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
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EARNINGS UPDATE

Key Metrics

OHI - NYSE - as of 7/26/17		$33.45
1 Year Price Target		$ 38.00
52-Week Range	$28.11 -	$38.09
Shares Outstanding (mm)		197.4
Market Cap. ($mm)		$6,603.0
1-Mo. Average Daily Volume		1,062,000
Institutional Ownership		85.0%
Debt/Total Capital Jun-17		40.5%
Est 3-year FFO Growth Rate		6.0%
Est 3-year Dividend Growth Rate		6.0%
Book Value		$ 21.40
Dividend		$ 2.56
Dividend Yield		7.65%
Est. Fixed Charge Coverage		3.7 X

FFO Per share

	2016	Prior 2017E	Current 2017E		Prior 2018E	Current 2018E
1Q	$0.83	--	$0.86	A	$0.89	$0.89
2Q	$0.87	--	$0.87	A	$0.90	$0.90
3Q	$0.83	$0.87	$0.87		$0.90	$0.90
4Q	$0.88	$0.91	$0.90		$0.94	$0.94
Year	$3.41	$3.49	$3.49	*	$3.63	$3.63
P/E	9.8x		9.6x			9.2x

*-May not add up due to rounding, not restated.

Revenue ($mm)

	2016	Prior 2017E	Current 2017E		Prior 2018E	Current 2018E
1Q	$212.9	--	$231.7	A	$521.9	$521.9
2Q	$228.8	--	$235.8	A	$258.0	$258.0
3Q	$224.6	$240.3	$240.3		$259.2	$259.2
4Q	$234.5	$250.9	$250.9		$267.8	$267.8
Year	$902.8	$960.4	$958.7		$1,036.9	$1,036.9

Company Description: *Omega Healthcare Investors, headquartered in Hunt Valley, MD, is a real estate investment trust (REIT) that has investments in healthcare facilities, specifically long term care facilities, located throughout the country, mainly skilled nursing facilities, although the company also owns a small number of assisted living facilities and specialty hospitals.*

Omega Healthcare Investors, Inc.

OHI -- NYSE – Buy-2

Q2 Earnings Update

Investment Highlights

- OHI reported Q2 normalized FFO of $0.87 a share, compared to $0.87 a share normalized in the year earlier period, a penny above our estimate and four cents above the consensus. The flat number was in spite of dilutive debt refinancing which saw a $23.5 million non-recurring charge in the quarter. Management also fine-tuned its guidance range to the high end of its previous range.
- OHI's share price is up slightly since the beginning of the year although it has modestly underperformed the peer group. As such, in our view the stock is even cheaper than it was and is very attractively priced at current levels. OHI sits at a larger discount to the peer group now. Worries over Medicare/Medicaid reimbursement under any replacement for the Affordable Care Act is likely the major factor, although we do not anticipate any bill passing, making the relative underperformance a continued buying opportunity. Also note the continued increase in the quarterly dividend, which has reached 20 straight quarters. Investors remain reticent to deliver a higher valuation to the company due, in our view, to the government payer issue. We are retaining our rating at Buy at this point. We will provide additional color after the company's 10AM conference call and a discussion with management.
- In light of the current interest rate environment, OHI's 7.7% dividend yield looks attractive sitting at the high end of the peer group and in the current interest rate environment. As such, at this point we remain of the opinion that investors willing to take on some risk and searching for dividend income and long term price appreciation should consider OHI shares to meet these goals in a relatively expensive group with strong demographics. At this point, our rating remains Buy, reflecting these positive fundamentals. The shares continue to trade under our $38 a share 1 year price target, which is based on a multiple of 10.5 times our 2018 FFO estimate, a solid discount to the peer group and below historic trading multiples, a very conservative valuation in our opinion.

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

Second Quarter Review

Total revenue was $235.8 million versus $228.8 million, a 3.0% increase. Rental income of $194.0 million was up 4.0% (please see income statement on page 3), a function mainly of rent increases/rollovers and recent investments. Mortgage interest income was down 23.7% to $16.3 million on mortgage payoffs. The company added $15.5 million in income from direct financing leases both years.

General and administrative expense fell 4.4% to $7.8 million. Interest expense increased 72.8%, a result of the non-recurring charge, without which it would have only been up 20.3%--a function of refinancing into longer term debt. The total was $72.3 million compared to $41.9 million. Depreciation expense rose 7.4% to $65.5 million. The company had a $0.6 million loss on discontinued operations versus a $13.2 million gain during the year earlier quarter. We note that acquisition costs were immaterial in the current period, versus $3.5 million in the year earlier period. The charge for debt refinancing during Q2 was $23.5 million, and there also was a $2.7 million charge for uncollectable accounts this year and a $1.2 million recovery last year. Second quarter net income available to common shareholders was $65.3 million versus $108.1 million. The per share net income this quarter was $0.33 versus $0.57 a share on 3.8% more common shares outstanding in this year's Q2.

