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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to Validus Holdings earnings call. My name is Carissa and I will be your operator for today. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session.

(Operator Instructions)

As a reminder, this conference is being recorded for replay purposes. I would now turn the call over to your host, Mr. Greg Faje. Please proceed.

Greg Faje - Brunswick Group - IR

Thank you, Carissa. Good morning, and welcome to the Validus Holdings conference call, covering the agreed acquisition of Flagstone. Before today's call, we issued a press release and a presentation, which are available on the Investor Relations section of our website located at www.ValidusHoldings.com. Today's call is being simultaneously webcast and will be available for replay until September 10, 2012. Details are provided on our Web site. Leading today's call are Validus Chairman and Chief Executive Officer, Ed Noonan, and Validus President and Chief Financial Officer, Jeff Consolino.

Before we begin, I would like to remind you that certain comments made during this call may be deemed forward-looking statements, as defined within US federal securities laws. These statements address matters that involve risks and uncertainties, many of which are beyond the Company's control. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in such statements, and therefore, you should not place undue reliance on any such statements. More detail about these risks and uncertainties can be found in the Company's most recent annual report on Form 10-K and quarterly report on Form 10-Q, both as filed with the US Securities and Exchange Commission. Management will also refer to certain non-GAAP financial measures when describing the Company's performance. These items are reconciled and explained in our earnings release and financial supplements. With that, I will turn the call over to Ed Noonan.

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Ed Noonan - Validus Holdings, Ltd. - Chairman and CEO

Well, thank you very much, and good morning, I appreciate everyone taking the time to join us today. This is obviously an exciting day for Validus. One more step forward in our development as a group. This is a strategic acquisition, that strengthens our position in our core competence of catastrophe reinsurance. I will be working off of the slide deck that is available. I don't know that it is essential, you have it in front of you, but it might be helpful. I will refer to slide numbers just to facilitate that discussion.

So if you're following the slide deck, I'm on slide 6. For Validus, we think that the catastrophe reinsurance and catastrophe risk management business is our core skill set. We have developed an outstanding reputation and market-leading position, and this transaction allows us to build on that position in the catastrophe business. We also have proven integration skills. We have done other acquisitions before, and we were able to integrate them quickly, smoothly, efficiently, and most importantly, to preserve the business that we seek to preserve in acquisitions. The acquisition of Flagstone adds $291 million of property catastrophe reinsurance premium to the group. It makes us essentially as large, if not larger, than anyone else in the catastrophe reinsurance business in Bermuda today. In terms of third-party reinsurance business, we are the largest reinsurer in Bermuda. And so this builds on that, on the advantages that come with that.

We also have done this acquisition with an appropriate margin of safety for our shareholders. We think it is an excellent transaction for Flagstone shareholders as well, and I will talk about that in more detail. But for the Validus shareholders, the transaction has a good margin of safety. The purchase price is roughly 73% of diluted book value per share and I will explain how we got there in a few minutes. It includes a $58 million bargain purchase gain for Validus at the outset, and we don't think of that as a purchase gain so much as a margin of safety for our shareholders. And $135 million in balance sheet adjustments, that I will talk about in more detail. This also provides an excellent liquidity event for Flagstone shareholders, as well as the ability to continue to participate in the growth in Validus' book value per share.

The transaction comes at a 19% premium to Flagstone's trading value as of yesterday. We think for the Flagstone shareholders, this is the culmination of the process that David Brown and his team commenced about a year ago, in terms of refocusing the Company around the catastrophe reinsurance business. I will talk more about that as well, because David and his team I think have done an excellent job of doing that. The combined entity will have $4 billion of shareholder's equity and $5.2 billion in total capitalization. For those of you who know Validus, we've said before we think that scale matters in the global catastrophe reinsurance market, and we think this only adds to our already considerable advantages in that regard.

I will turn to slide 7, and by way of background, in terms of how the transaction progressed, we were aware that Flagstone was having discussions with other parties earlier in the year. We declined to participate in the process at that point in time because it felt to us a bit like it might turn into an auction, and that's not a place that really fits well with our approach to things. But during 2012, David and his team continued to make, we think, great progress on repositioning its operations. They completed the sale of Island Heritage as well as their syndicate at Lloyd's. They did reduce their work force and streamline their operations. They also did a significant job in reducing their underwriting leverage, bringing their net premium written surplus down to about 40%, whereas historically it has been around 70%. In late July, Flagstone approached Validus about our interest in perhaps discussing a transaction with them. We moved quickly. The process was excellent. The Flagstone people were excellent and professional. And the parties, therefore were able to agree to a transaction which provides a market premium and enhanced liquidity to Flagstone shareholders as well as the ability to participate in the forward gain of the franchise.

Moving on to slide 8, I'm not sure everyone on the call knows Validus, so some of the Flagstone shareholders might not have tracked us over time, so I would just like to spend couple minutes talking about how we think about the business, and slide 8, we think we make a good case study in value creation. Like Flagstone, we started in late 2005. In our almost seven years of operation, we have established really outstanding global positions in Bermuda, particularly around catastrophe reinsurance, as well as with Lloyd's. Bermuda is the world's most important catastrophe market, and Validus is certainly amongst the elite in Bermuda and one of the most important companies on the island. Lloyd's is a marketplace that specializes in the short tail risk that we find attractive, and back in 2007, we acquired Talbot Syndicate. No one in Bermuda had acquired a Lloyd's syndicate in about a decade, we were the first in. That brought considerable advantage to us. Talbot is the 11th largest syndicate of Lloyd's, and it has been an outstanding profit generator for us, and I will give more detail on that in a few minutes as well. Most importantly, the acquisition of Talbot, the acquisition of IPC, gave us the size and scale to really be important in the catastrophe business, as well as to be a strong independent competitor, and chart our own destiny.

Our business plan since we started the company has been to focus on the short tail lines, because we believe that is where the best price classes of risk exist. To really maximize our position in that business, we have built an outstanding analytical and research function. We have got just, we think, the best underwriters in the marketplace and we've been able to validate that by attracting almost $1 billion of third-party capital to manage in the catastrophe risk space. We only think about the business in terms of underwriting profits. We only think about our balance sheet in terms of maintaining principal and liquidity.

Therefore, we have minimal exposure to interest rate risk, and we have a history of favorable reserve development. We think should that should continue post-acquisition of Flagstone. We have also delivered superior financial results since our 2007 IPO outperforming all of our short tail Bermuda peers. Part and parcel of our strategy is to be very careful stewards of our shareholder's capital. Since our IPO, we've returned $1.6 billion to investors through share repurchases and dividends. That's one of the ways that we've been able to achieve a superior return on equity relative to our peers.

If you turn to slide 9, this is a slide that everyone in Validus sees almost every day. Our goal is to grow our book value per share, plus accumulated dividends, faster than anyone else in the business and as fast as we can, while still being consistent with our prudent approach to risk. As you can see on slide 9, it has been a great ride. We think we're only in the early stages of our development as a company. But even through the credit crisis of 2008, and through the harsh global catastrophes last year, Validus continued to grow its book value. I think that is a good example of the combination of pressing our advantages in the catastrophe business, but using our underwriting acumen and our careful approach to asset and balance sheet management, to protect against downside risk.

If you look at slide 10, you get a sense of our growth in diluted book value per share relative to our peers since IPO, and with the exception of companies that have had significant reserve releases from the 2002 to 2006 period in the casualty business, Validus Re has grown our book value per share faster than anyone else in our peer group. We think that Flagstone has gotten their operations to a point where that will not only continue but hopefully should accelerate, and with that, I think I will turn the call over to Jeff Consolino and let him give you an overview of the transaction. Jeff?

Jeff Consolino - Validus Holdings, Ltd. - President and CFO

Thank you, Ed. Thank you all for joining our call during this pre-Labor Day week. We appreciate you dialing in the morning. It is good to see existing Validus shareholders, people who have invested with us in the past, as well as Flagstone shareholders on the call. We welcome you all.

For those of you following on this slide deck, I'm on slide 12. I'm going to run through the overview of the agreed transaction. This transaction is structured as a merger under Bermuda and Luxembourg law, which is the locations of the two respective holding companies for Validus and Flagstone. The consideration per share, valued as of the close of last night is $8.43 per Flagstone common share. That is comprised of $2.00 in cash, and 0.1935 Validus common shares per Flagstone share. The share component of this offer is a fixed exchange ratio, which means the value of the shares floats their share price without respect to any collar, caps, or other adjustments. Valued at last night's closes for the two companies, this represented a 19.4% premium to Flagstone's closing price of $7.06. It also represented 73.2% of Flagstone's June 30, 2012 diluted book value per share, which was $11.52 at that date.

