HILLIARD LYONS

Healthcare Real Estate Investment Trusts
John Roberts
502.588.1165 / jmroberts@hilliard.com
Institutional Sales Desk: George Moorin
502.585.8909/GMoorin@hilliard.com
August 1, 2017

COMPANY UPDATE

HCP, Inc.

HCP -- NYSE – Neutral-3

Second Quarter Earnings Highlights

Key Metrics

HCP - NYSE - as of 7/31/17		$31.65
2-3 Year Price Target		N/A
52-Week Range	$27.61 -	$36.81
Shares Outstanding (mm)		468.8
Market Cap. ($mm)		$14,837.5
1-Mo. Average Daily Volume		2,793,140
Institutional Ownership		95.3%
Debt/Total Capital	Jun-17	33.0%
Est 3-year FFO Growth Rate		4.5%
Est 3-year Dividend Growth Rate		2.5%
Dividend		$ 1.48
Dividend Yield		4.68%
Est. Fixed Charge Coverage		4.2 X

FFO

	2016	Prior 2017E	Current 2017E		Prior 2018E	Current 2018E	
1Q	$0.69	--	$0.51	A	$0.51	$0.51	
2Q	$0.74	--	$0.48	A	$0.52	$0.52	
3Q	$0.72	$0.47	$0.47		$0.50	$0.50	
4Q	$0.59	$0.49	$0.49		$0.52	$0.52	
Year	$2.74	$1.96	$1.96		$2.05	$2.05	*
P/E	11.6x		16.1x			15.4x	

*-May not add due to rounding

Revenue ($mm)

	2016	Prior 2017E	Current 2017E		Prior 2018E	Current 2018E
1Q	$640.8	--	$492.2	A	$515.90	$515.90
2Q	$662.2	--	$458.9	A	$524.30	$524.30
3Q	$654.3	$498.5	$498.5		$535.90	$535.90
4Q	$540.0	$509.1	$509.1		$544.90	$544.90
Year	$2,457.3	$1,988.2	$1,958.7		$2,121.0	$2,121.0

Revenue numbers not restated.

Company Description: *HCP, Inc., formerly known as Health Care Property Investors, Inc., headquartered in Long Beach, CA, is a real estate investment trust (REIT) that has investments in assisted living, medical office buildings, laboratory facilities and other healthcare facilities located throughout the country.*

Investment Highlights

- HCP reported Q2 normalized FFO of $0.48, two cents above the consensus estimate and equal to our number. Management retained its guidance for normalized FFO at $1.89 to $1.95 a share. At this point we are retaining our out quarter estimates resulting in a full year estimate of $1.96 a share, just above the high end of guidance, and above the $1.93 consensus, although we could fine tune it following the company's noon conference call and discussions with management.
- Following the spin-off of its problem assets, HCP shares have moved to a premium to many of the other companies in the peer group. With all of the uncertainty around that spin-off and with a number of management changes, as well as the current valuation, we are not at a point where we feel comfortable with a positive rating on the stock in light of the uncertainties.
- The company's conference call is at noon today, and we will have a full report laying out any changes to our estimates, rating and thesis following what we hear on the call.

Note Important Disclosures on Pages 6-7.
Note Analyst Certification on Page 6.

Second Quarter Review

Total revenue was $458.9 million versus $538.3 million, a 14.8% decline with divestitures the driver here. Rental income of $263.8 million was off 9.7% (please see income statement on page 3) as the company divested underperforming assets. Interest and other income fell 36.3% to $20.9 million compared to $32.8 million, as a result of debt amortization/payoffs. Income from direct financing leases fell 13.3% to $13.6 million again due to divestitures. Resident fees and services also fell due to asset sales, going to $125.4 million from $164.2 million, down 23.6%.

Operating and other expenses fell to $153.2 million compared to $179.1 million, down 14.5%, a function of the drop in revenue from divestitures. General and administrative expense fell 6.6% to $21.3 million from $22.8 million, a little above our expectations. Interest expense was down 35.9% due to debt divested with assets, with this expense falling to $77.8 million from $121.3 million, down 35.9%. Depreciation expense fell 6.6% to $130.8 million versus $139.9 million, due to the divestitures. Second quarter net income available to common shareholders was $19.3 million versus income of $301.3 million, with a $227 million gain on sale of assets in the year ago period. Earnings per share this quarter were $0.04 versus $0.64 on a 0.5% decline in diluted common shares outstanding in this year's second quarter.

