HILLIARD LYONS

Healthcare Real Estate Investment Trusts
John Roberts
J.J.B. Hilliard, W.L. Lyons, LLC
502.588.1165 / jmroberts@hilliard.com
Institutional Sales Desk: George Moorin
502.588.9141/GMoorin@hilliard.com
J.J.B. Hilliard, W.L. Lyons, LLC
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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		$0.41
2Q	$0.42	--	$0.39	A	$0.44		$0.43
3Q	$0.39	--	$0.38	A	$0.44		$0.42
4Q	$0.41	$0.43	$0.40		$0.45		$0.43
Year	$1.63	$1.60	$1.56		$1.75	*	$1.69
P/E	0.0x		20.8x				19.2x

* - 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	$112.0
2Q	$102.6	--	$ 105.2	A	$114.9	$114.3
3Q	$103.7	--	$ 107.0	A	$117.1	$116.4
4Q	$105.3	$110.7	$ 109.5		$119.2	$118.4
Year	$411.6	$426.9	$426.2		$463.8	$461.1

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, Inc.

HR -- NYSE – Underperform - 2

Conference Call Update

Investment Highlights

- We are reducing our estimate for HR's 2017 FFO to $1.56 a share, and we are also lowering our 2018 FFO estimate to $1.69 a share, after talking to management and assuming a higher level of near term acquisition activity although also dilution from asset sales and equity issuance. Our 2018 FFO estimate now equals the consensus. Management now anticipates a higher level of acquisition activity for the remainder of 2017, although with the cap rates on assets purchased continuing to decline, these transactions are less accretive than we had been projecting, thus our estimates are a little lower with the additional equity issued.
- As we have noted many times before, HR's focus is on the acute care and medical office building (MOB) sectors, something that could keep it in better stead than its peers in the current environment. Management discussed the opportunities around its development activity on the conference call. Such higher yielding development activity continues to provide a higher return, and management anticipates $50-$100 million in such activity on an annual basis with yields likely in excess of 7.5%, which is solidly above the current yields on the company's recent acquisitions, which were priced in the sub-6% cap rate area.
- We are retaining our rating on HR shares at Underperform. HR's share price remains expensive with a valuation well above the peer group, despite three years of essentially flat numbers. While management anticipates a stronger year in 2018 (and our estimate also projects such), we have seen similar expectations the past year that have not been delivered. The large Atlanta acquisition, while additive, is only very little so, and as a result, we remain in a wait and see mode here. As such, we continue to suggest taking some money off the table here on a valuation basis.

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 on both the stabilized and lease-up portion of the portfolio. Occupancy in the same store portfolio was up marginally to 89.6% from 88.9% in the year earlier period, with total portfolio occupancy sitting at 87.4%. Total same store portfolio NOI was up 3.9% year-over-year. Contractual rental bumps rose 2.8%. The retention rate was 80.5%.

Management noted that there continues to be a number of development projects that would come on line over the next several years. Most of these are in existing markets and with existing tenants and some are expansions/redevelopments of existing properties. The returns on these are 100-200 basis points higher than acquisitions. The company limits risk on these investments by signing them with existing tenants. Management discussed in particular a new development in Seattle, WA, which is an on-campus project expected to be completed in early 2019. The project is currently 60%-preleased and with tenants the company is currently talking to should go to 70% on the project, which is expected to have an investment that totals $64 million. We are keeping our expectations for development and acquisitions the same at this point. Cap rates continue to compress on acquisitions, so we expect management to invest as much as they can in more accretive development/redevelopment activity.

Management also offered some guidance around the dilution that resulted from the recent equity offering, noting that half of the dilution was eliminated by the purchases undertaken in the quarter and that once the Atlanta portfolio purchase is complete it should begin to be additive. Also, they noted that there was a penny of negative impact around seasonal G&A costs, which should reverse in Q4. We have worked this into our estimates. Also additive is the redemption of the bond that we noted in the earlier report. This should add about a penny a quarter. On the strategy front management noted that it is moving towards multi-tenant properties and away from single tenant properties.

4th Quarter and 2018 Outlook

Following our look at the third quarter, we are reducing our Q4 FFO estimate to $0.40 and our full year 2017 FFO estimate to $1.56 a share, off from the year earlier. We believe that there will be a little accretion from investments made in Q4, but not enough to offset the impact of the higher share count from the Q3 equity offering, especially with the Atlanta purchase not closing until later in Q4. Assuming some improved occupancy on the overall portfolio and some addition from the development properties and a little over $250 million in acquisitions in net, combined with the lower expected interest expense offset by the dilutive impacts of the higher cap rate level of divestitures, our 2018 FFO estimate is now $1.69 a share. We expect the cap rate environment to move up slightly as interest rates creep up and no additional equity issuance other than a modest amount from the DRP and/or ATM program. Our estimate equals the consensus number.

