FINAL TRANSCRIPT

# VersaBank

## Fourth Quarter and Fiscal Year 2024 Financial Results Conference Call

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Length: 40 minutes

## CORPORATE PARTICIPANTS

**David Taylor**
*VersaBank — President & Chief Executive Officer*

**John Asma**
*VersaBank — Chief Financial Officer*

## CONFERENCE CALL PARTICIPANTS

**Tim Switzer**
*KBW — Analyst*

**David Feaster**
*Raymond James — Analyst*

**Andrew Scott**
*Roth Capital Partners — Analyst*

## PRESENTATION

**Operator**

Good morning, ladies and gentlemen. Welcome to the VersaBank Fourth Quarter and Fiscal Year 2024 Financial Results Conference Call.

This morning, VersaBank issued news release reporting its financial results for the fourth quarter and year ended October 31, 2024. That news release, along with the Bank's financial statements, MD&A, and supplemental financial information, are available on the Bank's website in the 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 and 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 completion of the call. Details on how to access the replays are available in this morning's news release.

I would 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 management. Actual results could differ materially from our expectations due to various material risks and uncertainties associated with VersaBank's businesses. Please refer to VersaBank's forward-looking statement advisory in today's presentation.

And I would 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 today is our Chief Financial Officer, John Asma. And incidentally, one of the beauties of being able to operate throughout all of North America is that I'm talking to you today from Fort Lauderdale.

Turning to our financial results, as expected, as a result of preparation for and completion of the closing of our US bank acquisition on August 30th, there was a significant amount of noise in the fourth quarter that impacted our earnings numbers. We have done our best to describe and quantify those to provide a clear picture of the continuing underlying strength of our business model.

John will describe these in more detail in a few minutes, but at a high level, these fall into three buckets, which in aggregate total approximately $5.6 million for the quarter and $6.5 million for the year, and tax adjusted reduced EPS by an equivalent of $0.18 for the quarter and $0.20 for the year. These were one-time non-interest expenses, a change in the base of the acquired assets of VersaBank USA, and the impact of holding higher than typical cash balances ahead of the acquisition and funding of the US bank upon close of the acquisition.

We are, also, for the first time, providing fully segmented financial results that is broken out by Canadian Banking operations, our US Banking operations, and DRT Cyber. We believe this provides a clearer view of the profitability, efficiency, and return on common equity of the existing Canadian Banking business while also allowing you to not only definitively track the growth of our receivable purchase program portfolio in the US, but also see the greater efficiency that we expect from that business as it wraps up.

When we remove the noise associated with the acquisition, the underlying story for the fourth quarter is pretty straightforward and, importantly, paints a very positive picture heading into 2025 and the ramp-up of our US RPP business.

Q4 saw yet another record high of total assets at $4.8 billion, driven by 15 percent year-over-year growth in our Canadian RPP business, which expanded by 2 percent sequentially, even as discretionary spending in Canada generally remained soft.

Growth continued to dampen by higher-than-typical putbacks from loans that have gone 90 days in arrears to our partners due to a higher default from loan to borrowers as could be expected in these tougher economic times.

As we are made whole on these loans through our cash holdbacks, this higher rate of putback to our partners has no impacts on our provisioning for credit losses, which, for Q4, as it always is, de minimis.

Non-interest expenses were atypically high due to one-time costs associated mainly with the US acquisition. We expect to return to normalized NIEs in the first quarter of 2025 with the addition of the US bank expenses, including the new leadership team.

As it has been for nearly two years, net interest margin was dampened by the atypically inverted yield curve, which lowers our margin as we raise deposits in the short end of the curve and lend further out on the curve. We are now seeing yield curve flatten and are very encouraged by this trend.

Net interest margin was also impacted by the one-times noted above. We feel good about the direction of our NIM in 2025, especially as we start to add US RPP loans where we expect to realize a meaningfully higher spread.

For the year we generated record net income, excluding the one-time impacts of the US acquisition, driven by the strong growth in our Canadian Point of Sale Receivable Purchase Program. You can see that reflected in our efficiency ratio and our return on common equity. We expect to see new records for all of these metrics next year based on the continued growth of our RPP in Canada and the ramp-up of the RPP in the United States, as well as a couple of other meaningful opportunities that we'll discuss in a few minutes.

