



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	\$0.40	\$0.44	\$0.44
4Q	\$0.41	\$0.43	\$0.43	\$0.45	\$0.45
Year	\$1.63	\$1.64	\$1.60	\$1.75 *	\$1.75
P/E	0.0x		20.5x		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	\$112.5
2Q	\$102.6	--	\$ 105.2	A \$114.8	\$114.9
3Q	\$103.7	\$109.2	\$ 106.4	\$117.1	\$117.1
4Q	\$105.3	\$111.6	\$ 110.7	\$119.1	\$119.2
Year	\$411.6	\$431.5	\$426.9	\$463.4	\$463.8

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

Conference Call Update

Investment Highlights

- We are fine-tuning our estimate for HR's 2017 FFO to \$1.60 a share due to the Q2 miss versus our estimate and a push back to Q4 for the closing of the bulk of the acquisitions in 2017. Our expectations for operating fundamentals remain, anticipating continued improvement. We also note the continued dilution that has resulted from asset sales in the near term. We are assuming that management has visibility on some future investment based on our discussions. Our 2018 estimate is a penny above the consensus at \$1.75 a share.
- In listening to management, we see development activity continuing in the foreseeable future at a consistent level. Such activity is more accretive than acquisition activity, especially in light of the company's extremely low cost of capital. The development activity provides the company with returns above 7%.
- Having said that, with the shares continuing to trade at a solid premium to the peer group and FFO is growth unlikely until next year (our new 2017 estimate is actually below last year, we continue to find the investment merits of HR limited due to valuation. While management seems very sure that the moves it is making will create long-term value, we see risk here that makes us uncomfortable with the current valuation metrics. With this in mind our rating on HR remains Underperform on price/valuation. Valuation remains well above the peer group, and we believe there are better places in the group to invest, thus our continued Underperform rating on HR shares.

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

Additional Conference Call Discussion

On the property fundamentals side, HR continues to provide reasonable operating metrics. Occupancy in the same store stabilized portfolio was 89.7% compared to 90.0% in the year earlier period. Total same store portfolio NOI was up 2.8% year-over-year. Contractual rental bumps rose 2.8%, while new leases were up a strong 9.5%. The average yield on renewals was up 320 basis points from Q2 2016. The retention rate was a very strong 90%, although that number may be down going forward with management retaining its guidance there at 75-90%.

Acquisition activity has been below the guidance trend line so far in 2017 and management now expects Q4 to see most of the \$175-\$200 million in acquisition activity that they have guided to. Management noted the \$67 million spent on the three properties closed during the first half of the year-plus, while divestitures are anticipated to be between \$120-\$125 million, with most of those divestitures already completed. Management mentioned that the average cap rates on these asset sales have been in the 7.1% area, compared with the 5.3% cap rate on those assets purchased. This is resulting in about \$1 million in dilution per quarter. Looking further out, management is anticipating another \$45 million in divestitures in Q1 2018 as a result of an expected exercise of a purchase option by the tenant. This sale will result in the loss of a little over \$6 million in NOI, although we anticipate that new investment will be more than what is lost.

HR management also discussed its development pipeline, which should come on line in a reasonably consistent basis over the next several years. Management anticipates between \$50 and \$100 million in development starts annually, with yields on these projects above 7%.

3rd Quarter and 2017 Outlook

Following our look at the second quarter and discussions with management, we are dropping our Q3 FFO estimate to \$0.40 a share. We are also reducing our full year 2017 FFO number to \$1.60 a share with the assumption that the company will see the bulk of its investment nearer the end of 2017. Our 2018 FFO estimate remains at \$1.75 a share. We continue to assume a modest level of acquisitions and investments (\$185 million in total) in the current year. Gross investment and acquisitions are likely to be more skewed towards development activity in 2018, accounting for about a third of the \$225 million in total investment. We are assuming \$50 million in total divestitures for the year. We also expect the cap rate environment to rise slightly and any additional equity issuance from the ATM and DRP.

