CASS INFORMATION SYSTEMS INC
Form 10-Q
November 03, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

x	QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the quarterly period ended September 30, 2014
OR	
..	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the transition period from ___________________ to ___________________

Commission File No. 000-20827

CASS INFORMATION SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Missouri (State or other jurisdiction of incorporation or organization)	**43-1265338** (I.R.S. Employer Identification No.)
12444 Powerscourt Drive, Suite 550 **St. Louis, Missouri** (Address of principal executive offices)	**63131** (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 or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

(Check one)	Large Accelerated Filer _____	Accelerated Filer __X__
	Non-Accelerated Filer _____ (Do not check if a smaller reporting company)	Smaller Reporting Company _____

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

Yes No X

The number of shares outstanding of the registrant's only class of common stock as of October 27, 2014: Common stock, par value $.50 per share 11,516,248 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 2013 Annual Report on Form 10-K, filed with the Securities and Exchange Commission (SEC), which may be updated from time to time in our future filings with the SEC. We undertake no obligation to publicly update or revise any forward-looking statements to reflect changed assumptions, the occurrence of anticipated or unanticipated events, or changes to future results over time.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 2014 (Unaudited)	December 31, 2013
Assets		
Cash and due from banks	$ 11,444	$ 11,283
Interest-bearing deposits in other financial institutions	136,244	160,316
Federal funds sold and other short-term investments	90,974	53,663
Cash and cash equivalents	238,662	225,262
Securities available-for-sale, at fair value	339,840	317,767
Loans	677,581	652,177
Less: Allowance for loan losses	11,859	11,679
Loans, net	665,722	640,498
Premises and equipment, net	15,970	13,231
Investment in bank-owned life insurance	15,303	15,437
Payments in excess of funding	141,209	77,650
Goodwill	11,590	11,590
Other intangible assets, net	2,883	3,222
Other assets	18,994	21,363
Total assets	$ 1,450,173	$ 1,326,020
Liabilities and Shareholders Equity		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 139,398	$ 143,841
Interest-bearing	445,966	438,655
Total deposits	585,364	582,496
Accounts and drafts payable	645,687	543,953
Other liabilities	12,313	9,144
Total liabilities	1,243,364	1,135,593
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 September 30, 2014 and December 31, 2013	5,966	5,966
Additional paid-in capital	126,156	125,062
Retained earnings	87,269	75,939
Common shares in treasury, at cost (414,899 shares at September 30, 2014 and 409,667 shares at December 31, 2013)	(11,884)	(10,980)
Accumulated other comprehensive loss	(698)	(5,560)
Total shareholders equity	206,809	190,427
Total liabilities and shareholders equity	$ 1,450,173	$ 1,326,020

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Fee Revenue and Other Income:				
Information services payment and processing revenue	$ 19,743	$ 18,398	$ 57,694	$ 52,422
Bank service fees	279	298	835	904
Gains on sales of securities	23	866	23	4,003
Other	178	133	1,198	398
Total fee revenue and other income	20,223	19,695	59,750	57,727
Interest Income:				
Interest and fees on loans	7,486	7,765	22,266	24,523
Interest and dividends on securities:				
Taxable	3	5	17	34
Exempt from federal income taxes	2,353	2,151	7,015	6,625
Interest on federal funds sold and other short-term investments	149	161	440	379
Total interest income	9,991	10,082	29,738	31,561
Interest Expense:				
Interest on deposits	604	722	1,857	2,103
Net interest income	9,387	9,360	27,881	29,458
Provision for loan losses				500
Net interest income after provision for loan losses	9,387	9,360	27,881	28,958
Total net revenue	29,610	29,055	87,631	86,685
Operating Expense:				
Salaries and employee benefits	16,515	16,460	49,166	48,998
Occupancy	783	765	2,345	2,109
Equipment	945	970	3,092	2,801
Amortization of intangible assets	121	121	362	415
Other operating expense	2,832	3,068	8,562	8,467
Total operating expense	21,196	21,384	63,527	62,790
Income before income tax expense	8,414	7,671	24,104	23,895
Income tax expense	2,013	1,533	5,857	5,652
Net income	$ 6,401	$ 6,138	$ 18,247	$ 18,243
Basic earnings per share	$ .56	$ .54	$ 1.59	$ 1.60
Diluted earnings per share	.55	.53	1.57	1.57

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Comprehensive income:				
Net income	$ 6,401	$ 6,138	$ 18,247	$ 18,243
Other comprehensive income:				
Net unrealized gain (loss) on securities available-for-sale	801	708	7,885	(8,484)
Tax effect	(297)	(263)	(2,929)	3,152
Reclassification adjustments for gains included in net income	(23)	(866)	(23)	(4,003)
Tax effect	8	303	8	1,401
Foreign currency translation adjustments	(66)	47	(79)	24
Total comprehensive income	$ 6,824	$ 6,067	$ 23,109	$ 10,333

See accompanying notes to unaudited consolidated financial statements.

