

Medtronic

Medtronic Research (10/7/19)

Description: Medtronic develops, manufactures, distributes, and sells device-based medical therapies to hospitals, physicians, clinicians, and patients worldwide. It operates in four segments:

1. Cardiac and Vascular Group
 - a. The Cardiac and Vascular Group segment offers implantable cardiac pacemakers, cardioverter defibrillators, and cardiac resynchronization therapy devices; AF ablation products; insertable cardiac monitor systems; mechanical circulatory support; TYRX products; and remote monitoring and patient-centered software. It also provides aortic valves; percutaneous coronary intervention stents, surgical valve replacement and repair products, endovascular stent grafts, percutaneous angioplasty balloons, and products to treat superficial venous diseases in the lower extremities
2. Minimally Invasive Therapies Group
 - a. The Minimally Invasive Therapies Group segment offers surgical products, including surgical stapling devices, vessel sealing instruments, wound closure, electrosurgery products, hernia mechanical devices, mesh implants, and gynecology products; hardware instruments and mesh fixation device; and gastrointestinal, inhalation therapy, and renal care solutions.
3. Restorative Therapies Group
 - a. The Restorative Therapies Group segment offers products for spinal surgeons, neurosurgeons, neurologists, pain management specialists, anesthesiologists, orthopedic surgeons, urologists, colorectal surgeons, urogynecologists, interventional radiologists, and ear, nose, and throat specialists; and systems that incorporate energy surgical instruments. It also provides image-guided surgery and intra-operative imaging systems and robotic guidance systems used in robot assisted spine procedures; and therapies for vasculature in and around the brain.
4. Diabetes Group
 - a. The Diabetes Group segment offers insulin pumps and consumables, continuous glucose monitoring systems, and therapy management software.

Ticker: MDT

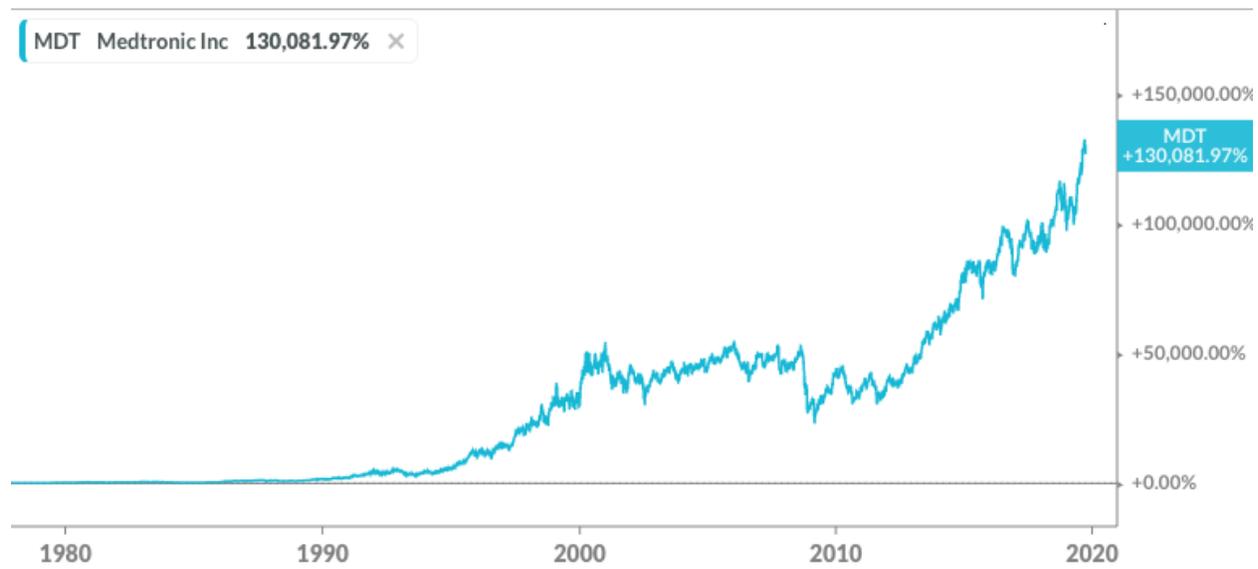
Price: \$107.26

Market Cap: \$143.9B

Performance: +21.3% YTD

Analysis

Medtronic (MDT) is one of the juggernauts of the medical technology space. The company was founded in 1949 and is headquartered in Dublin, Ireland. Since going public in the late 1970's, MDT has certainly been the stock to own as seen in the image below:



MDT has gained over 130,000% since November of 1977. In other words, if you invested \$10,000 in MDT on IPO day and haven't sold a share today it would be worth approximately \$13M excluding dividend payments.

