

CASS INFORMATION SYSTEMS INC
Form 10-Q
November 04, 2010

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, 2010

OR

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

For the transition period from to

Commission File No. 000-20827

CASS INFORMATION SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

Missouri
(State or other jurisdiction of incorporation or organization)

43-1265338
(I.R.S. Employer Identification No.)

13001 Hollenberg Drive
Bridgeton, Missouri
(Address of principal executive offices)

63044
(Zip Code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes 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 No

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

(Check one) Large Accelerated Filer Accelerated Filer
 Non-Accelerated Filer Smaller Reporting Company

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

Yes No

The number of shares outstanding of registrant's only class of stock as of November 1, 2010: Common stock, par value \$.50 per share – 9,394,547 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 the section Part I, Item 1A, “Risk Factors” of the Company’s 2009 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, unless otherwise required by applicable rules.

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, 2010 (Unaudited)	December 31, 2009
Assets		
Cash and due from banks	\$ 10,435	\$ 5,763
Interest-bearing deposits in other financial institutions	73,434	33,426
Federal funds sold and other short-term investments	125,599	40,105
Cash and cash equivalents	209,468	79,294
Securities available-for-sale, at fair value	238,262	224,597
Loans	689,683	641,957
Less: Allowance for loan losses	10,758	8,284
Loans, net	678,925	633,673
Premises and equipment, net	9,713	10,451
Investment in bank-owned life insurance	14,055	13,644
Payments in excess of funding	40,111	22,637
Goodwill	7,471	7,471
Other intangible assets, net	295	375
Other assets	19,129	20,839
Total assets	\$ 1,217,429	\$ 1,012,981
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Noninterest-bearing	\$ 121,028	\$ 113,151
Interest-bearing	380,231	324,725
Total deposits	501,259	437,876
Accounts and drafts payable	554,945	430,251
Short-term borrowings	13	26
Other liabilities	15,395	15,260
Total liabilities	1,071,612	883,413
Shareholders' Equity:		
Preferred stock, par value \$.50 per share; 2,000,000 shares authorized and no shares issued	—	—
Common Stock, par value \$.50 per share; 20,000,000 shares authorized and 9,949,324 shares issued at September 30, 2010 and December 31, 2009	4,975	4,975
Additional paid-in capital	46,439	45,696
Retained earnings	103,685	92,401
Common shares in treasury, at cost (554,777 shares at September 30, 2010 and 564,119 shares at December 31, 2009)	(13,167)	(13,323)
Accumulated other comprehensive income (loss)	3,885	(181)

Total shareholders' equity	145,817	129,568
Total liabilities and shareholders' equity	\$ 1,217,429	\$ 1,012,981

See accompanying notes to unaudited consolidated financial statements.

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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,	
	2010	2009	2010	2009
Fee Revenue and Other Income:				
Information services payment and processing revenue	\$ 13,895	\$ 12,302	\$ 40,173	\$ 36,282
Bank service fees	367	292	1,006	1,037
Gains on sales of securities	—	—	—	202
Other	139	140	415	413
Total fee revenue and other income	14,401	12,734	41,594	37,934
Interest Income:				
Interest and fees on loans	10,182	9,125	29,480	26,661
Interest and dividends on securities:				
Taxable	3	15	28	33
Exempt from federal income taxes	2,154	1,843	6,403	5,462
Interest on federal funds sold and other short-term investments	150	57	337	101
Total interest income	12,489	11,040	36,248	32,257
Interest Expense:				
Interest on deposits	1,249	1,372	3,624	3,541
Interest on short-term borrowings	—	—	—	23
Interest on subordinated convertible debentures	—	27	—	106
Total interest expense	1,249	1,399	3,624	3,670
Net interest income	11,240	9,641	32,624	28,587
Provision for loan losses	950	400	3,000	1,100
Net interest income after provision for loan losses	10,290	9,241	29,624	27,487
Total net revenue	24,691	21,975	71,218	65,421
Operating Expense:				
Salaries and employee benefits	13,026	12,583	38,199	37,762
Occupancy	658	611	1,841	1,797
Equipment	887	835	2,701	2,509
Amortization of intangible assets	26	55	80	195
Other operating	2,501	2,282	7,324	7,190
Total operating expense	17,098	16,366	50,145	49,453
Income before income tax expense	7,593	5,609	21,073	15,968
Income tax expense	2,013	1,291	5,844	4,066
Net Income	\$ 5,580	\$ 4,318	\$ 15,229	\$ 11,902
Basic Earnings Per Share	\$.60	\$.47	\$ 1.63	\$ 1.30

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Diluted Earnings Per Share	\$.59	\$.46	\$	1.61	\$	1.27
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See accompanying notes to unaudited consolidated financial statements.

