CASS INFORMATION SYSTEMS INC
Form 10-Q
August 04, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017

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 _____ Accelerated Filer X

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

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

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

Yes _____ No __X__

The number of shares outstanding of the registrant's only class of common stock as of July 28, 2017: Common stock, par value $.50 per share 11,203,801 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 2016 Annual Report on Form 10-K, filed with the Securities and Exchange Commission (SEC), which may be updated from time to time in our future filings with the SEC. We undertake no obligation to publicly update or revise any forward-looking statements to reflect changed assumptions, the occurrence of anticipated or unanticipated events, or changes to future results over time.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CASS INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands except Share and Per Share Data)

		June 30, 2017 (Unaudited)		December 31, 2016
Assets				
Cash and due from banks	$	14,538	$	11,814
Interest-bearing deposits in other financial institutions		99,984		136,852
Federal funds sold and other short-term investments		186,538		118,077
Cash and cash equivalents		301,060		266,743
Securities available-for-sale, at fair value		431,979		390,552
Loans		671,683		664,866
Less: Allowance for loan losses		10,196		10,175
Loans, net		661,487		654,691
Premises and equipment, net		21,259		21,086
Investment in bank-owned life insurance		16,692		16,445
Payments in excess of funding		111,435		105,347
Goodwill		12,569		11,590
Other intangible assets, net		2,217		1,997
Other assets		34,584		36,388
Total assets	$	1,593,282	$	1,504,839
Liabilities and Shareholders Equity				
Liabilities:				
Deposits:				
Noninterest-bearing	$	201,942	$	214,656
Interest-bearing		403,097		407,305
Total deposits		605,039		621,961
Accounts and drafts payable		729,403		642,287
Other liabilities		37,482		32,556
Total liabilities		1,371,924		1,296,804
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 11,931,147 shares issued at June 30, 2017 and December 31, 2016		5,966		5,966
Additional paid-in capital		128,478		128,455
Retained earnings		126,032		118,363
Common shares in treasury, at cost (727,346 shares at June 30, 2017 and 742,681 shares at December 31, 2016)		(29,922)		(30,206)
Accumulated other comprehensive loss		(9,196)		(14,543)
Total shareholders equity		221,358		208,035
Total liabilities and shareholders equity	$	1,593,282	$	1,504,839

See accompanying notes to unaudited consolidated financial statements.

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

(Unaudited)

(Dollars in Thousands except Per Share Data)

	Three Months Ended June 30, 2017	Three Months Ended June 30, 2016	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016
Fee Revenue and Other Income:				
Information services payment and processing revenue	$ 23,282	$ 20,880	$ 45,571	$ 40,425
Bank service fees	389	289	671	647
Gains on sales of securities		79		387
Other	129	209	329	503
Total fee revenue and other income	23,800	21,457	46,571	41,962
Interest Income:				
Interest and fees on loans	7,104	7,316	14,057	14,447
Interest and dividends on securities:				
Taxable	84	21	161	33
Exempt from federal income taxes	2,659	2,437	5,260	4,831
Interest on federal funds sold and other short-term investments	485	236	853	476
Total interest income	10,332	10,010	20,331	19,787
Interest Expense:				
Interest on deposits	470	504	950	1,017
Net interest income	9,862	9,506	19,381	18,770
Provision for loan losses				(1,000)
Net interest income after provision for loan losses	9,862	9,506	19,381	19,770
Total net revenue	33,662	30,963	65,952	61,732
Operating Expense:				
Personnel	19,162	18,102	37,961	35,948
Occupancy	889	866	1,731	1,700
Equipment	1,200	1,110	2,504	2,165
Amortization of intangible assets	108	102	207	204
Other operating expense	3,542	2,879	6,816	5,958
Total operating expense	24,901	23,059	49,219	45,975
Income before income tax expense	8,761	7,904	16,733	15,757
Income tax expense	2,248	2,035	3,913	4,055
Net income	$ 6,513	$ 5,869	$ 12,820	$ 11,702
Basic earnings per share	$ .58	$ .53	$ 1.15	$ 1.05
Diluted earnings per share	.58	.52	1.13	1.03

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended June 30, 2017	Three Months Ended June 30, 2016	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016
Comprehensive Income:				
Net income	$ 6,513	$ 5,869	$ 12,820	$ 11,702
Other comprehensive income:				
Net unrealized gain on securities available-for-sale	5,832	4,538	8,345	8,212
Tax effect	(2,167)	(1,686)	(3,100)	(3,051)
Reclassification adjustments for gains included in net income		(79)		(387)
Tax effect		29		143
Foreign currency translation adjustments	94	(35)	102	11
Total comprehensive income	$ 10,272	$ 8,636	$ 18,167	$ 16,630

See accompanying notes to unaudited consolidated financial statements.

