Omega Healthcare Investors (OHI)

Updated November 6th, 2018 by Bob Ciura

Key Metrics

Current Price:	$34	**5 Year CAGR Estimate:**	14.3%	**Volatility Percentile:**	58.3%
Fair Value Price:	$38	**5 Year Growth Estimate:**	4.5%	**Momentum Percentile:**	89.8%
% Fair Value:	90%	**5 Year Valuation Multiple Estimate:**	2.1%	**Growth Percentile:**	27.9%
Dividend Yield:	7.7%	**5 Year Price Target**	$47	**Valuation Percentile:**	69.4%
Dividend Risk Score:	C	**Retirement Suitability Score:**	A	**Total Return Percentile:**	83.1%

Overview & Current Events

Omega Healthcare Investors (OHI) is a healthcare REIT that generates 83% of its revenues from its skilled nursing facilities and 13% of its revenues from senior housing developments (4% comes from 'other'). OHI has a market capitalization of $6 billion and was founded in 1992. Two of Omega Healthcare's tenants are in bankruptcy: Orianna and Preferred Care. Preferred Care was a relatively small tenant with annual contractual revenues of $3.2 million. Orianna was Omega Healthcare's fifth-largest tenant, with annual contractual revenues of $47.3 million.

Omega Healthcare announced on May 14th that it had received court approval to transition 23 of the 42 Orianna properties to new tenants. Management said in the release the company was "confident" they would be able to generate rent of between $32 and $38 million after transitioning and or selling and reinvesting proceeds from the Orianna facilities. However, two months later Omega Healthcare announced it had terminated its deal to transition 23 properties to new tenants. Instead, the company has transitioned the Mississippi based Orianna facilities and will generate contractual annual rent of $12 million from them. The company reaffirmed it expects $32 to $38 million in annual rent total from these assets once they are transitioned or sold.

On 11/05/18 Omega Healthcare announced third-quarter results for fiscal 2018. For the quarter, revenue of $222 million increased 1% year-over-year, and beat analyst estimates by $28 million. Funds from operation (FFO) per share of $0.77 also beat by $0.02 per share, a 2.5% decline from the same quarter last year. Higher tenant revenue was more than offset by higher restructuring and interest expenses.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
FFO	$1.45	$1.40	$1.42	$1.89	$2.19	$2.53	$2.61	$2.81	$3.07	$2.15	***$3.04***	***$3.79***
DPS	$1.19	$1.20	$1.37	$1.55	$1.69	$1.86	$2.02	$2.18	$2.36	$2.54	***$2.64***	***$3.10***
Shares	75.2	83.7	94.2	102.2	108.0	118.1	127.3	180.5	201.6	206.8	***210.4***	***220.0***

OHI benefits from some favorable secular trends. The number of elderly people in need of healthcare is expected to grow at a fast pace over the next decade. In addition, the trend is for the elderly to spend an increasing amount of money on healthcare. OHI will see only a small portion of its leases expire over the next decade. Moreover, it has no material debt maturities until 2022. Therefore, the REIT is likely to enjoy reliable free cash flows in the upcoming years, without any shocks from debt maturities. While shorter-term prospects are mired by the Orianna bankruptcy and a difficult period for OHI's tenants, the company is well-positioned for the long run.

During the last decade, OHI has grown its FFO at a 4.5% average annual rate. We expect the REIT to grow its FFO at a 4.5% average annual rate over the next five years.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg P/FFO	11.0	13.9	15.8	10.2	10.9	11.8	15.0	12.4	10.2	12.8	***11.2***	***12.4***
Avg. Yld.	7.2%	7.6%	6.6%	7.7%	7.6%	6.1%	5.7%	5.9%	7.1%	8.1%	***7.7%***	***6.6%***

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OHI has traded at a 10-year average P/FFO ratio of 12.4. Due to its dramatic underperformance in the last two years, the stock valuation has declined to a P/FFO ratio of 11.2. It is likely to revert towards its average valuation level over the next five years, as the turnaround unfolds. If this occurs, the stock will enjoy a 2.1% average annual gain thanks to P/FFO expansion until 2023.

