



COMPANY UPDATE

Key Metrics

HCP - NYSE - as of 8/1/17	\$30.25
2-3 Year Price Target	N/A
52-Week Range	\$27.61 - \$36.81
Shares Outstanding (mm)	468.8
Market Cap. (\$mm)	\$14,181.2
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	4.89%
Est. Fixed Charge Coverage	4.2 X

FFO

	Prior	Current	Prior	Current
2016	2017E	2017E	2018E	2018E
1Q	\$0.69	--	\$0.51 A	\$0.51
2Q	\$0.74	--	\$0.48 A	\$0.52
3Q	\$0.72	\$0.47	\$0.47	\$0.50
4Q	\$0.59	\$0.49	\$0.50	\$0.52
Year	\$2.74	\$1.96	\$1.96	\$2.05 *
P/E	11.0x	15.4x		14.8x

*-May not add due to rounding

Revenue (\$mm)

	Prior	Current	Prior	Current
2016	2017E	2017E	2018E	2018E
1Q	\$640.8	--	\$492.2 A	\$503.30
2Q	\$662.2	--	\$458.9 A	\$512.40
3Q	\$654.3	\$498.5	\$489.1	\$523.90
4Q	\$540.0	\$509.1	\$499.8	\$533.80
Year	\$2,457.3	\$1,988.2	\$1,940.0	\$2,073.4

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.

HCP, Inc.

HCP -- NYSE – Neutral-3

Second Quarter Conference Call Highlights

Investment Highlights

- Following the conference call and a more in-depth look at HCP's results, we are retaining our 2017 FFO estimate at \$1.96 a share, just above the high end of guidance. Based on our discussion with management on the conference call we are retaining our assumption on acquisitions and investments of a net \$700 million. We are also retaining our 2018 FFO estimate at \$2.05 a share, although this is somewhat speculative and depends on how quickly the new management team is able to ramp up its investment activity.
- Operating metrics were mixed for the company, in our view. Cash net operating income growth for the company's entire portfolio was 2.1% for the quarter, and guidance for the second half of the year is reasonable, albeit mixed, with very poor guidance for the operating portfolio.
- The recent turnover in management is somewhat disconcerting, although at least the company has added a number of capable veterans of the industry. However, we will be watching this situation closely, as we expect the new hires to need some time to be up and running. On the call, management also noted that there are legal issues with the recently added Chief Investment Officer, which we will discuss more in-depth later in the report.
- HCP shares have moved up this year with the remainder of the group. This keeps the stock price above a level that we find attractive. Combine that with the recent management turnover and problems in the company's operating portfolio and we believe our Neutral rating is appropriate at this time.

Note Important Disclosures on Pages 5-6.
Note Analyst Certification on Page 5.

Conference Call Discussion

Management spent a lot of the conference call discussing operating metrics of the company's portfolio. Overall, they have kept their guidance the same, but how they got to that number is more disturbing. They increased expected operating metrics (same store NOI growth) at the medical office building, life science and triple net senior housing portfolios, while sharply reducing the expected same store NOI growth at the senior housing operating portfolio. This illustrates the caution we have raised many times in the past about REITs getting involved in the operating side of the business, and is the reason that we have offered the belief that REITs with such operating partnerships should trade at a discount to those REITs solely collecting rent. Due to operating problems and general underperformance in the senior housing operating portfolio, management is now anticipating a down year for that portfolio. A bad flu season and various other issues caused occupancy to drop 190 basis points in the portfolio. At this point, management is not anticipating an improvement for the remainder of the year, although they are working with the operator.

While management is anticipating some deterioration in NOI from the operating portfolio, they are projecting that all of the other areas will see gains ranging from a half percent to a full percent over previous guidance. This is led by the triple net senior housing portfolio, which is expected to see same store NOI gains of between five and six percent, although that is a function of one time issues, that will not be repeated going forward. As such, while this will offset the negative impact of the operating portfolio in 2017, we certainly do not anticipate such an offset in 2018. This could result in difficulties next year if management is unable to engineer a turnaround in the senior housing operating portfolio.

Management also discussed issues around the company's new Chief Investment Officer, Scott Brinker, who recently joined HCP from Welltower (HCN, \$72.32). Mr. Brinker is being sued by HCN, and will not join HCP until the start of next year. HCP is covering Mr. Brinker's legal expenses in this matter. While the expense here is not meaningful for HCP, we worry that there could be some management distraction around this issue, especially with regards to acquisition activity.

As far as guidance, management retained its guidance range at \$1.89-\$1.95 a share for 2017 FFO, despite the difficult issues at the senior housing operating portfolio. Management has entered into over \$100 million in development activity through the first half of the year, with significantly higher returns anticipated. An example of this is that management would expect to pay cap rates in the 4's for A quality life science properties, while development in the same asset class would be expected to produce returns topping 8%. Our number remains just above that guidance range.

