense)	—	467	(467)	—
Tax-equivalized pre-tax income*	6,525	2,538	591	9,654
Goodwill	12,433	136	—	12,569
Other intangible assets, net	1,664	—	—	1,664
Total Assets	903,055	847,673	(72,481)	1,678,247
Funding Sources	650,267	550,594	—	1,200,861
Three Months Ended September 30, 2017				
Fee income from customers	$ 23,809	$ 279	$ 119	$ 24,207
Interest income*	5,465	5,894	725	12,084
Interest expense	—	571	—	571
Intersegment income (expense)	—	339	(339)	—
Tax-equivalized pre-tax income*	7,130	3,179	369	10,678
Goodwill	12,433	136	—	12,569
Other intangible assets, net	2,106	—	—	2,106
Total Assets	820,596	738,478	(2,324)	1,556,750
Funding Sources	631,539	601,355	—	1,232,894
Nine Months Ended September 30, 2018				
Fee income from customers	$ 76,397	$ 947	$ 105	$ 77,449
Interest income*	16,553	17,342	2,996	36,891
Interest expense	—	2,502	—	2,502
Intersegment income (expense)	—	1,415	(1,415)	—
Tax-equivalized pre-tax income*	19,326	8,814	1,523	29,663
Goodwill	12,433	136	—	12,569
Other intangible assets, net	1,664	—	—	1,664
Total Assets	903,055	847,673	(72,481)	1,678,247
Funding Sources	637,508	566,390	—	1,203,898
Nine Months Ended September 30, 2017				
Fee income from customers	$ 69,453	$ 958	$ 367	$ 70,778
Interest income*	15,237	17,602	2,447	35,286
Interest expense	—	1,521	—	1,521
Intersegment income (expense)	—	962	(962)	—
Tax-equivalized pre-tax income*	18,946	9,922	1,414	30,282
Goodwill	12,433	136	—	12,569
Other intangible assets, net	2,106	—	—	2,106
Total Assets	820,596	738,478	(2,324)	1,556,750
Funding Sources	596,919	593,709	—	1,190,628

* Presented on a tax-equivalent basis assuming a tax rate of 21% for 2018 and 35% for 2017. The tax-equivalent adjustment was approximately $564,000 and $1,419,000 for the Three Months Ended 2018 and 2017, respectively, and $1,875,000 and $4,290,000 for the Nine Months Ended 2018 and 2017, respectively.

Note 6 – Loans by Type

A summary of loan categories is as follows:

(In thousands)	September 30, 2018	December 31, 2017
Commercial and industrial	$ 270,854	$ 236,394
Real estate:		
Commercial:		
Mortgage	92,972	94,675
Construction	22,883	9,359
Faith-based:		
Mortgage	307,679	316,073
Construction	30,838	25,948
Industrial Revenue Bonds	921	3,374
Other	92	408
Total loans	$ 726,239	$ 686,231

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

	Performing			Nonperforming		
(In thousands)	Current	30-59 Days	60-89 Days	90 Days and Over	Non-accrual	Total Loans
September 30, 2018						
Commercial and industrial	$ 270,854	$ —	$ —	$ —	$ —	$ 270,854
Real estate:						
Commercial:						
Mortgage	92,972	—	—	—	—	92,972
Construction	22,883	—	—	—	—	22,883
Faith-based:						
Mortgage	307,679	—	—	—	—	307,679
Construction	30,838	—	—	—	—	30,838
Industrial revenue bonds	921	—	—	—	—	921
Other	92	—	—	—	—	92
Total	$ 726,239	$ —	$ —	$ —	$ —	$ 726,239
December 31, 2017						
Commercial and industrial	$ 236,394	$ —	$ —	$ —	$ —	$ 236,394
Real estate:						
Commercial:						
Mortgage	94,675	—	—	—	—	94,675
Construction	9,359	—	—	—	—	9,359
Faith-based:						
Mortgage	316,073	—	—	—	—	316,073
Construction	25,948	—	—	—	—	25,948
Industrial revenue bonds	3,374	—	—	—	—	3,374
Other	408	—	—	—	—	408
Total	$ 686,231	$ —	$ —	$ —	$ —	$ 686,231

The following table presents the credit exposure of the loan portfolio as of September 30, 2018 and December 31, 2017:

(In thousands)	Loans Subject to Normal Monitoring[1]	Performing Loans Subject to Special Monitoring[2]	Nonperforming Loans Subject to Special Monitoring[2]	Total Loans
September 30, 2018				
Commercial and industrial	$ 267,696	$ 3,158	$ —	$ 270,854
Real estate:				
Commercial:				
Mortgage	91,998	974	—	92,972
Construction	22,883	—	—	22,883
Faith-based:				
Mortgage	307,596	83	—	307,679
Construction	30,838	—	—	30,838
Industrial Revenue Bonds	921	—	—	921
Other	92	—	—	92
Total	$ 722,024	$ 4,215	$ —	$ 726,239
December 31, 2017				
Commercial and industrial	$ 234,271	$ 2,123	$ —	$ 236,394
Real estate:				
Commercial:				
Mortgage	93,788	887	—	94,675
Construction	9,359	—	—	9,359
Faith-based:				
Mortgage	316,042	31	—	316,073
Construction	25,948	—	—	25,948
Industrial revenue bonds	3,374	—	—	3,374
Other	408	—	—	408
Total	$ 683,190	$ 3,041	$ —	$ 686,231