Moving to slide 13, this consideration package is valued at $623.2 million, as of last night's close. The aggregate cash consideration is approximately $147.8 million, and the issuance of the shares is worth approximately $475.4 million. In addition to the share consideration, Validus will also be assuming $250.2 million in Flagstone hybrid junior subordinated deferrable interest debentures. Validus has similar hybrid securities on its balance sheet. Pro forma for the transaction, and the share issuance, existing Validus shareholders will own approximately 88.1% of the expanded share base, and Flagstone shareholders will have 11.9%.

In terms of the steps between the signing and closing, the key approvals and conditions include Flagstone shareholder approval. I would note that Validus stockholder approval is not required, given the amount of stock to be issued in the transaction. Customary regulatory approvals are required, and each party has a mutual termination right in the event that the other party has a significant diminution in its book value per share, as measured from the beginning of calendar 2012. We would anticipate the closing to be late in the fourth quarter of 2012. Flagstone's shareholders collectively owning 22.5% of the outstanding shares of Flagstone as of June 30 have agreed to vote in favor of this transaction. Those shareholders are Trilantic and Light Year Capital. We will get into more detail on the notes on page 14, but in summary, this transaction is accretive to the Validus June 30, 2012 diluted book value per share by about $0.35, accretive to diluted tangible book value per share, at June 30, by approximately $0.50, and we expect this after closing to be immediately accretive to Validus' earnings per share.

Ed referenced some balance sheet adjustments. We intend to increase Flagstone's loss reserves by $76.3 million. We're doing this to harmonize our reserving practices and their reserving practices, given the similar nature of our catastrophe portfolios. We also intend to make other balance sheet adjustments at $58.9 million. After considering these adjustments, and considering estimated transaction expenses of $20 million for both parties, we expect to record a bargain purchase gain of $58.2 million at closing, if that was measured as of the June 30 balance sheet date for the two companies.

We're now going to go through an analysis that is Validus plus Flagstone and I will start with the financial attributes and Ed will continue on with the business. Slide 16 shows the pro forma business mix of the companies. Validus over the last 12 months ended June 30, 2012, underwrote $2.3 billion of gross premium income. Flagstone, on a continuing operations basis, excluding the discontinued and sold operations Island Heritage and Flagstone at Lloyd's, underwrote $514.3 million on a gross basis. The combined company, therefore, would have had $2.8 billion in gross premium income. Given the repositioning of Flagstone to focus on higher margin catastrophe and other short tail products, over the last 12 months, property catastrophe represents 57% of the Flagstone gross premium written portfolio, with other property at 24%, and short-tail specialty 19%. The effect on Validus as if we had owned Flagstone over the previous 12 months would have been to increase our property cat component from 32% to 37%, while slightly changing the contribution from other property, marine and specialty lines.

Turning to page 17, given the share component of this offer, and the bargain purchase gain, pro forma for this transaction, our stockholder's equity available to Validus common shareholder, IE excluding non-controlling interests, rises from $3.5 billion to $4 billion, making Validus one of the best capitalized companies in the Bermuda market. As Ed referenced earlier, we have $5.2 billion of total capital resources, including long-term debt, hybrid securities, and non-controlling interest. On slide 18, you can see the effect this has on our property catastrophe business, and where we rank in the Bermuda market. We already occupy a position as one of the leading writers of property catastrophe, and in combination with Flagstone, we believe we would be the largest. This is measured as of 2011. Flagstone has continued to prudently reduce the amount of business it writes, as Ed commented. And we, at Validus, have continued to find ways to write additional property catastrophe premium throughout our alpha tax segment, which is a growing segment for us. I would expect the bar you see on slide 18 to be composed of the different split of on balance sheet and AlphaCat third party writings going forward. Still, the overall effect on our property catastrophe capabilities directionally is undeniable.

Talking about the balance sheet, Flagstone's investment portfolio at June 30 was approximately $1.4 billion. Flagstone had made the determination for those of you who are familiar with the Company, to significantly reduce their investment risk during the course of 2012. The Flagstone investment portfolio is 65% invested in short-term investments and cash. Therefore, their fixed income duration is meaningfully below one year at 0.3 years. Pro forma for this transaction, Validus' total cash and investments will be $7.69 billion. We will continue to have an average portfolio rating of AA minus. And our duration will go to 1.41 years, given the cash that we are assuming in short-term investments in Flagstone's balance sheet. You can see the composition of that portfolio on slide 19.

One more financial slide. Slide 20 reviews the effect on Validus' diluted book value per share, diluted tangible book value per share, and ratios of debt and hybrid capitalization. As I said before, we picked up $0.34 per diluted share in book value from this transaction, as if measured at June 30, 2012, going from $34.43 to $34.78. Since we're creating no goodwill, given the bargain purchase nature of the accounting for the transaction, our diluted tangible book value per share rises by $0.50 from $33.17 to $33.67. Again, as if measured at June 30, 2012.

Finally, given the equity issuance, our debt to capital will fall from 5.6% to 4.7%, a material decline. Assuming the $250 million of Flagstone hybrid securities, we will raise our hybrid basket utilization from 6.6% of capital to 10.4%, bringing our total financial leverage, debt plus hybrids from 12.1% to 15.1%. I'm now going to turn it back to Ed to talk further about the integration of the business.

Ed Noonan - Validus Holdings, Ltd. - Chairman and CEO

Thank you very much, Jeff. This will be old ground for the Validus shareholders, but a little bit of background about how we think about risk. Our job in the catastrophe space is to maximize the expected return for a given level of risk, and so we are very, very careful risk managers. We have made an underwriting profits in Validus Re where we take most of our catastrophe risk every single year of our existence, including last year, despite the global catastrophes. Some of the ways we accomplish that are by managing our probable maximum loss and we will share that with you on slide 21. The Flagstone acquisition really doesn't add anything other than a trivial amount at the margin to our 1 and 100 year probable maximum loss as a percentage of capital.

Our maximum tolerance in ordinary circumstances is 25%. We have been running about 21.5% and this takes us to 22%. That's a static measure. What will happen now is we will look to optimize the combined portfolio, so as that we can maximize the expected profit for the risks we're willing to take. We've got experience in this. We did it extremely effectively in the IPC transaction. We've already run our portfolio optimization routines on the combined portfolio, customer by customer, layer by layer, so that our underwriters are armed with what they need to do to move us towards the best portfolio possible, and that will start immediately. That will start with the January 1 renewals.

We closed on IPC at a similar point in time back in 2009, and we were able to manage the 1/1 renewals very effectively. So the measures that you see here today will move. They may go up if pricing gets very attractive. They may come down if we don't see the type of opportunities in the marketplace. Or they may stay roughly the same. It will depend largely on market conditions. But we do know the any time you put two portfolios together, and you can move towards an optimized structure, you enhance the overall expected profit of the amount of risk you're taking. So we know that there is upside in that process for both, so that us and the Flagstone shareholders that are joining us.

If you look at slide 22, Validus tries to be as transparent as it can, in the disclosures around risk metrics. And so what you see here, the top half of the page is the probable maximum losses by zone and peril on a combined basis, Validus Flagstone. At the extreme right-hand side, we give you the net maximum zonal aggregate. That's the maximum amount of risk in absolute terms that we are willing to take in any one zone. There is no probabilistic modeled outcome in that. We simply add up our contracts at risk and say we will take no more than X in any given zone. For Validus, our risk management parameter is that we won't take any more than 65% of capital in any one zone. So you can see from our maximum zone being US hurricane on a combined basis, we're well below our risk tolerances so we feel quite comfortable that we've got the ability to not only write the existing portfolio, but grow it with our opportunities.

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The bottom half of the page gives you a sense of the Flagstone impact on the combined portfolio. And I know we have a lot of very sophisticated investors who would like to get people into this. What you will observe is that Flagstone, as I say, I think they've done an excellent job in repositioning the portfolio, they tend to, on average, attach a bit lower than Validus does. Those are more premium intensive layers. It is a different appetite. They've been trying to optimize their portfolio.

Going forward, it will be the Validus strategy towards optimizing the portfolio. But you can see as a result of that, Flagstone's 1 in 20 US hurricane is a much bigger percentage of their zonal aggregate than Validus', for example and that's just a function of where they attach on risk. So we're looking forward actually, to that process. It is important to us as we go through that to be very transparent to our customers and intermediaries, to communicate well ahead of time with them about how we view individual programs and layers, so that we're not providing any surprises to anyone. In fact, we're maximizing our position with our customers and brokers.

If we turn to slide 23, I've referenced our integration activities previously. I talked about Talbot. We generated over a $0.25 billion in net income from Talbot since we acquired them in 2007. It is actually $277 million. It is an excellent business. It was seamlessly integrated into the Validus group, and we couldn't be happier with the Talbot operation. There was a first mover advantage in that. As I said, no one in Bermuda had bought a Lloyd's syndicate in 10 years. Since we acquired Talbot, lots of people from Bermuda have gone into Lloyd's. They have not been able to reach the level of profitability that we have. A good example of how we think strategically about opportunity.

