Healthcare Real Estate Investment Trusts
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COMPANY UPDATE

HCP, Inc.

HCP -- NYSE – Neutral-3

First Quarter Earnings Highlights

Key Metrics

HCP - NYSE - as of 5/1/17		$31.45
2-3 Year Price Target		N/A
52-Week Range	$27.61 -	$36.81
Shares Outstanding (mm)		467.9
Market Cap. ($mm)		$14,715.5
1-Mo. Average Daily Volume		2,793,140
Institutional Ownership		95.3%
Debt/Total Capital Mar-17		35.4%
Est 3-year FFO Growth Rate		4.5%
Est 3-year Dividend Growth Rate		2.5%
Dividend		$ 1.48
Dividend Yield		4.71%
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	
2Q	$0.74	$0.50	$0.50		--	$0.52	
3Q	$0.72	$0.50	$0.50		--	$0.51	
4Q	$0.59	$0.51	$0.51		--	$0.53	
Year	$2.74	$1.99	$2.01			$2.07	*
P/E	11.5x		15.6x			15.2x	

*-May not add due to rounding

Revenue ($mm)

	2016	Prior 2017E	Current 2017		Prior 2018E	Current 2018E
1Q	$640.8	--	$492.2	A	--	$579.10
2Q	$662.2	$557.40	$557.4		--	$589.30
3Q	$654.3	$567.10	$567.1		--	$598.50
4Q	$540.0	$575.90	$575.9		--	$607.40
Year	$2,457.3	$2,246.7	$2,192.6			$2,374.4

** - 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.*

Investment Highlights

- HCP reported Q1 normalized FFO of $0.51 a share, two cents above our estimate and three cents above the consensus. The spin-off of the bulk of skilled nursing assets in a separate, publicly-traded REIT obviously hurt results in comparison to last year, while reducing company risk. Further, the company divested another $1.1 billion in assets during the quarter, further diluting earnings. We note that if last year's results were adjusted for the spin-off of the skilled nursing assets, last year's FFO would have been $0.48 a share, with existing operations showing year over year growth.
- HCP experienced management turnover during the quarter with the departure of its President, Justin Hutchens, to take the CEO job at a UK-based care home provider. We will be interested to see how HCP fills Mr. Hutchens' shoes, as he was concentrating on the company's investment opportunities. This change could have a negative impact on HCP's investment activity in the near term.
- Healthcare REIT shares have seen a decline in volatility so far this year, similar to the overall market and despite the Federal Reserve indicating that it will be raising rates this year on a relatively consistent basis. Having said that, the group as a whole has trailed the overall market. The group's movement this year has been much more in tune with the movement in the longer term bond market. As a whole, group valuations have moved back to being a little expensive in an environment where rates could be rising on a consistent basis. We note, however, that the overall market is not exactly inexpensive either, so our neutral stance on the sector is likely appropriate. With the dilutive impact of the recent transaction, HCP's valuation has pushed up a bit and sits above the group average. Q1 results may support that position, although we are holding our Neutral rating at this point and will need to hear from management on the 12 PM conference call before getting a better feel on the forward investment activity, especially in light of the recent management issues.

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

First Quarter Review

Total revenue was $492.2 million versus $520.5 million, a 5.4% decline. Rental income of $286.2 million was off 1.4% (please see income statement on page 3); a function of asset sales offset by rental rate increases. Interest and other income was $18.3 million compared to $18.0 million. Income from direct financing leases was off 8.0%, due to divestitures since last year generating revenue of $13.7 million versus $14.9 million. Resident fees and services fell with divestitures, down 15.4% to $140.2 million.

Operating and other expenses were $159.1 million, down 9.6% driven by asset sales. General and administrative expense fell 11.7% to $22.5 million, from $25.5 million. Interest expense was down 29.0% to $86.7 million, a function of lower debt which fell from $9.189 billion to $8,141 billion. Debt to capital at quarter end was 35.4%. We see no issues for HCP on the debt front, with the recent asset sales taking down debt to capital ratios. Depreciation expense fell 2.4% to $136.6 million versus $139.9 million, due to asset sales and divestitures. The company had a large, nearly $320 million gain around the various divestitures and gains on asset sales that is excluded from FFO. First quarter net income available to common shareholders was $460.4 million versus $115.8 million. Earnings per share this quarter were $0.97 versus $0.25 last year on more common shares outstanding in this year's first quarter.

