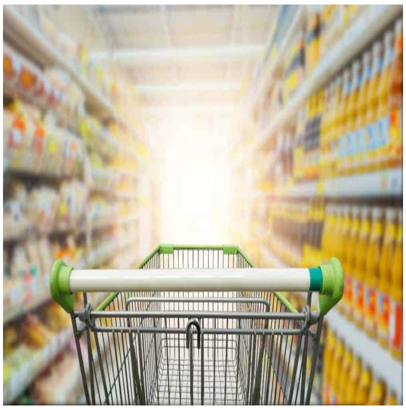

3 Small-Cap Financial Stocks, 1 Buy

Description

The Big Six Canadian banks reported their third-quarter earnings at the end of August. As usual, they rolled up big profits — $11.6 billion between May, June, and July — likely convincing those few investors who don't already own a bank stock or two to buy into their continuing success.

These large-cap bank stocks get most of the media attention for a reason: they make a lot of money and pay a nice dividend.

What's not to like?

Fool contributor Ambrose O'Callaghan recently recommended three bank stocks, two of which — **Toronto-Dominion Bank** and **Royal Bank of Canada** — are part of the Big Six.

A few days before Ambrose's recommendation, the Fool's David Jagielski suggested two more: **Bank of Nova Scotia** and **Canadian Imperial Bank of Commerce**.

I tend to avoid writing about the big banks because so many people already cover them, but I do enjoy discussing all the great things going on at CIBC, which is easily my favourite of the Big Six.

Missing out on all the other financial stocks

The problem with focusing exclusively on the biggest financial stocks is that you miss out on smaller companies, whose stocks are far more likely to be mispriced than the Big Six.

Sure, they might not deliver the same quality earnings or dividends, but the potential capital appreciation is far greater, albeit with greater risk attached.

If you're willing to step off the curb and add some risk to your portfolio, these three small-cap financial stocks are worth considering.

VersaBank (TSX:VB)

Back in May 2016, I recommended the branchless bank, when it was trading around $5.50, 25% lower than its 2013 IPO price of $7.25. Fast forward to 2018 and it's trading around $6.90 a share with plenty more gains available if you go by its third-quarter results.

Core cash earnings were $6.4 million in the third quarter, 48% higher than a year earlier with a return on common equity of 8.72%, 391 basis points higher than the same quarter a year ago.

"Our Bank's model of using advanced technologies to serve niche markets is continuing to demonstrate its tremendous earnings power and produced another record quarter," stated VersaBank CEO David Taylor.

"Core cash earnings for the past 3 quarters grew by 35% over the same period last year and I expect this growth trend to continue through the fourth quarter."

Well, off its 52-week high of $8.36, it's a good time to consider this smaller financial stock.

Olympia Financial Group (TSX:OLY)

The Calgary-based diversified financial services firm has a number of pies, but it is the company's self-directed RRSPs and TFSAs that generate 89% of its annual pre-tax profits.

Olympia doesn't give advice, mind you. It's simply the trust company that holds your cash and assets within the registered plans.

In 2017, Olympia grew revenue by 9% to $45 million while increasing pre-tax income by 20% to $8.3 million. In the quarter ended June 30, 2018, Olympia grew revenue and pre-tax income by 28% and 61% respectively.

Currently yielding 5.0%, Olympia Financial is still a good deal despite trading near an all-time high of $49.

North American Financial 15 Split Corp. (TSX:FFN)

This is what is called a split share fund, where there are both common and preferred shareholders. The preferred shareholder invests to receive dividend payments from the 15 North American banks that compose the portfolio.

If you're a big believer in the Big Six, they're all owned in the fund along with five U.S. banks, three Canadian insurance companies, and **CI Financial**.

The problem with the common share portion of the split share is that the preferred shareholders get first dibs on the dividends generated by the 15 holdings and the $10 per share in original capital.

Often, in this type of investment, the dividend on the common shares are paused or some of the holdings are sold to ensure the preferred shareholders get paid.

If you're going to go this route, the preferred shares are the better way to go.

The bottom line

While I like the diversity of Olympia Financial's revenue streams — not to mention its excellent dividend — I believe that VersaBank has the best capital appreciation potential over the next 12-18 months.

CATEGORY

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2. Investing

TICKERS GLOBAL

1. TSX:OLY (Olympia Financial Group Inc.)
2. TSX:VBNK (VersaBank)

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