HILLIARD LYONS

Healthcare Real Estate Investment Trusts
John Roberts
J.J.B. Hilliard, W.L. Lyons, LLC
502.588.1165 / jmroberts@hilliard.com
Institutional Sales Desk: George Moorin
502.585.8909/GMoorin@hilliard.com
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COMPANY UPDATE

Key Metrics

HCP - NYSE - as of 2/10/17		$30.70
2-3 Year Price Target		N/A
52-Week Range	$22.86 -	$36.81
Shares Outstanding (mm)		467.9
Market Cap. ($mm)		$14,364.5
1-Mo. Average Daily Volume		2,793,140
Institutional Ownership		95.3%
Debt/Total Capital	Dec-16	40.3%
Est 3-year FFO Growth Rate		4.5%
Est 3-year Dividend Growth Rate		2.5%
Dividend		$ 1.48
Dividend Yield		4.82%
Est. Fixed Charge Coverage		3.9 X

FFO

	2015		Current 2016	Prior 2017E	Current 2017E	
1Q	$0.79	--	$0.69	$0.74	$0.47	
2Q	$0.79	--	$0.74	$0.76	$0.49	
3Q	$0.79	--	$0.72	$0.76	$0.51	
4Q	$0.80	--	$0.59	$0.78	$0.52	
Year	$3.16		$2.74	$3.05	$1.99	*
P/E	9.7x		11.2x		15.4x	

*-May not add due to rounding

Revenue ($mm)

	2015		Current 2016	Prior 2017E	Current 2017E
1Q	$610.8	--	$640.8	$698.4	--
2Q	$607.5	--	$662.2	$716.0	--
3Q	$658.0	--	$654.3	$725.1	--
4Q	$668.0	--	$540.0	$736.6	--
Year	$2,565.8		$2,457.3	$2,876.1	$2,200.0

** - 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.*

HCP, Inc.

HCP -- NYSE – Neutral-3

Fourth Quarter Earnings Highlights

Investment Highlights

- HCP reported Q4 normalized FFO of $0.59 a share, equal to our estimate and compared to the consensus estimate of $0.57 a share. This was in spite of investment activity coming in somewhat below our expectations, with strong cost control remaining a positive factor here. Full year normalized FFO was $2.74. Management retained its normalized FFO per share range of $1.89 to $1.95 a share for 2017, not including any acquisitions, but including the impact of the recent spin-off of its skilled nursing operations into a separate publicly-traded company. The remainder of the company's assets are very strong, and the company's multiple has moved up apace to reflect the improved asset mix. The company's stock now trades at a premium to the market. We will wait until after the company's noon conference call before updating our 2017 estimate which currently sits at $1.99, above the high end of guidance, although we are including some accretive investment activity, which management does not include.
- The company adjusted its management group during Q4, putting in place a more permanent management structure by promoting its CFO, Tom Herzog to the CEO position and Justin Hutchens to President. We feel comfortable with these promotions and believe that they offer a positive direction for the company going forward.
- Healthcare REIT shares have underperformed the market with worries about higher interest rates holding back interest sensitive areas. We anticipate that this trend could continue, at least early in the year, as investors worry about Fed interest rate increases. If investors find that the Fed is hiking at a more leisurely pace, REITs may come back in favor, although we do not anticipate that to occur until the second half of the year at the earliest.
- The company's conference call is at noon today, and we will have a full report laying out any changes to our estimate and rating following what we hear on the call.

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

Fourth Quarter Review

Total revenue was $540.0 million versus $520.3 million, a 3.8% rise, adjusted for the spin-off of the skilled nursing assets. Rental income of $287.0 million was off 1.8% (please see income statement on page 3) as rent increases were offset by the sale of non-core assets. Interest and other income was $17.5 million compared to $23.1 million. Income from direct financing leases fell 1.5%. As we have noted before, the addition of operating properties does increase the company's risk, as HCP will be much more exposed to reimbursement risk which had formerly solely been a source of risk to HCP's tenants. Resident fees and services were up solidly to $186.1 million from $158.3 million as a result of recent investments.

Operating and other expenses were $195.6 million, up 14.0% a function of the increased investment in the area. General and administrative expense fell 5.7% to $20.6 million, from $21.8 million. Interest expense was down 15.5% to $103.1 million on a 17.0% decline in debt to $9.19 billion from $11.07 billion. Debt to capital at quarter end was 40.3%. We see no issues for HCP on the debt front and they have taken care of a large part of 2017 maturities already. Depreciation expense increased 5.2% to $146.9 million versus $139.7 million, due to recent acquisitions. Discontinued operations, including asset sales added $26.8 million this year and subtracted $679.8 million in the year ago period. JV income rose 26.7% to $15.4 million. Fourth quarter net income available to common shareholders was $58.4 million versus a loss of $599.2 million. Earnings per share this year were $0.12 versus a $1.29 loss on 0.7% more common shares outstanding in this year's fourth quarter.

