FINAL TRANSCRIPT

VersaBank

Fourth Quarter & Year End Fiscal 2022 Financial Results

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to VersaBank's Fourth Quarter and Year End Fiscal 2022 Financial Results Conference Call. This morning, VersaBank issued a news release reporting its financial results for the fourth quarter and fiscal year ended October 31. 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 this morning's conference call. 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 like to remind all 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 call over to David Taylor, President and Chief Executive Officer of VersaBank. Please go ahead, Mr. Taylor.

David Taylor — President & Chief Executive Officer, VersaBank

Good morning, everyone, and thank you for joining us for today's call. With me is Shawn Clarke, our Chief Financial Officer.

Before I begin, I'd like to remind you that our financial results are reported and will be discussed in this call in our reporting currency of Canadian dollars. For those interested, we provide US dollar translations for most of our financial numbers in our standard investor presentation, which will be updated and available on our website shortly.

On to our results. A record fourth quarter across each of our key performance metrics capped off a record year for VersaBank. In our digital banking operations, continued strong year-over-year growth in our point-of-sale loan and lease portfolio drove our loan portfolio to an all-time high of just under $3 billion. That was up 42% as we maintained our overall net interest margin without trading or taking any additional credit risk. This drove record revenue, record net interest income, record net income save for one outsized quarter in 2017 due to a large tax recovery. Additionally, the cybersecurity services component of DRTC had a strong fourth quarter and remains profitable. Importantly, we achieved net income despite the significant transitory expenses incurred during the year on our account of strategic growth initiatives, the returns of which we expect to begin to realize in fiscal 2023. All of this positions VersaBank for continued growth in 2023, comfortable in the knowledge that our bank has a track record of performing even a little better during economic slowdowns. I'll discuss this more in a few minutes.

Looking more closely at our performance, the fourth quarter was highlighted by the highest ever levels of revenue, net interest income, and net income, even with the dampening effect on our bottom line of the transitory investments and multiple strategic growth initiatives we made throughout the year. Combined, these investments totalled $1.8 million, the vast majority of which will run off during the current quarter. As Shawn will discuss, we've also experienced a temporary elevated provision for taxes in Q4, which further dampened our net income by $1.1 million and which we expect to reduce early in fiscal 2023. Fourth quarter performance was driven mainly by continued outsized growth in the Canadian point-of-sale financing business, which increased 11% sequentially to the end of the year and 74% higher than fiscal 2021. Again I will note that we achieved this growth with essentially no impact on net interest margin and without relaxing our stringent credit policy. Similarly, for the full fiscal year, the outsized growth in our Canadian point-of-sale drove record revenue, net interest income, and net income and, like the fourth quarter record net income, was dampened by expenses related to the transitory strategic investments, which for the year totalled $5.2 million. As well, the $1.1 million elevated tax in Q4. Again, these investments will substantially dissipate throughout Q1 of fiscal 2023 and our tax provision will reduce early in 2023.

I'd like to provide a quick update on our planned acquisition of Minnesota-based Stearns Bank Holdingford, a fully operational, OCC-chartered, national US bank. As I discussed on our last quarterly call, this acquisition is transformational, next step in VersaBank's long-term growth strategy that will enable us to bring our track record of innovative digital banking solutions to address unmet needs to one of the world's largest banking markets. Specifically, this acquisition will enable us to broadly roll out our receivable purchase program in the underserved US market, which has been so successful in Canada, where we call it our point-of-sale financing business. Although the process has taken a little longer than initially thought, I'm pleased to report that earlier this morning we submitted the requisite filing to the OCC and the Federal Reserve seeking approval of this acquisition. With these filings complete, we can now move ahead with our application to our Canadian regulators. I'm also pleased to announce that Tom Ridge, former governor of Pennsylvania and inaugural Secretary of the US Office of Homeland Security, has agreed to become Chair of our new US subsidiary, VersaBank USA. We are targeting to close this acquisition early in calendar 2023.

On the topic of US receivable purchase program, our first partner, a large North American commercial transportation financing business focused on independent owner-operators, have continued to expand their business with us, with loans now nearly $50 million. That number would've been even higher; however, we are somewhat constrained in this limited early rollout ahead of completing the US bank acquisition. Recently we added a second partner, the retail finance division of a $40-plus billion US-based financial services company, and expect to begin taking on loans shortly. And we continue to be very encouraged by our discussions we're having with other potential partners in the United States. They are repeatedly confirming our belief that we are a valuable alternative for point-of-sale financing in this $1.8 billion and growing US market.

And finally, before I turn over the call to Shawn, an update on our revolutionary digital deposit receipts. As I discussed last quarter, there have been tremendous amount of turmoil in the sector and heightened regulatory awareness and scrutiny, which has been further exacerbated by FTX debacle. The downside of this, of course, is that it has negative repercussions very broadly in our industry. The upside, at least for us, is that all of these events further underscore the importance of regulation and our belief that we share with some of our regulatory pundits that licensed banks are the right entities to be issuing digital currencies.