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

	Nine Months Ended September 30,	
	2010	2009
Cash Flows From Operating Activities:		
Net income	\$ 15,229	\$ 11,902
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,077	3,218
Gains on sales of securities	—	(202)
Provision for loan losses	3,000	1,100
Stock-based compensation expense	1,133	1,382
Deferred income tax expense	—	649
Decrease in income tax liability	(1,751)	(994)
Increase in pension liability	640	728
Other operating activities, net	355	(812)
Net cash provided by operating activities	21,683	16,971
Cash Flows From Investing Activities:		
Proceeds from sales of securities available-for-sale	—	14,591
Proceeds from maturities of securities available-for-sale	2,770	5,655
Purchase of securities available-for-sale	(11,548)	(37,994)
Net increase in loans	(48,252)	(29,186)
(Increase) decrease in payments in excess of funding	(17,474)	3,470
Purchases of premises and equipment, net	(890)	(1,043)
Net cash used in investing activities	(75,394)	(44,507)
Cash Flows From Financing Activities:		
Net increase in noninterest-bearing demand deposits	7,877	3,639
Net increase in interest-bearing demand and savings deposits	19,729	102,360
Net increase in time deposits	35,777	66,916
Net increase (decrease) in accounts and drafts payable	124,694	(41,835)
Net decrease in short-term borrowings	(13)	(300)
Cash dividends paid	(3,945)	(3,611)
Distribution of stock awards, net	(251)	—
Other financing activities, net	17	17
Net cash provided by financing activities	183,885	127,186
Net increase in cash and cash equivalents	130,174	99,650
Cash and cash equivalents at beginning of period	79,294	29,485
Cash and cash equivalents at end of period	\$ 209,468	\$ 129,135
Supplemental information:		
Cash paid for interest	\$ 3,568	\$ 3,641
Cash paid for income taxes	7,621	4,456

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. Certain amounts in the 2009 consolidated financial statements have been reclassified to conform to the 2010 presentation. Such reclassifications have no effect on previously reported net income or shareholders' equity. 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, 2009.

Note 2 – Intangible Assets

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

(In thousands)	September 30, 2010		December 31, 2009	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Assets eligible for amortization:				
Software	\$ 862	\$ (862)	\$ 862	\$ (862)
Customer List	750	(455)	750	(375)
Total	1,612	(1,317)	1,612	(1,237)
Unamortized intangible assets:				
Goodwill	7,698	(227)	7,698	(227)
Total unamortized intangibles	7,698	(227)	7,698	(227)
Total intangible assets	\$ 9,310	\$ (1,544)	\$ 9,310	\$ (1,464)

Software is amortized over four to five years and the customer list is amortized over seven years. Amortization of intangible assets amounted to \$80,000 and \$195,000 for the nine-month periods ended September 30, 2010 and 2009, respectively. Estimated amortization of intangibles over the next five years is as follows: \$107,000 in 2010, 2011 and 2012, \$54,000 in 2013 and \$0 in 2014.

Note 3 - Equity Investments in Non-Marketable Securities

Non-marketable equity investments in low-income housing projects are included in other assets on the Company's consolidated balance sheets. The total balance of these investments at September 30, 2010 and December 31, 2009 were \$456,000 and \$520,000, respectively.

Note 4 – 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, adjusted for the net income effect of the

interest expense on the outstanding convertible debentures, 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 antidilutive shares in the three-month and nine-month periods ended September 30, 2010 and 2009. The calculations of basic and diluted earnings per share are as follows:

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(In thousands except share and per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Basic				
Net income	\$ 5,580	\$ 4,318	\$ 15,229	\$ 11,902
Weighted-average common shares outstanding	9,338,006	9,157,055	9,333,884	9,144,521
Basic earnings per share	\$.60	\$.47	\$ 1.63	\$ 1.30
Diluted				
Basic net income	\$ 5,580	\$ 4,318	\$ 15,229	\$ 11,902
Net income effect of 5.33% convertible debentures	—	14	—	55
Diluted net income	5,580	4,332	15,229	11,957
Weighted-average common shares outstanding	9,338,006	9,157,055	9,333,884	9,144,521
Effect of dilutive restricted stock, stock options and stock appreciation rights	116,960	141,907	105,825	124,512
Effect of convertible debentures	—	66,622	—	124,309
Weighted-average common shares outstanding assuming dilution	9,454,966	9,365,584	9,439,709	9,393,342
Diluted earnings per share	\$.59	\$.46	\$ 1.61	\$ 1.27