The question now is whether MDT is still a buy? The answer over the last 40 year has consistently been yes but with a \$143B valuation, how much upside is left? Let's examine the stats.

Q1 2020 Results

Medtronic reported Q1 Non-GAAP EPS of \$1.26 beating estimates by \$0.07 (GAAP EPS of \$0.64 missed by \$0.24) on revenue of \$7.5B (+1.5% Y/Y) beating by \$100M.

Revenues: \$7,493M (+1.5%)

- Cardiac & Vascular Group: \$2,790M (-0.7%)
- Minimally Invasive Therapies Group: \$2,100M (+2.3%)
- Restorative Therapies Group: \$2,012M (+3.2%)
- Diabetes Group: \$626M (+3.5%).

Net Income: \$864M (-19.6%)

Non-GAAP Net Income: \$1.7B (+6.4%)

EPS: \$0.64 (-19.0%)

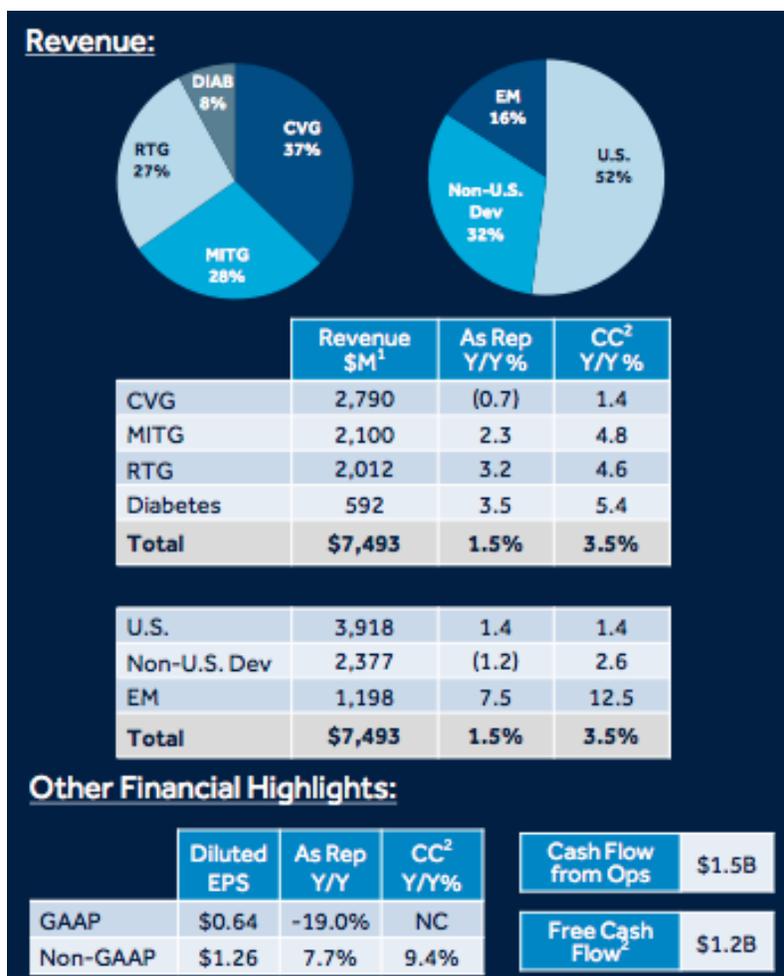
Non-GAAP EPS: \$1.26 (+7.7%)

Cash Flow from Operations: \$1.51B (-11.3%)

Fiscal 2020 Guidance:

Revenue growth (organic): ~4.0% (unchanged)