Third Quarter and 2017 Outlook

As noted earlier, we are retaining our 2017 FFO estimate at \$1.96 a share. We feel comfortable with our estimate, even in light of the issues in the operating portfolio. Our 3Q FFO estimate is \$0.47 a share. This compares to the consensus estimates of \$0.47 for the third quarter, and \$1.94 for the year. At this point our 2018 FFO estimate is \$2.05 a share, which compares to the consensus number of \$2.00 a share. We are assuming approximately \$400 million in net acquisitions and investments during the remainder of 2017. We believe it is going to be very difficult for management to secure its typical larger size portfolio of properties at an appropriate price, and that it may need to look at some smaller one-off transactions that it might not normally consider. Our expectation for 2018 is for \$850 million in net investments, although this number is highly speculative in light of the issues with Mr. Brinker.

Valuation

Using our \$1.96 a share normalized FFO estimate for 2017, HCP shares are trading at 15.4 times current year FFO. This compares to the peer group at 16.1 times. This puts HCP's valuation slightly below the peer group, although well above historic trading norms. In light of the issues in the company's operating portfolio and various management issues, we believe that HCP should be valued at a discount to the peer group. Further, we note that should rates rise on a consistent basis, this could place pressure on income-oriented securities, such as REITs. We believe that this could be especially harmful to the lower yielding

companies in the group, of which HCP is now one after last year's dividend reduction. And we also have the management turnover creating some uncertainty. As such, we see a Neutral rating as most appropriate at this point, and prefer sitting on the sidelines as the process proceeds.

Health Care REITs	Symbol	Closing Price	Current	2017E			2-Year Average		Price / FFO	
		8/1/2017	Dividend	Yield	Payout Ratio	2017E	2018E	Growth Rate	2017E	2018E
Welltower, Inc.	HCN	\$72.32	\$3.44	4.8%	76.3%	\$4.29	\$4.51	-0.4%	16.9x	16.0x
National Health Investors	NHI	\$76.45	\$3.80	5.0%	70.4%	\$5.20	\$5.40	5.3%	14.7x	14.2x
Healthcare Realty Corp.	HR	\$33.08	\$1.20	3.6%	66.7%	\$1.70	\$1.80	5.1%	19.5x	18.4x
Ventas, Inc.	VTR	\$66.00	\$2.92	4.4%	65.8%	\$4.24	\$4.44	3.7%	15.6x	14.9x
LTC Properties, Inc.	LTC	\$51.06	\$2.28	4.5%	69.3%	\$3.13	\$3.29	3.7%	16.3x	15.5x
Health Care Sector Average		\$61.96	\$2.84	4.6%	70.3%	\$3.86	\$4.04	3.1%	16.1x	15.3x
HCP, Inc.	HCP	\$30.25	\$1.48	4.9%	72.2%	\$1.96	\$2.05	-13.5%	15.4x	14.8x

Note: NHI, LTC and VTR are rated Neutral, and HR and HCN Underperform by Hilliard Lyons.

Source: NAREIT, Baseline and Hilliard Lyons' estimates.

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 from the HCR ManorCare situation, and believe the turmoil on the management front further 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.

