

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

CASS INFORMATION SYSTEMS INC

Form 10-Q

May 09, 2007

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

-----  
FORM 10-Q

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

For the quarterly period ended March 31, 2007

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. 2-80070

-----  
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 is a large accelerated filer,  
an accelerated filer, or a non-accelerated filer. See definition of "accelerated  
filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

(Check one)

Large Accelerated Filer ☐ Accelerated Filer ☒ Non-Accelerated Filer ☐

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  
May 7, 2007: Common stock, par value \$.50 per share - 8,371,089 shares  
outstanding.

TABLE OF CONTENTS

PART I - Financial Information

Item 1. FINANCIAL STATEMENTS

Consolidated Balance Sheets	
March 31, 2007 (unaudited) and December 31, 2006 .....	3
Consolidated Statements of Income	
Three months ended March 31, 2007 and 2006 (unaudited) .....	4
Consolidated Statements of Cash Flows	
Three months ended March 31, 2007 and 2006 (unaudited) .....	5
Notes to Consolidated Financial Statements (unaudited) .....	6

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS .....	12
--	----

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK .....	21
--	----

Item 4. CONTROLS AND PROCEDURES .....	21
---------------------------------------	----

PART II - Other Information - Items 1. - 6. ....	21
--	----

SIGNATURES .....	23
------------------	----

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. Forward-looking statements are not guarantees of future performance and involve risks, uncertainties, and other factors which may cause future performance to vary from expected performance summarized in the forward-looking statements, including those set forth in this paragraph and in the "Risk Factors" section of the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission. Important factors that could cause our actual results, performance, or achievements to be materially different from any future results, performance, or achievements expressed or implied by those statements include, but are not limited to: the failure to successfully execute our corporate plan, the loss of key personnel or inability to attract additional qualified personnel, the loss of key customers, increased competition, the inability to remain current with rapid technological change, risks related to acquisitions, risks associated with business cycles and fluctuations in interest rates, utility and system interruptions or processing errors, rules and regulations governing financial institutions and changes in such rules and regulations, credit risk related to borrowers' ability to repay loans, concentration of loans to certain segments such as commercial enterprises, churches and borrowers in the St. Louis area which creates risks associated with adverse factors that may affect these groups and volatility of the price of our common stock. 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.

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

-2-

## PART I. FINANCIAL INFORMATION

### ITEM 1. FINANCIAL STATEMENTS

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

	March 31 2007	December 31 2006
<b>Assets</b>		
Cash and due from banks	\$ 22,818	\$ 26,995
Federal funds sold and other short-term investments	120,168	169,509
	-----	-----
Cash and cash equivalents	142,986	196,504
	-----	-----
Securities available-for-sale, at fair value	130,401	102,749
	-----	-----
Loans	530,609	504,125
Less: Allowance for loan losses	6,822	6,592
	-----	-----
Loans, net	523,787	497,533
	-----	-----
Premises and equipment, net	12,618	12,898
Investment in bank-owned life insurance	12,156	12,024
Payments in excess of funding	12,525	9,333
Goodwill	7,471	7,471
Other intangible assets, net	1,086	1,156
Other assets	18,656	18,803
	-----	-----
Total assets	\$ 861,686	\$ 858,471
	=====	=====
<b>Liabilities and Shareholders' Equity</b>		
<b>Liabilities:</b>		
<b>Deposits:</b>		
Noninterest-bearing	\$ 90,781	\$ 106,587
Interest-bearing	182,720	183,307
	-----	-----
Total deposits	273,501	289,894
Accounts and drafts payable	484,013	468,393
Short-term borrowings	27	181
Subordinated convertible debentures	3,700	3,700
Liabilities related to discontinued operations	--	277
Other liabilities	13,300	12,105
	-----	-----
Total liabilities	774,541	774,550
	-----	-----
<b>Shareholders' Equity:</b>		
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 9,112,484 shares issued at March 31, 2007 and December 31, 2006, respectively	4,556	4,556
Additional paid-in capital	17,206	17,896
Retained earnings	84,697	81,516

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

Common shares in treasury, at cost		
(744,995 shares at March 31, 2007 and		
784,773 shares at December 31, 2006)	(16,211)	(17,077)
Accumulated other comprehensive loss	(3,103)	(2,970)
	-----	-----
Total shareholders' equity	87,145	83,921
	-----	-----
Total liabilities and shareholders' equity	\$ 861,686	\$ 858,471
	=====	=====

See accompanying notes to unaudited consolidated financial statements.

-3-

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

	Three Months Ended March 31	
	2007	2006
Fee Revenue and Other Income:		
Information services payment and processing revenue	\$11,249	\$ 9,688
Bank service fees	393	577
Other	221	201
	-----	-----
Total fee revenue and other income	11,863	10,466
	-----	-----
Interest Income:		
Interest and fees on loans	8,988	8,782
Interest and dividends on securities:		
Taxable	243	266
Exempt from federal income taxes	910	636
Interest on federal funds sold and other short-term investments	1,855	1,272
	-----	-----
Total interest income	11,996	10,956
	-----	-----
Interest Expense:		
Interest on deposits	1,960	1,264
Interest on short-term borrowings	2	2
Interest on subordinated convertible debentures	49	49
	-----	-----
Total interest expense	2,011	1,315
	-----	-----
Net interest income	9,985	9,641
Provision for loan losses	225	150
	-----	-----
Net interest income after provision for loan losses	9,760	9,491
	-----	-----
Operating Expense:		
Salaries and employee benefits	11,539	10,270
Occupancy	490	455
Equipment	812	653
Amortization of intangible assets	70	43

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

Other operating	2,422	2,448
	-----	-----
Total operating expense	15,333	13,869
	-----	-----
Income before income tax expense	6,290	6,088
Income tax expense	2,104	2,136
	-----	-----
Net income	\$ 4,186	\$ 3,952
	=====	=====
Basic earnings per share	\$ .50	\$ .47
Diluted earnings per share	.49	.47

See accompanying notes to unaudited consolidated financial statements.

