1 Small Bank Stock That Could Soar

Description

If a recession is on the horizon, there could be trouble for banks that focus on lending to Canadian consumers. And while the larger Canadian banks will be affected to a degree, the impact on smaller lenders will likely be substantial. The reasoning is simple: Canadians are dangerously over-leveraged. This will most likely leave these smaller lenders exposed to potentially massive losses if Canadians begin to lose their jobs, thereby reducing their ability to service or, heaven forbid, pay down their debt.

The effects of a Canadian slowdown has already been noted as banks have reported their full-year earnings. But while many banks have lost ground, some may still be good investments due to their business models. One small Canadian bank that might be a worthwhile investment even with the continuing recession risk is **VersaBank** (TSX:VB).

VersaBank is interesting as a financial technology play in the banking sector. It is not focused on lending to high-risk customers, but instead has the goal of creating a high-tech banking alternative to the large banks. Its business is almost entirely conducted online, reducing high overhead costs frequently associated with other banks.

One unique and attractive feature that the bank has recently released is VersaVault, a wholly-owned subsidiary that claims to be the world's first blockchain-based safety deposit box.

Another positive aspect of its funding is that most of its funding comes through GICs as opposed to more liquid savings accounts. These types of funding are more stable than bank accounts, as their maturities and interest rates are set. The bank is then able to plan its lending in accordance with the maturities of its GIC deposit base.

The company engages both in commercial and e-commerce lending. Its commercial lending is of the more traditional variety. Most of its lending consists of short duration construction financing and long-duration (up to 20-year) loans to real estate developers. Its e-commerce business operates its receivable purchase program. It is completely online for personal and commercial clients.

VersaBank has demonstrated some impressive growth. In the first quarter of 2019, the Bank reported an increase in its core cash earnings of 15% year-over-year. Net income increased by 24% and revenue by 8%, further underlining the potential growth in this bank.

While it does not have much of a yield, VersaBank does pay a dividend. The yield is currently less than 1%, which isn't exactly exciting. However, that yield is growing. In late 2018, VersaBank announced that it would increase its dividend payout by 50%. Its payout ratio is also very low, signifying that there could be more increases coming up in the future.

But in these troubled times, investors need to check to see if there are any red flags. The most substantial issue that is facing the company at the moment is the fact that its commercial lending is down over 8% over the first quarter of 2018. This could be a one-time event, but given the general slowdown in lending, this could be a warning sign that should be monitored closely.

Generally, the smaller Canadian banks are at risk if a recession occurs. VersaBank, however, with its focus on e-commerce, a quickly growing dividend, and relatively stable funding base is one bank that might prove to be the exception to the rule.

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