Note 5 – Stock Repurchases

The Company maintains a treasury stock buyback program pursuant to which the Board of Directors has authorized the repurchase of up to 300,000 shares of the Company's Common Stock. The Company did not repurchase any shares during the nine-month periods ended September 30, 2010 and 2009. As of September 30, 2010, 180,000 shares remained available for repurchase under the program. Repurchases are made in the open market or through negotiated transactions from time to time depending on market conditions.

Note 6 - Comprehensive Income

For the three and nine-month periods ended September 30, 2010 and 2009, unrealized gains and losses on securities available-for-sale and reclassification adjustments for gains included in net income were the Company's other comprehensive income components. Comprehensive income is summarized as follows:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income	\$ 5,580	\$ 4,318	\$ 15,229	\$ 11,902
Other comprehensive income:				
Reclassification adjustments for gains included in net income, net of tax	—	—	—	(131)
Net unrealized gain on securities available-for-sale, net of tax	3,558	4,108	4,066	7,981

Total comprehensive income	\$	9,138	\$	8,426	\$	19,295	\$	19,752
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Note 7 – Industry Segment Information

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

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

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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, 2009. Management evaluates segment performance based on net income after allocations for corporate expenses and income taxes. Transactions between segments are accounted for at what management believes to be fair value.

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

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, 2010				
Total Revenues:				
Revenue from customers	\$ 19,034	\$ 5,657	\$ —	\$ 24,691
Intersegment revenue	2,326	416	(2,742)	—
Net income	3,776	1,804	—	5,580
Total assets	664,112	564,554	(11,237)	1,217,429
Goodwill	7,335	136	—	7,471
Other intangible assets, net	295	—	—	295
Three Months Ended September 30, 2009				
Total Revenues:				
Revenue from customers	\$ 17,152	\$ 4,823	\$ —	\$ 21,975
Intersegment revenue	1,911	414	(2,325)	—
Net income	2,859	1,459	—	4,318
Total assets	536,063	503,744	(6,412)	1,033,395
Goodwill	7,335	136	—	7,471
Other intangible assets, net	402	—	—	402
Nine Months Ended September 30, 2010				
Total Revenues:				
Revenue from customers	\$ 54,813	\$ 16,405	\$ —	\$ 71,218
Intersegment revenue	6,585	1,209	(7,794)	—
Net income	10,033	5,196	—	15,229
Total assets	664,112	564,554	(11,237)	1,217,429
Goodwill	7,335	136	—	7,471
Other intangible assets, net	295	—	—	295
Nine Months Ended September 30, 2009				
Total Revenues:				
Revenue from customers	\$ 51,526	\$ 13,895	\$ —	\$ 65,421
Intersegment revenue	5,259	1,159	(6,418)	—
Net income	8,124	3,778	—	11,902
Total assets	536,063	503,744	(6,412)	1,033,395
Goodwill	7,335	136	—	7,471
Other intangible assets, net	402	—	—	402

Note 8 - Loans by Type

(In thousands)	September 30, 2010	December 31, 2009
Commercial and industrial	\$ 127,659	\$ 93,371

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Real estate: (Commercial and church)

Mortgage	501,536	469,097
Construction	58,547	74,407
Industrial revenue bonds	1,078	2,676
Other	863	2,406
Total loans	\$ 689,683	\$ 641,957

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Note 9 – 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, 2010 and December 31, 2009, 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, 2010, the balance of unused loan commitments, standby and commercial letters of credit were \$38,845,000, \$18,738,000 and \$3,571,000, 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 its 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, 2010:

(In thousands)	Amount of Commitment Expiration per Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	Over 5 Years
Operating lease commitments	\$ 2,480	\$ 702	\$ 903	\$ 456	\$ 419
Time deposits	151,519	130,093	19,164	2,262	¾
Total	\$ 153,999	\$ 130,795	\$ 20,067	\$ 2,718	\$ 419

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 10 – Stock-Based Compensation

In 2007, the Board and the Company's shareholders approved the 2007 Omnibus Incentive Stock Plan (the "Omnibus Plan"). The Omnibus Plan permits the issuance of up to 880,000 shares of the Company's common stock in the form of stock options, stock appreciation rights ("SARs"), restricted stock, restricted stock units and performance awards. The Company issues shares out of treasury stock for these awards. During the nine months ended September 30, 2010, 15,149 restricted shares and 23,311 SARs were granted under the Omnibus Plan.