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

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

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

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

(In thousands)	December 31, 2017	Charge-Offs	Recoveries	Provision	September 30, 2018
Commercial and industrial	$ 3,652	$ —	$ 15	$ 535	$ 4,202
Real estate:					
Commercial:					
Mortgage	1,394	—	—	(9)	1,385
Construction	70	—	—	100	170
Faith-based:					
Mortgage	3,962	—	—	(105)	3,857
Construction	196	—	—	34	230
Industrial Revenue Bonds	52	—	—	(38)	14
Other	879	—	—	(517)	362
Total	$ 10,205	$ —	$ 15	$ —	$ 10,220

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

(In thousands)	December 31, 2016	Charge-Offs	Recoveries	Provision	September 30, 2017
Commercial and industrial	$ 3,261	$ —	$ 27	$ (61)	$ 3,227
Real estate:					
Commercial:					
Mortgage	1,662	—	—	(160)	1,502
Construction	47	—	—	54	101
Faith-based:					
Mortgage	4,027	—	—	20	4,047
Construction	85	—	—	(26)	59
Industrial Revenue Bonds	101	—	—	(37)	64
Other	992	—	—	210	1,202
Total	$ 10,175	$ —	$ 27	$ —	$ 10,202

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, 2018 and December 31, 2017, no amounts have been accrued for any estimated losses for these instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commercial and standby letters of credit are conditional commitments issued by the Company or its subsidiaries to guarantee the performance of a customer to a third party. These off-balance sheet financial instruments generally have fixed expiration dates or other termination clauses and may require payment of a fee. At September 30, 2018, the balance of unused loan commitments, standby and commercial letters of credit were $73,830,000, $12,917,000, and $3,740,000, 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, 2018:

	Amount of Commitment Expiration per Period				
(In thousands)	Total	Less than 1 Year	1-3 Years	3-5 Years	Over 5 Years
Operating lease commitments	$ 10,075	$ 1,614	$ 3,570	$ 2,431	$ 2,460
Time deposits	56,269	43,033	10,769	2,467	—
Total	$ 66,344	$ 44,647	$ 14,339	$ 4,898	$ 2,460

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

Note 8 – Stock-Based Compensation

The Amended and Restated Omnibus Stock and Performance Compensation Plan (the "Omnibus Plan") permits the issuance of up to 1,500,000 shares of the Company's common stock in the form of stock options, stock appreciation rights ("SARs"), restricted stock, restricted stock units and performance awards. The Company may issue shares out of treasury stock for these awards. During the nine months ended September 30, 2018, 28,527 restricted shares, 29,278 performance-based restricted shares, and 0 SARs were granted under the Omnibus Plan.

Restricted Stock

Beginning on April 16, 2013, restricted shares granted to Company employees are amortized to expense over a three-year vesting period whereas restricted shares granted to members of the Board of Directors are amortized to expense over a one-year service period, with the exception of those shares granted in lieu of cash payments for retainer fees which are expensed in the period earned. Beginning on February 2, 2017, restricted shares granted to Company employees are amortized to expense over the three-year cliff vesting period. As of September 30, 2018, the total unrecognized compensation expense related to non-vested restricted shares was $1,750,000, and the related weighted-average period over which it is expected to be recognized is approximately 0.92 years.

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

	Nine Months Ended September 30, 2018	
	Shares	**Fair Value**
Balance at December 31, 2017	78,166	$ 50.30
Granted	28,527	59.69
Vested	(23,758)	46.83
Balance at September 30, 2018	82,935	$ 54.52

Performance-Based Restricted Stock

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

In February and July of 2018, the Company granted three-year PBRS awards which are contingent upon the Company's achievement of pre-established financial goals over the period from January 1, 2018 through December 31, 2020. The PBRS awards cliff vest on the three year anniversary of their grant date at levels ranging from 0% to 150% of the target opportunity based on the actual achievement of financial goals for the three-year performance period. The aggregate target number of PBRS shares granted was 29,278 with an average grant date fair value of $58.70 per share. The 2018 expense related to these grants is currently estimated to be $741,000 and is based on the grant date fair value of the awards and the Company's achievement of 144% of the target financial goals. The estimated expense for 2018 and each future period through the vesting date is subject to prospective adjustment based upon changes in the expected achievement of the financial goals.

SARs

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

	Shares	Weighted-Average Exercise Price	Average Remaining Contractual Term Years	Aggregate Intrinsic Value *(In thousands)*
Outstanding at December 31, 2017	234,236	$ 34.97	5.03	$ 7,291
Exercised	(36,624)	30.31		
Outstanding at September 30, 2018	197,612	35.84	3.75	5,787
Exercisable at September 30, 2018	197,612	$ 35.84	3.75	$ 5,787

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

Note 9 – Defined Pension Plans

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

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

Pension costs recorded to expense were $1,049,000 and $1,033,000 for the three-month periods ended September 30, 2018 and 2017, respectively, and totaled $3,147,000 and $3,070,000 for the nine-month periods ended September 30, 2018 and 2017, respectively. Pension costs increased in 2018 primarily due to a decrease in the discount rate. The Company made no contribution to the plan during the nine-month period ended September 30, 2018 and is evaluating the amount of additional contributions, if any, in the remainder of 2018.

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

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

Pension costs recorded to expense were $255,000 and $210,000 for the three-month periods ended September 30, 2018 and 2017, respectively, and were $766,000 and $628,000 for the nine-month periods ended September 30, 2018 and 2017, respectively.

