HILLIARD LYONS

Healthcare Real Estate Investment Trusts
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COMPANY UPDATE/ESTIMATE CHANGE

Key Metrics

HR - NYSE -	(8/2/2017)	$32.74
Price Target		N/A
52-Week Range	$26.66 -	$36.60
Shares Outstanding (mm)		104.4
Market Cap. ($mm)		$3,418.1
1-Mo. Average Daily Volume		680,000
Institutional Ownership		96.2%
Debt/Total Capital	Jun-17	23.6%
Est 3-year FFO Growth Rate		4.0%
Est 3-year Dividend Growth Rate		0.0%
Book Value		$14.13
Dividend		$ 1.20
Dividend Yield		3.67%
Est. Fixed Charge Coverage		3.9X

FFO

	2016	Prior 2017E	Current 2017E		Prior 2018E		Current 2018E
1Q	$0.41	--	$0.39	A	$0.42		$0.42
2Q	$0.42	--	$0.39	A	$0.44		$0.44
3Q	$0.39	$0.42	$0.42		$0.44		$0.44
4Q	$0.41	$0.43	$0.43		$0.45		$0.45
Year	$1.63	$1.64	$1.62		$1.75	*	$1.75
P/E	0.0x		20.2x				18.7x

* - May not add due to rounding, numbers historical, not adjusted

Revenue ($mm)

	2016	Prior 2017E	Current 2017E		Prior 2018E	Current 2018E
1Q	$100.0	--	$ 104.6	A	$112.4	$112.4
2Q	$102.6	--	$ 105.2	A	$114.8	$114.8
3Q	$103.7	$109.2	$ 109.2		$117.1	$117.1
4Q	$105.3	$111.6	$ 111.6		$119.1	$119.1
Year	$411.6	$431.5	$430.6		$463.4	$463.4

Company Description: *Healthcare Realty Trust, Inc., headquartered in Nashville, Tennessee, is a real estate investment trust (REIT) that invests primarily in properties associated with the delivery of healthcare services through mortgage loans and direct real estate property ownership. The company also undertakes development of the same class of properties.*

Healthcare Realty, Inc.

HR -- NYSE – Underperform-2

Second Quarter Earnings Highlights

Investment Highlights

- HR reported Q2 FFO of $0.39 a share excluding items. This compares to our estimate of $0.41 and the consensus estimate of $0.40 a share. Year ago results were $0.42 a share.
- HR shares have moved up with the rest of the group, generally outperforming the group so far this year. With this solid move up, valuation remains even further above historical norms and at an outsized premium to the peer group, especially in light of the Q2 miss. We see no compelling reason to purchase HR shares, in light of the current valuation levels.
- The company's results were a little below our expectations, with revenue a little light and operating expenses slightly higher than we expected. Interest expense was also above what we had modelled.
- A full report on the company's conference call, as well as updated earnings estimates, ratings and valuations will be out later today after the company's 10 AM Eastern conference call.

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

Second Quarter Review

Total revenue was $105.2 million versus $102.6 million, a 2.5% increase and a little below our expectations. Rental income of $104.9 million was up 3.3% (please see income statement on page 3). Other operating income was only $0.4 million.

Operating and other expense was up 5.3% at $38.2 million compared to $36.3 million in the year earlier period and was above our estimate of $37.2 million. General and administrative expense was up 3.2% to $8.0 million. EBITDA flow came in at $58.2 million flat with the year earlier period. Interest expense fell 3.3% to $14.2 million due to lower debt outstanding from the recent equity offering. Depreciation and amortization expense was up 11.3% to $34.8 million versus $31.3 million, as recent real estate acquisitions increased this number. There was a $16.1 million gain on sale of properties this year and no meaningful non-recurring items last year. Second quarter net income available to common shareholders was a profit of $25.2 million compared to $12.1 million in last year's Q2. Earnings per share for the quarter was $0.22 versus $0.12 on 10.4% more common shares outstanding in this year's second quarter.

Normalized ongoing funds from operations (FFO), which exclude real estate gains as well as other non-recurring items, were $45.3 million compared to $44.1 million in last year's second quarter, up 2.8%. Normalized FFO per diluted share were $0.39 versus $0.42. The company's balance sheet was consistent with the year end, although there is a little lower debt and a little higher equity balance.

Other 2nd Quarter Activity

Investment Activity – HR announced two acquisitions during the 2nd quarter, a 100% leased, 76,000 square foot medical office building in the San Francisco market for $26.8 million, and a 62,000 square foot medical office building in the Washington, DC area for $24.0 million that is 100% leased. Both properties are located on hospital campuses. Subsequent to quarter end the company purchased a Los Angeles based medical office building for $16.3 million. The property is located on a hospital campus and is 93% leased. The company also completed the core and shell of one of its development properties, with the first tenant expected to move in later this month and the balance of the initial leasing of the 100,000 square foot property expected to take occupancy through the early part of next year. The company also sold three properties during the quarter for the total amount of $38.2 million.

