

Stock Statistics

Ticker	MDT
Exchange	NYSE
Financial Year End	Apr 29

Market Price *	\$34.21
Market Cap *	\$36.4 bln
52-Week Hi / Low	\$30.1 / \$43.4
Average Daily Volume	6,715,480

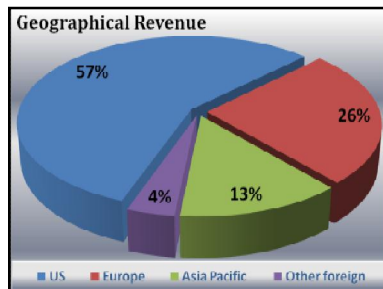
\*As of previous day close



Source: Yahoo! Finance

Company Description

Medtronic Inc. was founded in 1949 and was incorporated as a Minnesota Corporation in 1957. With its beginnings in the treatment of heart disease, Medtronic has expanded beyond its historical core business to provide products and therapies that help solve many challenging, life-limiting medical conditions.



Medtronic provides its services in more than 120 countries worldwide, with three of its largest markets for medical devices being the United States, Western Europe and Japan. The company operates in seven business segments: cardiac rhythm disease management, spinal, cardiovascular, neuromodulation, diabetes, surgical technologies and physio-control. Medtronic has manufacturing or research facilities in Arizona, California, Colorado, Connecticut, Florida, Indiana, Massachusetts, Michigan, Minnesota, Tennessee, Texas, Washington, Puerto Rico, China, France, Ireland, Mexico, The Netherlands and Switzerland.

\*\*\* Investment Recommendation – see below in red \*\*\*

**Note: September 8 -- Medtronic shares rose while this report was being prepared. The shares are up 11% since our August 15, 2011 recommendation and + 1100 bps versus the S&P. This report covers not just MDT, but also the medical equipment industry. We would not chase MDT > \$35 ... hopefully, the market/stock will correct and give investors a chance to get into this name < \$33 if they did not act on our original recommendation (date). Our target for MDT [with a dividend yielding 2.8%] remains \$38 but will most likely be revised upwards. This was the second of three recommendations we put out in this industry since August 1, 2011. ZMH -- recommended on August 19 is up 12.3% and + 650 bps versus the S&P. SYK -- recommended on August 5 is unchanged along with the S&P (through the September 6, 2011 close). There will be notes on ZMH & SYK in this report.**

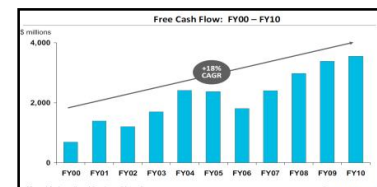
**Diversified Product Line** -- Medtronic enjoys a leading position in several medical device categories, including cardiac rhythm management, spinal, vascular, neurology and cardiac surgery. Cardiac rhythm disease management products (CRDM; 31.4% of FY 11 revenues) include implantable pacemakers to treat bradycardia, a condition of slow or irregular heartbeats. Cardiovascular products (19.5%) include products to treat coronary artery disease (CAD), peripheral vascular disease (PVD), abdominal and thoracic aortic aneurysms and heart valve disorders. Spinal (21.4%) products include thoracolumbar (the mid- to lower-vertebrae), cervical (upper spine and neck vertebrae) and interbody spinal devices. Neuromodulation products (10.0%) include implantable neurostimulators for chronic pain, implantable drug delivery systems, and deep brain stimulation systems to treat movement disorders like Parkinson's disease and essential tremor, and urology and gastroenterology devices. Diabetes products (8.5%) include continuous glucose monitoring systems and insulin pumps. Surgical technologies (6.5%) products include surgical products to treat ear, nose and throat diseases and conditions and certain neurological disorder and conditions. Physio-Control products (2.7%) develop, manufacture, market, and service external defibrillators, including manual defibrillator/monitors used by hospitals and emergency response personnel and automated external defibrillators (AEDs) used in commercial and public settings.



**Positioned to Tap Emerging Markets** -- The emerging markets, particularly China, are attracting multinational companies, including medical device manufacturers, to set up shops there. While Medtronic has reduced its global workforce by 1,700 positions, it plans to hire 1,000 workers in China and more than 600 in India over the next five years. MDT's new CEO recently outlined his strategy to enhance growth, which entails better execution, improving R&D productivity and accelerating globalization. In this regard, we believe we will see more investment in R&D, manufacturing and possibly M&A in emerging markets. We also expect MDT to improve the marketing of its existing product lines, and to prioritize the development of products that allow broad utilization and have a promising return on investment. **As of 2011, 91% of the revenue comes from developed markets while only 9% of the revenue is contributed by emerging markets.**



**Financially Stable** -- Medtronic has historically ranked among the more consistent generators of revenue, cash flow and net earnings growth within the large-cap medical equipment industry. The company has generated its growth through both organic expansion and via strategic acquisitions. During the five-year period from FY06 through FY11, Medtronic produced compounded annual growth rates (CAGRs) of 7.0% for sales, 5.8% for net income, and 9.3% for operating EPS.



Peer Benchmarking – additional comparisons on pages 11-12

Tick / Mkt Cap	5-Yr. ROE	EPS 5-Yr.	P/S (ttm)	EV/EBIDTA(ttm)
MDT / \$36B	21.6%	9%	2.34	8.3
ZMH / \$11B	14.2%	4%	2.53	6.8
SYK / \$18B	20.0%	12%	2.47	7.6

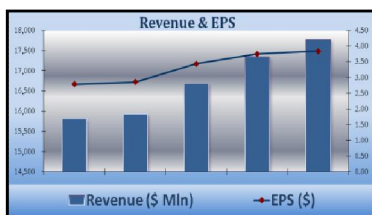
**Financial Analysis**

**Management Guidance** -- MDT provided its guidance for FY12. The company is expecting growth in revenue of 1%-3% on a constant currency basis. EPS is expected to be \$3.43-\$3.50, which includes the Adrian acquisition dilution impact of ~ \$0.04-\$0.06.

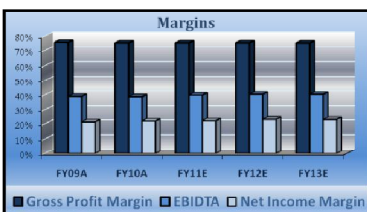
**Reuters Consensus Estimates** – Reuters’ mean consensus estimate for FY12 revenue is \$16.67 billion and EPS is \$3.46. For FY13, the revenue estimate is \$17.31 billion and EPS estimate is \$3.77.

*Note: The estimates in this Reuters section will not always match estimates on the right side, as those are from an independent forecasting service.*

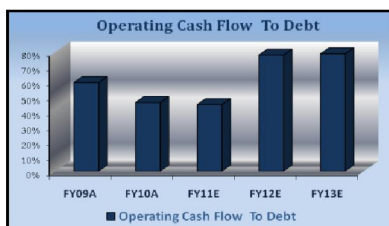
**Revenue** -- For FY11, MDT revenue increased by 0.7% to \$15.9 bln from \$15.8 bln in FY10. MDT experienced a significant slowdown which was mainly driven by the macroeconomic downturn. The delay in the launch of new multiple key products increased pricing pressure which in turn impacted the company’s expectation to gain considerable market share. The increase in sales in Restorative Therapies Group, driven by the diabetes and surgical technologies segment, contributed to the rise in revenue in FY11. The impact of lower than expected revenue on EPS was minimized through reduced spending in FY11. MDT reported EPS of \$2.86 in FY11 which was 2.5% higher than FY10 EPS of \$2.79. In FY12, we are expecting ~4%-5% revenue growth on a reported basis, mainly driven by acquisitions and growing business in emerging markets.



