FINAL

Q1 FY19 EARNINGS CALL COMMENTARY

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Medtronic

Ryan Weispfenning

Thank you. Good morning and welcome to Medtronic's first 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 first quarter, which ended on July 27, 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 first quarter of fiscal year 2018, and references to organic revenue growth exclude the impact of material acquisitions, divestitures, and currency. References to pro-forma exclude the impact of material divestitures. Unless we say otherwise, quarterly growth rates and ranges are given on a comparable, constant currency basis, which adjusts for material divestitures, as well as 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

Good morning. Thank you, Ryan, and thank you to everyone for joining us. I am pleased to announce that this morning we reported strong first quarter results.

Revenue grew 6.8 percent on an organic basis, marking the third straight quarter of 6.5 percent or better organic revenue growth, with strong growth across all four groups and regions. Operating profit grew 7.0 percent and non-GAAP diluted EPS grew 13.6 percent pro-forma and 8.7 percent adjusted for currency.

We are executing against our strategies. We are growing our markets and driving share gains across multiple businesses and multiple geographies[1]. Businesses that were challenged 12 months ago are now headed in the right direction – as evidenced by the past 3 quarters[2]. We continue to execute in emerging markets and with our differentiated programs that deliver improved economic value to payers and providers. Our execution is not only on the top line, but also down the P&L[3]. We delivered margin expansion through our Enterprise Excellence program, while increasing our investment in R&D to fuel future growth[4].

Looking at our group results in the first quarter, each of our operating groups delivered strong results[5], with over 6.5 percent growth in RTG, mid-single digit growth in CVG and MITG, and mid-twenties growth in Diabetes.

Our Cardiac & Vascular Group grew 5 percent, led by 10.9 percent growth in Coronary & Structural Heart. CSH had strong, high-teens growth in transcatheter valves, driven by sustained global demand for our Evolut® PRO valve. CSH also continued to see very strong adoption of the Resolute Onyx™ drug-eluting stent, including low-thirties growth in the US.

In Cardiac Rhythm & Heart Failure, we had robust growth in infection control, AF solutions, and our Mechanical Circulatory Support businesses. In addition, our pacemaker business had mid-single digit growth, driven by the continued rollout of our Micra® transcatheter pacing system and Azure™ next-generation family of pacemakers.

In our Aortic, Peripheral & Venous division, our endoVenous business grew in the mid-teens, driven by growth of our VenaSeal™ closure system.

Across CVG, we are seeing great success with multiple new value-based business models that directly link our therapies to improving outcomes. We now have nearly 1,700 active customers participating, with associated revenue from these programs representing an increasing percentage of our US CVG revenue.

Our Minimally Invasive Therapies Group grew 4.9 percent, led by 5.8 percent growth in Surgical Innovations, as we capitalize on the conversion of surgical procedures from open to minimally invasive, driven by our new products. In Advanced Energy, strong adoption of our recently launched enhancements of the LigaSure™ vessel sealing instruments resulted in low-double digit growth. In Advanced Stapling, we grew in the mid-single digits, driven by sales of our innovative Signia™ powered surgical stapling system and our Tri-Staple™ 2.0 reloads.

Our Restorative Therapies Group posted the best quarterly performance in its history, growing 6.8 percent, led by mid-teens growth in our Brain and Pain divisions. In Brain Therapies, both Neurovascular and Neurosurgery grew in the high-teens, with adoption of our endovascular stroke treatments driving growth in Neurovascular, and the strength of our imaging, navigation, robotic, and ablation systems driving growth in Neurosurgery.

In Pain Therapies, our Spinal Cord Stim business growth accelerated to the low-twenties this quarter, including high-twenties growth in the US, driven by customer preference for our new offerings, including the Intellis™ stimulator, the Evolve℠ workflow algorithm, and Snapshot™ reports. We also had low-teens growth in Targeted Drug Delivery, as we delivered the best quarter of SynchroMed™ II sales growth in over 6 years.

In Spine, while growth was flat this quarter, when our Spine revenue is combined with our sales of Spine enabling technologies that are reported in our Neurosurgery business, our overall revenue grew 4 percent. We believe this is a more relevant comparison of our Spine results against our competition and an indication that our Surgical Synergy strategy is working, driving above market growth.

Our Diabetes Group had its best quarterly performance in more than a decade, with 26.3 percent growth, driven by sustained, strong demand for our MiniMed® 670G hybrid closed loop system. We now have over 97 thousand trained, active users of our 670G system. Outside the US, our Diabetes Group grew in the high-teens, driven by sales of the MiniMed® 640G, and we are now just beginning to commercialize the 670G in international markets. Our strong global results led to over 6 points of share gain this quarter in pumps.

In standalone CGM, the US launch of our Guardian® Connect product is off to a solid start, taking share in the $1 billion standalone CGM market. With the Sugar.IQ™ assistant, Guardian® Connect is the only "smart CGM", using the cognitive computing capability of IBM Watson to give personalized insights and predictive alerts.