Capital/Financing Activity – The only major capital activity during the quarter, other than shares sold on its dividend reinvestment plan was the assumption of a $12 million mortgage note in conjunction with one of the company's property purchases.

Dividend – Following consistent dividend increases from the inception of the company, in 2007 HR cut its ongoing dividend from an annual rate of $2.64 a share down to an ongoing rate of $1.54 on an annual basis following the payment of a $4.75 a share extraordinary dividend. This extraordinary dividend was funded out of the proceeds from the sale of the company's non-core assets. Since that asset sale, despite the addition of assets, the company kept its regular dividend at $0.385 quarterly over the next ten quarters, before reducing it again in the first quarter of 2010 to $0.30 per quarter or $1.20 annually. This level of dividend payment has now fallen to a point where the current level of cash flow generation could argue for an increase in the payment, with a payout ratio of just over 70% of estimated current year FFO. This is now generally in-line with the company's peers in the healthcare REIT industry. As such, we would argue that the company could begin bumping the payment again. Given that its dividend yield in now under its peers, we would not be surprised to see the company begin such increases.

Quarterly Income Statement

(in thousands)	2Q 2017	2Q 2016	% Change
Rental Income	$104,869	$101,472	3.3%
Mortgage Interest	0	0	
Other Operating Income	376	1,170	-67.9%
Total Revenue	105,245	102,642	2.5%
General & Admin	8,005	7,756	3.2%
Acquisition related expense	785	373	
Bad debt expense	105	78	
Operating and other	38,184	36,263	5.3%
EBITDA	58,166	58,172	0.0%
Interest Expense	14,239	14,722	-3.3%
Depreciation & Amortization Expense	34,823	31,290	11.3%
Income (Loss) Before Discontinued Operations and Other Items	9,104	12,160	-25.1%
Discontinued Operations (including gain on sale of assets)	16,124	(12)	
Charges/other	(5)	(4)	
Income taxes	0	0	
Equity in income of JVs	0	0	
Minority Interest	0	0	
Gain on sale of properties	1	1	
Net Income (Loss)	$25,224	$12,145	107.7%
Net EPS (diluted)	$0.22	$0.12	88.1%
Avg. Shares Outstanding (diluted)	115,674	104,770	10.4%

Funds From Operations	2Q 2017	2Q 2016	
Net Income	$25,224	$12,145	107.7%
Depreciation Expense	35,421	31,716	11.7%
Other (adding/substracting one-time items)	(15,334)	228	
Funds From Operations	**$45,311**	**$44,089**	2.8%
Normalized FFO Per Share (diluted)	**$0.39**	**$0.42**	-7.1%

Source: Company reports.

Consolidated Balance Sheet

(in thousands)	June 30, 2017	December 31, 2016
Real Estate Assets		
Land	$213,195	$219,795
Buildings and Improvements (net of Depreciation)	$2,524,161	$2,545,641
Personal Property	$10,155	$10,291
Construction in progress	$0	$11,655
Mortgage Loans Receivable	0	0
Total Net Real Estate Investments	2,747,511	2,787,382
Cash and Cash Equivalents	2,033	5,409
Investments in JVs	0	0
Accounts Receivable	0	0
Restricted cash	9,151	49,098
Intangibles	0	0
Real estate held for sale	8,767	3,092
Other assets	191,036	195,666
Total Assets	**$2,958,498**	**$3,040,647**
Bank Borrowings	$0	$0
Mortgage Loan payable	0	0
Bond payable and capital leases	1,203,146	1,264,370
Accrued expenses and other liabilities	62,121	78,266
Liabilities of Discontinued	398	614
Other Liabilities	46,556	43,983
Minority interest in JVs	0	0
Non-managing member unitholders	0	0
Total Liabilities	**$1,312,221**	**$1,387,233**
Non-controlling interest	-	-
Common Stock	1,165	1,164
Capital in Excess of Par Value	2,923,519	2,917,914
Other	(1,316)	(1,401)
Cumulative Net Income for Shareholders	1,052,326	995,256
Cumulative Distributions	(2,329,417)	(2,259,519)
Total Shareholders' Equity	**1,646,277**	**1,653,414**
Total Liabilities and Shareholders' Equity	**$2,958,498**	**$3,040,647**

Balance Sheet Ratio Analysis	June 30, 2017	December 31, 2016
Net R/E Investments / Total Debt	43.8%	45.4%
Debt to Equity	73.1%	76.5%
Debt as % of Total Assets	40.7%	41.6%
Shareholders' Equity as % of Total Assets	55.6%	54.4%

Source: Company reports.