**Margins** -- The gross margin at MDT fell to 75.4% in FY11 from 75.9% in FY10. EBITDA margin of 38.7% was reported in FY11, compared to 39.0% in FY10. The fall was driven by a rise in R&D expenditures, which promises to deliver competitive advantages in the near future. Net income margin rose slightly to 21.82% in FY11 from 21.26% in FY10. The effective tax rate was considerably lower in FY11. For FY12, we expect gross margin, EBITDA margin and net income margin to be in ~ 75%, 40% and 22% respectively.



**Balance Sheet & Liquidity** -- Cash and cash equivalents stood at \$1.38 billion as of 29-April-11, which represents a decline of ~1% Y/Y. As of 29-April-11, the company had \$9.80 billion of debt on its balance sheet compared to \$9.52 billion in FY10 end. In March 2011, MDT issued \$1 billion in senior notes (in two tranches) repayable in 2016 and 2021, respectively. The debt capitalization ratio of the company was 0.38. The company has enough cash for acquisitions and repurchases.



**Financial Summary**

**Share Repurchase** -- In 2007 and 2009, the company’s board authorized the repurchase of up to 50 million and 60 million shares, respectively. In 2011 and 2010, MDT repurchased ~ 30 million and 27 million shares at an average price of \$37.86 and \$38.10, respectively. In June 2011, the board authorized repurchase of another 75 million shares of company’s common stock. In 1Q’12, the company repurchased \$400 million of common stock. As of 29-April-11, the company has remaining authorization of 68 million shares (6% of shares outstanding).

**Dividends** -- MDT has raised its quarterly dividend from \$0.22 in 2009, to \$0.23 in 2010 and \$0.24 in 2011. The yield currently stands at 2.8%.

	2011 A	2012 E	2013 E	2014E
<b>Summary Income Statement</b>				
Revenue	15,933	16,695	17,348	17,775
Gross Profit	12,021	12,605	13,098	13,403
EBIDTA	6,165	6,657	7,013	7,185
Interest Expense	278	354	300	243
Pre Tax Income	4,104	4,512	4,921	5,020
Net Income	3,477	3,632	3,961	4,041
EPS	2.86	3.40	3.72	3.81

	2011 A	2012 E	2013 E	2014E
<b>Summary Balance Sheet</b>				
Cash and Equivalents	1,382	1,690	1,813	2,297
Long-term Debt	8,078	5,862	5,310	4,058
Total Debt	9,835	9,305	6,925	6,185
Net Debt	8,453	7,615	5,112	3,887
Shareholders' Equity	15,968	18,102	20,799	23,505
Total Asset	30,424	32,379	33,216	35,417

	2011 A	2012 E	2013 E	2014E
<b>Summary Cash Flow</b>				
Cash from Operations	3,741	3,735	4,364	4,068
Capex	501	551	606	667
Capex, Net	501	551	606	667
Free Cash Flow	3,240	3,184	3,758	3,401
Cash Dividend	974	974	1,037	1,064

	2011 A	2012 E	2013 E	2014E
<b>Key Ratios</b>				
Revenue Growth/Y	0.7%	4.8%	3.9%	2.5%
EPS Growth Y/Y	2.5%	18.8%	9.6%	2.5%
Gross Margin	75.4%	75.5%	75.5%	75.4%
EBIDTA Margin	38.7%	39.9%	40.4%	40.4%
Debt/EBIDTA	1.60x	1.40x	0.99x	0.86x
EBIDTA/Interest Expense	22.18x	22.23x	27.18x	34.73x

**Significant Developments**

**(08/31/2011) Medtronic Completes Acquisitions of PEAK Surgical and Salient Surgical Technologies** -- MDT announced the completion of these two acquisitions, which focus on advanced energy surgical technologies and will broaden MDT’s surgical products portfolio.

**(08/03/2011) Healthcare stocks** – sold off sharply on fears that the debt-ceiling deal to be voted on by the U.S. Congress would lead to cuts in healthcare spending for the Medicare program.

**(05/11/2011) Medtronic Announces Appointment of Omar Ishrak as Chairman and Chief Executive Officer** -- appointed Ishrak as the company’s new Chairman and CEO effective 13-June-2011.

**(01/13/2011) Medtronic Completes Acquisition of Ardian** -- MDT announced the completion of its acquisition of Ardian; a developer of catheter-based therapies to treat hypertension and related conditions.

Standpoint Research 155-Variable Model / Quantitative Analysis with Fundamental & Subjective Overlay

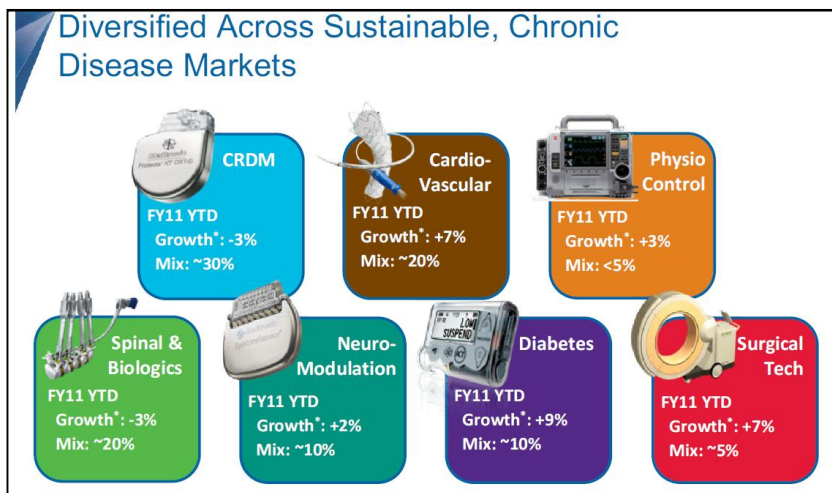
We recently ran 300 high-paying dividend names through our 155-variable computer model. MDT ranked very high ... # 17 out of 300. Refer to the *Legend* sheet in our Excel reports for the color code and description of all 155 variables used in our model. The 155-variable scoring is summarized in the 32 categories below (from roe through peg). The number in each of the cells, is the rank out of 300 stocks in the recent run. The seven cells to the right of the peg cell are coded and for internal use. The main marks against MDT at the time this recommendation was generated (on August 15, 2011) were on technicals and relative strength -- we see those as contrarian indicators when a company is ranking high on most of the other variables as MDT is.

rank	ticker	roe	roa	roc	ebitda	npm	acct	eps m	rev gr	eps gr	beta	debt	stab gr	
17 / 300	MDT	61	54	58	105	65	151	133	95	102	79	124	7	
div I	pbk	base	rel-ma	inside	safe	pcf I	pcf II	fcf	div II	rel str	pr mo	ps	rel ps	off hi-lo
36	67	1	78	197	10	229	21	127	158	264	270	207	19	49
pred	pertix	perhis	blend	peg	deducts	t val	t fund	t prop	t misc	t tech	total score			
115	53	23	45	81	7401	2176	2615	664	1334	612	66.66%			