Ongoing, normalized funds from operations (FFO), which exclude real estate gains as well as other non-recurring items, were $243.0 million compared to $325.4 million in last year's first quarter, a 25.3% decline. FFO per diluted share were $0.51 versus $0.69. As noted before, excluding the assets spun off, the year ago number would have been $0.48 a share, so we saw an over 6% gain on an apples-to-apples basis.

Other 1st Quarter Activity

Investment Activity – During Q1, HCP announced no meaningful investments, although it did begin construction on the next phase of its Cove at Oyster Point development, on which it anticipates spending $211 million, and expects delivery in late 2018. In addition, the company also completed the previously announced sale of a portfolio of 64 Brookdale (BKD-$13.14) senior living communities for $1.125 billion, sharply reducing the company's dependence upon BKD. Other divestitures were also completed during the quarter, including additional asset and debt sales that amounted to over $800 million.

Capital Markets Activity – With the divestitures completed in the last couple of quarters, HCP has not needed to issue any debt, paying off $1.1 billion from proceeds of the sales.

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.

Quarterly Income Statement

(in thousands)	1Q 2017	1Q 2016	% Change
Rental Income	$286,218	$290,380	-1.4%
Tenant Recoveries	$33,675	$31,375	7.3%
Income from Direct Financing Leases	13,712	14,910	-8.0%
Investment Management fee Income	0	0	
Resident Fees and Services	140,232	165,763	-15.4%
Interest and Other Income	18,331	18,029	1.7%
Total Revenue	492,168	520,457	-5.4%
General & Admin	22,478	25,451	-11.7%
Acquisition Costs	1,057	2,475	-57.3%
Operating and other	159,081	175,957	-9.6%
EBITDA	309,552	316,574	-2.2%
Interest Expense	86,718	122,062	-29.0%
Depreciation Expense	136,554	139,855	-2.4%
Income (Loss) Before Discontinued Operations and Other Items	86,280	54,657	57.9%
Discontinued Operations (including gain on sale of assets)	317,258	68,408	
(Charges), recoveries, other-net	51,208	1,292	
Income taxes	6,162	(3,704)	
Equity in income of JVs	3,269	(908)	-460.0%
Minority Interest	(3,802)	(3,983)	-4.5%
Preferred Stock Dividends	0	0	
Net Income (Loss)	$460,375	$115,762	297.7%
Net EPS (diluted)	$0.97	$0.25	290.2%
Avg. Shares Outstanding (diluted)	475,173	466,262	1.9%

Funds From Operations	1Q 2017	1Q 2016	
Net Income	$460,375	$115,762	297.7%
Depreciation Expense	136,554	141,322	-3.4%
Other (adding/substracting one-time items)	(353,880)	68,279	
Normalized Funds From Operations	**$243,049**	**$325,363**	-25.3%
Normalized FFO Per Share (diluted)	**$0.51**	**$0.69**	-26.1%

Source: Company reports.

Consolidated Balance Sheet

(in thousands)	March 31, 2017	December 31, 2016
Real Estate Assets		
Land	$1,772,174	$1,881,487
Buildings and Improvements (net of Depreciation)	$8,431,523	$9,043,724
Construction in progress	$430,007	$400,619
Net investing in direct financing leases	$712,540	$752,589
Mortgage Loans Receivable	788,486	807,954
Total Net Real Estate Investments	12,134,730	12,886,373
Cash and Cash Equivalents	764,114	94,730
Investments in JVs	827,202	571,491
Accounts Receivable	31,500	45,116
Restricted cash	60,806	42,260
Intangibles	432,109	479,805
Real estate held for sale	0	927,866
Other assets	605,407	711,624
Total Assets	**$14,855,868**	**$15,759,265**
Bank Borrowings	$492,421	$899,718
Mortgage Loan payable	147,329	623,792
Bond payable and capital leases	7,501,702	7,665,985
Accrued expenses and other liabilities	344,908	421,136
Intangible liabilities	54,472	58,145
Deferred Revenues	141,561	149,181
Minority interest in JVs	154,161	214,377
Non-managing member unitholders	177,966	179,336
Total Liabilities	**$9,014,520**	**$10,211,670**
Preferred stock	-	-
Common Stock	468,446	468,081
Capital in Excess of Par Value	8,203,778	8,198,890
Other	(28,658)	(29,642)
Cumulative Distributions in excess of earnings	(2,802,218)	(3,089,734)
Total Shareholders' Equity	**5,841,348**	**5,547,595**
Total Liabilities and Shareholders' Equity	**$14,855,868**	**$15,759,265**

Balance Sheet Ratio Analysis	March 31, 2017	December 31, 2016
Net R/E Investments / Total Debt	67.1%	71.3%
Debt to Equity	139.4%	165.6%
Debt as % of Total Assets	54.8%	58.3%
Shareholders' Equity as % of Total Assets	39.3%	35.2%

Source: Company reports.

