MORGAN-DEMPSEY
CAPITAL MANAGEMENT, LLC

Medtronic PLC | Ticker: MDT | Initiate 1.50% Position **June 2023**

Medtronic, headquartered in Dublin, Ireland, is a leading global healthcare technology company. Founded in 1949, Medtronic was initially a U.S.-based company. However, through the acquisition of Covidien in 2015, the company executed a corporate inversion, relocating its tax domicile from the U.S. to Ireland. This strategic move allowed them to pay a lower tax rate of 5% on foreign profits, as opposed to the 35% U.S. corporate tax rate in 2015. Despite this, Morgan Dempsey considers Medtronic a U.S.-based company, as the majority of its personnel and revenue are derived from the United States.

Today, Medtronic serves healthcare systems, physicians, and clinicians in more than 150 countries. The company operates through four cooperating and reportable segments, primarily focused on developing, manufacturing, distributing, and selling device-based medical therapies and services. These segments are the Cardiovascular Portfolio, the Medical Surgical Portfolio, the Neuroscience Portfolio, and the Diabetes Operating Unit. Additionally, a fifth segment, Renal Care, has been contributed to a private company jointly owned by Medtronic and DaVita.

<u>Company Business Segment & Description</u>

- **The Cardiovascular portfolio** is composed of three divisions and generates approximately 36% of the company's FY2023 revenue: Cardiac Rhythm & Heart Failure (CRHF), Structural Heart and Aortic (SHA), and Coronary & Peripheral Vascular (CPV).
    - CRHF develops, manufactures, and markets products for the diagnosis, treatment, and management of heart rhythm disorders and heart failure. Products include implantable devices, leads and delivery systems, products for the treatment of atrial fibrillation and products designed to reduce surgical site infections.
    - SHA includes therapies to treat heart valve disorders and aortic disease. Devices include products for the repair and replacement of heart valves, perfusion systems, positioning and stabilization systems for beating heart revascularization surgery, and surgical ablation products.
    - CPV is comprised of a comprehensive line of products and therapies to treat coronary artery disease as well as peripheral vascular disease and venous disease. The division's products include coronary stents and related delivery systems including a broad line of balloon angioplasty catheters, guide catheters, guide wires, diagnostic catheters, peripheral drug coated balloons, stent and angioplasty systems, carotid embolic protection systems for the treatment of vascular disease outside the heart, and products for superficial and deep venous disease.
- **The Medical Surgical portfolio** generated approximately 28% of the company's FY2023 revenue and is comprised of the Surgical Innovations division as well as the Respiratory, Gastrointestinal, & Renal division (RG&R).
    - The Surgical Innovations division develops, manufactures, and markets advanced and general surgical products including surgical stapling devices, vessel sealing instruments, wound closure, electrosurgery products, surgical artificial intelligence, and robotic assisted surgical products.
    - RG&R develops, manufactures, and markets products in the emerging fields of minimally invasive gastrointestinal and hepatologic diagnostics and therapies, patient monitoring, respiratory interventions including airway management and ventilation therapies, and for the treatment of renal disease.
- **The Neuroscience portfolio** generated approximately 27.6% of the company's FY 2023 revenue and is made up of Cranial and Spinal technologies, Specialty Therapies, and Neuromodulation divisions.

    - Cranial & Spinal Technologies division develops, manufactures, and markets an integrated portfolio of devices and therapies for surgical technologies designed to improve the precision and workflow of neuro procedures, and a comprehensive line of medical devices and implants used in the treatment of spine and musculoskeletal system. Specialty Therapies develops, manufactures, and markets products and therapies to treat diseases of ENT, patients afflicted with acute ischemic and hemorrhagic stroke, and help control the bladder and bowels.
    - The Neuromodulation division develops, manufactures, and markets spinal cord stimulation systems as well as implantable drug infusion systems for chronic pain.
- **The Diabetes operation Unit** develops, manufactures, and markets products and services for the management of Type 1 and Type 2 diabetes. Diabetes generates approximately 7% of Medtronic's FY 2023 revenue.
- **Renal Care solutions** has been contributed to Mozarc Medical, a private company that Medtronic co-owns with DaVita. It generated approximately 1.3% of Medtronic's FY2023 revenue.

