

Q2 FY19 EARNINGS CALL COMMENTARY NOVEMBER 20, 2018

FINAL

Medtronic

Ryan Weispfenning

Thank you. Good morning and welcome to Medtronic's second quarter conference call and webcast. During the next hour, Omar Ishrak, Medtronic Chairman and Chief Executive Officer, and Karen Parkhill, Medtronic Chief Financial Officer, will provide comments on the results of our second quarter, which ended on October 26, 2018. After our prepared remarks, we will be happy to take your questions.

First, a few logistical comments: Earlier this morning, we issued a press release containing our financial statements and a revenue-by-division summary. We also issued an earnings presentation that provides additional details on our performance and outlook. During this earnings call, many of the statements made may be considered forward-looking statements, and actual results may differ materially from those projected in any forward-looking statement. Additional information concerning factors that could cause actual results to differ is contained in our periodic reports and other filings that we make with the SEC, and we do not undertake to update any forward-looking statement. In addition, the reconciliations of any non-GAAP financial measures are available on our website, InvestorRelations.Medtronic.com. References to quarterly results increasing, decreasing, or staying flat are in comparison to the second quarter of fiscal year 2018, and references to organic revenue growth exclude the impact of any material acquisitions, divestitures, and currency. Unless we say otherwise, quarterly revenue growth rates and ranges are given on a constant currency basis, which adjusts for the impact of foreign currency. All of these adjustment details can be found in the reconciliation tables included with our earnings press release. Finally, our EPS guidance does not include any charges or gains that would be reported as non-GAAP adjustments to earnings during the fiscal year. With that, I am now pleased to turn the call over to Medtronic Chairman and Chief Executive Officer, Omar Ishrak.

Omar Ishrak

Thank you, Ryan, and thank you to everyone for joining us.

Let me start today's call by taking a few minutes to remember Earl Bakken, the co-founder of Medtronic, who passed away last month. Earl led our company for four decades, retiring as Chairman in 1989. He remained a beloved figure at Medtronic and continued to serve as Chairman Emeritus throughout his life. Earl watched the company he started in a modest Minneapolis garage grow into the industry-leading, multibillion-dollar company that we are today. Earl remained steadfastly committed to the Medtronic Mission, which he drafted nearly 60 years ago and remains the guiding principles of our company today. I was fortunate to spend some time with Earl and treasure the memories of visiting him over the

years. Earl improved the lives of millions of people, built a major corporation, and established an entire industry. We are excited to continue living his vision every day at Medtronic¹.

Turning now to Q2, this morning we reported another quarter of strong top- and bottom-line performance. Organic revenue grew 7.5%, marking the fourth straight quarter of 6.5% or better underlying revenue growth, reflecting once again, strong growth across all groups and regions. Adjusted operating profit grew 11.3% or 10.6% adjusted for currency. Adjusted diluted EPS grew 14.0% or 13.1% at constant currency.

This was an outstanding quarter for Medtronic. As you can see from the numbers – and as you'll hear over the course of this morning's call – we are executing on multiple fronts. Our comparisons will naturally turn more difficult in the back half of the year, but we are growing both our markets and our share across multiple businesses and multiple geographies. Our new product flow continues to be robust, with a series of recent launches driving both share gains and new market development. We are also pleased with our sustained execution in Emerging Markets, where we grew 13.5%.

Our results this quarter were not just on the revenue line, but also down the P&L, delivering 130 basis points of operating margin expansion or 80 basis points when adjusted for currency. This performance reflects the focus throughout our organization on margin expansion, and some early results from our Enterprise Excellence program.

Our organization is also highly focused on improving free cash flow. In the first half, we generated over \$2.4 billion of free cash flow, compared to \$1.1 billion in the prior year².

In all, an outstanding quarter. But what I want to share with you today, that is even more exciting than our quarterly and year-to-date results – is the progress that we are making in our pipeline, where we see more opportunities for growth, both near- and longer-term, than at any time in our company's history³. I'll cover the pipeline story shortly, but first let's review our performance this quarter in a little more detail.

It's worth noting that each of our operating groups delivered organic growth ahead of Street expectations for the third consecutive quarter. Our results are based not just on one business or segment, but across multiple businesses and geographies, all executing against their plans.