-4-

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

	Three Months Ended March 31	
	2007	2006
	-----	-----
Cash Flows From Operating Activities:		
Net income	\$ 4,186	\$ 3,952
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	645	471
Provision for loan losses	225	150
Stock-based compensation expense	139	48
Deferred income tax expense (benefit)	986	(1,031)
Increase in income tax liability	972	3,551
Increase in pension liability	479	375
Other operating activities, net	(1,430)	(996)
Operating activities of discontinued operations	--	(1,327)
	-----	-----
Net cash provided by operating activities	6,202	5,193
	-----	-----
Cash Flows From Investing Activities:		
Proceeds from maturities of securities available-for-sale	17,000	21,510
Purchase of securities available-for-sale	(44,904)	(21,290)
Net (increase) decrease in loans	(26,479)	2,040
Increase in payments in excess of funding	(3,192)	(909)
Purchases of premises and equipment, net	(248)	(605)
	-----	-----
Net cash (used in) provided by investing activities	(57,823)	746
	-----	-----
Cash Flows From Financing Activities:		
Net decrease in noninterest-bearing demand deposits	(15,806)	(13,387)
Net decrease in interest-bearing demand and savings deposits	(12,777)	(4,337)
Net increase in time deposits	12,189	8,648
Net increase (decrease) in accounts and drafts payable	15,619	(4,418)

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

Net decrease in short-term borrowings	(154)	(161)
Cash proceeds from exercise of stock options	4	322
Cash dividends paid	(1,005)	(890)
Tax benefits on stock awards	33	24
	-----	-----
Net cash used in financing activities	(1,897)	(14,199)
	-----	-----
Net decrease in cash and cash equivalents	(53,518)	(8,260)
Cash and cash equivalents at beginning of period	196,504	149,692
	-----	-----
Cash and cash equivalents at end of period	\$ 142,986	\$ 141,432
	=====	=====
Supplemental information:		
Cash paid for interest	\$ 1,939	\$ 1,154
Cash paid (received) for income taxes	186	(406)

See accompanying notes to unaudited consolidated financial statements.

-5-

### 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 2006 consolidated financial statements have been reclassified to conform to the 2007 presentation. Such reclassifications have no effect on previously reported net income or shareholders' equity. The Company's bank subsidiary sold the assets of Government e-Management Solutions, Inc. ("GEMS"), its wholly owned subsidiary, on December 30, 2005. The assets, liabilities and results of operations of GEMS were presented in the 2006 consolidated financial statements as discontinued operations. There was no discontinued operations activity in the three-month periods ended March 31, 2007 or 2006. The Company issued a 50% stock dividend on September 15, 2006 and the share and per share information have been restated for all periods presented in the accompanying consolidated financial statements. 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, 2006.

#### Note 2 - Intangible Assets

The Company accounts for intangible assets in accordance with Statement of Financial Accounting Standard ("SFAS") No. 142, "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. Intangible assets for the periods ended March 31, 2007 and December 31, 2006 are as follows:

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

	March 31, 2007		December 31, 2006	
(In Thousands)	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Assets eligible for amortization:				
Software	862	(445)	862	(445)
Customer List	750	(81)	750	(81)
Total	1,612	(526)	1,612	(526)
Unamortized intangible assets:				
Goodwill	7,698	(227)*	7,698	(227)
Total unamortized intangibles	7,698	(227)	7,698	(227)
Total intangible assets	\$ 9,310	\$ (753)	\$ 9,310	\$ (753)

\* Amortization through December 31, 2001 prior to adoption of SFAS No. 142.

Software is amortized over four to five years and the customer list is amortized over seven years. Amortization of intangible assets amounted to \$70,000 and \$43,000 for the three-month periods ended March 31, 2007 and 2006, respectively. Estimated amortization of intangibles over the next five years is as follows: \$280,000 in 2007 and 2008, \$222,000 in 2009 and \$107,000 in 2010 and 2011.

## 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 March 31, 2007 was \$302,000.

## 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. The calculations of basic and diluted earnings per share for the periods ended March 31, 2007 and 2006 are as follows:

-6-

	Three Months Ended March 31	
(Dollars in thousands, except per share data)	2007	2006
Basic		
Net income	\$ 4,186	\$ 8,309
Weighted average common shares outstanding	8,309,110	8,309,110

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

Basic earnings per share	\$	.50	\$
Diluted			
Net income	\$	4,186	\$
Net income effect of 5.33% convertible debentures		27	
Net income		4,213	
Weighted-average common shares outstanding		8,309,110	8,
Effect of dilutive stock options and awards		93,741	
Effect of 5.33% convertible debentures		172,717	
Weighted-average common shares outstanding assuming dilution		8,575,568	8,
Diluted earnings per share	\$	.49	\$

Share and per share data for 2006 in the schedule above have been restated for the 50% stock dividend issued on September 15, 2006.

