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FINAL TRANSCRIPT

VersaBank

Fourth Quarter & Year End Fiscal 2021 Financial Results

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the VersaBank Fourth Quarter and Year End Fiscal 2021 Financial Results Conference Call. This morning, VersaBank issued a news release reporting its financial results for the fourth quarter and year ended October 31, 2021. That news release, along with the Bank's financial statements and supplemental financial information, are available on the Bank's website in its Investor Relations section as well as on SEDAR and EDGAR.

Please note that, in addition to the telephone dial in, VersaBank is webcasting the conference call live over the Internet. The webcast is listen-only. If you are listening to the webcast but wish to ask a question in the Q&A session following Mr. Taylor's presentation, please dial in to the conference line, the details of which are included in this morning's news release and on the Bank's website. For those participating in today's call by telephone, the accompanying slide presentation is available on the Bank's website. Also, today's call will be archived for replay both by telephone and via the Internet beginning approximately one hour following the completion of the call. Details on how to access the replays are available in this morning's news release.

I would now like to remind our listeners that the statements about future events made on this call are forward looking in nature and are based on certain assumptions and analysis made by VersaBank's management. Actual results could differ materially from our expectations due to the various material risks and uncertainties associated with VersaBank's businesses. Please refer to VersaBank's forward-looking statement advisory in today's presentation.

I would now like to turn the conference call over to Mr. David Taylor, President and Chief Executive Officer of VersaBank. Please go ahead, Mr. Taylor.

David Taylor — President & Chief Executive Officer, VersaBank

Thank you, Kelsey. Good morning, everyone, and thank you for joining us for today's call. I'm very pleased to be here for what is our first earnings call since our very successful US IPO and welcome to our new shareholders who are joining us today. With me for today's call is Shawn Clarke, our Chief Financial Officer.

Our record fourth quarter capped off what was a record year for VersaBank as our core digital banking operations continued to deliver strong growth in both loans and income. We achieved another loan portfolio record of just under $2.1 billion and a record net income of $5.9 million, up 25% year over year. And a reminder to our US shareholders and analysts that we report our financial results in Canadian dollars and all amounts in today's call will be in Canadian dollars unless otherwise stated.

As proud as we are of our strong financial performance for both the quarter and the year, these were also periods in which we took a number of important steps that we believe will not only continue our growth trajectory, but accelerate it. These include initiation and expansion of our closed ecosystem testing of our revolutionary Digital Deposit Receipts, or DDRs for short, a significantly new low-cost deposit opportunity, as well as continued progress on execution of DRT Cyber's growth strategy. And perhaps most noteworthy during the quarter, we completed our initial public offering of common shares in the US for gross proceeds of US$63.3 million and concurrent listing on the Nasdaq.

I couldn't be more pleased with the success of our offering and the overwhelming positive reception that VersaBank received from US-based investors. I will note that our offering was well oversubscribed and I would like to take this opportunity to acknowledge the excellent work of the team at Raymond James US as well as KBW and Stifel Canada for their hard work and support in making the offering a great success.

Total loans at the end of the fourth quarter were up 27% year over year and 8% sequentially to a record $2.1 billion, the result of strong growth in both point-of-sale loan and lease receivable portfolio and our commercial real estate portfolio. Total revenue for Q4 increased 33% year over year and 16% sequentially to a record $18.2 million. Cost of funds decreased 20 basis points or 13% year over year and decreased 10 basis points or 7% sequentially to 1.31%. Net interest margin was down 9 basis points or 3% year over year but up 12 basis points or 5% sequentially to 2.73% with the year-over-year decline largely a result of our higher cash balances. And finally, net income increased 25% year over year and 9% sequentially to a record $5.9 million.

We are again this quarter especially proud to have achieved this performance amidst the temporary dampening effect of our higher than normal cash balances, as I just noted, which were 11% of total assets at the end of the fourth quarter compared to a historical 6% to 7%. This I will note is down from 13% at the end of Q3 this year as we put to work US$63 million in capital raised by our US IPO common share offering. Notably, 2021 saw a return to strong growth in profitability following a flat year in 2020 when we held atypically high cash balances out of an abundance of caution as the pandemic arose and unfolded. Our 15% year-over-year increase in net income contributed to a compounded annual growth rate and earnings of 22% since 2014 with growth in every year except 2020.

