Q4 FY20 EARNINGS CALL COMMENTARY
MAY 21, 2020

Medtronic

Ryan Weispfenning
Thank you. Good morning and welcome to Medtronic's fiscal year 2020 fourth quarter conference call and webcast. During the next hour, Geoff Martha, Medtronic Chief Executive Officer, Karen Parkhill, Medtronic Chief Financial Officer, and Omar Ishrak, Medtronic Executive Chairman, will provide comments on the results of our fourth quarter and fiscal year 2020, which ended on April 24, 2020. 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.
- During today's 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 given risks and uncertainties, including those related to the impact COVID-19 has had and is expected to continue to have on our business. 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.
- Finally, unless we say otherwise, revenue rates and ranges mentioned during this call are given on a constant currency basis, which compares to the fourth quarter after adjusting for foreign currency. References to "organic" revenue growth exclude the impact of our Titan Spine acquisition and currency. Reconciliations of all non-GAAP financial measures can be found in the attachment to our earnings press release or on our website at InvestorRelations.Medtronic.com.

With that, I am now pleased to turn the call over to Medtronic Chief Executive Officer, Geoff Martha. Geoff?

Geoff Martha
Thanks, Ryan, and thanks to everyone for joining us today. I hope everyone is staying healthy and safe, and our thoughts are with the many people who have been affected by the COVID-19 pandemic. I'd like to recognize the incredible heroism, resolve, and sacrifice of the frontline healthcare workers fighting COVID-19, as well as our employees who are supporting them. Many of these frontline healthcare workers are our long-time customers and friends, and we are continually inspired by their selfless efforts to care for others.

As has been said, this pandemic presented the world with an unprecedented challenge, which required an unprecedented response, including by our team at Medtronic. And, I'm extremely proud of the way our employees have risen to the occasion and jumped in to help healthcare workers, governments, and NGOs, and for the way they've continued to support their communities and their families.

Our top priority during this pandemic has been to ensure the health and well-being of our 90,000 employees and their families around the globe. Our employees have been impacted by this virus like everyone else, but I'm grateful for the way our people have continued to do their jobs and persevere through these challenging circumstances. Whether that employee is an engineer working on the next innovation breakthrough… in our factories making critical, lifesaving products… a field rep assisting a physician on the frontline with a medical procedure… or any of our employees working virtually – we are all fulfilling the Medtronic Mission.

We've taken a number of measures in our facilities around the world to protect our employees, and importantly, we've continued to invest in our employees during this time, including implementing reward and recognition programs for business-critical, onsite workers. We're also protecting our sales reps from significant impacts to their incentive compensation during this period. And, we've developed an extensive Emergency Leave Pay Policy to provide temporary pay for employees who can't work remotely and are facing certain situations, such as home schooling, childcare issues, or a positive COVID-19 diagnosis.

During the pandemic, we've been at the service of medical professionals and healthcare systems around the world, stepping up for physicians, hospitals, and health facilities that are on the frontlines. We've developed and rapidly deployed new remote procedure support and remote monitoring solutions to reduce patients' and clinicians' exposure to the virus causing COVID-19. We've hosted dozens of virtual forums and medical education programs to help physicians navigate the challenges of the pandemic.

We've also worked tirelessly to make sure our products and therapies are readily available. The most visible example of these efforts is the work we've done to expand our ventilators' capabilities and dramatically increase ventilator production. Physicians asked us if we could engineer a way to adjust ventilator settings remotely, outside of the ICU and away from the patient, so we partnered with Intel to develop a solution that we brought to the market in a matter of weeks. Furthermore, we're on track to increase our production of ventilators five-fold from pre-pandemic levels by the end of next month. We've enlisted help from others to accomplish this, including SpaceX, who is working to supply a critical valve for our PB980. And, we continue to closely partner with key government authorities to allocate our ventilators to the communities that need them most, including a recent focus on emerging markets.

