HILLIARD LYONS

Healthcare Real Estate Investment Trusts
John Roberts
J.J.B. Hilliard, W.L. Lyons, LLC
502.588.1165 / jmroberts@hilliard.com
502.588.9141/GMoorin@hilliard.com
J.J.B. Hilliard, W.L. Lyons, LLC
November 2, 2017

COMPANY UPDATE/ESTIMATE CHANGE

Key Metrics

HR - NYSE -	(11/1/2017)	$32.37
Price Target		N/A
52-Week Range		$26.66 - $36.25
Shares Outstanding (mm)		119.1
Market Cap. ($mm)		$3,855.3
1-Mo. Average Daily Volume		784,000
Institutional Ownership		96.2%
Debt/Total Capital	Sep-17	22.5%
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		3.71%
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	--	$0.38	A	$0.44		$0.44
4Q	$0.41	$0.43	$0.43		$0.45		$0.45
Year	$1.63	$1.60	$1.58		$1.75	*	$1.75
P/E	0.0x		20.5x				18.5x

* - 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	$112.5	$112.5
2Q	$102.6	--	$ 105.2	A	$114.9	$114.9
3Q	$103.7	--	$ 107.0	A	$117.1	$117.1
4Q	$105.3	$110.7	$ 110.7		$119.2	$119.2
Year	$411.6	$426.9	$427.5		$463.8	$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

Third Quarter Earnings Highlights

Investment Highlights

- HR reported normalized Q3 FFO of $0.38 a share. This compares to our estimate of $0.40 and the consensus estimate of $0.40. Year ago results were $0.39 a share. Dilution from recent equity issuance was the major factor behind the shortfall. That dilution should recede once the company closes its pending purchase of the Atlanta medical office building (MOB) portfolio. However, given the relatively low cap rate on the purchase (5.2%) we will not see a lot of initial accretion from the purchase.
- HR shares have moved pretty much along with the industry, with a generally positive bias. However, we note that the stock price continues to significantly outperform earnings, with 2017 likely to be another lost year from an earnings (FFO) perspective. We have now had three consecutive basically unchanged years for FFO, with our estimate for 2017 the same as the 2015 number before any change on yesterday's results. Thus, investors are either assuming a significant move up in earnings for 2018 and beyond, or are assuming an asset value above the current share price. Given recent earnings performance we find this speculative and we believe our negative rating for the shares remains appropriate on a valuation that is essentially the highest in the group.
- The company's results were generally in line with our expectations when adjusted for the equity offering. We are likely to adjust our 2017 and 2018 estimates to take into account the equity offering, as well as potential accretion once the deal closes. Yet, we see little upside to our 2018 numbers as we had already assumed a level of acquisition activity in line with the Atlanta deal at a slightly higher cap rate. As such, we still do not see the shares as offering value for investors given the valuation metrics.
- 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 6-7.
Note Analyst Certification on Page 6.

Third Quarter Review

Total revenue was $107.0 million versus $103.7 million, a 3.2% increase. Rental income of $106.6 million was up 3.9% (please see income statement on page 3). Other line items were in line with our expectations. Total revenue compared to our estimate of $105.5 million.

Operating and other expense was up 8.3% at $40.6 million and was above our estimate of $39.0 million. General and administrative expense was up 2.1% to $8.0 million. NOI came in at $57.8 million versus $57.5 million in the year earlier period. Net interest expense rose 0.3% to $13.7 million. Depreciation and amortization expense was up 12.2% to $35.9 million versus $32.0 million, as recent real estate acquisitions increased this number. Third quarter net income available to common shareholders was $3.2 million versus $11.8 million due to an impairment on a real estate asset on this year's number. Earnings per share for the quarter were $0.03 versus $0.10 on 3.6% more common shares outstanding in this year's third quarter.

Ongoing funds from operations (FFO), which exclude real estate gains as well as other non-recurring items, were $45.2 million compared to $45.1 million in last year's third quarter, up 0.2%. FFO per diluted share were $0.38 versus $0.39 on the increase in shares from the recent equity offering.

Other 3rd Quarter Activity

Investment Activity – During the third quarter HR purchased a LA-based medical office building for $16.3 million, which is located on a hospital campus and is 93% leased. The company also announced that it had arrived at an agreement to purchase an eight property medical office building portfolio in the Atlanta market for $193.8 million. The portfolio is 496,000 square feet and is expected to provide a first year yield of 5.2%. The company closed on four of the buildings amounting to $112.1 million and we expect the remainder of the deal to close later in the current quarter. Following quarter end the company purchased a 26,000 square foot medical office building in Seattle adjacent to a hospital for $12.7 million that is 96% leased.

Capital/Financing Activity – The company completed an equity offering during Q3, selling 8.3 million shares raising $215 million after underwriting fees. This will pay for the Atlanta purchase, as well as pay down some existing debt. In that vein, the company also announced that it would be redeeming $100 million of 5.75% notes due in 2021 in the current quarter. The company will be redeeming the notes at a premium price of $113.4 million including accrued interest and will record a fourth quarter charge of $12.2 million. The company's debt to total market capital ratio fell to 22.5% at quarter end, due to the recent share issuance.