With the rapid evolution of the market and the regulatory environment, we made a decision to substantially change our model such that our DDR accounts, our digital deposit receipt accounts, which are essentially e-wallets, are hosted by VersaBank as opposed to being hosted by an external third party. We are now able to do this through the addition of our "Viewer" software, a tool developed exclusively for our bank. To prove out the new model, in November we initiated an initial pilot program for the new offering, which we are calling CADV. The pilot is restricted to VersaBank's directors, executives, all of whom reside in Canada. With this progression to a new model, we'll further extend our time to launch.

Our DDR program is, as it always has been, a long-term opportunity to grow low-cost deposits. We still have access to abundant low-cost deposits to fuel our growth in Canada. In fact, I will discuss in a moment we expect to return to robust growth in our bankruptcy deposit channel resulting from the challenging and potentially more challenging economic environment. Finally I will note that we continue to see some digital currency offerings trickle out here and there and each and every time we do we're even more confident with respect to the significant competitive advantages that our offering brings.

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

Shawn Clarke — Chief Financial Officer, VersaBank

Thank you, David, and good morning, everyone. Before I begin, just a quick reminder that our full financial statements and MD&A for the fourth quarter and full fiscal 2022 year are available on our website under the investor relations section as well as on SEDAR and on EDGAR. And, as David mentioned, all the following numbers are reported in Canadian dollars, as per our financial statements, unless otherwise noted.

Starting with our balance sheet, total assets at the end of the fourth quarter crossed the $3.3 billion mark, up 35% from $2.4 billion at the end of Q4 of last year and up 6% from $3.1 billion at the end of the third quarter of this year. Cash and securities at the end of Q4 were at $230 million, or 7% of total assets, down from $272 million or 11% of total assets at the end of Q4 of last year and up from $218 million or 7% of total assets at the end of Q3 of this year. The year-over-year decrease was the result of the Bank deploying cash into higher yielding lending assets and low risk securities over the course of the quarter. Our total loan portfolio at the end of the fourth quarter expanded to another record balance of $2.99 billion, an increase of 42% year over year and 6% sequentially. I'll break this out into its component parts in a moment. Book value per share increase 7% year over year and 2% sequentially to another record at $12.37. These increases were both a function of high retained earnings resulting from net income growth, partially offset by dividends paid, while the year-over-year increase was also impacted by our common share offering in the US last September. Our CET1 ratio was 12%, down from 15.2% at the end of Q4 of last year and down from 12.51% at the end of Q3 of this year, while our leverage ratio at the end of Q4 was 9.8%, down from 12.6% at the same point last year and 10.38% at the end of Q3 of this year. Both our CET1 and leverage ratios remain comfortably above our internal regulatory ratio targets.

Turning to the income statement, total consolidated revenue increased 33% year over year at 14% sequentially to a record $24.3 million with the increase being driven primarily by higher net interest income derived from our digital banking operations resulting from the strong growth in our loan portfolio that was discussed earlier. Consolidated net income for Q4 increased 9% year over year and 12% sequentially to a record $6.4 million, with the exception of Q1 2017, during which we recorded a one-time tax recovery resulting from the amalgamation of the Bank and PWC Capital in that same period. Net income for Q4 was reduced by transitory costs totalling $1.8 million, as David mentioned earlier, including the period related to our investments in several strategic growth initiatives, including the US bank acquisition, the launch of the US version of our point-of-sale offering, our receivable purchase program, and preparation for the launch of our digital deposit receipts. We expect these investments to begin to contribute to profitability over the course of fiscal 2023. Net income was also reduced by $1.1 million in incremental tax provisions, which we also expect will reduce in fiscal 2023.

Consolidated earnings per share decreased 4% year over year to $0.23 with the decrease due primarily to the impact of the issuance of 6.3 million common shares concurrent with the Bank's listing on the Nasdaq in September of last year. On a sequential basis, however, consolidated EPS was up 15%. For context, the impact of the transitory strategic investments and higher income tax on our 2022 EPS metric was $0.06 per share and $0.04 per share, respectively.

A primary driver of growth in our loan portfolio was once again our point-of-sale financing business, which increased 74% year over year and 11% sequentially, surpassing the $2.2 billion mark. This growth continued to be driven primarily by strong demand for home finance, home improvement, HVAC, and auto receivable financing. Our point-of-sale portfolio continues to expand as a proportion of the overall portfolio as per our strategy, representing now 75% of our total loan portfolio as at the end of the fourth quarter, up from 71% at the end of the third quarter.

Our commercial real estate portfolio decreased 7% year over year and 6% sequentially to $759 million at the end of the fourth quarter. As we now have noted for several quarters, management has taken a more cautionary stance in respect to the commercial real estate portfolio due to expected volatility in the valuations within this asset class in a rising interest rate environment as well as concerns related to higher construction costs resulting from supplies chain disruptions and a very tight labour market. That said, we remain very comfortable with the risk profile of our commercial real estate portfolio based on our criteria of working only with well-established, well-capitalized development partners with excellent track records and restricting transactions to modest loan-to-value ratios.