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

Restricted Stock

Restricted shares are amortized to expense over the three-year vesting period. As of September 30, 2010, the total unrecognized compensation expense related to non-vested common stock was \$924,000 and the related weighted-average period over which it is expected to be recognized is approximately .9 years.

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

	Nine Months Ended September 30, 2010	
	Shares	Fair Value
Balance at December 31, 2009	75,965	\$ 28.97
Granted	15,149	30.91
Vested	(40,838)	30.25
Balance at September 30, 2010	50,276	\$ 28.51

Stock Options

Stock options vest and expire over a period not to exceed seven years. As of September 30, 2010, the total unrecognized compensation expense related to non-vested stock options was \$39,000, and the related weighted-average period over which it is expected to be recognized is approximately 2.0 years. Following is a summary of the activity of the stock options during the nine-month period ended September 30, 2010:

	Shares	Weighted- Average Exercise Price	Average Remaining Contractual Term Years	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2009	44,120	\$ 17.65		
Exercised	(3,302)	14.10		
Outstanding at September 30, 2010	40,818	17.93	1.7	\$ 830
Exercisable at September 30, 2010	28,378	\$ 17.12	1.5	\$ 519

The total intrinsic value of options exercised was \$60,000 and \$279,000 for the nine-month periods ended September 30, 2010 and 2009, respectively. Following is a summary of the activity of the non-vested stock options during the nine-month period ended September 30, 2010:

	Shares	Weighted- Average Grant Date Fair Value
Nonvested at December 31, 2009	27,586	\$ 2.81
Vested	(15,146)	2.70
Nonvested at September 30, 2010	12,440	\$ 2.94

SARs

SARs vest over a three-year period with one-third of the shares vesting and becoming exercisable each year on the anniversary date of the grant and they expire 10 years from the original grant date. As of September 30, 2010, the total unrecognized compensation expense was \$653,000 and the related weighted-average period over which it is expected to be recognized is 1.0 year. Following is a summary of the activity of the Company's SARs program for the nine-month period ended September 30, 2010:

	Shares	Weighted- Average Exercise Price	Average Remaining Contractual Term Years	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2009	231,262	\$ 27.02		
Granted	23,311	30.16		

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Exercised	(1,012)	33.29		
Outstanding at September 30, 2010	253,561	27.31	8.09	1,776
Exercisable at September 30, 2010	112,360	\$ 27.47	5.02	769

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Following is a summary of the activity of the nonvested SARs during the nine-month period ended September 30, 2010:

	Shares	Weighted-Average Grant Date Fair Value
Nonvested at December 31, 2009	195,119	\$ 6.74
Granted	23,311	9.12
Vested	(77,229)	6.89
Nonvested at September 30, 2010	141,201	\$ 7.06

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

	Nine Months Ended September 30,	
	2010	2009
Risk-free interest rate	3.33%	1.94%
Expected life	7 yrs.	7 yrs.
Expected volatility	30.00%	27.00%
Expected dividend yield	1.86%	2.02%

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

Note 11 – Defined Pension Plans

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

(In thousands)	Estimated 2010	Actual 2009
Service cost – benefits earned during the year	\$ 1,771	\$ 1,606
Interest cost on projected benefit obligation	2,291	2,080
Expected return on plan assets	(2,440)	(1,880)
Net amortization	615	873
Net periodic pension cost	\$ 2,237	\$ 2,679

Pension costs recorded to expense were \$594,000 and \$668,000 for the three-month periods ended September 30, 2010 and 2009, respectively, and totaled \$1,678,000 and \$2,009,000 for the nine-month periods ended September 30, 2010 and 2009, respectively. The Company made a contribution of \$450,000 to the plan during the three-month period ended September 30, 2010, for a total of \$1,350,000 for the nine-month period ending September 30, 2010 and expects to contribute at least an additional \$450,000 in 2010.

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 2009 and an estimate for 2010:

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(In thousands)	Estimated 2010	Actual 2009
Service cost – benefits earned during the year	\$ 78	\$ 33
Interest cost on projected benefit obligation	315	278
Net amortization	257	130
Net periodic pension cost	\$ 650	\$ 441

Pension costs recorded to expense were \$158,000 and \$103,000 for the three-month periods ended September 30, 2010 and 2009, respectively, and were \$488,000 and \$330,000 for the nine-month periods ended September 30, 2010 and 2009, respectively.

