



# Medtronic PLC (MDT)

Updated July 4<sup>th</sup>, 2018 by Nick McCullum

## Key Metrics

<b>Current Price:</b> \$86	<b>5 Year CAGR Estimate:</b> 7.2%	<b>Volatility Percentile:</b> 15.6%
<b>Fair Value Price:</b> \$79	<b>5 Year Growth Estimate:</b> 6.0%	<b>Momentum Percentile:</b> 32.5%
<b>% Fair Value:</b> 100%	<b>5 Year Valuation Multiple Estimate:</b> -1.1%	<b>Valuation Percentile:</b> 41.7%
<b>Dividend Yield:</b> 2.3%	<b>5 Year Price Target</b> \$105	<b>Total Return Percentile:</b> 34.6%

## Overview & Current Events

Medtronic is the largest manufacturer of biomedical devices and implantable technologies in the world. The company operates in more than 140 countries and has over 84,000 employees. Medtronic currently has four operating segments: Cardiac and Vascular Group, Minimally Invasive Therapies Group (MITG), Diabetes Group, and Restorative Therapies Group. Medtronic has increased its dividend for 40 consecutive years and is a member of the Dividend Aristocrats Index.

Prospective Medtronic investors should note that the company has established tax residence in Ireland. Dividends are considered Irish source income and Irish dividend withholding tax may automatically be applied to Medtronic's dividend payments. Many investors will qualify for an exemption from this withholding tax. You can read more information about the tax treatment of Medtronic's dividends [here](#).

In late May, Medtronic reported (5/24/18) financial results for the fourth quarter of fiscal 2018. In the quarter, revenue of \$8.1 billion grew 2.9% as reported and 6.5% organically. This higher-than-reported organic growth rate reflects the divestiture of its Patient Care, Deep Vein Thrombosis, and Nutritional Insufficiency businesses, which were purchased by fellow Dividend Aristocrat Cardinal Health in the second quarter of fiscal 2018. On the bottom line, Medtronic reported earnings-per-share of \$1.07 and adjusted diluted earnings-per-share of \$1.42, which represents 6.8% year-on-year growth on an adjusted basis. The full-year financial performance was similar. Revenue increased 0.8% on a reported basis, or 4.6% on an organic basis, while adjusted diluted earnings-per-share were \$4.77, which fell well below our target of \$5.05. The cause of this worse-than-expected earnings figure is the aforementioned business unit divestiture as well as a significant 4% impact from foreign currency. Adjusting for these figures, Medtronic noted that fiscal 2018 adjusted EPS would have risen by 10% (which would have caused it to exceed our 2018 earnings estimate).

Medtronic also issued its fiscal 2019 financial guidance with the release of fourth quarter earnings. The company expected organic revenue growth to be between 4.0% and 4.5% while also expecting to generate adjusted earnings-per-share of \$5.10 to \$5.15, which implies 10% growth at the midpoint of the guidance band.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$2.60	\$2.92	\$3.22	\$3.36	\$3.02	\$3.37	\$3.41	\$4.28	\$4.37	\$4.60	\$4.77	<b>\$5.13</b>	<b>\$6.85</b>
<b>DPS</b>	\$0.63	\$0.82	\$0.90	\$0.97	\$1.04	\$1.12	\$1.22	\$1.52	\$1.72	\$1.81	\$1.84	<b>\$2.07</b>	<b>\$3.05</b>

Prior to the release of Medtronic's fourth quarter earnings release, the company had been forecasting for 9%-10% earnings-per-share growth. It clearly failed to achieve this goal, largely due to unexpected foreign exchange fluctuations. Looking back, Medtronic has compounded its adjusted earnings-per-share at 6.3% per year over the last decade. We believe a similar rate of growth is achievable moving forward, and are maintaining our 6% per-share growth estimate for this high-quality Dividend Aristocrat. Dividends have grown at 11.3% per year as the company's dividend payout ratio has steadily increased. We expect dividend growth to continue outpacing earnings growth moving forward.

We are also introducing our 2019 and 2024 earnings-per-share estimates for Medtronic. The 2019 estimate reflects the midpoint of the company's recently-announced guidance band, while the 2024 estimate implies 6% annualized growth in earnings-per-share. We have also updated our fair value estimate for Medtronic to reflect 2019's expected earnings-per-share, with no change to our assessment of its proper valuation multiple.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	18.0	12.0	12.1	11.0	13.2	15.3	18.5	17.6	18.4	17.7	<b>16.3</b>	<b>15.4</b>
Avg. Yld.	1.5%	2.1%	2.4%	2.6%	2.5%	2.0%	1.8%	2.0%	2.1%	2.1%	<b>2.3%</b>	<b>2.5%</b>

Medtronic has traded at an average price-to-earnings ratio of 15.4 over the last decade. Using our estimate for 2019's earnings, the company is trading at a current price-to-earnings ratio of 16.3. Valuation contraction is likely to impair Medtronic's future returns at its current price. A 5-year period of earnings multiple mean reversion would introduce a 1.1% tailwind to this company's returns during that time period.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2023
GP/A	47.0%	42.7%	38.8%	37.5%	35.8%	33.4%	13.1%	19.8%	20.5%	22.9%	<b>20.0%</b>	<b>25.0%</b>
Debt/A	44.1%	47.9%	47.5%	47.9%	46.4%	48.8%	50.1%	47.8%	49.6%	44.4%	<b>45.0%</b>	<b>45.0%</b>
Int. Cov.	15.4	17.8	14.2	30.2	30.7	37.8	14.8	6.0	7.8	9.1	<b>9.0</b>	<b>10.0</b>
Payout	28.1%	28.0%	28.9%	34.4%	33.2%	35.8%	35.5%	39.4%	39.3%	40.4%	<b>40.4%</b>	<b>45.0%</b>
Std. Dev.	31.9%	23.6%	28.3%	18.2%	16.0%	18.3%	20.6%	19.0%	15.0%	15.0%	<b>18.0%</b>	<b>18.0%</b>

Medtronic's most compelling competitive advantage is its intellectual leadership in a complicated industry within the healthcare sector. It has filed more than 53,000 patents and spends more than \$2 billion per year on research and development. Medtronic also has a strong product pipeline that should drive its growth for the foreseeable future.

Medtronic's gross profits as a percent of its assets have declined over time, primarily due to margin compression. Debt to total assets remains firmly below the 50% mark, while the dividend payout ratio has slowly increased and its interest coverage remains adequate. Medtronic's financial house is in order. We believe the company's financial positioning combined with the recession-resistant nature of the healthcare industry make it appealing for conservative investors.

## Final Thoughts & Recommendation

Between dividends, earnings growth, and a lack of potential valuation changes, Medtronic is likely to deliver long-term total returns of around 7% per year. While this return estimate is not outstanding on its own, we believe it is attractive on a risk-adjusted basis. Still, the company is trading a bit above its normal valuation multiple. We recommend that investors monitor this security and wait for better buying opportunities before purchasing its stock.

## Total Return Breakdown by Year