Valuation and Rating

Using our \$1.60 a share estimate for 2017, HR shares are trading at 20.5 times current year's FFO. This is a premium to the company's peer group, as shown in the table on the following page. The company does have a debt to capital ratio below the peer group, a positive, although not enough to overcome the valuation level. As such, we do not believe that HR is attractive on a pure valuation basis. The potential growth beyond the current year could make the current valuation more reasonable, although we are in more of a wait and see mode on that front. The company's property mix is among the most sought after by investors and acquirers at the current time, with its low level of government reimbursement and lack of exposure to skilled nursing. We note that all of the large healthcare REITs are touting their lack of government exposure and the downward trend in exposure to government payment risk. This has pushed down the cap rate required by management and made the company's portfolio more valuable on an asset value basis. However, that has not yet translated into meaningfully higher cash flow and dividend payments. And since the company has not stated that it would be selling its assets to recognize this value, the cash flow and potential dividend payments are more important to us when looking at the shares. We note that the dividend has been stagnant now for more than seven years following a reduction in 2009. Having said that, in our view HR shares have yet to become attractive, all things considered, due to the extended valuation. Thus our rating remains Underperform.

Health Care REITs	Symbol	Closing Price	Current	2017E			2-Year Average		Price / FFO	
		8/2/2017	Dividend	Yield	Payout Ratio	2017E	2018E	Growth Rate	2017E	2018E
Welltower, Inc.	HCN	\$72.43	\$3.48	4.8%	81.1%	\$4.29	\$4.51	-0.4%	16.9x	16.1x
National Health Investors	NHI	\$75.80	\$3.80	5.0%	73.2%	\$5.19	\$5.40	5.3%	14.6x	14.0x
Physician's Realty Trust	DOC	\$18.23	\$0.92	5.0%	75.4%	\$1.22	\$1.32	16.1%	14.9x	13.8x
HCP, Inc.	HCP	\$30.03	\$1.48	4.9%	75.5%	\$1.96	\$2.05	-13.5%	15.3x	14.6x
Ventas, Inc.	VTR	\$66.02	\$2.92	4.4%	68.9%	\$4.24	\$4.44	3.7%	15.6x	14.9x
LTC Properties, Inc.	LTC	\$50.25	\$2.28	4.5%	72.2%	\$3.16	\$3.34	4.5%	15.9x	15.0x
Health Care Sector Average		\$52.50	\$2.52	4.8%	71.1%	\$3.38	\$3.54	1.3%	15.5x	14.8x
Healthcare Realty	HR	\$32.74	\$1.20	3.7%	68.6%	\$1.60	\$1.75	3.6%	20.5x	18.7x

Note: DOC is rated Long-term Buy, NHI, VTR, LTC and HCP Neutral and HCN Underperform by Hilliard Lyons.

Source: NAREIT, Baseline and Hilliard Lyons' estimates.

Suitability

HR has a suitability rating of 2 on our 1-4 scale, which we recently pushed up from 3 due to an equity offering. 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.