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

	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Cash Flows From Operating Activities:		
Net income	$ 18,247	$ 18,243
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,036	5,171
Net gains on sales of securities	(23)	(4,003)
Stock-based compensation expense	1,536	1,435
Provision for loan losses		500
Deferred income tax expense	140	935
Increase (decrease) in income tax liability	293	(1,030)
Increase in pension liability	1,710	1,741
Other operating activities, net	506	(1,105)
Net cash provided by operating activities	28,445	21,887
Cash Flows From Investing Activities:		
Proceeds from sales of securities available-for-sale	587	94,666
Proceeds from maturities of securities available-for-sale	8,790	10,682
Purchase of securities available-for-sale	(27,302)	(83,614)
Net (increase) decrease in loans	(25,224)	51,503
Increase in payments in excess of funding	(63,559)	(24,517)
Purchases of premises and equipment, net	(4,676)	(3,400)
Net cash (used in) provided by investing activities	(111,384)	45,320
Cash Flows From Financing Activities:		
Net (decrease) increase in noninterest-bearing demand deposits	(4,443)	3,107
Net increase in interest-bearing demand and savings deposits	22,878	1,549
Net decrease in time deposits	(15,567)	(7,527)
Net increase in accounts and drafts payable	101,734	41,970
Cash dividends paid	(6,917)	(6,207)
Distribution of stock awards, net	(435)	(880)
Purchase of shares for treasury	(911)	
Net cash provided by financing activities	96,339	32,012
Net increase in cash and cash equivalents	13,400	99,219
Cash and cash equivalents at beginning of period	225,262	141,088
Cash and cash equivalents at end of period	$ 238,662	$ 240,307
Supplemental information:		
Cash paid for interest	$ 1,871	$ 2,105
Cash paid for income taxes	5,252	5,858

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, 2013.

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.

Details of the Company s intangible assets are as follows:

	September 30, 2014		December 31, 2013	
(In thousands)	**Gross Carrying Amount**	**Accumulated Amortization**	**Gross Carrying Amount**	**Accumulated Amortization**
Assets eligible for amortization:				
Customer lists	$ 3,933	$ (1,625)	$ 3,933	$ (1,387)
Non-compete agreements	261	(144)	261	(105)
Software	234	(215)	234	(156)
Other	523	(84)	500	(58)
Unamortized intangible assets:				
Goodwill[1]	11,817	(227)	11,817	(227)
Total intangible assets	$ 16,768	$ (2,295)	$ 16,745	$ (1,933)

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

The customer lists are amortized over seven and ten years; the non-compete agreements over five years; software over three years; and other intangible assets over fifteen years. Amortization of intangible assets amounted to $362,000 and $415,000 for the nine-month periods ended September 30, 2014 and 2013, respectively. Estimated future amortization of intangibles is as follows: $483,000 in 2014, $405,000 in 2015, $405,000 in 2016 and $353,000 in each of 2017 and 2018.

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 nine months ended September 30, 2014 and 2013. The calculations of basic and diluted earnings per share are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands except share and per share data)	**2014**	**2013**	**2014**	**2013**
Basic				
Net income	$ 6,401	$ 6,138	$ 18,247	$ 18,243
Weighted-average common shares outstanding	11,480,981	11,450,978	11,482,850	11,435,400
Basic earnings per share	$ .56	$ .54	$ 1.59	$ 1.60

Diluted				
Net income	$ 6,401	$ 6,138	$ 18,247	$ 18,243
Weighted-average common shares outstanding	11,480,981	11,450,978	11,482,850	11,435,400
Effect of dilutive restricted stock and stock appreciation rights	151,711	217,085	171,890	191,915
Weighted-average common shares outstanding assuming dilution	11,632,692	11,668,063	11,654,740	11,627,315
Diluted earnings per share	$ .55	$ .53	$ 1.57	$ 1.57

