CASS INFORMATION SYSTEMS INC
Form 10-Q
November 07, 2018
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, 2018

OR

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

For the transition period from ______________ to ______________

Commission File No. 000-20827

CASS INFORMATION SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes X No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes X No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer X Accelerated Filer

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No X

The number of shares outstanding of the registrant's only class of common stock as of October 30, 2018: Common stock, par value $.50 per share – 12,289,377 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 2017 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, 2018 (Unaudited)	December 31, 2017
Assets		
Cash and due from banks	$ 11,835	$ 17,422
Interest-bearing deposits in other financial institutions	145,803	152,056
Federal funds sold and other short-term investments	22,409	58,632
Cash and cash equivalents	180,047	228,110
Securities available-for-sale, at fair value	446,440	470,523
Loans	726,239	686,231
Less: Allowance for loan losses	10,220	10,205
Loans, net	716,019	676,026
Premises and equipment, net	22,615	21,586
Investment in bank-owned life insurance	17,270	16,927
Payments in excess of funding	161,080	139,103
Goodwill	12,569	12,569
Other intangible assets, net	1,664	1,996
Other assets	120,543	90,369
Total assets	$ 1,678,247	$ 1,657,209
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 270,395	$ 281,541
Interest-bearing	364,329	396,547
Total deposits	634,724	678,088
Accounts and drafts payable	769,638	715,888
Other liabilities	44,543	38,145
Total liabilities	1,448,905	1,432,121
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 13,047,997 shares issued at September 30, 2018 and December 31, 2017	6,524	6,524
Additional paid-in capital	204,971	204,631
Retained earnings	73,183	59,314
Common shares in treasury, at cost (746,260 shares at September 30, 2018 and 760,962 shares at December 31, 2017)	(32,029)	(32,061)
Accumulated other comprehensive loss	(23,307)	(13,320)
Total shareholders' equity	229,342	225,088
Total liabilities and shareholders' equity	$ 1,678,247	$ 1,657,209

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,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
Fee Revenue and Other Income:				
Information services payment and processing revenue	$ 26,020	$ 23,761	$ 76,068	$ 69,332
Bank service fees	300	327	994	998
Losses on sales of securities	—	—	(42)	—
Other	115	119	429	448
Total fee revenue and other income	26,435	24,207	77,449	70,778
Interest Income:				
Interest and fees on loans	8,367	7,209	23,832	21,266
Interest and dividends on securities:				
Taxable	618	107	1,428	268
Exempt from federal income taxes	2,111	2,605	7,008	7,865
Interest on federal funds sold and other short-term investments	1,119	744	2,748	1,597
Total interest income	12,215	10,665	35,016	30,996
Interest Expense:				
Interest on deposits	1,029	571	2,502	1,521
Net interest income	11,186	10,094	32,514	29,475
Provision for loan losses	—	—	—	—
Net interest income after provision for loan losses	11,186	10,094	32,514	29,475
Total net revenue	37,621	34,301	109,963	100,253
Operating Expense:				
Personnel	21,747	19,423	63,718	57,384
Occupancy	975	903	2,754	2,634
Equipment	1,434	1,242	4,150	3,746
Amortization of intangible assets	110	110	331	317
Other operating expense	4,264	3,364	11,222	10,180
Total operating expense	28,530	25,042	82,175	74,261
Income before income tax expense	9,091	9,259	27,788	25,992
Income tax expense	1,481	2,396	4,577	6,309
Net income	$ 7,610	$ 6,863	$ 23,211	$ 19,683
Basic earnings per share	$ .62	$ .56	$ 1.90	$ 1.61
Diluted earnings per share	.61	.55	1.87	1.58

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,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
Comprehensive income:				
Net income	$ 7,610	$ 6,863	$ 23,211	$ 19,683
Other comprehensive income:				
Net unrealized (loss) gain on securities available-for-sale	(2,835)	(99)	(13,029)	8,246
Tax effect	675	37	3,101	(3,063)
Reclassification adjustments for losses included in net income	—	—	42	—
Tax effect	—	—	(10)	—
Foreign currency translation adjustments	(21)	41	(91)	143
Total comprehensive income	$ 5,429	$ 6,842	$ 13,224	$ 25,009

