

Medtronic, Inc.

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UBS Research

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Divestiture Improves Growth and Margin Profile, Increases Focus on Higher Return Opportunities

- Divestiture adds 50 bps to growth and margins, enhances cap structure
- What is being sold and what is being retained?
- Basics of the deal: \$5.5 bil after-tax proceeds
- Valuation: \$94 target, based on 13.5x EV/EBITDA on FY19E EBITDA of \$11.0 bil

MDT's agreement to divest certain assets within its Patient Monitoring & Recovery business to CAH for \$6.1 bil (\$5.5 bil after-tax) is roughly in-line with press reports over the past few weeks. MDT will use ~\$1 bil of the proceeds to buy back stock with the remaining \$4.5 bil used for debt paydown, consistent with its capital allocation strategy. The company expects the transaction to be 12-18c dilutive (net) in FY18. Based on our analysis, the bottom-line impact of the divestiture on MDT's projected FY18 EPS will be ~17c, offset by ~3c in share repurchases and ~1c in debt paydown. The OM of the divested business are in the low 20s, higher than previously expected. In addition to enhancing the company's growth and margin profile, we believe the divestiture of these lower growth/lower margin businesses indicates that MDT is focused on directing its efforts toward higher return/higher growth opportunities. We reiterate our Buy rating and \$94 price target on our large-cap diversified top pick MDT.

What is being sold and what is being retained?

MDT is selling certain Patient Monitoring & Recovery businesses, which include the Patient Care, Deep Vein Thrombosis, and Nutritional Insufficiency businesses, which include enteral feeding, urology, dental/animal health, wound care, compression (DVT), incontinence, etc. The deal will also include 17 dedicated manufacturing facilities. Combined, these businesses generated ~\$2.4 bil in sales over the last four reported quarters and were declining LSD. MDT is not divesting its Respiratory & Monitoring Solutions business (airway, ventilators, monitors, sensors, and health informatics product lines) or its Renal Care Solutions business.

Basics of the deal: \$5.5 bil after-tax proceeds

This morning, MDT announced that it had entered into a definitive agreement with Cardinal Health to sell part of its Patient Monitoring & Recovery business, which includes its Patient Care, Deep Vein Thrombosis, and Nutritional Insufficiency businesses for \$6.1 bil (\$5.5 bil after-tax) or ~2.5x sales. The deal is expected to close F2Q18. We provide an analysis of the deal from MDT's perspective later in the note.

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

Our \$94 price target is based on a 13.5x target multiple on our 2019E EBITDA.

12-month rating	Buy
12-month price target	\$94.00
Price	\$80.36

Contributing authors: Yi Cheng

Trading data and key metrics

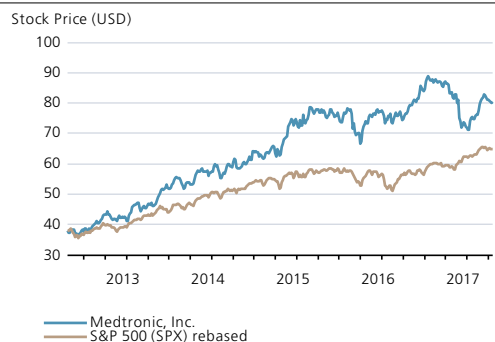
52-wk range	US\$88.92-70.61
Market cap.	US\$110bn
Shares o/s	1,372m (COM)
Free float	100%
Avg. daily volume ('000)	1,447
Avg. daily value (m)	US\$114.3
Common s/h equity (04/17E)	US\$51.7bn
P/BV (04/17E)	2.1x
Net debt / EBITDA (04/17E)	2.1x
RIC	MDT.N
BBG	MDT US

Sources: UBS, Bloomberg

EPS (UBS, diluted) (US\$)

	04/17E	
	UBS	Cons.
Q1	1.03	1.03
Q2	1.12	1.12
Q3	1.12	1.12
Q4E	1.30	1.31
04/17E	4.57	4.58
04/18E	4.87	4.95
04/19E	5.43	5.43

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 our FY19E 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	29,598	30,791	32,315	34,008	35,767
EBIT (UBS)	4,828	5,300	6,196	6,145	6,646	7,324	8,033	8,609
Net earnings (UBS)	3,925	4,745	6,230	6,348	6,665	7,342	8,026	8,726
EPS (UBS, diluted) (US\$)	3.87	4.28	4.37	4.57	4.87	5.43	5.98	6.55
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)	(19,063)	(17,696)	(15,092)	(11,769)	(11,769)
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	20.8	21.6	22.7	23.6	24.1
ROIC (EBIT) %	28.7	12.4	8.9	8.8	9.5	10.7	12.0	13.0
EV/EBITDA (core) x	9.4	12.6	13.7	13.9	12.7	11.4	10.3	9.6
P/E (UBS, diluted) x	14.4	16.1	17.2	17.6	16.5	14.8	13.4	12.3
Equity FCF (UBS) yield %	8.2	5.7	3.9	4.8	5.7	6.7	7.4	8.2
Net dividend yield %	2.0	1.8	2.0	2.1	2.6	2.9	3.3	3.7

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\$80.36 on 17 Apr 2017 19:34 EDT