Turning to the income statement for our digital banking operations, net interest margin on loans, that is excluding cash and securities and other assets, decreased 28 basis points or 8% year over year and four basis points or 1% sequentially to 3.03%, due primarily to a shift in the Bank's funding mix and rising interest rates over the respective periods as well as the successful execution of our strategy to grow our POS financing portfolio. These factors were partially offset by generally higher yields earned on our lending portfolio during the period, also as a function of rising interest rates. Net interest margin for the quarter, which includes the impact of cash, securities and other assets, increased eight basis points or 3% year over year and five basis points or 2% sequentially to 2.81%.

Non-interest expenses for the quarter were $13.8 million compared to $10.4 million for the same period last year and $13.2 million for Q3 of this year. The year-over-year and quarter-over-quarter increases were substantively due to transitory costs related to the strategic growth investments I described earlier. Investments associated with the acquisition and integration of the operation of the US bank are anticipated to be realized substantially by the end of the first quarter of 2023. The year-over-year and quarter-over-quarter increases were also impacted by higher salary and benefits costs due to increased staffing levels to support expanded revenue-generating business activity across the Bank, as well as higher cost associated with employee retention in this very tight labour market.

Cost of funds for the fourth quarter was 2.45%, up 114 basis points year over year and up 51 basis points sequentially, due primarily to our funding mix being comprised of a larger proportion of wealth management deposits relative to our lower-cost insolvency professional deposits and the impact, of course, of rising interest rates. Insolvency professional deposit balances contracted slightly in Q4 compared to a year ago despite adding more partners and as we continue to experience historically low bankruptcy activity, which remains well below pre-pandemic levels. During the same period, our wealth management deposits grew 65%. Looking ahead to 2023, we do expect insolvency deposits to grow moderately throughout the year as a function of an increase in the volume of consumer bankruptcy and proposed restructuring proceedings amidst the challenging current and forecasted economic environment.

Our provision for credit losses, or PCLs, in Q4 was again demonstrative of prudent risk mitigation strategies inherent in our lending and credit risk management processes as well as the outstanding credit quality of our current loan portfolio. PCLs in the current quarter were $205,000 compared with a recovery of credit losses (inaudible) $279,000 for the same period last year and a PCL of $166,000 for Q3 of this year. The recovery recorded last year was attributable primarily to changes in the Bank's lending asset portfolio mix and changes in the forward-looking information used in the Bank's credit risk models, offset partially by higher lending balances. The sequential change this year was a function primarily of higher lending asset balances and changes in the forward-looking information that we use in our credit risk models, offset partially by changes in the Bank's lending asset mix. Our PCL ratio remains one of the lowest in the Canadian banking industry at an average of 0% over the past 12 quarters and, as David will discuss in a moment, this superior risk profile is expected to serve us well should an economic downturn materialize over the course of 2023. Gross impaired loan balances at October 31, 2022 were $0.3 million, all of which were repaid on November 1, 2022, compared to $1.4 million last quarter and nil a year ago.

Turning now to DRTC sales, which are generated almost exclusively through our cybersecurity services business, Digital Boundary Group, increased 33% sequentially, decreased 8% year over year to $2.8 million, due primarily to the timing of service engagements in those respective periods. Gross profit, however, increased 48% sequentially and decreased 19% year over year to $1.7 million. The sequential increases were driven primarily by higher pricing charged on services as well as meaningful improvements in DBG's operational efficiency. DRT generated a net loss of $0.5 million in the current quarter compared with a net income of $0.5 million in Q4 of last year and a net loss of $0.7 million in Q3 of this year, attributable to higher gross profits from DBG being partially offset by higher salary and benefits expense associated with employee retention in a highly competitive labour market. I will note here that the net loss for DRTC includes costs associated with strategic technology development investments for our digital banking operations. The operations of DBG on a standalone basis continue to be profitable.

Finally, before I turn the call back to David, in August we received approval from the TSX to undertake a normal course issuer bid for up to 1.7 million common shares, or just over 9.5% of our public float at the time of application, and further in September we received approval from the Nasdaq to proceed with an NCIB on that exchange as well. As of October 31st of this year, we have repurchased in aggregate 195,300 shares under the NCIB program.

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.

We enter 2023 with considerable momentum and confidence in our ability to continue to generate strong growth in our loan portfolio that is in line with pre-2022 levels. We begin the year with nearly $3 billion in loans in our Canadian digital banking operations and annual revenue run rate of nearly $100 million. At the same time, both Shawn and I discussed we expect our non-interest expenses to decline meaningfully as the expenses associated with the acquisition of the US bank and the setup of our receivable purchase program in the United States come to an end. We expect that that will contribute to profitability margins on revenue that are in line with those prior to making these investments.