Table 1. Consolidated Income Statement
In Thousands

	2015		2016		2017E			2018E			Year	
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1A	Q2A	Q3		Q4
Master Lease Rent	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Property Operating/Rental Income	\$383,333	\$101,472	\$102,534	\$104,736	\$407,482	\$104,888	\$104,889	\$106,021	\$110,333	\$116,725	\$118,778	\$462,102
Straight Line Rent	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Mortgage Interest	\$91	\$1,170	\$1,125	\$573	\$4,149	\$481	\$376	\$380	\$396	\$410	\$426	\$1,657
Other	\$5,669	\$102,642	\$103,659	\$105,309	\$411,631	\$104,569	\$105,245	\$106,401	\$110,729	\$117,143	\$119,203	\$463,759
	\$388,471	\$100,021	\$102,642	\$105,309	\$411,631	\$104,569	\$105,245	\$106,401	\$110,729	\$117,143	\$119,203	\$463,759
Expenses												
General & Administrative	\$26,925	\$8,129	\$8,724	\$8,707	\$35,806	\$9,280	\$8,005	\$8,353	\$9,246	\$9,137	\$9,655	\$37,531
Property operating expense	140,195	35,406	36,263	37,285	146,458	37,834	38,184	39,387	38,716	41,437	41,394	161,352
Acquisition expense	-	-	-	-	-	-	-	-	-	-	-	-
Impairments	-	-	-	-	-	-	-	-	-	-	-	-
Bad Debt Expense, net	(201)	(39)	(47)	(13)	(21)	66	105	-	-	-	-	-
Interest Expense, net	71,903	14,852	13,636	13,839	57,049	14,159	14,239	13,729	14,107	16,400	16,773	64,059
Amortization	10,820	2,700	2,712	3,033	11,207	3,040	-	-	-	-	-	-
Other	9	-	-	-	-	-	-	-	-	-	-	-
Depreciation	100,586	27,693	28,528	30,989	116,483	31,412	34,823	35,136	35,754	37,402	37,839	148,551
Total Expenses	\$341,795	\$90,858	\$90,482	\$93,840	\$366,982	\$95,791	\$96,141	\$96,604	\$97,823	\$104,376	\$105,662	\$411,492
Income from Operations	\$38,489	\$9,163	\$12,160	\$11,857	\$44,649	\$8,778	\$9,104	\$9,798	\$12,906	\$12,767	\$13,542	\$52,267
Minority interests	(\$313)	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Other income/loss	\$78	\$0	\$0	\$74	\$74	\$0	(\$5)	\$0	\$0	\$0	\$0	\$0
Oper. Income from discontinued ops.	\$629	(\$7)	(\$12)	\$40,884	\$40,852	\$0	\$0	\$0	\$0	\$0	\$0	\$200
Income taxes	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Impairments	(\$37,094)	\$0	(\$4)	\$0	(\$4)	(\$23)	\$0	\$0	\$0	\$0	\$0	\$0
(Loss)/Gain on sale of assets	\$2,130	\$0	\$1	\$0	\$1	\$23,390	\$16,125	\$0	\$0	\$0	\$0	\$0
	\$69,436	\$9,156	\$12,145	\$11,834	\$52,437	\$31,845	\$25,224	\$9,798	\$12,906	\$12,817	\$13,592	\$52,467
Preferred dividends	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Net income for common	\$31,887	\$9,156	\$12,145	\$11,834	\$52,437	\$31,845	\$25,224	\$9,798	\$12,906	\$12,817	\$13,592	\$52,467
Per share bef. Extra	\$0.33	\$0.09	\$0.12	\$0.10	\$0.45	\$0.28	\$0.22	\$0.08	\$0.11	\$0.12	\$0.12	\$0.45
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
Net (loss) income per share	\$0.33	\$0.09	\$0.12	\$0.10	\$0.45	\$0.28	\$0.22	\$0.08	\$0.11	\$0.12	\$0.12	\$0.45
Quarterly dividend rate	\$1.20	\$0.30	\$0.30	\$0.30	\$1.20	\$0.30	\$0.30	\$0.30	\$0.30	\$0.30	\$0.30	\$1.20
Sts Outstanding (diluted)	96,744,500	102,165,000	104,770,000	115,052,000	115,408,000	115,507,000	115,674,000	115,977,030	116,886,121	117,518,178	117,743,984	117,410,945

