Earnings Call Commentary
Q2 FY16
December 3, 2015

Ryan Weispfenning
Thank you, Maria. 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 Gary Ellis, Medtronic Chief Financial Officer, will provide comments on the results of our fiscal year 2016 second quarter, which ended October 30, 2015. 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 updated our Combined Historical Covidien-Medtronic Financial Statement Presentation, which is posted to our Investor Relations website. This presentation now contains FY15 quarterly P&L's stated on a month-aligned basis instead of the prior quarter-aligned basis. Comparisons made today will be against the month-aligned P&L. Next, you should also note that some of the statements made during this call may be considered forward-looking statements, and that actual results might 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 filed 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 the Investors portion of our website at Medtronic.com. Unless we say otherwise, references to quarterly results increasing or decreasing are in comparison to the second quarter of fiscal year 2015, and all year-over-year growth rates are given on a comparable, constant currency basis, which adjusts for the negative effect of foreign currency translation, and includes Covidien plc in the prior year comparison, aligning Covidien's prior year monthly results to Medtronic's fiscal quarters. These adjustment details can be found in the reconciliation tables included with our earnings press release. With that, I am now pleased to turn the call over to Medtronic Chairman and Chief Executive Officer, Omar Ishrak.

Omar Ishrak
Good morning and thank you, Ryan, and thank you to everyone for joining us. This morning, we reported second quarter revenue of $7.1 billion, representing growth of 6 percent, at the upper end of our mid-single digit expectation. Q2 non-GAAP diluted earnings per share were $1.03, growing at 11 percent on a comparable, constant currency basis and reflecting 480 basis points of leverage, above our baseline expectation of 200 to 400 basis points.

Q2 was a strong quarter[1]. Our operational performance remains consistent, and, we believe, sustainable across all our functions, groups, and regions. At the same time, we are outperforming the overall market and delivering operating leverage[2]. We are also executing on our value capture programs from the Covidien integration and realizing the

targeted cost synergies[3]. This combination of solid top-line growth and leverage is generating significant accessible free cash flow, which provides us enormous flexibility to deploy through strong returns to our shareholders, paying off debt, and pursuing targeted acquisitions. Despite our strong performance, however, we recognize foreign currency translation is a significant pressure to our bottom line on a reported basis, as it is for most multinationals, but we are attempting to offset this as much as possible by stretching our operations and through our conventional hedging programs.

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As we look ahead, though, our confidence continues to grow around our ability to develop the right mindset, business models, and offerings to lead and compete in emerging value-based healthcare models around the world. I am pleased with our organization's willingness and aptitude to explore new and novel ways for Medtronic to not only deliver better clinical and patient outcomes, but to tie our success to these outcomes with providers, payers, and governments.

Our strong revenue growth is resulting from crisp execution on our three growth strategies: therapy innovation, globalization, and economic value. These strategies are designed to create competitive advantage for Medtronic by capitalizing on three long-term trends that we see playing out in healthcare: namely, the continued desire to improve clinical and economic outcomes; the growing demand for expanded access to healthcare; and the optimization of cost and efficiency within healthcare systems. We have translated each of our strategies into three independent growth vectors, and we continue to quantify and communicate our performance against these goals.

In Therapy Innovation, we are seeing very strong adoption of our new products[4]. Our New Therapies growth vector accounted for nearly three-quarters of our total company growth, contributing approximately 420 basis points. This remains well above our goal of 150 to 350 basis points.

In our Cardiac & Vascular Group, which grew 8 percent, we continue to see strong growth from recently launched products that are helping to create important, rapidly growing new MedTech markets such as transcatheter aortic valve replacement, drug-coated balloons, AF ablation, and insertable diagnostics. CVG is also seeing new therapies drive growth in its base businesses, such as our recently launched Evera MRI® ICD, which is helping to drive both sequential and year-over-year global High Power market share gains. Over the coming quarters, we expect to launch a number of additional exciting new products that will continue to differentiate us in the market and help protect and grow our leadership position. For example, we continue to make progress on bringing our revolutionary Micra® Transcatheter Pacing System to the US. Last month, we had a very successful late-breaking data presentation at AHA and a simultaneous New England Journal of Medicine publication. This data formed the basis for our FDA submission, which we filed in Q2. In addition, CVG continues to invest in key intermediate- to long-term technology programs.

