

Medtronic PLC

Buy Trade – Position Open

USA | HEALTHCARE | TRADING NOTE

17 January 2017

Investment Action

We are bullish on MDT on the company's commanding market share in many of its medical devices, 48.5% in Cardiac Rhythm Management segment, 61.96% in Diabetes segment and 42.84% in the Neuromodulation segment. Recent acquisitions and upcoming product innovations will help spur growth and the company is projecting about 7.8% revenue growth per year over the next 5 years. We believe that the selloff in November 2016 has caused the stock to be discounted relative to its fundamentals and along with its strong dividends and dividend growth history, MDT makes for a solid investment.

Since reaching an all-time high of USD 88 in July 2016, shares of MDT tumbled in November following the election of Donald Trump. With the threat of the affordable care act, colloquially known as Obamacare, being repealed looming, many stocks in the healthcare industry fell sharply. Coupled with a less than stellar Q2, where MDT beat EPS estimates by USD 0.01 but missed on revenue by about USD 160 mn, and the conditions seem right for MDT to fall close to their 52 week low.

However, we believe that tumble in the share price has caused MDT to become attractively valued. Management had attributed the poor performance of Q2 2016 to delays in product introduction for that quarter. Despite the delay, MDT was still able to grow sales by 3% on a constant currency basis and grew EPS by 9%.

MDT also has a slew of new products that have recently received approval from the FDA and should see distribution within this year. In April 2016, the FDA approved the MDT's [Micra](#), the world's smallest pacemaker. Coming in at the size of about 1 inch, the Micra is about 10% the size of a traditional pacemaker and due to its size and implementation method, could lead to less complications that come from more invasive surgeries. The device also does not require for wires to lead out of the device from the heart. Besides pacemakers, MDT also received approval from the FDA in October 2016 for the world's first "artificial pancreas", the MiniMed 670G. The device, which is meant for Type-1 diabetic patients, automatically monitors the patients' blood glucose levels and administers or withholds insulin. The MiniMed 670G is estimated to cost between USD 5,000 to USD 8,000 per device with the disposable sensors costing an additional few thousand dollars a year. The JDRF, a major charitable organization dedicated to Type 1 diabetes, estimates that cost associated with Type 1 diabetes totals about USD 14 bn a year. Barring issues with getting insurers to cover the cost of such devices, MDT is likely to be able to gain a large share of that market.

Key Points:

- Technical.** MDT has been moving in a robust uptrend since August 2011 with the 20 and 60 week moving average repeatedly holding price up. A sharp correction occurred recently after price formed an all-time high at around 89.00 psychological round number resistance, turning the 20 week moving average below the 60 week moving average signalling a slight change in the preceding bullish sentiment. Nonetheless, the confluence of 200 week moving average and 70.78 support area was strong enough to halt the correction, keeping the long term uptrend alive. There was a Bullish Engulfing Bar rejection off the support area on the week ended 6 January 2017 showing the resurgence of the bulls. Additionally, the bullish follow through on the week ended 13 January 2017 succeeded in breaking price above the 74.31 immediate range high.

Positive

CLOSING PRICE	USD 75.09
ENTRY PRICE	USD 75.09
STOP LOSS	USD 69.25
TARGET PRICE	USD 84.28
RISK/REWARD	1.6

COMPANY DATA

O/S SHARES (MN) :	1373
MARKET CAP (USD mn / SGD mn) :	103102 / 103102
52 - WK HI/LO (USD) :	89.27 / 69.35
3M Average Daily T/O (mn) :	6.69

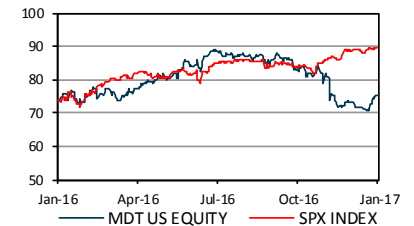
MAJOR SHAREHOLDERS (%)

VANGUARD GROUP INC	7.06%
CAPITAL GROUP COMPANIES INC	6.53%
WELLINGTON MANAGEMENT GROUP LLP	5.37%

PRICE PERFORMANCE (%)

	1M TH	3 M TH	1YR
COMPANY	3.0	(9.3)	2.7
SPX RETURN	0.28	7.23	22.98

PRICE VS. SPX



Source: Bloomberg, PSR

KEY FINANCIALS

USD BN	FY 13	FY 14	FY 15	FY 16
Revenue	16.6	17.0	20.3	28.8
EBITDA	5.7	5.9	5.9	9.0
NPAT (adj.)	3.7	3.8	3.6	4.8
EPS (adj.)	3.62	3.77	3.28	3.38
PER, x (adj.)	12.80	15.46	23.7	23.4
P/BV, x	2.52	2.99	2.1	2.1
DPS (USD)	10	11	12	15
Div Yield, %	3.1%	19%	19%	2.3%
ROE, %	19%	16%	7%	7%

Source: Company Data, PSR est.

