CASS INFORMATION SYSTEMS INC Files SEC form 10-Q, Quarterly Report

11/12/03

12-Nov-2003

Quarterly Report

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

The Company operates in four primary business segments: Transportation Information Services, Utility Information Services and through the Company's wholly owned subsidiaries, Cass Commercial Bank ("the Bank"), Banking Services and Government e-Management Solutions, Inc. (GEMS), Government Software Services. The Company is a payment processing and information services company, whose operations include the processing and payment of freight and utility invoices, preparation of management information, auditing and rating of invoices and other payment-related activities for customers located throughout the United States. The Bank provides specialized banking services to privately-held businesses located primarily in the St. Louis, Missouri metropolitan area and church and church-related entities located in the St. Louis metropolitan area and selected cities throughout the United States. GEMS provides the public sector in the United States with integrated financial, property and human resource management systems.

Critical Accounting Policies

The Company has prepared all of the consolidated financial information in this report in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). In preparing the consolidated financial statements in accordance with U.S. GAAP, management makes estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. There can be no assurances that actual results will not differ from those estimates.

Management has identified the accounting policy related to the allowance for loan losses as critical to the understanding of the Company's results of operations, since the application of this policy requires significant management assumptions and estimates that could result in materially different amounts to be reported if conditions or underlying circumstances were to change. The impact and any associated risks related to these policies on our business operations are discussed in the " Allowance and Provision for Loan Losses" section of this report.

In addition, management evaluates certain long-term assets such as premises and equipment, goodwill, investments and foreclosed assets for impairment. Generally, recognition of impairment is required when events and circumstances indicate that the carrying amounts of these assets will not be recoverable in the future. If impairment occurs, various methods of measuring impairment may be called for depending on the circumstances and type of asset, including quoted market prices, estimates based on similar assets, and estimates based on valuation techniques such as discounted projected cash flows. Assets held for sale are carried at the lower of cost or fair value less costs to sell. The application of this policy also requires significant management assumptions and estimates that could result in materially different results if conditions or underlying circumstances change.

Consolidation of Subsidiary

On January 2, 2001, the Bank foreclosed on certain operating assets relating to one borrower in order to protect its financial interests. This borrower was a software company that provided the public sector with integrated financial, property and human resource management systems. The Bank sold these assets to a wholly owned subsidiary, Government e-Management Solutions, Inc. (GEMS) and invested in and stabilized this business. From the date of foreclosure through December 31, 2002 these assets were accounted for as a foreclosed asset held for sale. Statement of Financial Accounting Standards SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", adopted by the Company on January 1, 2002, requires that if certain criteria are not met for long-lived asset (disposal) groups classified as held for sale by the end of the fiscal year in which SFAS 144 is initially applied, the related long-lived assets shall be reclassified as held and used. Therefore, as of January 1, 2003, the Company has reclassified the foreclosed assets relating to GEMS as held and used and consolidated its operations into those of the Company.

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, 2003 (the "Third Quarter of 2003") compared to the three-month period ended September 30, 2002 (the "Third Quarter of 2002") and the nine-month period ended September 30, 2003 ("First Nine Months of 2003") compared to the nine-month period ended September 30, 2002 ("First Nine Months of 2002"). The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes and with the statistical information and financial data appearing in this report as well as the Company's 2002 Annual Report on Form 10-K. Results of operations for the Third Quarter of 2003 are not necessarily indicative of the results to be attained for any other period.

The Company's net income was $2,022,000 for the Third Quarter of 2003, a $248,000 or 14.0% increase compared to net income of $1,774,000 for the Third Quarter of 2002. The Company's net income was $5,779,000 for the First Nine Months of 2003, a $428,000 or 8.0% increase compared to net income of $5,351,000 for the First Nine Months of 2002. Diluted earnings per share were $.60 for the Third Quarter of 2003, a 15.4% increase compared to $.52 for the Third Quarter of 2002. Diluted earnings per share were $1.71 for the First Nine Months of 2003, an 8.2% increase compared to $1.58 for the First Nine Months of 2002. Return on average assets for the Third Quarter of 2003 was 1.26% compared with 1.18% for the Third Quarter of 2002. Return on average assets for the First Nine Months of 2003 was 1.27% compared with 1.21% for the First Nine Months of 2002. Return on average equity for the Third Quarter of 2003 was 13.11% compared to 12.16% for the Third Quarter of 2002. Return on average equity for the First Nine Months of 2003 was 12.67% compared with 12.68% for the First Nine Months of 2002.