Note 10 – Income Taxes

As of September 30, 2018, the Company’s unrecognized tax benefits were approximately $1,822,000, of which $1,652,000 would, if recognized, affect the Company’s effective tax rate. As of December 31, 2017, the Company’s unrecognized tax benefits were approximately $1,632,000, of which $1,464,000 would, if recognized, affect the Company’s effective tax rate. During the next 12 months, the Company may realize a reduction of its unrecognized tax benefits of approximately $315,000 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 $191,000 and $139,000 of gross interest accrued as of September 30, 2018 and December 31, 2017, respectively. There were no penalties for unrecognized tax benefits accrued at September 30, 2018 and December 31, 2017.

The Company is subject to income tax in the U.S. federal jurisdiction and numerous state jurisdictions. U.S. federal income tax returns for tax years 2014 through 2017 remain subject to examination by the Internal Revenue Service. In addition, the Company is subject to state tax examinations for the tax years 2013 through 2017.

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

On December 22, 2017, the SEC issued Staff Accounting Bulletin No. 118, "Income Tax Accounting Implications of the Tax Cuts and Jobs Act ("SAB 118"), providing guidance on accounting for the Tax Act. The Company has not completed the accounting for the income tax effects of the Tax Act. In accordance with SAB 118, a provisional charge was recorded in December 2017 based on reasonable estimates of certain effects of the Tax Act. The Company expects to finalize its provisional amounts by the fourth quarter of 2018.

Note 11 – Investment in Securities

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

	September 30, 2018			
(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
State and political subdivisions	$ 337,378	$ 2,187	$ 4,691	$ 334,874
U.S. government agencies	108,158	—	2,337	105,821
Certificates of deposit	5,745	—	—	5,745
Total	$ 451,281	$ 2,187	$ 7,028	$ 446,440

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

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

	September 30, 2018					
	Less than 12 months		12 months or more		Total	
(In thousands)	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
State and political subdivisions	$ 178,137	$ 2,905	$ 36,804	$ 1,786	$ 214,941	$ 4,691
U.S. government agencies	79,513	974	26,308	1,363	105,821	2,337
Total	$ 257,650	$ 3,879	$ 63,112	$ 3,149	$ 320,762	$ 7,028

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

There were 197 securities, or 61% of the total (35 greater than 12 months), in an unrealized loss position as of September 30, 2018. There were 64 securities, or 17% of the total (24 greater than 12 months), in an unrealized loss position as of December 31, 2017. All unrealized losses were reviewed to determine whether the losses were other than temporary. Management believes that all unrealized losses are temporary since they were market driven, and it is more likely than not that the Company will not be required to sell prior to recovery of the amortized basis.

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

	September 30, 2018	
(In thousands)	Amortized Cost	Fair Value
Due in 1 year or less	$ 13,741	$ 13,782
Due after 1 year through 5 years	121,838	121,626
Due after 5 years through 10 years	232,821	231,333
Due after 10 years	82,881	79,699
Total	$ 451,281	$ 446,440

There were no sales of investment securities classified as available for sale for the three months ended September 30, 2018 or 2017. Proceeds from sales of investment securities classified as available for sale were $58,520,000 and $0 for the nine months ended September 30, 2018 and 2017, respectively. There were no gross realized gains for the three months ended September 30, 2018 or 2017. Gross realized losses were $42,000 and $0 for the nine months ended September 30, 2018 and 2017, respectively. There was one security totaling $3,750,000 pledged to secure public deposits and for other purposes at September 30, 2018.

Note 12 – Fair Value of Financial Instruments

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

	September 30, 2018		December 31, 2017	
(In thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Balance sheet assets:				
Cash and cash equivalents	$ 180,047	$ 180,047	$ 228,110	$ 228,110
Investment securities	446,440	446,440	470,523	470,523
Loans, net	716,019	709,807	676,026	675,020
Accrued interest receivable	6,323	6,323	7,413	7,413
Total	$ 1,348,829	$ 1,342,617	$ 1,382,072	$ 1,381,066
Balance sheet liabilities:				
Deposits	$ 634,724	$ 632,162	$ 678,088	$ 678,346
Accounts and drafts payable	769,638	769,638	661,888	661,888
Accrued interest payable	99	99	55	55
Total	$ 1,404,461	$ 1,401,899	$ 1,340,031	$ 1,340,289

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

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

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

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

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

Accrued Interest Receivable – The carrying amount approximates fair value.

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

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

Accrued Interest – The carrying amount approximates fair value.

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

Note 13 – Subsequent Events

On October 23, 2018, the Company's Board of Directors declared a 20% common stock dividend payable on December 14, 2018 to shareholders of record on December 4, 2018. Shareholders will receive one additional share of Cass common stock for each five shares of common stock owned. No fractional shares will be issued. Shareholders will receive cash for any fractional shares owned based on the share price reported by the Nasdaq Stock Market at the close of trading on December 4, 2018.

Additionally, on October 23, 2018, the Company's Board of Directors declared a fourth quarter cash dividend of $0.26 per share payable on December 14, 2018 to shareholders of record on December 4, 2018. The cash dividend will apply to all shares of common stock held after the 20% common stock dividend is completed.

The Board of Directors voted to restore the capacity of the Company's stock repurchase program to 500,000 shares.

