The Retail Apocalypse Is Accelerating: Get Ready for More Victims

Description

Regardless of claims that the worst was over in 2018 for retailers, the industry bloodshed has continued at a furious pace. The rise of online retailing and behemoth **Amazon.com** has challenged how traditional bricks and mortar retailing operates, creating a bloodbath of epic proportions among retailers.

Since the start of 2019, over 19 North American retailers have filed for bankruptcy and many more have closed stores at over 8,000 locations.

The catastrophe is expanding

There are no signs of the retail apocalypse slowing, contrary to the claims of many pundits in 2017 and 2018 that the worst had passed. E-commerce has triggered a fundamental shift in the retail industry, leading to the near collapse of traditional bricks and mortar retailing which is having a marked impact on traditional shopping malls.

There is every indication that the industry transformation will keep gaining momentum. Industry analysts expect 2019 global online retail sales to reach US$3.5 trillion, representing an 18% increase over 2018.

Not only is it anticipated that online retail sales will grow at a solid clip, but that they will penetrate what were thought to be relatively impenetrable market segments, including groceries, fresh food, beverages and discount dollar items.

Online shopping is growing

A recent analyst report expects online grocery sales to grow at a compound annual growth rate (CAGR) of 13% annually between now and the end of 2024.

The latest research sees some industry consultancies predicting that U.S. online fresh food, beverage and grocery sales will expand by 18% for 2019. That rate of growth will expand because groceries and fresh food represents an untapped marker for ecommerce retailers, with approximately 8% of all fresh food and grocery sales being completed online.

The growing ease with which consumers can access the internet through smartphones and other portable devices will promote this growth.

The carnage has had a notable impact on many U.S. retail real estate investment trusts (REITs) with some of the worst affected being **CBL & Associates Properties** and **Washington Prime Group,** which have been battered by sharply declining occupancy rates and earnings.

Thus far, Canadian retail REITs have remained relatively unaffected because of a combination of factors including higher quality properties, a greater reliance upon grocery stores as anchor tenants and less shopping malls.

There are signs, however, that Canadian retailers and retail REITs including **Slate Retail REIT** (TSX:SRT.UN) are vulnerable. This explains why Slate Retail has only gained a modest 6% for the year to date compared to others such as **Dream Industrial REIT,** which has risen by a stunning 39% on the back of strong results.

Slate Retail appears especially exposed to the latest developments because of its extensive U.S. operations and dependence on grocery stores as anchor tenants for its retail properties.

It finished the third quarter 2019 with an occupancy rate of 94.4%, which is lower than many other classes of REIT, including Dream Industrial which reported 96% occupancy.

The REIT also has a relatively short weighted average term to maturity for its leases of 5.1 years, highlighting Slate Retail's vulnerability to restricting initiatives among its tenants, should they be impacted by the retail apocalypse.

For the third quarter, net operating income and funds from operations (FFO) fell sharply, declining by 5% and 11% respectively.

The marked increase in retail store closures and bankruptcies in the U.S. will also weigh on demand for retail real estate, likely leading to a significant decline in rents, further impacting Slate Retail's earnings.

The REIT also has a high debt to gross book value of 59.7% despite initiatives aimed at strengthening its balance sheet, further magnifying its vulnerability to the deepening crisis among bricks and mortar retailers.

Slate Retail pays a monthly distribution, which is yielding a monster 9%, leading to speculation that it may be cut, particularly given the headwinds facing the retail industry.

It does, however, appear sustainable when considered that it has a payout ratio of 95% of trailing 12-month (TTM) adjusted funds from operations (AFFO).

Foolish takeaway

Slate Retail appears increasingly vulnerable to the industry transformation triggered by online retailing and the rise of major online retailers, particularly with their push to gain a greater share of the groceries and fresh food segments.

For the aforementioned reasons, investors should avoid retail REITs until the tempest engulfing the retail industry subsides.

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1. Dividend Stocks
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