Noninterest Income

Noninterest income is principally derived from payment and processing fees. Processing volumes related to these fees for the three and nine-month periods ended September 30, 2003 and 2002 are as follows:

	Three Months Ended September 30			Nine Months Ended September 30		
(In Thousands)	2003	2002	% Change	2003	2002	% Change
Transportation Information Services:						
Invoice Bill Volume	5,882	5,639	4.3%	17,358	15,914	9.1%
Invoice Dollar Volume	$2,208,878	$1,989,867	11.0%	$6,417,046	$5,717,571	12.2%
Payment and Processing Fees	$4,886	$4,542	7.6%	$14,525	$13,097	10.9%
Utility Information Services:						
Invoice Transaction Volume	1,218	870	40.0%	3,367	2,477	35.9%

Invoice Dollar Volume	$878,998	$725,695	21.1%	$2,493,073	$1,919,357	29.9%
Payment and Processing Fees	$2,422	$1,737	39.4%	$6,622	$4,855	36.4%

The increases in fees from the Transportation Information Services Division during the Third Quarter and First Nine Months of 2003 were due to new customers and new services. The increases in fees from the Utility Information Services Division were primarily due to the addition of new customers from the marketing efforts of this new segment.

The consolidation of GEMS resulted in $2,221,000 of additional noninterest income for the Third Quarter of 2003 and $5,871,000 for the First Nine Months of 2003. As explained earlier, the operating results of this wholly owned subsidiary were consolidated on January 1, 2003. Bank service fees for the Third Quarter of 2003 were $464,000, a $61,000 or 15.1% increase compared to the Third Quarter of 2002. Bank service fees for the First Nine Months of 2003 were $1,355,000, an $116,000 or 9.4% increase compared with the First Nine Months of 2002.

Gains on the sales of investment securities for the Third Quarter of 2003 were $92,000 compared with a net loss of $2,000 in Third Quarter of 2002. Gains for the First Nine Months of 2003 were $1,454,000, a $512,000 or 54.4% increase over the First Nine Months of 2002. The fair value of securities sold in the Third Quarter of 2003 was $13,297,000 and for the Third Quarter of 2002 was $633,000. The fair value of securities sold in the First Nine Months of 2003 was $37,831,000 and for the First Nine Months of 2002 was $52,870,000. The sales of securities were transacted to adjust the portfolio to reflect the changes in the interest rate environment and growth in the loan portfolio during the past two years and to offset the loss in interest income due to the dramatic decline in the general level of interest rates.

Other noninterest income increased $139,000 from $76,000 in the Third Quarter of 2002 to $215,000 in the Third Quarter of 2003. Other noninterest income for the First Nine Months of 2003 increased $351,000 from $129,000 in the First Nine Months of 2002 to $480,000 in the First Nine Months of 2003. This increase is primarily due to income recognized from the increase in the cash surrender value of bank owned life insurance purchased by the Company in the Third Quarter of 2002.

Net Interest Income

Third Quarter of 2003 compared to Third Quarter of 2002:

The Company's tax-equivalent net interest income decreased 11.8% or $899,000 from $7,593,000 to $6,694,000. Average earning assets increased 6.1% or $33,108,000 from $542,929,000 to $576,037,000. The tax-equivalent net interest margin decreased from 5.55% to 4.61%. The average tax-equivalent yield on earning assets decreased from 5.97% to 4.92%. The average rate paid on interest-bearing liabilities decreased from 1.61% to 1.14%.

The average balances of loans increased $34,034,000 from $414,378,000 to $448,412,000, investment in debt and equity securities, at amortized cost, decreased $34,484,000 from $80,582,000 to $46,098,000, and federal funds sold and other short-term investments increased $33,558,000 from $47,969,000 to $81,527,000. The average balance of noninterest-bearing demand deposit accounts increased $6,142,000 from $97,317,000 to $103,459,000, interest-bearing liabilities increased $13,875,000 from $142,304,000 to $156,179,000 and accounts and drafts payable increased $10,696,000 from $295,138,000 to $305,834,000.

The increase in average loan balances during this period was primarily attributable to the Bank's marketing efforts, both in the commercial and church and church-related areas. The decrease in debt and equity securities and increase in federal funds sold and other short-term investments reflects management's asset allocation decisions given projected liquidity requirements, market interest rates and the attractiveness of alternative investments. The increase in interest-bearing liabilities is primarily due to an increase in other time deposits as a result of a certificate of deposit promotion. The increase in average accounts and drafts payable relates to increases in invoice dollars paid, primarily from new business, reduced by a decrease in the amount of time funds were held by the Company for investment.

