

Medtronic, Inc.

United States of America/Equipment & Services

2 March 2016

UBS Research

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12-month rating	Buy
12-month price target	\$85.00
Prior	US\$87.00
Price	\$74.18

Updating Estimates, Q&A Tidbits and Post-Call Take-Aways

- Results and leverage roughly in-line, but prelim F17 EPS outlook unexpected
- Impact of preliminary F2017 outlook on stock equates to ~\$3-4/share
- Upping TAVR market estimate from \$3+ bil to \$4 bil in 2020
- Valuation: \$85 price target, 12.5x EV/EBITDA on FY18E EBITDA of \$10.6 bil

Results and leverage roughly in-line, but prelim F17 EPS outlook unexpected

Medtronic delivered a healthy +140 bps of year-over-year FX-adjusted op margin leverage on in-line earnings and workable F2016 (i.e. FQ4) guidance (see Figure 1). However, during the conference call, management provided preliminary F2017 EPS outlook for the first time that was below Street estimates which caught investors off-guard. Underlying EPS growth of 10-14%, adjusted for the impact of FX (20-25c) and the extra selling week (~2.0-2.5%) was in-line with expectations. However, EPS growth of ~mid-single digits on a reported basis is lower than prior Street estimates, raising questions and putting pressure on the stock. We've updated our top and bottom line estimates to be more closely in line with management's commentary regarding 2017, and in turn have reduced our price target from \$87 to \$85, due primarily to lower F2018 earnings projections, partially offset by a higher target multiple. We reiterate our Buy rating, which remains one of our two large-cap diversified top picks.

Impact of preliminary F2017 outlook on stock equates to ~\$3-4/share

Given management's preliminary F2017 EPS outlook, we expect Street estimates to have to come down by 20-25c for F17. Using the stock's recent P/E multiple of around 15x, this would equate to around \$3-4/share. With this adjustment adequately discounted in the stock by today's close, and a series of positive catalysts over the next few months, we view current levels as an attractive buying opportunity.

Upping TAVR market estimate from \$3+ bil to \$4 bil in 2020

Investors had anticipated an increase in management's long-term view of the market after EW upped its long-term (2021) estimate to \$5+ bil in December. We remain at \$6 bil in 2020E and \$9 bil in 2025E (please see our interactive TAVR market model, published in October), and we do not read too much into the subtle differences in MDT's and EW's long-term projections. We continue to expect Street estimates for the long-term TAVR market to move higher over the next several months driven in part by the PARTNER II intermediate-risk data, scheduled to be presented at ACC on April 2

Valuation: \$85 price target, 12.5x EV/EBITDA on FY18E EBITDA of \$10.6 bil

Our 12.5x target multiple is roughly in line with the large cap medical supply comps, and where the stock is currently trading on our projected F2017 EBITDA estimates.

Contributing authors: Yi Cheng

Trading data and key metrics

52-wk range	US\$78.79-64.52
Market cap.	US\$105bn
Shares o/s	1,419m (COM)
Free float	100%
Avg. daily volume ('000)	2,027
Avg. daily value (m)	US\$153.4
Common s/h equity (04/16E)	US\$53.3bn
P/BV (04/16E)	2.0x
Net debt / EBITDA (04/16E)	1.8x
RIC	MDT.N
BBG	MDT US

Sources: UBS, Bloomberg

EPS (UBS, diluted) (US\$)

	04/16E			
	From	To	% ch	Cons.
Q1	1.02	1.02	0	1.02
Q2	1.03	1.03	0	1.03
Q3	1.06	1.06	-1	1.06
Q4E	1.27	1.27	0	1.28
04/16E	4.38	4.37	0	4.38
04/17E	4.91	4.57	-7	4.88
04/18E	5.47	5.23	-4	5.41

Definitions of terms and abbreviations are available in the appendix section of this report, and more extensively on internet at www.ubs.com/glossary

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Investment Thesis

Investment Case

Our Buy rating is based on the following: 1) Large cap diversified medical supplies and devices leader in the sweet spot of balancing scale with innovative high growth programs; 2) Participating in almost every high-growth opportunity across our universe, like DCBs, TAVR and Afib Ablation; and 3) Medtronic is one of best-in-class at leveraging scale and breadth to its advantage.

Company Profile: Medtronic, Inc.