Non-GAAP EPS: \$5.54 - 5.60 from \$5.44 - 5.50



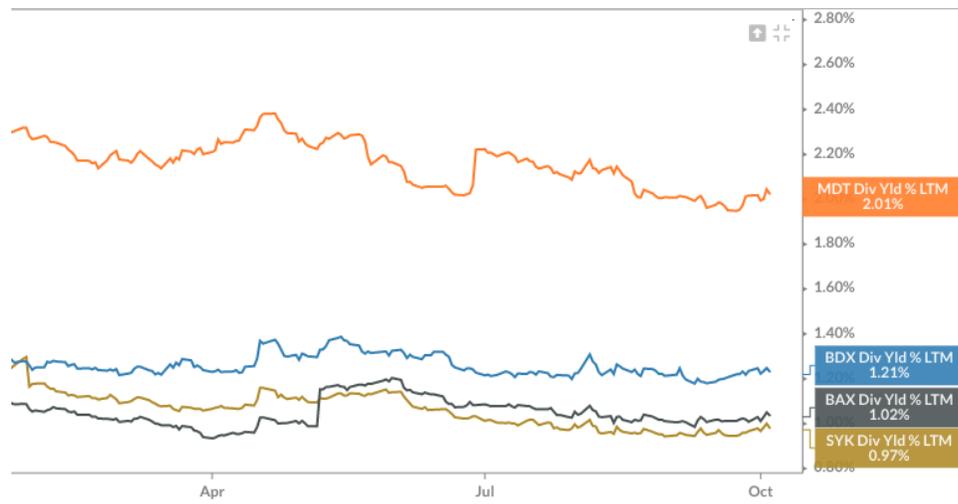
These are some pretty solid numbers and we will discuss them more towards the end but seeing growth pretty much across the board is essential for MDT. How do its fundamentals stack up against their peers like:

- Stryker (SYK)
- Boston Scientific (BSX)
- Baxter International (BAX)
- Edwards LifeSciences (EW)
- Beckton Dickinson (BDX)

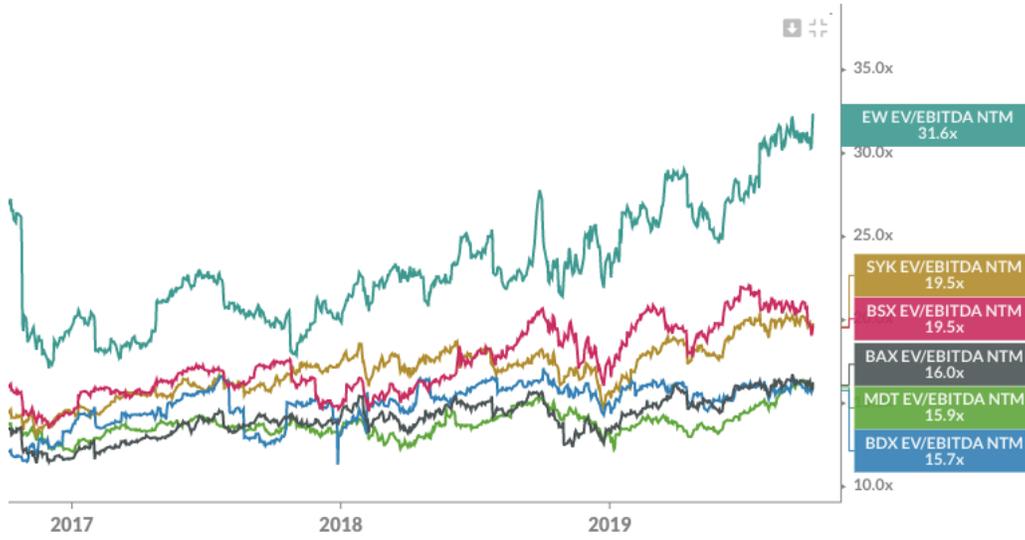
From a P/E perspective, MDT is the cheaper of the 6, trading at 19.0x forward earnings while EW leads the pack at 39.9x.



With regards to dividend yields, MDT is at the top with a 2.0% yield while the others hover around 1.0% while EQ and BSX do not pay one out.