Ongoing, normalized funds from operations (FFO), which exclude real estate gains as well as other non-recurring items, were $278.5 million compared to $378.3 million in last year's fourth quarter, a 26.4% decline. Normalized FFO per diluted share were $0.59 versus $0.80, although we note that on an apples-to-apples basis adjusted for the spin-off of the skilled nursing assets, HCP would have seen FFO of $0.53 versus $0.51 a share, up 5.1% gross. For the year, HCP reported adjusted FFO of $2.74 versus $3.16 in 2015.

Other 4th Quarter Activity

Investment Activity – During Q4, HCP undertook a variety of smaller investments, with a total of $345 million in investments which included the $131 million purchase of a prime care home in England and 10 medical office buildings for $163 million. The company also announced development activity and a number of divestitures during the quarter, in addition to the spin-off of the Quality Care Properties (QCP-$18.02) operations. This included the beginning of the third phase of its Cove at Oyster Point life science development as well as the sale of a portfolio of 64 Brookdale (BKD-$15.15) senior living communities for $1.125 billion, sharply reducing the company's dependence upon BKD. The Cove development will open over the next several years, while the sale of the BKD assets are expected to be closed by the end of the year. HCP closed on a total of $723 million in acquisitions during the year, placed $271 million in development and redevelopment project in service and began an additional $580 million in such projects. The company also completed the sale of $770 million in non-strategic assets during the year, excluding QCP, largely offsetting the investments for the year.

Capital Activity – HCP paid off $1.7 billion in debt using the proceeds of the QCP spin-off. HCP paid off some higher cost notes, as well as paying down the credit line.

Dividend – The spin-off of QCP 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.

Quarterly Income Statement

(in thousands)	4Q 2016	4Q 2015	% Change
Rental Income	$286,968	$292,083	-1.8%
Tenant Recoveries	$34,565	$31,785	8.7%
Income from Direct Financing Leases	14,789	15,010	-1.5%
Investment Management fee Income	0	0	
Resident Fees and Services	186,118	158,312	17.6%
Interest and Other Income	17,510	23,135	-24.3%
Total Revenue	539,950	520,325	3.8%
General & Admin	20,600	21,835	-5.7%
Transaction costs/other	3,760	-2,149	-275.0%
Operating and other	195,648	171,665	14.0%
EBITDA	319,942	328,974	-2.7%
Interest Expense	103,148	122,027	-15.5%
Depreciation Expense	146,927	139,686	5.2%
Income (Loss) Before Discontinued Operations and Other Items	69,867	67,261	3.9%
Discontinued Operations (including gain on sale of assets)	26,847	(679,765)	
Charges/other	(47,430)	3,147	
Income taxes	(3,372)	2,596	-229.9%
Equity in income of JVs	15,388	12,144	26.7%
Minority Interest	(2,860)	(4,547)	
Preferred Stock Dividends	0	0	0.0%
Net Income (Loss)	$58,440	($599,164)	
Net EPS (diluted)	$0.12	($1.29)	
Avg. Shares Outstanding (diluted)	468,210	465,036	0.7%

Funds From Operations	4Q 2016	4Q 2015	
Net Income	$58,440	($599,164)	-109.8%
Depreciation Expense	147,416	141,156	4.4%
Other (adding/substracting one-time items)	72,659	836,339	
Normalized Funds From Operations	**$278,515**	**$378,331**	-26.4%
Normalized FFO Per Share (diluted)	**$0.59**	**$0.80**	-26.3%

Source: Company reports.

Consolidated Balance Sheet

(in thousands)	December 31, 2016	December 31, 2015
Real Estate Assets		
Land	$1,881,487	$1,995,657
Buildings and Improvements (net of Depreciation)	$9,043,724	$9,896,475
Construction in progress	$400,619	$390,584
Net investing in direct financing leases	$752,589	$5,905,009
Mortgage Loans Receivable	807,954	768,743
Total Net Real Estate Investments	12,886,373	18,956,468
Cash and Cash Equivalents	94,730	346,500
Investments in JVs	571,491	605,244
Accounts Receivable	45,116	48,929
Restricted cash	42,260	60,616
Intangibles	479,805	614,227
Real estate held for sale	927,866	0
Other assets	711,624	817,865
Total Assets	**$15,759,265**	**$21,449,849**
Bank Borrowings	$899,718	$397,432
Mortgage Loan payable	623,792	932,212
Bond payable and capital leases	7,665,985	9,739,359
Accrued expenses and other liabilities	421,136	436,239
Intangible liabilities	58,145	75,273
Deferred Revenues	149,181	123,017
Minority interest in JVs	214,377	217,066
Non-managing member unitholders	179,336	185,608
Total Liabilities	**$10,211,670**	**$12,106,206**
Preferred stock	-	-
Common Stock	468,081	465,488
Capital in Excess of Par Value	8,198,890	11,647,039
Other	(29,642)	(30,470)
Cumulative Distributions in excess of earnings	(3,089,734)	(2,738,414)
Total Shareholders' Equity	**5,547,595**	**9,343,643**
Total Liabilities and Shareholders' Equity	**$15,759,265**	**$21,449,849**