On the right-hand side of slide 23, perhaps the most close analog to the Flagstone acquisition was our acquisition of IPC in 2009. IPC was a catastrophe only reinsurer. We consummated that transaction at a discount to book value. We solidified our position as a leader in the global short tail reinsurance market. We actually doubled the size of our capital and our importance in the market. And made ourselves a clear lead in quoting market.

That size and scale matters. When have you our analytical expertise, our underwriting expertise, and the technological infrastructure that we have, our business is extraordinarily scalable. And so size matters to us. Scale matters to our customers. I think one of the things that you're seeing here, is as I mentioned, David and the team have done a great job of repositioning the company, but it is a very competitive marketplace. And repositioning the company and being one of the smaller catastrophe reinsurers and one of the lower-rated while still a good rating, still one of the lower rated, doesn't give you the same advantages that being one of the largest players in the world and having an A rating both they invest in us and P does. So the Flagstone shareholders will immediately value, derive value from participating in a portfolio written in a higher-rated environment. That is a big asset in this transaction, I think, for both Validus and the Flagstone shareholders.

On slide 24, you can see what will happen post combination. Flagstone will become a wholly owned subsidiary of Validus Re after the transaction closes. As I talked about, we have a great track record of integrating similar businesses. We do it very, very rapidly, very efficiently. When I say within a matter of two or three weeks, the entire portfolio is harmonized on our book and looked at as one total portfolio, we're already well down that path as a result of our due diligence activities. So we feel like we're in great shape to be able to communicate well to our customers, and get the best outcomes flowing at January 1. We will merge the catastrophe portfolio using our V-cap system and technology. And the Flagstone customers will now get the benefit of our analytical research as well.

One of the things that Flagstone has done as part of their repositioning, they bought a lot of retrocession to protect their book. And I think that was a wise decision on their part. That gives us additional comfort in the windy season, obviously. But it also gives us additional upside as we look at 2013. We have the option of continuing to purchase retrocession. Or we can look, if we feel as though the price of retrocession is higher than the cost of writing the business net, we certainly have the capital and the willingness to increase our net retention there.

So we think that there is likely upside in looking at the retrocession program. So we're quite comfortable having them in place and we will continue to have them in place through wind season. The last thing I would just point out is that following the re underwriting, our residual excess capital really doesn't change, and we're willing to put it to work in the business or we will continue to return it to our shareholders. That's how we think about risk. With that context, I think I would like to ask Jeff Consolino to talk about what we did in the aftermath of the IPC transaction, and you will find that on slide 25.

Jeff Consolino - Validus Holdings, Ltd. - President and CFO

Thanks, Ed. We considered the case to be proven, that combining two catastrophe oriented companies creates value, creates value from optimizing the portfolio, and creates value by creating greater profit potential in a given level of risk. In IPC, what we believe happened is we took two companies, each specializing in property catastrophe, created a better company from that, and managed to return $1.9 billion in total capital between share repurchases, dividends, and cash consideration to IPC shareholders over time, effectively taking that capacity out of the market and bringing it back to shareholders, while still leaving them with a better investment with the stock that they held. We intend to employ the same game plan with Flagstone. Let me turn it back to Ed to close.

Ed Noonan - Validus Holdings, Ltd. - Chairman and CEO

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Thanks, Jeff. Just to wrap up, we think that this is a really attractive outcome for Flagstone shareholders. As I mentioned I couldn't -- I can't say enough good things about the repositioning that David Brown and his team have done with their business and I think they said to their shareholders that they would become a catastrophe-focused company. This transaction is the culmination of that process, and I think it is a great outcome for their shareholders. They get the benefit of size and scale as part of one of the biggest catastrophe reinsurers in the word. They get liquidity. They get a significant premium over the trading price of the stock. And the ability to ride up the value of Validus, a company that has grown their book value faster than anyone else in the space.

For Validus and its shareholders, the economics of this transaction have provided an appropriate margin of safety for us, as we go through wind season. And it further strengthens our leading franchise in the property catastrophe reinsurance business. Size matters. Controlling more risk in that space matters. Whether we write it on Validus Re or use AlphaCat to position it with third-party investors. In essence, this transaction is just Validus going from strength to strength. So with that, I would like to open the floor to any questions you may have.

QUESTION AND ANSWER

Operator

(Operator Instructions)

Your first question comes from the line of Sachin Shah of Tullett Prebon. Please proceed.

Sachin Shah - Tullett Prebon Plc - Analyst

Just had a couple of questions on the regulatory approval, so shareholder vote for Flagstone is required, but I just wanted to get a better idea of what specifically is required on the regulatory side for you guys to close by the end of the year.

Ed Noonan - Validus Holdings, Ltd. - Chairman and CEO

I think we will let Jeff Consolino address that, if you would.

Jeff Consolino - Validus Holdings, Ltd. - President and CFO

Sure. We have a number of regulatory approvals required. The most important of those are in Luxembourg, which is the home market for the holding company for Flagstone; Bermuda, which is where Validus is domiciled; and US regulatory, given the subsidiary involvement of Flagstone in Florida, and we have some other worldwide approvals as well that we need to get, Switzerland and [Finland], for example. But those four are the material ones.

Sachin Shah - Tullett Prebon Plc - Analyst

So it is Luxembourg, Bermuda, HSR in the US and then Switzerland?

Jeff Consolino - Validus Holdings, Ltd. - President and CFO

It is not HSR. Not anti-trust. In the US when you go over 9.9% of a regulated US insurance company, you have to get something called Form A approval. By acquiring Flagstone we will meet that hurdle for one of their subsidiary operations.

Sachin Shah - Tullett Prebon Plc - Analyst

Okay. And that's in Florida?

Jeff Consolino - Validus Holdings, Ltd. - President and CFO

That is correct.

Sachin Shah - Tullett Prebon Plc - Analyst

Okay. And because of the overlap, you're not expecting -- the minor overlap, you're not expecting any kind of regulatory issues, you're expecting the deal to close by the end of the year?

Jeff Consolino - Validus Holdings, Ltd. - President and CFO

We're not expecting any regulatory issues.

Sachin Shah - Tullett Prebon Plc - Analyst

Okay. And Flagstone is going to be able to continue to pay its dividend until the deal closes, as well as yourself?

Jeff Consolino - Validus Holdings, Ltd. - President and CFO

Each company will continue to pay at the dividend rate that was established before the transaction.

Sachin Shah - Tullett Prebon Plc - Analyst

Okay. Perfect. Thank you.

Operator

And your next question comes from the line of Amit Kumar of Macquarie. Please proceed.

Amit Kumar - Macquarie Research Equities - Analyst

Congrats on this announcement. Maybe just starting with the discussion regarding the management team and the employees. You did mention Dave Brown. I'm wondering, Flagstone has roughly 200-plus employees in its continuing operations. How should we think about that employee force going forward?

Ed Noonan - Validus Holdings, Ltd. - Chairman and CEO

Thank you, Amit. And thank you for the congratulations. It's early days. The Company will be managed by Validus. David has done a great job for the shareholders, but he will step down as part of this transaction. And we will very, very quickly make all of the decisions regarding the employees, our expectation is that our business is a very efficient one, in terms of the number of people that we need to do it, and as I mentioned, it is completely scalable, and so that will play a role in it. You should also not expect to see a top rating in all of the locations that are currently being operated in. But those decisions will come. And I feel a great obligation to the Flagstone employees to make sure that is done thoughtfully, with consideration and compassion, and quickly, so that everyone has a sense of certainty as to where they stand going forward.

Amit Kumar - Macquarie Research Equities - Analyst

What sort of number do you anticipate in sort of severance costs for the management team, and I guess any other employees?

Jeff Consolino - Validus Holdings, Ltd. - President and CFO

Amit, this is Jeff Consolino. Again, I'm not entirely comfortable with this line of questioning, which I think is a little unfair to the Flagstone employees, but in terms of our financial analysis, any severance costs or other realignment costs are embedded within the balance sheet adjustments that Ed referred to.

Amit Kumar - Macquarie Research Equities - Analyst

Got it. That was my next question. I guess just going back to slide 16, and then I will stop, this is the final question, you talked about Flagstone's book of business, and their mix of business. It is $514 million. How do you expect that to shape up for -- as we look forward, over the next 12 months, how much do you expect to keep, and how much of that will be non-renewed? That's my final question. Thanks.

Ed Noonan - Validus Holdings, Ltd. - Chairman and CEO

Amit, it kind of falls directly in line with -- if you can tell me what market conditions look like at January 1, I can give you a really good estimate of that. Our sense is that property catastrophe pricing is good. It is good, broadly, at this moment, generally, all over the world. It is not great. It is not -- we're not in a hard market, but pricing is good. So we would look to retain the lion's share of the business, but that is all subject to market conditions, how the business fits against the combined portfolio, and so it is probably a question that we can better answer when we get out deeper into wind season.