Operationally, Q4 was a very busy and productive quarter. As you've heard me discuss, VersaBank's access to ultra-low-cost deposits is a core component of our model to generate superior net interest margins and profitability while taking less risk. The significant growth in our insolvency professional deposit business, an entirely unique offering based on our proprietary software, over the past six years has contributed to a decrease in our cost of funds from 1.98% to 1.31% in the most recent quarter, building on the solid foundation and momentum. Our revolutionary, highly-encrypted Digital Deposit Receipts, or DDRs for short, is expected to provide an additional new opportunity for a step function growth in our low-cost deposits. We anticipate strong demand for these deposits as highly-encrypted Digital Deposit Receipts, when placed on a public blockchain, we believe our receipts can be a superior, regulatory-compliant alternative to the current stablecoins for mainstream financial applications.

In August we initiated closed ecosystem testing of our Canadian dollar denominated DDRs, or VCAD, and earlier this week we announced expansion of testing to include US dollar denominated DDRs, or VUSD, as well as the Algorand and Ethereum blockchains, in addition to the Stellar blockchain. We also added a receipt distributor who will become one of our primary distributers of our DDRs at our commercial launch. Concurrent with expanded testing, our DDR system is undergoing SOC 2 Audit, which is intended to verify the non-financial reporting controls relating to security, availability, processing integrity, confidentiality, and privacy of the system. Testing will continue until completion of the SOC 2 Audit as soon as possible, following which we plan to commercially launch VCAD and VUSD, which is currently targeted for early next year. As I noted earlier, we view our DDRs as a significant additional low-cost deposit generator but clearly, with rapidly developing regulatory environment for digital currencies, there are much broader business opportunities which we're actively and prudently exploring.

Alongside the continuing strong performance in our core digital banking operations, our wholly owned subsidiary, DRT Cyber, continued to steadily execute on its growth strategy. A central part of its strategy is the introduction of new services that enhance DRT's ability to provide a comprehensive suite of cybersecurity solutions anchored by its leading penetration testing solution and cross sell and up sell these solutions, including through partnerships with other leading cybersecurity providers. During the fourth quarter DRT entered into reciprocal reseller agreements with UK-based Syrenis, which provides personal information management and stakeholder engagement solutions for large global enterprises. Under these arrangements, DRT Cyber will sell Syrenis' subscription-based, flagship product, Cassie, a world leading Consent and Preference Management solution for organizations globally. DRT Cyber will add Cassie to its suite of innovative solutions for data protection, cybersecurity, and compliance, and Syrenis will act as a reseller of DRT Cyber's anti-spam legislation solution, RAVEN, which integrates seamlessly with Syrenis' Cassie. 2021 was a good year for DRT overall and we look forward to building on this success in 2022.

I'd now like to turn the call over to Shawn to review our financial results in detail.

Shawn Clarke — Chief Financial Officer, VersaBank

Thanks very much, David. Good morning, everyone. In the interest of time, I'm going to confine my remarks primarily to selected fourth quarter results. Our full financial statements and MD&A for both the fourth quarter and the year ended October 31, 2021 are available on our website under the investor section as well as on SEDAR and EDGAR. And I will remind you that all of the numbers reported here this morning are in Canadian dollars, as per our financial statements, unless otherwise noted.

With respect to our balance sheet, total assets at the end of the fourth quarter were $2.4 billion, up 24% from $1.9 billion a year ago and up modestly from $2.3 billion sequentially. Our cash balance at the end of Q4 was $272 million, down from $297 million last quarter and up from $258 million at the end of the fourth quarter of last year. As David noted earlier, the increase from Q4 of last year is primarily the result of the common share offering completed in the current quarter for net cash proceeds of $73 million and the subordinated debt issue completed in April of this year for net cash proceeds of $89.5 million, offset partially by the redemption of Series 3 preferred shares also completed in April of this year. The decrease from the third quarter of this year was the result of continued deployment of cash into lending assets over the course of the quarter. Our total loan portfolio in the fourth quarter was up 27% year over year and up 8% sequentially to another record of $2.1 billion, as David mentioned earlier.

Looking at the composition of our balance sheet growth, our point-of-sale portfolio grew 12% sequentially and 30% year over year to $1.28 billion, representing 61% of our total loan portfolio as at October 31st, up from 59% last quarter. Our commercial real estate portfolio grew 2% sequentially and 24% year over year to $784 million, representing 37% of our total loan portfolio as at October 31st, down slightly from 39% last quarter. Finally on the balance sheet, our book value per share increased 8.5% year over year and 3% sequentially to $11.61.