Balance Sheet Ratio Analysis	December 31, 2016	December 31, 2015
Net R/E Investments / Total Debt	71.3%	58.4%
Debt to Equity	165.6%	118.5%
Debt as % of Total Assets	58.3%	51.6%
Shareholders' Equity as % of Total Assets	35.2%	43.6%

Source: Company reports.

First Take

The company's results were in line with our expectations, and handily exceeded the consensus. Forward guidance, is the real issue at this point. We anticipate that growth will be higher than what we have seen over the last couple of years with the spin-off and sale of more problematic assets. This is especially the case given the reasonable growth metrics offered by the company, with same property projected NOI growth in the 2.5-3.5% range. We expect to remain above guidance, as we are looking for $500 million in net investment for the full year. Management has typically been reasonably conservative in its guidance and as it does not include any accretive actions (which we believe are all but assured), and expect this to especially be the case with the new management team undoubtedly not wanting to disappoint investors.

At this point, we believe management's assumption for forward same store NOI growth at 2.5% to 3.5% is likely to be conservative with the actual number likely to come at the high end of that range due to management being conservative in its guidance. Operations are likely to improve with the spin-off of the lower growth higher risk assets. Having said that, we remain of the opinion that with investors anticipating the near term trajectory of forward interest rates being higher, this is unlikely to result in a move higher for REIT shares. However, as we anticipate the eventual pace of rate increases being below what is being signaled by the Fed, REITs could see a move up later in the year. On the negative side, we remain of the opinion that forward acquisitions will remain difficult with spreads narrow and a likelihood of rates rising later in the future, something that is being presaged by the lower level of investment recently. Our report after the conference call will incorporate any changes on the acquisition front based on management discussion. We will be looking at adjusting our estimates following discussions with management, finalizing estimates for 2017, as well as 2018. Following the company's noon Eastern conference call, we will be putting out a full report with updated 2017 and 2018 estimates and earnings model as well as any change in our rating, which will incorporate management's commentary on the forward outlook.

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

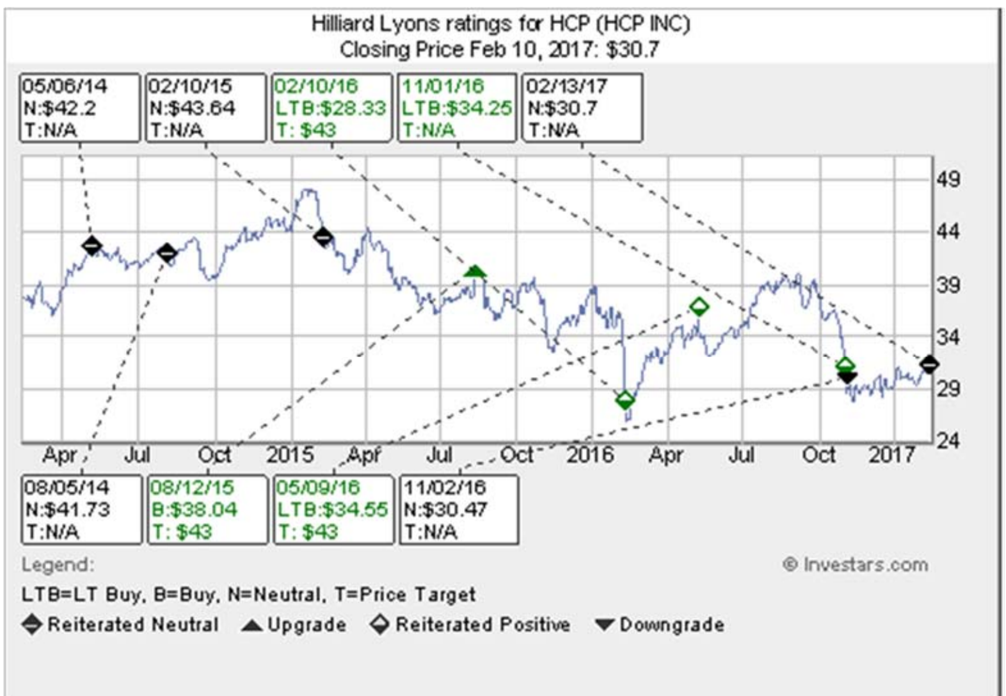
Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

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	30%	17%	83%
Hold/Neutral	76	62%	7%	93%
Sell	10	8%	0%	100%

As of 6 February 2017



Other Disclosures

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