Amit Kumar - Macquarie Research Equities - Analyst
Got it. Thanks. I will stop here and requeue. Congrats again.

Operator

Your next question comes from the line of Josh Shanker of Deutsche Bank. Please proceed.

Josh Shanker - Deutsche Bank - Analyst

Is there any exposure that Validus has to -- as a customer of Flagstone, that would go away and you need to replace business elsewhere in the market?

Jeff Consolino - Validus Holdings, Ltd. - President and CFO

There is no material inter-company business, Josh.

Josh Shanker - Deutsche Bank - Analyst

Okay. And in terms of the reserve strengthening adjustments, is there any detail you can give us on differences between Flagstone's methodology and your methodology? And I know certainly this is not a conference call where you want to get into RDE, I'm sure. But --

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Ed Noonan - Validus Holdings, Ltd. - Chairman and CEO

I'm surprised you bring that up.

Josh Shanker - Deutsche Bank - Analyst

But perhaps you can help us out a little bit.

Ed Noonan - Validus Holdings, Ltd. - Chairman and CEO

Josh, I can assure you, there will be no discussion of RDE on the call. It is really a question of actuarial methodology more than anything. I hesitate a bit to call it reserve strengthening. Different methodologies lead to different outcomes. We use different methodologies, so what we're really doing is just harmonizing the methodologies between the two companies. What you've seen from Validus in terms of reserving is what you should expect to see going forward. And that is probably as much as I can give you without reaching or stepping over the line into citizen actuary.

Jeff Consolino - Validus Holdings, Ltd. - President and CFO

Josh, this is Jeff, I would add that as part of this process, we asked our actuarial team at Validus to go in and give us an answer as to what reserve level we would book if we owned Flagstone, and we had been reserving the portfolio all along, so that is what Ed means by harmonizing. It is simply bringing that reserve level up to how we would have booked it, had we had been the operator of the business as of June 30.

Josh Shanker - Deutsche Bank - Analyst

Okay. I imagine, look, there are plenty of people who have questions. I might take this offline a little bit but I know you're busy. Thank you very much for the detail.

Operator

The next question comes from the line of Matthew Heimermann of JPMorgan. Please proceed.

Matthew Heimermann - JPMorgan Chase & Co. - Analyst

A couple of questions for you, if I may. First one is just maybe following up on Jeff's comment, Ed or Jeff could speak to this, but just the comment you made with respect to the form or the capacity backing the business going forward. Should we read that as potentially some of the business you might choose to keep from -- Flagstone might be written against some of the third party facilities rather than on the balance sheet?

Ed Noonan - Validus Holdings, Ltd. - Chairman and CEO

Matt, our job is to match the business and the risk profile associated with the most efficient capital we can. And so, I would expect the vast majority of the business to fit nicely within the Validus Re portfolio, but I'm certain there is business in there too that we might look at and say that is a great fit for the AlphaCat high yield fund, or it might be a great fit for our top layer facility, or other vehicles that we may have in place. So our feeling is that it is to our advantage to control more of the market. And the way to do that is to make sure that you are generating the most appropriate returns for the investors in each segment. We know what Validus shareholders are looking for, and we know what third parties are looking for through our AlphaCat segment so that is really our job.

Matthew Heimermann - JPMorgan Chase & Co. - Analyst

Okay. And just with respect to the comment that it's EPS accretive, is that kind of a static figure, your projections for next year, just layering this in, and the only reason I'm asking, I'm just trying to figure out whether or not that assumes incremental capital management, and maybe from this transaction, or it is just using what would have been your base case before?

Jeff Consolino - Validus Holdings, Ltd. - President and CFO

Matt, this is Jeff. Flagstone is not particularly deeply covered by the Street, at least relative to Validus. And I would respectfully submit that the estimates for next year for Flagstone don't fully reflect the efforts that Flagstone is taking to refocus on higher-margin business. And if you go back and do an analysis of Flagstone's earnings

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AUGUST 30, 2012 / 01:30PM GMT, VR - Validus Holdings, Ltd Conference Call to Acquire Flagstone Re

this year, what you will see is pretty strong underlying earnings on an accident year basis when you take out adverse development. You will see a company that has a very high retrocessional spend relative to its inwards book of business. So we think when we go through and write the business, on the basis that we will, we're going to get mid-teens to high-teens return on our invested capital here. So that is our base case.

Ed Noonan - Validus Holdings, Ltd. - Chairman and CEO

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 months ended March 31, 2015 and 2014. The calculations of basic and diluted earnings per share are as follows:

	Three Months Ended March 31,	
(In thousands except share and per share data)	**2015**	**2014**
Basic		
Net income	$ 5,539	$ 5,811
Weighted-average common shares outstanding	11,440,356	11,478,116
Basic earnings per share	$ .48	$ .51
Diluted		
Net income	$ 5,539	$ 5,811
Weighted-average common shares outstanding	11,440,356	11,478,116
Effect of dilutive restricted stock and stock appreciation rights	161,497	194,707
Weighted-average common shares outstanding assuming dilution	11,601,853	11,672,823
Diluted earnings per share	$ .48	$ .50

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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. The Company repurchased 69,288 and 0 shares during the three-month periods ended March 31, 2015 and 2014, respectively. As of March 31, 2015, 410,752 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, 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, 2014. 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**
Quarter Ended March 31, 2015				
Fee revenue and other income:				
Income from customers	$ 24,274	$ 5,519	$	$ 29,793
Intersegment income (expense)	2,194	423	(2,617)	
Net income	3,816	1,723		5,539
Goodwill	11,454	136		11,590
Other intangible assets, net	2,661			2,661
Total assets	686,492	724,292	(10,036)	1,400,748
Quarter Ended March 31, 2014				
Fee revenue and other income				
Income from customers	$ 23,215	$ 5,507	$	$ 28,722
Intersegment income (expense)	2,144	354	(2,498)	
Net income	4,100	1,711		5,811
Goodwill	11,454	136		11,590
Other intangible assets, net	3,102			3,102
Total assets	672,248	679,391	(9,712)	1,341,927

Note 6 Loans by Type

A summary of loan categories is as follows:

(In thousands)	March 31, 2015	December 31, 2014
Commercial and industrial	$ 221,645	$ 203,350
Real estate		
Commercial:		
Mortgage	111,709	117,754
Construction		
Church, church-related:		
Mortgage	311,100	305,887
Construction	16,424	18,612
Industrial Revenue Bonds	22,582	23,348
Other	77	395
Total loans	$ 683,537	$ 669,346

The following table presents the aging of loans by loan categories at March 31, 2015 and December 31, 2014:

	Performing			Nonperforming		
(In thousands)	Current	30-59 Days	60-89 Days	90 Days and Over	Non-accrual	Total Loans
March 31, 2015						
Commercial and industrial	$ 221,557	$	$	$	$ 88	$ 221,645
Real estate						
Commercial:						
Mortgage	108,632				3,077	111,709
Construction						
Church, church-related:						
Mortgage	310,979				121	311,100
Construction	16,424					16,424
Industrial Revenue Bonds	22,582					22,582
Other	77					77
Total	$ 680,251	$	$	$	$ 3,286	$ 683,537
December 31, 2014						
Commercial and industrial	$ 203,350	$	$	$	$	$ 203,350
Real estate						
Commercial:						
Mortgage	117,393				361	117,754
Construction						
Church, church-related:						
Mortgage	305,760				127	305,887
Construction	18,612					18,612
Industrial Revenue Bonds	23,348					23,348
Other	395					395
Total	$ 668,858	$	$	$	$ 488	$ 669,346

The following table presents the credit exposure of the loan portfolio as of March 31, 2015 and December 31, 2014:

(In thousands)	Loans Subject to Normal Monitoring[1]	Performing Loans Subject to Special Monitoring[2]	Nonperforming Loans Subject to Special Monitoring[2]	Total Loans
March 31, 2015				
Commercial and industrial	$ 217,740	$ 3,817	$ 88	$ 221,645
Real estate				
Commercial:				
Mortgage	97,709	10,923	3,077	111,709
Construction				
Church, church-related:				
Mortgage	309,527	1,452	121	311,100
Construction	16,424			16,424
Industrial Revenue Bonds	22,582			22,582
Other	77			77
Total	$ 664,059	$ 16,192	$ 3,286	$ 683,537
December 31, 2014				
Commercial and industrial	$ 199,837	$ 3,513	$	$ 203,350
Real estate				
Commercial:				
Mortgage	103,097	14,296	361	117,754
Construction				
Church, church-related:				
Mortgage	304,219	1,541	127	305,887
Construction	18,612			18,612
Industrial Revenue Bonds	23,348			23,348
Other	395			395
Total	$ 649,508	$ 19,350	$ 488	$ 669,346

[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 March 31, 2015 and December 31, 2014, all impaired loans were evaluated based on the fair value of the collateral. The fair value of the collateral is based upon an observable market price or current appraised value and therefore, the Company classifies these assets as nonrecurring Level 3. There were no loans delinquent 90 days or more and still accruing interest at March 31, 2015 and December 31, 2014. There were no loans classified as troubled debt restructuring at March 31, 2015 and December 31, 2014.