The decreases experienced during the Third Quarter of 2003 in net interest income and the net interest margin were due primarily to the decline in the general level of interest rates. The Company partially mitigated the effects of this decline in interest rates by increasing loan balances, which is one of the Company's highest yielding earning assets. The Company is positively affected by increases in the level of interest rates due to the fact that its rate sensitive assets significantly exceed its rate sensitive liabilities. Conversely, the Company is adversely affected by decreases in the level of interest rates. This is primarily due to the noninterest-bearing liabilities generated by the Company in the form of accounts and drafts payable. For more information please refer to the tables on pages 14 through 17.

First Nine Months of 2003 compared to the First Nine Months of 2002:

The Company's tax-equivalent net interest income decreased 11.9% or $2,753,000 from $23,086,000 to $20,333,000. Average earning assets increased 1.4% or $7,599,000 from $540,941,000 to $548,540,000. The tax-equivalent net interest margin decreased from 5.71% to 4.96%. The average tax-equivalent yield on earning assets decreased from 6.13% to 5.29%. The average rate paid on interest-bearing liabilities decreased from 1.63% to 1.24%.

The average balances of loans increased $41,028,000 from $398,346,000 to $439,374,000, investment in debt and equity securities, at amortized cost, decreased $49,183,000 from $104,737,000 to $55,554,000, and federal funds sold and other short-term investments increased $15,754,000 from $37,858,000 to $53,612,000. The average balance of noninterest bearing demand deposit accounts decreased $2,314,000 from $100,265,000 to $97,951,000, accounts and drafts payable increased $5,177,000 from $289,454,000 to $294,631,000, and interest-bearing liabilities increased $4,864,000 from $140,808,000 to $145,672,000.

The increases and decreases experienced in earning assets and funding sources during the First Nine Months of 2003 were attributable to the same factors as those described for the third quarter, except for noninterest- bearing deposits. The average balance of noninterest-bearing deposits decreased slightly in the First Nine Months of 2003 compared with the First Nine Months of 2002 due to a shift from demand and savings deposits to time deposits as new and existing customers shifted funds to higher yielding deposit accounts.

The decreases experienced during the First Nine Months of 2003 in net interest income and the net interest margin were also caused primarily by decreases in the general level of interest rates. For more information please refer to the tables on pages 14 through 17.

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

The following table shows the condensed average balance sheets for each of the periods reported, the 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 2003			Third Quarter 2002		
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
Assets(1)						
Earning assets:						
Loans(2),(3):						
Taxable	$ 442,753	$ 6,332	5.67%	$ 408,329	$ 6,679	6.49%
Tax-exempt(4)	5,659	107	7.50	6,049	114	7.48
Debt and equity securities(5):						
Taxable	19,598	91	1.84	33,709	377	4.44
Tax-exempt(4)	26,500	426	6.38	46,873	796	6.74
Federal funds sold and other short-term investments	81,527	187	.91	47,969	206	1.70

Total earning assets	576,037	7,143	4.92	542,929	8,172	5.97
Nonearning assets:						
Cash and due from banks	20,133			24,121		
Premises and equipment, net	14,639			16,276		
Foreclosed assets	1,154			5,623		
Other assets	28,646			15,102		
Allowance for loan losses	(5,397)			(5,142)		
Total assets	$ 635,212			$ 598,909		
Liabilities And Shareholders' Equity(1)						
Interest-bearing liabilities:						
Interest-bearing demand deposits	$ 51,348	$ 74	.57%	$ 51,047	$ 135	1.05%
Savings deposits	36,985	61	.65	38,169	115	1.20
Time deposits of $100 or more	45,835	191	1.65	46,776	282	2.39
Other time deposits	22,011	123	2.22	5,701	43	2.99
Total interest-bearing deposits	156,179	449	1.14	141,693	575	1.61
Short-term borrowings	--	--	--	611	4	2.60
Total interest-bearing liabilities	156,179	449	1.14	142,304	579	1.61
Noninterest-bearing liabilities:						
Demand deposits	103,459			97,317		
Accounts and drafts payable	305,834			295,138		
Other liabilities	8,545			6,257		
Total liabilities	574,017			541,016		
Shareholders' equity	61,195			57,893		
Total liabilities and shareholders' equity	$ 635,212			$ 598,909		
Net interest income		$ 6,694			$ 7,593	
Interest spread			3.78%			4.36%
Net interest margin			4.61%			5.55%

(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 2002 Consolidated Financial Statements. (3). Interest income on loans includes net loan fees of $26,000 and $101,000 for the Third Quarter of 2003 and 2002, respectively. (4). Interest income is presented on a tax-equivalent basis assuming a tax rate of 34%. The tax-equivalent adjustment was approximately $180,000 and $308,000 for the Third Quarter of 2003 and 2002, 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.