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

	Six Months Ended June 30, 2017	June 30, 2016
Cash Flows From Operating Activities:		
Net income	$ 12,820	$ 11,702
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,471	4,613
Net gains on sales of securities		(387)
Stock-based compensation expense	1,097	985
Provision for loan losses		(1,000)
Decrease in income tax benefit		16
Increase in income tax liability	748	1,325
Increase in pension liability	2,310	2,010
Other operating activities, net	(978)	(1,512)
Net cash provided by operating activities	21,468	17,752
Cash Flows From Investing Activities:		
Proceeds from sales of securities available-for-sale		21,491
Proceeds from maturities of securities available-for-sale	25,694	19,609
Purchase of securities available-for-sale	(62,279)	(28,053)
Net increase in loans	(6,796)	(39,042)
Increase in payments in excess of funding	(6,088)	(11,674)
Purchases of premises and equipment, net	(1,935)	(2,631)
Net cash used in investing activities	(51,404)	(40,300)
Cash Flows From Financing Activities:		
Net (decrease) increase in noninterest-bearing demand deposits	(12,714)	13,813
Net decrease in interest-bearing demand and savings deposits	(1,077)	(27,575)
Net decrease in time deposits	(3,131)	(1,728)
Net increase in accounts and drafts payable	87,116	73,729
Cash dividends paid	(5,151)	(4,947)
Purchase of common shares for treasury		(9,217)
Other financing activities, net	(790)	(566)
Net cash provided by financing activities	64,253	43,509
Net increase in cash and cash equivalents	34,317	20,961
Cash and cash equivalents at beginning of period	266,743	253,172
Cash and cash equivalents at end of period	$ 301,060	$ 274,133
Supplemental information:		
Cash paid for interest	$ 956	$ 1,009
Cash paid for income taxes	3,152	2,787

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. 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, 2016.

Note 2 Intangible Assets

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

In March 2017, the Company completed an acquisition and recorded intangible assets of $1,406,000. Those intangible assets were valued as $980,000 for goodwill, $355,000 for the customer list and $71,000 for non-compete agreements.

Details of the Company s intangible assets are as follows:

	June 30, 2017		December 31, 2016	
(In thousands)	**Gross Carrying Amount**	**Accumulated Amortization**	**Gross Carrying Amount**	**Accumulated Amortization**
Assets eligible for amortization:				
Customer lists	$ 4,288	$ (2,517)	$ 3,933	$ (2,342)
Patents	72	(10)	72	(8)
Non-compete agreements	332	(273)	261	(261)
Software	234	(234)	234	(234)
Other	500	(175)	500	(158)
Unamortized intangible assets:				
Goodwill[1]	12,796	(227)	11,817	(227)
Total intangible assets	$ 18,222	$ (3,436)	$ 16,817	$ (3,230)

[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 fifteen years. Amortization of intangible assets amounted to $207,000 and $204,000 for the six-month periods ended June 30, 2017 and 2016, respectively. Estimated annual amortization of intangibles is as follows: $427,000 in 2017, $442,000 in 2018, $412,000 in 2019, and $406,000 in each of 2020 and 2021.

Note 3 Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding. Diluted earnings per share is computed by dividing net income by the sum of the weighted-average number of common shares outstanding and the weighted-average number of potential common shares outstanding. There were no anti-dilutive shares in the three and six months ended June 30, 2017 and 2016. The calculations of basic and diluted earnings per share are as follows:

(In thousands except share and per share data)	Three Months Ended June 30, 2017	2016	Six Months Ended June 30, 2017	2016
Basic				
Net income	$ 6,513	$ 5,869	$ 12,820	$ 11,702
Weighted-average common shares outstanding	11,153,260	11,134,559	11,145,996	11,184,058
Basic earnings per share	$ .58	$ .53	$ 1.15	$ 1.05
Diluted				
Net income	$ 6,513	$ 5,869	$ 12,820	$ 11,702
Weighted-average common shares outstanding	11,153,260	11,134,559	11,145,996	11,184,058
Effect of dilutive restricted stock and stock appreciation rights	168,241	153,459	167,460	153,379
Weighted-average common shares outstanding assuming dilution	11,321,501	11,288,018	11,313,456	11,337,437
Diluted earnings per share	$ .58	$ .52	$ 1.13	$ 1.03

Note 4 Stock Repurchases

The Company maintains a treasury stock buyback program pursuant to which the Board of Directors has authorized the repurchase of up to 500,000 shares of the Company s common stock. As restored by the Board of Directors on October 17, 2016, 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 111,241 shares during the three-month periods and 0 and 187,123 shares for the six-month periods ended June 30, 2017 and 2016, respectively. As of June 30, 2017, 500,000 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, processing and capital requirements.

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

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, 2016. Management evaluates segment performance based on net income after allocations for corporate expenses and income taxes. Transactions between segments are accounted for at what management believes to be fair value.

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

Assets represent actual assets owned by Information Services and Banking Services and there is no allocation methodology used. Segment interest from customers is the actual interest earned on the loans owned by Information Services and Banking Services, respectively.

