HILLIARD LYONS

Healthcare Real Estate Investment Trusts
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COMPANY UPDATE/ESTIMATE CHANGE

HCP, Inc.

HCP -- NYSE – Neutral-3

Third Quarter Conference Call Highlights

Key Metrics

HCP - NYSE - as of 11/2/17	$26.58
2-3 Year Price Target	N/A
52-Week Range	$25.08 - $33.67
Shares Outstanding (mm)	469.2
Market Cap. ($mm)	$12,471.3
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	5.57%
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	$0.49	
2Q	$0.74	--	$0.48	A	$0.52	$0.49	
3Q	$0.72	--	$0.48	A	$0.50	$0.49	
4Q	$0.59	$0.50	$0.49		$0.52	$0.52	
Year	$2.74	$1.96	$1.96		$2.05	$1.99	*
P/E	9.8x		13.8x			13.5x	

*-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	$463.00
2Q	$662.2	--	$458.9	A	$512.40	$472.80
3Q	$654.3	--	$454.0	A	$523.90	$482.10
4Q	$540.0	$499.8	$460.0		$533.80	$492.20
Year	$2,457.3	$1,940.0	$1,865.1		$2,073.4	$1,910.1

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

- Following the conference call and taking into account the lack of Q3 and so far in Q4 investment compared to our expectations, we are retaining our estimate for 2017, although that does entail dropping our Q4 number by a penny due to the penny beat in Q3. Our estimate for 2017 remains $1.96. We are, however, dropping our 2018 estimate to $1.99 a share to account for dilution from the asset sales discussed in our previous report, which is offset by the solid investment activity already completed in Q4 and additional investment we are anticipating going forward.
- Operating metrics remain solid for the company, in fact some of the best we have seen from the group. Same store cash net operating income growth for the company's entire portfolio was up 3.2% for the quarter. We were especially impressed with the NOI growth at the senior housing operating properties, which showed strong positive growth trends despite a meaningful decline in occupancy at the properties.
- HCP is undertaking a restructuring of its portfolio, concentrating mostly on life science, medical office building (MOB) and senior housing properties. Management is undertaking a divestiture process with its largest tenant, Brookdale (BKD-$10.59) to rid itself of some problem assets, as well as to reduce its concentration on this tenant and the risk such a large position entails. Following these transactions, concentration in its three largest tenants will drop to about 29%. We are reasonably impressed with HCP's quarter and believe that they are doing the appropriate things to put the company's portfolio in good condition for the long term. However, with management early in its tenure and the likelihood of weak growth for next year, we going to stay on the sidelines and are retaining our Neutral rating on HCP shares at this point.

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

Conference Call Discussion

Management spent much of the conference call discussing the issues around the restructuring of its relationship with BKD. While the exact conclusion of the transactions are unsure, HCP's exposure to BKD will decline to 15.7% as a result of the various transactions. BKD will be acquiring six assets, and a variety of other HCP-owned assets managed by BKD will either be sold or transitioned to other tenants. The outcome of this part of the transaction will change whether the properties are re-tenanted or sold. BKD is receiving a $5 million rent reduction as part of the deal. Through a variety of other related moves, HCP expects to raise between $600-$900 million, depending on whether assets are sold or leased to other operators. We estimate that dilution from these transactions could be as high as $0.06 a share. The impact of these transactions will push the MOB/life science portion of the portfolio to 54% and the senior housing portion down to 39%. Also causing additional dilution was the pay off of all of the company's high yielding mezzanine debt during the quarter. All in, dilution should amount to about eight cents a share. Management believes that this should improve the overall portfolio.

Operating fundamentals were reasonably steady and consistent with previous quarters. Coverage ratios are adequate and occupancy has been reasonably strong, with gross coverage for the senior housing triple net portfolio at 1.31x. Management anticipates same store NOI growth of 2.5-3.5% for the full year, and pushed the number for the operating portfolio up 50 basis points due to the strong Q3.