Ongoing, normalized funds from operations (FFO), which exclude real estate gains as well as other non-recurring items, were $226.5 million compared to $351.4 million in last year's second quarter, a 35.5% decline. FFO per diluted share were $0.48 versus $0.74. The decline was mainly a function of the impact of the spin-off of assets into the newly public Quality Care Properties (QCP-$16.82). Excluding the impact of this transaction, per share diluted FFO would have been $0.48 versus $0.53.

The company's level of debt declined since yearend as the company paid down debt with the proceeds from asset sales and excess cash flow. At quarter end the company had approximately $7.5 billion in total debt, versus $9.2 billion at year end. The company's debt to capital ratio was an estimated 33%. HCP has $34 million in debt due in the remainder of 2017 and $168 million due in 2018, none of which we believe would pose a problem to management. We expect no liquidity issues for HCP, as it has been pro-active in taking care of its maturities.

Other 2nd Quarter Activity

Investment Activity – During Q2, HCP did not announce any major investment activity, with some small acquisitions amounting to $75 million during the quarter. The company's main investments during the quarter were on the development side and amounted to $116 million. More than offsetting these investments were just under $400 million in divestments and loan repayments. Subsequent to quarter end, the company made a more substantial purchase, purchasing three medical office buildings in Texas for $449 million.

Capital Activity – During the quarter, HCP repaid $131 million on its credit line and paid off $250 million in maturing bonds. Subsequent to quarter end the company repurchased $500 million in 5 3/8% senior bonds with proceeds from asset sales.

Management Changes – As noted in our Q1 report, HCP's former President Justen Hutchens departed the company during Q2 for a CEO position at another firm. Also during the quarter, Scott Brinker was hired from a competitor to serve as Chief Investment Officer (a position formerly filled by Mr. Hutchens), and Shawn Johnston was hired as Chief Accounting Officer, replacing former CAO, Scott Anderson, who is staying on through the middle of next month to facilitate the change. HCP has seen significant management turnover over the past year, something that we will be monitoring over the coming year.

Quarterly Income Statement

(in thousands)	2Q 2017	2Q 2016	% Change
Rental Income	$263,820	$292,168	-9.7%
Tenant Recoveries	$35,259	$33,531	5.2%
Income from Direct Financing Leases	13,564	15,647	-13.3%
Investment Management fee Income	0	0	
Resident Fees and Services	125,416	164,202	-23.6%
Interest and Other Income	20,869	32,787	-36.3%
Total Revenue	458,928	538,335	-14.8%
General & Admin	21,286	22,779	-6.6%
Acquisition costs	867	823	5.3%
Operating and other	153,163	179,080	-14.5%
EBITDA	283,612	335,653	-15.5%
Interest Expense	77,788	121,333	-35.9%
Depreciation Expense	130,751	139,919	-6.6%
Income (Loss) Before Discontinued Operations and Other Items	75,073	74,401	0.9%
Discontinued Operations (including gain on sale of assets)	412	226,989	
(Charges), recoveries, other-net	(56,611)	2,280	
Income taxes	2,987	2,179	
Equity in income of JVs	240	(1,067)	-122.5%
Minority Interest	(2,818)	(3,467)	-18.7%
Preferred Stock Dividends	0	0	
Net Income (Loss)	$19,283	$301,315	-93.6%
Net EPS (diluted)	$0.04	$0.64	-93.6%
Avg. Shares Outstanding (diluted)	468,839	471,425	-0.5%

Funds From Operations	2Q 2017	2Q 2016	
Net Income	$19,283	$301,315	-93.6%
Depreciation Expense	133,098	144,360	-7.8%
Other (adding/substracting one-time items)	74,127	(94,296)	
Normalized Funds From Operations	**$226,508**	**$351,379**	-35.5%
Normalized FFO Per Share (diluted)	**$0.48**	**$0.74**	-35.1%

Source: Company reports.