	First Nine Months of 2003			First Nine Months of 2002		
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
Assets(1)						
Earning assets:						
Loans(2),(3):						
Taxable	$ 433,670	$ 18,925	5.83%	$ 392,256	$ 19,315	6.58%
Tax-exempt(4)	5,704	323	7.57	6,090	344	7.55
Debt and equity securities(5):						
Taxable	22,971	412	2.40	64,125	2,580	5.38
Tax-exempt(4)	32,583	1,613	6.62	40,612	2,077	6.84
Federal funds sold and other short-term investments	53,612	413	1.03	37,858	485	1.71
Total earning assets	548,540	21,686	5.29	540,941	24,801	6.13
Nonearning assets:						
Cash and due from banks	19,840			23,817		
Premises and equipment, net	15,232			16,423		
Foreclosed assets	1,096			5,507		
Other assets	27,559			11,060		
Allowance for loan losses	(5,372)			(5,029)		
Total assets	$ 606,895			$ 592,719		
Liabilities And Shareholders' Equity(1)						
Interest-bearing liabilities:						
Interest-bearing demand						

deposits	$ 52,367	$ 295	.75%	$ 56,733	$ 479	1.13%
Savings deposits	36,244	224	.83	43,314	422	1.30
Time deposits of $100 or more	43,824	607	1.85	33,682	648	2.57
Other time deposits	12,022	213	2.37	5,367	137	3.41
Total interest-bearing deposits	144,457	1,339	1.24	139,096	1,686	1.62
Short-term borrowings	1,215	14	1.54	1,712	29	2.26
Total interest-bearing liabilities	145,672	1,353	1.24	140,808	1,715	1.63
Noninterest-bearing liabilities:						
Demand deposits	97,951			100,265		
Accounts and drafts payable	294,631			289,454		
Other liabilities	7,670			5,782		
Total liabilities	545,924			536,309		
Shareholders' equity	60,971			56,410		
Total liabilities and shareholders' equity	$ 606,895			$ 592,719		
Net interest income		$ 20,333			$ 23,086	
Interest spread			4.05%			4.50%
Net interest margin			4.96%			5.71%

(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 2002 Consolidated Financial Statements. (3). Interest income on loans includes net loan fees of $61,000 and $359,000 for the First Nine Months of 2003 and 2002, respectively. (4). Interest income is presented on a tax-equivalent basis assuming a tax rate of 34%. The tax-equivalent adjustment was approximately $655,000 and $819,000 for the First Nine Months of 2003 and 2002, respectively. (5). For purposes of these computations, yields on investment securities are computed as interest income divided by the average amortized cost of the investments.

Analysis of Net Interest Income Changes

The following table presents the changes in interest income and expense between periods due to changes in volume and interest rates. That portion of the change in interest attributable to the combined rate/volume variance has been allocated to rate and volume changes in proportion to the absolute dollar amounts of the change in each.

	Third Quarter 2003 Over 2002		
(In Thousands)	Volume	Rate	Total
Increase (decrease) in interest income:			
Loans(1),(2):			
Taxable	$ 535	$ (882)	$ (347)
Tax-exempt(3)	(7)	--	(7)
Debt and equity securities:			
Taxable	(119)	(167)	(286)
Tax-exempt(3)	(330)	(40)	(370)
Federal funds sold and other short-term investments	104	(123)	(19)
Total interest income	183	(1,212)	(1,029)
Interest expense on:			
Interest-bearing demand deposits	1	(62)	(61)
Savings deposits	(3)	(51)	(54)
Time deposits of $100 or more	(6)	(85)	(91)
Other time deposits	94	(14)	80
Short-term borrowings	(2)	(2)	(4)
Total interest expense	84	(214)	(130)
Net interest income	$ 99	$ (998)	$ (899)

(1). Average balances include nonaccrual loans. (2). Interest income includes net loan fees. (3). Interest income is presented on a tax-equivalent basis assuming a tax rate of 34%.