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,	
	2018	**2017**
Cash Flows From Operating Activities:		
Net income	$ 23,211	$ 19,683
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,524	8,361
Net losses on sales of securities	42	—
Stock-based compensation expense	2,238	1,658
Increase in income tax liability	773	551
Increase in pension liability	3,688	3,476
Decrease (increase) in accounts receivable	4,027	(3,637)
Other operating activities, net	(3,707)	(2,156)
Net cash provided by operating activities	38,796	27,936
Cash Flows From Investing Activities:		
Proceeds from sales of securities available-for-sale	58,520	—
Proceeds from maturities of securities available-for-sale	26,041	33,856
Purchase of securities available-for-sale	(78,772)	(97,473)
Net (increase) decrease in loans	(39,993)	6,803
Net increase in payments in excess of funding	(21,977)	(14,455)
Purchases of premises and equipment, net	(3,956)	(2,780)
Net cash used in investing activities	(60,137)	(74,049)
Cash Flows From Financing Activities:		
Net decrease in noninterest-bearing demand deposits	(11,146)	(3,243)
Net decrease in interest-bearing demand and savings deposits	(35,988)	(6,504)
Net increase (decrease) in time deposits	3,771	(2,984)
Net increase in accounts and drafts payable	27,849	44,946
Cash dividends paid	(9,342)	(7,725)
Purchase of common shares for treasury	(1,409)	(2,270)
Other financing activities, net	(457)	(752)
Net cash (used in) provided by financing activities	(26,722)	21,468
Net decrease in cash and cash equivalents	(48,063)	(24,645)
Cash and cash equivalents at beginning of period	228,110	266,743
Cash and cash equivalents at end of period	$ 180,047	$ 242,098
Supplemental information:		
Cash paid for interest	$ 2,459	$ 1,520
Cash paid for income taxes	3,776	5,758

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. All share and per share data have been restated to give effect to the 10% stock dividend issued on December 15, 2017. Certain amounts in prior-period financial statements have been reclassified to conform to the current period's presentation. 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, 2017.

On January 1, 2018, the Company adopted Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 606, Revenue from Contracts with Customers ("FASB ASC 606"), and selected the modified retrospective transition method. The adoption of this new standard did not impact the Company's results of operations or balance sheet and there was no cumulative effect of initially applying this new revenue standard to the opening balance of retained earnings. Since interest income on loans and securities are both excluded from this topic, a significant portion of the Company's revenues are not subject to the new guidance. The services that fall within the scope of FASB ASC 606 are presented within fee revenue and other income in the Consolidated Statements of Income and are recognized as revenue as the obligation to the customer is satisfied. Services within the scope of FASB ASC 606 include transportation and facility payment and processing fees, bank service fees, and other real estate owned ("OREO").

Invoice processing and payment fees – The Company earns fees on a per-item basis for the services rendered on behalf of customers. Fees are earned over the course of a month, representing the period over with the performance obligation is satisfied.

Bank service fees – Revenue from service fees consists of service charges and fees on deposit accounts under depository agreements with customers to provide access to deposited funds and, when applicable, pay interest on deposits. Service charges on deposit accounts are primarily all charges that are recognized on a monthly basis representing the period over which the performance obligation is satisfied.

OREO – The Company currently does not have any OREO and has not in recent years. Net gains or losses would be recorded when other real estate is sold to a third party and substantially all of the consideration for the transfer of property is received.

Note 2 – Intangible Assets

The Company accounts for intangible assets in accordance with FASB 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, 2018		December 31, 2017	
(In thousands)	**Gross Carrying Amount**	**Accumulated Amortization**	**Gross Carrying Amount**	**Accumulated Amortization**
Assets eligible for amortization:				
Customer lists	$ 4,288	$ (2,979)	$ 4,288	$ (2,702)
Patents	72	(15)	72	(12)
Non-compete agreements	332	(317)	332	(291)
Software	234	(234)	234	(234)
Other	500	(217)	500	(191)
Unamortized intangible assets:				
Goodwill[1]	12,796	(227)	12,796	(227)
Total intangible assets	$ 18,222	$ (3,989)	$ 18,222	$ (3,657)

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

The customer lists are amortized over seven and ten years; the patents over 18 years; the non-compete agreements over two and five years; software over three years; and other intangible assets over 15 years. Amortization of intangible assets amounted to $331,000 and $317,000 for the nine-month periods ended September 30, 2018 and 2017, respectively. Estimated annual amortization of intangibles is as follows: $442,000 in 2018, $412,000 in 2019, $406,000 in each of 2020 and 2021, and $88,000 in 2022.