Note 12 – Income Taxes

During the nine months ended September 30, 2010, unrecognized tax benefits increased by \$63,000 and related accrued interest increased by \$37,000. As of December 31, 2009, the Company's unrecognized tax benefits were approximately \$1,750,000, of which \$1,466,000 would, if recognized, affect the Company's effective tax rate. During the next twelve months, the Company may realize a reduction of its unrecognized tax benefits of approximately \$497,000 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. At December 31, 2009, before any tax benefits, the Company had \$147,000 of accrued interest on unrecognized tax benefits. There were no penalties for unrecognized tax benefits accrued at December 31, 2009.

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 2007 and 2008 remain subject to examination by the Internal Revenue Service. In addition, the Company is subject to state tax examinations for the tax years 2005 through 2008.

Note 13 – Investment Securities Available-for-Sale

Effective July 1, 2009, the Company adopted FASB ASC 820, “Fair Value Measurements and Disclosures.” Investment securities available-for-sale are recorded at fair value on a recurring basis. The Company’s investment securities available-for-sale are measured at fair value using Level 2 valuations. The market evaluation utilizes several sources which include “observable inputs” rather than “significant unobservable inputs” and therefore falls into the Level 2 category. The amortized cost, gross unrealized gains, gross unrealized losses and fair value of investment securities are summarized as follows:

(In thousands)	Amortized Cost	September 30, 2010		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
State and political subdivisions	\$ 220,060	\$ 18,202	\$ —	\$ 238,262

(In thousands)	Amortized Cost	December 31, 2009		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	

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State and political subdivisions	\$ 212,651	\$ 11,970	\$ 24	\$ 224,597
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The fair values of securities with unrealized losses are as follows:

(In thousands)	September 30, 2010					
	Less than 12 months		12 months or more		Total	
	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated Fair value	Unrealized losses
State and political subdivisions	\$ ¾	\$ ¾	\$ ¾	\$ ¾	\$ ¾	\$ ¾

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(In thousands)	December 31, 2009					
	Less than 12 months		12 months or more		Total	
	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated Fair value	Unrealized losses
State and political subdivisions	\$ 1,415	\$ 24	\$ ¾	\$ ¾	\$ 1,415	\$ 24

There were no securities in an unrealized loss position as of September 30, 2010. There were two securities (none greater than 12 months) in an unrealized loss position as of December 31, 2009. All unrealized losses were reviewed to determine whether the losses were other than temporary.

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.

(In thousands)	September 30, 2010	
	Amortized Cost	Fair Value
Due in 1 year or less	\$ 7,194	\$ 7,282
Due after 1 year through 5 years	39,371	41,792
Due after 5 years through 10 years	112,089	123,753
Due after 10 years	61,406	65,435
Total	\$ 220,060	\$ 238,262

The amortized cost of investment securities pledged to secure public deposits and for other purposes at September 30, 2010 was \$18,090,000.

There were no sales of investment securities for the three months ended September 30, 2010 and 2009. Proceeds from sales of investment securities were \$0 and \$14,591,000 for the nine months ended September 30, 2010 and 2009, respectively. Gross realized gains were \$202,000 for the nine months ended September 30, 2009.

Note 14 – Fair Value of Financial Instruments

Effective July 1, 2009, the Company adopted FASB ASC 270, “Interim Reporting.” Following is a summary of the carrying amounts and fair values of the Company’s financial instruments:

(In thousands)	September 30, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Balance sheet assets:				
Cash and cash equivalents	\$ 209,468	\$ 209,468	\$ 79,294	\$ 79,294
Investment securities	238,262	238,262	224,597	224,597
Loans, net	678,925	693,150	633,673	634,598
Accrued interest receivable	5,366	5,366	5,294	5,294
Total	\$ 1,132,021	\$ 1,146,246	\$ 942,858	\$ 943,783
Balance sheet liabilities:				
Deposits	\$ 501,259	\$ 501,259	\$ 437,876	\$ 437,876
Accounts and drafts payable	554,945	554,945	430,251	430,251
Short-term borrowings	13	13	26	26
Accrued interest payable	283	283	227	227
Total	\$ 1,056,500	\$ 1,056,500	\$ 868,380	\$ 868,380