Table 1. Consolidated Income Statement

	2014	2015	2016	2017E	2018E	Year
	Year	Year	Q1	Q2	Q3	Q4
Revenues:						
Rental and other revenue	\$1,174,256	\$1,144,482	\$297,194	\$299,076	\$297,178	\$298,968
Tenant recoveries	\$110,688	\$31,737	\$33,930	\$33,930	\$35,159	\$35,237
Income from direct financing leases	\$693,070	\$633,835	\$127,968	\$132,100	\$130,752	\$134,789
Resident fees and services	\$241,465	\$525,453	\$165,763	\$164,202	\$130,663	\$186,118
Investment management fee income	\$1,809	\$1,873	\$91	\$91	\$0	\$0
Interest & other	\$74,491	\$12,164	18,029	32,787	20,462	17,510
	\$2,286,279	\$2,944,312	\$640,782	\$662,176	\$654,270	\$539,950
						\$2,497,178
Expenses						
Interest Expense	\$439,742	\$479,696	\$122,062	\$121,333	\$117,860	\$103,148
Depreciation & Amort.	459,995	510,785	141,322	141,386	142,874	146,927
Operating expense	388,369	618,334	176,955	180,125	188,747	195,648
Acquisition Charge, Other	1,429,019					
Impairment Expenses	21,797	2,475	14,527	17,568	3,760	38,330
General & Administrative	95,651	97,575	25,499	22,793	34,787	20,600
Total Expenses	\$1,383,657	\$1,383,657	\$468,313	\$480,164	\$501,836	\$470,063
						\$1,920,396
Income from Operations	\$892,622	\$892,622	\$172,469	\$182,012	\$152,434	\$69,867
						\$576,782
Minority interests	(\$16,795)	\$13,810	(\$3,983)	(\$3,125)	(\$3,115)	(\$2,860)
Equity income from unconsolidated JVs	\$49,570	\$53,916	(\$908)	(\$1,409)	\$160	\$13,231
Other income from discontinued ops.	\$33,034	\$0			\$1,445	\$28,847
Income taxes	(\$260)	\$9,011	(\$53,038)	\$2,003	\$0	(\$3,372)
Gain on extinguishment of debt	\$0	\$0	\$0	\$0	\$0	\$0
Participating securities share	(\$28,385)	\$0	\$0	\$0	\$0	(\$47,430)
(Loss)/Gain on sale of assets	\$0	\$0	\$1,222	\$119,614	\$0	\$0
	\$919,796	(\$556,057)	\$115,762	\$301,375	\$150,924	\$64,440
						\$643,359
Net income for common shareholders	\$919,796	(\$556,057)	\$115,762	\$301,375	\$150,924	\$64,440
Add Back:						
Depreciation	459,995	527,801	144,284	144,360	145,374	147,416
JV Adjustment	26,084	1,512,924	2,475	25,258	17,568	72,659
Other			\$0	\$0	\$0	\$0
Non-recurring/misc.			\$0	\$0	\$0	\$0
Deduct:						
Gain/loss on sales of real estate	\$0	\$0	\$62,842	(\$119,614)	\$0	\$0
FFO Available for common	\$1,410,644	\$1,484,668	\$325,363	\$351,379	\$313,866	\$278,515
Diluted FFO available for common	\$1,410,644	\$1,480,173	\$325,363	\$351,379	\$313,866	\$278,515
Basic FFO per share	\$3.04	\$3.17	\$0.70	\$0.75	\$0.67	\$0.60
Diluted FFO per share	\$3.04	\$3.16	\$0.69	\$0.74	\$0.67	\$0.59
Shares, basic	463,470,750	467,652,250	464,912,000	470,075,000	466,485,000	466,860,000
Shares, diluted	464,820,750	469,002,250	466,262,000	471,425,000	467,835,000	468,210,000
						468,433,000

Table 5. Funds From Operations Calculation

	2014	2015	2016	2017E	2018E	Year
	Year	Year	Q1	Q2	Q3	Q4
Net income for common shareholders	\$919,796	(\$556,057)	\$115,762	\$301,375	\$150,924	\$64,440
Add Back:						
Depreciation	459,995	527,801	144,284	144,360	145,374	147,416
JV Adjustment	26,084	1,512,924	2,475	25,258	17,568	72,659
Other			\$0	\$0	\$0	\$0
Non-recurring/misc.			\$0	\$0	\$0	\$0
Deduct:						
Gain/loss on sales of real estate	\$0	\$0	\$62,842	(\$119,614)	\$0	\$0
FFO Available for common	\$1,410,644	\$1,484,668	\$325,363	\$351,379	\$313,866	\$278,515
Diluted FFO available for common	\$1,410,644	\$1,480,173	\$325,363	\$351,379	\$313,866	\$278,515
Basic FFO per share	\$3.04	\$3.17	\$0.70	\$0.75	\$0.67	\$0.60
Diluted FFO per share	\$3.04	\$3.16	\$0.69	\$0.74	\$0.67	\$0.59
Shares, basic	463,470,750	467,652,250	464,912,000	470,075,000	466,485,000	466,860,000
Shares, diluted	464,820,750	469,002,250	466,262,000	471,425,000	467,835,000	468,210,000
						468,433,000

Table 6. Funds Available for Distribution Calculation

	2014	2015	2016	2017E	2018E	Year
	Year	Year	Q1	Q2	Q3	Q4
FFO Available for common	\$1,410,644	\$1,484,668	\$325,363	\$351,379	\$313,866	\$278,515
Less:						
Recurring real estate CAPX	(\$53,974)	(\$60,185)	(\$15,394)	(\$15,402)	(\$15,414)	(\$14,616)
Straight-line adjustment (ACR)	(\$56,000)	(\$56,000)	(\$14,000)	(\$14,000)	(\$14,000)	(\$14,000)
Non-real estate depreciation, other	\$0	\$0	\$0	\$0	\$0	\$0
Funds available for distribution	\$1,300,670	\$1,368,483	\$295,969	\$321,977	\$284,452	\$248,899
Per share	\$2.81	\$2.93	\$0.64	\$0.68	\$0.61	\$0.54
						\$2,365

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 base.



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

As of 7 July 2017

Other Disclosures

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