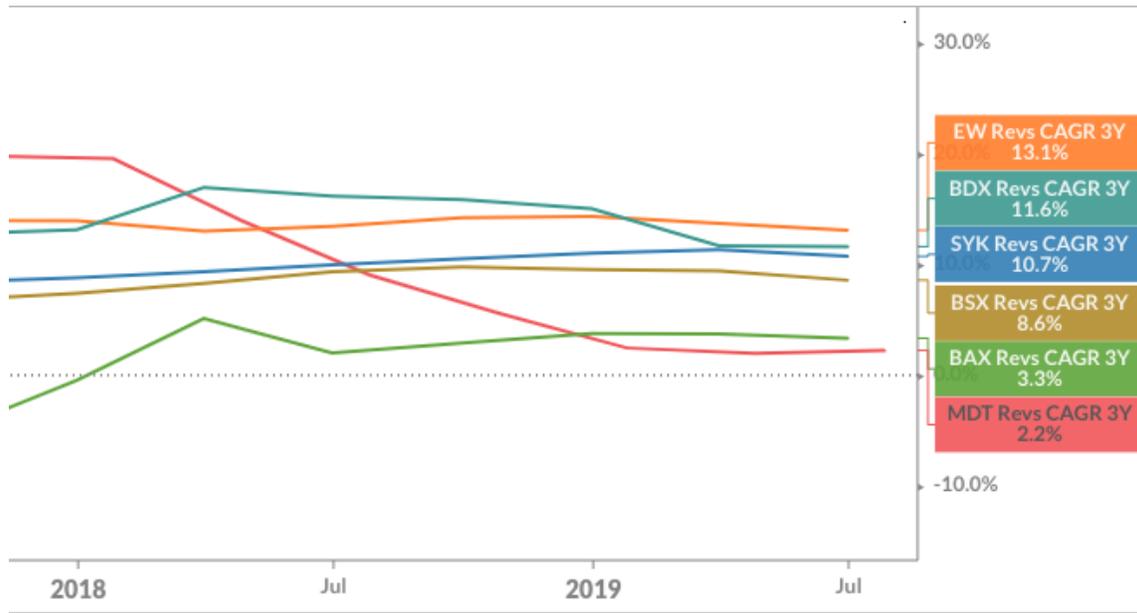
When taking into account debt (enterprise value), MDT is second to last on the list with an attractive 15.9x EV/EBITDA (earnings before interest, taxes, depreciation, amortization).



From an EV/Sales perspective, the company is in the middle of the pack at 5.1x while EW resides at the top again at 10.4x.

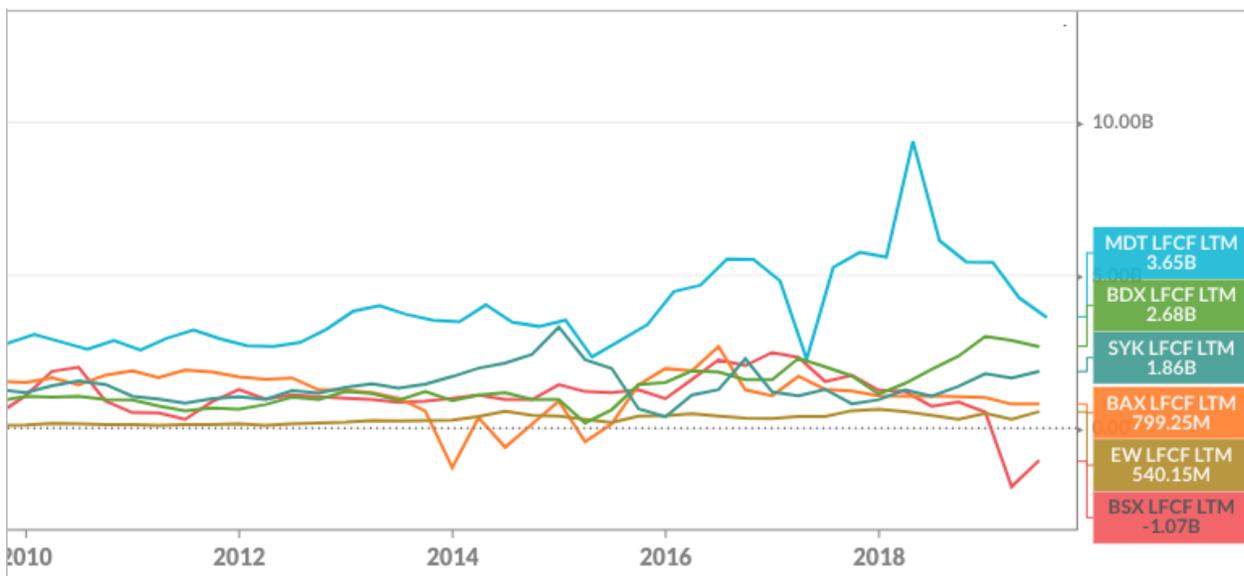


To provide some context, a lot of the reason MDT is on the cheaper side from a fundamentally valuation perspective is because they are growing their top line at a slower rate than competition.