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

**John Asma** — Chief Financial Officer, VersaBank

Thanks, David. Before I begin, I will remind you that our full financial statements and MD&A for the fourth quarter and full year are available on our website under the investor's section as well as on SEDAR and EDGAR.

All of the following numbers are reported in Canadian dollars as per our financial statements, unless noted.

Starting with the balance sheet, total assets at the end of the fourth quarter of fiscal 2024 grew 15 percent year over year and 7 percent sequentially to a new high of $4.8 billion.

Cash and securities were $525 million, or 11 percent of total assets, up from 7 percent in Q4 last year and 9 percent in Q3 of this year. Book value per share increased to a record 15.35.

Our CET1 ratio was 11.24 percent, and our leverage ratio was 7.38 percent, with both remaining above our internal targets.

Turning to the income statement, as David described, there were a number of one-time items, mostly related to the US bank acquisition, that impacted the fourth quarter and the full year results.

A number of one-time non-interest expenses. The expense of a deferred tax asset due to a change in tax base of the acquired assets of VersaBank USA; maintaining higher-than-typical cash balances ahead of the closing of the acquisition, which was exasperated by the impact of a temporary dampening of net interest margin that usually occurs when interest rates decline; and US$90 million in funding provided to VersaBank USA at closing of the SBH acquisition.

Total consolidated revenue was $27.3 million compared to $29.2 million last year. The year-over-year difference was driven primarily by lower non-interest income from the Bank's cybersecurity operations, DRTC, but was also impacted by higher cash assets associated with the funding of the US bank.

Consolidated non-interest expense was $19.4 million compared to the $12.4 million last year and $13.5 million for Q3 of this year. The quarter included $3.3 million in one-time costs that were mostly associated with US bank acquisition. The $3.3 million brought total acquisition-related, one-time costs for the year to $3.7 million.

As a reminder, DRT Cyber expenses are included in our consolidated NIEs and totalled $2.6 million and $9.4 million for the quarter and year, respectively.

Finally, as David noted, we will see NIEs return to a normalized level in Q1.

Excluding one-time NIEs and other one-time impacts, the impacts I just described, consolidated net income for the quarter was $10 million, or $0.38 per share, and consolidated net income for the year was $45 million, or $1.69 per share.

Looking at our Digital Banking operations, which, with the close of the US acquisition on October 30th now consists of our Canadian Banking operations and our US Banking operations, as David mentioned, these are broken out in our press release and MD&A. But for the sake of brevity, I will discuss the combined results as the US Banking operations had limited, although positive, contribution.

Our loan portfolio grew to a new record of $4.24 million at the end of Q4, driven once again by our Point of Sale Receivable Purchase Program, which increased 15 percent year over year, or 2 percent sequentially, to $3.3 billion.

Our RPP portfolio represents 78 percent of our total loan portfolio at the end of Q4, down from 80 percent at the end of Q3. As David noted, RPP growth was dampened for both periods due to higher amount of putbacks.

Our real estate portfolio contracted 12 percent year over year to $788 million as we continue to transition the portfolio towards CMHC-insured loans. We are starting to see a ramp-up of the program, which drove a 6 percent sequential increase in the real estate portfolio. We currently have commitments of close to $600 million with the loans outstanding of over $210 million, which continues to grow monthly, almost doubling since the end of Q3.

As a reminder, our real estate portfolio is primarily business-to-business mortgages and construction loans for residential properties. We have little exposure to commercial-use properties.

Turning to the income statement for our Digital Banking operations, net interest margins on loans, that is excluding cash and securities, was 2.34 percent. That was 35 basis points, or 13 percent, lower on a year-over-year basis and 7 basis points, or 3 percent, sequentially, mainly the result of an atypical, inverted yield curve adversely affecting POS margins and the change in the real estate portfolio to CMHC insured loans.

Net interest margin, including the impact of cash and securities and other assets, was 2.12 percent, which was impacted by the higher cash balances as well as the $90 million in capital provided to the US Digital Banking operations from the Canadian Digital Bank.