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

(In thousands)	Information Services	Banking Services	Corporate, Eliminations and Other	Total
Three Months Ended June 30, 2017				
Fee revenue and other income:				
Income from customers	$ 26,749	$ 6,913	$	$ 33,662
Intersegment income (expense)	3,049	383	(3,432)	
Net income	3,932	2,581		6,513
Goodwill	12,433	136		12,569
Other intangible assets, net	2,217			2,217
Total assets	863,562	742,659	(12,939)	1,593,282
Three Months Ended June 30, 2016				
Fee revenue and other income				
Income from customers	$ 24,436	$ 6,527	$	$ 30,963
Intersegment income (expense)	2,815	403	(3,218)	
Net income	3,478	2,391		5,869
Goodwill	11,454	136		11,590
Other intangible assets, net	2,201			2,201
Total assets	777,312	753,333	(9,461)	1,521,184
Six Months Ended June 30, 2017				
Fee revenue and other income:				
Income from customers	$ 52,395	$ 13,557	$	$ 65,952
Intersegment income (expense)	6,013	744	(6,757)	
Net income	7,755	5,065		12,820
Goodwill	12,433	136		12,569
Other intangible assets, net	2,217			2,217
Total assets	863,562	742,659	(12,939)	1,593,282
Six Months Ended June 30, 2016				
Fee revenue and other income:				
Income from customers	$ 47,994	$ 13,738	$	$ 61,732
Intersegment income (expense)	6,073	779	(6,852)	
Net income	6,425	5,277		11,702
Goodwill	11,454	136		11,590
Other intangible assets, net	2,201			2,201
Total assets	777,312	753,333	(9,461)	1,521,184

Note 6 Loans by Type

A summary of loan categories is as follows:

(In thousands)	June 30, 2017	December 31, 2016
Commercial and industrial	$ 225,627	$ 214,767
Real estate		
Commercial:		
Mortgage	94,367	104,779
Construction	8,482	6,325
Church, church-related:		
Mortgage	325,906	321,168
Construction	12,214	11,152
Industrial revenue bonds	5,007	6,639
Other	80	36
Total loans	$ 671,683	$ 664,866

The following table presents the aging of loans by loan categories at June 30, 2017 and December 31, 2016:

	Performing			Nonperforming		
(In thousands)	Current	30-59 Days	60-89 Days	90 Days and Over	Non-accrual	Total Loans
June 30, 2017						
Commercial and industrial	$ 225,627	$	$	$	$	$ 225,627
Real estate						
Commercial:						
Mortgage	94,148				219	94,367
Construction	8,482					8,482
Church, church-related:						
Mortgage	325,906					325,906
Construction	12,214					12,214
Industrial revenue bonds	5,007					5,007
Other	80					80
Total	$ 671,464	$	$	$	$ 219	$ 671,683
December 31, 2016						
Commercial and industrial	$ 214,767	$	$	$	$	$ 214,767
Real estate						
Commercial:						
Mortgage	104,534				245	104,779
Construction	6,325					6,325
Church, church-related:						
Mortgage	321,168					321,168
Construction	11,152					11,152
Industrial revenue bonds	6,639					6,639
Other	24	12				36
Total	$ 664,609	$ 12	$	$	$ 245	$ 664,866

The following table presents the credit exposure of the loan portfolio by internally credit grade as of June 30, 2017 and December 31, 2016:

(In thousands)	Loans Subject to Normal Monitoring[1]	Performing Loans Subject to Special Monitoring[2]	Nonperforming Loans Subject to Special Monitoring[2]	Total Loans
June 30, 2017				
Commercial and industrial	$ 223,968	$ 1,659	$	$ 225,627
Real estate				
Commercial:				
Mortgage	93,422	726	219	94,367
Construction	8,482			8,482
Church, church-related:				
Mortgage	325,822	84		325,906
Construction	12,214			12,214
Industrial Revenue Bonds	5,007			5,007
Other	80			80
Total	$ 668,995	$ 2,469	$ 219	$ 671,683
December 31, 2016				
Commercial and industrial	$ 213,024	$ 1,743	$	$ 214,767
Real estate				
Commercial:				
Mortgage	103,778	756	245	104,779
Construction	6,325			6,325
Church, church-related:				
Mortgage	318,030	3,138		321,168
Construction	11,152			11,152
Industrial revenue bonds	6,639			6,639
Other	36			36
Total	$ 658,984	$ 5,637	$ 245	$ 664,866

[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. At June 30, 2017 and December 31, 2016, impaired loans were evaluated using the expected cash flow method. There were no loans delinquent 90 days or more and still accruing interest at June 30, 2017 and December 31, 2016. There were no loans classified as troubled debt restructuring at June 30, 2017 and December 31, 2016.

There were no foreclosed loans recorded as other real estate owned as of June 30, 2017, and December 31, 2016.