With the cash raised from the various transactions and the divestiture of some of the troublesome properties, HCP's overall portfolio quality and financial strength will both improve. We anticipate that debt to total capital will approach the low 30% level following all of these transactions, while the remaining properties in the company's portfolio should be very high quality and be among the best in the sector.

Looking forward, management adjusted its normalized FFO guidance range to $1.92-$1.96 a share for 2017 up two cents at the mid-point. Management has not offered any indication on its expectations for 2018, although it is likely to be lower than 2017 as a result of the negative impact of the remaining asset sales and divestitures. We note that they will likely not be including any meaningful acquisitions/investments, so we believe there is some upside to the 2018 numbers, thus our numbers being slightly up year over year.

Fourth Quarter and 2018 Outlook

As noted earlier, we are retaining our 2017 FFO estimate of $1.96 a share. Our 4Q FFO estimate is $0.49 a share. We feel comfortable with our estimate at this point. We are also adjusting our 2018 FFO estimate to $1.99 a share assuming some level of investment above the level of assets divested as management moves its way through the year and adds more properties in the life science area, in particular. We could see total investment in the area of a little under $1.0 billion, although this will only be about $250 million in net taking into account the assets being divested. This compares to the consensus number of $1.90 a share. We are assuming only limited acquisitions on the property side during the remainder of 2017 as we expect management to remain very careful with its acquisition opportunities.

Valuation

Using our $1.96 a share normalized FFO estimate for 2017, HCP shares are trading at 13.6 times current year FFO. This compares to the peer group at 15.8 times. This puts HCP's valuation below the peer group, although above historic trading norms. In light of the company likely to see weak near term earnings growth with the various dilutive asset sales, we believe that HCP should be valued at a slight discount to the peer group, especially with management needing to prove itself to some degree. Further, we note that should rates rise on a consistent basis, this could place pressure on income-oriented securities, such as REITs. While we like the moves management is taking, 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 11/2/2017	Current Dividend	Yield	2017E Payout Ratio	2017E	2018E	2-Year Average Growth Rate	Price / FFO 2017E	Price / FFO 2018E
Welltower, Inc.	HCN	$67.72	$3.48	5.1%	77.2%	$4.29	$4.51	-0.4%	15.8x	15.0x
National Health Investors	NHI	$77.52	$3.80	4.9%	69.3%	$5.28	$5.48	6.1%	14.7x	14.1x
Healtchare Realty Corp.	HR	$32.36	$1.20	3.7%	71.0%	$1.56	$1.69	1.8%	20.7x	19.1x
Ventas, Inc.	VTR	$63.84	$3.10	4.9%	71.1%	$4.17	$4.36	2.7%	15.3x	14.6x
LTC Properties, Inc.	LTC	$46.31	$2.28	4.9%	69.7%	$3.07	$3.27	3.4%	15.1x	14.2x
Health Care Sector Average		**$60.36**	**$2.90**	**4.8%**	**72.2%**	**$3.83**	**$4.01**	**2.8%**	**15.8x**	**15.1x**
HCP, Inc.	HCP	$26.58	$1.48	5.6%	74.4%	$1.96	$1.99	-14.8%	13.6x	13.4x

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 around the HCR ManorCare situation, and believe the turmoil on the management front only supports that rating. While the spin-off of the HCR ManorCare assets alleviated this situation the addition of the Brookdale situation adds another layer of uncertainty. 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.

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 interest 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.