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

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

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

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

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

Critical Accounting Policies

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

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

Results of Operations

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

Net Income

The following table summarizes the Company’s operating results:

	Third Quarter of			Nine Months Ended		
(In thousands except per share data)	**2018**	**2017**	**% Change**	**2018**	**2017**	**% Change**
Net income	$ 7,610	$ 6,863	10.9	$ 23,211	$ 19,683	17.9
Diluted earnings per share	$ .61	$ .55	10.9	$ 1.87	$ 1.58	18.4
Return on average assets	1.84%	1.70%	—	1.92%	1.70%	—
Return on average equity	13.31%	12.34%	—	13.96%	12.27%	—

Fee Revenue and Other Income

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

	Third Quarter of			Nine Months Ended		
(In thousands)	**2018**	**2017**	**% Change**	**2018**	**2017**	**% Change**
Transportation invoice volume	9,530	8,962	6.3%	28,349	26,585	6.6%
Transportation invoice dollar volume	$ 7,264,898	$ 6,162,957	17.9%	$ 21,227,816	$ 18,271,178	16.2%
Expense management transaction volume*	7,124	6,935	2.7%	21,414	20,477	4.6%
Expense management dollar volume*	$ 3,667,007	$ 3,391,672	8.1%	$ 10,338,979	$ 9,647,573	7.2%
Payment and processing revenue	$ 26,020	$ 23,761	9.5%	$ 76,068	$ 69,332	9.7%

*Includes energy, telecom and waste

Third Quarter of 2018 compared to Third Quarter of 2017:

Payment and processing fee revenue increased 10%. Highlighting third quarter performance was an 18% increase in transportation dollar volume. Higher carrier and fuel prices, in concert with higher volume from current accounts, produced the positive result. Transportation invoice volume for the period was up 6%. Facility-related (electricity, gas, waste and telecom expense management) dollar volume was up 3% with facility related expense transaction volume up 8%. New customer wins plus increased volume from current accounts generated the favorable outcome.

There were no gains on sales of securities in either the Third Quarter of 2018 or 2017.

Nine Months Ended 2018 compared to Nine Months Ended 2017:

Transportation invoice and dollar volumes, as well as expense management transaction and dollar volumes, increased for the same reasons as the Third Quarter.

Losses of $42,000 on the sales of securities were recognized in the Nine Months Ended 2018, compared to $0 in the Nine Months Ended 2017. These sales were part of an effort to right size the investment security portfolio given recent changes in both interest rates, which have increased, and tax rates, which have declined.

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 tax-equivalent net interest income and related factors:

	Third Quarter of		%	**Nine Months Ended**		%
(In thousands)	**2018**	**2017**	**Change**	**2018**	**2017**	**Change**
Average earnings assets	$ 1,397,477	$ 1,395,025	0.2 %	$ 1,385,488	$ 1,348,253	2.8 %
Average interest-bearing liabilities	359,793	393,262	(8.5%)	369,016	388,693	(5.1%)
Net interest income*	11,749	11,513	2.0 %	34,389	33,765	1.8 %
Net interest margin*	3.34 %	3.27 %		3.32 %	3.35 %	
Yield on earning assets*	3.63 %	3.44 %		3.56 %	3.50 %	
Rate on interest-bearing liabilities	1.13 %	.58 %		.91 %	.52 %	

*Presented on a tax-equivalent basis assuming a tax rate of 21% for 2018 and 35% for 2017. The TCJA reduced the net interest margin and yield on earning assets by approximately 20 basis points in 2018.

Third Quarter of 2018 compared to Third Quarter of 2017:

Third Quarter of 2018 average earning assets increased $2,452,000, or 0.2%, compared to the same period in the prior year. Interest-bearing deposits in other financial institutions increased $60,831,000, or 59.5%, loans increased $57,857,000, or 8.8%, and average investment securities increased $14,454,000, or 3.4%. These were partially offset by a decrease in average federal funds sold and other short-term investments of $130,634,000, or 65.3%, in the Third Quarter of 2018 compared to the Third Quarter of 2017.

Total average interest-bearing liabilities for the Third Quarter of 2018 decreased $33,469,000, or 8.5%, compared to the Third Quarter of 2017 for a variety of reasons, including some customers that shifted excess balances to higher yielding investments. Average accounts and drafts payable increased $16,404,000, or 2.2%, in the Third Quarter of 2018 compared to the Third Quarter of 2017.

Third Quarter of 2018 tax-equivalized net interest income increased $236,000, or 2.0%, compared to the same period in the prior year as a result of the increase in average earning assets and the improving rate environment. However, the lower tax-equivalent adjustment as a result of the federal tax rate decrease in 2018 from the enactment of TCJA in December 2017 negatively impacted the comparison to the Third Quarter of 2017. The federal tax rate decrease also negatively impacted net interest margin and yield on earning assets for the Third Quarter of 2018 compared to the Third Quarter of 2017.

The changes to the interest rate environment also led to an increase in the rate on interest-bearing liabilities in the Third Quarter of 2018 compared to the Third Quarter of 2017.

Nine Months Ended 2018 compared to Nine Months Ended 2017:

Nine Months Ended 2018 average earning assets increased $37,235,000, or 2.8%, compared to the same period in the prior year. Loans increased $43,953,000, or 6.6%, average investment securities increased $32,840,000, or 7.9%, and interest-bearing deposits in other financial institutions increased $17,602,000, or 17.7%. These were partially offset by a decrease in average federal funds sold and other short-term investments of $57,702,000, or 35.4%, for the Nine Months Ended 2018 as compared to the Nine Months Ended 2017.