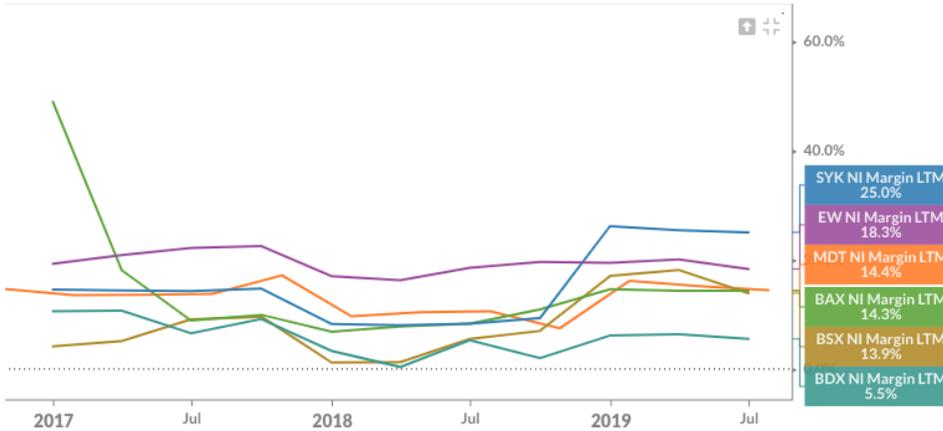
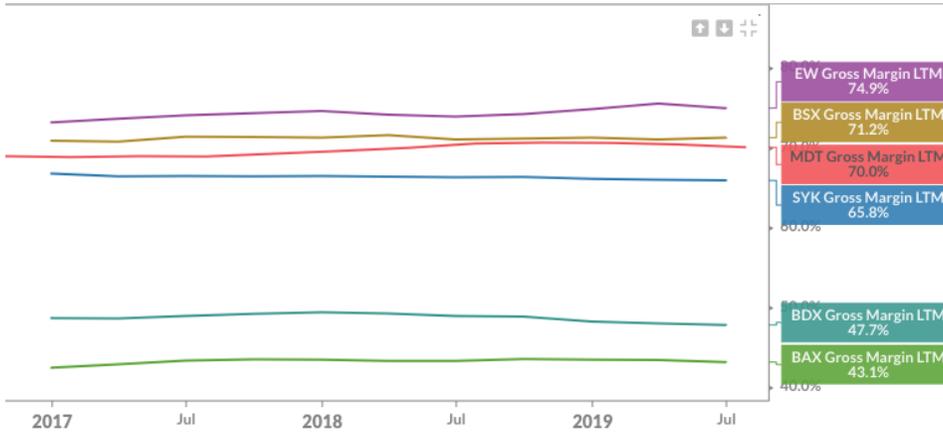
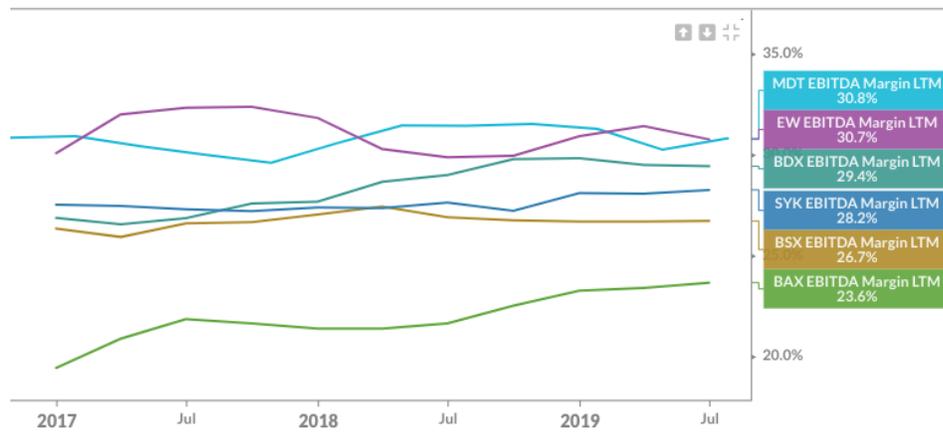


