HILLIARD LYONS

Healthcare Real Estate Investment Trusts
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COMPANY UPDATE/ESTIMATE CHANGE

Key Metrics

HR - NYSE -	(5/3/2017)	$31.70
Price Target		N/A
52-Week Range	$26.66 -	$36.60
Shares Outstanding (mm)		104.4
Market Cap. ($mm)		$3,309.5
1-Mo. Average Daily Volume		680,000
Institutional Ownership		96.2%
Debt/Total Capital	Mar-17	25.3%
Est 3-year FFO Growth Rate		4.0%
Est 3-year Dividend Growth Rate		0.0%
Book Value		$12.71
Dividend		$ 1.20
Dividend Yield		3.79%
Est. Fixed Charge Coverage		3.5X

FFO

	2016	Prior 2017E	Current 2017E		Prior 2018E		Current 2018E
1Q	$0.41	--	$0.39	A	--		$0.42
2Q	$0.42	--	$0.43		--		$0.45
3Q	$0.39	--	$0.43		--		$0.44
4Q	$0.41	--	$0.43		--		$0.45
Year	$1.63	$1.70	$1.68			*	$1.76
P/E	0.0x		18.8x				18.0x

* - 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	--	$114.8
2Q	$102.6	--	$ 109.1		--	$117.2
3Q	$103.7	--	$ 111.4		--	$119.5
4Q	$105.3	--	$ 113.3		--	$121.5
Year	$411.6		$440.7			$473.0

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-3

First Quarter Earnings Highlights

Investment Highlights

- HR reported normalized Q1 FFO of $0.39 a share. This was two cents under our number as well as the consensus. Year ago results were an as adjusted $0.41 a share.
- While operating numbers were solid, they were down a bit from recent numbers and this did not translate to the top line with revenue coming in under our expectations. Same store NOI increased 4.4% and same store occupancy moved up 50 basis points to 89.1%. The retention rate during the quarter was 79.2%. These metrics were all lower than a year ago. The other factor behind the shortfall is that the company acquired only a single property during the quarter for $13.5 million, while selling $82 million worth of properties. This mix of transactions is going to be dilutive in light of the company's very low cost of capital.
- A full report on the company's conference call, as well as updated earnings estimates, ratings and valuation will be out later today after the company's 10 AM Eastern conference call. In light of what was reported, we anticipate a decline in our forward estimates, which will make HR even more expensive.

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

First Quarter Review

Total revenue was $104.6 million versus $100.0 million, a 4.5% increase. Rental income of $104.1 million was up 5.4% (please see income statement on page 3). This was a little below our $106.3 million number. Total revenue compared to our estimate of $106.9 million.

Operating and other expense was up 6.9% at $37.8 million compared to $35.4 million in the year earlier period and our estimate of $35.4 million. General and administrative expense was down 9.4% to $9.3 million, below our $10.2 million estimate. EBITDA came in at $57.4 million. Interest expense fell 5.2% to $14.2 million on refinanced debt at lower costs. Depreciation and amortization expense was up 13.4% to $34.5 million versus $30.4 million, as recent real estate investments increased these numbers. Non-recurring items for the quarter were a net $23 million profit as a result of asset sales versus $0.1 million in the year earlier period. First quarter net income available to common shareholders was $31.8 million versus $9.2 million. Earnings per share for the quarter were $0.28 versus $0.09 on 13.1% more common shares outstanding in this year's first quarter.

Normalized funds from operations (FFO), which exclude real estate gains as well as other non-recurring items, were $44.9 million compared to $41.7 million in last year's first quarter, a 7.8% increase. FFO per diluted share were $0.39 versus $0.41. On a balance sheet front, debt rose slightly since year end amounting to $1.28 billion, or 25.3% of total market value.

Other 1st Quarter Activity

Investment Activity – HR acquired a 100%-leased, 35,000 square foot medical office building in St. Paul, MI for $13.5 million. As noted earlier, the company also sold $82 million in properties, including three inpatient rehabilitation facilities for $69.5 million. Depending on what management says on today's conference call we may be fine-tuning our expectations for acquisitions the remainder of the year.

Capital/Financing Activity – HR undertook no meaningful capital markets activity during the quarter other than equity raised under its dividend reinvestment plan.

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)	1Q 2017	1Q 2016	% Change
Rental Income	$104,088	$98,740	5.4%
Mortgage Interest	0	0	
Other Operating Income	481	1,281	-62.5%
Total Revenue	104,569	100,021	4.5%
General & Admin	9,280	10,246	-9.4%
Bad debt expense	66	-39	
Operating and other	37,834	35,406	6.9%
EBITDA	57,389	54,408	5.5%
Interest Expense	14,159	14,938	-5.2%
Depreciation & Amortization Expense	34,452	30,393	13.4%
Income (Loss) Before Discontinued Operations and Other Items	8,778	9,077	-3.3%
Discontinued Operations (including gain on sale of assets)	23,390	(7)	
Charges	(323)	0	
Income taxes	0	0	
Equity in income of JVs	0	0	
Minority Interest	0	0	
Interest and other income	0	86	
Net Income (Loss)	$31,845	$9,156	247.8%
Net EPS (diluted)	$0.28	$0.09	207.6%
Avg. Shares Outstanding (diluted)	115,507	102,165	13.1%

Funds From Operations	1Q 2017	1Q 2016	
Net Income	$31,845	$9,156	247.8%
Depreciation Expense	35,555	30,800	15.4%
Other (adding/substracting one-time items)	(22,475)	1,707	
Funds From Operations	**$44,925**	**$41,663**	7.8%
Normalized FFO Per Share (diluted)	**$0.39**	**$0.41**	-4.9%

Source: Company reports.