Average accounts and drafts payable balances for the Nine Months Ended 2018 increased $33,171,000, or 4.7%, and non-interest bearing liabilities increased $39,704,000, or 19.3%, as compared to the Nine Months Ended 2017. These were partially offset by a decrease in average total interest bearing deposits of $19,677,000, or 5.1%. This decreased for a variety of reasons, including some customers that shifted excess balances to higher yielding investments.

Nine Months Ended 2018 tax-equivalized net interest income increased $624,000, or 1.8%, compared to the same period in the prior year as a result of the increase in average earning assets and the improving rate environment. However, the lower tax-equivalent adjustment as a result of the federal tax rate decrease in 2018 from the enactment of TCJA in December 2017 negatively impacted the comparison to the Nine Months Ended 2017. The federal tax rate decrease also negatively impacted net interest margin and yield on earning assets for the Nine Months Ended 2018 compared to the Nine Months Ended 2017.

The changes to the interest rate environment increased for the same reasons as the Third Quarter.

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

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.

	Third Quarter of 2018			Third Quarter of 2017		
(In thousands)	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
Assets[1]						
Earning assets						
Loans[2, 3]:						
Taxable	$ 716,849	$ 8,356	4.62%	$ 655,723	$ 7,178	4.34%
Tax-exempt[4]	1,197	13	4.31	4,466	47	4.18
Investment securities[5]:						
Taxable	100,530	593	2.34	19,703	94	1.89
Tax-exempt[4]	339,758	2,671	3.12	406,131	4,007	3.91
Certificates of deposit	6,707	26	1.54	6,763	14	.82
Interest-bearing deposits in other financial institutions	163,034	794	1.93	102,203	300	1.16
Federal funds sold and other short-term investments	69,402	325	1.86	200,036	444	.88
Total earning assets	1,397,477	12,778	3.63	1,395,025	12,084	3.44
Non-earning assets:						
Cash and due from banks	13,398			12,704		
Premises and equipment, net	22,583			21,256		
Bank-owned life insurance	17,197			16,738		
Goodwill and other intangibles	14,300			14,742		
Other assets	182,565			149,266		
Allowance for loan losses	(10,218)			(10,199)		
Total assets	$ 1,637,302			$ 1,599,532		
Liabilities and Shareholders' Equity[1]						
Interest-bearing liabilities:						
Interest-bearing demand deposits	$ 292,038	$ 802	1.09%	$ 327,997	$ 434	.52 %
Savings deposits	11,129	30	1.07	12,493	17	.54
Time deposits >= $100	24,718	95	1.52	23,486	68	1.15
Other time deposits	31,908	102	1.27	29,286	52	.70
Total interest-bearing liabilities	359,793	1,029	1.13	393,262	571	.58
Non-interest bearing liabilities:						
Demand deposits	250,389			208,932		
Accounts and drafts payable	755,697			739,293		
Other liabilities	44,652			37,317		
Total liabilities	1,410,531			1,378,804		
Shareholders' equity	226,771			220,728		
Total liabilities and shareholders' equity	$ 1,637,302			$ 1,599,532		
Net interest income		$ 11,749			$ 11,513	
Net interest margin			3.34%			3.27%
Interest spread			2.50			2.86

1. Balances shown are daily averages.
2. 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 2017 consolidated financial statements, filed with the Company's 2017 Annual Report on Form 10-K.
3. Interest income on loans includes net loan fees of $98,000 for the Third Quarter of 2018 and $76,000 for the Third Quarter of 2017.
4. Interest income is presented on a tax-equivalent basis. 2018 figures assume a tax rate of 21% and 2017 figures assume a tax rate of 35%. The tax-equivalent adjustment was approximately $564,000 and $1,419,000 for the Third Quarter of 2018 and 2017, respectively. The TCJA reduced the yield/rate by approximately 70 basis points in 2018.
5. For purposes of these computations, yields on investment securities are computed as interest income divided by the average amortized cost of the investments.

	Nine Months Ended 2018			Nine Months Ended 2017		
(In thousands)	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
Assets[1]						
Earning assets						
Loans[2, 3]:						
Taxable	$ 703,535	$ 23,786	4.52%	$ 656,314	$ 21,164	4.31%
Tax-exempt[4]	2,006	57	3.80	5,274	157	3.98
Investment securities[5]:						
Taxable	78,609	1,348	2.29	15,905	232	1.95
Tax-exempt[4]	372,039	8,872	3.19	401,903	12,100	4.03
Certificates of deposit	7,134	80	1.50	6,592	36	.73
Interest-bearing deposits in other financial institutions	116,808	1,539	1.76	99,206	703	.95
Federal funds sold and other short-term investments	105,357	1,209	1.53	163,059	894	.73
Total earning assets	1,385,488	36,891	3.56	1,348,253	35,286	3.50
Non-earning assets:						
Cash and due from banks	13,472			12,729		
Premises and equipment, net	22,322			21,225		
Bank-owned life insurance	17,084			16,615		
Goodwill and other intangibles	14,409			14,408		
Other assets	173,833			144,086		
Allowance for loan losses	(10,213)			(10,190)		
Total assets	$ 1,616,395			$ 1,547,126		
Liabilities and Shareholders' Equity[1]						
Interest-bearing liabilities:						
Interest-bearing demand deposits	$ 303,976	$ 1,932	.85 %	$ 317,046	$ 1,090	.46 %
Savings deposits	11,230	76	.90	17,007	62	.49
Time deposits >= $100	23,764	257	1.45	23,238	195	1.12
Other time deposits	30,046	237	1.05	31,402	174	.74
Total interest-bearing liabilities	369,016	2,502	.91	388,693	1,521	.52
Non-interest bearing liabilities:						
Demand deposits	245,002			205,298		
Accounts and drafts payable	737,083			703,912		
Other liabilities	42,955			34,821		
Total liabilities	1,394,056			1,332,724		
Shareholders' equity	222,339			214,402		
Total liabilities and shareholders' equity	$ 1,616,395			$ 1,547,126		
Net interest income		$ 34,389			$ 33,765	
Net interest margin			3.32%			3.35%
Interest spread			2.65			2.98

