HILLIARD LYONS

Healthcare Real Estate Investment Trusts
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February 16, 2017

COMPANY UPDATE

Key Metrics

HR - NYSE -	(2/15/2017)	$30.39
Price Target		N/A
52-Week Range	$26.66 -	$36.60
Shares Outstanding (mm)		104.4
Market Cap. ($mm)		$3,172.7
1-Mo. Average Daily Volume		680,000
Institutional Ownership		96.2%
Debt/Total Capital	Dec-16	25.8%
Est 3-year FFO Growth Rate		4.0%
Est 3-year Dividend Growth Rate		1.0%
Book Value		$12.71
Dividend		$ 1.20
Dividend Yield		3.95%
Est. Fixed Charge Coverage		3.5X

FFO

	2015		2016	Prior 2017E		Current 2017E
1Q	$0.38	--	$0.41	$0.41		$0.41
2Q	$0.39	--	$0.42	$0.43		$0.43
3Q	$0.41	--	$0.39	$0.43		$0.43
4Q	$0.41	--	$0.41	$0.43		$0.43
Year	$1.60		$1.63	$1.71	*	$1.71
P/E	0.0x		18.6x			17.8x

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

Revenue ($mm)

	2015		2016	Prior 2017E	Current 2017E
1Q	$ 96.5	--	$ 100.0	$107.9	$107.9
2Q	$ 96.7	--	$ 102.6	$110.1	$110.1
3Q	$ 96.7	--	$ 103.7	$112.1	$112.1
4Q	$ 98.6	--	$ 105.3	$113.9	$113.9
Year	$388.5		$411.6	$444.1	$444.1

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 Trust, Inc.

HR -- NYSE – Underperform-3

Fourth Quarter Earnings Highlights

Investment Highlights

- HR reported normalized Q4 FFO of $0.41 a share. This equals our number and is a penny above the consensus. Year ago results were $0.41 a share. The company met our above consensus estimate in spite of the loss of a few leases over the past several quarters, something that will stretch into 2017. While we anticipate that the company will be able to replace these leases, there may be some timing issues here that could push our expectations down a penny or two. At this point while we are retaining our FFO estimate for 2017 at $1.71, we will wait until after the conference call and an update of our earnings model before making a final decision on that front given these issues.
- HR shares have moved up a bit since hitting a 52-week low last November. The shares have acted in line with the group over the period, although we anticipate that worries about higher interest rates could place pressure on the group. Either way, the valuation of HR shares remains out of the range of its peers in the group and looks dearly priced, in our opinion. As such, our Underperform rating remains appropriate, with the shares trading at a significant premium to its peers.
- A full report on the company's conference call, as well as updated earnings estimates, rating and valuations will be out later this morning after the company's 10 AM Eastern conference call.

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

Fourth Quarter Review

Total revenue was $105.3 million versus $98.6 million, a 6.8% increase. Rental income of $104.7 million was up 7.5% (please see income statement on page 3). Other operating income fell 48.7% to $0.6 million.

Operating and other expense was up 1.4% at $37.2 million and was below our estimate of $38.0 million. General and administrative expense was up 20.7% to $8.7 million, above our estimate. Net interest expense fell 7.0% to $13.8 million in line with the reduction in debt driven by the recent share offering. Debt to total capital was 25.8% at year end. Depreciation and amortization expense was up 15.0% to $34.0 million versus $29.6 million, as recent real estate acquisitions increased this number. Non-recurring items for the quarter were gains of $40.9 million versus gains of $8.4 million in the year earlier period. Fourth quarter net income available to common shareholders was $52.4 million versus $18.7 million. Earnings per share for the quarter were $0.45 versus $0.19 on 14.9% more common shares outstanding in this year's fourth quarter.

Ongoing normalized funds from operations (FFO), which exclude real estate gains as well as other non-recurring items, were $47.1 million compared to $41.1 million in last year's fourth quarter, up 14.6%. FFO per diluted share were $0.41 versus $0.41. For the full year, HR reported FFO of $1.63 a share, versus $1.60 a share in 2015.