There were no foreclosed loans recorded as other real estate owned (included in other assets) as of March 31, 2015, and December 31, 2014.

The following table presents the recorded investment and unpaid principal balance for impaired loans at March 31, 2015 and December 31, 2014:

(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance for Loan Losses
March 31, 2015			
Commercial and industrial:			
Nonaccrual	$ 88	$ 88	$
Real estate			
Commercial Mortgage:			

Nonaccrual		3,077		3,077		1,127
Church Mortgage:						
Nonaccrual		121		121		121
Total impaired loans	$	3,286	$	3,286	$	1,248
December 31, 2014						
Commercial and industrial:						
Nonaccrual	$		$		$	
Real estate						
Commercial Mortgage:						
Nonaccrual		361		361		
Church Mortgage:						
Nonaccrual		127		127		127
Total impaired loans	$	488	$	488	$	127

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

(In thousands)	December 31, 2014	Charge-Offs	Recoveries	Provision	March 31, 2015
Commercial and industrial	$ 3,515	$	$ 3	$ 323	$ 3,841
Real estate					
Commercial:					
Mortgage	3,060			(152)	2,908
Construction					
Church, church-related:					
Mortgage	4,016		1	56	4,073
Construction	140			(17)	123
Industrial Revenue Bond	394			(13)	381
Other	769			(197)	572
Total	$ 11,894	$	$ 4	$	$ 11,898

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 March 31, 2015 and December 31, 2014, no amounts have been accrued for any estimated losses for these instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commercial and standby letters of credit are conditional commitments issued by the Company or its subsidiaries to guarantee the performance of a customer to a third party. These off-balance sheet financial instruments generally have fixed expiration dates or other termination clauses and may require payment of a fee. At March 31, 2015, the balance of unused loan commitments, standby and commercial letters of credit were $12,917,000, $11,754,000, and $2,017,000, 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 March 31, 2015:

	Amount of Commitment Expiration per Period				
(In thousands)	Total	Less than 1 Year	1-3 Years	3-5 Years	Over 5 Years
Operating lease commitments	$ 7,161	$ 1,343	$ 2,409	$ 1,545	$ 1,864
Time deposits	75,712	60,779	13,486	1,447	
Total	$ 82,873	$ 62,122	$ 15,895	$ 2,992	$ 1,864

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 three months ended March 31, 2015, 35,657 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 March 31, 2015, the total unrecognized compensation expense related to non-vested restricted shares was $2,578,000, and the related weighted-average period over which it is expected to be recognized is approximately 1.3 years.

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

	Three Months Ended March 31, 2015	
	Shares	**Fair Value**
Balance at December 31, 2014	51,161	$ 48.13
Granted	35,657	$ 50.55
Vested	(20,441)	$ 43.97
Balance at March 31, 2015	66,377	$ 50.71

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 March 31, 2015, the total unrecognized compensation expense was $661,000, and the related weighted-average period over which it is expected to be recognized is .8 years. Following is a summary of the activity of the Company s SARs program for the three-month period ended March 31, 2015:

	Shares	**Weighted-Average Exercise Price**	**Average Remaining Contractual Term Years**	**Aggregate Intrinsic Value *(In thousands)***
Outstanding at December 31, 2014	353,955	$ 35.52	6.77	$ 6,277
Exercised	(35,511)	$ 28.20		
Outstanding at March 31, 2015	318,444	$ 36.33	6.71	$ 6,307
Exercisable at March 31, 2015	264,976	$ 33.34	6.37	$ 6,043

Following is a summary of the activity of the non-vested SARs during the three-month period ended March 31, 2015:

	Shares	**Weighted-Average Grant Date Fair Value**
Non-vested at December 31, 2014	124,982	$ 45.85
Vested	(71,514)	$ 41,87
Non-vested at March 31, 2015	53,468	$ 51.19

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

	Three Months Ended March 31,	
	2015	**2014**
Risk-free interest rate	N/A	2.38%
Expected life	N/A	7 yrs.
Expected volatility	N/A	28.11%

Expected dividend yield	N/A	1.30%

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

Note 9 Defined Pension Plans

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

(In thousands)	**Estimated 2015**	**Actual 2014**
Service cost benefits earned during the year	$ 3,977	$ 3,003
Interest cost on projected benefit obligations	3,217	3,037
Expected return on plan assets	(4,863)	(4,711)
Net amortization	1,605	244
Net periodic pension cost	$ 3,936	$ 1,573

Pension costs recorded to expense were $991,000 and $410,000 for the three-month periods ended March 31, 2015 and 2014, respectively. Pension costs increased significantly in 2015 due to a decrease in the discount rate assumption and the use of the updated mortality tables. The Company made no contribution to the plan during the three-month period ended March 31, 2015 and is evaluating the amount of additional contributions, if any, in the remainder of 2015.

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 2014 and an estimate for 2015:

(In thousands)	**Estimated 2015**	**Actual 2014**
Service cost benefits earned during the year	$ 140	$ 136
Interest cost on projected benefit obligation	348	377
Net amortization	654	431
Net periodic pension cost	$ 1,142	$ 944

Pension costs recorded to expense were $285,000 and $236,000 for the three-month periods ended March 31, 2015 and 2014, respectively.

Note 10 Income Taxes

As of March 31, 2015, the Company s unrecognized tax benefits were approximately $1,191,000, of which $876,000 would, if recognized, affect the Company s effective tax rate. As of December 31, 2014, the Company's unrecognized tax benefits were approximately $1,117,000, of which $819,000 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 $210,000 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 $54,000 and $45,000 of gross interest accrued as of March 31, 2015 and December 31, 2014, respectively. There were no penalties for unrecognized tax benefits accrued at March 31, 2015 and December 31, 2014.

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 2011 through 2013 remain subject to examination by the Internal Revenue Service. In addition, the Company is subject to state tax examinations for the tax years 2011 through 2013.

Note 11 Investment in Securities

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

	March 31, 2015			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
State and political subdivisions	$ 304,441	$ 14,497	$ 61	$ 318,877
Certificates of deposit	3,750			3,750
Total	$ 308,191	$ 14,497	$ 61	$ 322,627

	December 31, 2014			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
State and political subdivisions	$ 338,469	$ 14,120	$ 198	$ 352,391
Certificates of deposit	3,750			3,750
Total	$ 342,219	$ 14,120	$ 198	$ 356,141

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

	March 31, 2015					
	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	$ 8,354	$ 40	$ 1,220	$ 21	$ 9,574	$ 61
Certificates of deposit						
Total	$ 8,354	$ 40	$ 1,220	$ 21	$ 9,574	$ 61

	December 31, 2014					
	Less than 12 months		12 months or more		Total	
(In thousands)	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
State and political subdivisions	$ 8,700	$ 15	$ 13,833	$ 183	$ 22,533	$ 198
Certificates of deposit						
Total	$ 8,700	$ 15	$ 13,833	$ 183	$ 22,533	$ 198

There were 8 securities, or 2% of the total (one greater than 12 months), in an unrealized loss position as of March 31, 2015. There were 20 securities, or 6% of the total (12 greater than 12 months), in an unrealized loss position as of December 31, 2014. 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, the Company does not have the intent to sell the security, 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.

	March 31, 2015	
(In thousands)	**Amortized Cost**	**Fair Value**
Due in 1 year or less	$ 29,318	$ 29,603
Due after 1 year through 5 years	88,584	92,912
Due after 5 years through 10 years	130,196	136,890
Due after 10 years	60,093	63,222
Total	$ 308,191	$ 322,627

Proceeds from sales of investment securities classified as available for sale were $45,198,000 for the three months ended March 31, 2015. Gross realized gains were $949,000 for the three months ended March 31, 2015. There was one security totaling $3,750,000 pledged to secure public deposits and for other purposes at March 31, 2015.