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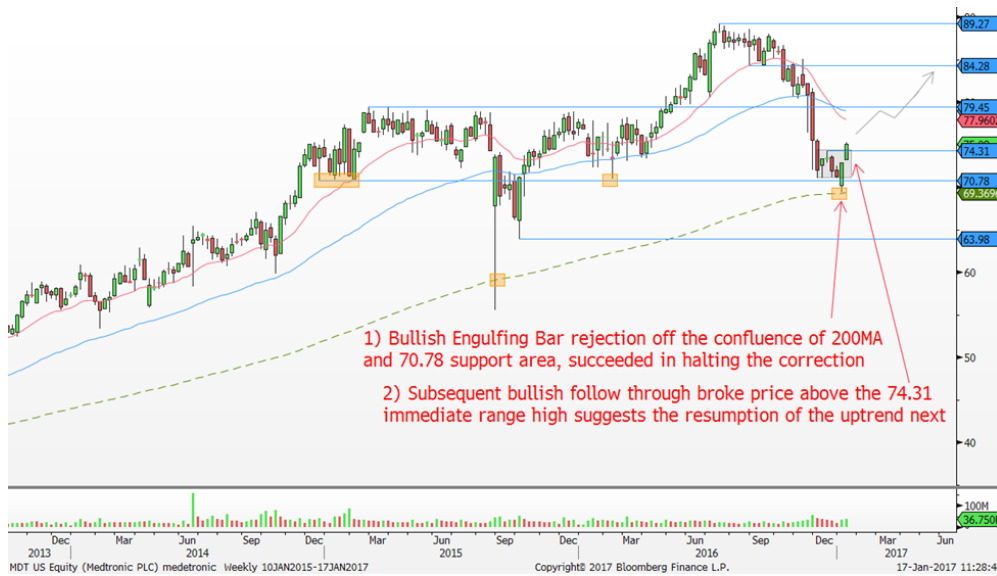
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- Expect the uptrend to resume next for price to test the 79.45 resistance area next followed by 84.28.

Resistance 1: 79.45
Resistance 2: 84.28

MDT weekly chart



Support 1: 70.78
Support 2: 64.00

Red line = 20 period moving average, blue line = 60 period moving average,
Green line = 200 period moving average

Source: Bloomberg, PSR

- Valuations.** MDT currently trades at a PER of 24.95. In comparison, Abbott Laboratories trades at 61.56 PER and Boston Scientific Corporation at 417.82 PER. MDT had previously made an [acquisition deal](#) with Covidien PLC that allowed it to domicile in Ireland. This move allowed MDT to free up over USD 9 bn that would otherwise have been tied up tax wise and MDT has indicated a large portion of these funds will be channelled to its R&D department. MDT’s dividend history is also particularly noteworthy. Since 1978, MDT has not only been paying a dividend, but it has been increasing that dividend every consecutive year since. While its current dividend yield is only about 2.3%, MDT has a divided CAGR of more than 10% for the last 5 years. MDT’s payout ratio is about 0.60, meaning it can not only continue to boost its dividends, but can do so comfortably. MDT has an Operating Margin of 18.35% and Net Profit Margin of 12.27%. Overall, we believe that MDT is currently slightly **Under Valued**.
- Risk.** If the Affordable Care Act is repealed, millions of Americans will be left uninsured, and as such, might not be able to afford the devices that MDT manufactures. However, MDT has been working to increase its exposure to global markets and as of FY15, derives 44% of its revenue outside the USA. Another source of risk would be if patients decide not to take up MDT’s new devices or if complications were to occur from these devices.

Counter	Sector	Ticker	Currency	Last Price	Time Horizon	Entry	Stop Loss	Target	Bloomberg Consensus T/P
Medtronic PLC	Healthcare	MDT	USD	75.09	1-3 Month	75.09	69.25	84.28	84.05

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