Shifting to our regulatory capital position, our CET1 ratio at the end of Q4 was 15.18%, up from 13.88% last year and up from 11.94% last quarter. Our leverage ratio at the end of Q4 was 12.60%, up from 12.19% last year and up from 9.99% last quarter. The year-over-year increases in our regulatory capital levels and ratio, as well as our leverage ratio, were a function of a number of factors, which included the issuance of the subordinated notes in late April, our common share offering completed in late September, and of course retained earnings growth and cash provision recoveries related to the Bank's deferred tax asset, all offset partially by the redemption of the Bank's outstanding non-cumulative Series 3 preferred shares in late April. Our regulatory capital and leverage ratios at this time remain well above target.

As David noted, the fourth quarter was not only a record quarter for VersaBank across a number of financial metrics but also one that saw strong year-over-year and sequential growth across substantially all of key performance indicators. Total revenue for the fourth quarter was up 33% year over year and up 16% sequentially to $18.2 million as a function primarily of higher interest income, higher non-interest income, and lower cost of funds.

Net interest margin for the quarter was 2.73%, down 9 basis points from 2.82% for the same period last year but up 12 basis points from 2.61% for the third quarter of 2021. The year-over-year decease is a function primarily of lower yields earned on elevated cash balances, which was, as you know, an internal decision made out of an abundance of caution at the onset of the pandemic, as well as a function of lower yields earned on lending assets, offset partially by the lower cost of funds. The sequential increase was due primarily to higher fees earned and lower cost of funds in the current quarter.

Net interest income for the quarter was $16.1 million, up 18% from $13.7 million for the same period a year ago and up 11% from $14.5 million for the third quarter of 2021. Both the sequential and year-over-year trends were a function primarily of higher interest income attributable to strong lending asset growth and lower cost of funds.

Non-interest expenses for the quarter were $10.4 million, up from $7.8 million compared to the same period a year ago and up from $8.2 million compared to the third quarter of 2021. Both the year-over-year and sequential increases were the result of higher administrative cost attributable primarily to the US IPO share offering and concurrent listing on the Nasdaq in September. The year-over-year trend also reflects higher salary and benefit expense attributable to an increase in staff complement and a general increase in staff-related costs as well as the consolidated results of Digital Boundary Group. As a result, our efficiency ratio for the fourth quarter jumped to 57%, well north of the low 50% range we enjoyed over the course of the year. That said, we view these additional costs as an investment in our future growth and fully expect our efficiency ratio to trend back to the low 50% range over the course of the first half of this coming year and likely breaking the high 40% range as our loan portfolio grows.

Net income for the fourth quarter of 2021 was a record $5.9 million or $0.24 per common share on both a basic and diluted basis, up 25% from $4.7 million or $0.20 per common share for the same period last year and up 9% from $5.4 million or $0.25 per common share for the third quarter this year. Sorry, with the sequential decrease in EPS a function primarily of the increased administrative expenses I mentioned earlier combined with the dilution resulting from the common share offering completed in September. More broadly, the year-over-year increase in net income was a function primarily of higher revenue, offset partially by a lower recovery of credit losses and higher non-interest expenses, while the sequential quarter-over-quarter increase in net income was a function of higher revenue combined with a higher recovery of credit losses, offset partially by higher non-interest expenses.

As David noted earlier, Q4 once again saw a decrease in our cost of funds, which fell to 1.31%, down 20 basis points from 1.51% for the fourth quarter of last year and down 10 basis points from the third quarter of this year. The decrease was primarily the result of the continued growth in our insolvency professional deposits base, which currently pays 0% interest despite lower bankruptcy activity in Canada. Looking ahead, we expect insolvency professional deposits to continue to grow over the course of fiscal 2022 due to continued on-boarding of new trustee partners and organic growth from existing partners combined with the potential for increased consumer bankruptcy and proposal restructuring volumes in the coming year as a number of COVID-19-related Canadian government support programs come to an end as well as the prospect for potentially higher interest rates as a result of the Bank of Canada potentially tightening monetary policy.

Credit quality of our loan portfolio remains very strong and as at the end of the quarter we had no impaired loans or loans in arrears on our balance sheet, which continues to be the case today. For Q4 we recorded a recovery of credit losses in the amount of $279,000 compared to a recovery of credit losses in the amount of $582,000 for the same period a year ago and a provision for credit losses in the amount of $96,000 for the third quarter of this year. The sequential trend was a function primarily of changes in the asset mix comprising our commercial real estate portfolio as well as broadly more favourable macroeconomic forecast data (inaudible) forward-looking statements in the Bank’s credit risk models, offset partially by higher loan balances.

