CASS INFORMATION SYSTEMS INC
Form 10-Q
November 02, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended ___September 30, 2016_________

OR

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

For the transition period from __________________ to __________________

Commission File No. 000-20827

CASS INFORMATION SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

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

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

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

Yes __X__ No _____

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes __X__ No _____

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer 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 26, 2016: Common stock, par value $.50 per share 11,176,204 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 2015 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, 2016 (Unaudited)	December 31, 2015
Assets		
Cash and due from banks	$ 13,437	$ 9,015
Interest-bearing deposits in other financial institutions	117,789	176,405
Federal funds sold and other short-term investments	171,877	67,752
Cash and cash equivalents	303,103	253,172
Securities available-for-sale, at fair value	382,671	375,696
Loans	684,874	659,055
Less: Allowance for loan losses	10,673	11,635
Loans, net	674,201	647,420
Premises and equipment, net	20,776	19,648
Investment in bank-owned life insurance	16,319	15,933
Payments in excess of funding	111,334	105,526
Goodwill	11,590	11,590
Other intangible assets, net	2,099	2,405
Other assets	25,560	24,116
Total assets	$ 1,547,653	$ 1,455,506
Liabilities and Shareholders Equity		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 202,384	$ 181,823
Interest-bearing	421,629	464,661
Total deposits	624,013	646,484
Accounts and drafts payable	682,762	577,259
Other liabilities	28,566	24,385
Total liabilities	1,335,341	1,248,128
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, 2016 and December 31, 2015	5,966	5,966
Additional paid-in capital	126,016	126,290
Retained earnings	114,513	103,994
Common shares in treasury, at cost (755,405 shares at September 30, 2016 and 598,875 shares at December 31, 2015)	(30,460)	(22,208)
Accumulated other comprehensive loss	(3,723)	(6,664)
Total shareholders equity	212,312	207,378
Total liabilities and shareholders equity	$ 1,547,653	$ 1,455,506

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, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Fee Revenue and Other Income:				
Information services payment and processing revenue	$ 21,737	$ 19,781	$ 62,162	$ 58,898
Bank service fees	284	308	931	908
Gains on sales of securities		1,271	387	2,910
Other	127	154	630	468
Total fee revenue and other income	22,148	21,514	64,110	63,184
Interest Income:				
Interest and fees on loans	7,264	7,086	21,711	21,528
Interest and dividends on securities:				
Taxable	36	5	69	20
Exempt from federal income taxes	2,386	2,371	7,217	6,996
Interest on federal funds sold and other short-term investments	299	119	775	392
Total interest income	9,985	9,581	29,772	28,936
Interest Expense:				
Interest on deposits	505	498	1,522	1,610
Net interest income	9,480	9,083	28,250	27,326
Provision for loan losses			(1,000)	
Net interest income after provision for loan losses	9,480	9,083	29,250	27,326
Total net revenue	31,628	30,597	93,360	90,510
Operating Expense:				
Personnel	18,319	17,761	54,267	52,630
Occupancy	860	872	2,560	2,565
Equipment	1,124	1,067	3,289	3,208
Amortization of intangible assets	101	103	305	306
Other operating expense	3,147	2,831	9,105	8,873
Total operating expense	23,551	22,634	69,526	67,582
Income before income tax expense	8,077	7,963	23,834	22,928
Income tax expense	1,855	2,083	5,910	5,961
Net income	$ 6,222	$ 5,880	$ 17,924	$ 16,967
Basic earnings per share	$ .56	$ .52	$ 1.61	$ 1.49
Diluted earnings per share	.55	.51	1.58	1.47

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, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Comprehensive income:				
Net income	$ 6,222	$ 5,880	$ 17,924	$ 16,967
Other comprehensive income:				
Net unrealized gain (loss) on securities available-for-sale	(3,176)	3,301	5,036	(327)
Tax effect	1,180	(1,226)	(1,871)	122
Reclassification adjustments for gains included in net income		(1,271)	(387)	(2,910)
Tax effect		472	143	1,081
Foreign currency translation adjustments	9	2	20	(69)
Total comprehensive income	$ 4,235	$ 7,158	$ 20,865	$ 14,864

