Healthcare Real Estate Investment Trusts
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COMPANY UPDATE

Key Metrics

HCP - NYSE - as of 11/1/17		$26.02
2-3 Year Price Target		N/A
52-Week Range	$25.08 -	$33.67
Shares Outstanding (mm)		469.2
Market Cap. ($mm)		$12,208.6
1-Mo. Average Daily Volume		2,793,140
Institutional Ownership		95.3%
Debt/Total Capital Sep-17		37.1%
Est 3-year FFO Growth Rate		4.5%
Est 3-year Dividend Growth Rate		2.5%
Dividend		$ 1.48
Dividend Yield		5.69%
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	--	$0.48	A	$0.50	$0.50	
4Q	$0.59	$0.50	$0.50		$0.52	$0.52	
Year	$2.74	$1.96	$1.97		$2.05	$2.05	*
P/E	9.5x		13.2x			12.7x	

*-May not add due to rounding

Revenue ($mm)

	2016	Prior 2017E	Current 2017E		Prior 2018E	Current 2018E
1Q	$640.8	--	$492.2	A	$503.30	$503.30
2Q	$662.2	--	$458.9	A	$512.40	$512.40
3Q	$654.3	--	$454.0	A	$523.90	$523.90
4Q	$540.0	$499.8	$499.8		$533.80	$533.80
Year	$2,457.3	$1,940.0	$1,904.9		$2,073.4	$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

Third Quarter Earnings Highlights

Investment Highlights

- HCP reported adjusted Q3 FFO of $0.48 a share, a penny above our estimate and two cents above the consensus. Management pushed up its guidance range to $1.92 to $1.96 a share from $1.89 to $1.95 a share. Our estimate is now at the high end of that range, although we will wait until after the noon conference call to make any potential adjustments of our estimates, likely in light of the penny beat versus our Q3 estimate.
- HCP shares have been especially weak so far this year, and have performed much worse than its peers. Uncertainty at the company and a new CEO have made analysts nervous about the company, resulting in several brokerage firms placing negative ratings on the stock. We hope to gain more clarity on valuation after management's conference call discussion.
- The company's conference call is at noon today, and we will have a full report laying our analysis following the call. While our previous estimate equals the high end of the new normalized guidance range, and with the penny beat in Q3 is a penny above that number, we feel reasonably comfortable with that number due to the likelihood of the company adding new investments to push up the actual number.

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

Third Quarter Review

Total revenue was $454.0 million versus $530.6 million, a 14.4% decline, a function of various divestitures. Rental income of $266.1 million was off 8.3% (please see income statement on page 3), a function of asset sales offset by investment and normal rental bumps. Interest and other income fell to $11.8 million from $20.5 million. Income from direct financing leases fell 7.0% to $13.2 million. Resident fees and services dropped to $126.0 million from $170.8 million due to asset sales.

Operating and other expenses dropped to $155.3 million compared to $187.7 million, down 17.2%, a function of the decline in assets. General and administrative expense fell 32.4% to $23.5 million from $34.8 million. Interest expense fell 39.5% to $117.9 million due to lower debt balances and refinancing activity. Depreciation expense fell 7.7% to $130.6 million versus $141.4 million, due to divestitures. Third quarter net loss available to common shareholders was ($7.8) million versus income of $150.9 million, with various non-recurring charges hurting this year's numbers. Loss per share was ($0.02) versus income of $0.32 on slightly more common shares outstanding in this year's third quarter.

Ongoing, normalized funds from operations (FFO), which exclude real estate gains as well as other non-recurring items, were $227.8 million compared to $336.5 million in last year's third quarter, a 32.3% decline, mainly a function of divestitures. Normalized FFO per diluted share were $0.48 versus $0.72.

At quarter end the company had approximately $7.47 billion in total debt, including unconsolidated debt (please see balance sheet on page 4) compared to $9.19 billion at year end. The company's debt to capital ratio moved up to 37.1% as the share price declined. HCP has just over $33 million in debt due for the remainder of 2017 and $637 million in 2018 (with the credit line being almost all of the amount), none of which we believe would pose a problem to management. We expect no liquidity issues for HCP.