Overview

Medtronic, Inc. (MDT) is a medical technology company. The company is engaged in research, design, manufacture and sale of products to alleviate pain, restore health and extend life. It manufactures and sells device-based medical therapies. It operates in two segments: **Cardiac and Vascular Group** which includes Cardiac Rhythm Disease Management, CardioVascular, PhysioControl; and **Restorative Therapies Group** which includes Spinal, Neuromodulation, Diabetes, and Surgical Technologies. Its primary customers include hospitals, clinics, third-party healthcare providers, distributors and other institutions, including governmental healthcare programs and group purchasing organizations. On February 25, 2011, the company acquired Jolife, a privately-held company. On January 13, 2011, the company acquired Ardian, Inc. For the nine months ended 28-Jan-11, Medtronic revenues increased by less than 1% to \$11.64 bln. Net income increased 8% to \$2.32 bln. The revenue gain reflects the increase from diabetes and cardiovascular. Net income also reflects the absence of restructuring charges, decreased litigation charges, a decrease in other expenses and higher gross profit margin. During 2009, the company acquired privately-held CoreValve, a developer of percutaneous, catheter-based transfemoral aortic valve replacement products; privately-held Ventor, a development stage company focused on transcatheter heart valve technologies for the treatment of aortic valve disease; and privately-held Ablation Frontiers, a developer of radiofrequency (RF) ablation solutions for treatment of atrial fibrillation. On 11-May-09, Medtronic announced it had chosen San Antonio, Texas for the location of its new Diabetes Therapy Management and Education Center and expects 1,400 new jobs to be created to staff this 150,000-square-foot facility.

The company's **Cardiac Rhythm Disease Management** segment offers products for the diagnosis, treatment, and management of heart rhythm disorders and heart failure, including implantable cardioverter-defibrillators, cardiac resynchronization therapy devices, and cardiac pacemakers; AF products; diagnostics and monitoring devices; and patient management tools. Its **Spinal** segment provides medical devices and implants used in the treatment of the spine and the musculoskeletal system, such as thoracolumbar, cervical, and biologics products; and minimal access spinal technologies platform that facilitates spinal surgeries. Medtronic's **CardioVascular** segment offers percutaneous coronary and peripheral vascular interventions; endovascular stent grafts; arrested heart surgery and beating heart surgery equipment; surgical ablations; and surgical heart and transcatheter heart valves.



The company's **Neuromodulation** segment provides neurostimulators for chronic pain; implantable drug delivery and deep brain stimulation systems; and urology and gastroenterology devices. Its **Diabetes** segment offers integrated diabetes management solutions; professional continuous glucose monitoring; carelink therapy management software; and blood glucose meters. The company's **Surgical Technologies** segment develops, manufactures, and markets products and therapies to treat diseases and conditions of the ear, nose, and throat, as well as certain neurological disorders; and image-guided surgery and intra-operative imaging systems that facilitate surgical planning during surgeries. Its **Physio-Control** segment offers external defibrillators, including manual defibrillator/monitors used by hospitals and emergency response personnel; and automated external defibrillators used in commercial and public settings for the treatment of sudden cardiac arrest.

Leadership Position

Cardiac and Vascular														
CRDM				Cardiovascular										Physio
ICD	Pacing	AF	Monitor	Coronary PCI	Peripheral	TCV	AAA	TAA	Surgical Valves	Perfusion	CABG	Surgical Ablation	External Defib	
#1	#1	*	#1	#3	*	#1	#1	#1	#3	#3	#1	#2	#1	
Restorative Therapies														
Spinal			Neuro			Diabetes		Surgical Technologies						
Core Spine	Biologics	BKP	Pain Stim	Drug Pumps	DBS	Uro / Gastro	Pumps	CGM	ENT	Surgical Sinus	Hydrocephalus	IntraOp 3D Image	Nav	
#1	#1	#1	#1	#1	#1	#1	#1	#1	#1	#1	#1	#1	#1	#1

Medtronic holds a leading position in many medical device categories, including cardiac rhythm management, spinal, vascular, neurology and cardiac surgery.

The major segments of medical supplies and products are cardiovascular, orthopedics, wound care, in-vitro diagnostics, diagnostic imaging, and surgical instruments. Large corporations with global scale -- including Medtronic, Baxter International, Johnson & Johnson, and Becton, and Dickinson -- dominate these fields, offering comprehensive lines of conventional hospital supplies and high-tech products.

Most leading technology-oriented medical device makers spend 8%-12% of their sales dollars on R&D programs. However, their success in creating lucrative new medical products differs markedly. For example, Medtronic has maintained its dominance in cardiac pacemakers by investing heavily in new technologies that have spawned a steady stream of state-of-the-art products. These successes notwithstanding, the company is also channeling its significant R&D expenditures towards emerging technologies in spinal repair, diabetes management, and electronic patient management systems.

Implantable cardioverter defibrillators (ICD) Market

ICDs treat abnormally fast heart beats by monitoring the heart; when a rapid rhythm is detected, electrical impulses or shocks are delivered. Cardiac resynchronization therapy (CRT) devices synchronize contractions of multiple heart chambers. The company's InSynch ICD offers CRT for heart failure, as well as advanced defibrillation capabilities for patients also at risk for potentially lethal tachyarrhythmias that may lead to cardiac arrest. The CRDM segment also includes diagnostics and monitoring devices to record the heart's electrical activity and patient management tools, including CareLink, which enables patients to transmit data from their pacemaker, ICD or CRT-D using a portable monitor that is connected to a standard telephone line.


According to market researcher Frost & Sullivan, the global ICD market generated sales of just under \$7 billion in 2010. Based on company data, we estimate that MDT had the lead with global market share of near 45%, followed by St. Jude Medical (26%), and Boston Scientific (23%). Frost & Sullivan projects this market to grow at ~ 2.2%/year (CAGR) through 2015. With the US ICD market likely hurt due to the Journal of Medical Association (JAMA) article and Justice Department probe, we project ICD sales growth to come mostly from international markets. In any event, we note that these trends are an approximation, reflecting the average of each company's experience in the ICD market. Medtronic, for example, said in February 2010 that a year earlier, it was experiencing price declines of 50-100 basis points (0.5%–1.0%), but in November 2010 and again in February 2011, the company reported that it was seeing mid-single-digit price declines in the US. In May 2011, however, Medtronic said that it saw its pricing stabilize in the April 2011 quarter for the first time in seven quarters, which it attributes to an ICD product line launched in the quarter.

In October 2007, Medtronic announced a worldwide recall of its Sprint Fidelis defibrillator leads due to a higher-than-expected rate of fracture -- a problem that may have been connected with the deaths of five patients. Some rival ICD lead manufacturers benefited from the recall, and we believe a modest amount of market share will remain in the hands of Medtronic competitors. There has been decelerating growth in the ICD market following the Medtronic and Guidant ICD recalls between 2005 and 2007; volume growth rates declined from approximately 20% to the low-single-digits. We believe the market experienced price declines of 1%–2% in 2008, as volumes continued to remain soft, in part reflecting residual concerns by both doctors and patients about product safety due to recalls related to defibrillator lead wires. We believe that pricing deteriorated by this rate again in 2009 and worsened in 2010.