## 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 150,000 shares of the Company's Common Stock. The Company did not repurchase any shares during the three-month periods ended March 31, 2007 and 2006. As of March 31, 2007, 120,000 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-month periods ended March 31, 2007 and 2006, unrealized gains and losses on debt and equity securities available-for-sale were the Company's only other comprehensive income component. Comprehensive income for the three-month periods ended March 31, 2007 and 2006 is summarized as follows:

	Three Months Ended March 31	
(In Thousands)	2007	2006
Net income	\$ 4,186	\$ 3,952
Other comprehensive income:		
Net unrealized (loss) gain on debt and equity securities available-for-sale, net of tax	(133)	98
Total comprehensive income	\$ 4,053	\$ 4,050

## 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



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

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.

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, 2006. 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 market value.

-7-

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.

Summarized information about the Company's operations in each industry segment for the three-month periods ended March 31, 2007 and 2006, is as follows:

(In Thousands)	Information Services	Banking Services	Corporate, Eliminations and Other
=====			
Quarter Ended March 31, 2007			
Total Revenues:			
Revenue from customers	\$ 17,743	\$ 3,880	\$ --
Intersegment revenue	487	348	(835)
Net income	3,194	992	--
Total assets	546,245	324,686	(9,245)
Goodwill	7,335	136	--
Other intangible assets, net	1,086	--	--
Quarter Ended March 31, 2006			
Total Revenues:			
Revenue from customers	\$ 15,826	\$ 4,131	\$ --
Intersegment revenue	354	405	(759)
Net income	2,761	1,191	--
Total assets	505,962	317,864	(12,928)
Goodwill	4,262	136	--
Other intangible assets, net	892	--	--
Assets related to discontinued operations	--	--	326

### Note 8 - Loans by Type

(In Thousands)	March 31, 2007	December
=====		
Commercial and industrial	\$ 123,165	\$ 113,

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

Real estate (Commercial and church):			
Mortgage	368,645		352,
Construction	29,852		29,
Industrial revenue bonds	6,196		6,
Other	2,751		2,
-----			
Total loans	\$ 530,609		\$ 504,
=====			

## 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 and capital 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 March 31, 2007, 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 March 31, 2007 the balance of unused loan commitments, standby and commercial letters of credit were \$28,745,000, \$5,643,000 and \$2,998,000, 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,

-8-

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 and capital lease commitments, time deposits and convertible subordinated debentures at March 31, 2007:

		Amount of Commitment Expiration pe		
		Less than	1-3	3
(Dollars in thousands at March 31, 2007)	Total	1 Year	Years	Ye
=====				

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

Operating lease commitments	\$ 4,301	\$ 709	\$1,187	\$
Time deposits	100,986	97,263	2,291	1,
Convertible subordinated debentures*	3,700	--	--	
-----				
Total	\$ 108,987	\$ 97,972	\$3,478	\$2,
=====				

\* Includes principal payments only.

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

The Company maintains stock-based incentive plans, which permit the awards of up to 259,875 shares of restricted common stock and the granting of options to acquire up to 1,039,000 shares of common stock. Restricted shares are amortized to expense over the three-year vesting period. Options currently vest and expire over a period not to exceed seven years. The plans authorize the grant of awards in the form of options intended to qualify as incentive stock options under Section 422 of the Internal Revenue Code, options that do not qualify (non-statutory stock options) and grants of restricted shares of common stock. The Company issues shares out of treasury stock for restricted shares and option exercises.

Effective January 1, 2006, the Company adopted SFAS No. 123R "Share based Payment." As of March 31, 2007, the total unrecognized compensation expense related to non-vested stock options was \$126,000 and the related weighted-average period over which it is expected to be recognized is approximately 4.6 years. As of March 31, 2007, the total unrecognized compensation expense related to non-vested stock awards was \$1,692,000 and the related weighted-average period over which it is expected to be recognized is approximately 2.3 years.

Changes in restricted shares outstanding were as follows:

	Shares	Fair Value
-----		
Balance at December 31, 2006	22,481	22.88
Granted	39,520	37.30
Vested	(5,416)	18.64
Forfeited	--	--
-----		
Balance at March 31, 2007	56,585	33.36
-----		

There were no stock options granted during the three-month period ended March 31, 2007. Following are the assumptions used to estimate the fair value of option grants during the three-month period ended March 31, 2006:

	Three Months Ended March 31	
	2007	2006
Risk-free interest rate	--	4.37%
Expected life	--	7 yrs.
Expected volatility	--	5.00%

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

Expected dividend yield	--	1.88%
-------------------------	----	-------

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 options 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 options using average monthly closing market prices of the Company's stock. The expected dividend yield is determined based on the Company's current rate of annual dividends.

- 9 -

Under the treasury stock method, outstanding stock options are dilutive when the average market price of the Company's common stock, when combined with the effect of any unamortized compensation expense, exceeds the option price during a period. In addition, proceeds from the assumed exercise of dilutive options along with the related tax benefit are assumed to be used to repurchase common shares at the average market price of such stock during the period. Anti-dilutive shares are those option shares with exercise prices in excess of the current market value.

A summary of the Company's stock option program for the three-month period ended March 31, 2007 is shown below.

	Shares	Weighted- Average Exercise Price	Average Remaining Contractual Term Years	Aggregate Intrinsic Value (\$'000)
Outstanding at January 1, 2007	87,805	\$ 15.40		
Granted	--	--		
Exercised	(258)	15.96		
Forfeited or expired	--	--		
Outstanding at March 31, 2007	87,547	15.40	4.09	\$ 1,607
Exercisable at March 31, 2007	17,477	\$ 11.49	3.07	\$ 389

The total intrinsic value of options exercised was \$5,000 and \$1,623,000 for the three-month periods ended March 31, 2007 and 2006, respectively.