Note 3 – Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding. Diluted earnings per share is computed by dividing net income by the sum of the weighted-average number of common shares outstanding and the weighted-average number of potential common shares outstanding. There were no anti-dilutive shares in the three and nine months ended September 30, 2018 and 2017. 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)	**2018**	**2017**	**2018**	**2017**
Basic:				
Net income	$ 7,610	$ 6,863	$ 23,211	$ 19,683
Weighted-average common shares outstanding	12,245,975	12,251,084	12,239,678	12,257,337
Basic earnings per share	$ .62	$ .56	$ 1.90	$ 1.61
Diluted:				
Net income	$ 7,610	$ 6,863	$ 23,211	$ 19,683
Weighted-average common shares outstanding	12,245,975	12,251,084	12,239,678	12,257,337
Effect of dilutive restricted stock and stock appreciation rights	206,388	176,767	200,315	179,029
Weighted-average common shares outstanding assuming dilution assuming dilution	12,452,363	12,427,851	12,439,993	12,436,366
Diluted earnings per share	$ .61	$ .55	$ 1.87	$ 1.58

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 24, 2017, 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 41,846 shares during the three-month periods and 15,547 and 41,846 during the nine-month periods ended September 30, 2018 and 2017, respectively. As of September 30, 2018, 484,453 shares remained available for repurchase under the program. Repurchases may be made in the open market or through negotiated transactions from time to time depending on market conditions.

Note 5 – Industry Segment Information

The services provided by the Company are classified into two reportable segments: Information Services and Banking Services. Each of these segments provides distinct services that are marketed through different channels. They are managed separately due to their unique service and processing 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 faith-based ministries as well as supporting the banking needs of the Information Services segment.

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, 2017. Management evaluates segment performance based on tax-equivalized (as defined in the footnote to the chart on the following table) pre-tax income after allocations for corporate expenses. 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.

Funding sources represent average balances and deposits generated by Information Services and Banking Services and there is no allocation methodology used. Segment interest income is a function of the relative share of average funding sources generated by each segment multiplied by the following rates:

Information Services – one or more fixed rates depending upon the specific characteristics of the funding source, and

Banking Services – a variable rate that is based upon the overall performance of the Company's earning assets.

Any difference between total segment interest income and overall total Company interest income is included in Corporate, Eliminations, and Other.

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, 2018				
Fee income from customers	$ 26,263	$ 253	$ (81)	$ 26,435
Interest income*	5,703	5,856	1,219	12,778
Interest expense	—	1,029	—	1,029
Intersegment income (expense)	—	467	(467)	—
Tax-equivalized pre-tax income*	6,525	2,538	591	9,654
Goodwill	12,433	136	—	12,569
Other intangible assets, net	1,664	—	—	1,664
Total Assets	903,055	847,673	(72,481)	1,678,247
Funding Sources	650,267	550,594	—	1,200,861
Three Months Ended September 30, 2017				
Fee income from customers	$ 23,809	$ 279	$ 119	$ 24,207
Interest income*	5,465	5,894	725	12,084
Interest expense	—	571	—	571
Intersegment income (expense)	—	339	(339)	—
Tax-equivalized pre-tax income*	7,130	3,179	369	10,678
Goodwill	12,433	136	—	12,569
Other intangible assets, net	2,106	—	—	2,106
Total Assets	820,596	738,478	(2,324)	1,556,750
Funding Sources	631,539	601,355	—	1,232,894
Nine Months Ended September 30, 2018				
Fee income from customers	$ 76,397	$ 947	$ 105	$ 77,449
Interest income*	16,553	17,342	2,996	36,891
Interest expense	—	2,502	—	2,502
Intersegment income (expense)	—	1,415	(1,415)	—
Tax-equivalized pre-tax income*	19,326	8,814	1,523	29,663
Goodwill	12,433	136	—	12,569
Other intangible assets, net	1,664	—	—	1,664
Total Assets	903,055	847,673	(72,481)	1,678,247
Funding Sources	637,508	566,390	—	1,203,898
Nine Months Ended September 30, 2017				
Fee income from customers	$ 69,453	$ 958	$ 367	$ 70,778
Interest income*	15,237	17,602	2,447	35,286
Interest expense	—	1,521	—	1,521
Intersegment income (expense)	—	962	(962)	—
Tax-equivalized pre-tax income*	18,946	9,922	1,414	30,282
Goodwill	12,433	136	—	12,569
Other intangible assets, net	2,106	—	—	2,106
Total Assets	820,596	738,478	(2,324)	1,556,750
Funding Sources	596,919	593,709	—	1,190,628