Building on our success in transcatheter aortic valves, we are particularly enthusiastic about our recent acquisition of Twelve. The company has a differentiated transcatheter mitral valve, which has the potential to create a new, multi-billion dollar end market. We are also making progress in enrolling our SPYRAL HTN clinical program for renal denervation, an important therapy that we are pioneering. Renal denervation has the potential to help fulfill the huge unmet need in treatment-resistant hypertension. Overall, I feel that our strategy has positioned us exceptionally well in the global cardiovascular device market. The team is executing consistently, gaining share, developing new markets and effectively leveraging its breadth of therapy innovations to positively affect the lives of thousands of patients around the globe.

In our Minimally Invasive Therapies Group, which grew 3 percent, new therapies such as our differentiated Endo GIA™ Reinforced Reload stapling system and LigaSure™ Maryland jaw laparoscopic sealer & divider are driving strong growth. MITG also has a full therapy innovation pipeline, with a specific focus on four areas: the transition from open surgery to minimally invasive surgery, respiratory compromise, lung cancer, and gastrointestinal cancer. Across these growth drivers, we are developing solutions that span the entire care continuum, aspiring to enable earlier diagnosis, better treatment, faster complication-free recovery, and enhanced patient outcomes through less invasive solutions. I am pleased with the clear strategic roadmap the MITG team has developed from a very complex mix of products and capabilities. The strategy supports the outcomes-based Medtronic Mission and will serve as a foundation against which we are assessing our entire MITG portfolio.

In our Restorative Therapies Group, which grew 5 percent, we have a number of new products driving growth. In Surgical Technologies, we recently launched our O-arm® 2 surgical imaging system and Nuvent® sinus balloon. In Neurovascular, our Pipeline™ Flex and Solitaire™ FR devices are leading the rapidly growing stroke market. In Spine, our business outside the United States performed well and grew above the market. In the US, while our performance was below market, we did see sequential improvement after adjusting for the extra week in Q1. In Neuromodulation, while we continue to make progress against our FDA consent decree commitments and are focused on resolving this matter, our drug pump revenue has been somewhat affected by this situation. We also are facing increased competition in Pain Stim, where our sales were flat compared to last year. Our Restorative Therapies Group is urgently addressing these specific issues as well as leveraging the breadth and scale of the group through the commercial implementation of Surgical Synergy. One example is a program that combines O-arm® placements with increased spine implant commitments. Under our new integrated RTG sales management structure, we have already finalized several of these contracts in the first half of this fiscal year and have seen notable increases in our Spine implant sales in these accounts. While still early, our expectation is that strategies like this will result in improved performance.

Our Diabetes Group, which grew 11 percent, also has new products driving growth, including the MiniMed® 530G and 640G Systems, as well as MiniMed® Connect, which provides convenient and discreet access to patient data and remote monitoring from the

user's smartphone. In our Non-Intensive Diabetes Therapies division, we recently launched Pattern Snapshot for iPro® Professional CGM, which uses new algorithms to streamline data interpretation for healthcare professionals. These advancements, along with a full pipeline of new products and solutions, are aimed at creating an annual cadence of innovation that can extend our leadership position globally.

As a result of the products that are currently launching, as well as our robust pipeline, and the potential of new markets across all of our groups, we believe we can sustain our new therapy growth vector at the upper-end of the 150 to 350 basis point range.

Now, let's turn to our Globalization strategy. In Q2, Emerging Markets grew 11 percent, a sequential improvement over the prior quarter, and contributed approximately 140 basis points to our Q2 total company growth. This was just below our baseline goal of 150 to 200 basis points, but we are encouraged by our relatively consistent, above-market performance in countries that are under significant macro-economic pressure. We continue to see increased diversification of our emerging market revenue, which stabilizes the growth rate and reduces the dependency on any single market[5].

In Q2, Greater China, the Middle East & Africa, Latin America, India, and Southeast Asia all grew double-digits. In mainland China, we grew 13 percent and improved sequentially with balanced contributions from each of our four groups. We continue to implement our channel optimization strategy in China, which is focused on transitioning our distribution channel to include consolidated platform distributors. We are also leveraging the breadth of our therapies to establish expanded, multi-line selling presence in Tier 2 and Tier 3 cities. Another priority is to develop deep partnerships with Chinese governments, such as the one that we have already forged with the Chengdu government in Sichuan province, and are looking to further broaden. Recently, our entire executive committee spent a week in China, meeting with several provincial and central government officials to discuss the creation of more partnerships across all of our businesses. Although complex, China will become the largest healthcare market over the long-term, serving more patients and doctors than any other country. We can never lose sight of this potential.