A summary of the activity of the non-vested options during the three-month period ended March 31, 2007 is shown below.

	Shares	Weighted-Average Grant Date Fair Value
Nonvested at January 1, 2007	85,406	\$ 2.38
Granted	--	\$ --
Vested	(15,336)	\$ 1.75
Forfeited	--	--

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

Nonvested at March 31, 2007	70,070	\$ 2.52
-----------------------------	--------	---------

=====

## 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 for 2006 and an estimate for 2007:

(In Thousands)	Estimated 2007	Actual 2006
Service cost - benefits earned during the year	\$ 1,565	\$ 1,554
Interest cost on projected benefit obligation	1,721	1,565
Expected return on plan assets	(1,871)	(1,603)
Net amortization	125	270
Net periodic pension cost	\$ 1,540	\$ 1,786

Pension costs recorded to expense were \$403,000 and \$338,000 for the three-month periods ended March 31, 2007 and 2006, respectively. The Company has not made any contribution to the plan during the three-month period ended March 31, 2007, but expects to contribute at least \$1,800,000 in 2007.

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

-10-

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 2006 and an estimate for 2007:

(In Thousands)	Estimated 2007	Actual 2006
Service cost - benefits earned during the year	\$ 43	\$ 43
Interest cost on projected benefit obligation	164	150
Net amortization	100	111
Net periodic pension cost	\$ 307	\$ 304

Pension costs recorded to expense were \$86,000 and \$48,000 for the three-month periods ended March 31, 2007 and 2006, respectively.

## Note 12 - Income Taxes

The Company adopted FASB Interpretation No. 48 ("FIN 48"), "Accounting for

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

Uncertainty in Income Taxes" effective January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes in financial statements and prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken.

The Company had unrecognized tax benefits of approximately \$655,000 as of January 1, 2007. The total amount of federal and state unrecognized tax benefits at January 1, 2007 that, if recognized, would affect the effective tax rate was \$488,000, net of federal tax benefit. There have been no significant changes to the unrecognized tax benefits during the three months ended March 31, 2007. The company expects a reduction of \$31,000 in unrecognized tax benefits during the remaining nine-month period ending December 31, 2007 as a result of the lapse of federal and state statutes of limitations.

Interest and penalties are immaterial at the date of adoption. The company recognizes interest and penalties related to uncertain tax positions in income tax expense. The amount of interest recognized during the three months ended March 31, 2007 was immaterial.

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 2003 and 2006 remain subject to examination by the Internal Revenue Service ("IRS"). In addition, the Company is subject to state tax examinations for the tax years 2003 through 2006.

-11-

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

#### Overview

Cass Information Systems, Inc. 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 provide 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

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

interchange ("EDI"), 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 account balances that are 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. The Bank also assesses fees on other services such as cash management services.

Industry-wide factors that impact the Company include the acceptance by large corporations of the outsourcing of 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. The general level of interest rates also has a significant effect on the revenue of the Company.

On July 7, 2006, the Company acquired 100% of the stock of NTransit, Inc., a company whose service provides auditing and expense management of parcel shipments. While this acquisition did not meet the Regulation S-X criteria of a significant business combination, it positioned the Company to expand its offerings in the specialized service and expertise in parcel shipping, which is a unique segment of the transportation industry that has experienced tremendous growth in recent years.

Currently, management views Cass' major opportunity and challenge 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 lead in applied technology, which, when combined with the security and processing controls of the Bank, makes Cass unique in the industry.

-12-

### 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

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

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 our business operations are discussed in the "Provision and Allowance for Loan Losses" section of this report.

**Impairment of Assets.** The Company periodically evaluates certain long-term assets such as intangible assets including goodwill, foreclosed assets, internally developed software and investments in private equity securities 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. Assets held for sale are carried at the lower of cost or fair value less costs to sell. 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, 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. Effective January 1, 2007, the Company adopted FIN No. 48, "Accounting for Uncertainty in Income Taxes- an interpretation of FASB Statement No. 109." FIN No. 48 provides guidance for the recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. See Note 12 to the financial statements.

**Pension Plans.** The amounts recognized in the consolidated financial statements related to pension 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, 2006, rate of increase in future compensation levels and mortality rates. These assumptions are updated annually and are disclosed in Note 13 to the consolidated financial statements filed with the Company's annual report on Form 10-K for the year ended December 31, 2006. In September 2006, the FASB issued Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)" ("SFAS No. 158"). SFAS No. 158 requires companies to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur 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. The Company recognized the required changes and disclosures in its



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

consolidated 2006 financial statements.

### Results of Operations

The following paragraphs more fully discuss the results of operations and changes in financial condition for the three-month period ended March 31, 2007 ("First Quarter of 2007") compared to the three-month period ended March 31, 2006 ("First Quarter of 2006"). 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 2006 annual report on Form 10-K. Results of operations for the First Quarter of 2007 are not necessarily indicative of the results to be attained for any other period.