* Presented on a tax-equivalent basis assuming a tax rate of 21% for 2018 and 35% for 2017. The tax-equivalent adjustment was approximately $564,000 and $1,419,000 for the Three Months Ended 2018 and 2017, respectively, and $1,875,000 and $4,290,000 for the Nine Months Ended 2018 and 2017, respectively.

Note 6 – Loans by Type

A summary of loan categories is as follows:

(In thousands)	September 30, 2018	December 31, 2017
Commercial and industrial	$ 270,854	$ 236,394
Real estate:		
Commercial:		
Mortgage	92,972	94,675
Construction	22,883	9,359
Faith-based:		
Mortgage	307,679	316,073
Construction	30,838	25,948
Industrial Revenue Bonds	921	3,374
Other	92	408
Total loans	$ 726,239	$ 686,231

The following table presents the aging of loans by loan categories at September 30, 2018 and December 31, 2017:

	Performing			Nonperforming		
(In thousands)	Current	30-59 Days	60-89 Days	90 Days and Over	Non-accrual	Total Loans
September 30, 2018						
Commercial and industrial	$ 270,854	$ —	$ —	$ —	$ —	$ 270,854
Real estate:						
Commercial:						
Mortgage	92,972	—	—	—	—	92,972
Construction	22,883	—	—	—	—	22,883
Faith-based:						
Mortgage	307,679	—	—	—	—	307,679
Construction	30,838	—	—	—	—	30,838
Industrial revenue bonds	921	—	—	—	—	921
Other	92	—	—	—	—	92
Total	$ 726,239	$ —	$ —	$ —	$ —	$ 726,239
December 31, 2017						
Commercial and industrial	$ 236,394	$ —	$ —	$ —	$ —	$ 236,394
Real estate:						
Commercial:						
Mortgage	94,675	—	—	—	—	94,675
Construction	9,359	—	—	—	—	9,359
Faith-based:						
Mortgage	316,073	—	—	—	—	316,073
Construction	25,948	—	—	—	—	25,948
Industrial revenue bonds	3,374	—	—	—	—	3,374
Other	408	—	—	—	—	408
Total	$ 686,231	$ —	$ —	$ —	$ —	$ 686,231

The following table presents the credit exposure of the loan portfolio as of September 30, 2018 and December 31, 2017:

(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, 2018				
Commercial and industrial	$ 267,696	$ 3,158	$ —	$ 270,854
Real estate:				
Commercial:				
Mortgage	91,998	974	—	92,972
Construction	22,883	—	—	22,883
Faith-based:				
Mortgage	307,596	83	—	307,679
Construction	30,838	—	—	30,838
Industrial Revenue Bonds	921	—	—	921
Other	92	—	—	92
Total	$ 722,024	$ 4,215	$ —	$ 726,239
December 31, 2017				
Commercial and industrial	$ 234,271	$ 2,123	$ —	$ 236,394
Real estate:				
Commercial:				
Mortgage	93,788	887	—	94,675
Construction	9,359	—	—	9,359
Faith-based:				
Mortgage	316,042	31	—	316,073
Construction	25,948	—	—	25,948
Industrial revenue bonds	3,374	—	—	3,374
Other	408	—	—	408
Total	$ 683,190	$ 3,041	$ —	$ 686,231

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." There were no impaired loans, loans delinquent 90 days or more and still accruing, or loans classified as troubled debt restructuring at September 30, 2018 and December 31, 2017.

There were no foreclosed loans recorded as other real estate owned as of September 30, 2018 and December 31, 2017.

