HILLIARD LYONS

Healthcare Real Estate Investment Trusts
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COMPANY UPDATE

Key Metrics

OHI - NYSE - as of 2/13/18		$26.96
2-3 Year Price Target		$ 36.00
52-Week Range	$24.90 -	$35.14
Shares Outstanding (mm)		198.3
Market Cap. ($mm)		$5,346.2
1-Mo. Average Daily Volume		1,062,000
Institutional Ownership		85.0%
Debt/Total Capital Dec-17		44.4%
Est 3-year FFO Growth Rate		6.0%
Est 3-year Dividend Growth Rate		1.0%
Book Value		$ 21.40
Dividend		$ 2.64
Dividend Yield		9.79%
Est. Fixed Charge Coverage		4.3 X

FFO Per share

	2016		2017		Prior 2018E	Current 2018E
1Q	$0.83	--	$0.86		$0.80	$0.80
2Q	$0.87	--	$0.87		$0.87	$0.87
3Q	$0.83	--	$0.79		$0.89	$0.89
4Q	$0.88	--	$0.79		$0.92	$0.92
Year	$3.41		$3.30	*	$3.47	$3.47
P/E	7.9x		8.2x			7.8x

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

Revenue ($mm)

	2016		2017	Prior 2018E	Current 2018E
1Q	$212.9	--	$231.7	$235.9	$235.9
2Q	$228.8	--	$235.8	$254.5	$254.5
3Q	$224.6	--	$219.6	$261.0	$261.0
4Q	$234.5	--	$221.2	$269.9	$269.9
Year	$902.8		$908.3	$1,021.4	$1,021.4

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 and in the UK, 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 – Long-term Buy-3

Q4 Earnings Update

Investment Highlights

- OHI reported Q4 normalized FFO of $0.79 a share, compared to $0.88 a share normalized in the year earlier period, to our estimate of $0.78 a share, and the consensus estimate of $0.77. Non-recurring items pushed as reported FFO down to $0.77 a share, but we exclude these items for our normalized estimate. Issues around non-paying tenants continued to impact results, although management anticipates these issues will be largely cured by year end.
- An expected rise in interest rates has driven REIT prices down significantly, with virtually every healthcare REIT hitting multiple 52-week lows over the past month or so. OHI has not escaped that decline, which has made the shares even more attractive for long-term investors, in our opinion. Note that despite all of these issues, management once again raised the dividend in the most recent quarter. Our $38 per share 2-3 year price target is based on a multiple of 10 times our projection for 2020 FFO-which investors will be looking at in 2-3 years, below historical multiples. We may adjust this target after the conference call based on any changes to our estimates and in light of the dilution from asset sales management has outlined.
- In light of the current interest rate environment, OHI's 9.8% yield on its just increased dividend looks very attractive, sitting well over three percentage points above the peer group. We believe the payment should continue in the future, as it is well covered, although we are not as optimistic on continued quarterly increases due to several tenants encountering problems and dilution from asset sales. At this point we remain of the opinion that investors with a longer term time horizon willing to take on some risk and searching for dividend income and price appreciation should consider OHI shares, although we will be waiting until after the 10AM conference call before making any adjustments to our rating, estimates and/or price target.

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

Fourth Quarter Review

Total revenue was $221.2 million versus $234.5 million, a 5.7% decline as a result of asset sales and non-paying assets, offset slightly by recent investments and normal rental bumps. Rental income of $194.6 million was off 0.2% (please see income statement on page 3). Mortgage interest income rose 7.5% to $17.0 million from $15.8 million due to mortgage additions. The company saw a 96.1% decline in revenue from direct financing leases to $0.6 million this year as a result of non-paying assets.

General and administrative expense rose 9.9% to $8.2 million from $7.5 million, above our expectations as we believe management experienced additional costs around the issues with its problem tenants and working on re-tenanting some of these properties. Interest expense rose 7.4% to $50.3 million with the increase in quarter-end debt, which has risen to $4.57 billion from $4.37 billion at the end of 2016. Interest expense was under our expectations. Depreciation expense rose 6.4% to $75.3 million versus $70.8 million. Fourth quarter net income available to common shareholders was $62.4 million versus $124.3 million. The per share net income this quarter was $0.31 versus $0.63 on 1.3% more common shares outstanding in this year's Q4.
Note that this quarter's numbers were negatively impacted by a $63.7 million impairment charge.

