



Can Slate Retail REIT (TSX:SRT.UN) Sustain its Monster 18% Yield?

Description

Before the outbreak of the coronavirus pandemic retail real estate investment trusts (REITs) were under considerable pressure because of the retail apocalypse. The rapid growth of online shopping sparked an apocalypse of epic proportions for traditional brick-and-mortar retailers. The arrival of the coronavirus pandemic [has magnified](#) the gloomy outlook for traditional retailers and shopping malls. It will accelerate their collapse and cause the volume of bankruptcies to grow weighing on retail REITs.

One REIT under pressure is **Slate Retail REIT** (TSX:SRT.UN). It has lost a whopping 54% year to date, or almost double the **S&P/TSX Composite's** 24% decline. The considerable plunge in Slate Retail's value sees it paying a distribution yielding a monster 18%. That has sparked considerable speculation that the REIT's distribution will be cut, as the economic fallout from the coronavirus mounts.

Rising industry risk

Slate Retail was facing a range of headwinds prior to the coronavirus pandemic. At the end of 2019, it owned 76 U.S. retail properties, which were all grocery-anchored locations. The retail apocalypse sparked by the rapid expansion of online retailing was applying considerable pressure to brick-and-mortar retailers as well as retail REITs.

Nevertheless, a large proportion of Slate Retail's income is generated by tenants that sell products and services that are classified as consumer staples. Those retailers including grocery chains and pharmacies have been resistant to the structural changes underway in the retail industry.

Slate REIT earns 38% of its annual base rent from grocery stores and supermarkets as well as another 15% from medical services. Its top tenants by annualized base rent are **Walmart** and **Kroger**.

This has been a key reason why Slate Retail has not been as harshly handled by the market compared to U.S. peers like **CBL & Associates**. It also indicates that Slate Retail will survive the retail apocalypse unlike other U.S. retail REITs, such as CBL and **Washington Prime**, which the market is pricing for bankruptcy.

Growing earnings pressure

Despite claims that Slate Retail's distribution and monster yield are safe, there are plenty of signs that the REIT is under pressure. Internet-based retailers have been pressing for some time to move into the grocery space. Online retail giant **Amazon** is shaking up the grocery industry. It has invested heavily in building an online grocery shopping platform and has started opening technology-based cashless supermarkets.

There has also been an explosion in the volume of online delivery platforms. These are directly threatening the viability of restaurants. They have also spurred the creation of industrial kitchens aimed solely at cooking meals for home delivery. It is only a matter of time before groceries and fresh produce are managed in a similar manner. When that occurs, it will challenge the viability of brick-and-mortar supermarkets.

The coronavirus pandemic will deal a harsh blow to an already struggling industry. The measures implemented to prevent it spreading, including travel bans, restrictions on movement, and the closure of non-essential services including shopping malls will trigger a sharp decline in sales. That will weigh on Slate Retail's earnings, placing pressure on its financial position and, ultimately, the distribution.

Looking ahead

The risk of a distribution cut because of a sharp decline in earnings is magnified by the REIT's less-than-stellar financial position. Slate Retail's debt to gross book value is a high 60% and nine times its 2019 annual EBITDA. This indicates that Slate Retail's balance sheet is heavily levered, leaving it vulnerable in the current [difficult operating environment](#).

That also means Slate Retail may not be able to maintain its distribution, particularly if earnings and adjusted funds flow from operations fall sharply in response to the economic fallout from the coronavirus pandemic.

I have argued for some time that Slate Retail should cut its distribution. That would allow the REIT to protect cash flow and shore up its balance sheet at critical time. Excess free cash flow can then be used to reduce debt to a manageable level. That would bolster Slate Retail's balance sheet and provide greater financial flexibility in a challenging business environment. The coronavirus's arrival at a time when the retail apocalypse was accelerating means there is worse ahead for many retailers.

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Date

2025/08/26

Date Created

2020/04/02

Author

mattdsmith

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