To be clear, this is just the starting point for fiscal 2023. Despite forecasts for moderation in consumer spending, we expect to generate continued strong growth in our Canadian point-of-sale business. While we expect it would be tough to repeat the 74% year over year growth that we saw in 2022, we do expect business with existing partners to expand and to add additional partners, which should contribute to growth of this portfolio, in line with the very healthy pre 2022 levels. We also expect the investments we made in 2022 will provide meaningful additional upside to growth. We continue to be very encouraged by the limited launch of our receivable purchase program in the US, confirming both the value proposition of the offering and the market opportunity, as we continue to plan for a broad launch upon completion of our US bank acquisition.

We expect to see strong profitable growth in revenue and gross profits in our cybersecurity business, as both DBG continues to expand its business activities with existing clients while adding new clients. As it grows, we expect our cybersecurity business to be increasingly accretive to the Bank's overall earnings.

On the deposit side, we expect our low cost insolvency deposits to return to growth, expanding throughout fiscal 2023, as a function of an increase in the volume of consumer bankruptcy over the same timeframe, attributable primarily to the more challenging economic environment. We also expect to continue to expand our diverse broker network, which we source through personal wealth management deposits, mainly GICs, and expand our business with existing partners. Recent data from one of our major banking partners is bearing this out.

Finally and very importantly, as I noted earlier, VersaBank was designed specifically to perform well in any economic environment and, as I noted earlier, the Bank has a track record of performing even a little better in economic downturns. As our banking peers are hunkering down for difficult times, our low-risk model enables us to capitalize on opportunities that might not have otherwise been available to us.

With that, I would now like to open the call to questions. Operator?

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

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

Greg MacDonald — Analyst, LodeRock Research

Thanks. Good morning, Shawn. Good morning, David. How are you guys?

David Taylor — President & Chief Executive Officer, VersaBank

Good, Greg. We're here in foggy London, Ontario today.

Greg MacDonald — Analyst, LodeRock Research

Listen, I wanted to ask, there's been a lot of discussion on net interest margins this quarter with earnings season. You made reference a little bit to it, David. I know that the mix of this bank's a little different than what most banks in Canada have. Can you talk about a couple of things? One is, you make reference to the deposit mix, specifically bankruptcy deposits, and we haven't really seen a whole lot of traction on that. Maybe that's been surprising to some. Can you give us a sense of what you see in 2023 from that perspective? And then I have a second question on loan growth. The loan growth expectation on point-of-sale, I think it's not a surprise to anyone. Is there anything that you're seeing in the mix within point-of-sale that you can comment on or is that mix still relatively similar to what the growth in 2022 was? Thanks.

David Taylor — President & Chief Executive Officer, VersaBank

Sure. Good questions, Greg. With respect to our deposit mix, yes, the deposits we received from the insolvency industry are even a little lower than the previous year and I think that is the result, well I know that's the result of the various support payments that our government made to help Canadians that were suffering with the pandemic. So we're coming off a 35-year low of insolvencies and there's a bit of a lag effect from that turning into deposits when the insolvencies increase. So I expect that now, of course, the support payments have ended and interest rates are going up and it's becoming a more challenging environment particularly for consumers and small businesses that, unfortunately, we'll see a lot more insolvencies in Canada. It will get back to sort of normal levels, maybe even exceed that. And that does bode well for us. It means that insolvency deposits will start growing again and could very well get well to the $1 billion mark. They're at $600 million right now, coming off of 35-year lows. So the mix should, throughout 2023, increase in percentage to insolvency deposits.

Now with respect to loan growth, we're not really seeing much of a reduction in our point-of-sale growth presently, although I do expect the higher interest rates will dampen loan growth into 2023. The mix is primary, well, not primarily, about two thirds has been in home improvement and home-type financing. And we love that business and it represents a low-risk segment of the market. In 2023, slightly a little more emphasis on the home improvement side than there has been, but it is already a big business for us and, of course, we welcome it in that it's the lower risk segments of the point-of-sale market.

Greg MacDonald — Analyst, LodeRock Research

And then with respect to the US market, this is an opportunity to grow in point-of-sale as well. I suspect the mix is a little bit different in the US, but any general comments on what you're seeing in trends in the US market so far with respect to growth opportunities in that segment?

David Taylor — President & Chief Executive Officer, VersaBank

Well, there seems to be a tremendous growth opportunity. I guess a huge market. I think one figure we have is $1.8 trillion as opposed to Canada, maybe (inaudible) to that, 5% of that maybe. So, a huge growth from size. And any one of the industries that we finance in Canada, we'd be happy to do in the States it just, by chance, the first customer we got was a large tractor trailer financing company. And coincidentally, that was the very first customer we got in Canada too. Not the same company, but the same industry. It was a tractor trailer financing. So, I don't really have a good sort of visibility on what segments we'll grow most rapidly in, it's just the market is so big and our product seems to be so attractive to these point-of-sale finance companies that, once we've got our US bank, we expect really big growth in the States.