Note 12 Fair Value of Financial Instruments

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

	March 31, 2015		December 31, 2014	
(In thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Balance sheet assets:				
Cash and cash equivalents	$ 208,515	$ 208,515	$ 294,335	$ 294,335
Investment securities	322,627	322,627	356,141	356,141
Loans, net	671,639	679,017	657,452	663,247
Accrued interest receivable	5,117	5,117	6,521	6,521
Total	$ 1,207,898	$ 1,215,276	$ 1,314,449	$ 1,320,244
Balance sheet liabilities:				
Deposits	$ 615,078	$ 615,651	$ 618,199	$ 618,199
Accounts and drafts payable	556,826	556,826	655,428	655,928
Accrued interest payable	66	66	57	57
Total	$ 1,171,970	$ 1,172,543	$ 1,273,684	$ 1,274,184

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 results 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 three months ended March 31, 2015 and 2014. No financial instruments are measured using Level 3 inputs for the three months ended March 31, 2015 and 2014.

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 March 31, 2015, 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 transportation invoice rating, payment processing, auditing, and the generation of accounting and transportation information. Cass also processes and pays energy invoices, which include electricity and gas as well as waste and other facility related expenses. Cass is also in the telecommunications expense management market which includes bill processing and expense management solutions. Cass extracts, stores, and presents information from transportation, energy, telecommunication and environmental invoices, assisting its customers transportation, energy, environmental and information technology managers in making decisions that will enable them to improve operating performance. The Company receives data from multiple sources, electronic and otherwise, and processes the data to accomplish the specific operating requirements of its customers. It then provides the data in a central repository for access and archiving. The data is finally transformed into information through the Company s databases that allow client interaction as required and provide Internet-based tools for analytical processing. The Company, through Cass Commercial Bank, its St. Louis, Missouri-based bank subsidiary (the Bank), also provides commercial banking services in the St. Louis metropolitan area and has loan production offices in Southern California and Colorado Springs, Colorado. In addition to supporting the Company s payment operations, the Bank provides banking services to its target markets, which include privately-owned businesses and churches and church-related ministries.

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

Industry-wide factors that impact the Company include the willingness of large corporations to outsource key business functions such as transportation, energy, telecommunication and environmental payment and audit. The benefits that can be achieved by outsourcing transaction processing, and the management information generated by Cass systems can be influenced by factors such as the competitive pressures within industries to improve profitability, the general level of transportation costs, deregulation of energy costs, and consolidation of telecommunication providers. Economic factors that impact the Company include the general level of economic activity that can affect the volume and size of invoices processed, the ability to hire and retain qualified staff, and the growth and quality of the loan portfolio. The general level of interest rates also has a significant effect on the revenue of the Company. As discussed in greater detail in Item 7A, Quantitative and Qualitative Disclosures about Market Risk, in the Company s 2014 Annual Report on Form 10-K, a decline in the general level of interest rates can have a negative impact on net interest income.

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

Critical Accounting Policies

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

Investment in Debt Securities. The Company classifies its debt marketable securities as available-for-sale. Securities classified as available-for-sale are carried at fair value. Unrealized gains and losses, net of the related tax effect, are excluded from earnings and reported in accumulated other comprehensive income, a component of shareholders' equity. A decline in the fair value of any available-for-sale security below cost that is deemed other than temporary results in a charge to earnings and the establishment of a new cost basis for the security. To determine whether impairment is other than temporary, the Company considers guidance provided in FASB ASC Topic 320, "Investments – Debt and Equity Securities". When determining whether a debt security is other-than-temporarily impaired, the Company assesses whether it has the intent to sell the security and whether it is more likely than not that the Company will be required to sell prior to recovery of the amortized cost basis. Evidence considered in this assessment includes the reasons for impairment, the severity and duration of the impairment, changes in value subsequent to year-end and forecasted performance of the investee.

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

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, 2014, rate of increase in future compensation levels and mortality rates. These assumptions are updated annually and are disclosed in Item 8, Note 10 to the consolidated financial statements filed with the Company's Annual Report on Form 10-K for the year ended December 31, 2014. 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 March 31, 2015 ("First Quarter of 2015") compared to the three-month period ended March 31, 2014 ("First Quarter of 2014"). 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 2014 Annual Report on Form 10-K. Results of operations for the First Quarter of 2015 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:

	First Quarter of		%
(In thousands except per share data)	**2015**	**2014**	**Change**
Net income	$ 5,539	$ 5,811	(4.7)%
Diluted earnings per share	$ .48	$ .50	(4.0)%
Return on average assets	1.54%	1.70%	
Return on average equity	11.31%	12.26%	

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:

	First Quarter of		%
(In thousands)	**2015**	**2014**	**Change**
Transportation invoice transaction volume	8,125	7,759	4.7%
Transportation invoice dollar volume	$ 6,056,711	$ 5,892,571	2.8%
Expense management transaction volume*	5,041	5,095	(1.1)%
Expense management dollar volume	$ 2,983,190	$ 3,274,553	(8.9)%
Payment and processing revenue	$ 19,418	$ 18,397	5.5%

*Includes energy, telecom and environmental

First Quarter of 2015 compared to First Quarter of 2014:

The growth of 5.5% in payment and processing fee revenue was driven mainly by a large number of new customers added during the past year. Transportation volume increased despite softening activity from existing accounts. Expense management dollar volume declined as on-going competitor consolidation in the energy sector continued to impact client retention.

Bank service fees were slightly higher than last year. There were $949,000 gains on sales of securities in the First Quarter of 2015, compared to $0 in the First Quarter of 2014.

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:

	First Quarter of		%
(In thousands)	**2015**	**2014**	**Change**
Average earnings assets	$ 1,262,085	$ 1,235,622	2.14%
Average interest-bearing liabilities	454,027	422,004	7.59%
Net interest income*	10,286	10,413	(1.22)%
Net interest margin*	3.31%	3.42%	
Yield on earning assets*	3.50%	3.62%	
Rate on interest-bearing liabilities	.53%	.60%	

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

First Quarter of 2015 compared to First Quarter of 2014:

First Quarter of 2015 average earning assets increased $26,463,000, or 2%, compared to the same period in the prior year (see discussion in the following paragraphs). The yield on earning assets and the tax equivalent net interest margin both decreased in 2015 as the general level of interest rates remains low and the impact becomes more pronounced as longer-term, higher-yielding assets re-price, mature or are sold.

Total average loans increased $20,301,000, or 3.1%, for the First Quarter of 2015 as compared to the First Quarter of 2014 due to continuing competition from other lenders. Average investment securities increased $2,410,000, or less than 1%, for the First Quarter of 2015.

Total average interest-bearing deposits for the First Quarter of 2015 increased $32,023,000, or 7.6%, compared to the First Quarter of 2014. Average accounts and drafts payable increased $6,439,000, or 1.1%, for the First Quarter of 2015 due to the increase in processing activity.

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.

(Dollars in thousands)	First Quarter of 2015 Average Balance	First Quarter of 2015 Interest Income/ Expense	First Quarter of 2015 Yield/ Rate	First Quarter of 2014 Average Balance	First Quarter of 2014 Interest Income/ Expense	First Quarter of 2014 Yield/ Rate
Assets[1]						
Earning assets						
Loans[2, 3]:						
Taxable	$ 645,929	$ 6,927	4.35%	$ 639,604	$ 7,263	4.61%
Tax-exempt[4]	22,844	244	4.33	8,868	64	2.93
Investment securities[5]:						
Taxable	1,103	1	.37	1,085	1	.37
Tax-exempt[4]	310,986	3,543	4.62	308,594	3,554	4.67
Certificates of deposit	3,750	2	.22	3,750	4	.43
Interest-bearing deposits in other financial institutions	177,713	126	.29	151,394	114	.31
Federal funds sold and other short-term investments	99,760	34	.14	122,327	38	.13
Total earning assets	1,262,085	10,877	3.50	1,235,622	11,038	3.62
Non-earning assets						
Cash and due from banks	13,068			11,970		
Premises and equipment, net	17,504			13,375		
Bank-owned life insurance	15,479			15,367		
Goodwill and other intangibles	14,311			14,763		
Other assets	149,682			105,637		
Allowance for loan losses	(11,896)			(11,770)		
Total assets	$ 1,460,233			$ 1,384,964		
Liabilities and Shareholders Equity[1]						
Interest-bearing liabilities						
Interest-bearing demand deposits	$ 359,426	$ 388	.44%	$ 304,717	$ 380	.51%
Savings deposits	17,203	19	.45	16,431	23	.57
Time deposits >= $100	26,886	81	1.22	36,945	89	.98
Other time deposits	50,512	103	.83	63,910	133	.84
Federal Funds purchased				1		
Total interest-bearing deposits	454,027	591	.53	422,004	625	.60
Non-interest bearing liabilities						
Demand deposits	162,256			150,160		
Accounts and drafts payable	617,560			611,121		
Other liabilities	27,693			9,463		
Total liabilities	1,261,536			1,192,748		
Shareholders equity	198,697			192,216		
Total liabilities and shareholders equity	$ 1,460,233			$ 1,384,964		
Net interest income		$ 10,286			$ 10,413	
Net interest margin			3.31%			3.42%
Interest spread			2.97			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 2014 consolidated financial statements, filed with the Company s 2014 Annual Report on Form 10-K.
3. Interest income on loans includes net loan fees of $59,000 and $50,000 for the First Quarter of 2015 and 2014, respectively.
4. Interest income is presented on a tax-equivalent basis assuming a tax rate of 35%. The tax-equivalent adjustment was approximately $1,325,000 and $1,266,000 for the First Quarter of 2015 and 2014, 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 tables present 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.