Note 4 Stock Repurchases

The Company maintains a treasury stock buyback program which allows for the repurchase of shares of the Company s common stock. The Company repurchased 19,542 shares at an aggregate cost of $911,000 during the nine-month period ended September 30, 2014 and 0 during the nine-month period ending September 30, 2013. As of September 30, 2014, 343,458 shares remained available for repurchase under the program. On October 20, 2014, the Company s Board of Directors increased the number of authorized shares from 363,000 to 500,000. 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, 2013. 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 September 30, 2014				
Fee revenue and other income:				
Income from customers	$ 23,840	$ 5,770	$	$ 29,610
Intersegment income (expense)	2,391	370	(2,761)	
Net income	4,392	2,009		6,401
Goodwill	11,454	136		11,590
Other intangible assets, net	2,883			2,883
Total assets	772,847	690,718	(13,392)	1,450,173
Three Months Ended September 30, 2013				
Fee revenue and other income				
Income from customers	$ 23,208	$ 5,847	$	$ 29,055
Intersegment income (expense)	2,408	353	(2,761)	
Net income	4,123	2,015		6,138
Goodwill	11,454	136		11,590
Other intangible assets, net	3,342			3,342
Total assets	679,844	663,101	(13,618)	1,329,327
Nine Months Ended September 30, 2014				
Fee revenue and other income:				
Income from customers	$ 70,792	$ 16,839	$	$ 87,631
Intersegment income (expense)	6,693	1,100	(7,793)	
Net income	12,772	5,475		18,247
Goodwill	11,454	136		11,590
Other intangible assets, net	2,883			2,883

Total assets	772,847	690,718	(13,392)	1,450,173
Nine Months Ended September 30, 2013				
Fee revenue and other income				
Income from customers	$ 68,977	$ 17,708	$	$ 86,685
Intersegment income (expense)	7,253	1,122	(8,375)	
Net income	11,982	6,135	126	18,243
Goodwill	11,454	136		11,590
Other intangible assets, net	3,342			3,342
Total assets	679,844	663,101	(13,618)	1,329,327

Note 6 Loans by Type

A summary of loan categories is as follows:

(In thousands)	September 30, 2014	December 31, 2013
Commercial and industrial	$ 200,951	$ 171,304
Real estate		
Commercial:		
Mortgage	130,816	128,358
Construction		6,632
Church, church-related:		
Mortgage	306,925	326,832
Construction	14,275	9,817
Industrial Revenue Bond	24,417	9,167
Other	197	67
Total loans	$ 677,581	$ 652,177

The following table presents the aging of loans by loan categories at September 30, 2014 and December 31, 2013:

	Performing			Nonperforming		
(In thousands)	Current	30-59 Days	60-89 Days	90 Days and Over	Non-accrual	Total Loans
September 30, 2014						
Commercial and industrial	$ 200,951	$	$	$	$	$ 200,951
Real estate						
Commercial:						
Mortgage	130,453				363	130,816
Construction						
Church, church-related:						
Mortgage	305,811				1,114	306,925
Construction	14,275					14,275
Industrial Revenue Bond	24,417					24,417
Other	197					197
Total	$ 676,104	$	$	$	$ 1,477	$ 677,581
December 31, 2013						
Commercial and industrial	$ 171,293	$	$	$	$ 11	$ 171,304
Real estate						
Commercial:						
Mortgage	127,879				479	128,358
Construction	6,632					6,632
Church, church-related:						
Mortgage	325,091	434			1,307	326,832
Construction	9,817					9,817
Industrial Revenue Bond	9,167					9,167
Other	67					67
Total	$ 649,946	$ 434	$	$	$ 1,797	$ 652,177

The following table presents the credit exposure of the loan portfolio by internally assigned credit grade as of September 30, 2014 and December 31, 2013:

(In thousands)	**Loans Subject to Normal Monitoring[1]**	**Performing Loans Subject to Special Monitoring[2]**	**Nonperforming Loans Subject to Special Monitoring[2]**	**Total Loans**
September 30, 2014				
Commercial and industrial	$ 195,283	$ 5,668	$	$ 200,951
Real estate				
Commercial:				
Mortgage	114,123	16,330	363	130,816
Construction				
Church, church-related:				
Mortgage	305,312	499	1,114	306,925
Construction	14,275			14,275
Industrial Revenue Bond	24,417			24,417
Other	197			197
Total	$ 653,607	$ 22,497	$ 1,477	$ 677,581
December 31, 2013				
Commercial and industrial	$ 167,878	$ 3,415	$ 11	$ 171,304
Real estate				
Commercial:				
Mortgage	119,521	8,358	479	128,358
Construction	6,632			6,632
Church, church-related:				
Mortgage	323,291	2,234	1,307	326,832
Construction	9,817			9,817
Industrial Revenue Bond	9,167			9,167
Other	67			67
Total	$ 636,373	$ 14,007	$ 1,797	$ 652,177

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 September 30, 2014 and December 31, 2013, all impaired loans were evaluated based on the fair value of the collateral. The fair value of the collateral is based upon an observable market price or current appraised value and therefore, the Company classifies these assets as nonrecurring Level 3. There were no loans delinquent 90 days or more and still accruing interest at September 30, 2014 and December 31, 2013. There were no loans classified as troubled debt restructuring at September 30, 2014 and December 31, 2013.

There were no foreclosed loans recorded as other real estate owned (included in other assets) as of September 30, 2014, and December 31, 2013.

The following table presents the recorded investment and unpaid principal balance for impaired loans at September 30, 2014 and December 31, 2013:

(In thousands)	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance for Loan Losses**
September 30, 2014			
Commercial and industrial:			
Nonaccrual	$	$	$
Real estate			
Commercial Mortgage:			

Nonaccrual	363	363	
Church Mortgage:			
Nonaccrual	1,114	1,114	232
Total impaired loans	$ 1,477	$ 1,477	$ 232
December 31, 2013			
Commercial and industrial:			
Nonaccrual	$ 11	$ 11	$ 6
Real estate			
Commercial Mortgage:			
Nonaccrual	479	479	89
Church Mortgage:			
Nonaccrual	1,307	1,307	223
Total impaired loans	$ 1,797	$ 1,797	$ 318

A summary of the activity in the allowance for loan losses from December 31, 2013 to September 30, 2014 is as follows:

(In thousands)	December 31, 2013	Charge-Offs	Recoveries	Provision	September 30, 2014
Commercial and industrial	$ 3,036	$ 3	$ 34	$ 230	$ 3,297
Real estate					
Commercial:					
Mortgage	3,946		222	235	4,403
Construction	151			(151)	
Church, church-related:					
Mortgage	4,354	76	3	(494)	3,787
Construction	124			45	169
Industrial Revenue Bond	68			133	201
Other				2	2
Total	$ 11,679	$ 79	$ 259	$	$ 11,859

Note 7 Commitments and Contingencies

In the normal course of business, the Company is party to activities that contain credit, market and operational risks that are not reflected in whole or in part in the Company s consolidated financial statements. Such activities include traditional off-balance sheet credit-related financial instruments and commitments under operating leases. These financial instruments include commitments to extend credit, commercial letters of credit and standby letters of credit. The Company s maximum potential exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, commercial letters of credit and standby letters of credit is represented by the contractual amounts of those instruments. At September 30, 2014 and December 31, 2013, no amounts have been accrued for any estimated losses for these instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commercial and standby letters of credit are conditional commitments issued by the Company or its subsidiaries to guarantee the performance of a customer to a third party. These off-balance sheet financial instruments generally have fixed expiration dates or other termination clauses and may require payment of a fee. At September 30, 2014, the balance of unused loan commitments, standby and commercial letters of credit were $12,582,000, $11,622,000, and $2,978,000, respectively. Since some of the financial instruments may expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. Commitments to extend credit and letters of credit are subject to the same underwriting standards as those financial instruments included on the consolidated balance sheets. The Company evaluates each customer s credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of the credit, is based on management s credit evaluation of the borrower. Collateral held varies, but is generally accounts receivable, inventory, residential or income-producing commercial property or equipment. In the event of nonperformance, the Company or its subsidiaries may obtain and liquidate the collateral to recover amounts paid under guarantees on these financial instruments.