The following table presents the recorded investment and unpaid principal balance for impaired loans at June 30, 2017 and December 31, 2016:

(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance for Loan Losses
June 30, 2017			
Commercial and industrial:			
Nonaccrual	$	$	$
Real estate			
Commercial Mortgage:			
Nonaccrual	219	219	
Church Mortgage:			
Nonaccrual			
Total impaired loans	$ 219	$ 219	$
December 31, 2016			
Commercial and industrial:			
Nonaccrual	$	$	$
Real estate			
Commercial Mortgage:			
Nonaccrual	245	245	
Church Mortgage:			
Nonaccrual			
Total impaired loans	$ 245	$ 245	$

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

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

A summary of the activity in the allowance for loan losses from December 31, 2015 to June 30, 2016 is as follows:

(In thousands)	December 31, 2015	Charge-Offs	Recoveries	Provision	June 30, 2016
Commercial and industrial	$ 3,083	$	$ 37	$ 497	$ 3,617
Real estate					
Commercial:					
Mortgage	2,803			(1,113)	1,690
Construction	9			96	105
Church, church-related:					
Mortgage	4,082			34	4,116
Construction	217			(30)	187
Industrial Revenue Bonds	320			(34)	286
Other	1,121			(450)	671
Total	$ 11,635	$	$ 37	$ (1,000)	$ 10,672

Note 7 Commitments and Contingencies

In the normal course of business, the Company is party to activities that contain credit, market and operational risks that are not reflected in whole or in part in the Company s consolidated financial statements. Such activities include traditional off-balance sheet credit-related financial instruments and commitments under operating leases. These financial instruments include commitments to extend credit, commercial letters of credit and standby letters of credit. The Company s maximum potential exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, commercial letters of credit and standby letters of credit is represented by the contractual amounts of those instruments. At June 30, 2017 and December 31, 2016, no amounts have been accrued for any estimated losses for these instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commercial and standby letters of credit are conditional commitments issued by the Company or its subsidiaries to guarantee the performance of a customer to a third party. These off-balance sheet financial instruments generally have fixed expiration dates or other termination clauses and may require payment of a fee. At June 30, 2017, the balance of unused loan commitments, standby and commercial letters of credit were $65,583,000, $13,977,000, and $2,759,000, respectively. Since some of the financial instruments may expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. Commitments to extend credit and letters of credit are subject to the same underwriting standards as those financial instruments included on the consolidated balance sheets. The Company evaluates each customer s credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of the credit, is based on management s credit evaluation of the borrower. Collateral held varies, but is generally accounts receivable, inventory, residential or income-producing commercial property or equipment. In the event of nonperformance, the Company or its subsidiaries may obtain and liquidate the collateral to recover amounts paid under guarantees on these financial instruments.

The following table summarizes contractual cash obligations of the Company related to operating lease commitments and time deposits at June 30, 2017:

	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	$ 5,589	$ 1,448	$ 2,036	$ 1,656	$ 449
Time deposits	52,653	47,759	2,319	2,575	
Total	$ 58,242	$ 49,207	$ 4,355	$ 4,231	$ 449

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

Note 8 Stock-Based Compensation

The Amended and Restated Omnibus Stock and Performance Compensation Plan (the Omnibus Plan) permits the issuance of up to 1,500,000 shares of the Company s common stock in the form of stock options, stock appreciation rights (SARs), restricted stock, restricted stock units and performance awards. The Company may issue shares out of treasury stock for these awards. During the six months ended June 30, 2017, 22,545 restricted shares, 23,038 performance-based restricted shares, and 0 SARs were granted under the Omnibus Plan.

Restricted Stock

Restricted shares granted prior to April 16, 2013 were amortized to expense over a three-year vesting period. 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. As of June 30, 2017, the total unrecognized compensation expense related to non-vested restricted shares was $2,217,000, and the related weighted-average period over which it is expected to be recognized is approximately 1.0 year.

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

	Six Months Ended June 30, 2017	
	Shares	**Fair Value**
Balance at December 31, 2016	73,840	$ 51.03
Granted	22,545	$ 65.42
Vested	(26,545)	$ 52.34
Balance at June 30, 2017	69,840	$ 55.18

Performance-Based Restricted Stock

On February 2, 2017, the Company granted three-year performance based restricted stock (PBRS) awards which are contingent upon the 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 target number of PBRS shares granted was 23,038 with a grant date fair value of $65.12 per share. The 2017 expense related to this grant is currently estimated to be $458,000 and is based on the grant date fair value and the achievement of 100% of the target financial goals. The estimated expense for 2017 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

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 June 30, 2017, all compensation expense has been recognized and all granted SARs are vested. Following is a summary of the activity of the Company s SARs program for the six-month period ended June 30, 2017:

	Shares	**Weighted-Average Exercise Price**	**Average Remaining Contractual Term Years**	**Aggregate Intrinsic Value *(In thousands)***
Outstanding at December 31, 2016	237,468	$ 38.22	5.73	$ 3,201
Exercised	(15,547)	40.60		
Outstanding at June 30, 2017	221,921	38.05	4.71	6,122
Exercisable at June 30, 2017	221,921	$ 38.05	4.71	$ 6,122

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 2017**	**Actual 2016**
Service cost benefits earned during the year	$ 3,805	$ 3,559
Interest cost on projected benefit obligations	3,587	3,505
Expected return on plan assets	(4,680)	(4,734)
Net amortization and deferral	1,328	1,259
Net periodic pension cost	$ 4,040	$ 3,589

Pension costs recorded to expense were $1,017,000 and $882,000 for the three-month periods ended June 30, 2017 and 2016, respectively and $2,037,000 and $1,759,000 for the six-month periods ended June 30, 2017 and 2016, respectively. Pension costs increased in 2017 due to a decrease in the discount rate and expected return on plan assets assumptions and the use of the updated mortality tables. The Company made no contribution to the plan during the six-month period ended June 30, 2017 and is evaluating the amount of additional contributions, if any, in the remainder of 2017.

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 2016 and an estimate for 2017:

(In thousands)	Estimated 2017	Actual 2016
Service cost benefits earned during the year	$ 143	$ 133
Interest cost on projected benefit obligation	361	367
Net amortization	323	295
Net periodic pension cost	$ 827	$ 795

Pension costs recorded to expense were $209,000 and $202,000 for the three-month periods ended June 30, 2017 and 2016, respectively, and were $418,000 and $403,000 for the six-month periods ended June 30, 2017 and 2016, respectively.

Note 10 Income Taxes

As of June 30, 2017, the Company s unrecognized tax benefits were approximately $1,835,000, of which $1,416,000 would, if recognized, affect the Company s effective tax rate. As of December 31, 2016, the Company s unrecognized tax benefits were approximately $1,623,000, of which $1,225,000 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 $253,000 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 $142,000 and $108,000 of gross interest accrued as of June 30, 2017 and December 31, 2016, respectively. There were no penalties for unrecognized tax benefits accrued at June 30, 2017 and December 31, 2016.

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 2013 through 2015 remain subject to examination by the Internal Revenue Service. In addition, the Company is subject to state tax examinations for the tax years 2012 through 2015.

On January 1, 2017, the Company adopted ASU No. 2016-09 *Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. The adoption of this new accounting pronouncement resulted in a $35,000 and $278,000 reduction in income tax expense for the three-month and six-month periods ending June 30, 2017, respectively.

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:

(In thousands)	June 30, 2017 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
State and political subdivisions	$ 403,935	$ 11,256	$ 1,076	$ 414,115
U.S. government agencies	12,446		328	12,118
Certificates of deposit	5,746			5,746
Total	$ 422,127	$ 11,256	$ 1,404	$ 431,979

(In thousands)	December 31, 2016 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
State and political subdivisions	$ 368,223	$ 5,239	$ 3,328	$ 370,134
U.S. government agencies	13,075		403	12,672
Certificates of deposit	7,746			7,746
Total	$ 389,044	$ 5,239	$ 3,731	$ 390,552

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

	June 30, 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	$ 45,082	$ 1,076	$	$	$ 45,082	$ 1,076
U.S. government agencies	12,118	328			12,118	328
Certificates of deposit						
Total	$ 57,200	$ 1,404	$	$	$ 57,200	$ 1,404

	December 31, 2016					
	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	$ 140,384	$ 3,328	$	$	$ 140,384	$ 3,328
U.S. government agencies	12,672	403			12,672	403
Certificates of deposit						
Total	$ 153,056	$ 3,731	$	$	$ 153,056	$ 3,731

There were 35 securities, or 11% of the total (none greater than 12 months) in an unrealized loss position as of June 30, 2017. There were 108 securities, 31% of the total (none greater than 12 months), in an unrealized loss position as of December 31, 2016. 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.

(In thousands)	June 30, 2017 Amortized Cost	Fair Value
Due in 1 year or less	$ 21,393	$ 21,574
Due after 1 year through 5 years	58,167	59,364
Due after 5 years through 10 years	207,799	215,950
Due after 10 years	134,768	135,091
Total	$ 422,127	$ 431,979

Proceeds from sales of investment securities classified as available-for-sale were $0 and $2,452,000 for the three months ended June 30, 2017 and 2016, respectively, and were $0 and $21,491,000 for the six months ended June 30, 2017 and 2016, respectively. Gross realized gains were $0 and $79,000 for the three months ended June 30, 2017 and 2016, respectively, and were $0 and $387,000 for the six months ended June 30, 2017 and 2016, respectively. There was one security totaling $3,750,000 pledged to secure public deposits and for other purposes at June 30, 2017.