Our PCL ratio, or provision for credit losses, as a percentage of average loans for the fourth quarter was a negative 0.05%, up from negative 0.14% for the same period last year. Our PCL ratio for the year ended October 31, 2021 was negative 0.02%, unchanged from 2020. Finally, our average PCL ratio for the past 12 quarters was negative 0.01%.

Amidst the continuing evolution of the pandemic, we continue to operate at a heightened level of awareness to ensure that our origination and underwriting practices remain highly disciplined and focused.

I'd now like to turn the call back to David for some closing remarks. David?

David Taylor — President & Chief Executive Officer, VersaBank

Thank you, Shawn.

The success of VersaBank is nearly 30 years in the making. In 1993 we became the first fully digital, branchless financial institution using proprietary technology to provide unique, high-value-add solutions that addressed unmet needs in commercial deposit taking and lending. Despite our long track record of success, I truly believe we are just getting started. The time is right to fully capitalize on our opportunities as a digital bank. We have significant macro wind at our backs as the financial world increasingly becomes comfortable with and recognizes the benefits of digital banking.

Within our bank itself, we look forward to 2022 with a great deal of confidence and enthusiasm. Building on the best year ever, 2021, we are well positioned to accelerate our growth. We expect continued growth in total loans as we continue to deploy capital to opportunities in our existing portfolio. Each of our point of sale and commercial real estate portfolios have long runways of future growth ahead. We also expect to generate growth from new opportunities, most notably the opportunity to bring point-of-sale financing model to the US market, that we believe, based on our research, is similar to Canada a decade ago and there are limited options available for consumer-facing finance companies in the USA. Accordingly, we see tremendous potential in what is estimated to be a $1.8 trillion market that is growing at 20% annually.

There is no denying that this sectoral trend at the consumer-facing end of the market which has created a significant opportunity for our unique offering based on our proprietary technology, access to ample, low-cost funding, to provide an attractive alternative source of inexpensive flexible financing to these businesses. The US launch of our point-of-sale model is a top priority for 2022 and I look forward to keeping you abreast of our progress going forward.

And with that said, I'd like to open up the call to questions. Kelsey?

Q & A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press the star followed by the one on your touchtone phone. You will then hear a three-tone prompt acknowledging your request and your questions will be polled in the order that they are received. Should you wish to decline from the polling process, please press star followed by the two. If you are using a speakerphone, please lift the handset before pressing any keys. One moment please for your first question.

And your first question does come from William Wallace from Raymond James. Please go ahead.

William Wallace — Analyst, Raymond James

Hi. Good morning. Thanks for taking my call, my question. David, maybe just following up on the last point that you ended with about expanding point of sale into the US, what needs to occur for that to happen?

David Taylor — President & Chief Executive Officer, VersaBank

Well, we are ploughing presently through some legal work in order to close our first sort of milestone deal in the United States, so it's really just a matter of getting the lawyers to sort out the legal documentation. There aren't really any other impediments other than that.

William Wallace — Analyst, Raymond James

And so, based on wherever you feel like you are in the process, do you feel like this is likely to be a first half event for 2022?

David Taylor — President & Chief Executive Officer, VersaBank

Yes. Yes, indeed. Hopefully we'll have a number of new US relationships in the first half. As time progresses, you know, we're dreaming of huge growth in the States, so it may be advisable for us to obtain a US bank as a subsidiary at some time in the future, but presently we're able to lend from funding in Canada.

William Wallace — Analyst, Raymond James

Okay, great. And then on the Canada business, obviously the October quarter was exceptionally strong in point of sale. With one month into this quarter, do you feel like that rate of growth is continuing or do you feel like there was just some lumpiness in the October quarter that drove such a strong growth rate?

David Taylor — President & Chief Executive Officer, VersaBank

Yeah, not lumpy at all, it's just gathering momentum in Canada. The pandemic caused a bit of concern amongst our point-of-sale finance partners with perhaps some, the treatment they received from some of our competitors, and we bent over backwards, our team bent over backwards to ensure that our point-of-sale partners were comfortable and could survive it, and now we're sort of reaping the benefits of that where we're seeing a lot of enthusiasm for our product throughout Canada. That's what's driving this extraordinary growth in the point-of-sale business. And there's some consolidation in the Canadian market that's helping out too.