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

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

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Loans – The Company does not record loans at fair value on a recurring basis other than loans that are considered impaired. Once a loan is identified as impaired, management measures impairment in accordance with FASB ASC 310, “Allowance for Credit Losses.” At September 30, 2010, all impaired loans were evaluated based on the fair value of the collateral. The fair value of the collateral is based upon an observable market price or current appraised value and therefore, the Company classifies these assets as nonrecurring Level 2. The total principal balance of impaired loans measured at fair value at September 30, 2010 and December 31, 2009 were \$618,000 and \$1,115,000, respectively. The fair value of loans in the above table is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

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

Note 15 – Subsequent Events

In accordance with FASB ASC 855, “Subsequent Events,” the Company has evaluated subsequent events after the consolidated balance sheet date of September 30, 2010 and there were no events identified that would require additional disclosures to prevent the Company’s consolidated financial statements from being misleading.

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

Overview

Cass provides payment and information processing services to large manufacturing, distribution and retail enterprises from its processing centers in St. Louis, Missouri, Columbus, Ohio, Boston, Massachusetts, Greenville, South Carolina and Wellington, Kansas. The Company's services include freight invoice rating, payment processing, auditing, and the generation of accounting and transportation information. Cass also processes and pays utility invoices, which includes electricity, gas and telecommunications expenses and is a provider of telecom expense management solutions. Cass extracts, stores and presents information from freight, utility and telecommunication invoices, assisting its customers' transportation, energy and information technology managers in making decisions that will enable them to improve operating performance. The Company receives data from multiple sources, electronic and otherwise, and processes the data to accomplish the specific operating requirements of its customers. It then provides the data in a central repository for access and archiving. The data is finally transformed into information through the Company's databases that allow client interaction as required and provides Internet-based tools for analytical processing. The Company also, through Cass Commercial Bank, its St. Louis, Missouri based bank subsidiary (the "Bank"), provides banking services in the St. Louis metropolitan area, Orange County, California and other selected cities in the United States. In addition to supporting the Company's payment operations, the Bank provides banking services to its target markets, which include privately-owned businesses and churches and church-related ministries.

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

Industry-wide factors that impact the Company include the willingness of large corporations to outsource key business functions such as freight, utility and telecommunication 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. As lower levels of economic activity are encountered, such as those experienced in 2009, the number and total dollar amount of transactions processed by the Company may decline, thereby reducing fee revenue, interest income, and possibly liquidity. Conversely, improving economic conditions, as those experienced in 2010, will tend to increase fee revenue, interest income and liquidity. 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 2009 Annual Report on Form 10-K, a decline in the general level of interest rates can have a negative impact on net interest income.

Currently, management views Cass’ major opportunity as the continued expansion of its payment and information processing service offering and customer base. While the economic slow-down in 2009 reduced the short-term growth rate, management remains optimistic about the long-term prospects for growth.

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Critical Accounting Policies

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

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

Impairment of Assets. The Company periodically evaluates certain long-term assets such as intangible assets including goodwill, foreclosed assets and investments in private equity securities and assets held for sale for impairment. Generally, these assets are initially recorded at cost, and recognition of impairment is required when events and circumstances indicate that the carrying amounts of these assets will not be recoverable in the future. If impairment occurs, various methods of measuring impairment may be called for depending on the circumstances and type of asset, including quoted market prices, estimates based on similar assets, and estimates based on valuation techniques such as discounted projected cash flows. The Company had no impairment of goodwill and intangible assets for the three or nine month periods ended September 30, 2010 or for the fiscal year ended December 31, 2009, and management does not anticipate any future impairment loss. Investment securities available-for-sale are measured at fair value using Level 2 valuations calculated by an independent research firm. The market evaluation utilizes several sources which include “observable inputs” rather than “significant unobservable inputs.” These policies affect both segments of the Company and require significant management assumptions and estimates that could result in materially different results if conditions or underlying circumstances change.

Income Taxes. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity’s financial statements or tax returns. Judgment is required in addressing the future tax consequences of events that have been recognized in the Company’s financial statements or tax returns such as the realization of deferred tax assets or changes in tax laws or interpretations thereof. In addition, the Company is subject to the continuous examination of its income tax returns by the Internal Revenue Service and other taxing authorities. In accordance with ASC 740, “Income Taxes,” the Company has unrecognized tax benefits related to tax positions taken or expected to be taken. See Note 12 to the financial statements.