The following table summarizes contractual cash obligations of the Company related to operating lease commitments and time deposits at September 30, 2014:

		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	$ 7,190	$ 1,271	$ 2,148	$ 1,592	$ 2,179
Time deposits	83,429	71,087	10,877	1,465	
Total	$ 90,619	$ 72,358	$ 13,025	$ 3,057	$ 2,179

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 issues shares out of treasury stock for these awards. During the nine months ended September 30, 2014, 22,350 restricted shares and 37,213 SARs were granted under the Omnibus Plan.

Restricted Stock

Restricted shares granted prior to April 16, 2013 are 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 September 30, 2014, the total unrecognized compensation expense related to non-vested restricted shares was $1,462,000, and the related weighted-average period over which it is expected to be recognized is approximately .77 years.

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

	Nine Months Ended September 30, 2014	
	Shares	Fair Value
Balance at December 31, 2013	58,649	$ 37.45
Granted	22,350	$ 58.96
Vested	(30,043)	$ 35.33
Balance at September 30, 2014	50,956	$ 48.13

SARs

SARs vest over a three-year period, with one-third of the shares vesting and becoming exercisable each year on the anniversary date of the grant, and they expire 10 years from the original grant date. As of September 30, 2014, the total unrecognized compensation expense was $1,013,000, and the related weighted-average period over which it is expected to be recognized is 1.3 years. Following is a summary of the activity of the Company s SARs program for the nine-month period ended September 30, 2014:

	Shares	Weighted-Average Exercise Price	Average Remaining Contractual Term Years	Aggregate Intrinsic Value *(In thousands)*
Outstanding at December 31, 2013	343,445	$ 32.01	7.33	$ 12,137
Granted	37,213	$ 61.64		
Exercised	(7,605)	$ 34.77		
Outstanding at September 30, 2014	373,053	$ 34.91	6.84	$ 2,421
Exercisable at September 30, 2014	248,071	$ 29.40	6.01	$ 2,978

Following is a summary of the activity of the non-vested SARs during the nine-month period ended September 30, 2014:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested at December 31, 2013	177,128	$ 37.11
Granted	37,213	$ 61.64
Vested	(89,359)	$ 35.09

Non-vested at September 30, 2014	124,982	$ 45.85

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

	Nine Months Ended September 30,	
	2014	**2013**
Risk-free interest rate	2.38%	1.29%
Expected life	7 yrs.	7 yrs.
Expected volatility	28.11%	28.72%
Expected dividend yield	1.30%	1.71%

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

Note 9 Defined Pension Plans

The Company has a noncontributory defined-benefit pension plan, which covers most of its employees. The Company accrues and makes contributions designed to fund normal service costs on a current basis using the projected unit credit with service proration method to amortize prior service costs arising from improvements in pension benefits and qualifying service prior to the establishment of the plan over a period of approximately 30 years. Disclosure information is based on a measurement date of December 31 of the corresponding year. The following table represents the components of the net periodic pension costs for 2013 and an estimate for 2014:

	Estimated	**Actual**
(In thousands)	**2014**	**2013**
Service cost benefits earned during the year	$ 3,003	$ 3,452
Interest cost on projected benefit obligations	3,037	2,819
Expected return on plan assets	(4,711)	(4,469)
Net amortization and deferral	244	1,729
Net periodic pension cost	$ 1,573	$ 3,531

Pension costs recorded to expense were $360,000 and $790,000 for the three-month periods ended September 30, 2014 and 2013, respectively, and totaled $1,180,000 and $2,648,000 for the nine-month periods ended September 30, 2014 and 2013, respectively. Pension costs declined significantly in 2014 due to an increase in the discount rate assumption and the favorable asset return in 2013. The Company made no contribution to the plan during the nine-month period ended September 30, 2014 and is evaluating the amount of additional contributions, if any, in 2014.

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 2013 and an estimate for 2014:

	Estimated	**Actual**
(In thousands)	**2014**	**2013**
Service cost benefits earned during the year	$ 136	$ 144
Interest cost on projected benefit obligation	377	335
Net amortization	431	551
Net periodic pension cost	$ 944	$ 1,030

Pension costs recorded to expense were $236,000 and $257,000 for the three-month periods ended September 30, 2014 and 2013, respectively, and were $708,000 and $772,000 for the nine-month periods ended September 30, 2014 and 2013, respectively.