William Wallace — Analyst, Raymond James

Okay. And Shawn, in the release, when you were talking about the sequential growth in net interest margin, I believe you cited that there were elevated loan fees in the net interest income. Can you quantify (inaudible) on a dollar basis or on a basis point impact to NIM?

Shawn Clarke — Chief Financial Officer, VersaBank

Sorry, Wally, elevated which? I didn't catch that.

William Wallace — Analyst, Raymond James

Loan fees it sounded like, I believe I read.

Shawn Clarke — Chief Financial Officer, VersaBank

We talked about some loan fees. So those were some loan fees from the CRE portfolio that were bumped up a little bit this quarter, somewhat anomalous, Wally. As you know by looking at our numbers, they're fairly consistent quarter over quarter, so this was a bump just due to some transactions that were coming to fruition. So I wouldn't expect to see that kind of a lift going forward, but maintaining consistent in our past quarters.

William Wallace — Analyst, Raymond James

Okay. So kind of back down to where we were in the prior quarter is where you would point us on net interest margin.

Shawn Clarke — Chief Financial Officer, VersaBank

Correct. Sorry, net interest margin in general though, Wally, sorry, net interest margin, I thought you were talking about the fees, net interest margin, I think we'll see that start to continue to expand over the course of the coming half. As David mentioned a number of times, we would expect to see that climbing back toward norms and approaching 300 basis points. That's as we grow into the sub-debt funding and continue to reap the benefit of the organic growth of our trustee and bankruptcy program. So we expect, over the course of the year, to see it back up towards where we were much earlier in this year prior to the sub-debt offering.

William Wallace — Analyst, Raymond James

Okay. Okay, thank you. And then in the non-interest expense, are the administrative costs associated with the September capital raise, are those recurring or nonrecurring? And if they're nonrecurring, can you tell us how much comes back out?

Shawn Clarke — Chief Financial Officer, VersaBank

I think many of them will be recurring. As you know, talking about things like insurance, capital tax, audit fees, all items, of course, that were not capitalized as part of the offering, so we see potentially maybe $0.5 million to $600,000 may not be recurring on a go-forward basis. But as we noted in our remarks on the call, we view this as investment in our balance sheet growth going forward. So this is a little bit of a new normal for us but we think we'll grow into it very quickly. We do fully anticipate the spike in efficiency ratio to come down quickly over the course of the first half of the year back into the low 50s range and we're hoping to press into the high 40s range in the back half of 2022.

William Wallace — Analyst, Raymond James

Okay. All right. Very good. That's helpful. And then my last question is just on the, ah, the DDR offerings, would you anticipate continuing to expand the blockchains that those offerings would be available on and is there any way to help us think about how that launch looks when you do launch commercially?

David Taylor — President & Chief Executive Officer, VersaBank

It's David here. The blockchains we're presently on is probably where we'll be for the time being. What it will look like is we'll launch in Canada, strictly in Canada to start with, but both with US denominated coins and Canadian denominated coins, just to Canadian residents to start with. In the future, however, likely with an acquisition of a US bank subsidiary, we would expect to bring the US dollar denominated Digital Deposit Receipts, the VUSD, to the United States audience.

William Wallace — Analyst, Raymond James

Okay. All right. Thank you very much. I'll let somebody else ask a question. I appreciate it.

David Taylor — President & Chief Executive Officer, VersaBank

Thank you, Wally.

Operator

Your next question comes from Greg MacDonald from LodeRock Research. Please go ahead.

Greg MacDonald — Analyst, LodeRock Research

Thanks. Good morning, David, and congrats on the quarter and the US listing.

David Taylor — President & Chief Executive Officer, VersaBank

Good morning, Greg.

Greg MacDonald — Analyst, LodeRock Research

Good morning. I wanted to ask a question on the dividend. With OSFI lifting the restrictions, we've seen a couple of Canadian banks lift dividends, and given the earnings payout and current dividend that you have, certainly there's upside room, particularly as the US capital gets deployed, but at the same time I can appreciate you're embarking on a number of growth initiatives. Can you just talk about the Bank's current dividend policy and what the Bank's board and management's view is on dividends going forward? Just trying to get a sense of growth opportunity.

David Taylor — President & Chief Executive Officer, VersaBank

It's a good question, Greg. With all the growth opportunity that's in front of us, presently we're thinking, unlike the other banks it seems, not increasing our dividend, keeping it where it is, in that the retention of the capital fuels the growth and we see a lot of growth ahead of us, particularly in the United States.