Table 1. Consolidated Income Statement

	2014	2015			2016					2017E					2018E		
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1A	Q2A	Q3A	Q4	Year	Q1	Q2	Q3	Q4	Year
Revenues:																	
Rental and other revenue	$1,174,256	$1,144,482	$297,194	$299,076	$297,178	$286,968	$1,180,416	$286,218	$263,820	$266,109	$277,102	$1,093,249	$278,364	$286,045	$293,198	$300,937	$1,158,544
Tenant recoveries	$110,688	$126,485	$31,737	$33,930	$35,195	$34,565	$135,427	$33,675	$35,259	$36,860	$37,686	$143,480	$38,136	$39,188	$40,168	$41,379	$158,871
Income from direct financing leases	$663,070	$633,835	$127,968	$132,100	$170,752	$14,789	$445,609	$13,712	$13,564	$13,240	$13,386	$53,902	$13,533	$13,682	$13,832	$13,984	$55,031
Resident fees and services	$241,965	$525,453	$165,763	$164,202	$130,663	$186,118	$646,746	$140,232	$125,416	$126,040	$127,036	$518,724	$128,039	$129,051	$130,070	$131,098	$518,258
Investment management fee income	$1,809	$1,873	$91	$81	$0	$0	$172	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Interest & other	$74,491	$112,184	18,029	32,787	20,482	17,510	$88,808	18,331	20,869	11,774	4,786	$55,760	4,891	4,872	4,861	4,798	$19,422
	$2,266,279	$2,544,312	$640,782	$662,176	$654,270	$539,950	$2,497,178	$492,168	$458,928	$454,023	$459,995	$1,865,114	$462,963	$472,837	$482,130	$492,196	$1,910,127
Expenses																	
Interest Expense	$439,742	$479,596	$122,062	$121,333	$117,860	$103,148	$464,403	$86,718	$77,788	$71,328	$70,929	$306,763	$70,929	$71,660	$73,164	$75,450	$291,203
Depreciation & Amort.	459,995	510,785	141,322	141,386	142,874	146,927	572,509	136,554	130,751	130,588	133,291	531,184	133,111	132,931	134,701	137,071	537,814
Operating expense	388,369	618,334	176,955	180,125	188,747	195,648	741,475	159,081	153,163	155,338	155,593	623,175	151,182	161,057	167,191	166,333	645,764
Impairment Charge, Other	-	1,429,019	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Acquisition Expenses		21,797	2,475	14,527	17,568	3,760	38,330	1,057	867	580	1,000	3,504	1,000	1,000	1,000	1,000	4,000
General & Administrative	95,551	97,575	25,499	22,793	34,787	20,600	103,679	22,478	21,286	23,523	17,940	85,227	20,833	18,913	23,624	18,703	82,075
Total Expenses	$1,383,657	$3,157,106	$468,313	$480,164	$501,836	$470,083	$1,920,396	$405,888	$383,855	$381,357	$378,753	$1,549,853	$377,055	$385,562	$399,680	$398,558	$1,560,855
Income from Operations	$882,622	($612,794)	$172,469	$182,012	$152,434	$69,867	$576,782	$86,280	$75,073	$72,666	$81,242	$315,261	$85,908	$87,276	$82,450	$93,638	$349,271
Minority interests	($16,795)	$13,810	($3,983)	($3,125)	($3,115)	($2,860)	($13,083)	($3,802)	($2,818)	($2,068)	($2,315)	($11,003)	($2,448)	($2,487)	($2,350)	($2,669)	($9,954)
Equity income from unconsolidated JVs	$49,570	$33,916	($908)	($1,409)	$160	$15,388	$13,231	$3,269	$240	$1,062	$1,987	$6,558	$1,587	$1,458	$1,798	$2,105	$6,948
Oper. Income from discontinued opers.	$33,034	$0			$1,445	$26,847	$0	$0	$412	$5,182		$0					$0
Income taxes	($250)	$9,011	($53,038)	$2,003	$0	($3,372)	($54,407)	$6,162	$2,987	$5,481	$4,500	$19,130	$4,500	$4,500	$4,500	$4,500	$18,000
Gain on extinguishment of debt	$0	$0					$0					$0					$0
Other income	($28,385)			$2,280		($47,430)		$51,208	($56,611)	($90,111)							
Participating securities share	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
(Loss)/Gain on sale of assets	$0	$0	$1,222	$119,614	$0	$0	$120,836	$317,258	$0	$0	$0	$317,258	$0	$0	$0	$0	$0
Income Bef. Preferred div	$919,796	($556,057)	$115,762	$301,375	$150,924	$58,440	$643,359	$460,375	$19,283	($7,788)	$85,414	$647,204	$89,547	$90,746	$86,398	$97,574	$364,265
Preferred dividends	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Net Income for common	$919,796	($556,057)	$115,762	$301,375	$150,924	$58,440	$643,359	$460,375	$19,283	($7,788)	$85,414	$647,204	$89,547	$90,746	$86,398	$97,574	$364,265
Per share bef. Extra	$2.00	($1.20)	$0.25	$0.64	$0.32	$0.12	$1.37	$0.97	$0.04	($0.02)	$0.18	$1.38	$0.19	$0.19	$0.18	$0.21	$0.77
Extraordinary item	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Net (loss) income per share	$2.00	($1.20)	$0.25	$0.64	$0.32	$0.12	$1.37	$0.97	$0.04	($0.02)	$0.18	$1.38	$0.19	$0.19	$0.18	$0.21	$0.77
Quarterly dividend rate	$2.18	$2.26	$0.58	$0.58	$0.37	$0.37	$1.89	$0.37	$0.37	$0.37	$0.38	$1.49	$0.38	$0.38	$0.38	$0.39	$1.53
Shs Outstanding (diluted)	458,788,750	464,461,250	466,262,000	471,425,000	467,835,000	468,210,000	468,433,000	475,173,000	468,839,000	468,975,000	469,425,000	470,603,000	469,875,000	470,325,000	470,775,000	471,225,000	470,550,000

