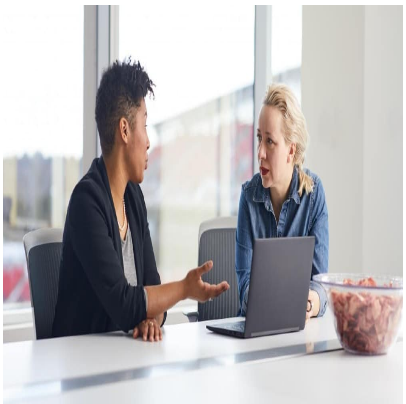

Slate Retail REIT (TSX:SRT.UN): Is This 19% Yield Sustainable?

Description

Many stocks have gotten crushed lately, as coronavirus-related fears have sent stocks reeling. Canada's top REITs have been among the biggest impacted, with some stocks, like **Slate Retail REIT** (TSX:SRT.UN), falling more than 50%.

The reason why retail REITs have gotten hammered so much is obvious. Many of their tenants were barely hanging on by a thread before the social-distancing strategy forced businesses to close. Retail is a tough business, and many of these tenants simply won't survive if they're forced to pay rent while not getting any sales.

If these REITs are only getting a small fraction of their rents, it makes it awfully hard to pay the mortgage. It all eventually results in the REIT defaulting on its debt and shareholders ending up with nothing.

But I don't think it'll play out that way. It seems to me everyone in this situation will hit the pause button. The landlord will simply extend the lease and not collect rent for a month or two. The bank will do the same with the mortgage. We'll resume a normal life a few months from now, and everything will be just fine. Nobody really benefits by forcing these companies into bankruptcy.

If you believe this will happen, then stocks like Slate Retail REIT are screaming buys. Let's take a closer look at this REIT and its 19% (no, that's not a typo) yield.

The skinny on Slate Retail REIT

Slate Retail REIT owns grocery-anchored retail real estate in what it calls secondary cities. These are places like Pittsburgh, Charlotte, and Atlanta — places that are still a decent size but are also a little under the radar. There are more acquisition opportunities in these locations, and they offer better returns on investment compared to larger centres like Chicago, New York, or San Francisco.

As it stands today, the portfolio has 76 different properties and spans close to 10 million square feet of gross leasable area. Approximately 40% of rents come from big-box stores and supermarkets, with another 15% or so coming from other necessity-type businesses, things like pharmacies, discount clothing, and dollar stores.

Despite this strong grocery rent base, investors have sent Slate Retail REIT shares reeling over the last month or so, with the stock falling approximately 50%. It's obvious the market is factoring in a worst-case scenario and assuming there will be zero rent from the company's non-grocery tenants for a long time.

Slate, meanwhile, has taken advantage of the market chaos to add to its portfolio. The company spent a little over US$106 million to add seven grocery-anchored retail complexes to the fold, totaling some 620,000 square feet of gross leasable area. The deal should close sometime in the second quarter and should immediately add to the REIT's bottom line on a per-unit basis.

The opportunity

If you believe today's downturn is just temporary, then you'll want to load up on Slate Retail REIT shares today. It's one of the cheapest stocks on the Toronto Stock Exchange today.

The company earned US$1.20 per share in funds from operations in 2019. When we convert that back to Canadian dollars, it translates into $1.68 per share. The stock, meanwhile, trades at $6.38 per share as I write this. That puts the company at less than four times funds from operations. You won't find many stocks cheaper.

Slate Retail REIT also offers investors a US$0.864-per-share annual distribution. That works out to an eye-popping 19% yield. The payout ratio is a mere 72% of trailing funds from operations. As long as the world returns to normal relatively quickly, I think the distribution is safe.

The bottom line

In this wacky world of investing, conservative REITs like Slate Retail REIT offer 19% yields and trade for around four times earnings. This is the kind of opportunity that only comes around once or twice during your investing career. Take advantage of it; I know I sure am.

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Date
2025/09/07
Date Created
2020/03/31
Author
nelsonpsmith