In the Middle East & Africa, we grew 10 percent, driven by our newly-formed joint venture with our largest Saudi distributor. Despite political instability in the region, our team continues to deliver strong growth, reflecting the fact that governments in this region continue to prioritize healthcare investments.

In Latin America, we grew 11 percent, driven by Mexico, Chile, and Argentina. In Brazil, we significantly outperformed the market, with strength in MITG, Neurovascular, and Neuromodulation. While the outlook in Brazil remains uncertain given the macro-economic and healthcare challenges in the country, we believe we can outperform the market by continuing to partner with healthcare stakeholders to reduce costs while improving patient outcomes.

We did experience some weakness this quarter in Eastern Europe and Russia, which together account for less than 10 percent of our Emerging Market revenue. This was a result of a planned distributor changeover in Eastern Europe, continued weakness in the Ukraine and Belarus, and year-end procedure delays affecting our MITG business in Russia. We continue to make progress in pursuing potential opportunities, such as government partnerships, to improve growth in this region.

Across the Emerging Markets, we are applying our standard market development activities, as well as our differentiated approach of local channel optimization in China, India, and Saudi Arabia, and establishing government partnerships like in Chengdu. In addition, we are developing unique partnerships with private entities such as the Abraaj Group. In Q2, we made a commitment to the Abraaj Group's Growth Markets Health Fund, which is focused on improving access to healthcare in Asia, the Middle East & Africa, as well as other developing markets. Abraaj purchases or builds hub hospitals, surrounded by networks of referring hospitals and clinics. We are strategic partners in this market development effort, with a commitment to improve patient access, healthcare delivery outcomes and efficiency, and product supply within these Abraaj hospital networks. In summary, we believe strongly that the penetration of existing therapies into Emerging Markets represents the single largest opportunity in MedTech over the long-term.

Turning now to our Economic Value growth strategy, our Services & Solutions growth vector contributed approximately 20 basis points to Medtronic growth. While this overall result was below our goal of 40 to 60 basis points, it represents strong mid-thirties growth, almost all organic. We expect to further improve our growth as the Services & Solutions model is expanded across all our business groups.

In Care Management Services, formally known as Cardiocom, we had high-teens growth in Q2, driven by a strong performance within the US VA Healthcare System. This business represents an important platform for us, especially as post-acute care services become even more critical in bundled payment models for different disease states.

In Cath Lab Managed Services, or CLMS, where we provide the administration, operational efficiency expertise, and daily management of cath labs within hospitals, we continue to generate rapid growth. In Q2, we expanded our CLMS business into Latin America by purchasing a majority stake and option to acquire Cardiored, a privately-held Chilean cath lab managed services provider. Cardiored already has a strong presence in Chile, with long-term agreements to operate 10 cath labs at 9 private clinics throughout the country. We expect that Medtronic's scale will help to quickly expand Cardiored's presence, both within Chile and throughout Latin America.

We also continue to expand our Operating Room Managed Services, or ORMS, offering, which applies our cath lab business model to an operating room setting, utilizing the breadth of MITG's products and expertise. We have now signed 6 ORMS deals,

representing approximately $140 million in cumulative revenue, with an average life of 7 years.

Since starting the Hospital Solutions business two years ago, we have now completed a total of 66 long-term CLMS and ORMS agreements with hospital systems, representing over $1.5 billion in revenue over an average span of 6 years, and we have a large number of potential contracts at various stages of negotiation with providers around the world.

We also continue to expand our solutions offerings into Diabetes care delivery with Diabeter, a Netherlands-based diabetes clinic and research center that has developed a unique care model incorporates standardized and scalable protocols. We continue to grow the number of Diabeter patients, and expect to expand Diabeter beyond the Netherlands to other countries around the globe, as we transform our Diabetes Group from a market-leading pump and sensor company to a holistic diabetes management company.

All of these activities are expected to serve as building blocks for value-based healthcare, where payment is based on actual outcomes over a specific time horizon. Specifically, we are creating unique offerings that combine bundled solutions across the care continuum to target specific patient populations or cohorts within a particular disease[6]. This is consistent with the direction of CMS's bundled payment initiative, which we fully support, and are encouraging expansion into other disease states where we participate. In the end, we remain convinced that there is an incredible amount of value to be realized in healthcare, and we believe our technologies and services can play a central role with providers, payers, and governments to make this shift to value-based healthcare successful[7].