But we understood that simply increasing our own production volumes would not be enough. So, we did what Medtronic does: consistent with our Mission, we put patients first. We decided to make our PB560 ventilator design specifications available – at no cost – so other manufacturers can use these specs in manufacturing ventilators during the pandemic. Through this initiative, we're creating partnerships with large-scale manufacturing companies such as Foxconn in the US, Baylis Medical in Canada, VinGroup in Vietnam, Walton Group in Bangladesh, and Tata Group in India.

During this time of need, we've been supporting our communities. Since the start of the fourth quarter, Medtronic, along with the Medtronic Foundation, has pledged more than $36 million in monetary and product donations to nearly 50 nonprofit organizations to support health systems, patients, and vulnerable communities around the world.

If you're interested in reading more on our response to our employees, our customers, and our communities, I encourage you to visit our website, Medtronic.com/Covid19.

Now, let me turn to our Q4 financial results, which have suffered due to COVID-19. Our revenue has declined 25%, both constant currency and organic. This resulted in EPS of $0.58, which was down 62%.

These results are in-line with the press release we provided last month, where we discussed the expected negative impact on our fourth quarter revenue resulting from a slowdown in procedures, and the associated significant deleveraging that was expected to affect our earnings. They're also consistent with the impact seen across the industry. It's important to note that <u>our</u> quarterly results include an additional month of impact in April when compared to the quarterly results of our competitors on a calendar year cycle.

When we look at our Q4 revenue, the difference in our individual business results can be explained by four factors:

- The first was the mix of urgent procedures versus those that are more deferrable. Almost all of our businesses were affected by the decline in procedure volumes this quarter. Healthcare systems diverted their attention and resources to fighting COVID-19. Governments implemented restrictions on elective procedures. And, people avoided seeking treatment, even for emergency conditions. Our businesses that had a larger mix of products used in urgent procedures felt an impact, but they were <u>far less</u> affected than those with therapies where the procedure could be deferred longer.

- The second factor was the loss of large, bulk purchases near the end of the quarter. As you can imagine, the normal flow of these orders – which tend to be larger in April given our fiscal year end – did not materialize. As I noted on our last earnings call, prior to COVID-19, we were already planning to reduce large bulk orders and balance them across the quarter, starting with our next fiscal year. With the pandemic, our efforts were clearly accelerated.

- The third factor was centered around capital equipment. While capital equipment represents a small amount of our overall revenue, there are certain businesses that have a higher mix and felt the impact of hospitals and surgery centers delaying their capital evaluation and purchases.

- The last factor was the degree to which businesses had products or services that played a role in fighting COVID-19, or had specific products that customers were stocking ahead of the pandemic. This led to greater-than-expected growth in a select few of our businesses.

So, with these four factors in mind, let's look at our results by business group:

Our Cardiac & Vascular Group declined 33%. CVG's therapies tend to overall be less deferrable, but we still saw substantial declines in procedure volumes. Moreover, CVG felt a greater impact than some of our groups from the reduction in bulk purchases, with particular impact on CRM implantables, diagnostics, and transcatheter valves.

Our Minimally Invasive Therapies Group declined 12%. MITG's revenue mix is weighted more to the middle of the deferability spectrum, so it did experience a significant impact from the decline in surgical volumes, particularly in Surgical Innovations and GI, which both declined in the low-20's. This was offset by growth in Respiratory & Patient Monitoring, as well as in Renal Care Solutions. In Respiratory & Patient Monitoring, which was up mid-teens, we saw significant growth in Airways and Ventilators as we sought to meet the COVID-19 related patient needs around the world. We significantly ramped production, which led to ventilator revenue nearly doubling.

We also saw a strong correlation in demand for Pulse Oximetry and Capnography, but the increased demand was offset by overall reduced demand for patient monitoring products, given fewer non-COVID-19 hospitalizations and procedures. Renal Care grew high-single digits, driven by access catheters and acute and chronic dialysis products, as dialysis treatment continued throughout the pandemic.

Our Restorative Therapies Group declined 32%. RTG's therapies tend to be used in procedures that are more deferrable, including those in Core Spine, Pain Stim, ENT, and Pelvic Health. RTG also was impacted by the reduction in customer bulk purchases and capital equipment purchases. RTG's Neurosurgery business, in particular, has a high mix of capital sales.