Valuation and Rating

Using our $1.56 a share FFO estimate for 2017, HR shares are trading at 20.8 times current year's FFO. This is a solid premium to the company's peer group, as shown in the table on page 3. We note that the company's yield is lower than the peer group, although with the recent equity issuance, debt to capital is below the peer group, and it has a projected growth rate (assuming it occurs) above its peers. Despite these positives, we do not believe that HR is attractive on a pure valuation basis. While we believe the group as a whole is a little on the expensive side, HR appears much more so. We anticipate that the group could see some further weakness due to our worries on the Fed funds increase we expect for December and higher rates in the future. As a result, we see better places to put money in the group with HR shares being overvalued on a pure comparison basis, in our opinion. So while in our opinion its property mix is probably the most sought after by investors and acquirers, with its low level of government reimbursement and lack of exposure to skilled nursing, we just do not find the shares compelling at the current price and in fact would tend towards having investors reduce exposure to the company.

Health Care REITs		Closing Price	Current		2017E			2-Year Average	Price / FFO	
	Symbol	11/1/2017	Dividend	Yield	Payout Ratio	2017E	2018E	Growth Rate	2017E	2018E
Welltower, Inc.	HCN	$67.02	$3.48	5.2%	81.1%	$4.29	$4.51	-0.4%	15.6x	14.9x
National Health Investors	NHI	$76.74	$3.80	5.0%	73.2%	$5.19	$5.40	5.3%	14.8x	14.2x
Physician's Realty Trust	DOC	$17.38	$0.92	5.3%	75.4%	$1.22	$1.32	16.1%	14.2x	13.2x
HCP, Inc.	HCP	$26.02	$1.48	5.7%	75.5%	$1.96	$2.05	-13.5%	13.3x	12.7x
Ventas, Inc.	VTR	$63.07	$3.10	4.9%	74.3%	$4.17	$4.36	2.7%	15.1x	14.5x
LTC Properties, Inc.	LTC	$46.54	$2.28	4.9%	72.2%	$3.16	$3.34	4.5%	14.7x	13.9x
Health Care Sector Average		**$50.05**	**$2.56**	**5.1%**	**72.4%**	**$3.37**	**$3.53**	**1.1%**	**14.9x**	**14.2x**
Healthcare Realty	HR	$32.37	$1.20	3.7%	71.0%	$1.56	$1.69	1.8%	20.8x	19.2x

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.

With that in mind, we are retaining our rating on HR at Underperform on valuation. The shares continue to command a large premium to the group. While forward growth is likely to be above the peer group, we do not believe it is enough to justify the current valuation and suggest investors take some money off the table at current price levels.

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 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