Growth this quarter was led once again by Diabetes, growing 27%, reflecting strong demand for our MiniMed[®] 670G hybrid closed loop system, both in the US, and now outside the US as we enter international markets. We have over 135 thousand trained, active users of our 670G system, and we continue to generate strong, real-world clinical outcomes, with time-in-range exceeding 70%.

Emerging Technologies revenue more than doubled this past quarter, driven by the launch of our Guardian® Connect standalone CGM. We continue to be pleased with the introduction of this product as it takes share in the \$1 billion standalone CGM market. With the Sugar.IQ™ assistant, Guardian® Connect is the only “smart CGM”, using cognitive computing capabilities to provide personalized insights and predictive alerts.

Overall, sales of CGM from both the Guardian® Connect and the sensors attached to pumps, grew 70%, with over 90% growth in the US. Revenue from CGM now exceeds our pump revenue, and is establishing a consistent, long-term and dependable revenue stream for our Diabetes Group.

Our Restorative Therapies Group posted another record performance, growing 7.8%, with very strong growth in the Pain, Brain, and Specialty Therapies divisions.

In Pain Therapies, our growth in Spinal Cord Stim accelerated to the mid-thirties this quarter, including mid-forties growth in the US. Customer feedback continues to be very positive on Intellis™, with its EvolveSM workflow algorithm and Snapshot™ reports. In addition, our Targeted Drug Delivery business grew low-double digits this quarter, with SynchroMed™ II continuing to perform well.

Specialty Therapies was led by strong mid-teens growth in Pelvic Health, driven by sales of the Interstim™ II neurostimulator. Transformative Solutions also grew in the low-double digits, with strength in Aquamantys™ sealers and PlasmaBlade™ dissection devices.

In Brain Therapies, we had another strong quarter led by mid-teens growth in Neurovascular, reflecting broad based strength across stroke therapies. In particular, our Solitaire™ Platinum stent continues to lead the market, growing in the high twenties. Neurosurgery also had a good quarter, with strong capital sales of navigation and robotic guidance systems.

In September, we announced our intent to acquire Mazor Robotics and plan to close the acquisition in our third quarter. We believe that integrating the Mazor X™ robot with our StealthStation® navigation and O-arm® imaging equipment, as well as with our spine implants, creates a long-term competitive advantage for us in the Spine market – one that we intend to capitalize on.

Our Minimally Invasive Therapies Group grew 6.8%, driven by balanced growth across both our SI and RGR divisions. Sales of Advanced Energy products grew in the low-double digits, driven by the adoption of enhanced LigaSure™ vessel sealing instruments and the FT10 energy platform. In Advanced Stapling, we grew in the high-single digits, as our innovative Signia™ surgical stapling system and Tri-Staple™ 2.0 endo stapling reloads continue to perform well in the minimally invasive surgery market.

Our Respiratory, GI, and Renal division grew 7.3%, with strong results across all businesses. Our Patient Monitoring business grew in the high-single digits driven by

robust sales of Nellcor™ Pulse Oximetry, Microstream™ capnography, and BIS™ anesthesia monitoring. The GI business grew in the low-double digits, including mid-teens growth in GI Diagnostics, resulting from the launch of our calibration-free Bravo™ and the adoption of the Endoflip™ imaging system.

Our Cardiac & Vascular Group grew 4.4% this quarter, with high-single digit growth in both our CSH and APV divisions. CSH benefitted from mid-teens growth in transcatheter valves, driven by global demand for our Evolut® Pro valve. CSH also continues to see strong adoption of the Resolute Onyx™ drug-eluting stent, posting low-twenties growth in the US. APV's results were driven by solid growth in drug-coated balloons, an improved performance in abdominal aortic stent grafts, and the continued rapid adoption of the differentiated VenaSeal™ vein closure system.

In Cardiac Rhythm & Heart Failure, our pacemaker business grew high-single digits, including low-double digit growth in the US and low-twenties growth in Japan on the strength of our Micra® transcatheter pacing system and Azure™ wireless pacemaker. This offset mid-single digit declines in Heart Failure, reflecting the headwind of fewer CRT-D replacement sales given our introduction of longer lasting implants over the last several years.