A summary of the activity in the allowance for loan losses from December 31, 2017 to September 30, 2018 is as follows:

(In thousands)	December 31, 2017	Charge-Offs	Recoveries	Provision	September 30, 2018
Commercial and industrial	$ 3,652	$ —	$ 15	$ 535	$ 4,202
Real estate:					
Commercial:					
Mortgage	1,394	—	—	(9)	1,385
Construction	70	—	—	100	170
Faith-based:					
Mortgage	3,962	—	—	(105)	3,857
Construction	196	—	—	34	230
Industrial Revenue Bonds	52	—	—	(38)	14
Other	879	—	—	(517)	362
Total	$ 10,205	$ —	$ 15	$ —	$ 10,220

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

(In thousands)	December 31, 2016	Charge-Offs	Recoveries	Provision	September 30, 2017
Commercial and industrial	$ 3,261	$ —	$ 27	$ (61)	$ 3,227
Real estate:					
Commercial:					
Mortgage	1,662	—	—	(160)	1,502
Construction	47	—	—	54	101
Faith-based:					
Mortgage	4,027	—	—	20	4,047
Construction	85	—	—	(26)	59
Industrial Revenue Bonds	101	—	—	(37)	64
Other	992	—	—	210	1,202
Total	$ 10,175	$ —	$ 27	$ —	$ 10,202

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, 2018 and December 31, 2017, no amounts have been accrued for any estimated losses for these instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commercial and standby letters of credit are conditional commitments issued by the Company or its subsidiaries to guarantee the performance of a customer to a third party. These off-balance sheet financial instruments generally have fixed expiration dates or other termination clauses and may require payment of a fee. At September 30, 2018, the balance of unused loan commitments, standby and commercial letters of credit were $73,830,000, $12,917,000, and $3,740,000, respectively. Since some of the financial instruments may expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. Commitments to extend credit and letters of credit are subject to the same underwriting standards as those financial instruments included on the consolidated balance sheets. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of the credit, is based on management's credit evaluation of the borrower. Collateral held varies, but is generally accounts receivable, inventory, residential or income-producing commercial property or equipment. In the event of nonperformance, the Company or its subsidiaries may obtain and liquidate the collateral to recover amounts paid under guarantees on these financial instruments.

The following table summarizes contractual cash obligations of the Company related to operating lease commitments and time deposits at September 30, 2018:

	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	$ 10,075	$ 1,614	$ 3,570	$ 2,431	$ 2,460
Time deposits	56,269	43,033	10,769	2,467	—
Total	$ 66,344	$ 44,647	$ 14,339	$ 4,898	$ 2,460

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

Note 8 – Stock-Based Compensation

The Amended and Restated Omnibus Stock and Performance Compensation Plan (the "Omnibus Plan") permits the issuance of up to 1,500,000 shares of the Company's common stock in the form of stock options, stock appreciation rights ("SARs"), restricted stock, restricted stock units and performance awards. The Company may issue shares out of treasury stock for these awards. During the nine months ended September 30, 2018, 28,527 restricted shares, 29,278 performance-based restricted shares, and 0 SARs were granted under the Omnibus Plan.

Restricted Stock

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. Beginning on February 2, 2017, restricted shares granted to Company employees are amortized to expense over the three-year cliff vesting period. As of September 30, 2018, the total unrecognized compensation expense related to non-vested restricted shares was $1,750,000, and the related weighted-average period over which it is expected to be recognized is approximately 0.92 years.

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

	Nine Months Ended September 30, 2018	
	Shares	**Fair Value**
Balance at December 31, 2017	78,166	$ 50.30
Granted	28,527	59.69
Vested	(23,758)	46.83
Balance at September 30, 2018	82,935	$ 54.52

Performance-Based Restricted Stock

In February of 2017, the Company granted three-year performance based restricted stock ("PBRS") awards which are contingent upon the Company's achievement of pre-established financial goals over the period from January 1, 2017 through December 31, 2019. The PBRS awards cliff vest on the three year anniversary of their grant date at levels ranging from 0% to 150% of the target opportunity based on the actual achievement of financial goals for the three-year performance period. The aggregate target number of PBRS shares granted was 25,342 with an average grant date fair value of $59.20 per share. The 2018 expense related to these grants is currently estimated to be $690,000 and is based on the grant date fair value of the awards and the Company's achievement of 132% of the target financial goals. The estimated expense for 2018 and each future period through the vesting date is subject to prospective adjustment based upon changes in the expected achievement of the financial goals.