	First Nine Months 2003 Over 2002		
(In Thousands)	Volume	Rate	Total
Increase (decrease) in interest income:			
Loans(1),(2):			
Taxable	$ 1,928	$(2,318)	$ (390)

Tax-exempt(3)	(22)	1	(21)
Debt and equity securities:			
Taxable	(1,163)	(1,005)	(2,168)
Tax-exempt(3)	(399)	(65)	(464)
Federal funds sold and other short-term investments	161	(233)	(72)
Total interest income	505	(3,620)	(3,115)
Interest expense on:			
Interest-bearing demand deposits	(35)	(149)	(184)
Savings deposits	(61)	(137)	(198)
Time deposits of $100 or more	167	(208)	(41)
Other time deposits	128	(52)	76
Short-term borrowings	(7)	(8)	(15)
Total interest expense	192	(554)	(362)
Net interest income	$ 313	$(3,066)	$(2,753)

(1). Average balances include nonaccrual loans. (2). Interest income includes net loan fees. (3). Interest income is presented on a tax-equivalent basis assuming a tax rate of 34%.

Allowance and Provision for Loan Losses

A significant determinant of the Company's operating results is the provision for loan losses and the level of loans charged off. There was no provision made for loan losses during the Third Quarter of 2003 and a $90,000 provision made in the Third Quarter of 2002. There was a $90,000 provision made during the First Nine Months of 2003 and a $360,000 provision made during the First Nine Months of 2002. Net loans recovered for the Third Quarter of 2003 were $6,000 compared to $5,000 for the Third Quarter of 2002. Net loans recovered for the First Nine Months of 2003 were $16,000 compared with net loans charged off of $62,000 for the First Nine Months of 2002. The provision for loan losses can vary over time based on an ongoing assessment of the adequacy of the allowance for loan losses.

The allowance for loan losses at September 30, 2003 was $5,399,000 and at December 31, 2002 was $5,293,000. The ratio of allowance for loan losses to total loans outstanding at September 30, 2003 was 1.20% and 1.22% at December 31, 2002. Nonperforming loans were $1,943,000 or .43% of total loans at September 30, 2003 compared to $9,194,000 or 2.12% of total loans at December 31, 2002. The decrease from December 31, 2002 is primarily due to two loans totaling $4,252,000 that were renegotiated in 2002 that are currently performing under their new terms and two loans totaling $4,891,000 that were contractually past due over 90 days at year-end and were fully paid-off during the First Quarter of 2003.

At September 30, 2003, impaired loans totaled $8,350,000, which included $1,462,000 of nonaccrual loans compared with impaired loans at December 31, 2002 of $12,188,000, which included $51,000 of nonaccrual loans. The allowance for loan losses on impaired loans was $1,122,000 at September 30, 2003. The decrease in impaired loans from December 31, 2002 relates primarily to the decrease in loans contractually past due over 90 days as explained in the previous paragraph. The current balance of $4,199,000 of loans renegotiated in 2002, as explained in the previous paragraph, relates to two borrowers and although currently performing, are still considered impaired by management. The remaining balance of impaired loans relates to several other borrowers. One represents a borrower that has an outstanding balance of $1,425,000, which is collateralized by all business assets and has been current on all payments. This borrower has experienced financial difficulties due to general economic conditions. Should its condition not improve, a shortfall in collection of the full principal balance could result. The probable shortfall has been specifically reserved for in the allowance for loan losses. A second borrower has an outstanding balance of $760,000 collateralized by real estate and has a SBA guarantee. There has been delinquency in loan payments due to slower than expected lease-up of real estate property. Another borrower with an outstanding balance of $635,000 is current under the loan terms, but is going through a liquidation of assets. This loan is secured by the borrower's inventory, but management believes that there may be a shortfall in collecting the full principal balance of the loan upon liquidation and therefore has specifically reserved for the expected shortfall. The remaining balance is made up of smaller loans, one with a balance of $481,000 that was renegotiated in the First Quarter of 2003 and is current under the new terms of the agreement.