Note 12 Fair Value of Financial Instruments

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

	June 30, 2017		December 31, 2016	
(In thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Balance sheet assets:				
Cash and cash equivalents	$ 301,060	$ 301,060	$ 266,743	$ 266,743
Investment securities	431,979	431,979	390,552	390,552
Loans, net	661,487	658,280	654,691	652,028
Accrued interest receivable	7,037	7,037	6,543	6,543
Total	$ 1,401,563	$ 1,398,356	$ 1,318,529	$ 1,315,866
Balance sheet liabilities:				
Deposits	$ 605,039	$ 605,382	$ 621,961	$ 622,173
Accounts and drafts payable	729,403	729,403	642,287	642,287
Accrued interest payable	41	41	46	46
Total	$ 1,334,483	$ 1,334,826	$ 1,264,294	$ 1,264,506

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.

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

Accrued Interest Receivable The carrying amount approximates fair value.

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

Accounts and Drafts Payable The carrying amount approximates fair value.

Accrued Interest The carrying amount approximates fair value.

There were no transfers between Levels 1 and 2 of the fair value hierarchy for the six months ended June 30, 2017 and 2016. No financial instruments are measured using Level 3 inputs for the six months ended June 30, 2017 and 2016.

Note 13 Subsequent Events

In accordance with FASB ASC 855, Subsequent Events, the Company has evaluated subsequent events after the consolidated balance sheet date of June 30, 2017, and there were no events identified that would require additional disclosures to prevent the Company s unaudited consolidated financial statements from being misleading.

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

Cass provides payment and information processing services to large manufacturing, distribution and retail enterprises from its offices/locations in St. Louis, Missouri, Columbus, Ohio, Boston, Massachusetts, Greenville, South Carolina, Wellington, Kansas, Jacksonville, Florida, and Breda, Netherlands. The Company s services include freight invoice rating, payment processing, auditing, and the generation of accounting and transportation information. Cass also processes and pays energy invoices, which include electricity and gas as well as environmental and telecommunications expense and is a provider of telecom expense management solutions. Cass extracts, stores, and presents information from transportation, energy, telecommunication and environmental invoices, assisting its customers transportation, energy, environmental and information technology managers in making decisions that will enable them to improve operating performance. The Company receives data from multiple sources, electronic and otherwise, and processes the data to accomplish the specific operating requirements of its customers. It then provides the data in a central repository for access and archiving. The data is finally transformed into information through the Company s databases that allow client interaction as required and provide Internet-based tools for analytical processing. The Company also, through Cass Commercial Bank, its St. Louis, Missouri-based bank subsidiary provides banking services in the St. Louis metropolitan, 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 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, 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 2016 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.

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.

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

Pension Plans. The amounts recognized in the unaudited consolidated financial statements related to pension plans are determined from actuarial valuations. Inherent in these valuations are assumptions, including expected return on plan assets, discount rates at which the liabilities could be settled at December 31, 2016, rate of increase in future compensation levels and mortality rates. These assumptions are updated annually and are disclosed in Item 8, Note 10 to the consolidated financial statements filed with the Company s Annual Report on Form 10-K for the year ended December 31, 2016. Pursuant to FASB ASC 715, Compensation Retirement Benefits, the Company has recognized the funded status of its defined benefit postretirement plan in its balance sheet and has recognized changes in that funded status through comprehensive income. The funded status is measured as the difference between the fair value of the plan assets and the projected benefit obligation as of the date of its fiscal year-end.

Results of Operations

The following paragraphs more fully discuss the results of operations and changes in financial condition for the three-month period ended June 30, 2017 (Second Quarter of 2017) compared to the three-month period ended June 30, 2016 (Second Quarter of 2016) and the six-month period ended June 30, 2017 (First Half of 2017) compared to the six-month period ended June 30, 2016 (First Half of 2016). 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 2016 Annual Report on Form 10-K. Results of operations for the Second Quarter and First Half of 2017 are not necessarily indicative of the results to be attained for any other period.

Net Income

The following table summarizes the Company s operating results:

	Second Quarter of			First Half of		
(In thousands except per share data)	**2017**	**2016**	**% Change**	**2017**	**2016**	**% Change**
Net income	$ 6,513	$ 5,869	11.0	$ 12,820	$ 11,702	9.6
Diluted earnings per share	$ .58	$ .52	11.5	$ 1.13	$ 1.03	9.7
Return on average assets	1.70%	1.59%		1.70%	1.60%	
Return on average equity	12.13%	11.44%		12.24%	11.41%	

Fee Revenue and Other Income

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

	Second Quarter of			First Half of		
(In thousands)	**2017**	**2016**	**% Change**	**2017**	**2016**	**% Change**
Transportation invoice volume	9,248	8,776	5.4%	17,623	16,888	4.4%
Transportation invoice dollar volume	$ 6,231,378	$ 5,800,675	7.4%	$ 12,108,221	$ 11,243,007	7.7%
Expense management transaction volume*	6,729	5,667	18.7%	13,542	10,955	23.6%
Expense management dollar volume*	$ 3,079,988	$ 2,775,639	11.0%	$ 6,255,901	$ 5,581,132	12.1%
Payment and processing revenue	$ 23,282	$ 20,880	11.5%	$ 45,571	$ 40,425	12.7%