Now, turning to our revenue growth by geography, as I mentioned earlier, we continue to execute well in emerging markets, which grew 13.5% representing 15% of Medtronic revenue. Importantly, our years of experience and investment are paying off in not just one geography, but in multiple geographies⁴. China grew 13% this quarter, Eastern Europe by 27%, the Middle East & Africa by 20%, South Asia by 14%, and Southeast Asia by 9%. Our differentiated strategies of public and private partnerships and optimizing the distribution channel are making a real difference in emerging markets around the world.

Today, Medtronic has leadership positions in most of the fastest growing markets in MedTech; and, we are intentionally allocating our capital to higher growth markets and new opportunities. As we invest in these opportunities, we are looking to go beyond simply improving and innovating on existing products and therapies. Our goal is to invent and disrupt markets – with our focus squarely on market leadership⁵.

Pleased as I am with our results this quarter, even more important is the progress we are making on our pipeline, which contains more opportunities for growth than at any time in our company's history. Let me now first give you a glimpse of some of what we have coming in the back half of this fiscal year.

In RTG, the launch of the Mazor X Stealth™, an integrated robotics and navigation platform, should accelerate our Spine and enabling technology growth. In Brain Therapies, the React™ catheter and Riptide™ aspiration system, along with our next-generation

Solitaire™ revascularization device, should contribute to growth in the back half of the year and into FY20.

In CVG, our recently approved Valiant Navion™ thoracic stent graft system is expected to capture share and drive incremental growth, especially in the US and Western Europe. In Japan, we look forward to the continued roll out of our recently launched CRT-P Quad and Azure™ line of pacemakers, our IN.PACT™ Admiral™ drug-coated balloon, and the third quarter introduction of our HeartWare™ HVAD system. We also anticipate the release of two landmark clinical trials at the American College of Cardiology meeting in March. The first is the interim results of our low-risk TAVR study, which has the potential to expand indications to the low risk patient population. The second is the WRAP-IT trial of our TYRX™ antibacterial envelope, which could enable guideline changes in cardiac rhythm implantables.

The pipeline at MITG is equally impressive, with the expansion into key specialty areas of our Tri-Staple™ Technology and our Sonicision™ ultrasonic dissection platforms, as well as the launch of our next generation consumables for the Capnostream™ 35 Portable Respiratory Monitor – all being introduced in the back half of this fiscal year.

And lastly, our Diabetes business should benefit from the global launch of the 670G into multiple markets around the world. We will also release the next generation of Sugar.IQ™ algorithms to accurately predict hypoglycemia up to four hours in advance, which will set the standard for predictive alerts.

Everything I just highlighted represents real innovation, enabling us to grow our markets and take market share; we have plenty of such opportunities in FY20 as well. The Reveal LINQ™ 2.0, our next generation insertable cardiac monitor, is just one example. This product will include Bluetooth connectivity, five year battery longevity, and the ability to monitor additional physiologic parameters. Another example is our next generation CoreValve® platform in TAVR, the Evolut® Pro Plus. The Evolut® Pro Plus features a lower profile and improved predictability of placement for enhanced ease of use.

But what excites me even more than these examples of continuous innovation are some of the more disruptive CVG technologies that will follow, including:

- The Micra® AV, our transcatheter cardiac pacemaker, which we are targeting for a late FY20 approval, enabling us to access and disrupt 56% of the eligible pacemaker market, up from 16% today.
- Our extravascular ICD, where we're nearing completion of our feasibility study and plan to start our US pivotal in early FY20.
- Our Intrepid™ transcatheter mitral valve replacement system, now enrolling its US pivotal; and
- Symplicity Spyral™, our renal denervation system for hypertension patients, now enrolling in a pair of randomized, sham-controlled trials, building off the positive clinical results presented at EuroPCR earlier this year.

Each of these disruptive technologies in CVG has the potential to be multi-billion-dollar market opportunities.

In MITG, we're preparing for an FY20 launch of our robotic assisted surgery platform, one of the largest R&D programs within the company. We believe this platform, combined with our industry-leading surgical instruments and surgeon training centers around the world, can expand the market for minimally invasive surgery.