The allowance for loan losses has been established and is maintained to absorb losses inherent in the loan portfolio. An ongoing assessment of risk of loss is performed to determine if the current balance of the allowance is adequate to cover probable losses in the portfolio. A charge or credit is made to expense to cover any deficiency or reduce any excess. The current methodology employed to determine the appropriate allowance consists of two components, specific and general. The Company develops specific valuation allowances on commercial, commercial real estate, and construction loans when a loan is considered to be impaired. A loan is impaired when, based on an evaluation of current information and events, it is probable that the Company will not be able to collect all amounts due (principal and interest) pursuant to the original contractual terms. The Company measures impairment based upon the present value of expected future cash flows discounted at the loan's original effective interest rate or the fair value of the collateral if the loan is collateral dependent. The general component relates to all other loans, which are evaluated based on loan grade. The loan grade assigned to each loan is typically evaluated on an annual basis, unless circumstances require interim evaluation. The Company assigns a reserve amount consistent with each loan's rating category. The reserve amount is based on loss experience over prescribed periods. In addition to the amounts derived from the loan grades, a portion is added to the general reserve to take into account other factors including national and local economic conditions, downturns in specific industries including loss in collateral value, trends in credit quality at the Company and the banking industry, and trends in risk rating changes. As part of their examination process, federal and state agencies review the Company's methodology for maintaining the allowance for loan losses and the balance in the account. These agencies may require the Company to increase the allowance for loan losses based on their judgments and interpretations about information available to them at the time of their examination.

Summary of Asset Quality

The following table presents information as of and for the three and nine-month periods ended September 30, 2003 and 2002 pertaining to the Company's provision for loan losses and analysis of the allowance for loan losses.

	Three Months Ended September 30		Nine Months Ended September 30	
(Dollars in Thousands)	2003	2002	2003	2002
Allowance at beginning of period	$ 5,393	$ 5,109	$ 5,293	$ 4,906
Provision charged to expense	--	90	90	360
Loans charged off	--	--	2	95
Recoveries on loans previously charged off	6	5	18	33
Net loans (recovered) charged-off	(6)	(5)	(16)	62
Allowance at end of period	$ 5,399	$ 5,204	$ 5,399	$ 5,204
Loans outstanding:				

Average	$ 448,412	$ 414,378	$ 439,374	$ 398,346
September 30	450,977	416,473	450,977	416,473
Ratio of allowance for loan losses to loans outstanding:				
Average	1.20%	1.26%	1.23%	1.31%
September 30	1.20	1.25	1.20	1.25
Nonperforming loans:				
Nonaccrual loans	$ 1,462	$ 450	$ 1,462	$ 450
Loans past due 90 days or more	--	1,911	--	1,911
Renegotiated loans	481	172	481	172
Total non performing loans	$ 1,943	$ 2,533	$ 1,943	$ 2,533
Other impaired loans	$ 6,407	$ 4,978	$ 6,407	$ 4,978
Foreclosed assets	$ 1,154	$ 5,911	$ 1,154	$ 5,911
Nonperforming loans as percentage of average loans	.43%	.61%	.44%	.64%

Foreclosed assets at September 30, 2002 includes $5,315,000 related to operating assets of one business, which was foreclosed on by the Bank on January 2, 2001. This entity, Government e-Management Solutions, Inc. (GEMS), is a software company that provides the public sector with integrated financial, property and human resource management systems. As explained earlier, under the provision of SFAS 144, this group of assets was reclassified effective January 1, 2003 and the related operations have been consolidated into those of the Company.

The Bank currently has two properties which it is carrying as other real estate owned at what management believes to be fair value less costs to sell. The first property was foreclosed on August 8, 2001 and is recorded at $858,000 and the second property was foreclosed on December 19, 2002 and is recorded at $296,000.

Noninterest Expense

Total noninterest expense for the Third Quarter of 2003 increased $2,364,000 or 20.6% compared to the Third Quarter of 2002 and increased $7,018,000 or 20.3% in the First Nine Months of 2003 over 2002. Of these increases, the consolidation of GEMS contributed $2,016,000 for the quarter and $5,523,000 for the first nine months. Excluding the GEMS consolidation, total noninterest expense increased 3.0% for the quarter and 4.3% for the first nine months.

Salaries and benefits expense for the Third Quarter of 2003 increased $1,427,000 or 18.2% over the same period last year and increased $4,676,000 or 20.0% for the First Nine Months of 2003 over 2002. Of these increases, the consolidation of GEMS amounted to $1,041,000 for the quarter $3,064,000 for the first nine months. The remaining increases were due primarily to an increase in staff in the utility processing division due to an increase in production and to increases in health, worker's compensation, pension and short-term disability insurance expenses.