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, 2016	Nine Months Ended September 30, 2015
Cash Flows From Operating Activities:		
Net income	$ 17,924	$ 16,967
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,964	6,476
Net gains on sales of securities	(387)	(2,910)
Stock-based compensation expense	1,471	1,543
Provision for loan losses	(1,000)	
Increase in income tax benefit	(121)	(1,156)
Increase in income tax liability	973	1,513
Increase in pension liability	3,102	3,626
Other operating activities, net	(3,311)	(254)
Net cash provided by operating activities	25,615	25,805
Cash Flows From Investing Activities:		
Proceeds from sales of securities available-for-sale	21,491	99,347
Proceeds from maturities of securities available-for-sale	29,970	31,390
Purchase of securities available-for-sale	(57,637)	(142,014)
Net increase in loans	(25,781)	(1,508)
Net (increase) decrease in payments in excess of funding	(5,808)	11,368
Purchases of premises and equipment, net	(3,549)	(4,320)
Net cash used in investing activities	(41,314)	(5,737)
Cash Flows From Financing Activities:		
Net increase in noninterest-bearing demand deposits	20,561	13,938
Net decrease in interest-bearing demand and savings deposits	(37,855)	(41,054)
Net decrease in time deposits	(5,177)	(13,611)
Net increase (decrease) in accounts and drafts payable	105,503	(30,198)
Cash dividends paid	(7,406)	(7,203)
Purchase of common shares for treasury	(9,217)	(9,426)
Other financing activities, net	(779)	(767)
Net cash provided by (used in) financing activities	65,630	(88,321)
Net increase (decrease) in cash and cash equivalents	49,931	(68,253)
Cash and cash equivalents at beginning of period	253,172	294,335
Cash and cash equivalents at end of period	$ 303,103	$ 226,082
Supplemental information:		
Cash paid for interest	$ 1,517	$ 3,313
Cash paid for income taxes	5,128	4,501

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, 2015.

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, 2016		December 31, 2015	
(In thousands)	**Gross Carrying Amount**	**Accumulated Amortization**	**Gross Carrying Amount**	**Accumulated Amortization**
Assets eligible for amortization:				
Customer lists	$ 3,933	$ (2,262)	$ 3,933	$ (2,023)
Patents	72	(7)	72	(4)
Non-compete agreements	261	(248)	261	(209)
Software	234	(234)	234	(234)
Other	500	(150)	500	(125)
Unamortized intangible assets:				
Goodwill[1]	11,817	(227)	11,817	(227)
Total intangible assets	$ 16,817	$ (3,128)	$ 16,817	$ (2,822)

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

The customer lists are amortized over seven and ten years; the patents over 18 years; the non-compete agreements over five years; software over three years; and other intangible assets over fifteen years. Amortization of intangible assets amounted to $305,000 and $306,000 for the nine-month periods ended September 30, 2016 and 2015, respectively. Estimated annual amortization of intangibles is as follows: $408,000 in 2016, and $356,000 in each of 2017, 2018, 2019 and 2020.

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, 2016 and 2015. 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)	**2016**	**2015**	**2016**	**2015**
Basic				
Net income	$ 6,222	$ 5,880	$ 17,924	$ 16,967
Weighted-average common shares outstanding	11,110,824	11,329,002	11,159,469	11,385,680
Basic earnings per share	$ .56	$ .52	$ 1.61	$ 1.49

Diluted				
Net income	$ 6,222	$ 5,880	$ 17,924	$ 16,967
Weighted-average common shares outstanding	11,110,824	11,329,002	11,159,469	11,385,680
Effect of dilutive restricted stock and stock appreciation rights	158,541	158,177	155,112	161,005
Weighted-average common shares outstanding assuming dilution assuming dilution	11,269,365	11,487,179	11,314,581	11,546,685
Diluted earnings per share	$ .55	$ .51	$ 1.58	$ 1.47

Note 4 Stock Repurchases

The Company maintains a treasury stock buyback program pursuant to which the Board of Directors has authorized the repurchase of up to 500,000 shares of the Company s common stock. As restored by the Board of Directors on October 19, 2015, the program provides that the Company may repurchase up to an aggregate of 500,000 shares of common stock and has no expiration date. The Company repurchased 0 and 68,105 shares during the three-month periods and 187,123 and 192,690 during the nine-month periods ended September 30, 2016 and 2015, respectively. As of September 30, 2016, 301,156 shares remained available for repurchase under the program. Repurchases may be made in the open market or through negotiated transactions from time to time depending on market conditions. On October 17, 2016, the Company s Board of Directors restored the repurchase program to 500,000 shares.