-13-

### Net Income

The following table summarizes the Company's operating results:

	Three Months Ended March 31		
(Dollars in thousands, except per share data)	2007	2006	% Change
Net income	\$ 4,186	\$ 3,952	5.8%
Diluted earnings per share	\$ .49	\$ .47	4.3%
Return on average assets	1.97%	1.97%	—
Return on average equity	20.12%	21.03%	—

### Fee Revenue and Other Income from Continuing Operations

The Company's fee revenue is derived mainly from freight and utility 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 related to fees and accounts and drafts payable for the First Quarter of 2007 and First Quarter of 2006 were as follows:

	Three Months Ended March 31		
(In Thousands)	2007	2006	% Change
Freight Core Invoice Transaction Volume*	6,064	5,994	1.2%
Freight Invoice Dollar Volume	\$ 3,411,394	\$ 3,450,076	(1.1)%
Utility Transaction Volume	2,240	1,503	49.0%
Utility Transaction Dollar Volume	\$ 1,774,004	\$ 1,374,215	29.1%
Payment and Processing Fees	\$ 11,249	\$ 9,688	16.1%

\* Core invoices exclude parcel shipments.

Freight transaction volume and invoice dollar volume for the First Quarter of 2007 remained consistent with the same period in 2006. This is reflective of the lack of growth in shipping activity in the United States, particularly in the large manufacturing segments. The increase in transaction and dollar volume from utility transactions increased primarily due to new customers as the growth of this division continues. The increase in utility transaction volume drove the increase in payment and processing fees.

Bank service fees decreased \$184,000 or 32%. This decrease was due primarily to a penalty charged for the early withdrawal of a certificate of deposit by one large bank customer in 2006. Other income increased \$20,000 in the First Quarter of 2007.

#### 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 for the First Quarter of 2007 and First Quarter of 2006:

(Dollars In Thousands)	Three Months Ended March 31		
	2007	2006	Change
Average earning assets	\$779,623	\$743,472	4.9%
Net interest income*	10,515	10,015	5.0%
Net interest margin*	5.47%	5.46%	--
Yield on earning assets*	6.52%	6.18%	--
Rate on interest bearing liabilities	4.13%	3.03%	--

\* Presented on a tax-equivalent basis assuming a tax rate of 35% in 2007 and 2006.

The increase in net interest income was primarily due to a significant increase in earning assets and an increase in yields on earning assets that exceeded the counteracting effect of increases in rates paid on deposit accounts. The increase in earning assets was funded by an increase in accounts and drafts payable due to the increase in dollar volume processed that exceeded a decrease in bank deposits. This decrease was caused mainly by management's decision to

reduce the balances of higher-cost funding. Yields on earning assets and rates paid on deposit accounts both increased as the general level of interest rates increased. However, as the balances of earning assets greatly exceed the balances of interest-bearing deposits, the net effect on net interest margin was positive.

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

Total average loans decreased \$12,433,000 or 2.3% to \$516,705,000. This decrease was attributable to the repayment of several commercial loans. Total average investment in debt and equity securities increased \$22,011,000 or 23% to \$116,804,000 as the Company invested a portion of the increase in payables. Total average federal funds sold and other short-term investments increased \$26,573,000 or 22% to \$146,114,000. This increase provides additional liquidity to the Company. For more information on the changes in net interest income please refer to the tables that follow.

The Company is positively affected by increases in the level of interest rates due to the fact that its rate-sensitive assets significantly exceed its rate-sensitive liabilities. This is primarily due to the noninterest-bearing liabilities generated by the Company in the form of accounts and drafts payable. Changes in interest rates will affect some earning assets such as federal funds sold and floating rate loans immediately and some earning assets, such as fixed rate loans and municipal bonds, over time.

## Distribution of Assets, Liabilities and Stockholders' 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.

(Dollars in thousands)	First Quarter 2007			
	Average Balance	Interest Income/Expense	Yield/Rate	Average Balance
Assets (1)				
Earning assets:				
Loans (2,3):				
Taxable	\$ 510,465	\$ 8,916	7.08%	\$ 52
Tax-exempt (4)	6,240	112	7.31	
Debt and equity securities (5):				
Taxable	20,549	243	4.80	2
Tax-exempt (4)	96,255	1,399	5.90	6
Federal funds sold and other short-term investments	146,114	1,856	5.15	11
Total earning assets	779,623	12,526	6.52	74
Nonearning assets:				
Cash and due from banks	25,386			2
Premises and equipment, net	12,843			1
Bank-owned life insurance	12,069			1
Goodwill and other intangibles, net	8,593			
Other assets	28,181			2
Assets related to discontinued operations	--			
Allowance for loan losses	(6,672)			(
Total assets	\$ 860,023			\$ 81
Liabilities and Shareholders' Equity (1)				

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

## Interest-bearing liabilities:

Interest-bearing demand deposits	\$ 64,669	\$ 518	3.25%	\$ 8
Savings deposits	22,978	194	3.42	1
Time deposits of \$100 or more	69,282	890	5.21	3
Other time deposits	29,476	358	4.94	3
<hr/>				
Total interest-bearing deposits	186,405	1,960	4.27	17
Short-term borrowings	175	2	5.11	
Subordinated Debentures	3,700	49	5.37	
<hr/>				
Total interest-bearing liabilities	190,280	2,011	4.29	17

-15-

## Noninterest-bearing liabilities:

Demand deposits	96,306			10
Accounts and drafts payable	476,275			45
Other liabilities	12,775			
Liabilities related to discontinued operations	--			
<hr/>				
Total liabilities	775,636			73
Shareholders' equity	84,387			7
Total liabilities and shareholders' equity	\$ 860,023			\$ 81
<hr/>				
Net interest income		\$ 10,515		
Net interest margin			5.47%	
Interest spread			2.23%	

- Balances shown are daily averages.
- For purposes of these computations, nonaccrual loans are included in the average loan amounts outstanding. Interest on nonaccrual loans is recorded when received as discussed further in Note 1 to the Company's 2006 consolidated financial statements, filed with the Company's 2006 annual report on Form 10-K.
- Interest income on loans includes net loan fees of \$46,000 and \$72,000 for the First Quarter of 2007 and 2006, respectively.
- Interest income is presented on a tax-equivalent basis assuming a tax rate of 35% in 2007 and 2006. The tax-equivalent adjustment was approximately \$530,000 and \$374,000 for the First Quarter of 2007 and 2006, respectively.
- For purposes of these computations, yields on investment securities are computed as interest income divided by the average amortized cost of the investments.