* - Does not add up due to inter-year changes

Table 5. Funds From Operations Calculation

	2014	2015			2016					2017E					2018E		
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1A	Q2A	Q3A	Q4	Year	Q1	Q2	Q3	Q4	Year
Net income for common shareholders	$919,796	($556,057)	$115,762	$301,375	$150,924	$58,440	$643,359	$460,375	$19,283	($7,788)	$85,414	$647,204	$89,547	$90,746	$86,398	$97,574	$364,265
Add Back:																	
Depreciation	459,995	527,801	144,284	144,360	145,374	147,416	572,509	136,554	133,098	145,628	141,791	531,184	140,611	140,431	142,201	144,571	537,814
JV Adjustment	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other	26,084	1,512,924	2,475	25,258	17,568	72,659	117,960	(36,622)	74,127	89,929	1,000	128,434	1,000	1,000	1,000	1,000	4,000
Non-recurring/misc.	-	-	$0	$0	$0	$0	-	$0	$0	$0	$0	-	$0	$0	$0	$0	-
Deduct:																	
Gain/loss on sales of real estate	$0	$0	$62,842	($119,614)	$0	$0	($120,836)	($317,258)	$0	$0	$0	($317,258)	$0	$0	$0	$0	$0
FFO Available for common	$1,410,644	$1,484,668	$325,363	$351,379	$313,866	$278,515	$1,212,992	$243,049	$226,508	$227,769	$228,205	$989,564	$231,158	$232,177	$229,599	$243,145	$906,079
Diluted FFO available for common	$1,410,644	$1,480,173	$325,363	$351,379	$313,866	$278,515	$1,269,123	$243,049	$226,508	$227,769	$228,205	$925,531	$231,158	$232,177	$229,599	$243,145	$936,079
Basic FFO per share	$3.04	$3.17	$0.70	$0.75	$0.67	$0.60	$2.72	$0.51	$0.48	$0.49	$0.49	$1.97	$0.49	$0.50	$0.49	$0.52	$2.00
Diluted FFO per share	$3.04	$3.16	$0.69	$0.74	$0.67	$0.59	$2.71	$0.51	$0.48	$0.48	$0.49	$1.96	$0.49	$0.49	$0.49	$0.52	$1.99
Shares, basic	463,470,750	467,652,250	464,912,000	470,075,000	466,485,000	466,860,000	467,083,000	473,823,000	467,489,000	467,625,000	468,075,000	469,253,000	468,525,000	468,975,000	469,425,000	469,875,000	469,200,000
Shares, diluted	464,820,750	469,002,250	466,262,000	471,425,000	467,835,000	468,210,000	468,433,000	475,173,000	468,839,000	468,975,000	469,425,000	470,603,000	469,875,000	470,325,000	470,775,000	471,225,000	470,550,000