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)	3Q 2017	3Q 2016	% Change
Rental Income	$106,561	$102,534	3.9%
Mortgage Interest	0	0	
Other Operating Income	392	1,125	-65.2%
Total Revenue	106,953	103,659	3.2%
General & Admin	8,021	7,859	2.1%
Acquisition costs	507	865	
Bad debt expense	14	(47)	
Operating and other	40,626	37,504	8.3%
EBITDA	57,785	57,478	0.5%
Interest Expense (net)	13,681	13,636	0.3%
Depreciation & Amortization Expense	35,873	31,985	12.2%
Income (Loss) Before Discontinued Operations and Other Items	8,231	11,857	-30.6%
Discontinued Operations (including gain on sale of assets)	1	(23)	-104.3%
Charges	(5,059)	0	
Income taxes	0	0	
Equity in income of JVs	0	0	
Minority Interest	0	0	
Preferred Stock Dividends	0	0	
Net Income (Loss)	$3,173	$11,834	-73.2%
Net EPS (diluted)	$0.03	$0.10	-74.1%
Avg. Shares Outstanding (diluted)	119,181	115,052	3.6%

Funds From Operations (normalized)	3Q 2017	3Q 2016	
Net Income	$3,173	$11,834	-73.2%
Depreciation Expense	36,478	32,557	12.0%
Other (adding/substracting one-time items)	5,573	730	
Funds From Operations	**$45,224**	**$45,121**	0.2%
Normalized FFO Per Share (diluted)	**$0.38**	**$0.39**	-2.6%

Source: Company reports.

Consolidated Balance Sheet

(in thousands)	Sept. 30, 2017	December 31, 2016
Real Estate Assets		
Land	$216,340	$219,795
Buildings and Improvements (net of Depreciation)	$2,511,349	$2,545,641
Personal Property	$10,300	$10,291
Construction in progress	$1,138	$11,655
Mortgage Loans Receivable	0	0
Total Net Real Estate Investments	2,739,127	2,787,382
Cash and Cash Equivalents	196,981	5,409
Investments in JVs	0	0
Accounts Receivable	0	0
Restricted cash	0	49,098
Intangibles	0	0
Real estate held for sale	8,772	3,092
Other assets	200,824	195,666
Total Assets	**$3,145,704**	**$3,040,647**
Bank Borrowings	$0	$0
Mortgage Loan payable	0	0
Bond payable and capital leases	1,166,060	1,264,370
Accrued expenses and other liabilities	69,918	78,266
Liabilities of Discontinued	59	614
Other Liabilities	45,405	43,983
Minority interest in JVs	0	0
Non-managing member unitholders	0	0
Total Liabilities	**$1,281,442**	**$1,387,233**
Non-controlling interest	-	-
Common Stock	1,249	1,164
Capital in Excess of Par Value	3,173,167	2,917,914
Other	(1,274)	(1,401)
Cumulative Net Income for Shareholders	1,055,499	995,256
Cumulative Distributions	(2,364,379)	(2,259,519)
Total Shareholders' Equity	**1,864,262**	**1,653,414**
Total Liabilities and Shareholders' Equity	**$3,145,704**	**$3,040,647**

Balance Sheet Ratio Analysis	Sept. 30, 2017	December 31, 2016
Net R/E Investments / Total Debt	42.6%	45.4%
Debt to Equity	62.5%	76.5%
Debt as % of Total Assets	37.1%	41.6%
Shareholders' Equity as % of Total Assets	59.3%	54.4%

Source: Company reports.

First Take

In looking at the company's Q3 results, the top line numbers were generally a little better than our expectations, although the bottom line numbers were a little below due to higher costs, as were the per share numbers as a result of the recent equity offering. Occupancy was down a bit, the first time we have seen this occur in some time with same store occupancy sitting at 89.7% at quarter end compared to 90.0% in the year earlier quarter. Acquisitions have been reasonably constant, and have been additive to the company's bottom line in light of HR's very low cost of capital, at least prior to the equity offering until these funds are leveraged up in spite of the low cap rates due to the company's very low cost of capital with the high stock price. The company has undertaken both investments and asset sales, and we believe that additional acquisitions will be reasonably constant over the coming year, as will the development activity and follow-on investments, both which provide HR with higher returns. Operating performance has also shown continued improvement, with same facility NOI on its same store multi-tenant portfolio up a very solid 3.9%. Overall, the quarter was in line with our expectations, with the two cent miss versus our and the consensus mainly a function of the higher share count and the dilution it engenders, although gross numbers were also a little weak due to higher operating expenses. Once the dilution from the offering is behind the company with the Atlanta purchase, per share FFO numbers should come back to expectations. Despite that, the shares are not what we would consider attractively valued, with valuation metrics well above the peer group, and with per share numbers having been flat over a three year period. Our full report will follow the company's conference call and we will offer our updated thoughts 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 recent equity offerings that have sharply reduced the leverage on the company. 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	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

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.