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, 2015. 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, 2016				
Fee revenue and other income:				
Income from customers	$ 25,090	$ 6,538	$	$ 31,628
Intersegment income (expense)	2,797	416	(3,213)	
Net income	3,806	2,416		6,222
Goodwill	11,454	136		11,590
Other intangible assets, net	2,099			2,099
Total assets	808,568	742,933	(3,848)	1,547,653
Three Months Ended September 30, 2015				
Fee revenue and other income				
Income from customers	$ 24,694	$ 5,903	$	$ 30,597
Intersegment income (expense)	2,310	410	(2,720)	

Net income	3,961	1,919		5,880
Goodwill	11,454	136		11,590
Other intangible assets, net	2,507			2,507
Total assets	751,264	713,173	(30,917)	1,433,520
Nine Months Ended September 30, 2016				
Fee revenue and other income:				
Income from customers	$ 73,084	$ 20,276	$	$ 93,360
Intersegment income (expense)	8,870	1,195	(10,065)	
Net income	10,231	7,693		17,924
Goodwill	11,454	136		11,590
Other intangible assets, net	2,099			2,099
Total assets	808,568	742,933	(3,848)	1,547,653
Nine Months Ended September 30, 2015				
Fee revenue and other income				
Income from customers	$ 73,120	$ 17,390	$	$ 90,510
Intersegment income (expense)	6,854	1,266	(8,120)	
Net income	11,368	5,599		16,967
Goodwill	11,454	136		11,590
Other intangible assets, net	2,507			2,507
Total assets	751,264	713,173	(30,917)	1,433,520

Note 6 Loans by Type

A summary of loan categories is as follows:

(In thousands)	**September 30, 2016**	**December 31, 2015**
Commercial and industrial	$ 213,060	$ 193,430
Real estate		
Commercial:		
Mortgage	102,569	108,836
Construction	13,704	1,182
Church, church-related:		
Mortgage	322,800	306,728
Construction	15,094	28,957
Industrial Revenue Bonds	17,390	19,831
Other	257	91
Total loans	$ 684,874	$ 659,055

The following table presents the aging of loans by loan categories at September 30, 2016 and December 31, 2015:

	Performing				**Nonperforming**	
(In thousands)	**Current**	**30-59 Days**	**60-89 Days**	**90 Days and Over**	**Non-accrual**	**Total Loans**
September 30, 2016						
Commercial and industrial	$ 213,060	$	$	$	$	$ 213,060
Real estate						
Commercial:						
Mortgage	102,309				260	102,569
Construction	13,704					13,704
Church, church-related:						
Mortgage	321,631	105		984	80	322,800
Construction	15,094					15,094
Industrial Revenue Bonds	17,390					17,390

Other	257					257
Total	$ 683,445	$ 105	$	$ 984	$ 340	$ 684,874
December 31, 2015						
Commercial and industrial	$ 193,430	$	$	$	$	$ 193,430
Real estate						
Commercial:						
Mortgage	105,804				3,032	108,836
Construction	1,182					1,182
Church, church-related:						
Mortgage	306,625				103	306,728
Construction	28,957					28,957
Industrial Revenue Bonds	19,831					19,831
Other	91					91
Total	$ 655,920	$	$	$	$ 3,135	$ 659,055

The following table presents the credit exposure of the loan portfolio as of September 30, 2016 and December 31, 2015:

(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, 2016				
Commercial and industrial	$ 210,824	$ 2,236	$	$ 213,060
Real estate				
Commercial:				
Mortgage	101,238	1,071	260	102,569
Construction	13,704			13,704
Church, church-related:				
Mortgage	315,516	7,204	80	322,800
Construction	15,094			15,094
Industrial Revenue Bonds	17,390			17,390
Other	257			257
Total	$ 674,023	$ 10,511	$ 340	$ 684,874
December 31, 2015				
Commercial and industrial	$ 190,303	$ 3,127	$	$ 193,430
Real estate				
Commercial:				
Mortgage	104,642	1,162	3,032	108,836
Construction	1,182			1,182
Church, church-related:				
Mortgage	299,135	7,490	103	306,728
Construction	28,957			28,957
Industrial Revenue Bonds	19,831			19,831
Other	91			91
Total	$ 644,141	$ 11,779	$ 3,135	$ 659,055