Other 3rd Quarter Activity

Investment Activity – HCP made a small amount of acquisitions during the quarter, amounting to $113 million with the purchases being three medical office buildings and a life science building. The company also undertook $101 million in capital improvements and ongoing development activity under various contractual agreements with existing tenants during the quarter, with a development pipeline that is now $870 million. In addition, the company also entered into an agreement to sell various assets to Brookdale (BKD-$9.84) for $275 million and ended various management agreements, as well as purchasing a minority stake in operating partnerships held by BKD, reduce rent on certain BKD properties, and sell operating joint ventures operated by BKD. These transactions reduce HCP's BKD exposure to 15.7% of cash NOI from 27.0%. Also subsequent to quarter end the company agreed to purchase a $228 million life science campus in the Boston area. The property amounts to 400,000 square feet, is occupied by major pharmaceutical companies and there is an option for an expansion. No fundamentals were offered on the purchase.

Capital Markets Activity – During the quarter HCP tendered for $500 million of its 5 3/8% senior notes due in 2021. Subsequent to quarter end, the company closed on a new $2 billion revolving credit facility and a $750 million expansion option, with a maturity date in 2021 plus two six-month extension options. The facility bears interest at LIBOR plus 100 basis points and has a 20 basis point facility fee. The new facility lowers the company's interest cost by five basis points.

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)	3Q 2016	3Q 2016	% Change
Rental Income	$266,109	$290,280	-8.3%
Tenant Recoveries	$36,860	$34,809	5.9%
Income from Direct Financing Leases	13,240	14,234	-7.0%
Investment Management fee Income	0	0	
Resident Fees and Services	126,040	170,752	-26.2%
Interest and Other Income	11,774	20,482	-42.5%
Total Revenue	454,023	530,557	-14.4%
General & Admin	23,523	34,781	-32.4%
Acquisition costs	580	2,763	
Operating and other	155,338	187,714	-17.2%
EBITDA	274,582	305,299	-10.1%
Interest Expense	71,328	117,860	-39.5%
Depreciation Expense	130,588	141,407	-7.7%
Income (Loss) Before Discontinued Operations and Other Items	72,666	46,032	57.9%
Discontinued Operations (including gain on sale of assets)	5,182	108,204	-95.2%
Charges/Other	(90,111)	1,432	
Income taxes	5,481	424	
Equity in income of JVs	1,062	(2,053)	-151.7%
Minority Interest	(2,068)	(3,115)	-33.6%
Preferred Stock Dividends	0	0	
Net Income (Loss)	($7,788)	$150,924	-105.2%
Net EPS (diluted)	($0.02)	$0.32	-105.1%
Avg. Shares Outstanding (diluted)	468,975	467,835	0.2%

Funds From Operations	3Q 2016	3Q 2016	
Net Income	($7,788)	$150,924	-105.2%
Depreciation Expense	145,628	153,197	-4.9%
Other (adding/substracting one-time items)	89,929	32,392	
Normalized Funds From Operations	**$227,769**	**$336,513**	-32.3%
Normalized FFO Per Share (diluted)	**$0.48**	**$0.72**	-33.3%

Source: Company reports.

Consolidated Balance Sheet

(in thousands)	30-Sep-17	December 31, 2016
Real Estate Assets		
Land	$1,752,890	$1,881,487
Buildings and Improvements (net of Depreciation)	$8,353,404	$9,043,724
Construction in progress	$429,459	$400,619
Net investing in direct financing leases	$715,104	$752,589
Mortgage Loans Receivable	402,152	807,954
Total Net Real Estate Investments	11,653,009	12,886,373
Cash and Cash Equivalents	133,887	94,730
Investments in JVs	822,369	571,491
Accounts Receivable	34,571	45,116
Restricted cash	27,135	42,260
Intangibles	400,867	479,805
Real estate held for sale	216,074	927,866
Other assets	616,169	711,624
Total Assets	**$13,904,081**	**$15,759,265**
Bank Borrowings	$605,837	$899,718
Mortgage Loan payable	145,417	623,792
Bond payable and capital leases	6,714,949	7,665,985
Accrued expenses and other liabilities	389,842	421,136
Intangible liabilities	53,427	58,145
Deferred Revenues	140,378	149,181
Minority interest in JVs	145,496	214,377
Non-managing member unitholders	177,302	179,336
Total Liabilities	**$8,372,648**	**$10,211,670**
Preferred stock	-	-
Common Stock	469,035	468,081
Capital in Excess of Par Value	8,224,531	8,198,890
Other	(24,491)	(29,642)
Cumulative Distributions in excess of earnings	(3,137,642)	(3,089,734)
Total Shareholders' Equity	**5,531,433**	**5,547,595**
Total Liabilities and Shareholders' Equity	**$13,904,081**	**$15,759,265**