	2014	2015			2016					2017E					2018E		
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1A	Q2A	Q3A	Q4	Year	Q1	Q2	Q3	Q4	Year
Master Lease Rent		$0					$0					$0					$0
Property Operating/Rental Income	$365,006	$383,333	$98,740	$101,472	$102,534	$104,736	$407,482	$104,088	$104,869	$106,561	$109,056	$424,574	$111,568	$113,917	$116,004	$117,944	$459,432
Straight Line Rent	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Mortgage Interest	$3,666	$91	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Other	$5,669	$5,047	$1,281	$1,170	$1,125	$573	$4,149	$481	$376	$392	$401	$1,650	$410	$419	$427	$434	$1,690
	$374,341	$388,471	$100,021	$102,642	$103,659	$105,309	$411,631	$104,569	$105,245	$106,953	$109,458	$426,225	$111,978	$114,336	$116,431	$118,377	$461,122
Expenses																	
General & Administrative	$22,824	$26,925	$10,246	$8,129	$8,724	$8,707	$35,806	$9,280	$8,005	$8,021	$9,085	$34,391	$9,966	$8,289	$9,082	$9,589	$36,926
Property operating expense	135,631	140,195	35,406	36,263	37,504	37,285	146,458	37,834	38,184	40,626	38,268	154,912	38,491	39,643	41,181	41,103	160,419
Acquisition expense	-	-	-	-	-	-	-	-	785	507	-	1,292	-	-	-	-	-
Impairments	-	-	-	-	-	-	-	-	-	5,059	-	5,059	-	-	-	-	-
Bad Debt Expense, net	31	(201)	(39)	78	(47)	(13)	(21)	66	105	14	-	185	-	-	-	-	-
Interest Expense, net	71,903	65,442	14,852	14,722	13,636	13,839	57,049	14,159	14,239	14,107	13,468	55,973	13,410	13,664	14,121	14,568	55,763
Amortization	10,820	10,083	2,700	2,762	2,712	3,033	11,207	3,040	-	-	-	3,040					-
Other	-	9	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Depreciation	100,586	106,529	27,693	28,528	29,273	30,989	116,483	31,412	34,823	35,873	35,537	137,645	36,077	36,359	36,848	37,286	146,571
Total Expenses	$341,795	$348,982	$90,858	$90,482	$91,802	$93,840	$366,982	$95,791	$96,141	$104,207	$96,358	$392,497	$97,944	$97,955	$101,233	$102,546	$399,678
Income from Operations	$32,546	$39,489	$9,163	$12,160	$11,857	$11,469	$44,649	$8,778	$9,104	$2,746	$13,099	$33,727	$14,035	$16,380	$15,198	$15,831	$61,444
Minority interests	($313)	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Other income/loss	$0	$78	$0	$0	$0	$74	$74	$0	($5)	$419	$0	$414	$0	$0	$0	$0	$0
Oper. Income from discontinued opers.	$629	$16,276	($7)	($12)	($23)	$40,894	$40,852	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Income taxes	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Impairments	($3,105)	($37,094)	$0	($4)	$0	$0	($4)	($323)	$0	$0	$0	$0	$0	$0	$0	$0	$0
(Loss)/Gain on sale of assets	$2,130	$50,687	$0	$1	$0	$0	$1	$23,390	$16,125	$8	$0	$39,523	$0	$0	$0	$0	$0
Income Bef. Preferred div	$31,887	$69,436	$9,156	$12,145	$11,834	$52,437	$85,572	$31,845	$25,224	$3,173	$13,099	$73,664	$14,035	$16,380	$15,198	$15,831	$61,444
Preferred dividends	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Net Income for common	$31,887	$69,436	$9,156	$12,145	$11,834	$52,437	$85,572	$31,845	$25,224	$3,173	$13,099	$73,664	$14,035	$16,380	$15,198	$15,831	$61,444
Per share bef. Extra	$0.33	$0.70	$0.09	$0.12	$0.10	$0.45	$0.78	$0.28	$0.22	$0.03	$0.10	$0.62	$0.11	$0.13	$0.12	$0.13	$0.49
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	$0.00	$0.00	$0.00	$0.00	$0.00
Net (loss) income per share	$0.33	$0.70	$0.09	$0.12	$0.10	$0.45	$0.78	$0.28	$0.22	$0.03	$0.10	$0.62	$0.11	$0.13	$0.12	$0.13	$0.49
Quarterly dividend rate	$1.20	$1.20	$0.30	$0.30	$0.30	$0.30	$1.20	$0.30	$0.30	$0.30	$0.30	$1.20	$0.30	$0.30	$0.30	$0.30	$1.20
Shs Outstanding (diluted)	96,744,500	99,888,250	102,165,000	104,770,000	115,052,000	115,408,000	109,348,750	115,507,000	115,674,000	119,181,000	124,900,000	118,815,500	125,103,125	125,306,250	125,532,056	125,757,863	125,424,824

Table 5. Funds From Operations Calculation
In Thousands

					2016					2017E					2018E		
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1A	Q2A	Q3A	Q4	Year	Q1	Q2	Q3	Q4	Year
Net income for common shareholders	$31,887	$69,436	$9,156	$12,145	$11,834	$52,437	$85,572	$31,845	$25,224	$3,173	$13,099	$73,664	$14,035	$16,380	$15,198	$15,831	$61,444
Add Back:																	
Depreciation	108,859	114,533	30,800	31,716	32,557	34,699	129,772	35,555	35,421	36,478	36,586	144,040	37,141	37,432	37,936	38,386	150,895
JV Adjustment	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other	$1,235	$41,871	$0	$229	$0	$0	$229	$915	$0	$0	$0	$0	$0	$0	$0	$0	$0
Non-recurring																	
Deduct:																	
Gain/loss on sales of real estate	($666)	($65,863)	$1,707	($1)	$730	($40,001)	($37,565)	($23,390)	($15,334)	$5,573	$0	($39,523)	$0	$0	$0	$0	$0
FFO Available for common	$141,315	$159,977	$41,663	$44,089	$45,121	$47,135	$178,008	$44,925	$45,311	$45,224	$49,685	$178,181	$51,176	$53,812	$53,134	$54,217	$212,339
Diluted FFO available for common	$141,315	$159,977	$41,663	$44,089	$45,121	$47,135	$178,008	$44,925	$45,311	$45,224	$49,685	$185,145	$51,176	$53,812	$53,134	$54,217	$212,339
Basic FFO per share	$1.46	$1.61	$0.41	$0.42	$0.39	$0.41	$1.63	$0.39	$0.39	$0.38	$0.40	$1.50	$0.41	$0.43	$0.42	$0.43	$1.70
Diluted FFO per share	$1.46	$1.60	$0.41	$0.42	$0.39	$0.41	$1.63	$0.39	$0.39	$0.38	$0.40	$1.56	$0.41	$0.43	$0.42	$0.43	$1.69
Shares, basic	96,505,000	99,538,250	101,815,000	104,420,000	114,702,000	115,058,000	108,998,750	115,157,000	115,324,000	118,831,000	124,550,000	118,465,500	124,753,125	124,956,250	125,182,056	125,407,863	125,074,824
Shares, diluted	96,855,000	99,888,250	102,165,000	104,770,000	115,052,000	115,408,000	109,348,750	115,507,000	115,674,000	119,181,000	124,900,000	118,815,500	125,103,125	125,306,250	125,532,056	125,757,863	125,424,824