In RTG, we are developing next-generation cranial mounted and closed loop DBS systems in our Brain Therapies division. In Pelvic Health, we are developing a microstimulator that is only 3 cubic centimeters and features full body MRI compatibility.

In Diabetes, we are developing an advanced hybrid closed-loop system, which we expect to launch in FY20. Our next-generation algorithms will improve time-in-range to over 80% by automating insulin delivery following a snack or a meal. In addition, the system will reduce the burden of carb counting, enable remote monitoring and automatic software downloads. We are also making advancements in our CGM sensors and expect a steady cadence of innovation that will drive non-adjunctive labeling, reduce the need for calibration, make the sensors smaller and longer lasting, all while using cognitive computing to enhance personalized insights for the patient.

These are just some of the highlights of our robust pipeline. I could continue, but the key message that I want to leave with you today is that we are executing on the strongest and most exciting pipeline in Medtronic's near 70 year history.

Let me now ask Karen to take you through a discussion of our second quarter financials. Karen?

Karen Parkhill

Thank you, Omar.

Our second quarter revenue of 7 billion, 481 million dollars represented organic growth of 7.5 percent. Foreign currency had a negative 95 million dollar impact. Adjusted diluted earnings per share was a dollar, 22 cents. And, after adjusting for foreign currency, adjusted diluted EPS grew 13.1 percent.

While we came in 8 cents above the midpoint of our guidance, it's worth noting that 3 cents was driven by stronger-than-expected FX tailwinds. Given this, we would characterize the balance as operational outperformance, including a 2 cent benefit from a modestly lower tax rate, along with better-than-expected revenue and operating margin expansion in the quarter.

Adjusted operating margin was 27.9 percent, increasing 130 basis points or 80 basis points on a constant currency basis. We are expanding margins and at the same time investing more in research and development to enhance our pipeline and create long-term value.

Adjusted gross margin improved by 50 basis points, or 10 basis points on a constant currency basis, and adjusted SG&A as a percent of sales improved 50 basis points. We continue to execute on our company-wide Enterprise Excellence program, driving improved efficiency, cost savings, and generating leverage on strong sales growth.

Net Other Operating Expense was 73 million dollars compared to 96 million dollars in the prior year, with the decrease primarily due to the year-over-year change related to our currency hedging program.

Our adjusted nominal tax rate was 13.3 percent, which was better-than-expected due to increased deductions from the exercise of employee stock options along with finalizing taxes owed on certain returns. For the remainder of the fiscal year, we expect our tax rate to be 15 percent plus or minus.

Second quarter free cash flow was 957 million dollars versus 661 million in the prior year. As Omar said, improving cash generation is a priority at Medtronic, from the top of the company on down. We are pleased with our performance over the last several quarters and are seeing the benefit of our increased focus around cash flow.

We remain committed to disciplined capital deployment, balancing reinvestment with returning a minimum of 50 percent of our annual free cash flow to our shareholders. Combining our 1.2 billion dollars of year-to-date net share repurchase activity with the 1.4 billion dollars we paid in dividends over the same period, our total shareholder payout ratio was 80 percent on adjusted net income. In addition, the increased investment in organic R&D that I mentioned earlier, as well as inorganic investments we are making in tuck-in acquisitions like Mazor Robotics, are examples of our focus to increase our return on invested capital and create long-term shareholder value.

Before turning the call back to Omar, I would like to update our guidance.

For the full fiscal year, we are increasing our organic revenue growth guidance from a range of 4.5 to 5 percent to a range of 5 to 5.5 percent. **Importantly**, given the strength of our first half and the upcoming product launches that Omar has mentioned, we are comfortable with the **higher end** of this upwardly revised range.

For the year, we expect Diabetes to grow in the low- to mid-teens, RTG to grow 5 to 5.5 percent, an increase of 100 basis points from our prior expectation, and MITG to grow 5 percent plus or minus, an increase of 50 basis points from our prior expectation. With regard to CVG, we expect it to grow 4 percent plus or minus, which is a slight decline from our prior expectation, given a change in the accounting for third party product going through our Integrated Health Solutions business.

