

Medtronic, Inc.

United States of America/Equipment & Services

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UBS Research

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Pivot in Ortho, MDT Sees Bundled Payments as an Opportunity

Entrance into ortho is the most surprising take-away from MDT's analyst day

As part of Medtronic's biennial analyst meeting, management described its strategy for entering the total joint reconstruction market for hips and knees (i.e. orthopaedics), which will involve leveraging an investment in a small private orthopaedic manufacturer and the company's broader experience in value-based healthcare. The comments were unexpected, but should be a relief for those investors concerned that MDT might have contemplated entering the ortho market via a larger acquisition, which will clearly not be part of their plan. The topic of ortho as a potential adjacency had come up intermittently over the past couple of years, and we view the plan that management unveiled today as consistent with our expectations and the company's CEO at our investor lunch in December. We view the comments as positive for Buy-rated top-pick MDT, and potentially neutral to modestly negative for Neutral-rated SYK and ZBH.

Other take- aways from meeting thus far have been in-line with expectations

As we head into the final segment of the meeting, which is focused on margins and financial outlook, we have found most of the take- aways from the meeting to be in-line with expectations, including Chairman CEO Omar Ishrak's comments reiterating the broad strokes of the company's long-term outlook: Mid-single digit top-line growth and double-digit earnings growth. Cash flows over the next 5 years are expected to be \$40 billion, to be allocated across returns to shareholders (\$20 bil), M&A and debt reduction (\$10 bil) and financial flexibility (\$10 bil). So, with the exception of the ortho announcement, there have been no surprises thus far.

| | |
|-----------------------|----------------|
| 12-month rating | Buy |
| 12-month price target | \$92.00 |
| Price | \$82.94 |

Contributing authors: Yi Cheng

Trading data and key metrics

| | |
|----------------------------|-----------------|
| 52-wk range | US\$82.99-64.52 |
| Market cap. | US\$117bn |
| Shares o/s | 1,416m (COM) |
| Free float | 100% |
| Avg. daily volume ('000) | 1,477 |
| Avg. daily value (m) | US\$115.3 |
| Common s/h equity (04/17E) | US\$51.7bn |
| P/BV (04/17E) | 2.2x |
| Net debt / EBITDA (04/17E) | 1.9x |
| RIC | MDT.N |
| BBG | MDT US |

Sources: UBS, Bloomberg

EPS (UBS, diluted) (US\$)

| | 04/17E | |
|--------|--------|-------|
| | UBS | Cons. |
| Q1E | 1.02 | 1.02 |
| Q2E | 1.14 | 1.14 |
| Q3E | 1.13 | 1.15 |
| Q4E | 1.38 | 1.36 |
| 04/17E | 4.66 | 4.66 |
| 04/18E | 5.42 | 5.18 |
| 04/19E | 5.94 | 5.65 |

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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Medtronic, Inc.

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, neuro-modulation, surgical equipment and diabetes.

Statement of Risk

MDT: Our \$92 price target is based on 13.5x EV/EBITDA on FY18E EBITDA of \$10.8 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. ZBH: Our price target of \$117 is based on a 10.5x EV/EBITDA multiple and 2017E EBITDA of \$3.1 bil. SYK: Our \$112 price target is based on a 13.5x EV/EBITDA multiple on projected 2017E EBITDA of \$3.3 bil.

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| Highlights (US\$m) | 04/14 | 04/15 | 04/16 | 04/17E | 04/18E | 04/19E | 04/20E | 04/21E |
|---------------------------|--------|----------|----------|----------|----------|----------|---------|---------|
| Revenues | 17,006 | 20,261 | 28,833 | 29,961 | 31,993 | 33,898 | 35,756 | 37,648 |
| EBIT (UBS) | 4,828 | 5,300 | 6,196 | 6,621 | 7,513 | 8,187 | 8,802 | 9,277 |
| Net earnings (UBS) | 3,925 | 4,745 | 6,230 | 6,464 | 7,383 | 8,081 | 8,744 | 9,403 |
| EPS (UBS, diluted) (US\$) | 3.87 | 4.28 | 4.37 | 4.66 | 5.42 | 5.94 | 6.42 | 6.91 |
| DPS (US\$) | 1.12 | 1.24 | 1.52 | 1.82 | 2.19 | 2.41 | 2.65 | 2.91 |
| Net (debt) / cash | 2,313 | (16,706) | (18,606) | (18,071) | (16,171) | (11,448) | (6,266) | (6,266) |
| Profitability/valuation | 04/14 | 04/15 | 04/16 | 04/17E | 04/18E | 04/19E | 04/20E | 04/21E |
| EBIT margin % | 28.4 | 26.2 | 21.5 | 22.1 | 23.5 | 24.2 | 24.6 | 24.6 |
| ROIC (EBIT) % | 28.7 | 12.4 | 8.9 | 9.5 | 11.0 | 12.2 | 13.4 | 14.2 |
| EV/EBITDA (core) x | 9.4 | 12.6 | 13.7 | 14.0 | 12.4 | 11.2 | 10.1 | 9.4 |
| P/E (UBS, diluted) x | 14.4 | 16.1 | 17.2 | 17.8 | 15.3 | 14.0 | 12.9 | 12.0 |
| Equity FCF (UBS) yield % | 8.2 | 5.7 | 3.9 | 4.9 | 6.2 | 6.9 | 7.6 | 8.2 |
| Net dividend yield % | 2.0 | 1.8 | 2.0 | 2.2 | 2.6 | 2.9 | 3.2 | 3.5 |

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\$82.94 on 03 Jun 2016 19:35 EDT

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Medtronic, Inc.

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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.