Occupancy expense for the Third Quarter of 2003 increased $80,000 or 21.8% compared to the Third Quarter of 2002 and increased $225,000 or 20.2% in the First Nine Months of 2003 over 2002. Of these increases, $59,000 relates to the consolidation of GEMS for the quarter and $175,000 for the first nine months. The remaining increases relate primarily to real estate taxes and the maintenance and repair of premises.

Equipment expense for the Third Quarter of 2003 increased $31,000 compared to the Third Quarter of 2002 and increased $109,000 or 3.4% in the First Nine Months of 2003 over 2002. Increases in equipment expenses related to the consolidation of GEMS were $118,000 for the quarter and $320,000 in the first nine months. The increases related to the consolidation were offset by decreases in computer equipment maintenance from the consolidation of equipment within the transportation processing division and lower depreciation and amortization on equipment and computer software.

Other noninterest expenses for the Third Quarter of 2003 increased $826,000 or 36.8% compared to the Third Quarter of 2002 and increased $2,008,000 or 29.4% in the First Nine Months of 2003 over 2002. The consolidation of GEMS contributed $798,000 for the quarter and $1,964,000 for the first nine months. Included in the other noninterest expenses of GEMS is the amortization of customer list and software intangible assets of $78,000 for the quarter and $233,000 for the first nine months. Excluding the affect of the GEMS consolidation, these expenses remained relatively flat for the Third Quarter and increased for the first nine months due to increases in consulting and legal fees.

Income tax expense for the Third Quarter of 2003 increased $252,000 or 36.9% compared to the Third Quarter of 2002 and increased $281,000 or 12.3% for the First Nine Months of 2003 over 2002. The effective tax rate for the Third Quarter of 2003 was 32% compared with 28% in the Third Quarter of 2002 and was 31% for the First Nine Months of 2003 compared to 30% for the First Nine Months of 2002. The primary reason for the increase in the effective tax rate for the Third Quarter of 2003 was due to the reduction of the Company's investment in tax-exempt securities. Since the decrease in the investment in tax-exempt securities occurred in the Second Quarter of 2003 the effective tax rate for First Nine Months of 2003 did not have the full effect of this reduction.

Financial Condition

Total assets at September 30, 2003 were $636,830,000, an increase of $64,597,000 or 11.3% from December 31, 2002. Loans, net of the allowance for loan losses, at September 30, 2003 were $445,578,000, an increase of $16,182,000 or 3.8% from December 31, 2002. Total investments in debt and equity securities at September 30, 2003 were $56,316,000, a $13,055,000 or 18.8% decrease from December 31, 2002. Federal funds sold and other short-term investments at September 30, 2003 were $65,175,000 a $59,448,000 increase from December 31, 2002.

Total deposits at September 30, 2003 were $269,629,000, a $26,111,000 or 10.7% increase from December 31, 2002. Accounts and drafts payable were $295,706,000, a $72,085,000 or 32.2% increase from December 31, 2002. Short-term borrowings at September 30, 2003 were $7,000, a $37,431,000 decrease from December 31, 2002. Total shareholders' equity at September 30, 2003 was $62,854,000, a $1,808,000 or 3.0% increase from December 31, 2002.

The increase in loans relates primarily to the Bank's marketing efforts. The decrease in debt and equity securities relates to the sale of $37,831,000 of securities and the maturity $15,145,000 of securities during the First Nine Months of 2003. The reduction in securities contributed to an increase in federal funds sold and other short-term investments. The increase in deposits was primarily due to the Bank's promotional efforts in the Second Quarter of 2003. The ending balances of accounts and drafts payable increased due to both the fact that these balances will fluctuate from period-end to period-end due to the payment processing cycle, which results in lower balances on days when checks clear and higher balances on days when checks are issued and due to special funding arrangements the Company made with a few large customers at year-end. For this reason, average balances are a more meaningful measure of accounts and drafts payable (for average balances refer to the tables on pages 14 through 16). The increase in total shareholders' equity resulted from net income of $5,779,000; cash received from the exercise of stock options of $260,000; the tax benefit received from the exercise of stock options of $176,000; and the amortization of the stock bonus plan of $41,000; offset by dividends paid of $2,114,000 ($.63 per share); purchase of treasury shares of $1,764,000 (59,237 shares); a decrease in other comprehensive income of $569,000 and $1,000 of other items.