Ongoing funds from operations (FFO) on a normalized basis, which exclude real estate gains as well as other non-recurring and non-cash items, were $179.0 million compared to $173.0 million in last year's second quarter, a 3.5% increase. FFO per diluted share were $0.87 versus $0.87.

OHI increased its debt slightly since the end of the year, having approximately $4,429.9 million in total debt (please see balance sheet on page 4) at quarter end, up from $4,366.9 million at the end of 2016. The company's debt to capital ratio was 40.5% at quarter end, down from the end of 2016 due to a higher share price. OHI has no meaningful debt coming due until its line of credit ($1.25 billion in total) matures in 2022 including the one year company extension option. We expect no liquidity issues for OHI, as it has been very pro-active in taking care of its maturities and refinancing debt.

Other 2nd Quarter Activity

Investment/Capital Markets Activity – During the second quarter the company completed its previously announced purchase of 18 UK-based home care facilities for $118 million, expanding the company's UK investment to 53 properties. The properties were leased to Gold Care Homes. Beyond that, OHI made $64 million in additional investments and capital renovation and construction projects. Also during the quarter, the company refinanced its credit facilities, adding a new $1.8 billion senior unsecured credit facility and term loan facility, lengthening its term and reducing its interest rate. This refinancing also include an accordion feature with the potential to push total commitments to $2.5 billion. It also issued $550 million in notes due in 2028 and $150 million of notes due in 2025. The company redeemed $400 million in higher cost senior notes and prepaid a $200 million term loan.

Dividend – Following an elimination of the dividend for a period stretching from 2001 through the latter part of 2003, OHI has instituted consistent dividend increases. In fact, OHI has raised the dividend 12 times over the past 3 years. In 2011 alone, the quarterly rate per share was increased to $0.38 (from $0.37) in the second quarter, and then to $0.40 for the third quarter payment. OHI then increased the payment for the first quarter of 2012 by another penny to $0.41 a share and another penny with the Q2 payment to $0.42 a share and two cents more in the fourth quarter, raising the payment to $1.76 annually. Then in 2013, 2014, 2015 and 2016 the company increased the dividend in each quarter, ending with an annual payment of $2.44 a share and then made another bump up early this year for the first quarter pushing the payment to $2.48 a share, another for the second quarter with its payment going to $2.52 a share and then one earlier this month for Q3 pushing the number to $2.56 a share annually.

Quarterly Income Statement

(in thousands)	2Q 2017	2Q 2016	% Change
Rental Income	$193,997	$186,454	4.0%
Other Investment Income	$7,278	$4,982	46.1%
Miscellaneous	$2,763	$496	
Income from Direct Financing Leases	$15,462	$15,521	
Mortgage Interest Income	16,297	21,371	-23.7%
Total Revenue	235,797	228,824	3.0%
General & Admin	7,807	8,167	-4.4%
Legal expense	0	0	0.0%
Restricted Stock Expense	3,734	3,665	1.9%
Acquisition Costs	19	3,504	
Provision for Uncollectables	2,673	-1,154	
Impairments	10,135	6,893	
Nursing Home Expense for Owned and Operated	0	0	
EBITDA	211,429	207,749	1.8%
Interest Expense	72,339	41,857	72.8%
Depreciation Expense	70,350	65,505	7.4%
Income (Loss) Before Discontinued Operations and Other Items	68,740	100,387	-31.5%
Discontinued Operations (including gain on sale of assets)	(622)	13,221	
(Charges)/Gains	79	0	
Investment interest and other	(591)	(454)	
Non-controlling	(2,349)	(5,102)	
Net Income (Loss)	$65,257	$108,052	-39.6%
Net EPS (diluted)	$0.33	$0.57	-42.1%
Avg. Shares Outstanding (diluted)	206,672	199,157	3.8%

Funds From Operations	2Q 2017	2Q 2016	
Net Income	$68,157	$113,154	-39.8%
Depreciation Expense	70,350	65,505	7.4%
Other (adding/substracting one-time items)	40,499	(5,703)	
Normalized Funds From Operations	**$179,006**	**$172,956**	3.5%
Normalized FFO Per Share (diluted)	**$0.87**	**$0.87**	0.0%

Source: Company reports.