Table 6. Funds Available for Distribution Calculation

FFO Available for common	$141,315	$159,977	$41,663	$44,089	$45,121	$47,135	$178,008	$44,925	$45,311	$45,224	$49,685	$178,181	$51,176	$53,812	$53,134	$54,217	$212,339
Less:																	
Recurring real estate CAPX	($12,900)	($13,900)	($2,950)	($3,000)	($3,050)	($3,075)	($12,075)	($2,950)	($3,000)	($3,050)	($3,075)	($12,075)	($2,950)	($3,000)	($3,050)	($3,075)	($12,075)
Debt adjustments	$0	($4,750)	($1,200)	($1,200)	($1,200)	($1,150)	($4,750)	($1,200)	($1,200)	($1,200)	($1,150)	($4,750)	($1,200)	($1,200)	($1,200)	($1,150)	($4,750)
Other	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Funds available for distribution	$128,415	$141,327	$37,513	$39,889	$40,871	$42,910	$161,183	$40,775	$41,111	$40,974	$45,460	$161,356	$47,026	$49,612	$48,884	$49,992	$195,514
Per share	$1.33	$1.42	$0.37	$0.38	$0.36	$0.37	$1.48	$0.35	$0.36	$0.34	$0.36	$1.36	$0.38	$0.40	$0.39	$0.40	$1.56

Source: Company reports and Hilliard Lyons estimates

Additional information is available upon request.

Analyst Certification

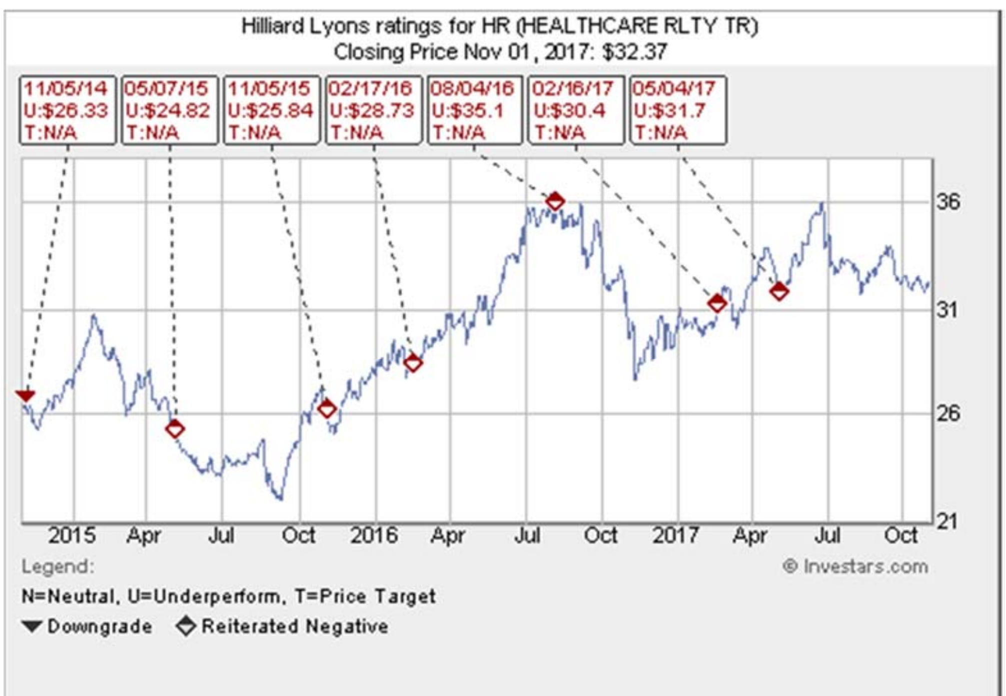
I, John M. Roberts, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing 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.	
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.

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