### Traditional Valve Market

Transcatheter aortic valves (TAVs) are heart valve replacement and repair technologies designed to treat heart valve disease using a catheter-based approach (as opposed to open-heart surgery). Transcatheter valve replacements can be done via minimally invasive surgical techniques, dramatically reducing recovery and rehabilitation times as well as the cost of the procedure. In addition, while mechanical valves require patients to remain on blood thinners for the rest of their lives, TAVs don't have this requirement, greatly reducing the burden on the patient. TAVs are used predominantly for high risk patients with severe aortic stenosis, who ordinarily would not be optimal candidates for conventional valve replacement -- anywhere from 30%-60% of the heart valve patient population.

**CoreValve: Industry's Leading Transfemoral Valve**



- Multi-billion dollar market opportunity
- Successfully activated hundreds of centers in over 30 countries; over 10,000 implants
- Started US pivotal trial; approved trial design revisions expected to rapidly drive enrollment
- SURTAVI study: indication expansion into moderate risk patients
- True 18Fr delivery across all valve sizes
- Self-expanding design provides physicians with control throughout deployment
- Subclavian: Expanding access and opportunities

DES • Drug Filled Stents • Transcatheter Valves

TAVs are not yet on the market in the US. The Sapien TAV from Edwards Lifesciences completed in March 2011 the second of two clinical trials required by the FDA for US marketing approval. The company reported that both trials were completed successfully, and an FDA advisory panel is scheduled to meet regarding the Sapien on July 20. Edwards is expected to have the Sapien commercialized in the US by October 2011; in addition, the company had received permission for its next-generation TAV, the Sapien XT, which is already available in Europe, to start clinical trials in the US. Medtronic's CoreValve TAV started its clinical trials in the US.

The global heart valve market includes tissue valves, mechanical valves, and heart valve repair products. According to Frost & Sullivan, this market was estimated at about \$1.9 billion in 2010, of which approximately \$400 million in sales came from the newer transcatheter aortic valve (TAV) products available in Europe from Medtronic and Edwards Lifesciences. The growth out to 2015 is hard to predict, according to Frost & Sullivan, since a great deal of the forecast is dependent on the US commercial launch of the TAV. Frost & Sullivan notes that the traditional valve market is growing with a CAGR in the low-single digits, but adoption of the TAV in Europe has been enthusiastic, with growth to \$400 million in last three years and it sees equal enthusiasm in the US. We estimate this market could approach anywhere from \$1.0-\$1.3 billion worldwide over the next five years.

The global heart valve market includes tissue valves, mechanical valves, and heart valve repair products. According to Frost & Sullivan, this market was estimated at about \$1.9 billion in 2010, of which approximately \$400 million in sales came from the newer transcatheter aortic valve (TAV) products available in Europe from Medtronic and Edwards Lifesciences. The growth out to 2015 is hard to predict, according to Frost & Sullivan, since a great deal of the forecast is dependent on the US commercial launch of the TAV. Frost & Sullivan notes that the traditional valve market is growing with a CAGR in the low-single digits, but adoption of the TAV in Europe has been enthusiastic, with growth to \$400 million in last three years and it sees equal enthusiasm in the US. We estimate this market could approach anywhere from \$1.0-\$1.3 billion worldwide over the next five years.

### Stent Market

Boston Scientific said in December 2010 that it had been seeing a bit more pricing pressure than its competitors, and that in the previous six months to a year it had experienced price declines of 3%-4%, up from the 1%-3% annual declines it experienced historically. It did not update its view in Apr-11 when it spoke about its performance in the quarter ended March 2011. More importantly, overall volume trends across the industry were negative in late 2010/early 2011.

Another trend being observed in the stent market is increased competition, particularly abroad, which is holding down pricing. Medtronic's stent, the Endeavor, has been marketed in the European Union (EU) since the fourth quarter of 2005 and has captured market share in the high teens, according to Boston Scientific. In December 2007, Abbott received European approval to begin marketing its XIENCE drug-coated stent, and that product obtained US marketing approval from the FDA in July 2008.

We estimate that the number of percutaneous procedures involving coronary artery stents rose in the low-single-digits in 2008 and continued to rise at that level through 2010. The slow recovery of drug-eluting stents (DES) market share in percutaneous coronary intervention (PCI) treatments may be due to the release of the zotarolimus-eluting stent, according to an article published July 2009, in MedPage Today. Zotarolimus, used in Medtronic's stent, prevents restenosis, but does not reduce the incidence of LST. While additional studies (including one in Switzerland, with results released in November 2010) show the efficacy and safety of DES, others show that risks still exist. Meanwhile, we believe that Boston Scientific's PROMUS (a private-label version of Abbott's XIENCE stent) and TAXUS stents, and Abbott Laboratories' XIENCE stent, which use paclitaxel, will continue to fight for market supremacy. We anticipate that strong competition, particularly on price, will persist from Medtronic's Endeavor and Resolute stents. The Resolute is currently available in non-US markets and is awaiting FDA approval for its sale in the US. A trend emerging from these price declines is that hospitals are better able to afford more DES within their limited budgets.

By our calculation, Abbott assumed the leading share of the DES market in 2010, realizing \$1.80 billion in revenue. Boston Scientific had the second-largest share of the global DES market in 2010, with \$1.54 billion in revenue. Note, though, that Abbott manufactures Boston's PROMUS stent, which accounted for \$810 million of the \$1.54 billion. According to Boston Scientific's 2010 10-K, the price the company pays Abbott for the PROMUS stents is based in part on Abbott's cost to manufacture the stents and third-party reports of its average selling price for the stents. In addition, Johnson & Johnson realized DES sales of \$630 million in 2010, and Medtronic had DES sales of \$711 million in the 12 months ended January 2011. We believe that Abbott's XIENCE stent, introduced in late 2008, enabled the company to assume the # 1 market share position, mainly at the expense of Johnson & Johnson. Meanwhile, Johnson & Johnson, which realized DES sales of \$919 million in 2009, has been seeing its DES market share continue to shrink and, in mid-June 2011, decided to exit the DES market.

### Competition

Following an investigation that started in Mar-2005, many of the financial ties between surgeons and device makers (including consulting arrangements and other inducements) were suspended as a result of settlements between five leading orthopedic device manufacturers -- Biomet, DePuy (a division of JNJ), Smith & Nephew, Stryker, and Zimmer Holdings -- and the US Department of Justice (DOJ). We believe that such ties may have influenced the surgeons to have the hospitals they are associated with purchase the devices of their device-maker patron with little regard to the costs incurred by hospitals, patients, or payers (*i.e.*, insurers).

In addition to consolidation, a number of medical device makers have also been divesting businesses that they view as underperforming. Boston Scientific sold its neurovascular segment to Stryker in January 2011 for \$1.5 billion; we believe the proceeds of this sale are being used to help fund acquisitions to improve Boston Scientific's growth prospects.