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 $163.7 million compared to $180.4 million in last year's fourth quarter, a 9.3% decline. Normalized FFO per diluted share were $0.79 versus $0.88. For the year, normalized FFO was $3.30 versus $3.41 a share.

The company had $85.9 million in cash on its balance sheet at quarter end. The company's debt to capital ratio was 44.4% at quarter end up from 41.6% at the end of 2016, due to the decline in share price. OHI has no debt coming due until its line of credit matures in 2019. We expect no liquidity issues for OHI, as it has been very pro-active in taking care of its maturities and has a strong balance sheet.

Other 4th Quarter Activity

Investment/Capital Markets Activity – During the fourth quarter OHI announced $71 million in new investments, including the purchase of six skilled nursing facilities with 575 beds in Texas leased to a new operator at a cash yield of 9.25% with 2.5% annual escalators. In addition, the company also funded ongoing capital renovation and construction projects, which amounted to $31.1 million during the quarter. Also during Q4 the company issued 0.24 million shares of common stock under its dividend reinvestment programs, raising $6.6 million. The company also sold 34 facilities during the quarter for $189 million generating a gain of $46.4 million. The company has an additional 22 facilities with a book value of $86.7 million for sale and is looking at more than $300 million in additional assets for divestiture. As part of this process, the company took a $63.5 million impairment on the assets for sale. We note that there has been a significant amount of insider share purchases recently, with four insiders purchasing shares under options grants just last month, with the exercise prices on those grants actually higher than the current market price.

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 21 straight quarters over the past 5-plus 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, 2016 and 2017 the company increased the dividend in each quarter, ending with an annual payment of $2.64 a share after increasing the dividend last month.

Quarterly Income Statement

(in thousands)	4Q 2017	4Q 2016	% Change
Rental Income	$194,579	$194,891	-0.2%
Other Investment Income	$7,788	$7,210	8.0%
Miscellaneous	$1,196	$823	0.0%
Income from Direct Financing Leases	$614	$15,724	-96.1%
Mortgage Interest Income	17,029	15,838	7.5%
Total Revenue	221,206	234,486	-5.7%
General & Admin	8,218	7,478	9.9%
Legal expense	0	0	0.0%
Restricted Stock Expense	3,862	3,674	5.1%
Acquisition Costs	0	-2	
Provision for Uncollectables	913	5,878	
Impairments	63,691	0	
Nursing Home Expense for Owned and Operated	0	0	0.0%
EBITDA	144,522	217,458	-33.5%
Interest Expense	50,339	46,872	7.4%
Depreciation Expense	75,323	70,808	6.4%
Income (Loss) Before Discontinued Operations and Other Items	18,860	99,778	-81.1%
Discontinued Operations (including gain on sale of assets)	46,421	30,277	
Non controlling	(2,247)	(5,185)	
Investment interest and other	(634)	(611)	
Debt refinancing costs	0	0	
Net Income (Loss)	$62,400	$124,259	-49.8%
Net EPS (diluted)	$0.31	$0.63	-50.8%
Avg. Shares Outstanding (diluted)	207,646	204,955	1.3%

Funds From Operations	4Q 2017	4Q 2016	
Net Income	$65,156	$129,883	-49.8%
Depreciation Expense	76,980	71,915	7.0%
Other (adding/substracting one-time items)	21,532	(21,377)	
Normalized Funds From Operations	**$163,668**	**$180,421**	-9.3%
Normalized FFO Per Share (diluted)	**$0.79**	**$0.88**	-10.5%

Source: Company reports.

Consolidated Balance Sheet

(in thousands)	December 31, 2017	December 31, 2016
Real Estate Assets		
Land and Buildings	$7,655,960	$7,566,358
Less: accumulated depreciation	$ (1,376,828)	$ (1,240,336)
Total Net Real Estate Investments	6,279,132	6,326,022
Cash and Cash Equivalents	85,937	93,687
Net Investment in Direct Financing Leases	364,965	601,938
Mortgage notes receivable	671,232	639,343
Accounts Receivable	279,334	240,035
Other Investments	276,342	256,846
Goodwill	644,690	643,474
Restricted Cash	10,871	13,589
Real estate held for sale	86,699	52,868
Other assets	74,103	81,458
Total Assets	**$8,773,305**	**$8,949,260**
Bank Borrowings	$290,000	$190,000
Mortgage Loan payable	53,098	54,365
Unsecured Borrowings	4,229,060	4,122,489
Real Estate Purchase Liability	0	0
Bond payable	0	0
Accounts payable and accrued expenses	295,142	360,514
Dividends payable	0	0
Other	17,747	9,906
Total Liabilities	**$4,885,047**	**$4,737,274**
Preferred stock	-	-
Common Stock	19,831	19,614
Capital in Excess of Par Value	4,936,302	4,861,408
Cumulative Net Income	1,839,356	1,738,937
Cumulative Dividends	(3,210,248)	(2,707,387)
Other	303,017	299,414
Total Shareholders' Equity	**3,888,258**	**4,211,986**
Total Liabilities and Shareholders' Equity	**$8,773,305**	**$8,949,260**