## Analysis of Net Interest Income Changes

The following table presents the changes in interest income and expense between periods due to changes in volume and interest rates. That portion of the change

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

in interest attributable to the combined rate/volume variance has been allocated to rate and volume changes in proportion to the absolute dollar amounts of the change in each.

(In Thousands)	First Quarter 2007 Over 2006		
	Volume	Rate	Total
=====			
Increase (decrease) in interest income:			
Loans (1,2):			
Taxable	\$ (231)	\$ 422	\$ 191
Tax-exempt (3)	22	1	23
Debt and equity securities:			
Taxable	(86)	63	(23)
Tax-exempt (3)	438	(17)	421
Federal funds sold and other short-term investments	312	272	584
-----			
Total interest income	455	741	1,196
-----			
Interest expense on:			
Interest-bearing demand deposits	(119)	166	47
Savings deposits	19	72	91
Time deposits of \$100 or more	394	114	508
Other time deposits	(27)	77	50
Short-term borrowings	--	--	--
Subordinated debentures	--	--	--
Total interest expense	\$ 267	\$ 429	\$ 696
-----			
Net interest income	\$ 188	\$ 312	\$ 500
=====			

1. Average balances include nonaccrual loans.
2. Interest income includes net loan fees.
3. Interest income is presented on a tax-equivalent basis assuming a tax rate of 35% in 2007 and 2006.

### Provision and Allowance for Loan Losses

A significant determinant of the Company's operating results is the provision for loan losses and the level of loans charged off. Provisions of \$225,000 and \$150,000 were made for loan losses during the First Quarter of 2007 and the

-16-

First Quarter of 2006, respectively. As discussed below, the Company continually analyzes the outstanding loan portfolio based on the performance, financial condition and collateralization of the credits. There was \$5,000 of net loan recoveries in the First Quarter of 2007 and \$221,000 of net loan charge-offs in the First Quarter 2006.

The allowance for loan losses at March 31, 2007 was \$6,822,000 and at December 31, 2006 was \$6,592,000. The ratio of allowance for loan losses to total loans outstanding at March 31, 2007 was 1.29% compared to 1.31% at December 31, 2006. Nonperforming loans were \$764,000 or .14% of total loans at March 31, 2007 compared to \$795,000 or .16% of total loans at December 31, 2006.

At March 31, 2007, nonperforming loans, which are also considered impaired, consisted of \$764,000 in non-accrual loans as shown in the following table. This

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

total consists of three loans that relate to businesses that are in bankruptcy, financial trouble or are in process of liquidation. Nonperforming loans at December 31, 2006 consisted of \$795,000 in non-accrual loans and relate to these three borrowers. Total nonperforming loans decreased \$621,000 from March 31, 2006 to March 31, 2007. This decrease was primarily due to the collection of one loan, charge-offs of three other loans and a reduction in principal balance of the other nonperforming loan.

In addition to the nonperforming loans discussed above, at March 31, 2007, approximately \$5,178,000 of loans not included in the table below were identified by management as having potential credit problems. They may also be classified for regulatory purposes. These loans are excluded from the table due to the fact they are current under the original terms of the loans, however circumstances have raised doubts as to the ability of the borrowers to comply with the current loan repayment terms. Included in this balance is \$3,220,000 related to one borrower that was renegotiated several years ago and although current under the new terms of the contract, management believes, due to the financial condition of the borrower, there still remains risk as to the collectability of all amounts under the loan agreement. The remaining loans are closely monitored by management and have specific reserves established for the estimated loss exposure.

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

### Summary of Asset Quality

The following table presents information as of and for the three-month periods ended March 31, 2007 and 2006 pertaining to the Company's provision for loan losses and analysis of the allowance for loan losses.

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

(Dollars in Thousands)	2007	2006
Allowance at beginning of period	\$ 6,592	\$ 6,284
Provision charged to expense	225	150
Loans charged off	--	(224)
Recoveries on loans previously charged off	5	3
Net loan recoveries (charge-offs)	5	(221)
Allowance at end of period	\$ 6,822	\$ 6,213
Loans outstanding:		
Average	\$ 516,705	\$ 529,138
March 31	530,609	527,045
Ratio of allowance for loan losses to loans outstanding:		
Average	1.32%	1.17%
March 31	1.29%	1.18%
Nonperforming loans:		
Nonaccrual loans	764	\$ 1,385
Loans past due 90 days or more	--	--
Renegotiated loans	--	--
Total non performing loans	\$ 764	\$ 1,385
Foreclosed assets	--	--
Nonperforming loans as a percent of average loans	.15%	.26%

The Bank had no properties carried as other real estate owned as of March 31, 2007 and 2006 and December 31, 2006.

## Operating Expense

Total operating expense for the First Quarter of 2007 increased \$1,464,000 or 11% to \$15,333,000 compared to the First Quarter of 2006 due primarily to expenses related to the 16% growth in processing activity.

Salaries and benefits expense increased \$1,269,000 or 12% to \$11,539,000 in the First Quarter of 2007 compared with the First Quarter of 2006 primarily due to additional headcount to service new transaction business and an increase in bonuses related to the earnings increase over the comparable period last year.