First Take

The company's results were better than our expectations, while exceeding the consensus to an even greater degree. Ongoing operations were strong in the quarter. The 2017 FFO outlook of $1.99-$2.05 management is offering aligns with our estimate of $2.01, which was above consensus at the low end of guidance. We have anticipated 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 and the lessened reduction on skilled nursing 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 push our number to at least the high end of guidance and likely above, as we are looking for $500 million in net investment for the full year, excluding the sale of the BKD and other assets, although the lack of investment in Q1 is troubling and we wonder if that is a reflection of management turnover. Management has typically been reasonably conservative in its guidance 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. We expect the new CEO to be very conservative as he does have something to prove to 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. Operations are likely to improve with the spin-off of the lower growth lower 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, we expect 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. Also the management turnover could cause issues on the acquisition front. 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. 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.

Suitability

HCP has a suitability rating of 3 on our 1-4 scale. We reduced our rating form 2 on all of the uncertainty around the HCR ManorCare situation, and believe the turmoil on the management front only supports that rating. With the recent spin-off of these assets we may go back to a 2 rating, but will wait to see what happens on the management front before making that call. 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. 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.

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.

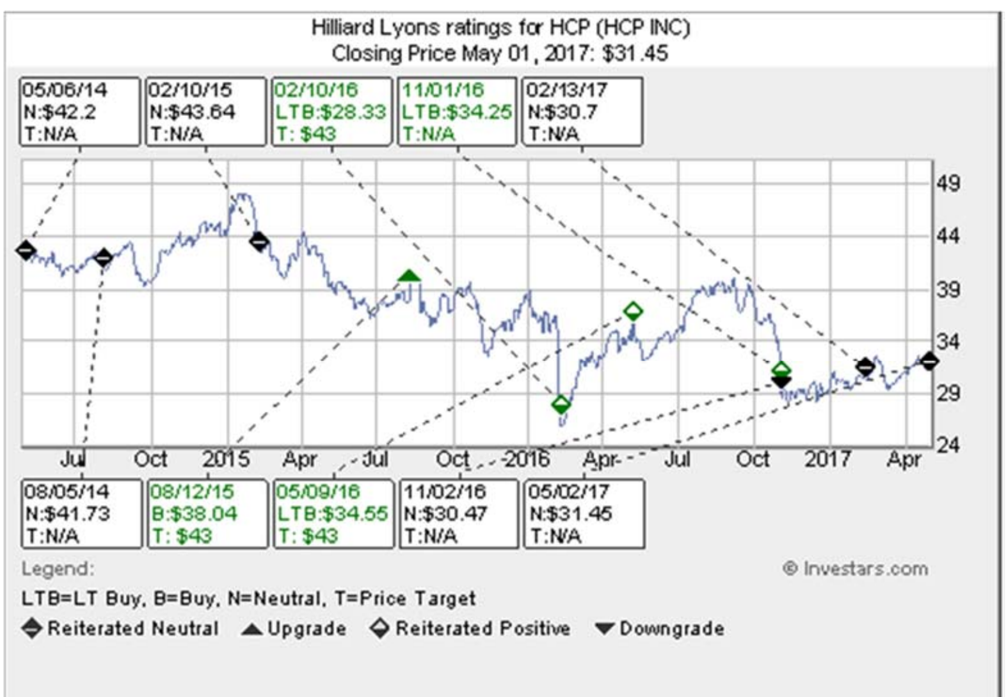
Important Disclosures

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

The author of this report or members of his household have a long position in the common stock of HCP, but may not engage in buying or selling contrary to the recommendation.

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%	14%	86%
Hold/Neutral	71	58%	6%	94%
Sell	15	12%	7%	93%

As of 5 April 2017

Other Disclosures

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