Balance Sheet Ratio Analysis	December 31, 2017	December 31, 2016
Net R/E Investments / Total Debt	72.8%	69.0%
Debt to Equity	117.6%	103.7%
Debt as % of Total Assets	52.1%	48.8%
Shareholders' Equity as % of Total Assets	44.3%	47.1%

Source: Company reports.

First Take

The fourth quarter results were above both ours and the consensus number. However, the real issue here is forward numbers, with guidance solidly below our estimate as well as the consensus. We believe this is a function of two things. First management is assuming no revenue from the Orianna portfolio for most of 2018. Second, the company is assuming dilution from asset sales during the year. They are not anticipating any additional investment activity, other than that already identified through pending acquisitions and ongoing development and redevelopment activity. With nearly $400 million in identified properties for sale, that accounts for about 4% of earning assets. While payoff of debt will eliminate some of that dilutive impact, it will not come anywhere close to eliminating all of it. We believe there will be some positive impact from re-deploying these assets, although that will not occur initially. Management initiated guidance for 2018, offering a range for normalized FFO of $2.96 to $3.06, below our current estimate as well as the consensus. We note that our estimate includes acquisitions and investments not included in OHI's guidance. We will have to talk to company management before getting a better feel on exactly how much rent will be lost under the new tenants likely to manage properties that are re-positioned, as well as expectations on divestitures. Although normal rental bumps, continued rationalization of all of the recent investments, and ongoing construction projects will have a positive impact on results, they are unlikely to overcome the loss on rent here in the near term. As such, we will wait until after the conference call before adjusting our numbers for these issues after talking to management.

While the company's results were reasonably positive in light of the issues that management is currently encountering, the longer term issues will drive the stock here. While the larger healthcare REITs have mostly exited the skilled nursing area now, they are seeing issues with overbuilding and tenant issues in the senior housing sector, as competition has picked up there. Positively, competition is likely to be lower in skilled nursing with all of the larger names having left the business. OHI is now the dominant company in the sector with a larger and more diversified portfolio and a wider network of relationships. We see this as a longer term positive once the company rationalizes its portfolio and corrects the current problem tenant issues. The lower level of competition should be positive in the future, especially as demand for space increases with demographics.

Acquisition/investment activity announced so far in Q1 is below our expectations, although we will also be asking management about any further potential acquisitions, as well as how the acquisition market is currently looking from a competition perspective and how future development activity is likely to impact results. There appears to be no issues with the company's capital structure at this point, as management has stretched out its maturities to a point where it has no appreciable debt due for nearly two years and has added debt capacity. Further, the capital being generated from asset sales should strengthen the company even further. All of this activity should offer significant opportunity to use additional debt for purchases should attractive acquisition opportunities arise, although with equity not a source of investment capital due to the low share price, we could see leverage tick up a bit in the near term. We will issue a full report discussing all of these issues and any changes in estimates or price target following the 10AM conference call. Overall we view it as a solid quarter and see the year ahead as one of taking care of problems and repositioning the portfolio and see a more positive forward outlook as these issues are taken care of—thus our Long-term Buy rating seems appropriate in that light.

Suitability

OHI has a suitability rating of 3 on our 1-4 scale. We find the company to have a strong balance sheet, while 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. The company is also exposed to several problem tenants, and increased labor costs could be stressing these operators' ability to pay rent.

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, 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. 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. There is also integration risk with all of the deals that OHI is doing and of individual deals being completed. Changes to the Affordable Care Act could also create risk for OHI.

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 2017 dividend or distribution was treated as return of capital and not as "dividend income" as reflected on the IRS Form 1099-Div for the 2017 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 household have a long position in the common stock of OHI, but may not engage in buying or selling contrary to the recommendation.

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	31	28%	10%	90%
Hold/Neutral	74	66%	9%	91%
Sell	7	6%	0%	100%

As of 7 February 2018

Other Disclosures

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