Occupancy expense for the First Quarter of 2007 increased \$35,000 or 8% to \$490,000 from the First Quarter of 2006 primarily due to additional maintenance and repairs.

Equipment expense for the First Quarter of 2007 increased \$159,000 or 24% compared to the First Quarter of 2006 due to additional contract maintenance and software licenses.

Amortization of intangible assets increased \$27,000 to \$70,000 for the First Quarter of 2007 due to the customer list purchased with the NTransit, Inc. acquisition in July 2006.

Other operating expenses decreased \$26,000 to \$2,422,000 for the First Quarter of 2007.

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

Income tax expense for the First Quarter of 2007 decreased \$32,000 or 2% compared to the First Quarter of 2006. The effective tax rate for the First Quarter of 2007 declined to 33.4% compared with 35.1% in the First Quarter of 2006 due to the increase in tax-exempt municipal securities held.

### Financial Condition

Total assets at March 31, 2007 increased \$3,215,000, less than 1% from December 31, 2006. The most significant changes in asset balances during this period was a decrease of \$49,341,000 or 29% in federal funds sold and other short-term investments. Changes in federal funds sold and other short-term investments reflect the Company's daily liquidity position and are affected by the changes in the other asset balances and changes in deposit and accounts and draft payable balances.

-18-

Total liabilities were \$774,541,000, approximately the same as the balance of \$774,550,000 at December 31, 2006. Total deposits at March 31, 2007 were \$273,501,000, a decrease of \$16,393,000 or 6%. Accounts and drafts payable were \$484,013,000, an increase of \$15,620,000 or 3%. Total shareholders' equity at March 31, 2007 was \$87,145,000, a \$3,224,000 or 4% increase from December 31, 2006.

The decrease in deposits in the First Quarter of 2007 mainly reflects a seasonal reduction of demand deposits by customers due to typical cash flow requirements such as payments for taxes and bonuses. Accounts and drafts payable will fluctuate from period-end to period-end due to the payment processing cycle, which results in lower balances on days when checks clear and higher balances on days when checks are issued. For this reason, average balances are a more meaningful measure of accounts and drafts payable (for average balances refer to the tables under the "Distribution of Assets, Liabilities and Stockholders' Equity; Interest Rate and Interest Differential" section of this report).

The increase in total shareholders' equity resulted from net income of \$4,186,000, cash received on the exercise of stock options of \$4,000, \$33,000 tax benefit on stock awards, \$139,000 from stock-based compensation expense, offset by dividends paid of \$1,005,000 (\$.12 per share), and an increase of \$133,000 in other comprehensive loss.

### Liquidity and Capital Resources

The balance of liquid assets consists of cash and cash equivalents, which include cash and due from banks, federal funds sold and money market funds, and was \$142,986,000 at March 31, 2007, a decrease of \$53,518,000 or 27% from December 31, 2006. At March 31, 2007 these assets represented 17% of total assets. These funds are the Company's and its subsidiaries' primary source of liquidity to meet future expected and unexpected loan demand, depositor withdrawals or reductions in accounts and drafts payable.

Secondary sources of liquidity include the investment portfolio and borrowing lines. Total investment in securities was \$130,401,000 at March 31, 2007, an increase of \$27,652,000 from December 31, 2006. These assets represented 15% of total assets at March 31, 2007. Of this total, 85% were state and political subdivision securities, 13% were U.S. Treasury securities and 2% were U.S. government agencies. Of the total portfolio, 14% mature in one year, 28% mature in one to five years, and 58% mature in five or more years. During the First Quarter of 2007 the Company did not sell any securities.

The Bank has unsecured lines at correspondent banks to purchase federal funds up



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

to a maximum of \$29,000,000. Additionally, the Bank maintains a line of credit at unaffiliated financial institutions in the maximum amount of \$69,295,000 collateralized by U.S. Treasury and agency securities and commercial and residential mortgage loans.

The deposits of the Company's banking subsidiary have historically been stable, consisting of a sizable volume of core deposits related to customers that utilize other commercial products of the Bank. The accounts and drafts payable generated by the Company has also historically been a stable source of funds.

Net cash flows provided by operating activities were \$6,202,000 for the First Quarter of 2007 compared with \$5,193,000 for the First Quarter of 2006. This increase is attributable to the increase in net income of \$234,000, the absence of \$1,327,000 in operating activities used by discontinued operations, the other normal fluctuations in asset and liability accounts, offset by the net change in income taxes deferred and payable of \$562,000. Net cash flows from investing and financing activities fluctuate greatly as the Company actively manages its investment and loan portfolios and customer activity influences changes in deposit and accounts and drafts payable balances. Other causes for the changes in these account balances are discussed earlier in this report. Due to the daily fluctuations in these account balances, the analysis of changes in average balances, also discussed earlier in this report, can be more indicative of underlying activity than the period-end balances used in the statements of cash flows. Management anticipates that cash and cash equivalents, maturing investments and cash from operations will continue to be sufficient to fund the Company's operations and capital expenditures in 2007.

The Company faces market risk to the extent that its net interest income and fair market value of equity are affected by changes in market interest rates. For information regarding the market risk of the Company's financial instruments, see Item 3. "QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK".