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Turning now to the P&L, as I mentioned earlier, we delivered EPS leverage in Q2 of 480 basis points on a comparable, constant currency basis, which exceeded our baseline expectation of 200 to 400 basis points. All areas of our global operations are executing to the plan we laid out at the beginning of the fiscal year, as we deliver on our productivity improvements and cost synergy expectations. We also executed below the operating income line, delivering above-plan financial performance through higher interest income, a lower tax rate, and fewer shares outstanding. It is also worth noting that this strong performance was against a difficult comparison due to legacy Covidien's fiscal year end in the prior year. For the back half of this fiscal year, we expect to significantly exceed our baseline EPS leverage expectation of 200 to 400 basis points. As we have communicated, this over-performance will be driven by planned cost synergies from the Covidien integration.

The integration of Covidien is, in fact, going extremely well[8]. We are executing on our priorities of preserve, optimize, accelerate, and transform. Our cultures continue to come together; talent retention and employee satisfaction, which we monitor and quantify

through frequent employee surveys and focus groups, remain strong. Our cost synergy efforts thus far have been focused on the following areas:

- Indirect sourcing, where we are using best-case contracts and improved purchasing power to achieve meaningful savings;
- Common expense policies, which we are driving across the organization;
- Real estate, where we have now closed over 80 redundant sites, mostly back office and field distribution centers;
- and SAP, where we are bringing legacy Covidien entities onto Medtronic's common enterprise system, leveraging our internal expertise from having orchestrated similar system-wide implementations within legacy Medtronic.

In addition to executing on the promised cost synergies, every function is uncovering additional opportunities for savings. The Covidien acquisition is truly serving as a catalyst to reexamine and redefine our overall operating models and cost structures.

Another key element of the Covidien acquisition that we are beginning to execute is unlocking our trapped cash. We were able to free a significant amount of our trapped cash in Q2, transferring $9.3 billion into accessible cash through an internal reorganization, as part of the Covidien legal entity integration. The ability to deploy this cash in the US gives us increased flexibility and options. We are working quickly and diligently to determine the best way to utilize this cash, with the priority of creating long-term shareholder value, and we will communicate our strategy in the very near term. This is just one more example of the benefit of the Covidien acquisition, perhaps even more meaningful than the cost synergies that we are delivering. The improved financial flexibility and our ability to invest in US technologies and products, as well as return additional cash to shareholders is – and is expected to continue to be – a significant differentiator for Medtronic shareholders[9].

Our strong revenue growth and focus on operating leverage is generating significant free cash flow. In Q2, we generated $1.1 billion, and are expecting to generate nearly $40 billion in free cash flow over the next 5 years. We are deploying our capital with a focus on M&A investments, providing strong returns to our shareholders, and meeting our debt commitments. Earlier this fiscal year, we increased our dividend by 25 percent, and we expect to grow our dividend faster than earnings, with the intent of reaching a 40 percent payout ratio on a non-GAAP basis within the next few years. As an S&P Dividend Aristocrat, we remain focused on delivering dependable, long-term dividend growth. This quarter, we also accelerated our share repurchase activity from our prior plans, and are committed to returning a minimum of 50 percent of our free cash flow to our shareholders through dividends and share repurchases. Regarding investments, we remain disciplined when evaluating potential M&A opportunities. Any investment we make must be aligned with, and ultimately strengthen, one or more of our three growth strategies, while at the same time offer high return metrics and minimize near-term shareholder dilution.

In summary, I am extremely pleased with how our team is executing. Gary will now take you through a more detailed look at our second quarter results. Gary?

Gary Ellis
Thanks, Omar.

Second quarter revenue of $7 billion, 58 million increased 62 percent as reported, or 6 percent on a comparable, constant currency basis, which excludes the $452 million unfavorable impact of foreign currency. Acquisitions and divestitures contributed a net 30 basis points to Q2 revenue growth.

Q2 non-GAAP EPS was $1.03, an increase of 1 percent versus the $1.02 delivered by Medtronic, Inc. last year, or an increase of 11 percent on a comparable, constant currency basis after adjusting for the 12 cent impact to EPS from foreign currency translation. Q2 GAAP diluted earnings per share were $0.36, a decrease of 57 percent.

This quarter's non-GAAP adjustments to earnings on an after-tax basis were:

- a $442 million certain tax adjustment, primarily related to the internal reorganization that resulted in approximately $9.3 billion of previously "trapped" cash becoming "accessible"; and
- a $29 million loss on forward interest rates swaps related to this same internal reorganization;
- a $373 million amortization charge;
- a $56 million net restructuring charge and a $32 million acquisition-related items charge, primarily related to the Covidien integration; and
- a $17 million certain litigation charge related to INFUSE product liability.