[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, 2016, impaired loans were evaluated using the expected cash flow method. At December 31, 2015, all impaired loans were evaluated based on the fair value of the collateral and the expected cash flow method. 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. One loan was delinquent 90 days and still accruing interest at September 30, 2016, which was brought current on October 4, 2016 and has a sale contract that will pay the loan in full upon closing. Therefore, it is not considered impaired. There were no loans delinquent 90 days or more and still accruing interest at December 31, 2015. There were no loans classified as troubled debt restructuring at September 30, 2016 and December 31, 2015.

There were no foreclosed loans recorded as other real estate owned (included in other assets) as of September 30, 2016 and December 31, 2015.

The following table presents the recorded investment and unpaid principal balance for impaired loans at September 30, 2016 and December 31, 2015:

(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance for Loan Losses
September 30, 2016			
Commercial and industrial:			
Nonaccrual	$	$	$
Real estate			
Commercial Mortgage:			
Nonaccrual	260	260	
Church Mortgage:			
Nonaccrual	80	80	80
Total impaired loans	$ 340	$ 340	$ 80
December 31, 2015			
Commercial and industrial:			
Nonaccrual	$	$	$
Real estate			
Commercial Mortgage:			
Nonaccrual	3,032	3,032	1,039
Church Mortgage:			
Nonaccrual	103	103	103
Total impaired loans	$ 3,135	$ 3,135	$ 1,142

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

(In thousands)	December 31, 2015	Charge-Offs	Recoveries	Provision	September 30, 2016
Commercial and industrial	$ 3,083	$	$ 38	$ 217	$ 3,338
Real estate					
Commercial:					
Mortgage	2,803			(1,179)	1,624
Construction	9			93	102
Church, church-related:					
Mortgage	4,082			48	4,130
Construction	217			(102)	115
Industrial Revenue Bonds	320			(47)	273
Other	1,121			(30)	1,091
Total	$ 11,635	$	$ 38	$ (1,000)	$ 10,673

A summary of the activity in the allowance for loan losses from December 31, 2014 to September 30, 2015 is as follows:

(In thousands)	December 31, 2014	Charge-Offs	Recoveries	Provision	September 30, 2015
Commercial and industrial	$ 3,515	$ 30	$ 10	$ (133)	$ 3,362
Real estate					
Commercial:					
Mortgage	3,060		5	(3)	3,062
Construction				1	1
Church, church-related:					
Mortgage	4,016		2	127	4,145
Construction	140			10	150

Industrial Revenue Bonds	394			(50)	344
Other	769		1	48	818
Total	$ 11,894	$ 30	$ 18	$ 0	$ 11,882

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, 2016 and December 31, 2015, 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. The balance of unused loan commitments, standby and commercial letters of credit were $15,976,000, $14,238,000, and $1,820,000 at September 30, 2016 and were $11,755,000, $11,581,000, and $1,857,000 at December 31, 2015, 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, 2016:

	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	$ 6,119	$ 1,416	$ 2,192	$ 1,605	$ 906
Time deposits	56,523	49,340	4,967	2,216	
Total	$ 62,642	$ 50,756	$ 7,159	$ 3,821	$ 906

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, 2016, 35,330 restricted shares and 0 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, 2016, the total unrecognized compensation expense related to non-vested restricted shares was $2,120,000, and the related weighted-average period over which it is expected to be recognized is approximately .8 years.

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

	Nine Months Ended September 30, 2016	
	Shares	**Fair Value**
Balance at December 31, 2015	69,041	$ 51.33
Granted	35,330	$ 50.02
Vested	(29,268)	$ 50.89
Forfeited	(765)	$ 51.87
Balance at September 30, 2016	74,338	$ 50.87

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, 2016, the total unrecognized compensation expense was $74,000, and the related weighted-average period over which it is expected to be recognized is 0.3 years. Following is a summary of the activity of the Company s SARs program for the nine-month period ended September 30, 2016:

	Shares	Weighted-Average Exercise Price	Average Remaining Contractual Term Years	Aggregate Intrinsic Value *(In thousands)*
Outstanding at December 31, 2015	307,323	$ 36.57	5.99	$ 4,577
Exercised	(32,391)	$ 33.48		
Outstanding at September 30, 2016	274,932	$ 36.93	5.27	$ 5,421
Exercisable at September 30, 2016	262,768	$ 35.79	5.17	$ 5,482

Following is a summary of the activity of the non-vested SARs during the nine-month period ended September 30, 2016:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested at December 31, 2015	52,507	$ 51.17
Vested	(40,343)	$ 48.02
Non-vested at September 30, 2016	12,164	$ 61.64

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 2015 and an estimate for 2016:

(In thousands)	**Estimated 2016**	**Actual 2015**
Service cost benefits earned during the year	$ 3,559	$ 3,796
Interest cost on projected benefit obligations	3,504	3,178
Expected return on plan assets	(4,734)	(4,864)
Net amortization and deferral	1,259	1,542
Net periodic pension cost	$ 3,588	$ 3,652

Pension costs recorded to expense were $965,000 and $1,010,000 for the three-month periods ended September 30, 2016 and 2015, respectively, and totaled $2,724,000 and $2,978,000 for the nine-month periods ended September 30, 2016 and 2015, respectively. Pension costs decreased in 2016 due to an increase in the discount rate assumption and the use of the updated mortality tables. The Company made no contribution to the plan during the nine-month period ended September 30, 2016 and is evaluating the amount of additional contributions, if any, in the remainder of 2016.

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 2015 and an estimate for 2016:

(In thousands)	Estimated 2016	Actual 2015
Service cost benefits earned during the year	$ 133	$ 140
Interest cost on projected benefit obligation	367	348
Net amortization	295	654
Net periodic pension cost	$ 795	$ 1,142

Pension costs recorded to expense were $201,000 and $286,000 for the three-month periods ended September 30, 2016 and 2015, respectively, and were $604,000 and $857,000 for the nine-month periods ended September 30, 2016 and 2015, respectively.

Note 10 Income Taxes

As of September 30, 2016, the Company s unrecognized tax benefits were approximately $1,503,000, of which $1,124,000 would, if recognized, affect the Company s effective tax rate. As of December 31, 2015, the Company s unrecognized tax benefits were approximately $1,194,000, 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 $374,000 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 $86,000 and $54,000 of gross interest accrued as of September 30, 2016 and December 31, 2015, respectively. There were no penalties for unrecognized tax benefits accrued at September 30, 2016 and December 31, 2015.

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

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, 2016			
(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
State and political subdivisions	$ 348,829	$ 17,350	$ 174	$ 366,005
U.S. government agencies	8,159	12	1	8,170
Certificates of deposit	8,496			8,496
Total	$ 365,484	$ 17,362	$ 175	$ 382,671

	December 31, 2015			
(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
State and political subdivisions	$ 356,531	$ 12,552	$ 13	$ 369,070
Certificates of deposit	6,626			6,626
Total	$ 363,157	$ 12,552	$ 13	$ 375,696

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

	September 30, 2016					
	Less than 12 months		**12 months or more**		**Total**	
(In thousands)	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**
State and political subdivisions	$ 19,000	$ 174	$	$	$ 19,000	$ 174
U.S. government agencies	3,095	1			3,095	1
Certificates of deposit						
Total	$ 22,095	$ 175	$	$	$ 22,095	$ 175

	December 31, 2015					
	Less than 12 months		12 months or more		Total	
	Estimated	Unrealized	Estimated	Unrealized	Estimated	Unrealized
(In thousands)	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
State and political subdivisions	$ 3,638	$ 5	$ 1,208	$ 8	$ 4,846	$ 13
Certificates of deposit						
Total	$ 3,638	$ 5	$ 1,208	$ 8	$ 4,846	$ 13

There were 16 securities, or 5% of the total (none greater than 12 months), in an unrealized loss position as of September 30, 2016. There were 5 securities, or 1% of the total (1 greater than 12 months), in an unrealized loss position as of December 31, 2015. 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, 2016	
(In thousands)	Amortized Cost	Fair Value
Due in 1 year or less	$ 36,857	$ 37,215
Due after 1 year through 5 years	56,860	58,725
Due after 5 years through 10 years	146,015	155,834
Due after 10 years	125,752	130,897
Total	$ 365,484	$ 382,671

Proceeds from sales of investment securities classified as available for sale were $0 and $33,395,000 for the three months ended September 30, 2016 and 2015, respectively, and were $21,491,000 and $99,347,000 for the nine months ended September 30, 2016 and 2015, respectively. Gross realized gains were $0 and $1,271,000 for the three months ended September 30, 2016 and 2015, respectively, and were $387,000 and $2,910,000 for the nine months ended September 30, 2016 and 2015, respectively. There was one security totaling $3,750,000 pledged to secure public deposits and for other purposes at September 30, 2016.