Net income, excluding one-time impacts for the Digital Banking operations for the quarter was $10 million, or $0.38 per share. Net income for the Canadian Banking operations was $9.5 million, or 0.36 a share. And net income for the US Banking operations, which for the quarter includes the contribution of only the acquired Stearns Holdingford Bank operations was $0.5 million, or $0.02 per share.

Turning to our credit losses, our provision for credit losses, or PCL, in Q4 remained negligible at negative 0.1 percent on average assets compared to negative 0.02 last year and with a 12-quarter average of 0 percent.

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

**David Taylor**

Well, thank you, John. 2025 promises another year of growth in our loan portfolio and profitability, driving continued improvements in our efficiency ratio and return on common equity as we continue to capitalize on the operating leverage in our business model.

We have a strong foundation in our Canadian Digital Banking operations where we are very proud to lead the publicly traded banks in net interest margin, which is even more impressive given that we don't give anything back for loan losses.

We expect continued steady growth in Canada with our Receivable Purchase Program expanding in line with 2024 and some upside should interest rates continue their downward trend, as is forecast. And we expect to begin to see the contribution of our growing CMHC-insured loan business in our opportunistic real estate portfolio. As a reminder, these are zero-risk-rated loans requiring no capital and delivering and very nice spread.

We also expect to see continuation of several favourable trends that support net interest margin. As noted earlier, we are starting to see the flattening of the yield curve, which will be beneficial to the spread of our RPP loans.

In addition, we should continue to see favourable impact of our low-cost and solvency professional deposit business in Canada as bankruptcies continue to steadily trend upward.

We're moving aggressively forward in US RPP opportunity. We are in the process of moving our first US partners from our pilot program to VersaBank USA balance sheet. More importantly, we expect to add our first post-acquisition partner imminently and others to follow in due course.

I will note that it does take some time to finalize these contracts and onboard new partners. However, we do expect the pace of new additions to accelerate going forward. We have a robust and growing pipeline as our discussions with both potential partners and others in the industry continue to validate that our RPP is both unique and very attractive solution for companies who finance big ticket and services at the point of sale.

The support we expect will be very active ramp-up in 2025. Earlier today, we announced that we are transitioning the team responsible for the success of the Canadian RPP to the US opportunity. This team of Nick Kristo, appointed Chief Credit Officer for the US; Mike Dixon, appointed SVP, RPP in the US, have been fundamental to the growth and success of the RPP in Canada since inception 14 years ago, and along with Mike Robinson, (sic) [David] appointed VP, RPP US, who has been integral to the program for the last seven years, are responsible for 27 percent compounded annual growth rate over the last five years, more than $9 billion in financing for point-of-sale lenders and, of course, no losses.

They join a formidable team whose collective experience and expertise will be invaluable as we scale up the US RPP program in the multi-trillion-dollar US point of sale market.

As a reminder, overall, we expect our US RPP business to benefit from even greater efficiencies than we achieved in Canada due to the lower personnel requirement on both the deposit and lending sides.

We have a lot of bench strength in Canada, and we are proud to also announce the appointment of David Thoms as SVP, Point of Sale Financing, VersaBank Canada, and Saad Inam, Chief Credit Officer, VersaBank Canada. Congratulations, guys.

We will grow our US RPP business as quickly as our balance sheet capacity permits. Given the significant anticipated demand, we will, at least initially, be syndicating our RPP loans to other US banks. Under this model, we earn our typical RPP spread on the portion of the loan, and our partner earns the same spread on the other portion. And we earn a fee, expected to be around 1 percent, from our partner banks.

The cash holdbacks will reside on our balance sheet, and the risk profile is unchanged. In fact, we gain some diversification as do our partners. You can think of this simply as VersaBank additionally white-labelling RPP to generate greater profitability. And just as a reminder, we do expect the RPP spread to be as much as 1 percent higher in the US than in Canada.