1. Balances shown are daily averages.
2. 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 2017 consolidated financial statements, filed with the Company's 2017 Annual Report on Form 10-K.
3. Interest income on loans includes net loan fees of $289,000 and $319,000 for the Nine Months Ended 2018 and 2017, respectively.
4. Interest income is presented on a tax-equivalent basis. 2018 figures assume a tax rate of 21% and 2017 figures assume a tax rate of 35%. The tax-equivalent adjustment was approximately $1,875,000 and $4,290,000 for the Nine Months Ended 2018 and 2017, respectively. The TCJA reduced the yield/rate by approximately 70 basis points in 2018.
5. 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.

	Third Quarter of 2018 Over Third Quarter of 2017		
(In thousands)	**Volume**	**Rate**	**Total**
Increase (decrease) in interest income:			
Loans[1, 2]:			
Taxable	$ 695	$ 483	$ 1,178
Tax-exempt[3]	(35)	1	(34)
Investment securities:			
Taxable	472	27	499
Tax-exempt[3]	(596)	(740)	(1,336)
Certificates of deposit	—	12	12
Interest-bearing deposits in other financial institutions	234	260	494
Federal funds sold and other short-term investments	(409)	290	(119)
Total interest income	361	333	694
Interest expense on:			
Interest-bearing demand deposits	(52)	420	368
Savings deposits	(2)	15	13
Time deposits >=$100	4	23	27
Other time deposits	5	45	50
Total interest expense	(45)	503	458
Net interest income	$ 406	$ (170)	$ 236

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 21% for the Third Quarter of 2018 and a tax rate of 35% for the Third Quarter of 2017.

	Nine Months Ended 2018 Over Nine Months Ended 2017		
(In thousands)	**Volume**	**Rate**	**Total**
Increase (decrease) in interest income:			
Loans[1, 2]:			
Taxable	$ 1,567	$ 1,055	$ 2,622
Tax-exempt[3]	(93)	(7)	(100)
Investment securities:			
Taxable	1,068	48	1,116
Tax-exempt[3]	(850)	(2,378)	(3,228)
Certificates of deposit	3	41	44
Interest-bearing deposits in other financial institutions	143	693	836
Federal funds sold and other short-term investments	(400)	715	315
Total interest income	1,438	167	1,605
Interest expense on:			
Interest-bearing demand deposits	(47)	889	842
Savings deposits	(26)	40	14
Time deposits >=$100	5	57	62
Other time deposits	(8)	71	63
Total interest expense	(76)	1,057	981
Net interest income	$ 1,514	$ (890)	$ 624

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 21% for the Nine Months Ended 2018 and a tax rate of 35% for the Nine Months Ended 2017.

Provision and Allowance for Loan Losses ("ALLL")

A significant determinant of the Company's operating results can be the provision for loan losses. There was no provision for loan loss recorded during the Third Quarter of 2018 or the Third Quarter of 2017. There was no loan loss provision recorded during the Nine Months Ended 2018 or the Nine Months Ended 2017. As discussed below, the Company continually analyzes the outstanding loan portfolio based on the performance, financial condition and collateralization of the credits. Net loan recoveries were $5,000 in the Third Quarter of 2018 and $6,000 in the Third Quarter of 2017. Net loan recoveries were $15,000 in the Nine Months Ended 2018 and $27,000 during the Nine Months Ended 2017.

The ALLL at September 30, 2018 was $10,220,000 and at December 31, 2017 was $10,205,000. The ratio of ALLL to total loans outstanding at September 30, 2018 was 1.41% compared to 1.49% at December 31, 2017. There were no nonperforming loans at September 30, 2018 or December 31, 2017.

The ALLL has been established and is maintained to absorb reasonably estimated and probable losses in the loan portfolio. An ongoing assessment is performed to determine if the balance is adequate. Charges or credits are made to expense to cover any deficiency or reduce any excess, as required. The current methodology consists of two components: 1) estimated credit losses on individually evaluated loans that are determined to be impaired in accordance with FASB ASC 310 “Allowance for Credit Losses,” and 2) estimated credit losses inherent in the remainder of the loan portfolio in accordance with FASB ASC 450, “Contingencies.” Estimated credit losses is an estimate of the current amount of loans that is probable the Company will be unable to collect according to the original terms.

For loans that are individually evaluated, the Company uses two impairment measurement methods: 1) the present value of expected future cash flows and 2) collateral value. For the remainder of the portfolio, the Company groups loans with similar risk characteristics into eight segments and applies historical loss rates to each segment based on a five fiscal-year look-back period. In addition, qualitative factors including credit concentration risk, national and local economic conditions, nature and volume of loan portfolio, legal and regulatory factors, downturns in specific industries including losses in collateral value, trends in credit quality at the Company and in the banking industry and trends in risk-rating agencies are also considered.