Note 10 Income Taxes

As of September 30, 2014, the Company s unrecognized tax benefits were approximately $1,379,000, of which $983,000 would, if recognized, affect the Company s effective tax rate. As of December 31, 2013, the Company's unrecognized tax benefits were approximately $1,208,000, of which $861,000 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 $251,000 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 $67,000 and $41,000 of gross interest accrued as of September 30, 2014 and December 31, 2013, respectively. There were no penalties for unrecognized tax benefits accrued at September 30, 2014 and December 31, 2013.

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 2010 through 2013 remain subject to examination by the Internal Revenue Service. In addition, the Company is subject to state tax examinations for the tax years 2010 through 2013.

Note 11 Investment in Securities

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

	September 30, 2014			
(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
State and political subdivisions	$ 322,614	$ 13,841	$ 365	$ 336,090
Certificates of deposit	3,750			3,750
Total	$ 326,364	$ 13,841	$ 365	$ 339,840

	December 31, 2013			
(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
State and political subdivisions	$ 308,403	$ 8,537	$ 2,923	$ 314,017
Certificates of deposit	3,750			3,750
Total	$ 312,153	$ 8,537	$ 2,923	$ 317,767

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

	September 30, 2014					
	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	$ 6,325	$ 11	$ 27,626	$ 354	$ 33,951	$ 365
Certificates of deposit						
Total	$ 6,325	$ 11	$ 27,626	$ 354	$ 33,951	$ 365

	December 31, 2013					
	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	$ 101,792	$ 2,661	$ 3,554	$ 262	$ 105,346	$ 2,923
Certificates of deposit						

Total	$ 101,792	$ 2,661	$ 3,554	$ 262	$ 105,346	$ 2,923

There were 30 securities, or 9% of the total (24 greater than 12 months), in an unrealized loss position as of September 30, 2014. There were 102 securities, or 31% of the total (3 greater than 12 months), in an unrealized loss position as of December 31, 2013. All unrealized losses were reviewed to determine whether the losses were other than temporary. Management believes that all unrealized losses are temporary since they were market driven, and it is more likely than not that the Company will not be required to sell prior to recovery of the amortized basis.

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

	September 30, 2014	
(In thousands)	Amortized Cost	Fair Value
Due in 1 year or less	$ 28,278	$ 28,636
Due after 1 year through 5 years	76,717	80,844
Due after 5 years through 10 years	143,710	149,285
Due after 10 years	77,659	81,075
Total	$ 326,364	$ 339,840

Proceeds from sales of investment securities classified as available for sale were $587,000 and $31,006,000 for the three months ended September 30, 2014 and 2013, respectively, and were $587,000 and $94,666,000 for the nine months ended September 30, 2014 and 2013, respectively. Gross realized gains were $23,000 and $866,000 for the three months ended September 30, 2014 and 2013, respectively, and were $23,000 and $4,003,000 for the nine months ended September 30, 2014 and 2013, respectively. There were two securities totaling $3,750,000 pledged to secure public deposits and for other purposes at September 30, 2014.

Note 12 Fair Value of Financial Instruments

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

	September 30, 2014		December 31, 2013	
(In thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Balance sheet assets:				
Cash and cash equivalents	$ 238,662	$ 238,662	$ 225,262	$ 225,262
Investment securities	339,840	339,840	317,767	317,767
Loans, net	665,722	671,908	640,498	642,543
Accrued interest receivable	5,437	5,437	6,030	6,030
Total	$ 1,249,661	$ 1,255,847	$ 1,189,557	$ 1,191,602
Balance sheet liabilities:				
Deposits	$ 585,364	$ 581,075	$ 582,496	$ 583,989
Accounts and drafts payable	645,687	645,687	543,953	543,953
Accrued interest payable	74	74	88	88
Total	$ 1,231,125	$ 1,226,836	$ 1,126,537	$ 1,128,030

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

Accrued Interest Receivable - The carrying amount approximates fair value.

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

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

Accrued Interest - The carrying amount approximates fair value.

There were no transfers between Levels 1 and 2 of the fair value hierarchy for the nine months ended September 30, 2014 and 2013. No financial instruments are measured using Level 3 inputs for the nine months ended September 30, 2014 and 2013.

