

Medtronic, Inc.

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UBS Research

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F3Q: Expect Stable Growth, Setting F2018 Bar for Outperformance, Reiterate Buy

- Solid Med Supplies and Device group performance bodes well for MDT F3Q
- What does 2017 MS&D group outlook tell us about MDT's F2018 outlook?
- Our F18 estimates reflect 10% underlying EPS growth, trimmed for tougher FX
- Valuation: \$94 PT, based on 13.5x EV/EBITDA on FY19E EBITDA of \$11.0 bil

MS&D results were for the most part better than expected (or feared?) after MDT's jarring F2Q performance, restoring confidence that med device end markets and utilization trends remain healthy in the U.S. We expect some potential bright spots for MDT, like TAVR, Afib ablation where product launches and the FIRE and ICE study continues to drive share gains. Other business lines may take another quarter or so to re-accelerate, but in total we see management able to track back up to the 5% range over the next few quarters. We reiterate our Buy rating on top large cap diversified pick MDT, raising our PT from \$88 to \$94, driven by our rolling forward to a F2019 EBITDA basis, partially offset by reductions in top and bottom line estimates due to FX.

What does 2017 MS&D group outlook tell us about MDT's F2018 outlook?

We expect management to provide preliminary outlook commentary on F2018, consistent with prior years. The company has reiterated its commitment to mid-single digit top line constant currency growth (including 50-100 bps contribution from strategic investments), and double digit underlying EPS growth (before the impact of FX). This is also directionally consistent with our analysis of MS&D group 2017 outlook vs. Street estimates. We expect key topics for the call to include: 1) MRI-labeling and competition in CRM; 2) Expected implications for intermediate-risk TAVR data at ACC in mid-March (SURTAVI); 3) Potential for uptake of the Micra leadless pacer, and; 4) Potential implications of regulatory and policy initiatives in the U.S.

Our F18 estimates reflect 10% underlying EPS growth, trimmed for tougher FX

We have updated our model to reflect ~5% CC top line growth in 2018, and 10% underlying EPS growth (low- to mid-teens total return), net of tougher FX. We estimate FX negatively impacted our 2018 sales and EPS estimates by ~\$150-200 mil and 13c, respectively. Our F3Q estimates call for top-line growth 3.8% in F3Q (up 4.2% CC) and \$1.10 in EPS (vs. \$1.11 consensus).

Valuation: \$94 PT, based on 13.5x EV/EBITDA on FY19E EBITDA of \$11.0 bil

Our \$94 price target (up from \$88) is based on a 13.5x target multiple (unchanged) on 2019E EBITDA (rolled forward from 2018E). We are trimming our FY18 EPS by 13c, in-line with management expectations for of a 10-20c FX headwind.

12-month rating	Buy
12-month price target	\$94.00
Prior	US\$88.00
Price	\$77.99

Contributing authors: Yi Cheng

Trading data and key metrics

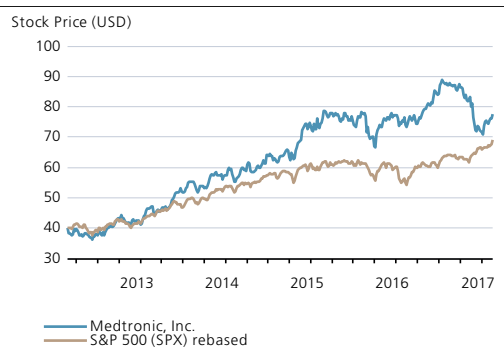
52-wk range	US\$88.92-70.61
Market cap.	US\$108bn
Shares o/s	1,380m (COM)
Free float	100%
Avg. daily volume ('000)	1,795
Avg. daily value (m)	US\$133.3
Common s/h equity (04/17E)	US\$51.8bn
P/BV (04/17E)	2.1x
Net debt / EBITDA (04/17E)	2.0x
RIC	MDT.N
BBG	MDT US

Sources: UBS, Bloomberg

EPS (UBS, diluted) (US\$)

	04/17E			Cons.
	From	To	% ch	
Q1	1.03	1.03	0	1.03
Q2	1.12	1.12	0	1.12
Q3E	1.10	1.10	NM	1.11
Q4E	1.32	1.31	-1	1.31
04/17E	4.56	4.55	0	4.56
04/18E	5.00	4.87	-3	4.98
04/19E	5.55	5.42	-2	5.45

Performance



Sources: Bloomberg, UBS

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.

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 \$94 price target is based on 13.5x EV/EBITDA on FY18E EBITDA of \$11.0 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)	04/14	04/15	04/16	04/17E	04/18E	04/19E	04/20E	04/21E
Revenues	17,006	20,261	28,833	29,485	30,657	32,145	33,866	35,714
EBIT (UBS)	4,828	5,300	6,196	6,315	6,604	7,269	7,986	8,589
Net earnings (UBS)	3,925	4,745	6,230	6,312	6,636	7,302	7,990	8,721
EPS (UBS, diluted) (US\$)	3.87	4.28	4.37	4.55	4.87	5.42	5.97	6.52
DPS (US\$)	1.12	1.24	1.52	1.72	2.06	2.31	2.66	3.00
Net (debt) / cash	2,313	(16,706)	(18,606)	(18,653)	(17,359)	(14,851)	(11,629)	(11,629)
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	21.4	21.5	22.6	23.6	24.0
ROIC (EBIT) %	28.7	12.4	8.9	9.0	9.6	10.7	12.0	13.1
EV/EBITDA (core) x	9.4	12.6	13.7	13.3	12.4	11.2	10.1	9.4
P/E (UBS, diluted) x	14.4	16.1	17.2	17.1	16.0	14.4	13.1	12.0
Equity FCF (UBS) yield %	8.2	5.7	3.9	5.5	6.0	6.7	7.5	8.3
Net dividend yield %	2.0	1.8	2.0	2.2	2.6	3.0	3.4	3.9

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\$77.99 on 16 Feb 2017 18:43 EST

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UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	45%	28%
Neutral	Hold/Neutral	39%	25%
Sell	Sell	15%	17%

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 December 2016.

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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