In February and July of 2018, the Company granted three-year PBRS awards which are contingent upon the Company's achievement of pre-established financial goals over the period from January 1, 2018 through December 31, 2020. The PBRS awards cliff vest on the three year anniversary of their grant date at levels ranging from 0% to 150% of the target opportunity based on the actual achievement of financial goals for the three-year performance period. The aggregate target number of PBRS shares granted was 29,278 with an average grant date fair value of $58.70 per share. The 2018 expense related to these grants is currently estimated to be $741,000 and is based on the grant date fair value of the awards and the Company's achievement of 144% of the target financial goals. The estimated expense for 2018 and each future period through the vesting date is subject to prospective adjustment based upon changes in the expected achievement of the financial goals.

SARs

There were no SARs granted and no expense recognized during the nine months ended September 30, 2018. Following is a summary of the activity of the Company's SARs program for the nine-month period ended September 30, 2018:

	Shares	Weighted-Average Exercise Price	Average Remaining Contractual Term Years	Aggregate Intrinsic Value *(In thousands)*
Outstanding at December 31, 2017	234,236	$ 34.97	5.03	$ 7,291
Exercised	(36,624)	30.31		
Outstanding at September 30, 2018	197,612	35.84	3.75	5,787
Exercisable at September 30, 2018	197,612	$ 35.84	3.75	$ 5,787

There were no non-vested SARs at June 30, 2018.

Note 9 – Defined Pension Plans

The Company has a noncontributory defined-benefit pension plan, which covers most of its employees. Effective December 31, 2016, the Plan was closed to all new participants. The Company accrues and makes contributions designed to fund normal service costs on a current basis using the projected unit credit with service proration method to amortize prior service costs arising from improvements in pension benefits and qualifying service prior to the establishment of the plan over a period of approximately 30 years. Disclosure information is based on a measurement date of December 31 of the corresponding year. The following table represents the components of the net periodic pension costs:

(In thousands)	Estimated 2018	Actual 2017
Service cost – benefits earned during the year	$ 4,294	$ 3,733
Interest cost on projected benefit obligations	3,655	3,621
Expected return on plan assets	(5,206)	(4,681)
Net amortization and deferral	1,409	1,382
Net periodic pension cost	$ 4,152	$ 4,055

Pension costs recorded to expense were $1,049,000 and $1,033,000 for the three-month periods ended September 30, 2018 and 2017, respectively, and totaled $3,147,000 and $3,070,000 for the nine-month periods ended September 30, 2018 and 2017, respectively. Pension costs increased in 2018 primarily due to a decrease in the discount rate. The Company made no contribution to the plan during the nine-month period ended September 30, 2018 and is evaluating the amount of additional contributions, if any, in the remainder of 2018.

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 2017 and an estimate for 2018:

(In thousands)	Estimated 2018	Actual 2017
Service cost – benefits earned during the year	$ 92	$ 143
Interest cost on projected benefit obligation	348	360
Net amortization	581	324
Net periodic pension cost	$ 1,021	$ 827

Pension costs recorded to expense were $255,000 and $210,000 for the three-month periods ended September 30, 2018 and 2017, respectively, and were $766,000 and $628,000 for the nine-month periods ended September 30, 2018 and 2017, respectively.

Note 10 – Income Taxes

As of September 30, 2018, the Company’s unrecognized tax benefits were approximately $1,822,000, of which $1,652,000 would, if recognized, affect the Company’s effective tax rate. As of December 31, 2017, the Company’s unrecognized tax benefits were approximately $1,632,000, of which $1,464,000 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 $315,000 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 $191,000 and $139,000 of gross interest accrued as of September 30, 2018 and December 31, 2017, respectively. There were no penalties for unrecognized tax benefits accrued at September 30, 2018 and December 31, 2017.

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 2014 through 2017 remain subject to examination by the Internal Revenue Service. In addition, the Company is subject to state tax examinations for the tax years 2013 through 2017.

On December 22, 2017, the Tax Cuts and Jobs Act (“TCJA”) was enacted. Among other things, the new law (i) establishes a new, flat corporate federal statutory income tax rate of 21% beginning January 1, 2018; (ii) eliminates the corporate alternative minimum tax and allows the use of any such carryforwards to offset regular tax liability for any taxable year; (iii) limits the deduction for net interest expense incurred by U.S. corporations; (iv) allows businesses to immediately expense, for tax purposes, the cost of new investments in certain qualified depreciable assets; (v) eliminates or reduces certain deductions related to meals and entertainment expenses; (vi) modifies the limitation on excessive employee remuneration to eliminate the exception for performance-based compensation and clarifies the definition of a covered employee; and (vii) limits the deductibility of deposit insurance premiums. The TCJA also significantly changes U.S. tax law related to foreign operations, though, such changes do not currently impact the Company on a significant level.