Consolidated Balance Sheet

(in thousands)	June 30, 2017	December 31, 2016
Real Estate Assets		
Land and Buildings	$7,730,199	$7,566,358
Less: accumulated depreciation	$ (1,366,376)	$ (1,240,336)
Total Net Real Estate Investments	6,363,823	6,326,022
Cash and Cash Equivalents	21,031	93,687
Net Investment in Direct Financing Leases	582,307	601,938
Mortgage notes receivable	662,709	639,343
Accounts Receivable	288,686	240,035
Other Investments	278,985	256,846
Goodwill	644,184	643,474
Restricted Cash	12,203	13,589
Real estate held for sale	18,889	52,868
Other assets	73,837	81,458
Total Assets	**$8,946,654**	**$8,949,260**
Bank Borrowings	$155,000	$190,000
Mortgage Loan payable	53,737	54,365
Unsecured Borrowings	4,221,150	4,122,489
Real Estate Purchase Liability	0	0
Bond payable	0	0
Accounts payable and accrued expenses	323,543	360,514
Dividends payable	0	0
Other	17,714	9,906
Total Liabilities	**$4,771,144**	**$4,737,274**
Preferred stock	-	-
Common Stock	19,722	19,614
Capital in Excess of Par Value	4,896,076	4,861,408
Cumulative Net Income	1,908,634	1,738,937
Cumulative Dividends	(2,954,230)	(2,707,387)
Other	305,308	299,414
Total Shareholders' Equity	**4,175,510**	**4,211,986**
Total Liabilities and Shareholders' Equity	**$8,946,654**	**$8,949,260**

Balance Sheet Ratio Analysis	June 30, 2017	December 31, 2016
Net R/E Investments / Total Debt	69.6%	69.0%
Debt to Equity	106.1%	103.7%
Debt as % of Total Assets	49.5%	48.8%
Shareholders' Equity as % of Total Assets	46.7%	47.1%

Source: Company reports.

First Take

The second quarter results were a little above our expectations despite the level of investment for the quarter falling a little short of our expectations. More than offsetting that was a drop in general and administrative expense as well as a drop in various other expenses. We were also heartened with the coverage ratios in the company's portfolio as a whole, which was relatively static over the previous quarter. We had worried that higher labor costs could begin to impact this measure, and although that is still a risk for the future, we did not see an impact this quarter. Less than 4% of OHI's revenue was represented by properties that had a coverage level of less than 1.2 times, while less than 2% were less than 1.0 times. These levels seem more than manageable, and are at levels that should not present a hurdle should OHI need to find new operators for the properties. Management has adjusted up the low end of its 2017 FFO guidance by two cents and it now stands at $3.42 to $3.44 a share. Our estimate remains above that number with the expectation for some additive investment in the second half of the year. We may fine-tune our forward numbers following the company's conference call, however.

We also note that management has tended to be very conservative in its guidance, and this makes us feel comfortable staying slightly above guidance. OHI continues to perform well, and we remain partial to the company and anticipate continued consistent dividend increases going forward. There appears to be no issues with the company's capital structure at this point, as the company has stretched out its maturities to a point where it has no appreciable debt due over the next several years and has a very high level of debt capacity to pay for further investments. Recent refinancing should also lock in low interest rates for longer terms, albeit at a little higher expense in the near term, as it reduced debt on its lowest cost source, the credit line. The large discount to the peer group remains, offering a solid opportunity for investors, in our opinion. A full report will follow the company's 10AM conference call.

Suitability

OHI has a suitability rating of 2 on our 1-4 scale. We find the company to have a very strong balance sheet in relation to its peers, and the triple net structure of most of its leases limit its property risk. Its real estate ownership is also a positive factor, as is the company's geographic and operator diversification, with the largest portfolio of skilled nursing properties in the industry. On the other hand, the company is highly exposed to the skilled nursing sector, with the bulk of its operator revenue paid by Medicare and Medicaid adding risk due to potential political issues.

Risks

There are a number of risks in owning OHI shares and REITs as an investment group. REITs in general need access to debt capital to grow, and if such debt capital is unavailable, the company may have difficulty in growing. The company's dividend is very attractive to shareholders and OHI, as well as REITs in general, have seen their prices rise with the decline in overall interest rates. Should rates rise, that could hurt OHI'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. OHI's dependence upon the long-term care sector of the health care real estate group could create issues due to government payments being the de-facto source for much of its rent. With reimbursements cut, as the Center for Medicare and Medicaid Services reduction illustrates, there will be a negative impact on its tenant base, which in turn could have a negative impact on OHI. It is always possible that the company could make a poor acquisition in the future or not realize synergies from prior acquisitions. OHI's geographic exposure to Florida might be an issue if the state has further economic problems and is forced to cut reimbursements to providers claiming Medicaid payments.

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.

The author of this report or members of his family has a long common equity position in Omega Healthcare but may not trade the share contrary to Hilliard Lyons' rating.

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 two to three 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	29%	14%	86%
Hold/Neutral	79	63%	5%	95%
Sell	10	8%	0%	100%

As of 7 July 2017

Other Disclosures

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