One final note before we open the call to questions. Those of you who have followed VersaBank for some time will know that within our wholly owned Washington D.C. based cybersecurity firm, DRT Cyber, we developed what we believe to be the world's first, in our opinion, the world's most secure digital vault, VersaVault, as well as, to our knowledge, the world's first digital deposit receipts, which can be issued by banks themselves. We believe these technologies have a tremendous value enabling US banks to provide state-of-the-art access to the emerging world of digital commerce.

Thus, we are very encouraged by the favourable stance of President-elect Donald Trump, and his proposed administration with respect to digital currencies and what it will mean for our Made-in-America solution. Our digital deposit receipts are on Algorand, Ethereum, and Stellar Blockchains and are SOC2 Type1 compliant using VersaVault.

With that, I'd like to open the call to questions. Operator?

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## Q&A

**Operator**

Thank you, Mr. Taylor. Ladies and gentlemen, if you would like to ask a question, please press *, followed by 1 on your touch-tone phone. You will then hear a prompt that your hand has been raised. Should you wish to decline from the polling process, please press *, followed by 2. And if you're using a speakerphone, please lift the handset first before pressing any keys. One moment please.

And your first question will be from Tim Switzer at KBW. Please go ahead.

**Tim Switzer** — KBW

Hey, good morning, guys. Thank you for taking my questions.

**David Taylor**

Good morning, Tim.

**Tim Switzer**

Could you provide an update on how the conversations with new partners in the US are going? And how many partners should we expect to be kind of fully launched over the next few quarters?

**David Taylor**

Well, we had very productive discussions with one US bank as a partner. And we've tested the data flow. It works exceptionally well. So we'd expect very soon to have our first RPP new point of sale partner. And we'll also have a partner bank sharing in those loans. So I said eminently, and we're just in the paper stage where the lawyers are working as, hopefully, as quickly as they can to put that one to bed.

With respect to additional partners, there's been about 30 or so that we've been talking to, and I think the concern has just been how fast we're going to be able to do the paperwork to sign them up.

**Tim Switzer**

Okay. Great. And related to that, how should we think about the origination trajectory in the US and the balance sheet growth over the course of the year? Is it a gradual acceleration kind of evenly each quarter? Or is there a point in the year where you think it really starts to significantly pick up?

**David Taylor**

Well, it's sort of quantum jumps in growth depending on how fast we sign up the partners. Right now, we're looking to have on balance sheet about $250 million by the end of the year, and that would be sharing at least 50 percent with other banks. So, in total, as an administration, about $500 million, and it may grow a lot faster depending on how quickly we can get the paperwork done.

**Tim Switzer**

Okay. And if I can get one more, please. What is the expense outlook for next year? Once we exclude some of the one-timers you guys reported, are most of the costs associated with running the US business now in the run rate? Or is there kind of another lift to the expense space as some of these customers come on?

**David Taylor**

Most of the expenses are now in the run rate in that we've hired almost everybody we need to run the US. We may have a couple more to put on, but the heavy hitters are already on board.

**Tim Switzer**

Perfect. Okay. That's all for me. Thank you, Dave.

**David Taylor**

Thanks, Tim.

**Operator**

Next question will be from David Feaster at Raymond James. Please go ahead, David.

**David Feaster** — Raymond James

Hi. Good morning, everybody.

**David Taylor**

Good morning, David. I'm enjoying (unintelligible) Florida today, thankfully.

**David Feaster**

I love it. That's great. One thing that you touched on was given the growth governors on the US expansion, y'all are going to be syndicating some loans out to be able to support the growth but not necessarily have it all on balance sheet. I'm curious where you are in the build-out in that process, in the platform, and whether you've started to test that yet.

**David Taylor**

Well, we've built it. It's called AMS 3.0. That's short for Asset Management System 3.0. Canada, we use AMS 2.0. It's in the cloud facility in Des Moines, Iowa at the Azure facility, and it's fully functional. It's also, on the syndication side, it's also able to parse each individual loan to the component parts of the—we'd retain on our balance sheet and our partners would retain. So that's all set to go.

We're just waiting for the finalizing documentation for the first brand new Point of Sale partner. Hopefully that's very soon. And then the data starts to flow, representing the loans being parsed for us and for our first community bank partner.