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, 2016		December 31, 2015	
(In thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Balance sheet assets:				
Cash and cash equivalents	$ 303,103	$ 303,103	$ 253,172	$ 253,172
Investment securities	382,671	382,671	375,696	375,696
Loans, net	674,201	678,185	647,420	649,161
Accrued interest receivable	5,498	5,498	6,647	6,647
Total	$ 1,365,473	$ 1,369,457	$ 1,282,935	$ 1,284,676
Balance sheet liabilities:				
Deposits	$ 624,013	$ 624,367	$ 646,484	$ 646,892
Accounts and drafts payable	682,762	682,762	577,259	577,259
Accrued interest payable	40	40	35	35
Total	$ 1,306,815	$ 1,307,169	$ 1,223,778	$ 1,224,186

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, 2016 and 2015. No financial instruments are measured using Level 3 inputs for the nine months ended September 30, 2016 and 2015.

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, 2016, and there were no events identified that would require additional disclosures to prevent the Company s unaudited consolidated financial statements from being misleading.

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

Overview

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

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

Industry-wide factors that impact the Company include the willingness of large corporations to outsource key business functions such as freight, energy, telecommunication and environmental payment and audit. The benefits that can be achieved by outsourcing transaction processing, and the management information generated by Cass systems can be influenced by factors such as the competitive pressures within industries to improve profitability, the general level of transportation costs, deregulation of energy costs, and consolidation of telecommunication providers. Economic factors that impact the Company include the general level of economic activity that can affect the volume and size of invoices processed, the ability to hire and retain qualified staff, and the growth and quality of the loan portfolio. The general level of interest rates also has a significant effect on the revenue of the Company. As discussed in greater detail in Item 7A, Quantitative and Qualitative Disclosures about Market Risk, in the Company s 2015 Annual Report on Form 10-K, a decline in the general level of interest rates can have a negative impact on net interest income and conversely, a rise in the general level of interest rates can have a positive impact on net interest income.

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

Critical Accounting Policies

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

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

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

Pension Plans. The amounts recognized in the unaudited consolidated financial statements related to pension plans are determined from actuarial valuations. Inherent in these valuations are assumptions, including expected return on plan assets, discount rates at which the liabilities could be settled at December 31, 2015, 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, 2015. 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, 2016 (Third Quarter of 2016) compared to the three-month period ended September 30, 2015 (Third Quarter of 2015) and the nine-month period ended September 30, 2016 (Nine Months Ended 2016) compared to the nine-month period ended September 30, 2015 (Nine Months Ended 2015). 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 2015 Annual Report on Form 10-K. Results of operations for the Third Quarter of 2016 are not necessarily indicative of the results to be attained for any other period.

Net Income

The following table summarizes the Company s operating results:

	Third Quarter of			Nine Months Ended		
(In thousands except per share data)	**2016**	**2015**	**% Change**	**2016**	**2015**	**% Change**
Net income	$ 6,222	$ 5,880	5.8	$ 17,924	$ 16,967	5.6
Diluted earnings per share	$ .55	$ .51	7.8	$ 1.58	$ 1.47	7.5
Return on average assets	1.59%	1.63%		1.60%	1.58%	
Return on average equity	11.84%	11.86%		11.56%	11.48%	