Balance Sheet Ratio Analysis	30-Sep-17	December 31, 2016
Net R/E Investments / Total Debt	64.1%	71.3%
Debt to Equity	135.0%	165.6%
Debt as % of Total Assets	53.7%	58.3%
Shareholders' Equity as % of Total Assets	39.8%	35.2%

Source: Company reports.

Management Changes – During the quarter, HCP appointed a new Chief Accounting Officer, to replace the former one who is leaving the company for other opportunities. The company has also recently added the former CEO of nationwide Health Properties as an advisor, and has promoted its Senior Managing Director of its Medical Office building business to COO and has seen the resignation of one of its Senior Managing Directors for its Life Science business. HCP continues to see significant management turnover, somewhat worrisome, although it may just be a function of the new CEO bringing in his own team.

First Take

The company's results were somewhat better than our general expectations. The biggest surprise in the quarter was the increase in same store NOI at the company's senior housing operating (SHOP) portfolio. Same store NOI for the SHOP portfolio was up 5.3% despite a 250 basis point decline in occupancy. Pricing had to be very strong given those metrics. Other companies have seen much less robust gains on this front. We will need to see exactly why HCP was able to extract such positive results from its SHOP portfolio before extrapolating such positive numbers into the future.

The management turnover seen over the past year continued in the current quarter and investors may be getting a little nervous with all of the changes, with the share price underperforming the peer group to the degree it has. The spin-off of the bulk of its problem assets into a separate publicly-traded company initially allowed for multiple expansion, although over the past year the company has seen that premium valuation go away. We will be looking to get a better feel of these issues in our discussion with company management, especially the strength in the SHOP portfolio. We will also be looking at whether there is a solid pipeline that could be in the wings, especially with all of the capital raised through the recent divestment activity and the BKD transaction. The next step here is improving investment activity, and that is where we see the current management team adding to future value. We will need to get more color on the call whether our expectations for forward investment is valid. A full report outlining our new estimates and thesis will follow the company's 12PM conference call.

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 HCR ManorCare situation, 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 has seen a significant amount of management turnover over the past year results in additional uncertainty. 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.

Risk Factors

There are a number of risks in owning HCP shares and REITs as an investment group. REITs in general need access to debt capital to grow; if such debt capital is unavailable, the company may have difficulty in growing. The company's dividend is very attractive to shareholders and HCP, as well as REITs in general, will see their prices rise and fall with the change in overall interest rates. Should rates rise, that could hurt HCP's share price. Because of their thirst for debt, changes in interest rates can also impact a REIT's cash flow and ability to make accretive acquisitions. HCP has exposure to the long-term care sector of the health care real estate group, which could create issues due to government payments being the de-facto source for much of its rent. The company also has exposure to other classes of healthcare-related real estate, such as senior housing and medical office buildings that can have boom and bust cycles that can impact values and rates and potentially negatively impact their values and cash flow generating ability. It is always possible that the company could make a poor acquisition in the future, which could have a negative impact. Its move into operating assets could also have a negative impact if operating issues arise at any of its owned and operated properties.

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 base.

	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	39	32%	8%	92%
Hold/Neutral	74	60%	9%	91%
Sell	8	7%	0%	100%
Restriction	2	2%	100%	0%

As of 5 October 2017

Other Disclosures

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