Going forward though and looking a bit into the future, as things sort of stabilize I can see the dividend increasing again to, ah, not the sort of level the other banks are at, because we expect we'll always be growing, but at least higher than it is today.

Greg MacDonald — Analyst, LodeRock Research

Okay. And so we've seen in the past sort of 10%, 6% to 10% earnings payouts. Should we be thinking, as earnings grow, you're going to try and stick to that type of level just in terms of a quantum? Or is there opportunity to actually increase payouts relative to what you've had historically?

David Taylor — President & Chief Executive Officer, VersaBank

Well, for the short run I would look at the 10% payout. Thereafter, we definitely could go higher, there's lots of room, but we are looking at tremendous growth opportunities. So that's what's sort of modifying our view on dividend payouts presently. The extent to how fast we can grow in the US market will weigh on us. As I was saying earlier, a $1.8 trillion market with, ah, we're bringing a somewhat disruptive new way of funding these point-of-sale finance companies that was extremely well received in Canada. I don't think we actually did any real marketing in that area in Canada. It was sort of word of mouth and it caught on almost like a grass fire. And this year, of course, it's growing very rapidly. So we think we can deploy our capital probably more effectively for our shareholders via fuelling growth rather than paying it out.

Greg MacDonald — Analyst, LodeRock Research

Okay. That makes sense. And the growth numbers are certainly there. It's a nice bridge to my second question, a little more context on the point-of-sale growth. That was a surprise for at least me in the quarter. You mentioned both home improvement and home financing in the press release. Can you give a little more context on what the growth in the quarter was? Particularly I'm keen to know was home financing a bigger part of what you saw in the quarter?

David Taylor — President & Chief Executive Officer, VersaBank

It was. Home improvement and home financing has been gathering momentum over the last few quarters as Canadians, I guess, are looking to improve their home offices, their backyards, and all the places they've been confined to for quite some time. And there's been somewhat of an exodus from the major centres to the more economical outlying areas. That's all driven our point-of-sale program and also our real estate construction business has benefitted from that trend also.

Greg MacDonald — Analyst, LodeRock Research

Okay. That's good to know. And you indicated you saw sustainability of that going into 2022, that's helpful. Last question I'll ask, David, and then I'll pass it on to others, the TIB deposits that you referenced continue to grow quite handsomely, I don't think we've seen as many consumer bankruptcies as what we thought we would. You still indicate that there's an expectation for that, but I know you still have room also for growth within your existing partner base there. Can you give us some context? Do you anticipate the growth in 2022 to be similar to that in 2021? Is there any reason we should think that that wouldn't be the case?

David Taylor — President & Chief Executive Officer, VersaBank

No reason to think it wouldn't be the case. We expect the bankruptcy level in Canada to increase. We're presently at a 35-year low and, with the support payments coming to an end for the most part and with the prospect of interest rates increasing, I think bankruptcies will get to sort of normal levels. And that in combination with us still on-boarding new insolvency firms should give rise to more accelerated growth for the TIB business in 2022.

Greg MacDonald — Analyst, LodeRock Research

Okay. That's good to note. Thanks very much, David.

David Taylor — President & Chief Executive Officer, VersaBank

Thank you, Greg.

Operator

And your next question comes from Brad Ness from Choral Capital. Please go ahead.

Brad Ness — Analyst, Choral Capital Management

Hello, gentlemen. First question is just a clarification from Wally's question regarding net interest income. Was there elevated fee or one-time fees in there related to maybe loan pre-payments?

David Taylor — President & Chief Executive Officer, VersaBank

Brad, to just expand a little bit on that, we routinely have pre-payment penalties flowing in each quarter. It might have been a slight increase in this quarter of a few basis points, but nothing significant.

Brad Ness — Analyst, Choral Capital Management

Okay, thanks. And regarding fee-based income, it looked like it was $2.1 million versus, say, $1.2 million in the previous quarter. What was that jump related to?

David Taylor — President & Chief Executive Officer, VersaBank

That would be fees related solely to Digital Boundary Group, a subsidiary of DRTC, and they had a bit of a slowdown due to pandemic issues and then it sort of rebounded towards the end of the year. So that was, all in all, Digital Boundary Group as a sub of DRTC we thought did very well and it looks like that sort of momentum it was developing in the second half of the year will continue on.

Brad Ness — Analyst, Choral Capital Management

Okay. So this is a better run rate to think about going forward.