Greg MacDonald — Analyst, LodeRock Research

Okay. Thanks for that. And then just a final one for me and then I'll pass it on, with respect to timing on bankruptcy deposit growth. Thank you for the reference point of $1 billion. Are you getting any indications from the trustees that you deal with in that side of things on timing? Is this something that you expect happening in the first half of the year or, as I suspect, more so in the second half of the year?

David Taylor — President & Chief Executive Officer, VersaBank

Well, we're all seeing the cracks in the economy right now. The trustees are seeing increased volume already. Other banks are reporting larger provisions for losses. Their arrears rates are going up. So it's just what you'd expect. We're seeing the leading indicators. And so I would say second half of 2023 it'll be growing like, unfortunately for Canadians, it'll be growing like gangbusters. These deposits start pouring in the door as (inaudible) are being wound up. So, towards the end of middle, say, 2023 you probably start seeing the type of growth we used to experience in this area.

Greg MacDonald — Analyst, LodeRock Research

Okay. Thanks very much for answering the questions. I'll pass it on. Thanks.

David Taylor — President & Chief Executive Officer, VersaBank

Thank you, Greg.

Operator

Thank you. Ladies and gentlemen, as a reminder, should you have a question, please press the star followed by the number one.

Your next question comes from Stephen Ranzini from University Bank. Please go ahead.

Stephen Ranzini — Analyst, University Bank

Good morning, David. Thank you for a great quarter. I've got several questions, but I'm just going to ask two and then go back in the queue. The last time we talked you were thinking that you would have approval for your digital dollar project by the end of October. Obviously, that deadline's come and gone. What are your current thoughts on that? And secondly, have you ever given any thought to off-balance sheet structures to hold some of your loans to be more capital efficient and drive a higher ROE for the Bank?

David Taylor — President & Chief Executive Officer, VersaBank

Well, Stephen, thanks for logging in and I wonder if you have just seen the fog and rainy weather that's just gone through London here. I imagine you saw just a bit earlier than we did where you're located.

Stephen Ranzini — Analyst, University Bank

Yeah, it's pretty gray here in Ann Arbor.

David Taylor — President & Chief Executive Officer, VersaBank

So, what happened with the digital deposit receipt is the model that we had worked on, we called VCAD, that used a third party to hold the wallet, didn't seem to sit well with the various regulators that we were discussing it with. So we pivoted over to a different model, but using all the same technology where we would host and we are hosting right now the wallets ourselves and hence the name change to

CADV. We think this is the model that will have legs and, frankly, I wouldn't be surprised every other bank will want it too, in that it has a lot of advantages over the original one. For one thing, the data for the deposits are maintained both on the Stellar blockchain and also in our tried and true what we call deposit management system, DMS.

So, to alleviate sort regulatory fears, say something should happen to a blockchain, which I really, really doubt that would ever happen, but if it were, the data is maintained simultaneously on our existing deposit system. So, sort of in reaction to feedback we got from various regulators, and what we noticed happening in the world, we pivoted over to this, what we think is the best of, ah, the best that's out there, where a bank itself is the host of the wallet and the digital deposit receipt isn't really a token, it represents a real deposit with a real bank that goes through all the normal AML procedures and all that. But it did take time. It is fully functional now amongst our directors and our employees, but we'll tactically wait to lift the curtain up to make it available to our other depositors.

So, with respect to utilizing off-balance sheet techniques to fund our loans, presently we have a lot of capital, so we're just using our own capital to fund the loans and leases as we're generating them. As time progresses though, we are contemplating portfolioing these assets so that they would be readily available for sale, for two reasons. One, increases the Bank's liquidity and the other one, as you say, it improves the Bank's return on common equity.

Stephen Ranzini — Analyst, University Bank

Okay, great. I've got two more questions, but I'll go back in the queue and we'll see if we get back to me. Thanks.

Operator

Thank you. Your next question comes from Brad Ness from Choral Capital. Please go ahead.

Brad Ness — Analyst, Choral Capital Management

Hello, gentlemen. How are you doing?

David Taylor — President & Chief Executive Officer, VersaBank

Very good, Brad.

Brad Ness — Analyst, Choral Capital Management

Good. Hey, on the effective tax rate, that $1.1 million in additional taxes for the quarter, what was that specifically related to and are we going to go back to that 27% effective tax rate, say, going forward?

David Taylor — President & Chief Executive Officer, VersaBank

I think that's a good question for our CFO, who's been on the line waiting for a good question to answer. So, Shawn, I'll leave that one to you.