Pension Plans. The amounts recognized in the consolidated financial statements related to pension plans are determined from actuarial valuations. Inherent in these valuations are assumptions, including expected return on plan assets, discount rates at which the liabilities could be settled, rate of increase in future compensation levels and mortality rates. These assumptions are updated annually and are disclosed in Note 11 to the consolidated financial statements filed with the Company’s Annual Report on Form 10-K for the year ended December 31, 2009. There have been no significant changes in the Company’s long-term rate of return assumptions for the past three fiscal years

ended December 31 and management believes they are not reasonably likely to change in the future. Pursuant to ASC 715, "Compensation – Retirement Benefits," the Company has recognized the funded status of its defined benefit postretirement plan in its statement of financial position and has recognized changes in that funded status through comprehensive income. The funded status is measured as the difference between the fair value of the plan assets and the benefit obligation as of the date of its fiscal year-end.

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Results of Operations

The following paragraphs discuss the results of operations and changes in financial condition for the three-month period ended September 30, 2010 (“Third Quarter of 2010”) compared to the three-month period ended September 30, 2009 (“Third Quarter of 2009”) and the nine-month period ended September 30, 2010 (“Nine Months Ended September 30, 2010”) compared to the nine-month period ended September 30, 2009 (“Nine Months Ended September 30, 2009”). The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes and with the statistical information and financial data appearing in this report as well as the Company's 2009 Annual Report on Form 10-K. Results of operations for the Third Quarter of 2010 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:

(In thousands except per share data)	Third Quarter			Nine Months Ended		
	2010	2009	% Change	2010	2009	% Change
Net income	\$ 5,580	\$ 4,318	29.2%	\$ 15,229	\$ 11,902	28.0%
Diluted earnings per share	\$.59	\$.46	28.3%	\$ 1.61	\$ 1.27	26.8%
Return on average assets	1.84%	1.68%	—	1.80%	1.69%	—
Return on average equity	15.72%	14.44%	—	15.03%	13.84%	—

Fee Revenue and Other Income

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

(In thousands)	Third Quarter			Nine Months Ended		
	2010	2009	% Change	2010	2009	% Change
Transportation Invoice Volume	6,886	5,962	15.5%	19,619	17,073	14.9%
Transportation Dollar Volume	\$ 4,534,235	\$ 3,573,371	26.9%	\$ 12,497,079	\$ 10,351,933	20.7%
Utility Transaction Volume	3,061	2,903	5.4%	9,161	8,556	7.1%
Utility Dollar Volume	\$ 2,878,647	\$ 2,546,747	13.0%	\$ 7,938,521	\$ 7,305,848	8.7%
Payment and Processing Fees	\$ 13,895	\$ 12,302	12.9%	\$ 40,173	\$ 36,282	10.7%

Third Quarter of 2010 compared to Third Quarter of 2009:

Transportation and utility transaction volumes were up 16% and 5%, respectively, and dollar volumes were up 27% and 13%, respectively, due to new business and improved activity for existing customers.

Bank service fees increased \$75,000, or 26%, due to an increase in letter of credit fees and higher bank commission and foreign exchange fees. Other income was approximately the same as the prior period. There were no gains on sales of securities in the Third Quarter of 2010.

Nine Months Ended September 30, 2010 compared to Nine Months Ended September 30, 2009:

Transportation and utility transaction volumes were up 15% and 7%, respectively, and dollar volumes were up 21% and 9%, respectively, due to new business and improved activity for existing customers.

Bank service fees decreased \$31,000, or 3%, due to a decrease in account analysis fees as more customers chose to pay for services with compensating balances rather than fees partially offset by higher letter of credit fees and bank commission and foreign exchange fees. Other income was approximately the same as the prior period. There were no gains on sales of securities in the Nine Months Ended September 30, 2010.

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Net Interest Income

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

(In thousands)	Third Quarter			Nine Months Ended		
	2010	2009	% Change	2010	2009	% Change
Average earnings assets	\$ 1,102,218	\$ 938,566	7.8%	\$ 1,035,345	\$ 858,557	20.6%
Average interest-bearing liabilities	367,571	308,980	19.0%	342,063	255,875	33.7%
Net interest income*	12,405	10,652	16.4%	36,103	31,584	14.3%
Net interest margin*	4.47%	4.50%	—	4.66%	4.92%	—
Yield on earning assets*	4.91%	5.09%	—	5.13%	5.49%	—
Rate on interest-bearing liabilities	1.35%	1.80%	—	1.42%	1.92%	—

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

Third Quarter of 2010 compared to Third Quarter of 2009:

Third Quarter 2010 average earning assets increased 8% compared to the same period in the prior year (see discussion in the following paragraphs). The yield on earning assets and the tax equivalent net interest margin both decreased in 2010 as the general level of interest rates declined; however, the significant increase in average earning assets caused net interest income to increase 16%.