Our Diabetes Group declined 7%. The decline was driven by a delay in new patient starts on insulin pumps and due to the closing of physician offices as a result of COVID-19, as well as continued competitive pressure. This was offset by an increase in demand for diabetes supplies, including continuous glucose sensors and infusion sets, particularly in international markets.

Next, let's review our fourth quarter performance by geography, which I think is a particularly helpful way to analyze our results, given the progression of the pandemic to different regions throughout our quarter.

First, China declined 38% and experienced the impact of COVID-19 for the entire quarter. Our revenue in China declined 46% in both February and March. We started to see gradual sequential revenue improvements midway through March, and our April revenue improved to a decline of 21%.

In Asia Pacific, our revenue declined 13%, as we saw the impact of the virus in many markets through the quarter, with the number of COVID-19-related cases peaking in some countries within the quarter. Korea declined 2%, as COVID cases peaked in mid-March, and Australia/New Zealand declined 11%, with cases peaking in early April. Japan declined 14%, as cases continued to increase as we exited the quarter.

In EMEA, our revenue declined 10%. Western Europe revenue was tracking with expectations through mid-March, when we started to experience significant declines. Revenue in Western Europe declined 32% in April, driven by procedure delays, and to a lesser extent, fewer customer bulk purchases.

In the Americas, our revenue declined 32%, with the US declining 33%, Canada down 24%, and Latin America declining 15%. Like Western Europe, our US revenue was tracking with expectations through mid-March before experiencing significant declines, driven by a combination of procedure delays and the reduction of bulk purchases.

Turning to our pipeline, we think about the impact of COVID-19 in three categories: products that just received regulatory approvals over the past few months, products under regulatory review, and products that are in clinical trials or preparing to enter clinical trials.

Starting with the products that recently received their regulatory approvals, the pandemic has interrupted some of our recent launches, given the delay in procedures. This includes the European launches of our Percept™ PC deep brain stimulator, InterStim™ Micro rechargeable sacral nerve stimulator, Cobalt™ and Crome™ high power CRM devices, and the DiamondTemp™ ablation catheter. It also slowed the US launches of our AV fistula indication in our IN.PACT™ Admiral™ drug-coated balloon, our DTM™ therapy in Pain Stim, and our Micra AV™ pacemaker. It's worth noting that prior to the pandemic, Micra grew over 60% in the US in both February and March.

The good news is that as procedures come back, we expect these launches to pick up steam. Moreover, we just received approval for Micra™ AV and our Reveal LINQ™ 2 cardiac diagnostic monitor in Europe, as well as US approval for our Cobalt™ and Crome™ high power CRM devices, which we announced earlier this month. Our Cobalt™ and Crome™ offerings should be particularly valuable in the current COVID-19 environment, as they are the first and only Bluetooth-enabled high power devices in the US that allow for distance programming and better remote monitoring.

Regarding the second category of products, those in regulatory review, the pandemic doesn't currently appear to be affecting the approval process. As a result, we're expecting a number of approvals this quarter, including US approvals for our InterStim™ Micro sacral nerve stimulator, our Percept™ PC deep brain stimulator, and our Reveal LINQ™ 2. We're also expecting European approval this quarter of the Minimed™ 780G. In the US, we anticipate approval this summer of a new product we're calling Minimed™ 770G, which is Bluetooth-enabled and allows for wireless, over-the-air software upgrades, before launching our 780G later in the fiscal year. In addition, 770G will be the first hybrid closed loop system available to patients aged 2-6. Patients who purchase the 770G will get the free software upgrade to 780G with our Advanced Hybrid Closed Loop algorithm upon approval. We expect to show the pivotal results of our Advanced Hybrid Closed Loop algorithm in adults at the virtual ADA conference in June.