Other 4th Quarter Activity

Investment Activity – HR purchased 5 properties accounting for 212,000 square feet for a total purchase price of $63.8 million. The properties average about 91%-leased. This brought total acquisitions for the year to nearly $242 million. We believe that the cap rate was in the low-6% range on these purchases. The company also had total dispositions of $95 million for the year, all in Q4. We expect these sales to be slightly dilutive to the company's bottom line. In addition to the divestitures, the company also had $45.3 million in development and redevelopment funding.

Capital/Financing Activity – HR undertook no major capital raising activity in Q4, other than normal share issuance under its dividend reinvestment and at the market stock issuance plans.

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 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)	4Q 2016	4Q 2015	% Change
Rental Income	$104,736	$97,466	7.5%
Mortgage Interest	0	0	
Other Operating Income	573	1,116	-48.7%
Total Revenue	105,309	98,582	6.8%
General & Admin	8,707	7,216	20.7%
Bad debt expense	-13	9	
Operating and other	37,285	36,758	1.4%
EBITDA	59,330	54,599	8.7%
Interest Expense	13,839	14,885	-7.0%
Depreciation & Amortization Expense	34,022	29,575	15.0%
Income (Loss) Before Discontinued Operations and Other Items	11,469	10,139	
Discontinued Operations (including gain on sale of assets)	40,894	8,442	
Charges	0	(1)	
Other Income	74	78	
Equity in income of JVs	0	0	
Minority Interest	0	0	
Preferred Stock Dividends	0	0	
Net Income (Loss)	$52,437	$18,658	
Net EPS (diluted)	$0.45	$0.19	
Avg. Shares Outstanding (diluted)	115,408	100,474	14.9%

Funds From Operations	4Q 2016	4Q 2015	
Net Income	$52,437	$18,658	
Depreciation Expense	34,699	29,021	19.6%
Other (adding/substracting one-time items)	(40,001)	(6,537)	
Funds From Operations	**$47,135**	**$41,142**	14.6%
Normalized FFO Per Share (diluted)	**$0.41**	**$0.41**	0.0%

Source: Company reports.

Consolidated Balance Sheet

(in thousands)	December 31, 2016	December 31, 2015
Real Estate Assets		
Land	$219,795	$216,037
Buildings and Improvements (net of Depreciation)	$2,545,641	$2,373,967
Personal Property	$10,291	$9,954
Construction in progress	$11,655	$19,024
Mortgage Loans Receivable	0	0
Total Net Real Estate Investments	2,787,382	2,618,982
Cash and Cash Equivalents	5,409	4,102
Investments in JVs	0	0
Accounts Receivable	0	0
Restricted cash	49,098	0
Intangibles	0	0
Real estate held for sale	3,092	724
Other assets	195,666	192,918
Total Assets	**$3,040,647**	**$2,816,726**
Bank Borrowings	$0	$0
Mortgage Loan payable	0	0
Bond payable and capital leases	1,264,370	1,431,494
Accrued expenses and other liabilities	78,266	75,489
Liabilities of Discontinued	614	33
Other Liabilities	43,983	66,963
Minority interest in JVs	0	0
Non-managing member unitholders	0	0
Total Liabilities	**$1,387,233**	**$1,573,979**
Non-controlling interest	-	-
Common Stock	1,164	1,015
Capital in Excess of Par Value	2,917,914	2,461,376
Other	(1,401)	(1,569)
Cumulative Net Income for Shareholders	995,256	909,685
Cumulative Distributions	(2,259,519)	(2,127,760)
Total Shareholders' Equity	**1,653,414**	**1,242,747**
Total Liabilities and Shareholders' Equity	**$3,040,647**	**$2,816,726**

Balance Sheet Ratio Analysis	December 31, 2016	December 31, 2015
Net R/E Investments / Total Debt	45.4%	54.7%
Debt to Equity	76.5%	115.2%
Debt as % of Total Assets	41.6%	50.8%
Shareholders' Equity as % of Total Assets	54.4%	44.1%

Source: Company reports.