<u>Investment Thesis</u>

Geoffrey Martha became CEO of Medtronic at the end of April 2020. His objective is to return the company to consistent growth through greater innovation and improved execution. He plans to do this by a longer-term focus on growing revenues and increasing market share instead of a short-term focus on maintaining and/or increasing margins. While the Covid pandemic slowed the implementation of his new vision for the company, it is taking shape. These changes include:

- Improving capital allocation across the company by:
    - Disproportionately allocating capital to high growth and high return capabilities
    - Ensuring all businesses get an appropriate level of investment.
    - Increasing R&D with the expectation of growing it at or above revenue growth
- Actively managing Medtronic's business portfolio primarily through divestitures and tuck-in acquisitions. The company has contributed its Renal Care division to Mozarc Medical, an independent company owned by Medtronic and DaVita, and has announced its intention to spin-off its Patient Monitoring and Respiratory businesses. These segments represented a little over 8% of Medtronic's revenue. Tuck-in acquisitions primarily have been made in faster growing areas of the company.
- Reducing the company's complexity through a new operating model that eliminates group and regional structures, empowering individual business leaders with P&L responsibility.
- Improving the company's culture by adding leadership from outside the company and, in some cases, outside of the industry, and by implementing a new performance-based incentive system
- Taking advantage of Medtronic's scale by:
    - Centralizing global operations and supply chain management
    - Leveraging technology like batteries, robotics and catheter delivery systems across multiple businesses
    - Coordinating sales to larger healthcare systems with the objective of becoming a vendor of choice.

Murtha also wants to bring Tech back into Medtech. He wants to drive meaningful progress through miniaturization, battery technology, sensing technology, data analytics, and remote monitoring and programming.

This new strategy is taking time to implement and has yet to have a meaningful impact on the company's financials. However, we believe this approach has the potential to improve the long-term growth profile of the company.

Positives

- Management's focus on increasing R&D spending should have a positive impact on new product development and the company's market share in a competitive industry.
- Headwinds are subsiding in the Diabetes segment with both the lifting of the FDA's warning letter surrounding the Northridge CA manufacturing facility and improvements in its supply chain. This, combined with the recent acquisition of EOFlow and the FDA approval of the MiniMed 780G insulin pump, should accelerate the growth of diabetes business unit.
- The Hugo robotic assisted surgery system is being sold overseas and currently is in the regulatory approval process for sales in the US.
- The company is in the process of a significant cost reduction program driven by the reorganization program discussed above as well as through layoffs. This should help offset the impact of the current soft macroeconomic environment, higher inflation, and foreign currency fluctuations while allowing Medtronic to maintain its R&D spending.
- Medical procedure volumes continue to increase after bottoming during Covid.
- The company generates significant cash flow and is committed to returning at least 50% of the free cash flow to shareholders, primarily though dividends. The company has increased its dividend for 46 consecutive years.

Risks

- Additional R&D expenditure may not result in the expected level of viable products or product improvements.
- Regulatory issues may slow product approvals.
- New products such as the Hugo robotic assisted surgery system and integrated diabetes treatments may take longer than expected to be adopted by the medical community.
- An increase in the unemployment rate in the US could reduce insurance coverage leading to a lower volume of medical procedures.
- Acquisitions may be more difficult or expensive to integrate than originally planned.
- Medtronic may be unable to get acceptable value for its divestitures.
- Margins may be impaired by higher inflation and the inability to accelerate top line growth.

Current & Historical Valuations

Valuation Matric	Current	5-Year High	5-Year Low	Average	Vs. Industry
Trailing PE	31.6	61.9	19.6	34.7	.9
Forward PE	17.4	26.7	12.1	18.6	.6
Price to Book Value	2.3	3.6	1.9	2.7	.5
Price to Cash Flow	19.7	30.2	13.0	21.3	.7
Price to Sales	3.8	6.4	3.2	4.5	.8
Enterprise Value to EBITDA	16	28.8	13.2	17.9	.7
Enterprise Value to Sales	4.5	7.0	4.1	5.1	.8
Dividend Yield	3.1	3.5	1.7	2.3	4.4
Market Capitalization	$116 Billion				

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