Shawn Clarke — Chief Financial Officer, VersaBank

Thank you, David. I hope I'm off mute here, folks. Good morning, Brad. The tax rate there we're seeing is a function of kind of three core variables, Brad, that we're pointing to. And we do expect this to diminish over the course of 2023. We don't think we'll get back to our statutory rate at 27%, but we do think we'll be south of 30% as the various elements are rationalized over the course of the year. They're comprised primarily of non-deductible expenses associated with our stock options, Brad, as well as some non-deductible losses. We think this is going to be one that we'll be able to utilize early in the coming year. As well as the, ah, you're probably familiar with, we had a (inaudible) tax here in Canada which we'll pay and it's a function of the foreign exchange gains realized over the last, particularly over the last quarter on our current US lending operations through VersaFinance. So, those three elements, there were some miscellaneous items underneath that, but those three items contributed to about 90% of the increase that we noted in our public disclosure.

Brad Ness — Analyst, Choral Capital Management

Okay, great. I've got several more here, if you guys have time. Nowadays, what type of rates are you getting on your point-of-sale loan financing and what's the incremental cost to fund those?

David Taylor — President & Chief Executive Officer, VersaBank

Well, the rates are running in Canada about 2.5% over the same term Government of Canada bond. So, say the Government of Canada bond is, say, 4%, we're up at least 6.5%, 7% is the yield on the point-of-sale in Canada. In the United States you add about a 1% to that on the net interest margin.

With respect to incremental costs, there may be a little bit of hiring necessary to take on the US market, but not very much in relation to the scale of the operation. It's very, very scalable and, for the most part, all the operations will be handled at the tech center, which I'm sitting in today in London. So there's no need to duplicate what we have here in London to take on the US market. So, marginal increases, tiny increases maybe in a few staff members to take on the US market, but other than that the systems are capable of many times the volume that they're presently dealing with.

Brad Ness — Analyst, Choral Capital Management

Okay, great. If I heard that correct, in the Canadian market you're getting 250 basis points over treasuries and in the US market you're getting 350 basis points over treasuries for this point-of-sale product?

David Taylor — President & Chief Executive Officer, VersaBank

That'd be about right. Yeah, it's about 1% better than we get in Canada, roughly speaking, those numbers.

Brad Ness — Analyst, Choral Capital Management

Okay, great. And can you update me on kind of the timing of the CADV rollout as you kind of see things play out next year?

David Taylor — President & Chief Executive Officer, VersaBank

Well, I think sort of early in 2023 we'll be in a position to take CADV to the open market, but that all depends on the regulator's perception. And right now, thanks to a certain fellow in the Bahamas who created a whole lot of nervousness in this area, even though, of course, our digital deposit receipt is an entirely different animal than what was being promoted out of Bahamas. I mean technically we'd be ready to go first part of 2023, but we are cognizant of the caution and concern that various regulators have about this use of a blockchain. And that's about the only similarity. We're simply using Stellar to account for our actual deposits with our bank. So, not a whole lot of similarity to all the things that have gone wrong, or even what the so-called stablecoins where they've placed deposits with another financial institution as collateral for their coin. Ours represents a real deposit with a real bank and, in fact, the data is duplicated, as I was saying earlier, on our own DMS deposit system and on Stellar so that, in effect, our depositor has the ability to use Versa "View", our view software or view app, and look at their deposit, just like they would with any other bank using an internet app, but you can look at it on Stellar. The bonus is, of course, should you choose to move your digital deposit receipt from your wallet to somebody else's wallet, say to effect a payment, you can do it. So what we've in effect done is turned an old school bank account into the most modern type of checking account where our CADV's become cheques, certified cheques in fact, because they're drawn on our bank, and moved to somebody else's e-wallet, say Amazon's e-wallet, to effect a payment. When I say that, some folks say, but there are already (inaudible) that do that, David, there's already ways of doing payments, but nowhere near as efficiently, nowhere near as cost effective. The transaction's on Stellar in the order of fractions of cents and takes place instantaneously anywhere in the world versus if you try to move money even from Canada to United States you might be waiting three days and be charged a hefty fee for that.

We think it's a fantastic revolutionary adaption of blockchain technology and we're hoping that our regulators, and this is all throughout the world, will understand what we're doing and endorse it. It's about as low risk as you can imagine. As a bank, we pay attention to all the things that others don't seem to have paid attention to, like say anti-money laundering and anti-terrorist financing to not be the least. Anyway, Brad, we're keenly excited about putting it out in Canada and hopefully our regulators, in the new year, after we've had some good solid interaction with them, will endorse it too.

Brad Ness — Analyst, Choral Capital Management

Great, thanks. A couple more here. On Digital Boundary Group, you had a strong revenue increase in the quarter of $1.8 million. Is that sustainable or is that an anomaly or a seasonal boost in revenue or do you think that's more reoccurring?

David Taylor — President & Chief Executive Officer, VersaBank

I think that's more reoccurring in that we've received a large contract with one of the largest corporations in Canada to do app testing. And it's very profitable. It's a specialized type work that DBG is doing for this large corporate. And the only constraint really is finding enough app testers. So we're actively trying to hire as many as we can to bolster that business. So, yeah, we're excited. DBG, I think, round numbers, was $10 million in revenue, $5.86 million in gross profit. That should just keep going up at the same trajectory. App testing, like I say, is a wonderful business for us, and all the other products we have in DBG, such as sophisticated penetration testing, there's always an increasing demand for it.