	First Quarter of 2015 Over First Quarter of 2014		
(In thousands)	Volume	Rate	Total
Increase (decrease) in interest income:			
Loans[1, 2]:			
Taxable	$ 71	$ (407)	$ (336)
Tax-exempt[3]	138	42	180
Investment securities:			
Taxable			
Tax-exempt[3]	27	(38)	(11)
Certificates of deposit		(2)	(2)
Interest-bearing deposits in other financial institutions	19	(7)	12
Federal funds sold and other short-term investments	(7)	3	(4)
Total interest income	248	(409)	(161)
Interest expense on:			
Interest-bearing demand deposits	63	(55)	8
Savings deposits	1	(5)	(4)
Time deposits of >=$100	(27)	19	(8)
Other time deposits	(27)	(3)	(30)
Total interest expense	10	(44)	(34)
Net interest income	$ 238	$ (365)	$ (127)

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

Provision and Allowance for Loan Losses (ALLL)

A significant determinant of the Company's operating results can be the provision for loan losses. Provision for loan losses were $0 and $0 during the First Quarter of 2015 and the First Quarter of 2014, respectively. As discussed below, the Company continually analyzes the outstanding loan portfolio based on the performance, financial condition and collateralization of the credits. Net loan recoveries during the First Quarter of 2015 were $4,000, and net loan recoveries during the First Quarter of 2014 were $165,000.

The ALLL at March 31, 2015 was $11,898,000 and at December 31, 2014 was $11,894,000. The ratio of ALLL to total loans outstanding at March 31, 2015 was 1.74% compared to 1.78% at December 31, 2014. Nonperforming loans were $3,286,000, or .48%, of total loans at March 31, 2015 compared to $488,000, or .07%, of total loans at December 31, 2014. These loans, which are also considered impaired, consisted of four nonaccrual loans at March 31, 2015. Total nonaccrual loans increased $1,712,000 from March 31, 2014 to March 31, 2015, primarily due to the addition of two loans.

The ALLL has been established and is maintained to absorb reasonably estimated and probable losses in the loan portfolio. An ongoing assessment is performed to determine if the balance is adequate. Charges or credits are made to expense to cover any deficiency or reduce any excess, as required. The current methodology consists of two components: 1) estimated credit losses on individually evaluated loans that are determined to be impaired in accordance with FASB ASC 310 Allowance for Credit Losses, and 2) estimated credit losses inherent in the remainder of the loan portfolio in accordance with FASB ASC 450, Contingencies. Estimated credit losses is an estimate of the current amount of loans that is probable the Company will be unable to collect according to the original terms.

For loans that are individually evaluated, the Company uses two impairment measurement methods: 1) the present value of expected future cash flows and 2) collateral value. For the remainder of the portfolio, the Company groups loans with similar risk characteristics into eight segments and applies historical loss rates to each segment based on a three fiscal-year look-back period. The historical look-back calculation is additionally risk-weighted with the emphasis on the most-recent charge-off activity. In addition, qualitative factors including credit concentration risk, national and local economic conditions, nature and volume of loan portfolio, legal and regulatory factors, downturns in specific industries including losses in collateral value, trends in credit quality at the Company and in the banking industry and trends in risk-rating agencies are also considered.

The Company also utilizes ratio analysis to evaluate the overall reasonableness of the ALLL compared to its peers and required levels of regulatory capital. Federal and state agencies review the Company s methodology for maintaining the ALLL. These agencies may require the Company to adjust the ALLL based on their judgments and interpretations about information available to them at the time of their examinations.

Summary of Asset Quality

The following table presents information on the Company's provision for loan losses and analysis of the ALLL:

	First Quarter of			
(In thousands)		**2015**		**2014**
Allowance at beginning of period	$	11,894	$	11,679
Provision charged to expense				
Loans charged off				(76)
Recoveries on loans previously charged off		4		241
Net recoveries (loans charged off)		4		165
Allowance at end of period	$	11,898	$	11,844
Loans outstanding:				
Average	$	668,773	$	648,472
March 31		683,537		665,101
Ratio of ALLL outstanding:				
Average		1.78%		1.83%
March 31		1.74		1.78
Impaired loans:				
Nonaccrual loans	$	3,286	$	1,574
Loans past due 90 days or more				
Troubled debt restructurings				
Total impaired loans	$	3,286	$	1,574
Foreclosed assets	$			
Impaired loans as percentage of average loans		.49%		.24%

The Bank had no property carried as other real estate owned as of March 31, 2015 and March 31, 2014.

Operating Expenses

Total operating expenses for the First Quarter of 2015 were up 6.1%, or $1,283,000, compared to the First Quarter of 2014.

Salaries and benefits expense for the First Quarter of 2015 increased 7% to $17,326,000 compared to the First Quarter of 2014 due to several factors, including a significant increase in retirement plan expense related to the use of new mortality tables and a decline in the discount rate, annual merit salary increases, increased headcount to support growth in the telecom and environmental expense groups and higher health insurance costs.

Occupancy expense for the First Quarter of 2015 increased $31,000 to $837,000 from the First Quarter of 2014 due to the expansion of the Company s operating facilities for its transportation and waste management operations.

Equipment expense for the First Quarter of 2015 increased $45,000, or 4.4%, compared to the First Quarter of 2014 due to depreciation on building improvements at the transportation processing facility.

Amortization of intangible assets decreased $19,000 in the First Quarter of 2015 as compared to the prior year period.

Other operating expenses for the First Quarter of 2015 increased $87,000, or 3.0%, compared to the First Quarter of 2014 due to an increase in legal fees.

Income tax expense for the First Quarter of 2015 increased $60,000 compared to the First Quarter of 2014. The effective tax rate was 26.0% and 24.5% for the First Quarters of 2015 and 2014, respectively.

Financial Condition

Total assets at March 31, 2015 were $1,400,748,000, a decrease of $99,983,000, or 6.7%, from December 31, 2014. The most significant changes in asset balances during this period were an decrease in payment in cash and cash equivalents of $85,820,000 and a decrease in securities of $33,514,000 offset by an increase of $14,191,000 in loans. Changes in cash and cash equivalents reflect the Company s daily liquidity position and are affected by the changes in the other asset balances and changes in deposit and accounts and drafts payable balances.

Total liabilities at March 31, 2015 were $1,200,558,000, a decrease of $99,741,000, or 7.7%, from December 31, 2014. Accounts and drafts payable at March 31, 2015 were $556,826,000, a decrease of $98,602,000, or 15.0%, from December 31, 2014. Total shareholders equity at March 31, 2015 was $200,190,000, a $242,000, or .1%, decrease from December 31, 2014.

Accounts and drafts payable will fluctuate from period-end to period-end due to the payment processing cycle, which results in lower balances on days when checks clear and higher balances on days when checks are issued. For this reason, average balances are a more meaningful measure of accounts and drafts payable (for average balances refer to the tables under the Distribution of Assets, Liabilities and Shareholders Equity; Interest Rate and Interest Differential section of this report).

The decrease in total shareholders equity of $242,000 resulted primarily from net income of $5,539,000 offset by a increase of $2,555,000 in shares purchased for treasury and dividends paid of $2,412,000.

Liquidity and Capital Resources

The balance of liquid assets consists of cash and cash equivalents, which include cash and due from banks, interest-bearing deposits in other financial institutions, federal funds sold and money market funds, and was $208,515,000 at March 31, 2015, a decrease of $85,820,000, or 29.2%, from December 31, 2014. At March 31, 2015, these assets represented 14.9% of total assets. These funds are the Company s and its subsidiaries primary source of liquidity to meet future expected and unexpected loan demand, depositor withdrawals or reductions in accounts and drafts payable.

Secondary sources of liquidity include the investment portfolio and borrowing lines. Total investment in securities was $322,627,000 at March 31, 2015, a decrease of $33,514,000 from December 31, 2014. These assets represented 23.0% of total assets at March 31, 2015. Of this total, 99% were state and political subdivision securities. Of the total portfolio, 9.2% mature in one year, 28.8% mature in one to five years, and 62.0% mature in five or more years.