David Taylor — President & Chief Executive Officer, VersaBank

We're hoping that Digital Boundary Group in itself will grow at, say, 20%, 30% in the upcoming year. And then there's all the cross-selling of the individual cybersecurity products that we talked about to cross sell to the existing customer base, so we're hoping for significant growth in the DRTC sub.

Brad Ness — Analyst, Choral Capital Management

Okay, great. Thanks. Regarding VCAD and the US digital currency, it sounds like the plan is to launch at the same time, the Canadian and the US. Is that correct?

David Taylor — President & Chief Executive Officer, VersaBank

That's right, but strictly in Canada for the time being in that that's our test market. And, as you know, we have VCAD and VUSD available on our wallets, actually on my phone and Shawn's phone, so we can transact business on Algorand presently, but we're waiting sort of patiently to, not so patiently (inaudible), to have the SOC 2 Audit completed, which we're expecting in the next couple of weeks, so with that completed a commercial launch early in 2022 is quite likely.

Brad Ness — Analyst, Choral Capital Management

Okay. And with that launch just in Canada, I mean I'm just trying to think about that relative to other stablecoins, USDC for one, you know, they're not bound by borders, how long—is that tough to do, to bound a stablecoin by borders? And two, how long do you think it will be bound and when you can just open it up to, you know, borderless?

David Taylor — President & Chief Executive Officer, VersaBank

It depends on the regulation in the United States. That's what we're keeping our eye on. And I'm sure USDC is keeping their eye on it too considering what the press has been talking about and concern. So we're keeping—from our perspective, it's not a technological issue. It's making sure that our coins comply with US regulation. Thinking ahead, it may very well be that we need a US subsidiary of VersaBank in order to provide a regulatory sort of platform for our USD and even VCAD.

Brad Ness — Analyst, Choral Capital Management

So could you envision a scenario where, say, if you don't have this clear guidance regarding US regulation, you could actually still have your stablecoin anywhere in the world but not in the US? So I mean there's still a big market in Europe, Asia, et cetera, that you could capitalize on while you're waiting for this regulatory guidance to clarify.

David Taylor — President & Chief Executive Officer, VersaBank

Yeah, that's certainly technically possible. We are as technically able to have our stablecoins throughout the world, just as all the rest are, it's just we, as a Schedule I federal bank, we pay close attention to the regulations. Our view is that we're unique in the world in that we're a bank issuing a Digital Deposit Receipt whereas the rest are not banks. And we believe the Bank Act gives us sort of unfettered power to do what we're doing, we just want to make sure that that's the same understanding that the US regulator would have. It appears they would. As I said, that's what a bank does. It issues deposits. And having the most highly encrypted deposits, I think, is a good thing for a bank as opposed to the others that are participating in this space that are not banks. And I think that's what's causing the regulators some concern, that the industry has grown so large without the normal regulatory scrutiny oversight that we banks have had since the beginning of banking.

Brad Ness — Analyst, Choral Capital Management

Right. And when you kind of think of the dynamic between waiting for this US regulation, which you know could take years, even though they say they want to do it quicker, versus just launching it in the United States, allowing the stablecoin for US residents, and just seeing what the consequences are thereafter, which it seems like that's normally, you know, like certainly in the sense of DeFi, what the industry has done, you know, moving full forward and we'll see what the regulation says afterwards, when you think of those two scenarios, how do you think about that?

David Taylor — President & Chief Executive Officer, VersaBank

Well, I think we banks will never do something like that. We're maybe a lot more cautious than the unregulated entities that are operating in that space. However, it appears to us that we are well within our rights to issue Digital Deposit Receipts in the United States as a federal bank; however, we don't have a federal bank subsidiary in the States yet. So I think that's the first step. But other than that, our read of the Bank Acts in Canada and in the States is that we are well within our rights to issue Digital Deposit Receipts. We don't see the other guys being (inaudible) and I think that's where the concern is coming from. I think they, I mean the pressure is, for them, is to get onside. From our point of view we are onside, but we don't have a US sub. And I think the step for us is to have a US sub. In Canada, we're already able to do it.

So that's what I'm saying basically, is that I don't see any impediments to a bank issuing what we're issuing, but to operate in various jurisdictions I think it's important to have a subsidiary in that jurisdiction where the regulators can take a hard look at it and understand it and regulate it, as they should. We banks take hard earned peoples' money and hopefully look after it very, very well for them and that's why we have regulators, so we're able to do that.