Table 6. Funds Available for Distribution Calculation

	2014	2015			2016					2017E					2018E		
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1A	Q2A	Q3A	Q4	Year	Q1	Q2	Q3	Q4	Year
FFO Available for common	$1,410,644	$1,484,668	$325,363	$351,379	$313,866	$278,515	$1,212,992	$243,049	$226,508	$227,769	$228,205	$989,564	$231,158	$232,177	$229,599	$243,145	$906,079
Less:																	
Recurring real estate CAPX	($53,974)	($60,185)	($15,394)	($15,402)	($15,414)	($14,616)	($60,825)	($13,761)	($13,893)	($13,816)	($13,953)	($55,423)	($13,778)	($13,916)	($14,147)	($14,409)	($56,250)
Straight-line adjustment (ACR)	($56,000)	($56,000)	($14,000)	($14,000)	($14,000)	($14,000)	($56,000)	($14,000)	($14,000)	($14,000)	($14,000)	($56,000)	($14,000)	($14,000)	($14,000)	($14,000)	($56,000)
Non-real estate depreciation, other	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Funds available for distribution	$1,300,670	$1,368,483	$295,969	$321,977	$284,452	$249,899	$1,096,167	$215,288	$198,615	$199,953	$200,252	$878,141	$203,379	$204,261	$201,452	$214,735	$793,828
Per share	$2.81	$2.93	$0.64	$0.68	$0.61	$0.54	$2.35	$0.45	$0.42	$0.43	$0.43	$1.87	$0.43	$0.44	$0.43	$0.46	$1.69

Source: Company reports and Hilliard Lyons estimates

Additional information is available upon request.

Analyst Certification

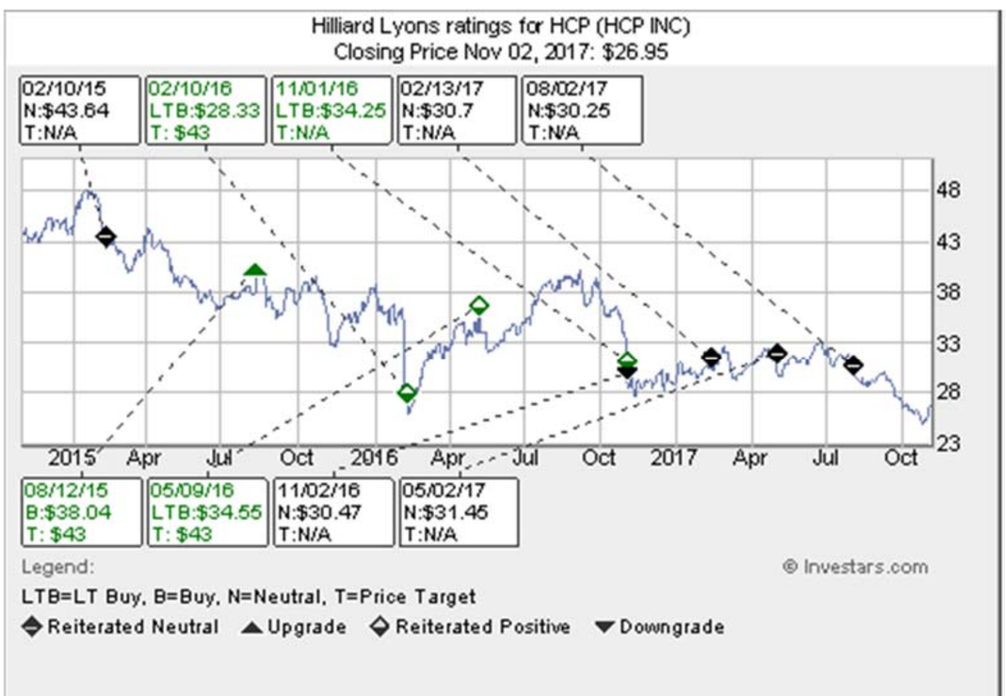
I, John M. Roberts, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing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