Another large medical device company expanding in the orthobiologics business is Stryker Corp. In May 2011, the company signed a definitive agreement to acquire Orthovita, which makes products for the fusion, regeneration, and fracture fixation of human bone, including Vitoss synthetic bone graft substitute, and Cortoss, a vertebral (spinal) augmentation material. Orthovita also has a biosurgery business, which manufactures homeostasis products.

In February 2011, Stryker sold its OP-1 product family for spinal applications, which appears to have fit well within its plan to divest underperforming products and to acquire and/or invest in promising ones. The company kept the rights to seek future use of bone morphogenetic protein, OP-1's main biologic ingredient, in other product areas, such as osteoarthritis treatment.

The top seven companies in orthopedics hold more than 70% market share. Five of these companies are based in the United States. They are Stryker, Johnson & Johnson's DePuy division, Zimmer Holdings, Medtronic, and Biomet. Other important global suppliers include Switzerland-based Synthes, which was slated to be acquired by JNJ in early August 2011, and UK-based Smith & Nephew.

### Demographics in favor

The Health Care Equipment & Supplies industry has two main lines of business. One sub-industry supplies health care equipment to hospitals and patients in outpatient care. The other sub-industry focuses on the creation of new and more technologically advanced medical equipment to improve the efficiency and accuracy of patient care. The industry remained relatively strong throughout the recent bear market and weak economy. The improvement in the economic backdrop up until recently drove opportunities and growth in many industries. That being said, the Health Care Equipment & Supplies (industry) performance was lackluster on an absolute basis.

There are a couple of main growth factors that have driven this industry to perform well. The first and most influential factor for this industry is the increasing age of the population. The elderly population has grown significantly, while "baby boomers" are at or near retirement age. Not only is the average life span increasing, but people are also remaining much more active later in life than in the past. This has expanded demand for many products supplied by this industry ranging from medical devices for serious conditions that (more often than not) impact the older population (such as pacemakers and stents) to devices and surgeries that help improve the quality of life (such as joint replacements and laser eye surgery).

Another factor is the growing demand by patients and doctors alike for improved technology and better health care equipment. This has caused health care equipment suppliers to increase their research and development expenditures in an effort to discover more efficient and effective products. One concern for this industry is the potential for federal budget cutbacks that would negatively impact those companies receiving some form of federal funding. The future of the industry looks positive, due to the continually aging population. The key factors mentioned above not only indicate the increase in the industry's clientele, but also show that the Health Care Equipment & Supplies industry is actively working towards helping health care facilities improve their ability to treat this clientele more accurately and efficiently.

## Orthobiologics

In a presentation to analysts in June 2007, Medtronic cited its push to develop several combination drug-device therapies and take them through clinical trials as one of its long-term growth drivers. Among these combination therapies are coating joint implants with drugs that speed healing, and using implantable pumps to deliver drugs directly to the site of injury. Today, Medtronic derives more than 20% of its revenues from such products, including implantable pumps, external pumps, drug-coated stents, and tissue-regeneration devices for spinal cord injuries. Therapeutic areas that are ripe for convergence include chronic pain, age-related macular degeneration, heart muscle regeneration, and many diseases that could benefit from site-specific therapies. Orthopedics and wound care are perhaps the most active areas. Orthobiology, which has acquired significance in orthopedics, refers to the inclusion of biology and biochemistry in the development of bone replacement materials for muscular-skeletal healing. In March 2007, Medtronic bought a stake in OsteoGenix, a biotech company that is developing a compound that stimulates bone growth. Since 2002, the company has been selling a bone-growth product called Infuse, which it uses to coat several of its joint implants. The OsteoGenix product would be directed at accelerating the healing of fractures.

Orthobiologics products can have serious side effects. In June 2011, a US Senate committee began investigating whether surgeons that were paid consulting and other fees by Medtronic failed to report complications associated with Infuse. These unreported complications included abnormal bone growth, swelling in the neck and throat, and a form of sterility. While these side effects were listed on the Infuse product label, the *New York Times* noted on June 22, 2011, that the senators' query was prompted in part by the forthcoming *Spine Journal* issue (published June 28). That issue was fully devoted to articles highlighting that the 13 Medtronic-sponsored clinical trials of Infuse failed to properly disclose serious complications. On June 29, the *Wall Street Journal* noted that 15 of the surgeons involved in the trials collectively received about \$62 million for unrelated work over the past decade. Medtronic responded stating that the *Spine Journal* articles do not question the data it supplied the FDA, and that it noted the negative side effects in the brochure attached to each product sold. S&P believes the problem has less to do with the unreported side effects, and more with financial ties. In this regard, Medtronic said it implemented reforms to reduce conflicts of interest.

## Recent Quarter Results – reported August 23, 2011

The company recorded revenue growth of 7.3% from \$3.77 billion in Q1, 2011 to \$4.05 billion in Q1, 2012. On a constant currency basis the growth was recorded as 2.4% with a favorable foreign currency impact of \$186 million. US revenue showed a decline of 1%, while international revenue increased by 19%. Cardiac and Vascular grew 3% on revenue of \$2.21 billion. The decline in the ICD market led to the 3% slide in CRDM revenue y/y. Even though there was a decline in the pacing market, MDT managed 1% y/y growth in pacing revenue. Atrial Fibrillation Solutions grew by > 40%. Cardio Vascular business recorded revenue of \$850 million; up 11% y/y. Coronary revenue witnessed growth of 6% which included revenues from newly acquired Adrian. **Structural heart** revenue, **Endovascular and Peripheral** revenue and **Physio-Control** revenue also grew by 15%, 16% and 17%, respectively. Revenues from Restorative Therapies Group grew 2% driven by strong performances in Diabetes and Surgical Technologies. The company reported EPS of \$0.77 in Q1, 2012, which was 1.3% higher than Q1, 2011 EPS of \$0.76.

**Note:** We put out our recommendation on MDT 8/15/11 (\$31.58) one week before the company reported quarterly results because we felt the market had already discounted bad news – the shares dropped from > \$43 on May 18 to < \$32 on 8/15. The shares have risen steadily since 8/15 outpacing its competitors and the major indices by 500-1000 bps. In the near-term the shares may be a bit over-extended, so we would not initiate a new position aggressively at this price (\$35.05).

Gross margin reported for the first quarter of FY12 was 75.2% compared to 76.3% in the same year ago period. Cost of sales was up by 12.7% y/y. Net income for Q1, 2012 was \$821 million which was ~ 1% lower y/y. In Q1, 2012, R&D expenditures were 9.2% of revenue or \$371 million. SG&A expenditures amounted to \$1.41 billion or 34.8% of sales, compared to Q1, 2011 expenditures of \$1.33 billion. Amortization expense of \$88 million was recorded and expected to remain at that level throughout the fiscal year. Due to significant losses from its hedging programs, the company recorded other expenses of \$109 million in Q1, 2012 versus \$35 million in 'other income' in Q1, 2011. Net interest expense was \$32 million compared to \$74 million in the year ago period and the effective tax rate for the quarter was 19.7%.