Turning to margins, we outperformed in the second quarter and are making good early progress on our Enterprise Excellence initiatives, which is offsetting a stronger than expected headwind from mix. Looking at the second half of the year, we remain confident

in our ability to deliver on the 50 basis points of full year underlying operating margin expansion, despite the mix headwinds and the impact of both China tariffs and expected dilution from the Mazor acquisition. As Omar mentioned, there are more opportunities to drive accelerated top line growth than at any point in Medtronic's history, and as such, our intent, wherever possible, is to accelerate R&D spending while still delivering on our margin expansion commitments.

With respect to earnings, as mentioned earlier, our strong operational performance, including tax benefits, have resulted in 8 cents of outperformance in the first half of the year versus the midpoint of our quarterly guidance. This has allowed us to absorb nearly 10 cents of headwinds, including foreign exchange that is a net 5 cents worse than the beginning of the year, as well as the expected second half impact of China tariffs and Mazor dilution. For these reasons, we have elected to leave our adjusted EPS guidance unchanged in the range of 5 dollars and 10 cents to 5 dollars and 15 cents, which implies constant currency EPS growth of 9 to 10 percent at current rates. As such, we continue to be comfortable with fiscal 19 street consensus.

While the impact from currency is fluid, if recent exchange rates hold, our full year revenue would be negatively affected by approximately 420 to 520 million dollars. Despite the incremental headwind on the topline, given the benefit of our hedging program, FX is still expected to be a modest positive to fiscal 19 operating margin and neutral to earnings and free cash flow.

Moving from the year to the upcoming third quarter, we expect organic revenue growth to be in the range of 4 to 4.5 percent. And, while we face tougher comparisons, we are also comfortable with the high end of the range. We expect Diabetes to grow in the high-single digits, RTG and MITG to grow 4.5 percent plus or minus, and CVG to grow 3.5 percent plus or minus. We also expect continued operating margin improvement, consistent with our full year guidance.

We expect third quarter adjusted diluted EPS in the range of a dollar, 23 cents to a dollar, 25 cents. If recent rates hold, revenue would be negatively affected by approximately 120 to 170 million dollars, operating margin would have a slight-to-modest benefit, and the impact to EPS would be neutral.

Finally, on free cash flow, we continue to expect to generate between 4.7 and 5.1 billion dollars in fiscal year 19. And, over the next couple of years, we expect to make additional progress on improving our conversion of earnings into free cash flow as we continue to drive increased focus across the organization.

Now I will return the call back to Omar.

Omar Ishrak

Thanks, Karen. And before going to Q&A, I want to thank all of our employees around the world for another strong quarter of execution and dedication to the Medtronic Mission.

As I mentioned at the start, this was an outstanding quarter. We are executing on multiple fronts. Our end markets are strong, and we are leading in several of the fastest growing markets in MedTech.

In addition, we are allocating our capital across our business and focusing incremental resources on our biggest growth opportunities. In the process, we are driving our WAMGR upwards to the right, while at the same time driving operating leverage and margin expansion. We are also improving our free cash flow conversion, with major emphasis on this across our entire organization. This will create additional capital that can be returned to shareholders or reinvested to drive future growth, creating long-term shareholder value.

Finally, over the balance of this fiscal year and into FY20, our pipeline contains numerous growth opportunities and has never been stronger. We expect to develop and bring to market a long list of technology innovations, which will improve the lives of millions of people around the world, help healthcare systems become more efficient, and ultimately, grow the intrinsic value of Medtronic⁶.

We know there is much work to be done, but we are up for the challenge, and I am excited about these opportunities.

With that, let's now move to Q&A. In addition to Karen, our four group presidents, Mike Coyle, Bob White, Geoff Martha, and Hooman Hakami, are here to answer your questions. We want to try to get to as many questions as possible, so please help us by limiting yourself to one question, and if necessary, a related follow-up. If you have additional questions, please contact Ryan and our Investor Relations team after the call. Operator, first question please.

Following Q&A:

Omar Ishrak

OK. Thanks for your questions. On behalf of our entire management team, I would like to thank you again for your continued support and interest in Medtronic, and for those of you in the US, I want to wish you and your families all a very Happy Thanksgiving. We look forward to updating you on our progress on our third quarter earnings call, which we currently anticipate holding on Tuesday, February 19th. Thank you.