With the third category of our pipeline, those that are enrolling clinical trials or preparing to enter clinical trials, the pandemic has slowed things down, as clinical trial startups and enrollments have been placed on temporary pause. This includes our soft-tissue robot, products in our Diabetes CGM sensor pipeline, and our RDN ON MED trial. Regarding our soft-tissue robot, our ability to finalize system and pre-clinical testing has been delayed, and given the uncertainty of the pandemic, it's too early to update you on timelines. However, we're exploring ways to expediate this work, with the intent of minimizing the delay. In Diabetes, we continue to be optimistic on our ability to close the competitive gap in continuous glucose monitoring sensors. We intend to submit data to regulatory agencies on our Zeus transmitter at the end of the summer, and we have completed verification of our Synergy sensor that will enable our IDE submission within the next few weeks. And in renal denervation, we will combine our RDN ON MED data with our recently presented OFF MED data to support US approval. Look, we are excited about creating the new renal denervation market with its potential to treat millions of patients with hypertension.

With all of these recently approved and near-term pipeline products, customer enthusiasm remains high, and collectively, these represent growth acceleration as we emerge from the pandemic.

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

Karen Parkhill
Thank you.

As Geoff mentioned, our fourth quarter organic revenue declined 25 percent, and adjusted EPS was 58 cents, a decline of 62 percent.

We did have significant deleveraging down the P&L in the quarter, as we continued to invest for the future despite the lower revenue growth. Gross margin declined by approximately 700 basis points, driven in large part by increased expenses as a result of COVID-19, including manufacturing facility cleaning, increased protective equipment, bonuses for our factory employees, and higher freight and obsolescence charges. In addition, we experienced a negative impact from mix, as products in higher demand carried lower margins. And, we continued to experience a year-over-year impact from increased China tariffs.

In addition to a lower gross margin, our operating profit was affected by continued R&D investment in our pipeline and continued spending in SG&A, as we purposely protected the variable compensation of our sales reps.

Below the operating profit line, our adjusted interest expense declined 30 percent, driven by our successful debt issuance and tender transactions that we completed last spring and summer. And, our adjusted nominal tax rate was 12.6 percent for the quarter and 14.3 percent for the year. Both were favorably impacted by lower earnings and the jurisdictional mix of profits. Excluding any non-recurring tax benefits we received in fiscal year 20, our adjusted nominal tax rate would have been approximately 15 percent.

Despite the decline in earnings, we did not lose our focus on driving free cash flow. In fact, we generated $6 billion for the fiscal year, converting 97 percent of non-GAAP earnings, well above our long-term target of 80 percent.

And, our financial position remains strong. Over the past several years, we have made important decisions to maintain a healthy and robust balance sheet, which enable us to not only withstand significant disruption, but more importantly, maintain our focus on the long-term. We have ample liquidity, with $10.9 billion of cash and investments as of the end of the quarter, and an undrawn $3.5 billion credit facility. In addition, we have no public debt maturing until March of 2021.

As we stay focused on the long-term, we will continue to allocate our capital to drive our growth strategies, including investing in our pipeline to accelerate our long-term organic revenue growth. In addition, we have not slowed our business development activities, as we continue to look to supplement our organic growth drivers with inorganic opportunities, including minority investments and tuck-in acquisitions.

We also continue to focus on generating proper returns for you, our shareholders, through both our organic long-term growth and our strong dividend. As an S&P Dividend Aristocrat, Medtronic has increased our dividend over the past 42 years, and this morning, we will make it 43 by increasing our annual dividend 16 cents.

Looking ahead, the uncertainty of the COVID-19 pandemic makes it difficult to provide our traditional annual and quarterly guidance. Instead, we are happy to provide our thoughts on the recovery. As you know, there are many factors that will influence its speed and trajectory, and these will vary by geography and therapy.

COVID case volumes and potential resurgence will certainly play a role, as will updates to recommendations from government agencies on the resumption of elective procedures and provision of non-COVID related healthcare.

Hospital capacity will be another key factor. We recognize that new protocols designed to ensure patient and provider safety can slow the return to full capacity. And, some healthcare systems are planning to increase capacity by extending workdays or doing procedures on weekends, though this isn't the case in all regions. Moreover, some hospitals are at this point maintaining surge capacity, in case there is a second wave.