Brad Ness — Analyst, Choral Capital Management

Absolutely. You said $10 million in revenue. I'm showing $5.7 million for the year. What is that $10? Is that expectations?

David Taylor — President & Chief Executive Officer, VersaBank

No, we show a gross profit on our statements and total revenue, Shawn's on the line, I think it was $9.8 million for the year, Shawn, total revenue?

Shawn Clarke — Chief Financial Officer, VersaBank

That's right, David. Brad, you're right, you're looking at gross profit of $5.7 million as published and David's talking about revenue, top-line revenue over sales.

Brad Ness — Analyst, Choral Capital Management

Oh, so it's in the income statement. When I see non-interest income of $1.8 million, that's not revenue? You said that's net?

Shawn Clarke — Chief Financial Officer, VersaBank

On the quarter, Brad, you're right, $1.8 million, and that's gross profit at DBG. And the challenge there is integrating that with the bank statement, so it's the most intuitive way we can merge the two income streams to have it somewhat sort of align with how the bank's statements are structured. So, you're right. What you're looking at is gross profit.

Brad Ness — Analyst, Choral Capital Management

Okay. So, Shawn, what was revenue for the quarter?

David Taylor — President & Chief Executive Officer, VersaBank

(Inaudible)

Shawn Clarke — Chief Financial Officer, VersaBank

Yeah.

David Taylor — President & Chief Executive Officer, VersaBank

We published the total (inaudible)…

Brad Ness — Analyst, Choral Capital Management

Okay. So, you're saying core revenue of Digital Boundary Group was $3 million and the $1.8 million you report in the income statement is the lower gross profit part of that?

Shawn Clarke — Chief Financial Officer, VersaBank

That's right. About $2.8 million on the quarter, Brad, for sales, and then $1.8 million as you meant for gross margin. Or gross profit. My apologies.

Brad Ness — Analyst, Choral Capital Management

Okay. And if that's something you could present going forward, that would definitely be helpful, so I can differentiate that. But let's see. Lastly here, when I add back that $1.8 million and $1.1 million, roughly $0.10 a share, it comes up to 1.1 ROA, 11% ROE kind of on a core basis, so I imagine that's a good starting place as I think about profitability next year, early next year. How much leverage should I think you have in this model? If you continue to grow 20%-plus, do you get to 15% ROE? I know you do eventually, but what's the timing of something like that?

David Taylor — President & Chief Executive Officer, VersaBank

Well, we do get to 15%. That's the number we use in our planning. And a good question is on the timing. Presently, the point-of-sale business in Canada is still growing rapidly, which is quite surprising to me in that it's driven by the actual cost per month of the item that the person's purchasing and interest rates, of course, have a huge bearing on that. So you would think it would dampen down, but presently it's still growing rapidly in Canada, like I was saying earlier, not to the extent of the year we just completed, 70%-odd growth. In the States, the model looks really attractive from the real-life customers we've been dealing with and pitching to. So the major constraint to get into that 15% ROE is how long it takes us to be granted the acquisition of the Holdingford bank. That's what's holding us back in the United States. We created a sort of interim company we call VersaFinance to hold these assets, and it's quite cumbersome, so we've actually been backing off until we've got that US license. So that's the gating item on rapid growth and a huge improvement in ROE. Now, after saying that, as you noted, we end the year at a run rate of about $100 million in revenue and fixed costs are, Shawn would know better than I, but without any extraneous items they're probably running around $55 million. We're already starting to… Is that the number you would have, Shawn?

Shawn Clarke — Chief Financial Officer, VersaBank

Yes, sir.

David Taylor — President & Chief Executive Officer, VersaBank

Yeah, so we're already starting the year with a $45 million pre tax. If we did nothing else, I mean if we didn't grow a bit, and we are growing rapidly still in the Canadian market, so we really are heading into 2023 with a full head of steam. And then if it turns out that the bankruptcies increase, as they seem to be already, well that helps our margin too, because what we pay on what are really operating accounts is a lot less than we pay on GICs.

So, you know, I hate to be so optimistic when all my colleagues are looking at their boots and weeping at times, but, as I was saying earlier, our little bank is designed for this type of economy and it's looking really good. You didn't hear us complaining about loan losses or cracks in the portfolio or any of those things. In fact, the only loan we had in arrears paid off the next day, and that's just a crazy anomaly in accounting that you show a loan impaired for one day, the next day it pays off. So, we're going into the market with a really solid portfolio, a full head of steam of existing loans and customers growing, and if the recession kicks in, as everybody thinks it does, that just means an abundance of economical price deposits for us.

Brad Ness — Analyst, Choral Capital Management

Got it. Thank you, gentlemen, and happy holidays.