Our Cardiac and Vascular Group, which accounted for 35 percent of our total company revenue, grew revenue by 8 percent. CVG had strong performances in all three of its divisions, with each growing above the company average.

Cardiac Rhythm & Heart Failure, or CRHF, had another strong quarter with 7 percent revenue growth, which included mid-single digit growth in both High Power and Low Power, high-twenties growth in AF Solutions, and low-thirties growth in Services & Solutions. We estimate the CRHF implantables market is growing in the low-single digits, and we continue to take share, both year-over-year and sequentially. High Power had a particularly strong quarter in US ICDs, driven by the launch of the Evera MRI® ICD, the only FDA-approved MR-conditional ICD system. We also continue to see strong customer acceptance of our differentiated CRT-D technology, including our AdaptivCRT® algorithm, quadripolar leads, VectorExpress® programming, and improved device longevity. In Low Power, we are seeing strong demand for the Reveal LINQ®, which resulted in robust Diagnostic growth in the mid-twenties. Pacemaker sales also had solid mid-single digit growth in the US, where we gained over 400 basis points of share due to strong pacing pull-through generated by Reveal LINQ® and increasing customer preference for MRI-safe technology, including our recently FDA-approved Advisa SR MRI™ single-chamber device. Looking ahead, we are expecting to receive FDA and CE Mark approvals for both our

Amplia MRI™ and Compia MRI™ CRT-Ds, along with our Visia AF MRI™ single-chamber ICD by the end of the fiscal year.

Our Coronary & Structural Heart division grew 10 percent, with mid-twenties growth in Heart Valve Therapies, mid-single digit growth in Coronary, and low-single digit growth in Extracorporeal Therapies. In Heart Valve Therapies, transcatheter valves grew in the high-thirties globally and over 50 percent in the US, our first full quarter of US commercial launch of the CoreValve® Evolut® R. We estimate the global TAVR market is growing nearly 30 percent. In Japan, we are expecting reimbursement and launch of CoreValve® in Q3. Regarding intermediate risk, we expect to meet our SURTAVI trial enrollment target this winter and submit to the FDA by the middle of FY17, with data expected at ACC 2017. In our Coronary business, drug-eluting stents grew mid-single digits globally, including high-single digit growth outside the US on the strength of Resolute Onyx™ and mid-single digit growth in the US from the continued acceptance of Resolute® Integrity®. In balloons, we grew low double-digits as we continue to gain share with our differentiated Euphora® PTCA product family.

In the Aortic & Peripheral Vascular division, revenue grew 10 percent, including mid-single digit growth in Aortic, low-double digit growth in Peripheral, and mid-teens growth in endoVenous. In Aortic, while we faced increased competitive pressure outside the US and felt the impact of market reimbursement cuts in Japan, the business grew in the high-single digits in the US, driven by the continued market adoption of our Endurant® IIs AAA stent graft. We also are seeing strong adoption of our Aptus endoanchor technology, which is resulting in competitive account conversion and AAA device pull-through. In Peripheral, we continued to execute on our US launch of the IN.PACT® Admiral® drug-coated balloon and maintain our leading market position on the strength of our exceptional clinical and economic data. Data presented at TCT and published in JACC showed sustained superiority in primary patency and reintervention rates over balloon angioplasty at two years, and cost effectiveness data released at VIVA showed IN.PACT® Admiral® lowers the overall cost of treatment. In endoVenous, we launched the VenaSeal™ closure system in the US last month and expect it to drive growth in this business going forward.

Across CVG, the use of wrap-around programs, services and solutions bundles, and multi-line contracting strategies continues to drive growth, with the number of cross-business multi-line contracts growing over 20 percent in the US.

Now, turning to our Minimally Invasive Therapies Group, revenue grew 3 percent and accounted for 33 percent of total company revenue. MITG's revenue performance was driven by mid-single digit growth in Surgical Solutions and low-single digit growth in Patient Monitoring & Recovery. It is worth noting that MITG's growth this quarter was slightly slower than its historical run rate as a result of a difficult comparison due to the legacy Covidien fiscal year end in the year-ago period.