*Includes energy, telecom and waste

Second Quarter of 2017 compared to Second Quarter of 2016:

In the transportation sector, a growing roster of clients and an increase in base activity boosted invoice volume by 5.4% and dollar volume by 7.4%. The expense management group had growth of 18.7% in transaction volume. New customer wins, combined with increased volume from current accounts, fueled the increase. Expense management dollar volume was also up 11.0% for the period.

There were no gains on sales of securities in the Second Quarter of 2017, compared to $79,000 in the Second Quarter of 2016.

First Half of 2017 compared to First Half of 2016:

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

There were no gains on sales of securities in the First Half of 2017, compared to $387,000 in the First Half of 2016.

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:

	Second Quarter of			First Half of		
(In thousands)	**2017**	**2016**	**% Change**	**2017**	**2016**	**% Change**
Average earnings assets	$ 1,332,829	$ 1,289,339	3.4 %	$ 1,324,478	$ 1,275,824	3.8 %
Average interest-bearing liabilities	380,197	426,287	(10.8)%	386,372	425,834	(9.3)%
Net interest income*	11,312	10,896	3.8 %	22,252	21,528	3.4 %
Net interest margin*	3.40 %	3.40 %		3.39 %	3.39 %	
Yield on earning assets*	3.55 %	3.56 %		3.53 %	3.55 %	
Rate on interest-bearing liabilities	.50 %	.48 %		.50 %	.48 %	

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

Second Quarter of 2017 compared to Second Quarter of 2016:

Second Quarter of 2017 average earning assets increased $43,490,000, or 3.4%, compared to the same period in the prior year.

Average investment securities increased $73,864,000, or 21.4% and average federal funds sold and other short-term investments increased $32,348,000, or 27.1% for the Second Quarter of 2017 as compared to the Second Quarter of 2016. These increases were partially offset by interest-bearing cash deposits decreasing $36,535,000, or 29.5% and loans decreasing $24,708,000, or 3.6%. This net increase was the result of additional balances from funding sources.

Average accounts and drafts payable balances for the Second Quarter of 2017 increased $62,075,000, or 9.7%, as compared to the Second Quarter of 2016. This was partially offset by a decrease in total average interest-bearing deposits for the Second Quarter of 2017 of $46,090,000, or 10.8%, compared to the Second Quarter of 2016. Average interest-bearing demand deposits decreased $35,816,000, or 10.3% and time deposits decreased $5,911,000, or 9.7% for the Second Quarter of 2017.

Net interest margin and yield on earning assets remained stable in the Second Quarter of 2017 compared to the Second Quarter of 2016.

First Half of 2017 compared to First Half of 2016:

First Half of 2017 average earning assets increased $48,654,000, or 3.8%, compared to the same period in the prior year.

Average investment securities increased $69,107,000, or 20.1% and average federal funds sold and other short-term investments increased $29,578,000, or 25.8% for the First Half of 2017 as compared to the First Half of 2016. These increases were partially offset by interest-bearing cash deposits decreasing $32,858,000, or 25.2% and loans decreasing $16,412,000, or 2.4%. This net increase was the result of additional balances from funding sources.

Average accounts and drafts payable balances for the First Half of 2017 increased $59,421,000, or 9.5% as compared to the First Half of 2016. This was partially offset by a decrease in total average interest-bearing deposits for the First Half of 2017 of $39,462,000, or 9.3% compared to the First Half of 2016. For the First Half of 2017, average interest-bearing demand deposits decreased $34,846,000, or 10.1% and time deposits decreased $5,628,000, or 9.2%.

Net interest margin and yield on earning assets remained relatively stable in the First Half of 2017 compared to the First Half of 2016.

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.