**David Feaster**

Okay. And then you touched on some of the differences, too, between kind of the small ticket opportunity and the larger ticket opportunity. I'm curious, maybe, where are you focused in the US currently? Like where do you see the most opportunity here? Is it in the smaller ticker? Or maybe some of the larger stuff?

**David Taylor**

It's mainly the larger stuff, although our software is capable of dealing with tiny loans, too. But the sweet spot is the larger ticket items such as home improvement, new HVAC systems, that sort of thing. I think United States will be quite similar to what we experienced in Canada. About 50 percent of our Point of Sale portfolio is home improvement.

**David Feaster**

Okay. And then last one from me. You talked about 100 basis point better spread in the States. Do you see more opportunity? Is that on the funding side? Or is it on the loan yield side?

And then just kind of to the funding side, you touched on the election and the potential tailwinds maybe for some digital currencies. Curious if there's any interest in bringing back CADV (sic) [VCAD] in that opportunity?

**David Taylor**

Well, good point. We've seen, on the test market we did in the United States, we got better yields and we got lower cost of funds to give rise to that approximately 1 percent additional spread. So it was both on the yield and on the funding side.

With respect to DRTC's technology that we announced about four years ago, we were quite proud of it. We have what we call VUSD and VCAD, our digital deposit receipts on Algorand, Stellar, and

Ethereum, and we had it SOC2 reviewed and obtained a SOC2 Type 1 rating. So that technology is all set to go.

But as George Orwell said, "No wine before it's time." The regulatory environment wasn't mature enough to receive that product, but it appears, with the Trump- pending appointees, it looks like a favourable environment for digital in commerce, that this product that we have that's been tested and actually fully functional, would be sort of wonderful for the smaller FIs in United States to use. And DRT stands ready to provide that service for them.

With respect for our own bank, we have such wonderful access to cheap deposits through the large brokerage firms, there isn't a lot of need for us to adopt that. And now we have our work sort of cut out for us, expand the RPP program. But DRT Cyber could provide that service to other small banks, community banks, that don't have the wonderful access we do to very cheap funding.

So it'd be a part for DRTC, and some time in the future it may be something our US bank adopts too. But there isn't any burning need for our bank to adopt it.

**David Feaster**

Okay. And then maybe if I could squeeze one more in. You touched about increased putbacks to your partners in Canada and really validating your business model, and that's great. You've had no credit issues. But I'm curious, maybe how has this impacted the partners in Canada and helped with their balance sheet and their ability to absorb those losses so far?

**David Taylor**

Well, touch wood, they've all been able to do that. We tend to pick the strongest Point of Sale partners we can, and they've been dealing it with. It's sort of the inevitable downturn. Some people in Canada are calling it a recession. And considering our trustee deposits have increased by 20 percent year over year, that's a big number for—like it's a 20 percent in bankruptcies. We probably are in a bit of a recession.

But our partners have stood up, seem be fine. They're all sort of eagerly awaiting, perhaps, a jumbo decrease in the overnight rates the Bank of Canada that might be announced on Wednesday. So generally speaking, our model has held up wonderfully, and it's just slowed growth with record high putbacks this year.

And our partners seem to be in good shape. And if the Bank of Canada drops the rates as people are hoping and predicting, then that might return us to that upward-sloping yield curve again where we were scoring about 300 basis points in net interest margin. So sort of stay tuned. I hope Wednesday's good news for the Canadian economy.

**David Feaster**

That's great colour. Thanks, everybody.

**David Taylor**

Thank you.

**Operator**

Ladies and gentlemen, a reminder to please press *, 1 on your telephone keypad should you have any questions.

Next question will be from Andrew Scott at Roth Capital Partners. Please go ahead, Andrew.

**Andrew Scott** — Roth Capital Partners

Hey. Good morning, guys, and thanks for taking my questions. First one for me, you guys saw a return to growth in your CRE portfolio. I know you guys been recently kind of rightsizing that portfolio and maybe changing up the mix. Could you kind of talk about how you feel about the portfolio? Where it is now? And then maybe provide some additional colour on the CMHC portfolio.