First Take

In looking at the company's Q4 results, the bottom line numbers were right on our expectations. Operating margins were in line with our estimates, while G&A expense was a little higher, offset to some degree by slightly lower than expected interest expense. Property operating fundamentals remain solid, with a retention rate of 88.5%. The company's same store occupancy rate remains strong, at 89.2%, up from 88.7%. Re-leasing spreads remained solid for the quarter at 3.2% and same store revenue per average occupied square foot increased 2.9% over the prior year. Overall, the quarter was close to expectations. Acquisition activity in Q4 was above our expectations, putting the company in a good position to meet our forward expectations for 2017, in spite of no announced investments so far. As such our 2017 numbers look reasonable, although we will wait until after the morning conference call to adjust them as well as initiate a 2018 estimate. The company's valuation remains the issue here, however, as operating results are solid, but do not live up to the current valuation metrics, in our view. Our full report will follow the company's conference call and we will offer our updated estimates and rating following our discussion with management.

Suitability

HR has a suitability rating of 2 on our 1-4 scale, which we pushed up from 3 due to the recent 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 attractive to shareholders and REITs in general could see their prices decline if rates rise, as investors switch to lower risk, higher yielding bonds, potentially hurting 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 structure and falling cash flow 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

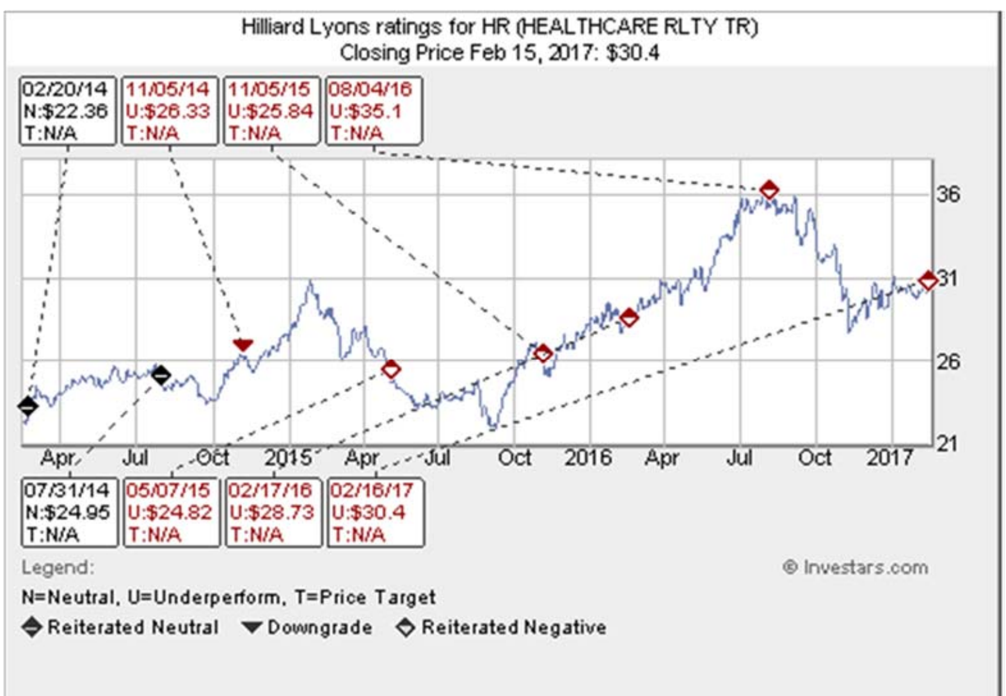
Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.
Neutral - We believe 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	30%	17%	83%
Hold/Neutral	76	62%	7%	93%
Sell	10	8%	0%	100%

As of 6 February 2017



Other Disclosures

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