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 September 30, 2014, 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 Information Systems, Inc. (Cass or the Company) 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 transportation invoice rating, payment processing, auditing, and the generation of accounting and transportation information. Cass also processes and pays energy invoices, which include electricity and gas as well as waste and other facility related expenses. Cass is also in the telecommunications expense management market which includes bill processing and 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, through Cass Commercial Bank, its St. Louis, Missouri-based bank subsidiary (the Bank), also provides banking services nationwide through its branches in the St. Louis metropolitan area and loan production offices in Orange County, California and Colorado Springs, Colorado. 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 transportation, 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 2013 Annual Report on Form 10-K, a decline in the general level of interest rates can have a negative impact on net interest income.

Currently, management views Cass major opportunity as the continued expansion of its payment and information processing service 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.

Investment in Debt Securities. The Company classifies its debt marketable securities as available-for-sale. Securities classified as available-for-sale are carried at fair value. Unrealized gains and losses, net of the related tax effect, are excluded from earnings and reported in accumulated other comprehensive income, a component of shareholders equity. A decline in the fair value of any available-for-sale security below cost that is deemed other than temporary results in a charge to earnings and the establishment of a new cost basis for the security. To determine whether impairment is other than temporary, the Company considers whether it is more likely than not that the Company will not be required to sell prior to recovery of the amortized cost basis. Evidence considered in this assessment includes the reasons for impairment, the severity and duration of the impairment, changes in value subsequent to period-end and forecasted performance of the investee.

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.

Impairment of Assets. The Company periodically evaluates certain long-term assets such as intangible assets including goodwill, foreclosed assets and assets held for sale for impairment. Generally, these assets are initially recorded at cost, and recognition of impairment is required when events and circumstances indicate that the carrying amounts of these assets will not be recoverable in the future. If impairment occurs, various methods of measuring impairment may be called for depending on the circumstances and type of asset, including quoted market prices, estimates based on similar assets, and estimates based on valuation techniques such as discounted projected cash flows. The Company had no impairment of goodwill and intangible assets for the nine-month period ended September 30, 2014 or for the fiscal year ended December 31, 2013, and management does not anticipate any future impairment loss. Investment securities available-for-sale are measured at fair value as determined by an independent research firm. These policies affect both segments of the Company and require significant management assumptions and estimates that could result in materially different results if conditions or underlying circumstances change.

Income Taxes. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in addressing the future tax consequences of events that have been recognized in the Company s financial statements or tax returns such as the realization of deferred tax assets or changes in tax laws or interpretations thereof. In addition, the Company is subject to the continuous examination of its income tax returns by the Internal Revenue Service and other taxing authorities. In accordance with FASB ASC 740, Income Taxes, the Company has unrecognized tax benefits related to tax positions taken or expected to be taken. See Note 10 to the 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, 2013, rate of increase in future compensation levels and mortality rates. These assumptions are updated annually and are disclosed in Note 10 to the consolidated financial statements filed with the Company s Annual Report on Form 10-K for the year ended December 31, 2013. There have been no significant changes in the Company s long-term rate of return assumptions for the past three fiscal years ended December 31, and management believes they are not reasonably likely to change in the future. Pursuant to FASB ASC 715, Compensation Retirement Benefits, the Company has recognized the funded status of its defined benefit postretirement plan in its balance sheet and has recognized changes in that funded status through comprehensive income. The funded status is measured as the difference between the fair value of the plan assets and the projected benefit obligation as of the date of its fiscal year-end.

Results of Operations

The following paragraphs more fully discuss the results of operations and changes in financial condition for the three-month period ended September 30, 2014 (Third Quarter of 2014) compared to the three-month period ended September 30, 2013 (Third Quarter of 2013) and the nine-month period ended September 30, 2014 (Nine Months Ended 2014) compared to the nine-month period ended September 30, 2013 (Nine Months Ended 2013). 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 2013 Annual Report on Form 10-K. Results of operations for the Third Quarter of 2014 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:

(Dollars in thousands except per share data)	Third Quarter of 2014	Third Quarter of 2013	% Change	Nine Months Ended 2014	Nine Months Ended 2013	% Change
Net income	$ 6,401	$ 6,138	4.3%	$ 18,247	$ 18,243	
Diluted earnings per share	$ .55	$ .53	3.8%	$ 1.57	$ 1.57	
Return on average assets	1.76%	1.79%		1.73%	1.82%	
Return on average equity	12.50%	14.09%		12.33%	13.98%	

Fee Revenue and Other Income

The Company s fee revenue is derived mainly from transportation and expense management 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 and fee revenue were as follows:

(In thousands)	Third Quarter of 2014	Third Quarter of 2013	% Change	Nine Months Ended 2014	Nine Months Ended 2013	% Change
Transportation invoice transaction volume	8,856	8,389	5.6%	25,489	23,668	7.7%
Transportation invoice dollar volume	$ 6,725,524	$ 6,113,332	10.0%	$ 19,283,017	$ 17,398,391	10.8%
Expense management transaction volume*	5,188	4,978	4.2%	15,464	14,396	7.4%
Expense management dollar						

volume*	$	3,250,130	$	3,213,889	1.1%	$	9,585,101	$	8,616,645	11.2%
Payment and processing fees	$	19,743	$	18,398	7.3%	$	57,694	$	52,422	10.1%

* Includes energy, telecom and environmental

Third Quarter of 2014 compared to Third Quarter of 2013:

Transportation and facility expense dollar volumes increased 10.0% and 1.1%, respectively. The increase in transportation dollar volume was mainly attributed to a large number of new customers and heightened activity from core transportation clients. Even as new sales remained strong, facility expense dollar volume was muted as recent competitor consolidation in the energy sector affected customer retention.

Bank service fees were slightly lower. There were $23,000 gains on sales of securities in the Third Quarter of 2014, compared to $866,000 in the Third Quarter of 2013.

Nine Months Ended 2014 compared to Nine Months Ended 2013:

Transportation and expense management dollar volumes were up 10.8% and 11.2%, respectively for the same reasons as the Third Quarter. Transportation transaction volumes were up 7.7%. Expense management transaction volumes were up 7.4%.

There were $23,000 gains on sales of securities in the Nine Months Ended 2014, compared to $4,003,000 in the Nine Months Ended 2013.

Net Interest Income

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

	Third Quarter of		%	Nine Months Ended		%
(In thousands)	**2014**	**2013**	**Change**	**2014**	**2013**	**Change**
Average earnings assets	1,243,375	$ 1,210,560	2.7%	1,233,136	$ 1,184,662	4.1%
Average interest-bearing liabilities	425,016	416,288	2.1%	421,565	408,385	3.2%
Net interest income*	10,742	10,519	2.1%	31,790	32,959	(3.5%)
Net interest margin*	3.43%	3.45%		3.45%	3.72%	
Yield on earning assets*	3.62%	3.68%		3.65%	3.96%	
Rate on interest-bearing liabilities	.56%	.69%		.59%	.69%	

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

Third Quarter of 2014 compared to Third Quarter of 2013:

Third Quarter of 2014 average earning assets increased $32,815,000, or 2.7%, compared to the same period in the prior year (see discussion in the following paragraphs). The yield on earning assets and the tax equivalent net interest margin both decreased in 2014 as the general level of interest rates remains low and the impact becomes more pronounced as longer-term, higher-yielding assets re-price, mature or are sold.

Total average loans increased $21,653,000, or 3.4%, for the Third Quarter of 2014 as compared to the Third Quarter of 2013. Average investment securities increased $35,970,000, or 12.7%, for the Third Quarter of 2014.

Total average interest-bearing deposits for the Third Quarter of 2014 increased $8,728,000, or 2.1%, compared to the Third Quarter of 2013. Average accounts and drafts payable increased $51,933,000, or 8.5%, for the Third Quarter of 2014 due to the increase in processing activity.

Nine Months Ended 2014 compared to Nine Months Ended 2013:

Nine Months Ended 2014 average earning assets increased $48,474,000, or 4.1%, compared to the same period in the prior year (see following discussion). The yield on earning assets and the tax equivalent net interest margin both decreased in 2014 as the general level of interest rates remained low.

Total average loans decreased $4,110,000 for the Nine Months Ended 2014 as compared to the Nine Months Ended 2013. This decrease was attributable to normal amortization of the loan portfolio and intense competition from other lenders for new loans. Average investment securities increased $28,433,000, or 9.9%, as the Company took advantage of market opportunities.

Total average interest-bearing deposits for the Nine Months Ended 2014 increased $13,180,000, or 3.2%, to $421,565,000 compared to the Nine Months Ended 2013. Average accounts and drafts payable increased $43,764,000, or 7.4%, to $636,670,000.

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

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

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

	Third Quarter of 2014			Third Quarter of 2013		
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
Assets[1]						