We are assuming that any potential second wave will be adequately contained, but we are watching this closely and are prepared for a range of scenarios. While it is still early, we believe we have seen the worst of procedure declines and are seeing encouraging signs of earlier-than-anticipated recovery in several places around the world.

In fact, the recovery has begun in China, although it is gradual. While the ultimate pace there is still uncertain, we've seen a reduction in our weekly decline in revenue over the first few weeks of May, with high-teens decline from the prior year. In other parts of Asia, such as Japan and India, we are still experiencing severe year-over-year procedure declines, and we continue to expect lockdowns to impact our first quarter, while other markets like Australia, New Zealand, and Korea should continue to see recovery.

In the US and Western Europe, we've started to see sequential revenue improvement and hope to see that continue. In May, we've seen our weekly revenue across Western Europe declining around 20% from the prior year, and the US has been declining around 30% over the same period.

With all of this in mind, we currently expect first quarter revenue growth to be modestly worse than the fourth quarter – for both the total company and each of our groups. To be clear: we are seeing encouraging signs in many geographies, but our largest regions are likely to experience a full quarter of impact compared with just 5 or 6 weeks in the fourth quarter.

And, at this point, we expect second quarter to be better than the first, as the recovery continues, and sequential improvement through the remainder of the fiscal year. By the time we reach the fourth quarter, we would expect to be back to more normal revenue growth on a 2-year stacked basis.

Focusing on the first quarter… while there is still a lot of uncertainty regarding the recovery, we would expect RTG revenue to be the most challenged, followed by CVG, with both expected to decline more than the total company. MITG and Diabetes are both expected to decline in the first quarter as well; however, they should be better than the company average.

And remember, we have an additional selling week in the first quarter, something that happens every 5 or 6 years with our fiscal calendar. Because this extra week already occurred the last week of April, during the time the impact of the pandemic was at its highest, we picked up only a minimal amount of additional revenue.

On the bottom line, we continue to plan for significant deleveraging in the near term. We expect our gross margin to remain under pressure owing to product mix, lower volumes, and the extra cost of safety protocols. Where we have more than enough inventory to meet current demand, manufacturing plants may operate at less than full capacity, which could lead to period expensing of some fixed overhead cost. With this in mind, our first quarter gross margin could be down a few points sequentially.

As stated, we are not taking a short-term view when it comes to investment. We believe in the strength of the company and are positioning ourselves to come out of this crisis even stronger as we continue to invest in our employees, our pipeline, and our product launches. Given this, the first quarter SG&A and R&D spend should be a couple hundred million dollars higher than the fourth. Though, similar to revenue, we would expect operating profit to improve as we progress through the fiscal year.

Regarding currency, the US dollar has strengthened substantially since the pandemic began, especially against Emerging Markets currencies. As a result, our FX impact is looking to be about 10 cents more negative to fiscal 21 EPS than a few months back and just over 20 cents for the fiscal year.

Before I turn the call back over to Geoff, I would like to express my sincere gratitude to our employees around the world for their ongoing commitment to our Mission. I couldn't be more proud of our teams and the way they have worked together to support our customers and ensure patients have access to our life-saving therapies.

Back to you, Geoff.

Geoff Martha
Thanks, Karen.

Now, looking back at what we've accomplished since the start of the pandemic, we are in many ways already a stronger company as a result of our actions. We've re-affirmed our Mission in a profound way. When patients and healthcare workers urgently needed solutions that we couldn't provide alone, we turned to Tenet 2 of our Mission for a path forward. Tenet 2 tells us to focus our efforts on "biomedical engineering where we display maximum strength," but it also says to "gather people and facilities that augment these areas." And, we did just that, forming new partnerships that enhance our biomedical expertise with additional technology, supply chain reach, and manufacturing capacity from other companies.

We've also gone back to our roots as a company by re-instilling the value of close partnerships with our customers. We're focused on our customers' needs during this pandemic, moving beyond just selling the best medical therapies, to using our expertise to bring broader solutions to the table. Feedback from customers and governments on our support has been incredibly positive, and they are grateful for our efforts.