Surgical Solutions growth of 5 percent included mid-single digit growth in Advanced Surgical and Early Technologies, and low-single digit growth in General Surgical. Advanced Surgical continued to benefit from new products and the continued shift from open to minimally invasive surgery. The business had solid growth in EndoStapling, driven by the Endo GIA™ Reinforced Reload stapling system, as well as in Vessel Sealing as a result of the continued acceptance of the LigaSure™ Maryland jaw. We estimate that surgical volume market growth in the US, while still growing, has normalized. General Surgical benefitted from the RF Surgical acquisition, which closed in Q2. Early Technologies delivered strong results, particularly in the US, from growth in gastrointestinal diagnostics.

The Patient Monitoring and Recovery division grew 1 percent, in-line with its markets. Respiratory & Patient Monitoring, as well as Patient Care & Safety grew in the low-single digits, with Nursing Care declining in the low-single digits. Respiratory & Patient Monitoring results were driven by growth in sensors and acute ventilators. Patient Care & Safety results were driven by strength in electrode sales, particularly in the US. While Nursing Care declined, it had strength in enteral feeding.

Now, moving to our Restorative Therapies Group, revenue grew 5 percent and accounted for 25 percent of total company revenue. Results were driven by low-thirties growth in Neurovascular and high-single digit growth in Surgical Technologies, with low-single digit growth in Neuromodulation and flat results in Spine.

In Spine, our overall international sales grew 5 percent and Core Spine business grew 6 percent, which was significantly above the market. Spine had strong double-digit growth in Japan and the Middle East & Africa, and solid mid-single digit growth in Canada and Latin America. Offsetting Core Spine's strong international performance was BMP, which had flat international sales in the quarter due to the InductOs stop shipment in Europe. This issue is limited to a third-party manufacturing facility that only supplies the European market. While the supplier has identified a remediation plan, we do expect to be off the market for the remainder of the fiscal year, reducing our expected international BMP revenue by approximately $7 million per quarter.

In the US, Spine declined 2 percent and the Core Spine business declined 4 percent, underperforming the market, which grew in the low-single digits. We expect our US Core Spine performance to improve as we realize the results from our recently realigned RTG commercial sales management, as well as the implementation of the Surgical Synergy™ programs that Omar mentioned earlier. In addition, we expect Core Spine results to improve as numerous recent and upcoming product launches reach scale, including our Elevate™ expandable cage and Solera® Voyager® system in Thoracolumbar, as well as our Divergence® standalone interbody cage, Zevo® anterior cervical plate system, Prestige LP™ cervical disc, and Anatomic PEEK PTC interbody spacer in Cervical.

Turning to Neuromodulation, revenue increased 2 percent. We continue to face challenges in our drug pump business as a result of the FDA consent decree. The division

had strong growth in deep brain stimulation, driven by referral development, emerging market expansion, and a commercial focus on Surgical Synergy™, which combines Activa® DBS implants with our PEAK® Surgery System, TYRX™ anti-bacterial envelope, and O-arm® imaging. In Pain Stim, while we are facing competitive pressure, we are receiving good reception of our AdaptiveStim® HD programming options. In Gastro/Uro, we continue to see solid growth of our InterStim® System for bladder and bowel control, and we expect the recently launched Verify™ Evaluation System to result in increased implants going forward.

In Surgical Technologies, revenue grew 8 percent, driven by mid-teens growth in Advanced Energy on strong sales of the PEAK® Surgery System and Aquamantys® System. ENT growth was driven by sales of the NuVent® sinus balloon and a backorder release of the powered ENT blade. The Neurosurgery business also had a strong quarter, driven by the US launch of the O-arm® 2 surgical imaging system.

Our Neurovascular division had another strong performance in Q2, with revenue growth of 32 percent. Growth was driven by stent retrievers for treating acute ischemic stroke, where recent clinical data and AHA/ASA stroke treatment guidelines are driving rapid adoption of our Solitaire™ FR revascularization device. The division also had very strong results in flow diversion, led by the continued adoption of the Pipeline™ Flex device for the treatment of intracranial aneurysms. During Q2, the Neurovascular division announced two technology acquisitions: Medina Medical, with its aneurysm embolization mesh technology for hemorrhagic stroke, which we believe can disrupt the coil market, as well as Lazarus Effect, and its mesh cover technology that is complementary to our Solitaire™ stent retriever platform.

Now, moving to our Diabetes Group, revenue grew 11 percent and accounted for 6 percent of total company sales.

