2 TSX Small Caps to Buy Right Now

Description

The stock market bears returned after the U.S. Federal Reserve chairman hinted at a prolonged high-interest rate. Investors are fearful and are avoiding risky bets. But that has created an opportunity to build a portfolio of small caps at dirt cheap prices.

The risk and reward of investing in small caps

Before jumping into the top small-cap picks, you should understand the risks and rewards that these stocks entail. Small caps are companies that have a market capitalization of above $300 million but below $2 billion. These stocks have lower trading volumes as they don't see much institutional buying.

The companies comprising small-cap stocks may or may not generate profits but they do generate revenue. They have the potential to grow significantly and become large-cap stocks in the future. If a small company grows successfully, it can attract institutional investors' attention. When that happens, the stock could grow severalfold and garner you significant wealth. The reward is attractive, but the risk is high.

Smaller companies have limited resources (cash and capital raising capacity) which makes them vulnerable to macro or industrial challenges. They face competition from larger companies and strive to gain market share to drive growth. Identifying the right small-cap stock is a challenge, because they may not have strong historical data and fundamentals. You have to take a holistic view of the company, the management's growth strategy, and execution to identify future growth potential.

Two TSX small caps to buy now

I have picked two **TSX** small-cap stocks I am bullish on because of their long-term growth potential.

Dye & Durham

Dye & Durham (TSX:DND), with a market cap of $956 million, provides information management services to legal and financial professionals. Its Unity platform is sticky, which enables it to pay quarterly dividends. The company looks to grow its adjusted EBITDA (earnings before interest, taxes, depreciation, and amortization) to $1 billion through acquisitions. Its acquisition of Australia's Link group was delayed because the 2022 tech stock sell-off led to further negotiations, and DND revised its offer price from A$5.5 to A$4.81 per share.

However, DND stock dipped over 25% in a month as its TM Group acquisition came under regulatory scrutiny. The stock is oversold because investors are bearish on tech stocks. They have not yet priced in the Link acquisition that could add A$257 million to DND's adjusted EBITDA and bring merger synergies of approximately $125 million.

Unlike other small-cap stocks, DND has a higher average trading volume of over 170,000, which indicates the share has reasonable liquidity. Moreover, the accretion of Link EBITDA could significantly increase DND's size. The Link acquisition will help DND expand in Australia and the United Kingdom. Once the economic recovery begins, investors could price in the growing fundamentals. You can buy the stock now and lock in significant recovery growth.

True North Commercial REIT

True North Commercial REIT (TSX:TNT.UN) has a market cap of $1.08 billion and an average trading volume of over 194,000. By comparison, mid-cap stock **SmartCentres REIT** has an average trading volume of over 300,000. True North Commercial is a pure-play office REIT with 46 properties and 96% occupancy. The latest addition to its portfolio is the Federal government tenanted office property in Ontario, increasing True North Commercial's portfolio to 47 properties.

The REIT's strength is in its tenant base, 76% of which is government entities and high credit ranking companies. It looks to grow by acquiring and developing new income-generating properties in strategic areas. The REIT's stock price dipped 10% in the last 30 days as the U.S. Fed's hawkish stance on interest rates made borrowing more expensive while negatively impacting property prices. True North Commercial is using this opportunity to acquire more properties.

On one side, a higher interest rate is reducing property prices. On the other side, high inflation is increasing the REIT's rent renewal spread. True North Commercial has been paying regular monthly distributions since 2013 without any cuts. By buying the stock now, you can lock in a whopping 9.8% dividend yield for a long time and book your position in the recovery growth of 9-16%.

Investor takeaway

Remember that small-cap stocks are highly volatile. Hence, consider investing a small portion of your portfolio (less than 10-15%) in these stocks.

CATEGORY

1. Investing
2. Stocks for Beginners

3. Tech Stocks

TICKERS GLOBAL

1. TSX:DND (Dye & Durham Limited)
2. TSX:SRU.UN (SmartCentres Real Estate Investment Trust)
3. TSX:TNT.UN (True North Commercial Real Estate Investment Trust)

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