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Company Disclosures

| Medtronic | MDT US | Buy | US\$82.94 | 03 Jun 2016 |
|---------------|---------|--------------|------------|-------------|
| Stryker | SYK US | Neutral | US\$113.56 | 03 Jun 2016 |
| Zimmer Biomet | ZBH US | Neutral | US\$121.82 | 03 Jun 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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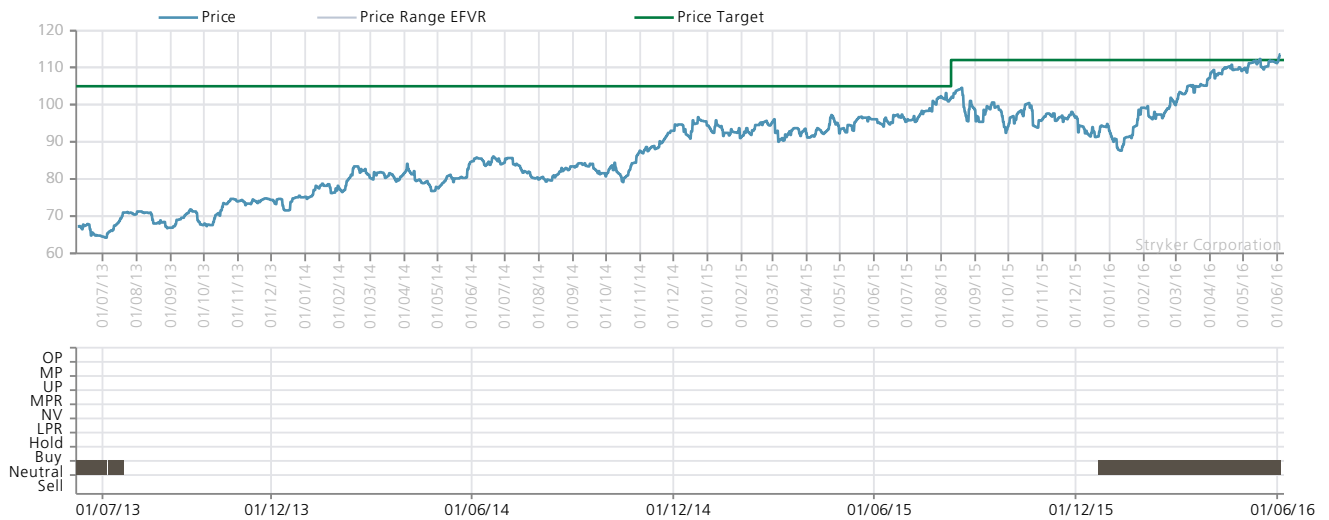
Medtronic, Inc.

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



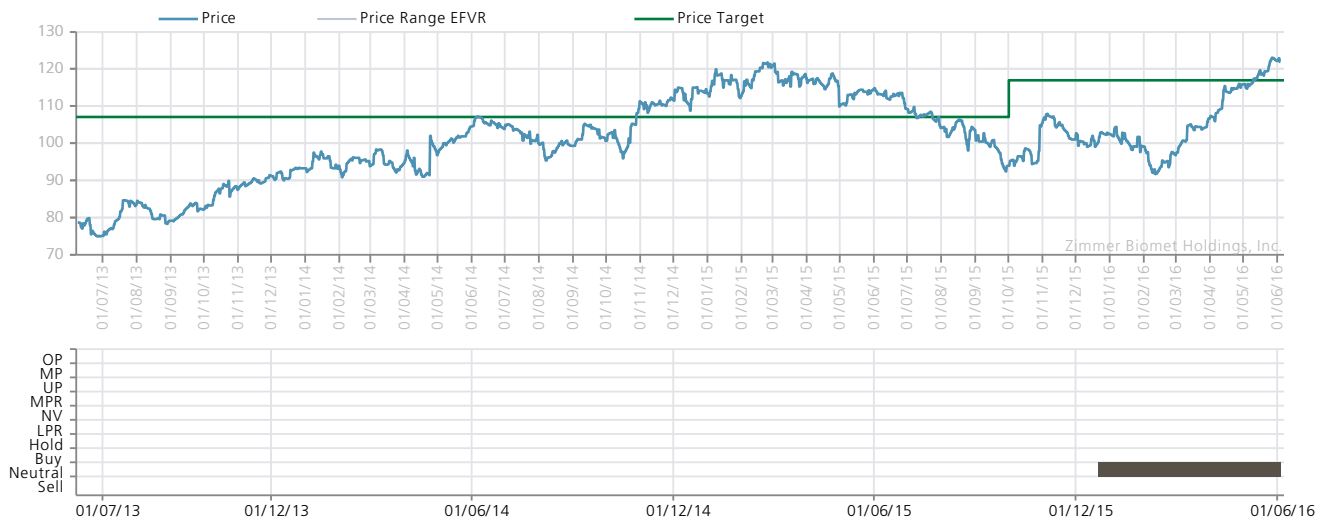
Source: UBS CIO as of 6 June 2016

Global rating history -- Stryker Corporation, SYK US



Source: UBS CIO as of 6 June 2016

Global rating history -- Zimmer Biomet Holdings, Inc., ZBH US



Source: UBS CIO as of 6 June 2016

Terms and Abbreviations

| Term / Abbreviation | Description / Definition | Term / Abbreviation | Description / Definition |
|---------------------|--------------------------|---------------------|--------------------------|
|---------------------|--------------------------|---------------------|--------------------------|

Medtronic, Inc.

| 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 depositary 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 expected i.e. 2011E | DPS | Dividend per share |
| E | | 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 |
| 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 |

Medtronic, Inc.

| Term / Abbreviation | Description / Definition | Term / Abbreviation | Description / Definition |
|---------------------|--------------------------------|----------------------|--|
| 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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