Total average loans increased \$57,293,000, or 9%, to \$677,715,000 for the Third Quarter of 2010 as compared to the Third Quarter of 2009. This increase was attributable to successful marketing efforts by the Company's lending staff. Average investment securities increased \$31,695,000, or 17%, to \$219,432,000, as the Company took advantage of buying opportunities in the market.

Total average interest-bearing deposits for the Third Quarter of 2010 increased \$60,515,000, or 20%, to \$367,507,000 compared to the Third Quarter of 2009, primarily due to customers transferring funds from lower-yielding investments at other institutions. Accounts and drafts payable increased \$100,308,000, or 22%, as freight and utility payment processing activities increased.

Nine Months Ended September 30, 2010 compared to Nine Months Ended September 30, 2009:

Average earning assets for the Nine months Ended September 30, 2010 increased 21% compared to the same period in the prior year (see discussion in the following paragraphs). The yield on earning assets and the tax equivalent net interest margin both decreased in 2010 as the general level of interest rates declined; however, the significant increase in average earning assets caused net interest income to increase 14%.

Total average loans increased \$59,570,000, or 10%, to \$667,167,000 for the Nine Months Ended September 30, 2010 as compared to the Nine Months Ended September 30, 2009. This increase was attributable to successful marketing

efforts by the Company's lending staff. Average investment securities increased \$30,713,000, or 16%, to \$217,048,000, as the Company took advantage of buying opportunities in the market.

Total average interest-bearing deposits for the Nine Months Ended September 30, 2010 increased \$93,798,000, or 38%, to \$342,024,000 compared to the Nine Months Ended September 30, 2009, primarily due to customers transferring funds from lower-yielding investments at other institutions. Accounts and drafts payable increased \$72,099,000, or 16%, as freight and utility payment processing activities increased.

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

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

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

(In thousands)	Third Quarter of 2010			Third Quarter of 2009		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
Assets¹						
Earning assets:						
Loans ^{2, 3} :						
Taxable	\$ 676,406	\$ 10,173	5.97%	\$ 617,368	\$ 9,093	5.84%
Tax-exempt ⁴	1,309	14	4.24	3,054	49	6.37
Debt and equity securities ⁵ :						
Taxable	928	3	1.28	3,425	15	1.74
Tax-exempt ⁴	218,504	3,314	6.02	184,312	2,837	6.11
Interest-bearing deposits in other financial institutions						
	45,982	42	.36	43,016	24	.22
Federal funds sold and other short-term investments						
	159,089	108	.27	87,391	33	.15
Total earning assets	1,102,218	13,654	4.91	938,566	12,051	5.09
Non-earning assets:						
Cash and due from banks						
	10,837			10,028		
Premise and equipment, net						
	9,839			10,996		
Bank owned life insurance						
	13,993			13,446		
Goodwill and other intangibles						
	7,781			7,901		
Other assets						
	68,351			45,167		
Allowance for loan losses						
	(10,316)			(7,075)		
Total assets	\$ 1,202,703			\$ 1,019,029		
Liabilities and Shareholders' Equity¹						
Interest-bearing liabilities:						
Interest-bearing demand deposits						
	\$ 183,806	\$ 521	1.12%	\$ 141,077	\$ 499	1.40%
Savings deposits	29,252	83	1.13	30,356	104	1.36
Time deposits >= \$100	53,591	207	1.53	46,503	264	2.25
Other time deposits	100,858	438	1.72	89,056	505	2.25
Total interest-bearing deposits	367,507	1,249	1.35	306,992	1,372	1.77
Short-term borrowings & other						
	64	—	—	13	—	—
Subordinated debentures						
	—	—	—	1,975	27	5.42
	367,571	1,249	1.35	308,980	1,399	1.80

Total interest bearing liabilities			
Non-interest bearing liabilities:			
Demand deposits	113,835		106,685
Accounts and drafts payable	565,241		464,933
Other liabilities	15,194		19,804
Total liabilities	1,061,841		900,402
Shareholders' equity	140,862		118,627
Total liabilities and shareholders' equity	\$ 1,202,703		\$ 1,019,029
Net interest income		\$ 12,405	\$ 10,652
Interest spread		3.56%	3.29%
Net interest margin		4.47	