As we can see, MDT over the last 3 years has averaged a 2.2% revenue compounded annual growth rate (CAGR). This is much lower than its peers who are averaging as high as 13.1%. This is a large reason MDT is being assigned a lower earnings and sales multiple and is also the same reason EW is being valued at higher multiples – to account for the above average growth.

As we know, revenues only tell one side of the story and while EPS is great it's also an accounting metric that can be tampered with from one-off items, share repurchases, etc. With that being said, let's take a look at the CUBE's favorite metric: Free Cash Flow.



As you can see over the last twelve months, MDT has generated over \$3.6B in levered free cash flow while its counterparts are trailing massively. This is a large reason MDT is able to provide shareholders with 2x the dividend yield and share buybacks. The dividend per share has grown by 77% in the past five years, and it has produced a compounded annual growth rate of 17% per year in the past 42 years. In addition, because the company's dividend payout ratio is 41%, there is a lot of room for additional payments. This all stems from superior cash flow that comes from fairly solid margins. In fact, if you take the share buybacks and dividends, MDT has returned \$5.9B to shareholders over the past year.



While all of that displayed the pros there are some cons to Medtronic:

1. Substantial debt on balance sheet of \$27.2B equating to over \$600M a quarter in interest
2. While margins are still healthy, they've been trending downwards over the last several quarters. For example, gross margins in Q1 2019 were 70.4% vs. Q1 2020 68.9%. Net income margin in Q1 2020 also came in at 11.2% vs. 14.6% in Q1 2019.
3. Extremely high goodwill on the balance sheet of \$40B
4. Strong growth ex. U.S. is solid but also opens the company up to foreign exchange risk. As you can see, the company is seeing growth of 18.2% in developed foreign countries but because of currency exposure only recognized 13.2% growth. The same applies for their young emerging market space as growth was 26.7% in constant currency but 22.2% when accounting for the change in currencies.

	Revenue \$M	As Rep Y/Y %	CC ¹ Y/Y %
U.S.	306	(5.6)	(5.6)
Non-U.S. Dev	231	13.8	18.2
EM	55	22.2	26.7
Total	\$592	3.5%	5.4%

5. Revenue growth of approximately 4% for FY2020 as per MDT's guidance is not something that will excite investors and the company will have to rely on growing margins to feed the bottom line better and provide more capital to shareholders.

Overall, CUBE sees MDT as a solid behemoth to gain exposure to the medtech space. One could also argue that they still haven't unlocked the full value of their acquisitions like that of the \$1.7B takeout of Mazor Robotics at the end of 2018. That is something CUBE believes can unlock solid shareholder value and provides even more depth to MDT's suite of products and services. All in all, we believe the company still has upside left but for the most part feel a lot of the upside has been priced in as shares are fairly valued in our eyes based on the metrics we've previously covered. The company is implementing cost cutting measures to add to the bottom-line, has a stacked portfolio of products and services, room to grow their shareholder payouts through healthy cash flow, solid potential in markets abroad, and some interesting M&A that could lead to unlocking new revenue streams.

With that being said, technically speaking we see a potential opportunity to grab shares for cheaper.

Technical Analysis



Based on the charts, MDT was unable to break the R1 resistance level of \$111.56 in late September. As a result, the stock fell a little lower and was resting on the pivot point of \$108.55 and that level also gave out as the stock now resides at \$107.26. The next level of support is \$105.84 and \$105.62, if those two levels don't hold the stock most likely will fall much harder as the uptrend will be pretty broken. Given that RSI and MFI are not in oversold territory at this point and the pivot point will now serve as a resistance level, CUBE sees a higher probability for more downside. If the \$105 level holds, MDT should tread higher but we do believe it will test it. To be clear, long-term we think MDT is a solid stock for a portfolio but short-term we believe shares can be picked up a bit cheaper.