## Industry Outlook

### Medical Devices Industry Dynamics

The worldwide medical device industry is very competitive, large and innovative. There significant contributions from medical devices towards health and quality of human life have certainly changed the mainstream practice of medicine. There is no denying the fact that the usage of information technology (IT) has significantly improved the overall efficiency in the healthcare industry and the quality of treatment given to patients. The United States, Japan, Germany, France, and Italy are some of the major markets for medical devices. The medical device industry consists of different segments including cardiology, oncology, orthopedic, neuro and aesthetic devices. Among these divisions, orthopedic, neuro and aesthetic are the fastest growing categories.

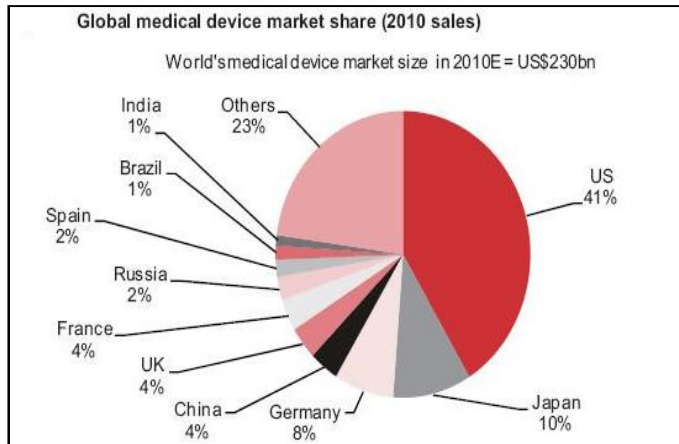
There are 18 stocks in this industry with market capitalization > \$4 bln, including seven that are > \$14 bln.

GLOBAL MEDICAL DEVICE COMPANY CATEGORY LEADERS										
	DES	BMS	Balloons	Pacers	ICD	CRT-D	CRT-P	RPM	IO	SCS
<b>Boston Scientific</b>	1	4	1	3	3	3	3	2	1	3
<b>ABT</b>	2	1	2							
<b>BCR</b>									3	
<b>JNJ</b>	3	5	3							
<b>MDT</b>	4	3	4	1	1	1	1	1		1
<b>STJ</b>				2	2	2	2	3		2

**Source: Boston Scientific**

The United States is the market leader in health equipment and accounted for more than 40% market share in the global medical device industry. The US medical devices market recorded ~ \$95 billion in sales last year. Advancing technology and high demand for medical devices backed by high disposable income are the major factors driving US to the top position. The market leaders of the industry spend billions of dollars every year in the R&D of new and innovative medical solutions. The US market is characterized by stiff competition, high regulation and significant M&A activity. The industry underwent a technological revolution in recent years.

Some of the IT applications that have become indispensable to the system are Telemedicine, Healthcare Information Systems (HIS) and Picture Archiving and Communication Systems (PACS). The Electronic Health Records (HER) market is also rising. It will change the present healthcare industry to a more pro-active and well-informed one that can leverage planned workflows. Innovation is the life-blood of the industry, but the path to success is marred with failures and rejections in the market. **Although healthcare (and this equipment industry) is considered a defensive sector in the stock market, it is not immune to recession. Since credit markets are tight, hospitals are likely to regulate and shrink their operations, and spend less on hospital equipment and supplies.** The growing and aging population, innovation in healthcare treatment and long-term medical care (and diagnosis) are the major factors contributing towards the rapid growth in global medical devices markets.



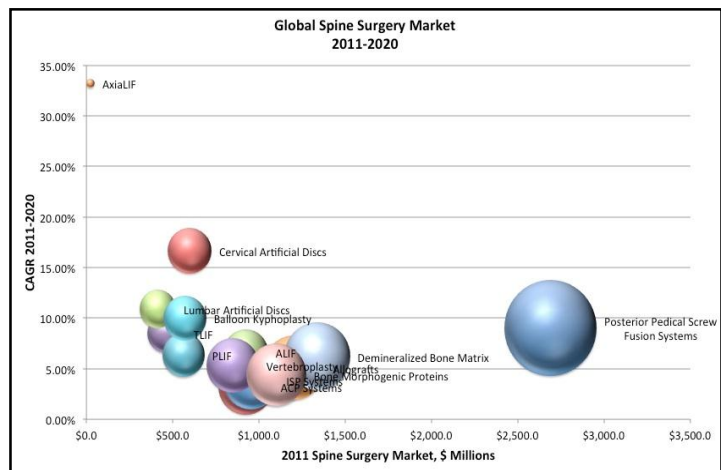
### Cardiovascular Devices Market

The cardiovascular monitoring and diagnostic (CMD) devices market consists of electrocardiograph (ECG) monitoring equipment, ECG stress testing systems, holter monitoring systems, cardiopulmonary stress testing systems, event monitoring systems, ECG data monitoring systems, cardiovascular monitoring and diagnostic devices. The advent of cardiovascular devices opened new vistas for the healthcare industry. Innovation and advanced technologies are expected to drive the global CMD devices market to reach \$1.2 billion in 2017. The US is the leading market for CMD devices, contributing ~ 44% to the CMD devices market worldwide. The US CMD devices market is estimated to register a growth of 4% CAGR in the near future. The continuous rise in the aging population and increase in the cardiovascular diseases such as cardiac arrhythmias, myocardial ischemia and Congestive Heart Failure (CHF) play a significant role in the growth of the CMD market. The advent of transcatheter heart valve (THV) devices and its rapid adoption will boost the demand for US heart valve devices. Moreover, the recent healthcare reform which led to an increase in the insurance coverage of nearly 40 million uninsured people will support the market.

Due to the increase in pressure on healthcare infrastructure, low reimbursement levels and the healthcare reforms, there is a change in the focus towards cost effective solutions. Emerging economies provide strong growth opportunities for the CMD devices market. Growth in income levels coupled with the rising level of healthcare access spurred the growth in emerging markets. With the boom in medical tourism industry and cost advantages in countries including Brazil, India and China, emerging countries are expected to witness high single-digit growth rate. Moreover, the governments of these countries are making efforts to improve healthcare quality and provide easy access to advanced medical technologies. The US cardiovascular devices companies are exploring new opportunities of growth beyond the pacemaker and ICD markets.

### Orthopedic and Spine Devices Market

The orthopedic and spine device market is highly dynamic and offers a wide array of complex and leading-edge products. The orthopedic device segment products comprise reconstruction, orthobiology, repairing of fractures, spinal implants, tissue and arthroscopy repair. Orthobiologics, trauma and spine are the fastest growing divisions in the orthopedic market. The rapid rise in disposable income in countries like China and India led to remarkable growth in orthopedic surgeries in Asia Pacific. The leading market competitors are DePuy Spine, Medtronic Spinal and Biologics, Stryker Spine and Zimmer Spine. United States, Japan and Germany are the leading orthopedic markets. During 2010, global orthopedic device industry sales reached \$30 billion. Driven by the significant increase in demand for hip and knee-replacement surgeries, knee implants became the most important segment of the US reconstruction market. Spine devices include Vertebral Compression Fracture (VCF), cervical, interbody devices, spinal stimulation and thoracolumbar devices. The US spine devices market showed impressive growth in 2009, but stumbled in 2010. Cost cutting measures and downward pressure on reimbursements are the factors which led to the poor performance in the market in 2010. Aging population, rising obesity, orthopedic surgery at an early age, more developed implants and materials are the factors stimulating growth in the spine devices market.