The Company also utilizes ratio analysis to evaluate the overall reasonableness of the ALLL compared to its peers and required levels of regulatory capital. Federal and state agencies review the Company’s methodology for maintaining the ALLL. These agencies may require the Company to adjust the ALLL based on their judgments and interpretations about information available to them at the time of their examinations.

Summary of Asset Quality

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

	Third Quarter of		Nine Months Ended	
(In thousands)	**2018**	**2017**	**2018**	**2017**
Allowance at beginning of period	$ 10,215	$ 10,196	$ 10,205	$ 10,175
Provision charged to expense:	—	—	—	—
Loans charged off	—	—	—	—
Recoveries on loans previously charged off	5	6	15	27
Net recoveries	5	6	15	27
Allowance at end of period	$ 10,220	$ 10,202	$ 10,220	$ 10,202
Loans outstanding:				
Average	$ 778,046	$ 660,189	$ 705,541	$ 661,588
September 30	726,239	658,090	726,239	658,090
Ratio of ALLL to loans outstanding:				
Average	1.42%	1.55%	1.45%	1.54%
September 30	1.41%	1.55%	1.41%	1.55%
Impaired loans:				
Nonaccrual loans	$ —	$ 215	$ —	$ 215
Loans past due 90 days or more	—	—	—	—
Troubled debt restructurings	—	—	—	—
Total impaired loans	$ —	$ 215	$ —	$ 215
Foreclosed assets	$ —	—	$ —	—
Impaired loans as percentage of average loans	—	.03%	—	.03%

The Bank had no property carried as other real estate owned as of September 30, 2018 or September 30, 2017.

Operating Expenses

Total operating expenses for the Third Quarter of 2018 were up 13.9%, or $3,488,000, compared to the Third Quarter of 2017 and were up 10.7%, or $7,914,000, for the Nine Months Ended 2018 compared to the Nine Months Ended 2017.

Personnel expense for the Third Quarter of 2018 increased $2,324,000 compared to the Third Quarter of 2017 and increased $6,334,000 to $63,718,000 for the Nine Months Ended 2018 compared to the Nine Months Ended 2017 due mainly to on-going strategic investment in technology and staff required to win new business and support services growth with existing clients, address increasing cybersecurity risk, annual salary merit increases, and increased retirement plan costs.

Equipment expense for the Third Quarter of 2018 increased $192,000, or 15.5%, compared to the Third Quarter of 2017 and $404,000, or 10.8%, for the Nine Months Ended 2018 from the Nine Months Ended 2017. Outside service expense for the Third Quarter of 2018 increased $151,000, or 8.6%, compared to the Third Quarter of 2017 and $372,000, or 7.1%, for the Nine Months Ended 2018 from the Nine Months Ended 2017. These increases were the result of the continued strategic investment in technology.

Financial Condition

Total assets at September 30, 2018 were $1,678,247,000, an increase of $21,038,000, or 1.3%, from December 31, 2017. The most significant changes in asset balances during this period were increases in loans of $40,008,000, other information services related assets of $25,901,000, and payments in excess of funding of $21,977,000. This was partially offset by a decrease of $48,063,000 in cash and cash equivalents and a decrease of $24,083,000 in investment 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, 2018 were $1,448,905,000, an increase of $16,784,000, or 1.2%, from December 31, 2017. Accounts and drafts payable at September 30, 2018 were $769,638,000, an increase of $53,750,000, or 7.5%, from December 31, 2017. Total deposits decreased $43,364,000, or 6.4%, from December 31, 2017. Total shareholders' equity at September 30, 2018 was $229,342,000, a $4,254,000, or 1.9%, increase from December 31, 2017. Total shareholders' equity increased as a result of net income of $23,211,000. This was offset by the change in accumulated other comprehensive loss of $9,987,000 and dividends paid of $9,342,000.

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 payments clear and higher balances on days when payments 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).

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 other short-term investments, was $180,047,000 at September 30, 2018, a decrease of $48,063,000, or 21.1%, from December 31, 2017. At September 30, 2018, these assets represented 10.7% 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 $446,440,000 at September 30, 2018, a decrease of $24,083,000 from December 31, 2017. These assets represented 26.6% of total assets at September 30, 2018. Of this total, 75% were state and political subdivision securities. Of the total portfolio, 3.1% mature in one year or less, 27.2% mature in one to five years, and 69.7% 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 $83,000,000 at the following banks: US Bank, $20,000,000; Wells Fargo Bank, $15,000,000; Frost National Bank, $10,000,000; PNC Bank, $12,000,000; UMB Bank, $20,000,000; and JPM Chase Bank, $6,000,000. The Bank also has secured lines of credit with the Federal Home Loan Bank of $189,918,000 collateralized by commercial mortgage loans. The Company also has secured lines of credit with UMB Bank of $50,000,000 and First Tennessee Bank of $50,000,000 collateralized by state and political subdivision securities. There were no amounts outstanding under any line of credit as of September 30, 2018 or December 31, 2017.

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. However, an increasingly competitive interest rate environment has resulted in deposit outflow. 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") and Insured Cash Sweep ("ICS") deposit placement programs. Time deposits include $32,000,000 of CDARS deposits and interest-bearing demand deposits include $73,562,000 of ICS deposits. These programs offer the Bank's customers the ability to maximize Federal Deposit Insurance Corporation ("FDIC") insurance coverage. The Company uses these programs to retain or attract deposits from existing customers.

Net cash flows provided by operating activities were $38,796,000 for the Nine Months Ended 2018 compared with $27,936,000 for the Nine Months ended 2017, an increase of $10,860,000. 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 2018, which are estimated to range from $6 million to $9 million.