Table 5. Funds From Operations Calculation
In Thousands

	2015		2016		2017E			2018E			Year	
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1A	Q2A	Q3		Q4
Net income for common shareholders	\$69,436	\$9,156	\$12,145	\$11,834	\$52,437	\$31,845	\$25,224	\$9,798	\$12,906	\$12,817	\$13,592	\$52,467
Acid Back:												
Depreciation	114,533	30,800	31,716	32,557	34,699	35,555	35,421	36,172	36,808	38,001	38,956	152,833
JV Adjustment	-	\$0	\$229	\$0	\$0	\$915	\$0	\$0	\$0	\$0	\$0	\$0
Other	\$41,871	\$0	\$229	\$0	\$229	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Non-recurring	-	-	-	-	-	-	-	-	-	-	-	-
Deduct:												
Gain/loss on sales of real estate	(\$666)	\$1,707	(\$1)	\$730	(\$4,001)	(\$23,390)	(\$15,334)	\$0	\$0	\$0	\$0	\$0
FFO Available for common	\$159,977	\$41,663	\$44,089	\$45,121	\$47,135	\$44,925	\$45,311	\$46,970	\$49,715	\$51,322	\$52,548	\$205,400
Diluted FFO available for common	\$141,315	\$41,663	\$44,089	\$45,121	\$47,135	\$44,925	\$45,311	\$46,970	\$49,715	\$51,322	\$52,548	\$205,400
Basic FFO per share	\$1.61	\$0.41	\$0.42	\$0.39	\$0.41	\$0.39	\$0.39	\$0.40	\$0.43	\$0.44	\$0.44	\$1.75
Diluted FFO per share	\$1.46	\$0.41	\$0.42	\$0.39	\$0.41	\$0.39	\$0.39	\$0.40	\$0.43	\$0.44	\$0.44	\$1.75
Shares, basic	96,505,000	101,815,000	104,420,000	114,702,000	115,058,000	115,507,000	115,674,000	115,977,030	116,886,121	117,518,178	117,393,984	117,060,945
Shares, diluted	96,855,000	102,165,000	104,770,000	115,052,000	115,408,000	115,507,000	115,674,000	115,977,030	116,886,121	117,518,178	117,743,984	117,410,945

Table 6. Funds Available for Distribution Calculation

FFO Available for common	\$141,315	\$159,977	\$141,315	\$141,315	\$141,315	\$141,315	\$141,315	\$141,315	\$141,315	\$141,315	\$141,315	\$141,315
Less:												
Recurring real estate CAPX	(\$13,900)	(\$2,990)	(\$3,000)	(\$3,050)	(\$3,075)	(\$2,950)	(\$3,000)	(\$3,050)	(\$3,075)	(\$3,050)	(\$3,075)	(\$12,075)
Debt adjustments	\$0	(\$4,750)	(\$1,200)	(\$1,200)	(\$1,150)	(\$1,200)	(\$1,200)	(\$1,200)	(\$1,150)	(\$1,200)	(\$1,150)	(\$4,750)
Other	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Funds available for distribution	\$128,415	\$141,327	\$128,415	\$128,415	\$128,415	\$128,415	\$128,415	\$128,415	\$128,415	\$128,415	\$128,415	\$128,415
Per share	\$1.33	\$1.42	\$1.33	\$1.33	\$1.33	\$1.33	\$1.33	\$1.33	\$1.33	\$1.33	\$1.33	\$1.33

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.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Rating				
Buy	36	29%	14%	86%
Hold/Neutral	79	63%	5%	95%
Sell	10	8%	0%	100%

As of 7 July 2017



Other Disclosures

Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation or needs of individual investors. Employees of J.J.B. Hilliard, W.L. Lyons, LLC or its affiliates may, at times, release written or oral commentary, technical analysis or trading strategies that differ from the opinions expressed here.

J.J.B. Hilliard, W.L. Lyons, LLC is a multi-disciplined financial services firm that regularly seeks investment banking assignments and compensation from issuers for services including, but not limited to, acting as an underwriter in an offering or financial advisor in a merger or acquisition, or serving as placement agent in private transactions.

The information herein has been obtained from sources we believe to be reliable but is not guaranteed and does not purport to be a complete statement of all material factors. This is for informational purposes and is not a solicitation of orders to purchase or sell securities. Reproduction is forbidden unless authorized. All rights reserved.