



Medtronic PLC (MDT)

Updated April 4th, 2018 by Nick McCullum

Key Metrics

| | | |
|-------------------------------|---|-------------------------------------|
| Current Price: \$78 | 5 Year CAGR Estimate: 8.4% | Quality Percentile: N/A |
| Fair Value Price: \$78 | 5 Year Growth Estimate: 6.0% | Momentum Percentile: N/A |
| % Fair Value: 100% | 5 Year Valuation Multiple Estimate: 0.0% | Total Return Percentile: N/A |
| Dividend Yield: 2.4% | 5 Year Price Target \$104 | Valuation Percentile: N/A |

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 February (2/20/18), Medtronic reported results for the third quarter of fiscal 2018 (Medtronic's financial calendar concludes at the end of April). Revenue increased by 7% on a comparable, constant-currency basis (including an adjustment for the sale of its Patient Care, Deep Vein Thrombosis, and Nutritional Insufficiency business to Cardinal Health). On a GAAP basis, Medtronic reported a loss of \$1.03 per share primarily due to an accounting charge related to U.S. tax reform. Adjusted earnings-per-share – excluding this tax charge – increased by 4%, or 12% after adjusting for the divestiture to Cardinal Health. After a weak first half to begin fiscal 2018, Medtronic's performance improved in the third quarter. This momentum should continue in the final quarter of the fiscal year.

Growth on a Per-Share Basis

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2023 |
|------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| EPS | \$2.60 | \$2.92 | \$3.22 | \$3.36 | \$3.02 | \$3.37 | \$3.41 | \$4.28 | \$4.37 | \$4.60 | \$5.05 | \$6.75 |
| DPS | \$0.63 | \$0.82 | \$0.90 | \$0.97 | \$1.04 | \$1.12 | \$1.22 | \$1.52 | \$1.72 | \$1.81 | \$1.90 | \$2.90 |

Medtronic has historically grown through organic reinvestment and tuck-in acquisitions, spending more than \$2 billion per year on R&D over the past several years. Medtronic has completed \$3.7 billion on tuck-in acquisitions between fiscal 2015 and fiscal 2018. The company maintains a long-term IRR hurdle rate in the mid-teens and seeks purchases that are immediately accretive to earnings. Acquisitions and R&D will drive Medtronic's growth moving forward.

Medtronic is forecasting for 9%-10% earnings-per-share growth in fiscal 2018 (which concludes at the end of April), giving a 2018 earnings estimate of \$5.05. The company has compounded its adjusted earnings-per-share at 6.5% per year since 2009. Looking ahead, we believe that a similar rate of growth is achievable for this high-quality Dividend Aristocrat. Dividends per share have grown at 12.4% per year during the same time period as the company's dividend payout ratio has steadily increased. Looking ahead, we expect Medtronic to continue raising its dividend at a faster pace than earnings – likely around 8% per year for the foreseeable future.

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 | 15.4 | 15.4 |
| Avg. Yld. | 1.5% | 2.1% | 2.4% | 2.6% | 2.5% | 2.0% | 1.8% | 2.0% | 2.1% | 2.1% | 2.4% | 2.5% |

Medtronic has traded at an average price-to-earnings ratio of 15.4 over the last decade. Using our estimate for 2018's earnings, the company is trading at a current price-to-earnings ratio of 15.4. Interestingly, Medtronic is trading exactly at its long-term average price-to-earnings ratio. Today's investors will generate returns not from valuation changes, but instead from business growth and dividend payments.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2023 |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------------|--------------|
| GP/A | 45.4% | 47.0% | 42.7% | 38.8% | 37.5% | 35.8% | 33.4% | 13.1% | 19.8% | 20.5% | 20.0% | 25.0% |
| Debt/A | 48.0% | 44.1% | 47.9% | 47.5% | 47.9% | 46.4% | 48.8% | 50.1% | 47.8% | 49.6% | 50.0% | 45.0% |
| Int. Cov. | 26.5 | 15.4 | 17.8 | 14.2 | 30.2 | 30.7 | 37.8 | 14.8 | 6.0 | 7.8 | 8.0 | 10.0 |
| Payout | 24.2% | 28.1% | 28.0% | 28.9% | 34.4% | 33.2% | 35.8% | 35.5% | 39.4% | 39.3% | 40.0% | 45.0% |
| Std. Dev. | 37.3% | 31.9% | 23.6% | 28.3% | 18.2% | 16.0% | 18.3% | 20.6% | 19.0% | 15.0% | 18.0% | 18.0% |

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 around the 50% mark, while the company's dividend payout ratio has slowly increased and its interest coverage remains adequate. Medtronic's financial house is in order, and we believe the company's sound positioning combined with its presence in the recession-resistant healthcare technology industry make it an appealing security 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 8% per year. While this return estimate is not outstanding on its own, we believe it is attractive on a risk-adjusted basis.

Total Return Breakdown by Year