The Intensive Insulin Management division grew in the mid-teens, including growth of nearly 40 percent in Europe as a result of strong sales of our MiniMed® 640G insulin pump system with the Enhanced Enlite® CGM sensor. This next-generation system features SmartGuard™ predictive low glucose management technology, as well as a new insulin pump design featuring a full-color screen. We continue to make progress in bringing this technology to the US, as we have completed the clinical trials and are on track for an early calendar 2016 submission to the FDA.

In our Non-Intensive Diabetes Therapies division, revenue doubled on strong sales of the iPro® 2 professional CGM technology. In addition to professional CGM, the NDT division continues to focus on market access and integrated patient care solutions for people with Type 2 diabetes.

In our Diabetes Service & Solutions division, revenue grew in the mid-single digits, driven by strong growth in consumables, new Diabeter service revenue, as well as sales from the

recent launch of the MiniMed® Connect. The uptake and user feedback on MiniMed® Connect have been extremely positive, and it is currently the highest rated connected glucose monitoring app in the US. We also continue to partner with IBM Watson, combining our clinical expertise, closed loop algorithm development, and CareLink data analytics with IBM's Watson Cloud and Watson Analytics and Machine Learning capabilities. An early pilot run using a database of 100 anonymized patients was able to predict some near-term hypoglycemic events, demonstrating the potential possibilities of applying cognitive computing to support diabetes management.

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Now, turning to the P&L, as I discuss the operating items, it is worth clarifying again that my comments will be made on a non-GAAP comparable, constant currency basis, unless I say otherwise. The Q2 operating margin was 28.4 percent, which excludes a 100 basis point negative impact from foreign currency, and represented a 20 basis point improvement over the prior year. This operating margin improvement included a 60 basis point improvement in SG&A, offset by a 20 basis point decline in gross margin, a 5 basis point decline in R&D, and a 20 basis point decline in Net Other Expense. This resulted in operating profit growth of 6.4 percent, or operating leverage of approximately 60 basis points over revenue growth. In the coming quarters, we expect this leverage contribution to grow and be a majority contributor to our overall EPS leverage.

In-line with our expectations, the amount of Q2 operating leverage was lower due to the difficult comparison against legacy Covidien's fiscal year end quarter, which included strong fiscal year-end sales. We estimate that the total benefit in the prior year was approximately $50 million on the operating profit line. Adjusting for this, operating profit growth would have been approximately 9 percent in Q2, representing operating leverage of approximately 300 basis points.

Our operating margin included gross margins of 70.2 percent, SG&A of 33.0 percent, and R&D of 7.4 percent. Also included in our Q2 operating margin was Net Other Expense of $57 million, which included net gains from our currency hedging program of $71 million. We hedge the majority of our operating results in developed market currencies to reduce volatility in our earnings from foreign exchange. However, a growing portion of our profits are unhedged, especially emerging market currencies, which can create modest volatility in our earnings. Assuming recent exchange rates for the remainder of the fiscal year, which include a $1.06 Euro and 123 Yen, we expect FY16 Net Other Expense to be in the range of $100 to $130 million, which includes an expected impact from the US Medical Device Tax of approximately $210 million. For Q3 FY16, we expect Net Other Expense to be in the range of $10 million in income to $10 million in expense, based on the previously mentioned exchange rates.

We expect our operating margin for the second half of FY16 to be in the range of 29 to 31 percent on an as-reported basis, including 28.0 to 28.5 percent on an as-reported basis in

Q3. This forecast implies over a 100 basis point improvement in our full fiscal year operating margin on a comparable, constant currency basis, which, on a reported basis, is almost completely offset by a similar amount of negative FX based on current rates. This strong operating margin improvement supports the significantly greater than 400 basis points of EPS leverage we intend to generate in the back half of the year, primarily a result of the Covidien cost synergy programs. We continue to expect these value capture programs to result in $300 to $350 million in FY16 savings, and a minimum of $850 million by the end of FY18, spread roughly equally across the three fiscal years.

Below the operating profit line, Q2 non-GAAP Net Interest Expense was $172 million, which was an improvement to our forecast due to modest outperformance in certain investment income classes. Based on current rates, we would expect FY16 Net Interest Expense to be in the range of $700 to $750 million, including $160 to $180 million in Q3.

At the end of Q2, we had approximately $35.8 billion in debt and approximately $17.2 billion in cash and investments, of which approximately $6 billion was "trapped". This cash mix is a significant improvement from prior quarters due to the $9.3 billion internal reorganization we executed in Q2 as part of our Covidien integration. We expect to announce our strategy on how we intend to use these proceeds in the very near term, with a likely focus on share repurchases and accelerated debt paydown, while preserving financial flexibility. These potential actions are not contemplated in our current outlooks.