Consolidated Balance Sheet

(in thousands)	30-Jun-17	December 31, 2016
Real Estate Assets		
Land	$1,765,305	$1,881,487
Buildings and Improvements (net of Depreciation)	$8,441,650	$9,043,724
Construction in progress	$444,528	$400,619
Net investing in direct financing leases	$711,777	$752,589
Mortgage Loans Receivable	393,575	807,954
Total Net Real Estate Investments	11,756,835	12,886,373
Cash and Cash Equivalents	391,965	94,730
Investments in JVs	829,231	571,491
Accounts Receivable	36,969	45,116
Restricted cash	61,481	42,260
Intangibles	414,404	479,805
Real estate held for sale	0	927,866
Other assets	611,690	711,624
Total Assets	**$14,102,575**	**$15,759,265**
Bank Borrowings	$136,311	$899,718
Mortgage Loan payable	146,337	623,792
Bond payable and capital leases	7,202,678	7,665,985
Accrued expenses and other liabilities	389,690	421,136
Intangible liabilities	51,463	58,145
Deferred Revenues	147,155	149,181
Minority interest in JVs	149,456	214,377
Non-managing member unitholders	177,438	179,336
Total Liabilities	**$8,400,528**	**$10,211,670**
Preferred stock	-	-
Common Stock	468,879	468,081
Capital in Excess of Par Value	8,216,781	8,198,890
Other	(27,289)	(29,642)
Cumulative Distributions in excess of earnings	(2,956,324)	(3,089,734)
Total Shareholders' Equity	**5,702,047**	**5,547,595**
Total Liabilities and Shareholders' Equity	**$14,102,575**	**$15,759,265**

Balance Sheet Ratio Analysis	30-Jun-17	December 31, 2016
Net R/E Investments / Total Debt	63.7%	71.3%
Debt to Equity	131.3%	165.6%
Debt as % of Total Assets	53.1%	58.3%
Shareholders' Equity as % of Total Assets	40.4%	35.2%

Source: Company reports.

Dividend – The spin-off of skilled nursing assets and the loss of the cash flow generated by these assets forced HCP to reduce its dividend from $2.30 a share annually, to $1.48 a share annually. Prior to the reduction, HCP had been the only REIT that had been a dividend aristocrat, with a streak of increasing its dividend that goes back 30 years to the company's IPO. However, with the significant drop in cash flow that the spin-off caused, it was impossible to hold the dividend. We anticipate that the company is likely to go back to raising the dividend going forward. Based on our current estimate for 2017, the payout ratio is 74.4%, which is a little above the peer group average.

First Take

The company's results were in line with our expectations. This was despite general and administrative expense being solidly higher than we had modelled, as interest expense was lower and the share count was slightly lower. The recent asset divestiture has created some uncertainty in numbers, although should provide a more consistent stream of cash flow going forward as HCP has divested assets subject to a potential shortfall. The various management changes we have seen over the past year-plus certainly warrant watching and in our opinion, create some uncertainty as the new management group creates its vision and strategy. This uncertainty makes our Neutral rating appropriate, especially in light of the rise in valuation we have seen on the company's shares since the spin-off of the HCR ManorCare portfolio. With management seeming to be more focused on the management changes at this point, acquisition and investment activity is likely to be subdued for the remainder of the year. At the very least we would expect Mr. Brinker to need to get settled into his new position before we see a pick-up in investment activity.

As such, we will have to see what is said on the conference call to get a better idea of what is in the company's investment/acquisition pipeline and whether our assumption that 2017 is likely to be another lost year for investment activity is appropriate. We typically assume forward acquisition/investment activity that management does not when we compute our estimates. At this point we are not assuming any this year other than ongoing investment and development activity and that already announced. The nearly $450 million medical office building purchase is a good sign, however, and could force us to revisit our thesis should management make us feel comfortable that this is a sign that investment will move to more normal levels. Either way, we will initially assume that in the near term FFO growth is likely to be organic, rather than driven by additional investment activity, at least over the remainder of 2017 with more divestitures likely as the new management team tweaks HCP's portfolio. We are likely to see more investment activity for 2018, however. Following the company's noon Eastern conference call, we will be putting out a full report with updated 2017 and 2018 estimates and earnings models.