**David Taylor**

Absolutely. So this portfolio is almost all composed of loans on residential properties. And there's the two types. One we call conventional loans. So these are the normal loans that banks have made over the years that are risk-rated fairly highly. This will be multifamily normally, construction apartment blocks construction, and some low- rise. And because of the high-risk weighting, and there's a little additional risk involved, we're running a loan-to-value ratio around 60 percent on these.

We pivoted over to CMHC-insured construction mortgages, and these are wonderful in that they're 0 percent risk weighted so don't absorb any CET1 capital and match really nicely against our floating rate trustee deposits. On average, we pay about, say, prime minus 2.85 percent on those, and we earn maybe prime minus 20 on the CMHCs. So we're making about a 265-basis-point spread on a zero-risk-weighted asset and no capital required.

That's the portfolio that John talked about, that's we have $600 million right now and committed to sell (unintelligible) the drawdown in 2025. almost double that we had last quarter. We're looking at probably that figure increasing by the end of 2025 say to $1.5 billion or maybe even $2 billion. So it's a really wonderful opportunity for us to help with the construction in Canada but not take, well, hardly any risk because they're government-insured and to get a really good rate of return.

**Andrew Scott**

Great. Well, thank you for the additional colour. And then second one for me. You've kind of expanded on this earlier, but as you look out into 2025, can you kind of just talk through the pipeline of business activity for DRTC?

**David Taylor**

Well, DRTC's cybersecurity business has been growing quite, by the sign-up of new customers, quite dramatically. We've had some really big, well-known names. And the revenue hasn't flowed into the statements yet, or not all of it. It's starting to come in. So there's increased demand for DRTC's cybersecurity product amongst the big players, the brand-name retailers and other financial institutions.

But the product that we have in DRTC that we just sort of kept under wraps for awhile pending a more favourable regulatory environment is the ability to issue digital deposit receipts.

So this is the state of the art. And I was just at a conference where a very smart individual pointed out there's a huge difference between a stable coin that's backed up by assets or deposits held by somebody else and an actual digital deposit receipt, which represents a deposit held by a real bank. And we developed this technology about four years ago, and proved it all out, and tested it, and had it audited. But we just kept it on the shelf until the right time. But it looks like it is the right time.

So we could host this for thousands of community banks in the United States and bring them to this new, state-of-the-art way to raise deposits, let their customers have the deposits in eWallets and such, and transact business in almost negligible fees and almost instantaneous. So it's state-of-the-art payment vehicle, state-of-the-art deposits.

So, for example, say you bought Bitcoin at $1,000, and you see it at $100,000, and you like to swap it into a bank deposit. Well, that can be done seamlessly in your eWallet with our VUSD product or our VCAD, courtesy of our technology and our VersaVault.

And I think the time is right. I was quoting George Orwell a while back saying, "no wine before its time." And that's why we just didn't promote it or just kept it on the shelf because the regulatory environment had to mature, and regulators had to get the rules in place. And I think regulators would like banks to issue these types of products rather than the unregulated entities that have, in some cases, got into trouble in the past.

So it's a service for DRTC to provide, and I'm pretty excited about it. I think it's something that a lot of community banks will want to take us up on.

**Andrew Scott**

All right. Yeah. That sounds like a wonderful opportunity. Congrats on the growth, and thanks for taking my questions.

**David Taylor**

Well, thank you, Andrew. Look forward to talking to you later on.

**Operator**

Ladies and gentlemen, again, a reminder to please press *, followed by 1, should you have any questions.

And at this time, Mr. Taylor, we have no other questions. Please proceed.

**David Taylor**

All righty. Well, I'd just like to thank everybody for joining the call and look forward to talking to you at the end of the next quarter. Stay safe and so long.

I'll have to put some suntan lotion on here. Being a cloud-based bank and a US operation now, I've got the luxury of operating anywhere in North America, and today's a very sunny day in Lauderdale. Thank you. Bye.

**Operator**

Thank you, sir. Ladies and gentlemen, this does indeed conclude your conference call for today. Once again, thank you for attending. And at this time, we ask that you please disconnect your lines.