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 a low interest rate environment, short-term relatively lower rate liquid investments may be reduced in favor of longer-term relatively higher yielding investments and loans. If the primary source of liquidity is reduced in a low interest rate environment, a greater reliance would be placed on secondary sources of liquidity including borrowing lines, the ability of the Bank to generate deposits, and the investment portfolio to ensure overall liquidity remains at acceptable levels.

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. Lower levels of energy costs will tend to decrease transportation and energy invoice amounts resulting in a corresponding decrease in accounts and drafts payable. Decreases in accounts and drafts payable generate lower interest income.

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.

The Basel III Capital Rules require FDIC insured depository institutions to meet and maintain several minimum capital standards: a common equity Tier 1 capital to risk-based assets ratio of 4.5%, a Tier 1 capital to risk-based assets ratio of 6.0%, a total capital to risk-based assets of 8.0%, and a 4.0% Tier 1 capital to total assets leverage ratio.

Common equity Tier 1 capital is generally defined as common stockholders' equity and retained earnings. Tier 1 capital is generally defined as common equity Tier 1 and Additional Tier 1 capital. Additional Tier 1 capital generally includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Total capital includes Tier 1 capital (common equity Tier 1 capital plus Additional Tier 1 capital) and Tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus meeting specified requirements. Also included in Tier 2 capital is the allowance for loan losses limited to a maximum of 1.25% of risk-weighted assets and, for non-advanced approaches institutions like Cass that have exercised a one-time opt-out election regarding the treatment of Accumulated Other Comprehensive Income, up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. The calculation of all types of regulatory capital is subject to deductions and adjustments specified in applicable regulations.

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In determining the amount of risk-weighted assets for purposes of calculating risk-based capital ratios, all assets, including certain off-balance sheet assets are multiplied by a risk weight factor assigned by the regulations based on the risks believed inherent in the type of asset. Higher levels of capital are required for asset categories believed to present greater risk. For example, a risk weight of 0% is assigned to cash and U.S. government securities, a risk weight of 50% is generally assigned to prudently underwritten first lien one to four-family residential mortgages, a risk weight of 100% is assigned to commercial and consumer loans, a risk weight of 150% is assigned to certain past due loans, and a risk weight of between 0% to 600% is assigned to permissible equity interests, depending on certain specified factors.

In addition to establishing the minimum regulatory capital requirements, the Basel III Capital Rules limit capital distributions and certain discretionary bonus payments to management if the institution does not hold a “capital conservation buffer” consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets above the amount necessary to meet its minimum risk-based capital requirements. The capital conservation buffer requirement is being phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increasing each year until fully implemented at 2.5% on January 1, 2019.

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

	September 30, 2018		December 31, 2017	
(Dollars in thousands)	**Amount**	**Ratio**	**Amount**	**Ratio**
Total capital (to risk-weighted assets):				
Cass Information Systems, Inc.	$ 248,488	21,42%	$ 234,389	22.53%
Cass Commercial Bank	133,916	18.23%	122,440	17.01%
Common Equity Tier I Capital (to risk-weighted assets):				
Cass Information Systems, Inc.	$ 238,267	20.54%	$ 224,184	21.55%
Cass Commercial Bank	126,063	17.16%	114,603	15.93%
Tier I capital (to risk-weighted assets):				
Cass Information Systems, Inc.	$ 238,267	20.54%	$ 224,184	21.55%
Cass Commercial Bank	126,063	17.16%	114,603	15.93%
Tier I capital (to average assets):				
Cass Information Systems, Inc.	$ 238,267	14.55%	$ 224,184	13.87%
Cass Commercial Bank	126,063	14.78%	114,603	14.99%

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

In February 2016, the FASB issued Accounting Standards Update (“ASU”) No. 2016-02, *Leases (ASC Topic 842)*. The ASU improves financial reporting about leasing transactions. The ASU affects all companies and other organizations that lease assets such as real estate, airplanes, and manufacturing equipment. Consistent with current generally accepted accounting principles (GAAP), the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, unlike current GAAP—which requires only capital leases to be recognized on the balance sheet—the new ASU will require both types of leases to be recognized on the balance sheet. The ASU also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements. The ASU on leases will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. A third-party vendor solution has been selected to assist in the application of ASU 2016-02. The impact of the adoption of this ASU is currently being evaluated but is not expected to have a material impact on the Company’s consolidated financial statements or results of operations.

In June 2016, the FASB issued ASU No. 2016-13 - Financial Instruments – *Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The ASU requires measurement and recognition of expected credit losses for financial assets held. Under this standard, the Company will be required to hold an allowance equal to the expected life-of-loan losses on the loan portfolio. The standard is effective for fiscal periods beginning after December 15, 2019. The impact of the adoption of this ASU is currently being evaluated.

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, 2017, 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 15.0% 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, 2018 has changed materially from that at December 31, 2017.

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-15e and 15d-15e 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 2018 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 is the subject of various pending or threatened legal actions and proceedings, including those that arise in the ordinary course of business. Management believes the outcome of all such 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, 2017, 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 2017 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

Not applicable.

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 2018.

ITEM 6. EXHIBITS

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.

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 7, 2018	By	/s/ Eric H. Brunngraber Eric H. Brunngraber Chairman, President and Chief Executive Officer (Principal Executive Officer)
DATE: November 7, 2018	By	/s/ P. Stephen Appelbaum P. Stephen Appelbaum Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)