Suitability

HCP has a suitability rating of 3 on our 1-4 scale. We recently reduced our rating from 2 on all of the uncertainty around the spin-off of skilled nursing assets, and believe the turmoil on the management front only supports that rating. While we find the company to have a strong balance sheet and its real estate ownership is also a positive factor, as is the company's property type, geographic and operator diversification, as well as the company's portfolio size, among the largest in the group, the earlier issues create some uncertainty. The company does have a strong management bench, but until there is a decision on a new CEO uncertainty will remain. Also, the company is exposed to operating risk through its taxable REIT subsidiary and could see some volatility around this operating ownership beyond the typical real estate cycles.

Annual yield is calculated by dividing the distribution amount by the current market price of the security. For US income tax purposes, the Company may classify all or a portion of its distributions as dividends or other non-dividend distributions. Note that for some investors, for US income tax purposes all or a portion of the Company's 2016 dividend or distribution was treated as return of capital and not as "dividend income" as reflected on the IRS Form 1099-Div for the 2016 tax year. The Company generally makes a final determination regarding the proper tax treatment of distributions after calendar year end. We urge each shareholder to consult with his or her own tax advisor to determine the tax consequences of the distributions received, including any state, local or foreign tax considerations.

Additional information is available upon request.

Analyst Certification

I, John M. Roberts, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

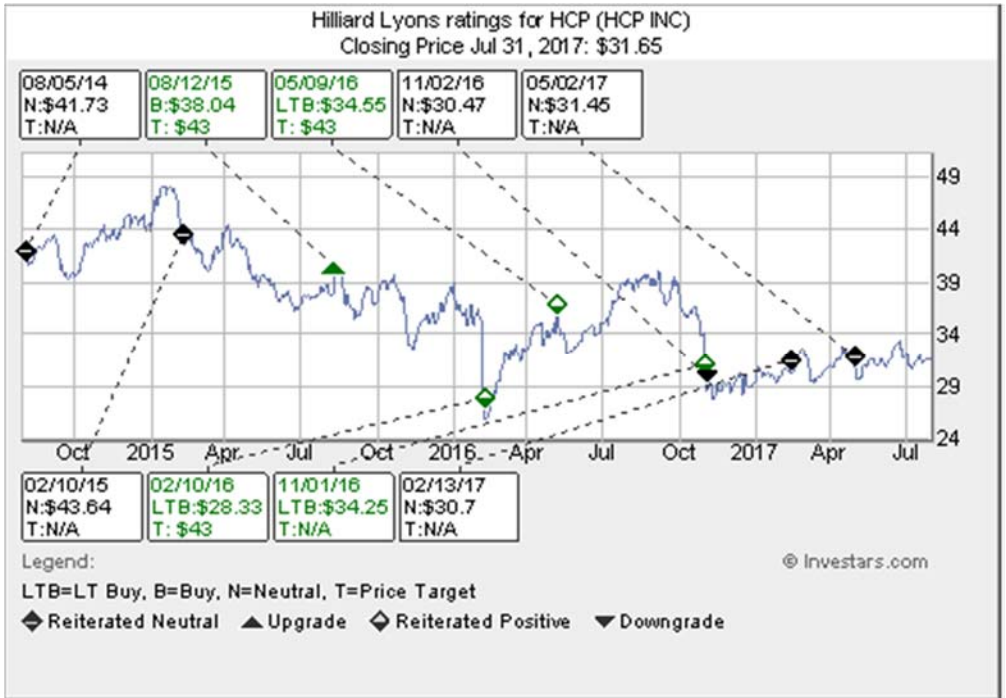
Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Investment Ratings
Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.
Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.
Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings
1 - A large cap, core holding with a solid history
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product

	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	36	29%	14%	86%
Hold/Neutral	79	63%	5%	95%
Sell	10	8%	0%	100%

As of 7 July 2017



Other Disclosures

Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation or needs of individual investors. Employees of J.J.B. Hilliard, W.L. Lyons, LLC or its affiliates may, at times, release written or oral commentary, technical analysis or trading strategies that differ from the opinions expressed here.

J.J.B. Hilliard, W.L. Lyons, LLC is a multi-disciplined financial services firm that regularly seeks investment banking assignments and compensation from issuers for services including, but not limited to, acting as an underwriter in an offering or financial advisor in a merger or acquisition, or serving as placement agent in private transactions.

The information herein has been obtained from sources we believe to be reliable but is not guaranteed and does not purport to be a complete statement of all material factors. This is for informational purposes and is not a solicitation of orders to purchase or sell securities. Reproduction is forbidden unless authorized.