On December 22, 2017, the SEC issued Staff Accounting Bulletin No. 118, "Income Tax Accounting Implications of the Tax Cuts and Jobs Act ("SAB 118"), providing guidance on accounting for the Tax Act. The Company has not completed the accounting for the income tax effects of the Tax Act. In accordance with SAB 118, a provisional charge was recorded in December 2017 based on reasonable estimates of certain effects of the Tax Act. The Company expects to finalize its provisional amounts by the fourth quarter of 2018.

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, 2018			
(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
State and political subdivisions	$ 337,378	$ 2,187	$ 4,691	$ 334,874
U.S. government agencies	108,158	—	2,337	105,821
Certificates of deposit	5,745	—	—	5,745
Total	$ 451,281	$ 2,187	$ 7,028	$ 446,440

	December 31, 2017			
(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
State and political subdivisions	$ 408,165	$ 9,528	$ 661	$ 417,032
U.S. government agencies	46,222	—	722	45,500
Certificates of deposit	7,991	—	—	7,991
Total	$ 462,378	$ 9,528	$ 1,383	$ 470,523

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

	September 30, 2018					
	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	$ 178,137	$ 2,905	$ 36,804	$ 1,786	$ 214,941	$ 4,691
U.S. government agencies	79,513	974	26,308	1,363	105,821	2,337
Total	$ 257,650	$ 3,879	$ 63,112	$ 3,149	$ 320,762	$ 7,028

	December 31, 2017					
	Less than 12 months		12 months or more		Total	
(In thousands)	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
State and political subdivisions	$ 34,755	$ 123	$ 31,251	$ 538	$ 66,006	$ 661
U.S. government agencies	34,183	376	11,317	346	45,500	722
Total	$ 68,938	$ 499	$ 42,568	$ 884	$ 111,506	$ 1,383

There were 197 securities, or 61% of the total (35 greater than 12 months), in an unrealized loss position as of September 30, 2018. There were 64 securities, or 17% of the total (24 greater than 12 months), in an unrealized loss position as of December 31, 2017. 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, 2018	
(In thousands)	Amortized Cost	Fair Value
Due in 1 year or less	$ 13,741	$ 13,782
Due after 1 year through 5 years	121,838	121,626
Due after 5 years through 10 years	232,821	231,333
Due after 10 years	82,881	79,699
Total	$ 451,281	$ 446,440

There were no sales of investment securities classified as available for sale for the three months ended September 30, 2018 or 2017. Proceeds from sales of investment securities classified as available for sale were $58,520,000 and $0 for the nine months ended September 30, 2018 and 2017, respectively. There were no gross realized gains for the three months ended September 30, 2018 or 2017. Gross realized losses were $42,000 and $0 for the nine months ended September 30, 2018 and 2017, respectively. There was one security totaling $3,750,000 pledged to secure public deposits and for other purposes at September 30, 2018.

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, 2018		December 31, 2017	
(In thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Balance sheet assets:				
Cash and cash equivalents	$ 180,047	$ 180,047	$ 228,110	$ 228,110
Investment securities	446,440	446,440	470,523	470,523
Loans, net	716,019	709,807	676,026	675,020
Accrued interest receivable	6,323	6,323	7,413	7,413
Total	$ 1,348,829	$ 1,342,617	$ 1,382,072	$ 1,381,066
Balance sheet liabilities:				
Deposits	$ 634,724	$ 632,162	$ 678,088	$ 678,346
Accounts and drafts payable	769,638	769,638	661,888	661,888
Accrued interest payable	99	99	55	55
Total	$ 1,404,461	$ 1,401,899	$ 1,340,031	$ 1,340,289

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. The estimated fair values of loans disclosed above as of September 30, 2018 follow the guidance in Accounting Standards Update 2016-01 which prescribes an exit price approach in estimating and disclosing fair value.

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, 2018 and 2017. No financial instruments are measured using Level 3 inputs for the nine months ended September 30, 2018 and 2017.