The Bank has unsecured lines of credit at correspondent banks to purchase federal funds up to a maximum of $88,000,000 at the following banks: Bank of America, $20,000,000; US Bank, $20,000,000; Wells Fargo Bank, $15,000,000; Frost National Bank, $10,000,000; PNC Bank, $12,000,000; UMB Bank, $5,000,000; and JPM Chase Bank, $6,000,000. The Bank also has secured lines of credit with the Federal Home Loan Bank of $160,968,000 collateralized by commercial mortgage loans. The Company also has secured lines of credit with UMB Bank of $50,000,000 and First Tennessee Bank of $50,000,000 collateralized by state and political subdivision securities. There were no amounts outstanding under any line of credit as of March 31, 2015 or December 31, 2014.

The deposits of the Company's banking subsidiary have historically been stable, consisting of a sizable volume of core deposits related to customers that utilize other commercial products of the Bank. The accounts and drafts payable generated by the Company has also historically been a stable source of funds. The Company is part of the Certificate of Deposit Account Registry Service (CDARS) and Insured Cash Sweep (ICS) deposit placement programs. Time deposits include $49,248,000 of CDARS deposits and interest-bearing demand deposits include $101,747,000 of ICS deposits. These programs offer the Bank s customers the ability to maximize Federal Deposit Insurance Corporation (FDIC) insurance coverage. The Company uses these programs to retain or attract deposits from existing customers.

Net cash flows provided by operating activities were $9,904,000 for the three months ended March 31, 2015, compared to $8,780,000 for the three months ended March 31, 2014, an increase of $1,126,000. Net cash flows from investing and financing activities fluctuate greatly as the Company actively manages its investment and loan portfolios and customer activity influences changes in deposit and accounts and drafts payable balances. Other causes for the changes in these account balances are discussed earlier in this report. Due to the daily fluctuations in these account balances, the analysis of changes in average balances, also discussed earlier in this report, can be more indicative of underlying activity than the period-end balances used in the statements of cash flows. Management anticipates that cash and cash equivalents, maturing investments and cash from operations will continue to be sufficient to fund the Company s operations and capital expenditures in 2015, which are estimated to range from $5 million to $7 million.

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.

There are several trends and uncertainties that may impact the Company s ability to generate revenues and income at the levels that it has in the past. In addition, these trends and uncertainties may impact available liquidity. Those that could significantly impact the Company include the general levels of interest rates, business activity, and energy costs as well as new business opportunities available to the Company.

As a financial institution, a significant source of the Company s earnings is generated from net interest income. Therefore, the prevailing interest rate environment is important to the Company s performance. A major portion of the Company s funding sources are the non-interest bearing accounts and drafts payable generated from its payment and information processing services. Accordingly, higher levels of interest rates will generally allow the Company to earn more net interest income. Conversely, a lower interest rate environment will generally tend to depress net interest income. The Company actively manages its balance sheet in an effort to maximize net interest income as the interest rate environment changes. This balance sheet management impacts the mix of earning assets maintained by the Company at any point in time. For example, in the lower interest rate environment currently faced by the Company, short-term, relatively lower rate liquid investments are reduced in favor of longer-term relatively higher yielding investments and loans.

The overall level of economic activity can have a significant impact on the Company s ability to generate revenues and income, as the volume and size of customer invoices processed may increase or decrease. Higher levels of economic activity increase both fee income (as more invoices are processed) and balances of accounts and drafts payable.

The relative level of energy costs can impact the Company s earnings and available liquidity. Higher levels of energy costs will tend to increase transportation and energy invoice amounts resulting in a corresponding increase in accounts and drafts payable. Increases in accounts and drafts payable generate higher interest income and improve liquidity.

New business opportunities are an important component of the Company s strategy to grow earnings and improve performance. Generating new customers allows the Company to leverage existing systems and facilities and grow revenues faster than expenses.

Risk-based capital guidelines require the Company to meet a minimum total capital ratio of 8.0%, of which at least 6.0% 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, ALLL, 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:

	March 31, 2015		December 31, 2014	
(Dollars in thousands)	**Amount**	**Ratio**	**Amount**	**Ratio**
Total capital (to risk-weighted assets)				
Cass Information Systems, Inc.	$ 208,626	21.98%	$ 207,468	21.91%
Cass Commercial Bank	92,919	16.25%	91,249	15.88%
Common Equity Tier I capital (to risk-weighted assets)				
Cass Information Systems, Inc.	$ 196,763	20.73%	$ 195,630	20.66%
Cass Commercial Bank	85,772	15.00%	84,049	14.62%
Tier I capital (to risk-weighted assets)				
Cass Information Systems, Inc.	$ 196,763	20.73%	$ 195,630	20.66%
Cass Commercial Bank	85,772	15.00%	84,049	14.62%
Tier I capital (to leverage assets)				
Cass Information Systems, Inc.	$ 196,763	13.59%	$ 195,630	13.42%
Cass Commercial Bank	85,772	11.78%	84,049	11.94%

Effective July 2, 2013, the Federal Reserve Board approved final rules known as the Basel III Capital Rules that substantially revise the risk-based capital and leverage capital requirements applicable to bank holding companies and depository institutions, including the Company and the Bank. The Basel III Capital Rules implement aspects of the Basel III capital framework agreed upon by the Basel Committee and incorporates changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. Among other things, the Basel III Capital Rules establish stricter capital requirements and calculation standards, as well as more restrictive risk weightings for certain loans and facilities. The Basel III Capital Rules were effective for the Company and the Bank on January 1, 2015 (subject to a phase-in period) and had no material impact on the Company s consolidated financial statements.

Inflation

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

Impact of New and Not Yet Adopted Accounting Pronouncements

The new accounting pronouncements are not applicable to the Company and/or do not materially impact the Company.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As described in the Company s Annual Report on Form 10-K for the year ended December 31, 2014, the Company manages its interest rate risk through measurement techniques that include gap analysis and a simulation model. As part of the risk management process, asset/liability management policies are established and monitored by management. The policy objective is to limit the change in annualized net interest income to 15% from an immediate and sustained parallel change in interest rates of 200 basis points. Based on the Company's most recent evaluation, management does not believe the Company's risk position at March 31, 2015 has changed materially from that at December 31, 2014.

ITEM 4. CONTROLS AND PROCEDURES

The Company s management, under the supervision and with the participation of the principal executive officer and the principal financial officer, evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report and concluded that, as of such date, these controls and procedures were effective.

There were no changes in the First Quarter of 2015 in the Company's internal control over financial reporting identified by the Company s principal executive officer and principal financial officer in connection with their evaluation that materially affected or are reasonably likely to materially affect the Company s internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended).

PART II. **OTHER INFORMATION**

ITEM 1. **LEGAL PROCEEDINGS**

The Company is the subject of various pending or threatened legal actions and proceedings, including those that arise in the ordinary course of business. Management believes the outcome of all such proceedings will not have a material effect on the businesses or financial conditions of the Company or its subsidiaries.

ITEM 1A. **RISK FACTORS**

The Company has included in Part I, Item 1A of its Annual Report on Form 10-K for the year ended December 31, 2014, a description of certain risks and uncertainties that could affect the Company s business, future performance or financial condition (the Risk Factors). There are no material changes to the Risk Factors as disclosed in the Company s 2014 Annual Report on Form 10-K.

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

During the three months ended March 31, 2015, the Company repurchased a total of 69,288 shares of its common stock pursuant to its treasury stock buyback program, as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs[1]	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
January 1, 2015 January 31, 2015				480,040
February 1, 2015 February 28, 2015	42,182	$ 47.63	42,182	437,858
March 1, 2015 March 31, 2015	27,106	$ 49.78	27,106	410,752
Total	69,288	$ 48.47	69,288	410,752

1. All repurchases made during the quarter ended March 31, 2015 were made pursuant to the treasury stock buyback program, which was authorized by the Board of Directors on October 17, 2011 and announced by the Company on October 20, 2011. The program, as modified by the Board of Directors on October 20, 2014, provides that the Company may repurchase up to an aggregate of 500,000 shares of common stock and has no expiration date.

ITEM 3. **DEFAULTS UPON SENIOR SECURITIES**

None.

ITEM 4. **MINE SAFETY DISCLOSURES**

Not applicable.

ITEM 5. **OTHER INFORMATION**

(a) None.

(b) There have been no material changes to the procedures by which security holders may recommend nominees to the Company s Board of Directors implemented in the First Quarter of 2015.

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ITEM 6. **EXHIBITS**

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

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

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

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

Exhibit 101.INS XBRL Instance Document.

Exhibit 101.SCH XBRL Taxonomy Extension Schema Document.

Exhibit 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.

Exhibit 101.LAB XBRL Taxonomy Extension Label Linkbase Document.

Exhibit 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

Exhibit 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CASS INFORMATION SYSTEMS, INC.

DATE: May 4, 2015	By /s/ Eric H. Brunngraber Eric H. Brunngraber Chairman, President, and Chief Executive Officer (Principal Executive Officer)
DATE: May 4, 2015	By /s/ P. Stephen Appelbaum P. Stephen Appelbaum Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)