Our non-GAAP nominal tax rate on a cash basis in Q2 was 16.5 percent, which was an improvement from our forecast as a result of operational tax adjustments and the allocation of profits among jurisdictions in which we operate. On a full year basis, we continue to expect our non-GAAP nominal tax rate on a cash basis to be in the range of 16.0 to 18.0 percent. We expect to be at the higher end of this range until the presently expired US R&D tax credit is reinstated.

In Q2, free cash flow was $1.1 billion. We remain committed to returning a minimum of 50 percent of our free cash flow, excluding the cash impact of non-GAAP adjustments to earnings, to shareholders and also continue to target an A credit profile. In Q2, we paid $537 million in dividends and accelerated our share repurchase activity, repurchasing $710 million of our ordinary shares. As of the end of Q2, we had remaining authorization to repurchase approximately 90 million shares. Second quarter average daily shares outstanding, on a diluted basis, were 1 billion, 429 million shares. For FY16, we now expect diluted weighted average shares outstanding to be approximately 1 billion, 430 million shares, including approximately 1 billion 427 million shares in Q3.

Let me conclude by providing our fiscal year 2016 revenue outlook and earnings per share guidance. We now expect revenue growth for the back half of the fiscal year to be in the upper-half of our mid-single digit baseline range on a comparable, constant currency basis. Our second half revenue outlook assumes that MITG grows in the low- to mid-single digits, RTG grows in the mid-single digits, CVG grows in the mid- to high-single digits, and

Diabetes grows in the high-single to low-double digits. While we cannot predict the impact of currency movements, to give you a sense of the FX impact if exchange rates were to remain similar to yesterday for the remainder of the fiscal year, then our full FY16 revenue would be negatively affected by approximately $1.45 to $1.65 billion, including a negative $330 to $390 million impact in Q3.

Turning to guidance on the bottom line, based on our first half performance, we now expect non-GAAP cash earnings per share in the range of $4.33 to $4.40, which includes an expected 45 to 50 cent negative foreign currency impact based on current exchange rates and approximately $300 to $350 million of targeted value capture synergies from the Covidien acquisition. As we look at the back half of our fiscal year, it is worth pointing out the uncertainty surrounding the U.S. R&D Tax Credit, which expired at the end of 2014. If Congress retroactively renews the credit for 2015, we would see a 3 cent benefit in FY16, and both the renewal and non-renewal scenarios are reflected in our EPS guidance. While we don't give quarterly EPS guidance, when looking at the gating of EPS consensus, we would not be surprised to see approximately 4 to 5 cents shifted from Q3 to Q4, which assumes that the R&D Tax Credit is renewed in Q3. Finally, I want to point out that the updated historical Covidien-Medtronic financial presentations that Ryan mentioned earlier reflect a lower FY15 comparable EPS. However, this has no impact on our FY16 expectations.

As in the past, my comments on EPS guidance do not include any charges or gains that are recorded or would be recorded as non-GAAP adjustments to earnings during the fiscal year.

Before turning the call back over to Omar, I would like to note that we plan to hold our Q3 earnings call on March 1st and our Q4 earnings call on May 31st. In addition, we plan to host our Investor Day on June 6th, which will be held again in New York City.

Omar?

Omar Ishrak
Thanks, Gary.

Before opening the lines for Q&A, I would like to reflect on our overall performance. Our team has come a long way, executing quarter after quarter. We are building a business with solid and diversified growth drivers, operational excellence, strong cash flow generation, and disciplined capital allocation[10]. But, it is also important for us to remember that we have a long journey ahead of us, and our work of fulfilling the Medtronic Mission goes on. I am confident this team can execute consistently, balancing tradeoffs and offsetting pressures, to create long-term, dependable value in healthcare[11].

With that, we will now open the phone lines for Q&A. In addition to Gary, I've asked Mike Coyle, President of our Cardiac and Vascular Group, Bryan Hanson, President of our

Minimally Invasive Therapies Group, Geoff Martha, President of our Restorative Therapies Group, and Hooman Hakami, President of our Diabetes Group, to join us. We are rarely able to get to everyone's questions, so please limit yourself to only one question and only one follow-up. If you have additional questions, please contact our Investor Relations team after the call. Operator, first question please.

Following Q&A:

Omar Ishrak
OK. Thanks for your questions. With that, 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 Q3 call on March 1st. Thank you, and have a great day.