

# Medtronic, Inc.

United States of America/Equipment & Services  
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**UBS Research**

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## F3Q: Solid Beat on Sales, EPS and Margins

Top-line beats, bottom-line beats with improving operating margins  
 Management delivered 1c beat to consensus, 2c to our estimate on broad-based stronger top-line growth and operating margin improvement. On the earnings line, sales net of COGS (+1c), lower R&D (+1c) and lower interest expense (+1c) were partially offset by higher SG&A (-1c) to deliver +2c relative to our estimates. Operating margins were 28.2% for the quarter (+40 bps YoY, +130 bps on CC basis), relative to our estimate of 28.0%. F3Q results represent a welcoming recovery from the company's prior quarter results and demonstrates management's ability to deliver total returns in the low- to mid-teens, driven by mid-single digit revenue growth, 200-400 bps of operating leverage, 100-200 bps from debt paydown and share repurchases, and dividend yield of ~2-3%. We reiterate our Buy rating on large-cap diversified top-pick MDT, and we expect the stock to react favourably to today's results.

Top-line beat was across business lines and geographies

Sales were \$7.28 bil, up 5% as reported (up 6% CC), ~\$88 mil above our estimate and ~4-5% CC expectations. The beat in sales was relatively broad-based, including higher than expected sales in MITG (+\$41 mil), CVG (+\$31 mil), RTG (+\$9 mil) and Diabetes (+\$7 mil) contributed to the \$88 mil top-line beat relative to our estimate. Both U.S. (+\$12 mil) and OUS (+\$76 mil) sales were also above our estimates.

What to look for on the call?

Management reiterated revenue and EPS guidance for FY17, but it will be commentary on FY18 that investors will be looking for, which we expect to be in the mid-single digits for top-line, and \$4.80-4.90 on the bottom line. 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 pacemaker, and; 4) Potential implications of regulatory and policy initiatives in the U.S.

|                       |                |
|-----------------------|----------------|
| 12-month rating       | <b>Buy</b>     |
| 12-month price target | <b>\$94.00</b> |
| Price                 | <b>\$78.88</b> |

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### Trading data and key metrics

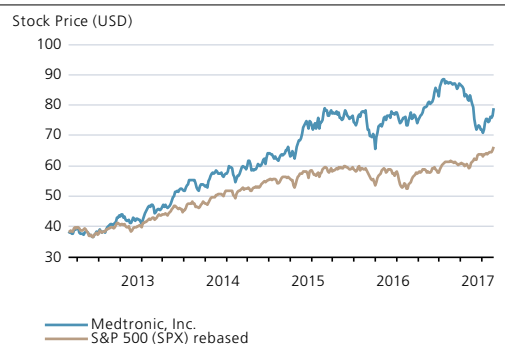
|                            |                 |
|----------------------------|-----------------|
| 52-wk range                | US\$88.92-70.61 |
| Market cap.                | US\$109bn       |
| Shares o/s                 | 1,380m (COM)    |
| Free float                 | 100%            |
| Avg. daily volume ('000)   | 1,829           |
| Avg. daily value (m)       | US\$135.9       |
| 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 |       |
|--------|--------|-------|
|        | UBS    | Cons. |
| Q1     | 1.03   | 1.03  |
| Q2     | 1.12   | 1.12  |
| Q3E    | 1.10   | 1.11  |
| Q4E    | 1.31   | 1.31  |
| 04/17E | 4.55   | 4.56  |
| 04/18E | 4.87   | 4.95  |
| 04/19E | 5.42   | 5.42  |

### 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](http://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

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     | 13.5     | 12.6     | 11.3     | 10.2     | 9.5      |
| P/E (UBS, diluted) x      | 14.4   | 16.1     | 17.2     | 17.3     | 16.2     | 14.6     | 13.2     | 12.1     |
| Equity FCF (UBS) yield %  | 8.2    | 5.7      | 3.9      | 5.4      | 5.9      | 6.7      | 7.4      | 8.2      |
| Net dividend yield %      | 2.0    | 1.8      | 2.0      | 2.2      | 2.6      | 2.9      | 3.4      | 3.8      |

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\$78.88 on 17 Feb 2017 19:37 EST

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| UBS 12-Month Rating | Rating Category | Coverage <sup>1</sup> | IB Services <sup>2</sup> |
|---------------------|-----------------|-----------------------|--------------------------|
| 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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**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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