Medtronic is a global manufacturer and provider of medical devices and equipment across a wide range of specialties including cardiac rhythm management, vascular intervention, structural and valvular disease, spinal disorders, neuromodulation, surgical equipment and diabetes.

Statement of Risk

Our \$85 price target is based on 12.5x EV/EBITDA on FY18E EBITDA of \$10.6 bil. Risks to our price target include lower than expected deal synergies, failure of key pipeline products, unexpected slowdown in key markets and regulatory delays of key products.

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Highlights (US\$m)	04/13	04/14	04/15	04/16E	04/17E	04/18E	04/19E	04/20E
Revenues	16,589	17,006	20,261	28,742	29,822	31,876	33,746	35,590
EBIT (UBS)	4,770	4,828	5,269	6,279	6,372	7,202	7,835	8,458
Net earnings (UBS)	3,855	3,925	4,745	6,231	6,341	7,160	7,793	8,435
EPS (UBS, diluted) (US\$)	3.75	3.87	4.28	4.37	4.57	5.23	5.69	6.16
DPS (US\$)	1.04	1.12	1.24	1.55	1.86	2.23	2.46	2.70
Net (debt) / cash	479	2,313	(16,706)	(16,178)	(14,394)	(11,066)	(5,614)	291
Profitability/valuation	04/13	04/14	04/15	04/16E	04/17E	04/18E	04/19E	04/20E
EBIT margin %	28.8	28.4	26.0	21.8	21.4	22.6	23.2	23.8
ROIC (EBIT) %	27.4	28.7	12.3	9.1	9.4	11.0	12.5	14.1
EV/EBITDA (core) x	8.2	9.4	12.6	13.3	12.8	11.3	10.1	9.0
P/E (UBS, diluted) x	11.2	14.4	16.1	17.0	16.2	14.2	13.0	12.0
Equity FCF (UBS) yield %	10.4	8.2	5.7	4.6	6.7	7.9	8.5	9.3
Net dividend yield %	2.5	2.0	1.8	2.1	2.5	3.0	3.3	3.6

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied.

Valuations: based on an average share price that year, (E): based on a share price of US\$74.18 on 01 Mar 2016 18:41 EST

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UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	47%	33%
Neutral	Hold/Neutral	42%	34%
Sell	Sell	11%	23%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 March 2014.

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.

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Global Equity 12-Month Rating Definitions

Buy: FSR is > 6% above the MRA. **Neutral:** FSR is between -6% and 6% of the MRA. **Sell:** FSR is > 6% below the MRA.

Key Definitions

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

Exceptions and Special Cases

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Company Disclosures

Medtronic	MDT US	Buy	US\$74.18	01 Mar 2016
Company Name	Reuters	12-mo rating	Price	Price date

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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6. A U.S.-based global equity strategist, a member of his team, or one of their household members has a long common stock position in Medtronic PLC.

Medtronic, Inc.