Liquidity and Capital Resources

The balances of liquid assets consist of cash and cash equivalents, which include cash and due from banks, federal funds sold, and money market funds were $89,778,000 at September 30, 2003, an increase of $59,772,000 from December 31, 2002. At September 30, 2003 these assets represented 14.1% of total assets. These funds are the Company's and its subsidiaries' primary source of liquidity to meet future expected and unexpected loan demand, depositor withdrawals or reductions in accounts and drafts payable.

Secondary sources of liquidity include the investment portfolio and borrowing lines. Total investment in debt and equity securities was $56,316,000 at September 30, 2003, a decrease of $13,055,000 or 18.8% from December 31, 2002. These assets represented 8.8% of total assets at September 30, 2003. Of this total, 73% were state and municipal securities, 20% were U.S. treasury securities, 6% were U.S. government agencies and 1% were other securities. Of the total portfolio, 14% matures in less than one year, 14% matures in one to five years and 72% matures in five or more years. The investment portfolio provides secondary liquidity through regularly scheduled maturities, the ability to sell securities and the ability to use these securities in conjunction with repurchase lines of credit.

The Bank has unsecured lines at correspondent banks to purchase federal funds up to a maximum of $33,000,000. Additionally, the Company maintains secured lines of credit at unaffiliated financial institutions in the maximum amount of $76,546,000.

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

Net cash provided by operating activities totaled $9,359,000 for the First Nine Months of 2003, compared to $7,173,000 for the First Nine Months of 2002. Net cash used in investing activities was $6,734,000 for the First Nine Months of 2003, compared with $40,288,000 for the First Nine Months of 2002. Net cash provided by financing activities for the First Nine Months of 2003 was $57,147,000, compared with net cash used of $19,404,000 for the First Nine Months of 2002. The increase in net cash provided by operating activities relates primarily to the consolidation of GEMS. The decrease of net cash used in investing activities in the First Nine Months of 2003 relates to the purchase of more securities, a larger increase in loan balances and the purchase of bank owned life insurance in the First Nine Months of 2002. The increase in net cash provided by financing activities in the First Nine Months of 2003 over net cash used in 2002 relates to the increase of accounts and drafts payable balances and an increase in deposit balances in 2003 compared with a decrease in 2002. These increases were partially offset by a decrease in short-term borrowings.

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

Risk-based capital guidelines require the Company to meet a minimum total capital ratio of 8.0% of which at least 4.0% must consist of Tier 1 capital. Tier 1 capital generally consists of (a) common shareholders' equity (excluding the unrealized market value adjustments on the available-for-sale securities), (b) qualifying perpetual preferred stock and related surplus subject to certain limitations specified by the FDIC, (c) minority interests in the equity accounts of consolidated subsidiaries less (d) goodwill, (e) mortgage servicing rights within certain limits, and (f) any other intangible assets and investments in subsidiaries that the FDIC determines should be deducted from Tier 1 capital. The FDIC also requires a minimum leverage ratio of 3.0%, defined as the ratio of Tier 1 capital less purchased mortgage servicing rights to total assets, for banking organizations deemed the strongest and most highly rated by banking regulators. A higher minimum leverage ratio is required of less highly rated banking organizations. Total capital, a measure of capital adequacy, includes Tier 1 capital, allowance for loan losses, and debt considered equity for regulatory capital purposes.

The Company and the Bank continue to exceed all regulatory capital requirements, as evidenced by the following capital amounts and ratios at September 30, 2003 and December 31, 2002:

September 30, 2003	Amount	Ratio
Total capital (to risk-weighted assets)		
Cass Information Systems, Inc.	$62,866,000	12.09%
Cass Commercial Bank	30,941,000	11.89
Tier I capital (to risk-weighted assets)		
Cass Information Systems, Inc.	$57,467,000	11.05%
Cass Commercial Bank	27,822,000	10.69
Tier I capital (to average assets)		
Cass Information Systems, Inc.	$57,467,000	9.54%
Cass Commercial Bank	27,822,000	9.54

December 31, 2002	Amount	Ratio
Total capital (to risk-weighted assets)		
Cass Information Systems, Inc.	$59,625,000	12.07%
Cass Commercial Bank	27,425,000	10.94
Tier I capital (to risk-weighted assets)		
Cass Information Systems, Inc.	$54,332,000	11.00%
Cass Commercial Bank	24,412,000	9.74
Tier I capital (to average assets)		
Cass Information Systems, Inc.	$54,332,000	9.16%
Cass Commercial Bank	24,412,000	8.98

Inflation

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