Fee Revenue and Other Income

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

	Third Quarter of			Nine Months Ended		
(In thousands)	**2016**	**2015**	**% Change**	**2016**	**2015**	**% Change**
Transportation invoice transaction volume	8,898	8,626	3.2%	25,786	25,720	0.3%
Transportation invoice dollar volume	$ 5,864,716	$ 6,140,747	(4.5)%	$ 17,107,723	$ 18,739,375	(8.7)%
Expense management transaction volume*	6,034	5,202	16.0%	16,989	15,264	11.3%
Expense management dollar volume*	$ 3,301,049	$ 3,162,787	4.4%	$ 8,882,181	$ 8,901,907	(0.2)%
Payment and processing revenue	$ 21,737	$ 19,781	9.9%	$ 62,162	$ 58,898	5.5%

*Includes energy, telecom and waste

Third Quarter of 2016 compared to Third Quarter of 2015:

In the transportation market, new accounts boosted transaction volume, but multiple factors continued to challenge dollar volume growth. A continuing impediment was declining activity from existing customers, especially those involved in oil and gas production. Transportation sector dollar volume was also retarded by lower fuel prices which reduced average invoice amounts. The expense management group had 16.0% growth in transaction volume. New customer acquisition, including several large accounts that switched from competitors, was the primary driver of the increase. Expense management dollar volume was also up for the quarter.

There were no gains on sales of securities in the Third Quarter of 2016, compared to $1,271,000 in the Third Quarter of 2015.

Nine Months Ended 2016 compared to Nine Months Ended 2015:

Transportation transaction and dollar volumes as well as expense management transaction volumes fluctuated for the same reasons as the Second Quarter. Expense management dollar volume decreased due to a change in the mix of its customer base.

There were $387,000 of gains on sales of securities in the Nine Months Ended 2016, compared to $2,910,000 in the Nine Months Ended 2015.

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)	**2016**	**2015**	**% Change**	**2016**	**2015**	**% Change**
Average earnings assets	$ 1,351,638	$ 1,234,469	9.5%	$ 1,301,280	$ 1,235,403	5.3%
Average interest-bearing liabilities	428,797	396,230	8.2%	426,825	416,992	2.4%
Net interest income*	10,842	10,444	3.8%	32,370	31,347	3.3%
Net interest margin*	3.19%	3.36%		3.32%	3.39%	
Yield on earning assets*	3.34%	3.52%		3.48%	3.57%	
Rate on interest-bearing liabilities	.47%	.50%		.48%	.52%	

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

Third Quarter of 2016 compared to Third Quarter of 2015:

Third Quarter of 2016 average earning assets increased $117,169,000, or 9.5%, compared to the same period in the prior year (see discussion in the following paragraphs).

Average federal funds sold and other short-term investments increased $62,777,000, or 51.1%, average interest bearing deposits in other financial institutions increased $20,600,000, or 19.3%, total average loans increased $15,919,000, or 2.4%, and average investment securities increased $13,497,000, or 4.0%, for the Third Quarter of 2016 as compared to the Third Quarter of 2015. This was due to an increase in deposits (see discussion in following paragraph) and accounts and drafts payable balances.

Total average interest-bearing liabilities for the Third Quarter of 2016 increased $32,567,000, or 8.2%, average accounts and drafts payable increased $48,287,000, or 7.5%, and average demand deposits increased $33,022,000, or 20.6%, for the Third Quarter of 2016.

Net interest margin and yield on earning assets decreased due to a less favorable mix of earning assets in the Third Quarter of 2016. However, the 9.5% increase in the volume of earning assets more than offset the decrease in yield and resulted in a 3.8% increase in net interest income.

Nine Months Ended 2016 compared to Nine Months Ended 2015:

Nine Months Ended 2016 average earning assets increased $65,877,000, or 5.3%, compared to the same period in the prior year (see following discussion).

Average federal funds sold increased $33,341,000, or 31.7%, for the Nine Months Ended 2016 as compared to the Nine Months Ended 2015. Average investment securities increased $24,371,000, or 7.6%, as the Company took advantage of market opportunities.

Total average interest-bearing liabilities for the Nine Months Ended 2016 decreased $9,833,000, or 2.4%, compared to the Nine Months Ended 2015. Average demand deposits increased $27,921,000, or 17.5%, and average accounts and drafts payable increased $19,648,000, or 3.1%.

Net interest margin and yield on earning assets decreased slightly, however, the 5.3% increase in the volume of earning assets more than offset the slight decrease in yield and resulted in a 3.3% increase in net interest income.