And, we're bringing these new solutions to market at record speed. Development timelines have been measured in hours and days, not weeks and months, and the output has been very impressive. This pace and impact has created a strong energy and spirit within Medtronic. Despite the day-to-day challenges of the pandemic, our people are really engaged and excited to assist customers in the recovery.

So now, as the world begins to recover, we're focused on emerging from this pandemic even stronger. We're executing strategies and supporting investments that others in our industry, who are in a different financial position, have been unable to make. We're harnessing new partnerships, cutting through the bureaucracy and operating at a high sense of urgency and speed. We're also sharpening our competitive edge to drive an even higher level of performance.

As we emerge, we expect these investments will even be more evident in our attraction and retention of top talent, and in the new products and solutions that we're offering physicians, patients, and healthcare systems. Now, for competitive reasons, I'm not going to get into the details of all of the actions we're taking. However, when you combine these new possibilities with our pipeline, I couldn't be more excited about the future. We will come out of this even stronger, and in doing so, create sustainable value for our shareholders and for society.

<PAUSE>

Finally, as many of you know, this is my first earnings call as CEO, which also means that this is Omar's last earnings call. So I want him to say a few words.

Omar?

Omar Ishrak
Thank you, Geoff. And, this is my 36th Medtronic earnings call, so it was definitely time to turn the job over to someone else. And, you're just doing great.

Geoff: Thanks, Omar.

Omar: The past nine years has really gone by fast, and it's been a pleasure getting to know all of you in the investment community, whether that was visiting your offices around the world, hosting you in Minneapolis, or meeting you at the conferences. I sincerely appreciate all of the interest you've had in this company and in this industry, and the support that you've given me and the Medtronic management team over the years.

As I look ahead, I have full confidence in Geoff and this leadership team to take the company forward. The team has been incredibly focused on the recovery and has a number of plans in the works. We're operating from a position of strength, given the strong financial position of the company and the full and robust pipeline. While I didn't expect to be turning over the CEO role during a pandemic, it's reassuring to know that the decisions that we've made over the past several years have prepared us for this time. I'm confident that we have the right engaged team in place to ensure that Medtronic emerges even stronger.

As you've heard me say many times before, healthcare is a perpetual growth opportunity, as the three universal healthcare needs of improving clinical outcomes, expanding access, and optimizing cost and efficiency will not go away. The Medtronic Mission and focus on these growth opportunities is enduring. I'm glad to have played a role in leading this storied company, and I'm sure its best days are ahead. I wish Geoff, the team, and all of our employees all the very best going forward.

Geoff, back to you.

Geoff Martha

Thank you, Omar. And, you didn't just play a role, you played a major role. And as you step away as CEO, you're leaving us well positioned to thrive. The list of your accomplishments is long and meaningful, but to list a few that come to mind when I think of your legacy: well, first you doubled the size of this company, and you inspired our global employees to think differently, to think bigger. And, you're the only CEO other than our co-founder, Earl Bakken, to be inducted into the company's Bakken Society – which is the highest technical honor at Medtronic. You've created value for our shareholders, you got our whole industry to focus on value-based healthcare, and importantly, you operationalized the Mission in everything we do, which led to improving the lives of millions of people over the past 9 years. It's been a pleasure and an honor working with you and learning from you. Finally, I really appreciate all you've done to make this transition a smooth one, and I look forward to continuing to work with you in your Executive Chairman and Chairman of the Board roles.

Before we start Q&A, I'd like to briefly note that we currently anticipate holding our Q1 earnings call on Tuesday, August 25th. We've also postponed our biennial Institutional Investor and Analyst Day as a result of the COVID-19 pandemic. This was originally scheduled for next month, and we'll let you know the date once it's scheduled.

Let's now move on to Q&A. In addition to Karen, Omar, and me, we also have our four group presidents – Mike Coyle, Bob White, Brett Wall, and Sean Salmon – here to answer your questions. As usual, we want 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:

Geoff Martha
OK. Thanks for your questions. On behalf of our entire management team, I would like to thank you for your continued support and interest in Medtronic. We look forward to updating you on our progress on our Q1 earnings call in August. Please stay healthy and safe.