Global rating history -- Medtronic, Inc., MDT US



Source: UBS CIO as of 2 March 2016

Terms and Abbreviations

Term / Abbreviation	Description / Definition	Term / Abbreviation	Description / Definition
1H, 2H, etc. or 1H11, 2H11, etc.	First half, second half, etc. or first half 2011, second half 2011, etc.	1Q, 2Q, etc. or 1Q11, 2Q11, etc.	First quarter, second quarter, etc. or first quarter 2011, second quarter 2011, etc.
2011E, 2012E, etc.	2011 estimate, 2012 estimate, etc.	A	actual i.e. 2010A
ADR	American depository receipt	ARPU	Average Revenue Per User
AUM	Assets under management = total value of own and third-party assets managed	Avg.	average
bn	Billion	bp or bps	Basis point or basis points (100 bps = 1 percentage point)
BVPS	Book value per share = shareholders' equity divided by the number of shares	CAGR	Compound annual growth rate
Cant Inc/Capita	Cantonal income per capita (Switzerland only)	Capex	Capital expenditures
CF	Cash flow	CFO	1) Cash flow from operations, 2) Chief financial officer
COGS	Cost of goods sold	COM	Common shares
Cons.	Consensus	Core Tier 1 Ratio	Tier 1 capital minus tier 1 hybrid securities
Cost/Inc Ratio (%)	Costs as a percentage of income	CPI	Consumer price index
CR	Combined ratio = ratio of claims and expenses as a percentage of premiums (for insurance companies)	CY	Calendar year
DCF	Discounted cash flow	DDM	Dividend discount model
Dividend Yield (%)	Dividend per share divided by price per share	DPS	Dividend per share
E	expected i.e. 2011E	EBIT	Earnings before interest and taxes
EBIT Margin (%)	EBIT divided by revenues	EBITDA	Earnings before interest, taxes, depreciation and amortization
EBITDA Margin (%)	EBITDA divided by revenues	EBITDA/Net Interest	EBITDA divided by net interest expense
EBITDAR	Earnings before interest, taxes, depreciation, amortization and rental expense	EFVR	Estimated fair value range
EmV	Embedded value = net asset value + present value of forecasted future profits (for life insurers)	EPS	Earnings per share
Equity Ratio (%)	Shareholders' equity divided by total assets	EV	Enterprise value = market value of equity, preferred equity, outstanding net debt and minorities
FCF	Free cash flow = cash a company generates above outlays required to maintain/expand its asset base	FCF Yield (%)	Free cash flow divided by market capitalization
FFO	Funds from operations	FY	Fiscal year / financial year
GDP	Gross domestic product	Gross Margin (%)	Gross profit divided by revenues
H	half year	h/h	Half-year over half-year; half on half
hist av.	Historical average	Interbank Ratio	Interbank deposits due from banks divided by interbank deposits due to banks
Interest Coverage	Ratio that expresses the number of times interest expenses are covered by earnings	Interest exp	Interest expense
ISIN	International securities identification number	K	One thousand
LLP/Net Int Inc (%)	Loan loss provisions divided by net interest income	LLR/Gross Loans (%)	Loan loss reserves divided by gross loans

Medtronic, Inc.

Term / Abbreviation	Description / Definition	Term / Abbreviation	Description / Definition
LPR	Least Preferred: The stock is expected to both underperform the relevant benchmark and depreciate in absolute terms.	Market cap	Number of all shares of a company (at the end of the quarter) times closing price
m/m	Month-over-month; month on month	mn or m	Million
M and A	Merger and Acquisition	MP	Marketperform: The stocks expected performance is in line with the sector benchmark
MPR	Most Preferred: The stock is expected to both outperform the relevant benchmark and appreciate in absolute terms.	n.a.	Not available or not applicable
NAV	Net asset value	Net Debt	Short- and long-term interest-bearing debt minus cash and cash equivalents
Net DPS	Net dividends per share	NIM or Net Int Margin (%)	Net interest income divided by average interest-bearing assets
Net Margin (%)	Net income dividend by revenues	NV	Neutral View: The stock is expected to neither outperform nor underperform the relevant benchmark nor significantly appreciate or depreciate in absolute terms.
n.m. or NM	Not meaningful	NPL	Non-performing loans
OP	Outperform: The stocks is expected to outperform the sector benchmark	Op Margin (%)	Operating income divided by revenues
p.a.	Per annum (per year)	P/BV	Price to book value
P/E or PE	Price to earnings / Price Earnings Ratio	P/E Relative	P/E relative to the market
P/EmV	Price to embedded value	PEG Ratio	P/E ratio divided by earnings growth
PPI	Producer price index	Prim Bal/Cur Rev (%)	Primary balance divided by current revenue (total revenue minus capital revenue)
Profit Margin (%)	Net income divided by revenues	q/q or QQQ	Quarter-over-quarter; quarter on quarter
R and D	Research and development	ROA (%)	Return on assets
ROAE (%)	Return on average equity	ROCE (%)	Return on capital employed = EBIT divided by difference between total assets & current liabilities
ROE (%)	Return on equity	ROIC (%) or ROI	Return on invested capital
Shares o/s	Shares outstanding	Solvency Ratio (%)	Ratio of shareholders' equity to net premiums written (for insurance companies)
sotp or SOTP	Sum of the parts	Tax Burden Index	Swiss tax index; 100 = average tax burden of all cantons
tgt	Target	Tier 1 Ratio (%)	Tier 1 capital divided by risk-weighted assets; describes a bank's capital adequacy
tn	Trillion	UP	Underperform: The stock is expected to underperform the sector benchmark
Valor	Swiss company identifier	WACC	Weighted average cost of capital
CIO	UBS WM Chief Investment Office	x	multiple / multiplier
y/y or YOY	Year-over-year; year on year	yr	Year
YTD	Year-to-date		

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