Safety, Quality, Competitive Advantage, & Recession Resiliency

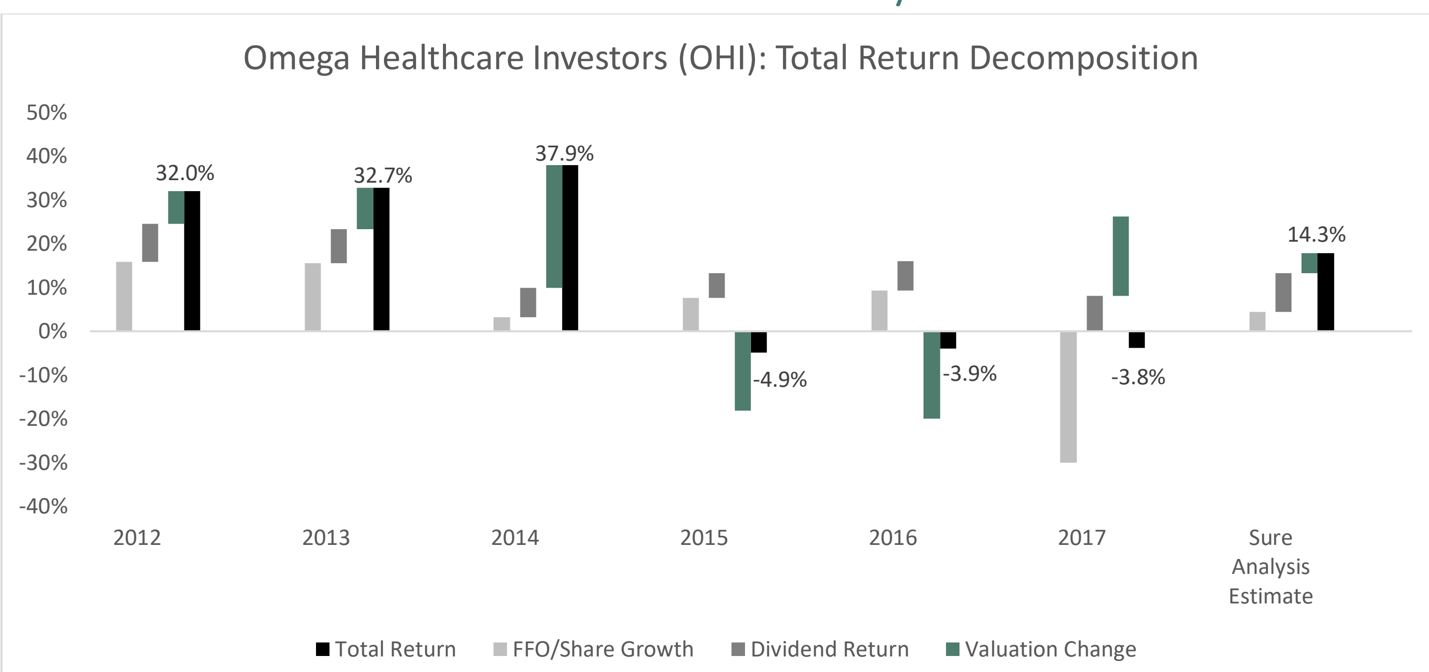
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
Debt/A	42.2%	47.7%	56.4%	65.6%	66.1%	62.4%	64.3%	48.7%	52.9%	55.7%	***56.0%***	***58.0%***
Int. Cov.	3.9	4.4	1.9	2.0	3.0	4.4	4.7	3.7	5.3	2.1	***2.5***	***3.0***
Payout	82.1%	85.7%	96.5%	82.0%	77.2%	73.5%	77.4%	77.6%	76.9%	118%	***86.8%***	***81.8%***
Std. Dev.	35.2%	35.9%	21.0%	32.5%	17.5%	29.6%	16.5%	21.6%	27.1%	18.3%	***18.0%***	***19.0%***

The healthcare sector is much less cyclical during recessions. As a result, whenever the next recession occurs, healthcare REITs are likely to perform much better than the market. This was seen during the Great Recession, when most companies saw their earnings collapse but OHI saw its FFO decrease only 3%. OHI also has an exceptional dividend growth record. More precisely, until last quarter, it had raised its dividend for 22 consecutive quarters. In addition, while it has kept its dividend constant this quarter due to the previously mentioned headwinds, it is likely to keep raising its annual dividend for many more years thanks to its reliable cash flows and its reasonable payout ratio.

Final Thoughts & Recommendation

OHI has a high 7.7% yield, and modest future growth is likely. As the stock has an opportune valuation and is resilient during recessions, retirees should certainly pay attention to its extraordinary dividend yield before the REIT completely recovers from its recent setbacks. Thanks to this dividend yield, its expected 4.5% average annual FFO growth and a 2.1% annualized P/FFO expansion, OHI is likely to offer a 14.3% average annual return over the next five years. It is a strong buy at current prices for investors who can tolerate the risks in the skilled nursing industry today.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	194	197	258	292	350	419	505	744	901	908
SG&A Exp.	12	12	15	19	21	22	26	39	46	48
D&A Exp.	40	45	85	100	113	129	123	211	267	288
Operating Profit	110	118	151	165	216	266	353	486	578	559
Operating Margin	56.9%	59.6%	58.3%	56.6%	61.7%	63.6%	69.9%	65.4%	64.2%	61.5%
Net Profit	78	82	58	53	121	173	221	225	366	100
Net Margin	40.3%	41.6%	22.6%	18.0%	34.4%	41.2%	43.8%	30.2%	40.7%	11.1%
Free Cash Flow	-41	-35	158	170	208	280	338	449	625	578

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	1364	1655	2304	2557	2982	3462	3922	7990	8949	8773
Cash & Equivalents	0	2	7	0	2	3	4	5	94	86
Accounts Receivable	75	82	93	99	122	142	162	195	230	268
Goodwill & Int. Ass.	N/A	N/A	N/A	N/A	N/A	N/A	N/A	646	643	645
Total Liabilities	576	790	1300	1679	1971	2162	2520	3889	4737	4885
Long-Term Debt	548	738	1177	1551	1825	2024	2379	3540	4367	4572
Shareholder's Equity	680	757	896	878	1011	1300	1401	3738	3859	3555
D/E Ratio	0.70	0.85	1.17	1.77	1.80	1.56	1.70	0.95	1.13	1.29

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	6.1%	5.4%	3.0%	2.2%	4.4%	5.4%	6.0%	3.8%	4.3%	1.1%
Return on Equity	13.6%	11.4%	7.1%	5.9%	12.8%	14.9%	16.4%	8.7%	9.6%	2.7%
ROIC	6.3%	5.6%	3.1%	2.3%	4.6%	5.6%	6.2%	3.9%	4.5%	1.2%
Shares Out.	75.2	83.7	94.2	102.2	108.0	118.1	127.3	180.5	201.6	206.8
Revenue/Share	2.58	2.36	2.74	2.86	3.24	3.55	3.97	4.12	4.47	4.39
FCF/Share	-0.54	-0.42	1.67	1.66	1.93	2.37	2.65	2.49	3.10	2.79

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.