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

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

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

(In thousands)	Third Quarter of 2016 Average Balance	Interest Income/ Expense	Yield/ Rate	Third Quarter of 2015 Average Balance	Interest Income/ Expense	Yield/ Rate
Assets[1]						
Earning assets						
Loans[2, 3]:						
Taxable	$ 664,705	$ 7,121	4.26%	$ 645,269	$ 6,931	4.26%
Tax-exempt[4]	17,703	219	4.92	21,220	239	4.47
Investment securities[5]:						
Taxable	5,714	22	1.53	1,189	1	.33
Tax-exempt[4]	342,305	3,672	4.27	333,333	3,648	4.34
Certificates of deposit	8,339	14	.67	3,963	4	.40
Interest-bearing deposits in other financial institutions	127,314	162	.51	106,714	80	.30
Federal funds sold and other short-term investments	185,558	137	.29	122,781	39	.13
Total earning assets	1,351,638	11,347	3.34	1,234,469	10,942	3.52
Non-earning assets						
Cash and due from banks	12,097			14,007		
Premises and equipment, net	20,773			18,960		
Bank-owned life insurance	16,238			15,725		
Goodwill and other intangibles	13,749			14,150		
Other assets	148,734			142,730		
Allowance for loan losses	(10,673)			(11,905)		
Total assets	$ 1,552,556			$ 1,428,136		
Liabilities and Shareholders Equity[1]						
Interest-bearing liabilities						
Interest-bearing demand deposits	$ 351,971	$ 347	.39%	$ 315,755	$ 329	.41%
Savings deposits	19,679	24	.49	13,225	15	.45
Time deposits >= $100	22,237	69	1.23	24,559	76	1.23
Other time deposits	34,899	65	.74	42,680	78	.73
Federal Funds purchased	11			11		
Total interest-bearing liabilities	428,797	505	.47	396,230	498	.50
Non-interest bearing liabilities						
Demand deposits	193,688			160,666		
Accounts and drafts payable	692,545			644,258		
Other liabilities	28,456			30,228		
Total liabilities	1,343,486			1,231,382		
Shareholders equity	209,070			196,754		
Total liabilities and shareholders equity	$ 1,552,556			$ 1,428,136		
Net interest income		$ 10,842			$ 10,444	
Net interest margin			3.19%			3.36%
Interest spread			2.87			3.02

1. Balances shown are daily averages.
2. For purposes of these computations, nonaccrual loans are included in the average loan amounts outstanding. Interest on nonaccrual loans is recorded when received as discussed further in Note 1 to the Company s 2015 consolidated financial statements, filed with the Company s 2015 Annual Report on Form 10-K.
3. Interest income on loans includes net loan fees of $76,000 and $73,000 for the Third Quarter of 2016 and 2015, respectively.
4. Interest income is presented on a tax-equivalent basis assuming a tax rate of 35%. The tax-equivalent adjustment was approximately $1,361,000 and $1,361,000 for the Third Quarter of 2016 and 2015, respectively.
5. For purposes of these computations, yields on investment securities are computed as interest income divided by the average amortized cost of the investments.

	Nine Months Ended 2016			Nine Months Ended 2015		
(In thousands)	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
Assets[1]						
Earning assets						
Loans[2, 3]:						
Taxable	$ 661,435	$ 21,278	4.30%	$ 652,326	$ 21,057	4.32%
Tax-exempt[4]	18,517	666	4.80	22,025	725	4.40
Investment securities[5]:						
Taxable	2,711	33	1.63	1,160	12	1.38
Tax-exempt[4]	343,052	11,104	4.32	320,232	10,763	4.49
Certificates of deposit	7,626	36	.63	3,822	8	.28
Interest-bearing deposits in other financial institutions	129,457	484	.50	130,697	290	.30
Federal funds sold and other short-term investments	138,482	291	.28	105,141	102	.13
Total earning assets	1,301,280	33,892	3.48	1,235,403	32,957	3.57
Non-earning assets						
Cash and due from banks	11,716			13,438		
Premises and equipment, net	20,371			18,234		
Bank-owned life insurance	16,110			15,603		
Goodwill and other intangibles	13,851			14,232		
Other assets	144,129			146,784		
Allowance for loan losses	(10,981)			(11,901)		
Total assets	$ 1,496,476			$ 1,431,793		
Liabilities and Shareholders Equity[1]						
Interest-bearing liabilities						