(In thousands)	Second Quarter of 2017 Average Balance	Second Quarter of 2017 Interest Income/ Expense	Second Quarter of 2017 Yield/ Rate	Second Quarter of 2016 Average Balance	Second Quarter of 2016 Interest Income/ Expense	Second Quarter of 2016 Yield/ Rate
Assets[1]						
Earning assets						
Loans[2, 3]:						
Taxable	$ 662,763	$ 7,071	4.28%	$ 674,227	$ 7,173	4.28%
Tax-exempt[4]	5,277	53	4.03	18,521	221	4.80
Investment securities[5]:						
Taxable	13,819	72	2.09	1,196	10	3.36
Tax-exempt[4]	405,489	4,090	4.05	344,248	3,748	4.38
Certificates of deposit	6,139	12	.78	7,618	12	.63
Interest-bearing deposits in other financial institutions	87,510	205	.94	124,045	154	.50
Federal funds sold and other short-term investments	151,832	279	.74	119,484	82	.28
Total earning assets	1,332,829	11,782	3.55	1,289,339	11,400	3.56
Non-earning assets						
Cash and due from banks	12,443			11,481		
Premises and equipment, net	21,257			20,496		
Bank-owned life insurance	16,615			16,110		
Goodwill and other intangibles	14,518			13,851		
Other assets	145,173			147,701		
Allowance for loan losses	(10,193)			(10,649)		
Total assets	$ 1,532,642			$ 1,488,329		
Liabilities and Shareholders Equity[1]						
Interest-bearing liabilities						
Interest-bearing demand deposits	$ 311,782	$ 331	.43%	$ 347,598	$ 345	.40%
Savings deposits	13,271	15	.45	17,634	21	.48
Time deposits >= $100	23,508	66	1.13	21,676	66	1.22
Other time deposits	31,636	58	.74	39,379	72	.74
Total interest-bearing deposits	380,197	470	.50	426,287	504	.48
Non-interest bearing liabilities						
Demand deposits	199,508			187,668		
Accounts and drafts payable	703,088			641,013		
Other liabilities	34,466			27,069		
Total liabilities	1,317,259			1,282,037		
Shareholders equity	215,383			206,292		
Total liabilities and shareholders equity	$ 1,532,642			$ 1,488,329		
Net interest income		$ 11,312			$ 10,896	
Net interest margin			3.40%			3.40%
Interest spread			3.05			3.08

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 2016 consolidated financial statements, filed with the Company s 2016 Annual Report on Form 10-K.
3. Interest income on loans includes net loan fees of $91,000 and $93,000 for the Second Quarter of 2017 and 2016, respectively.
4. Interest income is presented on a tax-equivalent basis assuming a tax rate of 35%. The tax-equivalent adjustment was approximately $1,450,000 and $1,390,000 for the Second Quarter of 2017 and 2016, respectively.
5. For purposes of these computations, yields on investment securities are computed as interest income divided by the average amortized cost of the investments.

(In thousands)	First Half of 2017 Average Balance	Interest Income/ Expense	Yield/ Rate	First Half of 2016 Average Balance	Interest Income/ Expense	Yield/ Rate
Assets[1]						
Earning assets						
Loans[2, 3]:						
Taxable	$ 656,615	$ 13,986	4.30%	$ 659,782	$ 14,157	4.31%
Tax-exempt[4]	5,684	111	3.94	18,929	447	4.75
Investment securities[5]:						
Taxable	13,975	138	1.99	1,193	10	1.69
Tax-exempt[4]	399,755	8,092	4.08	343,430	7,432	4.35
Certificates of deposit	6,504	23	.71	7,265	23	.64
Interest-bearing deposits in other financial institutions	97,682	403	.83	130,540	323	.50
Federal funds sold and other short-term investments	144,263	449	.63	114,685	153	.27
Total earning assets	1,324,478	23,202	3.53	1,275,824	22,545	3.55
Non-earning assets						
Cash and due from banks	12,741			11,523		
Premises and equipment, net	21,210			20,167		
Bank-owned life insurance	16,553			16,045		
Goodwill and other intangibles	14,239			13,902		
Other assets	141,453			141,804		
Allowance for loan losses	(10,186)			(11,137)		
Total assets	$ 1,520,488			$ 1,468,128		
Liabilities and Shareholders Equity[1]						
Interest-bearing liabilities						
Interest-bearing demand deposits	$ 311,480	$ 657	.43%	$ 346,326	$ 695	.40%
Savings deposits	19,302	45	.47	18,290	44	.48
Time deposits >= $100	23,112	127	1.11	22,520	133	1.19
Other time deposits	32,478	121	.75	38,698	145	.75
Total interest-bearing deposits	386,372	950	.50	425,834	1,017	.48
Non-interest bearing liabilities						
Demand deposits	203,451			184,129		
Accounts and drafts payable	685,929			626,508		
Other liabilities	33,550			25,468		
Total liabilities	1,309,302			1,261,939		
Shareholders equity	211,186			206,189		
Total liabilities and shareholders equity	$ 1,520,488			$ 1,468,128		
Net interest income		$ 22,252			$ 21,528	
Net interest margin			3.39%			3.39%
Interest spread			3.03			3.07

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 2016 consolidated financial statements, filed with the Company s 2016 Annual Report on Form 10-K.
3. Interest income on loans includes net loan fees of $243,000 and $235,000 for the First Half of 2017 and 2016, respectively.
4. Interest income is presented on a tax-equivalent basis assuming a tax rate of 35%. The tax-equivalent adjustment was approximately $2,871,000 and $2,758,000 for the First Half of 2017 and 2016, respectively.
5. For purposes of these computations, yields on investment securities are computed as interest income divided by the average amortized cost of the investments.

Analysis