First Take

In looking at the company's Q2 results, the numbers were pretty much negative versus our expectations, right across the board, with lower revenue combined with higher expenses resulting in the two cent miss versus our estimate. We had taken into account the higher share count, and in fact, we had assumed a small amount of share issuance under the at the market share issuance program that did not occur. Interestingly, fundamentals were reasonably good, with same store NOI up 3.9%, an increase in occupancy to 89.2% from 88.7%, cash leasing spreads were up 9.5% and the retention rate was a strong 90.3%. However, it seems as if dilution from asset sales is more than offsetting accretion from recent acquisitions and development activity. While the company did not offer any numbers on the recent purchases or sales, our best guess is that the company is receiving a lower return on those properties being purchased than those being sold. The development properties should begin adding some growth, but this has been the story here for several years.

We are likely to change our estimates for the year due to the Q2 shortfall, although we will wait until after this morning's conference call before making a final decision on that front. Based on the Q2 numbers, it looks like we will see the third straight year of basically flat FFO. And while expectations are for growth to begin again next year, we are somewhat uncertain that this expectation will occur as we have seen starts and stops in this regard over the past several years. Despite these uncertainties, HR shares continue to trade at an above group valuation. The valuation metrics have been the major reason for our negative rating on the shares, but this uneven FFO growth should also give investors pause on purchasing HR shares. Overall, the quarter did not measure up to our expectations. While we hope to see continuing improvement at the development properties and the continuing acquisitions as the company puts the recently raised capital to work, we suggest investors hold back here until we begin to see more steady improvement. With the shares remaining the most expensive company among the healthcare REITs, our Underperform rating seems appropriate. Our full report will follow the company's conference call.

Suitability

HR has a suitability rating of 2 on our 1-4 scale. We find the company to have a strong balance sheet, and its tenant base is very diversified with a number of small tenants, as well as larger, credit tenants. Its lease rolls are also solid, with leases rolling off over an extended period of time. Its real estate ownership is also a positive factor, as is the company's geographic and operator diversification. On the other hand, the company is focused on a single asset class, albeit one that is relatively well thought of by investors currently. This reliance on medical office buildings could also be an issue if changes arise in doctor reimbursement.

Risks

There are a number of risks in owning HR 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 HR, as well as REITs in general have seen their prices rise with the decline in overall interest rates. Should rates rise, that could hurt HR'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. HR's current capital size may limit its ability to make larger acquisitions. It is always possible that the company could make a poor acquisition in the future. HR's geographic exposure to Texas might be an issue should energy prices collapse. The company's construction business, while small, does create some additional issues versus those REITs that just own and lease 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

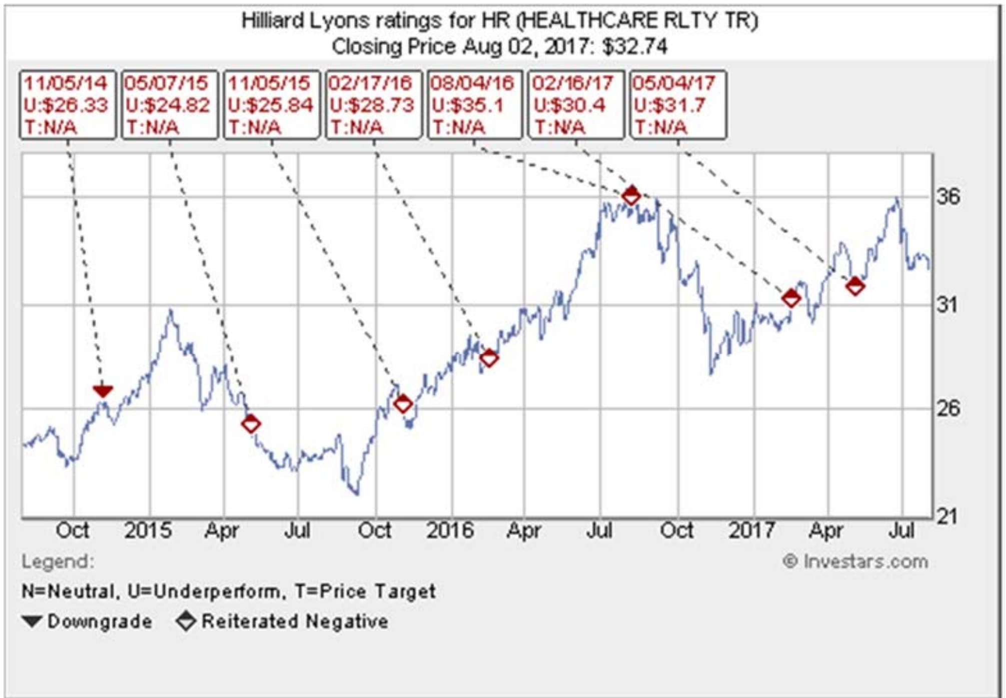
Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

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	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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