The higher CGM sensor attachment and utilization that we are seeing with integrated pump users, combined with the sensors that are used with Guardian® Connect, are not only driving strong CGM sales growth – which was nearly 50 percent this quarter – but also creating a consistent, long-term annuity stream for our Diabetes Group.

Turning to geographic revenue growth, we are continuing to execute well in emerging markets[6], which grew 11 percent and represented 15 percent of our revenue this quarter. Several markets drove our performance, reflecting broad diversification. China grew 12 percent, the Middle East & Africa grew 16 percent, Southeast Asia grew 14 percent, Eastern Europe grew 10 percent, and South Asia grew 11 percent. Our differentiated strategies of public and private partnerships and optimizing the distribution channel are making a difference in emerging markets around the world.

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Today, Medtronic has leadership positions in almost all of the fastest growing markets in MedTech[7]; and, as a management team, we are intentionally allocating our capital to higher growth markets and new opportunities. You have seen the early benefits in our top-line performance the last three quarters. But the bigger picture, which we outlined at our June Investor Day, is that we are increasing our WAMGR, our weighted average market growth rate, by shifting our mix of businesses to faster growing therapies and geographies. As we invest in these opportunities, our goal is not just to continuously innovate, but also to invent and disrupt – and our intention is to lead in all three areas.

This is reflected by our technology pipeline, which we detailed at our Investor Day. To mention just a few of the highlights… in CVG, we are investing in Micra® AV, which will allow us to access over half of the pacemaker market with our disruptive transcatheter pacing systems. During Q1, we had first-in-human implants of our extravascular ICD system. We are also funding clinical programs to bring therapies to market in transcatheter mitral valve replacement and renal denervation for hypertension, both of which have the potential to be multi-billion dollar markets.

In MITG, we remain on track with our robotic assisted surgery platform as we discussed at the Investor Day. In RTG, we are investing in next-generation cranial mounted and closed loop DBS systems. In Diabetes, we are developing a disruptive closed loop ecosystem, with advances in pump therapy, CGM, and informatics to drive dramatic improvements for people to manage their condition more easily.

I could go on with dozens of additional programs in every one of our groups, but suffice to say, we are executing on the strongest pipeline in Medtronic's nearly 70 year history.

In addition to driving our top-line growth, we are also executing on our Enterprise Excellence program, as evidenced by our margin expansion this quarter. As a reminder, this program is still just in its early stages and is expected to drive sustained cost savings, while also allowing for greater reinvestment in R&D over the next several years. We are working to leverage our breadth in many areas, from global manufacturing and technology sharing, to our clinical and regulatory expertise, shared services, and global distribution.

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As I mentioned at the start, the message overall is that we are executing. 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. Finally, and importantly, we are putting the processes in place to improve our free cash flow conversion, which will create additional capital that can be returned to shareholders and reinvested to drive future growth, all with a goal of creating long-term shareholder value[8].

With that, let me ask Karen now to take you through a discussion of our first quarter financials. Karen?

Karen Parkhill
Thank you, Omar.

Our first quarter revenue of 7 billion, 384 million dollars represented organic growth of 6.8 percent. Foreign currency had a positive 78 million dollar impact on first quarter revenue. Non-GAAP earnings per share was a dollar, 17 cents. And, after adjusting for the divestiture, non-GAAP diluted EPS grew 13.6 percent pro-forma and 8.7 percent constant currency.

While we came in 6 cents above the midpoint of our guidance range, it's worth noting that 3 cents was driven by stronger-than-expected FX tailwinds, and 1 cent was upside from tax. Given this, we would characterize 2 cents as operational outperformance, reflecting better-than-expected revenue in the quarter.

Non-GAAP operating margin was 27.3 percent, increasing 80 basis points pro-forma and reflecting a slight improvement on a constant currency basis, in-line with our outlook. We are expanding margins and at the same time investing more in research and development to enhance our pipeline, resulting in first quarter R&D expense growing 100 basis points faster than revenue, as we focus on driving long-term value. Non-GAAP SG&A as a percent of sales this quarter declined by 90 basis points pro-forma and 70 basis points constant currency, early evidence that we are executing on our company-wide Enterprise Excellence program.

Net Other Operating Expense, which is included in our operating margin, was 60 million dollars compared to 42 million dollars pro-forma in the prior year, with the increase primarily due to the year-over-year change in currency gains and losses related to our hedging program.

Our non-GAAP nominal tax rate was 13.3 percent, better-than-expected given favorable tax resolutions and expirations. For the remainder of the fiscal year, we expect our tax rate to be 15 percent, plus or minus, modestly higher than our previous expectations.

First quarter free cash flow was a robust 1.4 billion dollars. Improving our cash generation is a priority at Medtronic, from the top of the company on down. It can vary from quarter-to-quarter, given timing of payments, so we don't want you to extrapolate our first quarter results for the full year. That said, we are pleased with our performance over the last two quarters, and are beginning to see the benefit of our increased focus and discipline 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. We increased our dividend by 9 percent in June, making this our 41st consecutive year delivering a dividend increase. And, we repurchased a net 374 million dollars of our ordinary shares in the first quarter. Our total shareholder payout ratio was 66 percent on non-GAAP net income and 98 percent on GAAP net income. And, the increased investment in organic R&D that I mentioned earlier is an example of our reinvestment 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 annual revenue growth and EPS guidance.