Risk-based capital guidelines require the Company to meet a minimum total capital ratio of 8.0% of which at least 4.0% must consist of Tier 1 capital. Tier 1 capital generally consists of (a) common shareholders' equity (excluding the unrealized market value adjustments on the available-for-sale securities), (b) qualifying perpetual preferred stock and related surplus subject to certain limitations specified by the Federal Deposit Insurance Corporation ("FDIC"), (c) minority interests in the equity accounts of consolidated subsidiaries less (d) goodwill, (e) mortgage servicing rights within certain limits, and (f) any other intangible assets and investments in subsidiaries that the FDIC determines should be deducted from Tier 1 capital. The FDIC also requires a minimum leverage ratio of 3.0%, defined as the ratio of Tier 1 capital less purchased

-19-

mortgage servicing rights to total assets, for banking organizations deemed the strongest and most highly rated by banking regulators. A higher minimum leverage ratio is required of less highly rated banking organizations. Total capital, a measure of capital adequacy, includes Tier 1 capital, allowance for loan losses, and debt considered equity for regulatory capital purposes.

The Company and the Bank continue to exceed all regulatory capital requirements, as evidenced by the following capital amounts and ratios at March 31, 2007 and December 31, 2006:

March 31, 2007 (In Thousands)	Amount	Ratio
=====		
Total capital (to risk-weighted assets)		

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

Cass Information Systems, Inc.	\$ 88,862	13.66%
Cass Commercial Bank	42,027	14.95
Tier I capital (to risk-weighted assets)		
Cass Information Systems, Inc.	\$ 78,340	12.04%
Cass Commercial Bank	38,499	13.69
Tier I capital (to average assets)		
Cass Information Systems, Inc.	\$ 78,340	9.20%
Cass Commercial Bank	38,499	11.60

December 31, 2006 (In Thousands)	Amount	Ratio
Total capital (to risk-weighted assets)		
Cass Information Systems, Inc.	\$ 85,205	13.64%
Cass Commercial Bank	42,242	14.19
Tier I capital (to risk-weighted assets)		
Cass Information Systems, Inc.	\$ 74,913	11.99%
Cass Commercial Bank	38,511	12.94
Tier I capital (to average assets)		
Cass Information Systems, Inc.	\$ 74,913	8.65%
Cass Commercial Bank	38,511	11.25

### Inflation

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

### Impact of New Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes", an Interpretation of SFAS No. 109 "Accounting for Income Taxes". FASB Interpretation No. 48 clarifies the accounting for uncertainty in income taxes in financial statements and prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken. The Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The FASB Interpretation is effective for fiscal years beginning after December 15, 2006. The Company implemented FASB Interpretation No. 48 on January 1, 2007, which did not have a material impact on the Company's consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements". The objective of SFAS No. 157 is to increase consistency and comparability in fair value measurements and to expand disclosures about fair value measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. The provisions of SFAS No. 157 are effective for fair value measurements made in fiscal years beginning after November 15, 2007. The adoption of this statement is not expected to have a material effect on the Company's consolidated financial statements.

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

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)" ("SFAS No. 158"). SFAS No. 158 requires

-20-

companies to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur 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. The Company recognized the required changes and disclosures in its consolidated 2006 financial statements.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB No. 108"). SAB No. 108 provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. This statement is effective for fiscal years ending after November 15, 2006. This bulletin did not have an impact on the Company's consolidated financial statements.

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). SFAS No. 159 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently assessing the impact of SFAS No. 159 on its financial statements.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As described in the Company's annual report on Form 10-K for the year ended December 31, 2006, the Company manages its interest rate risk through measurement techniques that include gap analysis and a simulation model. As part of the risk management process, asset/liability management policies are established and monitored by management. The policy objective is to limit the change in annualized net interest income to 15% from an immediate and sustained parallel change in interest rates of 200 basis points. Based on the Company's most recent evaluation, management does not believe the Company's risk position at March 31, 2007 has changed materially from that at December 31, 2006.

### ITEM 4. CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures designed to ensure that the information it is required to disclose in the reports it files with the Securities and Exchange Commission ("SEC") is recorded, processed, summarized and reported to management, including the Chief Executive Officer and Principal Financial Officer, within the time periods specified in the rules of the SEC. The Company's Chief Executive Officer and Principal Financial Officer have evaluated the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of March 31, 2007 and based on their evaluation, believe that, as of March 31, 2007, these controls and procedures were effective at the reasonable assurance level to ensure that the Company is able to collect, process and disclose the information it is required to disclose in the reports it files with the SEC within the required time periods.

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

There were no changes in the first quarter of 2007 in the Company's internal control over financial reporting identified by the Chief Executive Officer and Principal Financial Officer in connection with their evaluation that materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended).

### PART II. OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

The Company and its subsidiaries are not involved in any pending proceedings other than ordinary routine litigation incidental to its businesses. Management believes none of these proceedings, if determined adversely, would have a material effect on the business or financial conditions of the Company or its subsidiaries.

#### ITEM 1A. RISK FACTORS

The Company has included in Part I, Item 1A of its annual report on Form 10-K for the year ended December 31, 2006, a description of certain risks and uncertainties that could affect the Company's business, future performance or financial condition (the "Risk Factors"). There are no material changes to the Risk Factors as disclosed in the Company's 2006 annual report on Form 10-K.

-21-

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

None

#### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

#### ITEM 5. OTHER INFORMATION

None

#### ITEM 6. EXHIBITS

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

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

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

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

-22-

### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the

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

Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CASS INFORMATION SYSTEMS, INC.

DATE: May 7, 2007

By /s/ Lawrence A. Collett

-----  
Lawrence A. Collett  
Chairman and Chief Executive Officer

DATE: May 7, 2007

By /s/ P. Stephen Appelbaum

-----  
P. Stephen Appelbaum  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

-23-