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UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	45%	29%
Neutral	Hold/Neutral	39%	27%
Sell	Sell	15%	16%

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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Company Disclosures

Company Name	Reuters	12-mo rating	Price	Price date
Medtronic	MDT US	Buy	US\$80.36	17 Apr 2017
Cardinal Health	CAH US	Neutral	US\$81.83	17 Apr 2017

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

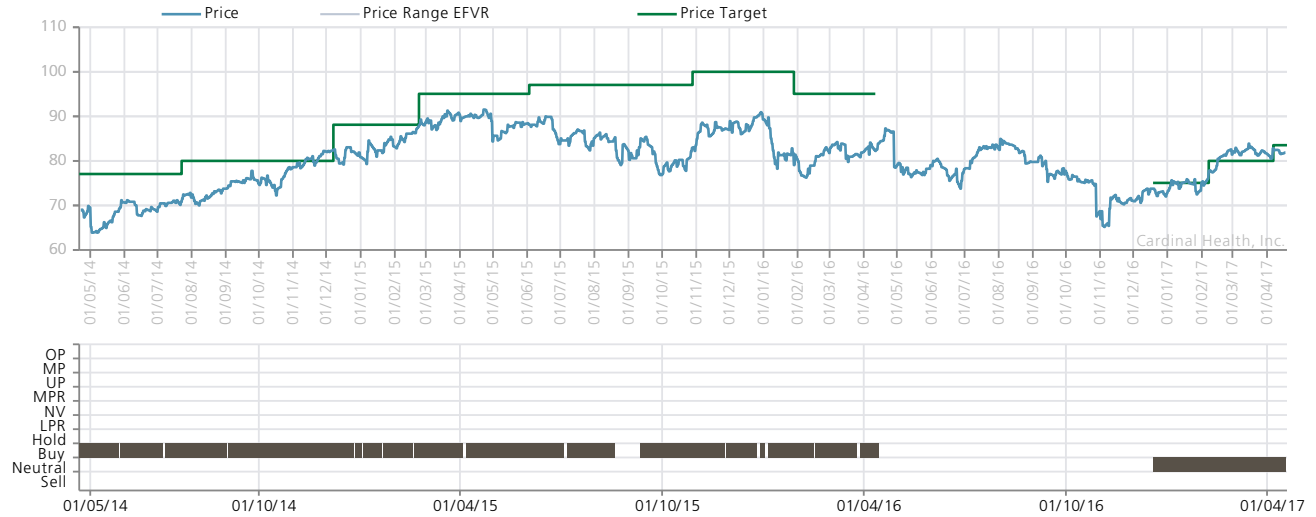
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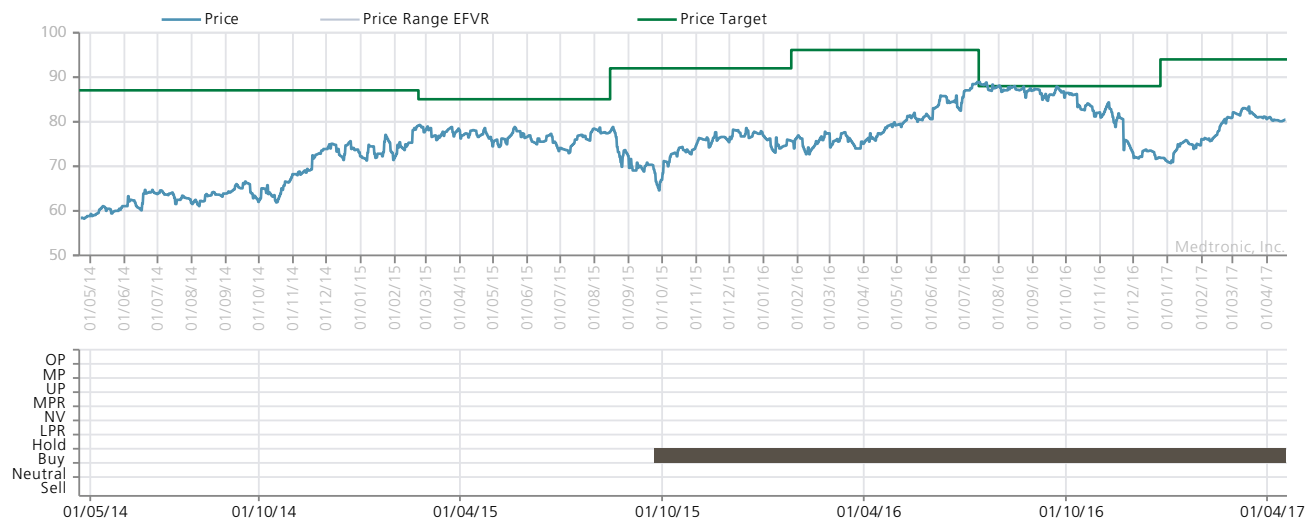
Medtronic, Inc.

Global rating history -- Cardinal Health, Inc., CAH US



Source: UBS CIO as of 18 April 2017

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



Source: UBS CIO as of 18 April 2017

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

Medtronic, Inc.

Term / Abbreviation	Description / Definition	Term / Abbreviation	Description / Definition
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
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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