Spine devices include Vertebral Compression Fracture (VCF), cervical, interbody devices, spinal stimulation and thoracolumbar devices. The US spine devices market showed impressive growth in 2009, but stumbled in 2010. Cost cutting measures and downward pressure on reimbursements are the factors which led to the poor performance in the market in 2010. Aging population, rising obesity, orthopedic surgery at an early age, more developed implants and materials are the factors stimulating growth in the spine devices market.

### US Healthcare Reforms: Side Effects

President Obama signed the Patient Protection and Affordable Care Act in March 2010 in order to address the inefficiencies of the existing healthcare structure. This healthcare reform will result in a dramatic rise in the insured population in the coming years. The bill included an excise tax of 2.3% to be levied on the revenues of medical device sales beginning January-2013. This increase in tax revenues will provide more than \$20 billion over the course of a decade which will be used to offset the costs for providing insurance. The burden of the tax will have an adverse impact on the access to new and innovative medical technologies. Moreover this law may result in decreased investment in medical devices, increase the costs of health care and increase layoffs.

### FDA Regulation of medical devices

In order to make the medical device review process more transparent, the US FDA revamped the 510(k) device approval protocols in 2010. These changes may lead to an increase in the product approval costs and delays for some products. Again in 2011 the FDA outlined 25 changes to the 510(k) process to improve the regulatory approval pathway for medical devices. Increasing FDA regulations are pressuring the development of new medical devices thereby discouraging potential investors and sponsors.

### Emerging Markets – Key to Medical Device Industry Growth

Emerging markets are a key catalyst for growth in the medical devices industry in 2011 and beyond. Medical devices demand in emerging nations will outpace the demand from developed nations. Markets in developed nations such as the US and Europe are growing at 4%-6% annually, whereas the emerging markets [like India and China] are growing at > 20% per year. The growing middle class in emerging markets is driving the demand for healthcare higher. The rapidly rising population in emerging markets offers significant opportunities for the sale of medical devices. Over the past decade, the medical device industry in China registered very high growth rates and is expected to continue at or near this pace over the next few years. China's medical device sector accounts for 14% of the worldwide healthcare market. The country has more than 100 million citizens aged > 65 years who are in continuous need of health care.

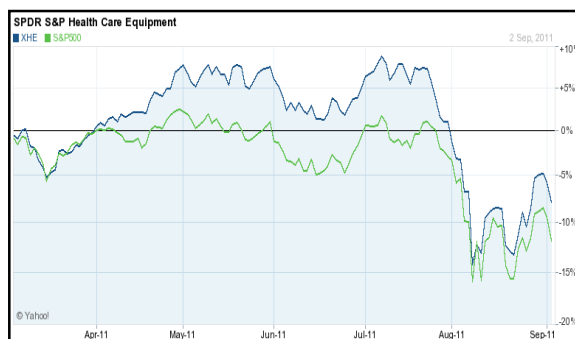
The domestic market is highly fragmented and consists of regional and overseas participants. Moreover, China's healthcare reform has a positive impact on medical devices in China and thereby strengthens the position of medical device manufacturers. China has the highest population in the world and thus serves as the home for a large patient base. In the near term, China is expected to take over the US as the market leader in medical devices. The Chinese medical device market, worth \$14.8 billion in 2010, is expected to rise to \$30.6 billion by 2017. In the past seven years, the Chinese industry recorded a CAGR of 8.9% which is higher than that of the developed economies. The Indian medical device market is one of the leading markets and has recorded double-digit growth in the past few years. The Indian medical devices and equipment market was valued at \$3.6 billion in 2010. The continuous rise in the number of tourists visiting India seeking medical devices pushes the demand for quality healthcare to meet international standards.

### Pricing Pressure

The performance of medical device companies is being pressured by rising price concerns. Medical devices have been regulated by the Food & Drug Administration (FDA) since the 1970s. As the medical device approval process by the FDA became more meticulous, the healthcare device manufacturers started launching products outside the US in Europe and Canada. Moreover, the government's healthcare cost curtailment initiatives and pressure from hospitals to renegotiate on prices have created stress on the medical device manufacturers to modify their pricing strategies. Thus, the pricing will remain an important concern even at the macro level. In addition, the advent of group purchasing organizations (GPOs), which act as an agent on behalf of its members for negotiating vendor contracts, has increased the pricing pressure. Further, this sector is also exposed to the risk of rising costs of regulation; this is expected to continue in 2011-2012.

### Health Care Index

The healthcare sector underperformed versus the S&P-500 during the market rebound off the the 2008-2009 lows. Being a defensive segment, healthcare shows smaller declines in corrective phases and under-performs during market rises. The rapid increase in healthcare costs strained state and federal budgets by decreasing the competitiveness of US insurance companies. Despite spending \$2.5 trillion on health care annually, the US healthcare industry is still behind other developed countries. Surprisingly, the healthcare sector significantly out-performed the market in the last month even though there was a rally.

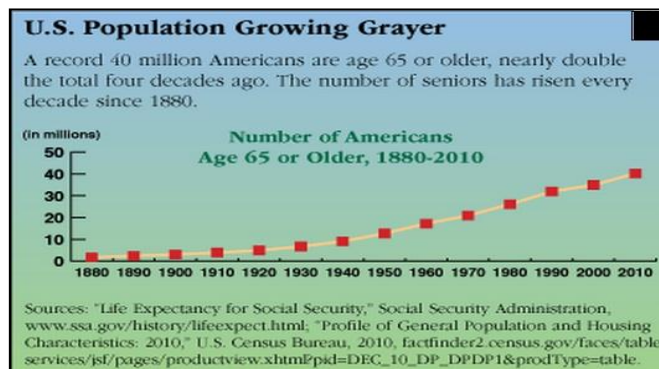


### Industry Challenges

Over the last two decades, innovation and development of medical device manufacturing techniques yielded significant growth. But most of the companies are under growing pressure to reduce costs, and abide by increasing regulations. The industry is struggling with patent expiration issues as well. Each medical device contains various patents for its different components and the patent expiry of even one patent opens entry to competitors in the market which was originally dominated by the brand names. The nature of the medical device industry is highly competitive and its success is mainly dependent on continuous investment in R&D for developing better medical technologies. However, the medical device manufacturers are also exposed to risk of litigation due to bad designs of products. These designing errors result in ~ \$30 billion in expenses to the US healthcare system annually.

### Medical Device Industry Prospects

Despite the uncertainty in the HC environment, the medical device industry is expected to show solid growth given the global population is rising along with the standard of living, giving rise to higher expectation for quality healthcare services. US, the market leader in the medical devices, accounts for ~ 33% of the global market. As a means of entry into new markets (and diversification of product offerings), the medical equipment market is likely to witness an increased level of consolidation in 2011-2012. Various factors contributing towards inorganic growth in the industry are competition, high R&D costs and stringent government regulations. Increasing demand in emerging economies, rise in the aging population, and reduction in the need for hospitalization are the factors behind growth of the device market. The increasing awareness towards health, and growth in offshore business operations transformed the emerging economies of Brazil, Russia, India and China into high growth device markets.