For the full fiscal year, we are increasing our organic revenue growth guidance from a range of 4 to 4.5 percent to a range of 4.5 to 5 percent, **and**, I will go a step further in saying we are comfortable with the higher end of this upwardly revised range.

For the year, we now expect CVG, MITG, and RTG to grow 4 to 4.5 percent versus our prior expectation of 4 percent, plus or minus. We expect Diabetes to grow in the low-to mid-teens, up from low double digits previously, with a stronger first half versus second half, based on prior year comparisons.

It is worth noting that while we have had 3 straight quarters of 6 to 7 percent revenue growth, we don't expect to grow 6 to 7 percent every quarter. Some of our businesses face tougher comparisons, particularly in the back half of the year, and others are in more challenging markets. Our guidance takes all of that into account, along with the diversification of our end markets, a strength of Medtronic.

Turning to margins, we continue to expect operating margin expansion in the full fiscal year of approximately 50 basis points on a pro-forma, constant currency basis, driven by our Enterprise Excellence initiatives.

And with respect to earnings, we are increasing our fiscal year 19 implied constant currency EPS growth forecast from a range of 8 to 9 percent to a range of 9 to 10 percent on the heels of our strong quarter. However, at recent rates, foreign exchange looks to be neutral to full year EPS versus a 5 cent benefit prior. So, despite the increase in our constant currency EPS forecast, given the recent currency volatility, the ongoing discussions around trade tariffs, and the fact that it is still early in our fiscal year, we have elected to leave our non-GAAP EPS guidance unchanged in the range of 5 dollars and 10 cents to 5 dollars and 15 cents.

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 a **slight** positive to fiscal 19 operating margin and neutral to earnings and free cash flow.

For the second quarter in particular, we expect organic revenue growth to be in the range of 5.5 to 6 percent. We expect CVG to grow approximately 4 percent, RTG and MITG to be in the range of 5 to 5.5 percent, and Diabetes to grow 20 percent, plus or minus. And given the impact of the hurricane and infusion set recall in the prior second quarter, we expect our operating margin improvement this upcoming quarter to be a little more than the full year.

We expect non-GAAP diluted EPS in the range of a dollar, 13 cents to a dollar, 15 cents. This guidance reflects solid revenue growth and margin expansion offset by a higher tax rate and an FX headwind of 2 cents at recent rates, which is 3 cents unfavorable relative to what we expected at the time of our last earnings call. And, if recent rates hold, revenue would be negatively affected by approximately 100 to 150 million dollars, operating margin would have a slight benefit, and EPS would have a 2 cent headwind, as previously mentioned.

Finally, on free cash flow, we continue to expect to generate between 4.7 and 5.1 billion dollars in fiscal year 19. And, as we mentioned at our Investor Day, over the next couple of years we expect to make significant progress in improving our conversion of earnings into free cash flow, as litigation and tax payments are expected to diminish based on what we know today, and we benefit from programs we have put in place to improve working capital. The past couple of quarters are a great start toward delivering on this goal.

Now I will return the call back to Omar.

Omar Ishrak
Thanks, Karen. Before we go to Q&A, I want to thank our more than 86,000 employees for their tireless work ethic and relentless execution once again this quarter.

This was another strong quarter for Medtronic. Not just in terms of the headline numbers of organic growth, margin expansion, and cash flow generation; but as importantly, we are executing on our strategies and positioning the company to create long-term shareholder value.

For one, our pipeline has never been stronger. As I outlined in June, everything at Medtronic starts with technology. We are innovating, we are inventing, and we are disrupting. With the advancements in our pipeline the last few months, I have never been more excited about our end markets, our opportunities, and our competitive positioning.

Second, we are allocating capital efficiently across our businesses. Third, we are leading the development of emerging markets for our therapies, and we are capitalizing on our leadership in value-based healthcare. Through our investments in higher growth markets and higher growth geographies, we are shifting our WAMGR upwards and to the right.

Lastly, we are consistently improving our free cash generation, and we are in the early stages of implementing our multi-year Enterprise Excellence program, which should enable us to drive multi-year margin expansion and reinvestment for long-term growth.

We know there is much work to be done, but I am excited about our progress and our positioning.

With that, let's now open the phone lines for Q&A. In addition to Karen, I've asked Mike Coyle, President of CVG, Bob White, President of MITG, Geoff Martha, President of RTG, and Hooman Hakami, President of our Diabetes Group, to join us. We want to try to get to as many questions as possible, so please help us by limiting yourself to only 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

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. We look forward to updating you on our progress on our second quarter earnings call, which we currently anticipate holding on Tuesday, November 20th. Thank you.