Brad Ness — Analyst, Choral Capital Management

Okay. Gotcha. Last question here, kind of on that same thing, so as I think about this stablecoin, you'll never have a charter in Asia probably, so should I think of this as never, you know, being borderless like other stablecoins, so it's more of a geographic stablecoin?

David Taylor — President & Chief Executive Officer, VersaBank

I think it depends on the jurisdiction itself. Some jurisdictions are not as particular, say, as the US, Canada, the UK, and European countries. Others are more, say, accepting that the bank is regulated by a prime regulator and they'll accept it. Others, I think, would like to see the subsidiary. The ones I mentioned probably would. I mean our coin could be throughout the world just as the others are. It comes with, I think, a comfort that it has been issued by a highly regulated real bank. And it carries an investment grade with it too, an A rating, which is a universal investment grade. So, as a bank, we're a little more careful, I think, than those that got into the space without needing to worry about regulation, at least at the early stage. I think they do now.

Brad, I hope that—

Brad Ness — Analyst, Choral Capital Management

Great. Thank you. Thank you. Someone else can ask some questions here. I appreciate it.

David Taylor — President & Chief Executive Officer, VersaBank

Okay, Brad. Good talking to you.

Operator

Thank you. And your next question comes from Charles Griege from Blue Lion. Please go ahead.

Charles Griege — Analyst, Blue Lion Capital

Good morning, guys. How are you?

David Taylor — President & Chief Executive Officer, VersaBank

We're good, Charles. We're here in the frozen north, but other than that we're okay.

Charles Griege — Analyst, Blue Lion Capital

The questions that Brad asked and the answers were very helpful. I just had a follow-up question on the expenses, just to get a better understanding of kind of how to think about run rate expenses. So if we could maybe just dig in a little bit, your insurance expenses increased meaningfully. What exactly drove that and what should we be thinking about as a sustainable level?

Shawn Clarke — Chief Financial Officer, VersaBank

Charles, insurance expense, obviously, with the Bank entering the US market through an IPO and a concurrent listing, so D&O insurance obviously took a little bit of a jump for us. That's probably the biggest component there. And so that's something that will be ongoing. We'll, of course, be doing everything we can to mitigate those amounts going forward, but at this point the D&O is the biggest lift in that portfolio.

Charles Griege — Analyst, Blue Lion Capital

Is that an expense that would be—is this the rough increase on a quarterly basis or…?

Shawn Clarke — Chief Financial Officer, VersaBank

So, to give you an idea from an (inaudible) perspective, so that's a prorated amount, obviously, Charles, for the last six weeks or so of the quarter. So it's about a tenfold increase year over year on an annual basis.

Charles Griege — Analyst, Blue Lion Capital

All right. And then when you go to professional fees and consulting services, those also increased pretty markedly. How should we think about that line item?

Shawn Clarke — Chief Financial Officer, VersaBank

As you know, Charles, obviously, with entering the US market, the audits are very comprehensive and we'll be exposed to those as we go forward, so those amounts, again, the lift that you would see, depending how you're modelling, would be consistent on a go-forward basis. (Inaudible) of course for the quarterly, but the annual amounts, of course, are a little bit higher with the comprehensive nature of the actual annual audit. So these are expenses that we will continue to incur going forward.

Charles Griege — Analyst, Blue Lion Capital

So that's a good run rate. Well, I guess we've got to prorate it for a full quarter.

Shawn Clarke — Chief Financial Officer, VersaBank

Correct. Correct, sir.

Charles Griege — Analyst, Blue Lion Capital

And then I guess more the one-time related expenses are in the other line item?

Shawn Clarke — Chief Financial Officer, VersaBank

(Inaudible)

Charles Griege — Analyst, Blue Lion Capital

(Inaudible) about $0.5 million?

Shawn Clarke — Chief Financial Officer, VersaBank

That’s right, sir. That’s exactly right, Charles, about $0.5 million.

Charles Griege — Analyst, Blue Lion Capital

Okay. All right, thank you very much. I’ll just jump back in queue.

Shawn Clarke — Chief Financial Officer, VersaBank

You’re welcome.

Operator

Thank you. And there are no further questions at this time. You may please proceed.

David Taylor — President & Chief Executive Officer, VersaBank

Well, I'd like to thank everyone for joining us today and I look forward to speaking to you at the time of our Q1 results. Thank you, everybody.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you very much for participating and ask that you please disconnect your lines.