David Taylor — President & Chief Executive Officer, VersaBank

Same to you, Brad. Hope to come and see you again sometime in the winter months. I might be spending a little time in my place in Florida, so it won't be too short a ride to go up to where you are.

Brad Ness — Analyst, Choral Capital Management

Sounds good. Just let me know.

David Taylor — President & Chief Executive Officer, VersaBank

Absolutely.

Operator

Thank you. Your next question comes from Stephen Ranzini from University Bank. Please go ahead.

Stephen Ranzini — Analyst, University Bank

Hey, guys. Thanks for having the chance to ask my last two questions. So I noticed in your financials that your average price per share on the buybacks that you did was C$9.88, right, which is actually higher than the current price, and I noticed that during the year you granted just under a million shares of options at C$15.90. I guess my question to you is, with the stock currently trading at $0.77 on the dollar of book value, why not get a little more aggressive than just buying 195,300 shares to at least offset the stock option dilution?

David Taylor — President & Chief Executive Officer, VersaBank

Well, good question, Stephen, and the answer is it took quite a while to take the normal course issuer bid into the United States. And it wasn't anything other than just paperwork and regulatory approvals required. It now is in place. Raymond James is out printing it for us. They've of course been blacked out, like we all are, but after the blackout you'll see RJ in there. And we've got about 1.5 million shares left that we can buy and, as you say, it's a fantastic price. We might be able to buy them at 77% of book. So we'll be looking to pick up as much as we can.

Stephen Ranzini — Analyst, University Bank

Awesome. And then my last question is on net interest margin and changes in interest rates, right? So, in the short run, the impact for a bank like VersaBank is not fully reflective of what the longer-term impacts are of a shift in interest rates, as you know. So I noticed that sequentially you had, I think it was a five basis point rise in your net interest margin, right, I would assume that, over a year since the bank of Canada rate rose 3.5% so far, that there's a bigger impact as assets continue to re-price. Can you quantify in dollars, for every 1% rise in rates, what the immediate impact is and then what's the, you know, one year impact is on net interest margin?

David Taylor — President & Chief Executive Officer, VersaBank

Well, short answer is that there's hardly any impact on us on a rising interest rate environment in that we're so precisely matched. We only run about 1.4 years asset duration and about the same in liabilities. So, we move very, very precisely with the interest rate environment by design; however, we do make out much better on the cash that we're holding for liquidity purposes. So that's why you would see the margin on our loans being pretty well the same, maybe decline even a tiny bit, the margins on the loans, but the actual overall net interest margin of the Bank improved to 2.81, which in Canada that would be by far the highest net interest margin of any bank. All of them are posting declines. So there will be, as rates continue to climb, and I expect they will a little bit more in Canada, there's a positive impact on our profit and loss, our net interest margin, in that we earn more on our liquid securities.

Stephen Ranzini — Analyst, University Bank

Okay. Thanks so much and, again, great work on a good quarter. Thank you.

David Taylor — President & Chief Executive Officer, VersaBank

Well, thank you, Stephen. We look forward to getting together in person one of these days. You're not that far away.

Stephen Ranzini — Analyst, University Bank

Thank you. I can actually come to Canada now.

David Taylor — President & Chief Executive Officer, VersaBank

Yes, yes, and we can go there. We can cross the border too it seems. I crossed at the Blue Water Bridge not long ago and got a nice welcome. I don't think it's that many customers coming in right now, so I was well received.

Stephen Ranzini — Analyst, University Bank

No, the tourism business is way down.

David Taylor — President & Chief Executive Officer, VersaBank

Yeah. Well, we'll get back. It'll get back. Look forward to seeing you, Stephen. We'll have to have a nice lunch.

Stephen Ranzini — Analyst, University Bank

Yes, thank you. Look forward to it.

Operator

Thank you. Mr. Taylor, There are no further questions. You can go ahead.

David Taylor — President & Chief Executive Officer, VersaBank

Well, I'd like to thank everyone for joining us today and I look forward to speaking with you at the time of our first quarter fiscal release. Obviously, we're a very excited team of bankers here at VersaBank as opposed to maybe our colleagues in our industry in that we designed our bank, as we've sort of talked about in a little more detail on this call, we've designed our bank to take advantage of what for other bankers are challenges, for us it tends to be an opportunity. And that was demonstrated I think quite readily in how fast we recovered to have a record year in 2022, particularly with the growth in our point-of-sale business that came off the pandemic's huge decline in volume. So that's sort of what you can expect with how this bank is set up to run, that when recessions come, our competition tends to be, let's say, a little more myopic having to look at their own portfolios, and our source of deposits from the insolvency industry, which now we've probably grown our client base of insolvency professionals to most of the industry, most of the large insolvency practice in Canada now bank with us, so we're in good shape to take advantage of what might be a tougher time for others. Again, thank you. Thanks for dialling in and we'll look forward to talking to you next quarter.

Operator

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