Consolidated Balance Sheet

(in thousands)	March 31, 2017	December 31, 2016
Real Estate Assets		
Land	$213,224	$219,795
Buildings and Improvements (net of Depreciation)	$2,486,233	$2,545,641
Personal Property	$9,998	$10,291
Construction in progress	$16,114	$11,655
Mortgage Loans Receivable	0	0
Total Net Real Estate Investments	2,725,569	2,787,382
Cash and Cash Equivalents	1,478	5,409
Investments in JVs	0	0
Accounts Receivable	0	0
Restricted cash	104,904	49,098
Intangibles	0	0
Real estate held for sale	15,111	3,092
Other assets	192,174	195,666
Total Assets	**$3,039,236**	**$3,040,647**
Bank Borrowings	$0	$0
Mortgage Loan payable	0	0
Bond payable and capital leases	1,278,662	1,264,370
Accrued expenses and other liabilities	62,746	78,266
Liabilities of Discontinued	93	614
Other Liabilities	44,444	43,983
Minority interest in JVs	0	0
Non-managing member unitholders	0	0
Total Liabilities	**$1,385,945**	**$1,387,233**
Non-controlling interest	-	-
Common Stock	1,165	1,164
Capital in Excess of Par Value	2,920,839	2,917,914
Other	(1,358)	(1,401)
Cumulative Net Income for Shareholders	1,027,101	995,256
Cumulative Distributions	(2,294,456)	(2,259,519)
Total Shareholders' Equity	**1,653,291**	**1,653,414**
Total Liabilities and Shareholders' Equity	**$3,039,236**	**$3,040,647**

Balance Sheet Ratio Analysis	March 31, 2017	December 31, 2016
Net R/E Investments / Total Debt	46.9%	45.4%
Debt to Equity	77.3%	76.5%
Debt as % of Total Assets	42.1%	41.6%
Shareholders' Equity as % of Total Assets	54.4%	54.4%

Source: Company reports.

First Take

In looking at the company's Q1 results, the top line numbers were definitely on the weak side and this, along with higher operating costs led to the company missing our and consensus expectations. Our assumption is that the dilutive impact of the asset sales led to the shortfall, but that is definitely something that will need to be addressed on the conference call. In our view, this would have to be considered a disappointing quarter, down from the year ago number and missing expectations. HR seemed to be turning the corner recently, with it finally showing some growth. However, this quarter would seem to set that back. We note that this year's expectations are the same FFO that the company reported in 2009.

As we noted in our recent report on Physicians Realty (DOC, $19.03), cap rates on the group have pulled in recently, driving up values. As a result, the company is probably trading for well below the value of its real estate based on recent transactions. However, we do not anticipate that the company will be selling off its properties any time soon, so from our perspective, cash flow and dividend growth are much more important, and HR is just not showing consistency in either. And this, in our opinion, does not justify the current above group valuation. This is the reason for our continued negative rating on the shares. We just do not see a rationale for the company's high valuation in the financial results the company continues to report. A full report will follow the company's conference call, although we will almost certainly be reducing our forward estimates on the company.

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

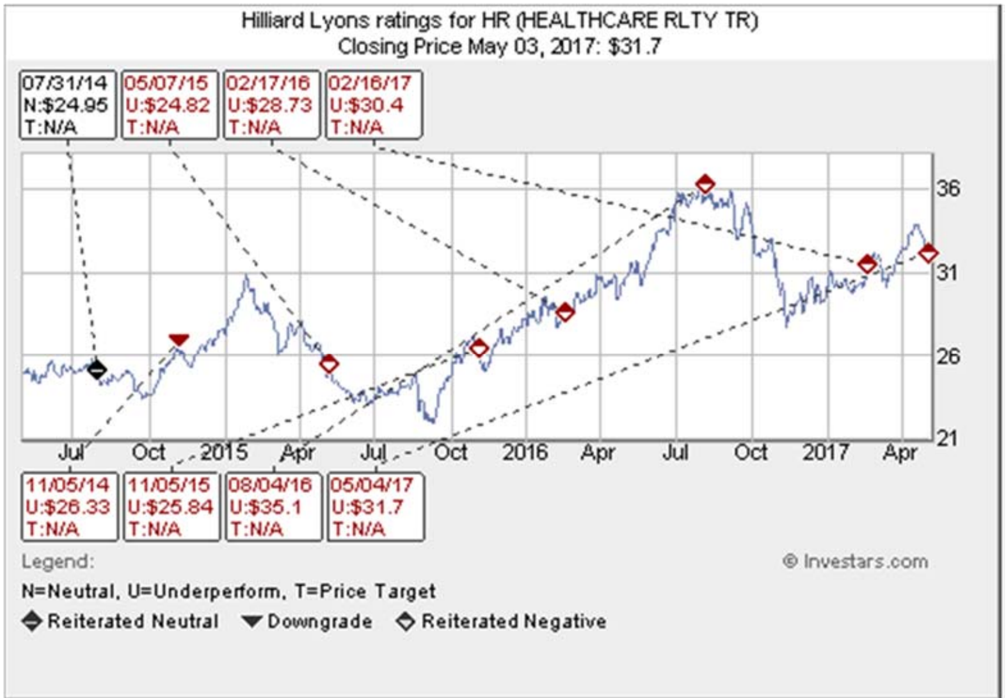
Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

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%	14%	86%
Hold/Neutral	71	58%	6%	94%
Sell	15	12%	7%	93%

As of 5 April 2017



Other Disclosures

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