The US medical device industry is expected to reach \$310 billion in 2011 mainly driven by the aging baby boomer population. With the commercialization of new and improved products, the orthobiologics sector is expected to gain momentum. The implantable device market here in the US is anticipated to move at a healthy pace and exceed \$50 billion by 2015. In the neurostimulation devices market, the US ranks # 1 and accounts for ~ 70% (\$1.3 billion in 2010) of the global market. Driven by a healthy pipeline of products, the neurostimulation devices market is estimated to hit \$3.5 billion by 2017. By encouraging hospitals and modernizing the health record keeping system, US Healthcare IT became an important area for growth in the US. The US market is projected to witness impressive growth in implantable drug pumps, glaucoma and retinal implants, intraocular lenses, dermal fillers, silicone breast implants, and tissue implants.

Although MDT shares are not as attractive here at > \$34-\$35 as they were at \$31-\$32 when we made this recommendation three weeks ago, they remain attractive with a 2.8% dividend yield, at 10X trailing twelve months earnings, 9X forward estimates, 40% off the all-time high from December 2000, trading at 1998 levels adjusted for inflation and still down 20% since May 18. The market over-reacted in the summer sell-off on this name. There are segments that are challenged, but these areas will be more than offset by acquisitions, share repurchases, dividends, acquisitions, emerging market demand and eventually an economic recovery. Our near-term price target is \$38 and our target for 2012-2013 is low- to mid-\$40s (that would represent 10X-11X earnings potential looking out to 2013-2014).

	MKT	ROE	NET		REVENUE	EARNINGS	
		5 YR	PROFIT	PURITY	5 YR HIST	5 YR HIST	BETA
COMPANY NAME	CAP	AVG	MARGIN	%	GR RATE	GR RATE	SPX
MEDTRONIC MDT	37033	21.6%	22.2%	82.0%	7.0%	9.0%	0.77
BAXTER INT'L BAX	31280	27.4%	17.6%	93.0%	6.0%	14.0%	0.51
COVIDIEN COV	24643	16.9%	16.6%	77.0%	-	-	0.87
STRYKER SYK	18888	20.0%	17.5%	92.0%	7.0%	12.0%	0.86
BECTON DICKIN BDX	17179	22.5%	15.5%	99.0%	6.0%	10.0%	0.49
INTUITIVE SURG ISRG	14963	18.1%	27.1%	100.0%	34.0%	38.0%	1.27
ST JUDE MEDICAL STJ	14581	19.5%	19.0%	76.0%	11.0%	16.0%	0.82
ZIMMER HLDGS ZMH	10923	14.2%	20.4%	76.0%	4.0%	4.0%	0.87
BOSTON SCIENTIF BSX	9918	-	10.9%	0.0%	0.0%	-11.0%	1.18
SMITH & NEPH SNN	8599	21.6%	15.6%	-	8.0%	12.0%	0.77
EDW LIFESCI EW	8381	17.5%	14.4%	86.0%	9.0%	16.0%	0.49
BARD (C.R.) BCR	8015	22.1%	18.4%	81.0%	8.0%	14.0%	0.47
VARIAN MED SYS VAR	6306	30.3%	15.6%	100.0%	9.0%	15.0%	1.03
CAREFUSION CFN	5501	9.5%	10.0%	-	-	-	0.81
KINE CONCEPTS KCI	4759	36.6%	16.2%	86.0%	9.0%	11.0%	0.83
RESMED RMD	4551	12.6%	18.0%	97.0%	14.0%	20.0%	0.75
IDEXX LABS IDXX	4393	24.9%	12.8%	99.0%	9.0%	13.0%	0.98
HOLOGIC HOLX	4320	-	17.5%	-	23.0%	16.0%	0.97
	% OF LT	PRICE		RELATIVE	P/S	E'PRISE	P/E
	DEBT TO	TO	DIV	STRENGTH	LATEST	VAL TO	LATEST
COMPANY NAME	CAPITAL	CASHFL	YIELD	NUMBER	4 QTRS	EBITDA	4 QTRS
MEDTRONIC MDT	33.0%	8.4	2.8%	38	2.28	8.16	10.3
BAXTER INT'L BAX	40.0%	10.2	2.3%	75	2.31	9.12	13.2
COVIDIEN COV	28.0%	10.1	1.6%	78	2.21	9.78	13.3
STRYKER SYK	11.0%	10.4	1.5%	31	2.41	7.46	13.8
BECTON DICKIN BDX	32.0%	10.3	2.1%	56	2.25	8.22	14.5
INTUITIVE SURG ISRG	0.0%	32.4	0.0%	86	9.67	21.64	35.7
ST JUDE MEDICAL STJ	34.0%	11.2	0.0%	71	2.69	10.07	14.2
ZIMMER HLDGS ZMH	16.0%	8.8	0.0%	62	2.51	6.76	12.3
BOSTON SCIENTIF BSX	27.0%	5.9	0.0%	74	1.27	6.07	11.6
SMITH & NEPH SNN	1.0%	9.2	1.7%	59	2.08	7.32	13.3
EDW LIFESCI EW	11.0%	29.4	0.0%	67	5.31	23.62	36.9
BARD (C.R.) BCR	32.0%	12.7	0.8%	63	2.84	8.47	15.5
VARIAN MED SYS VAR	0.0%	14.2	0.0%	17	2.49	9.39	16.0
CAREFUSION CFN	21.0%	9.8	0.0%	37	1.47	6.49	14.7
KINE CONCEPTS KCI	39.0%	9.9	0.0%	95	2.32	7.76	14.3
RESMED RMD	5.0%	15.5	0.0%	25	3.66	10.59	20.4
IDEXX LABS IDXX	0.0%	22.4	0.0%	83	3.77	16.68	29.5
HOLOGIC HOLX	34.0%	7.1	0.0%	36	2.47	NM	14.1

	11 P/E TO	BASE		EARNINGS	EARNINGS	REV EST	REV EST
	LT FUTURE	LINE	S&P	ESTIMATE	ESTIMATE	CURR YR	NEXT YR
COMPANY NAME	GR RATE	SD	RANK	CURR YR	NEXT YR	(MILL)	(MILL)
MEDTRONIC MDT	1.5	2-	A	3.45	3.73	17000	17000
BAXTER INT'L BAX	1.4	-2.0	A	4.31	4.71	14000	14000
COVIDIEN COV	1.2	-	NR	3.92	4.29	12000	12000
STRYKER SYK	1.1	2-	A+	3.71	4.12	8300	8900
BECTON DICKIN BDX	1.4	-1.8	A	5.63	6.21	7800	8300
INTUITIVE SURG ISRG	2.1	-	B-	11.47	13.53	1700	2000
ST JUDE MEDICAL STJ	1.1	-1.7	B+	3.28	3.63	5700	6100
ZIMMER HLDGS ZMH	1.2	-0.9	B+	4.77	5.25	4500	4700
BOSTON SCIENTIF BSX	1.4	-0.7	C	0.45	0.53	7800	7900
SMITH & NEPH SNN	1.2	-1.8	NR	3.78	4.16	4300	4500
EDW LIFESCI EW	1.6	0.4	B	2.05	2.78	1700	2000
BARD (C.R.) BCR	1.5	-1.8	A	6.38	7.03	2900	3100
VARIAN MED SYS VAR	1.0	2-	B+	3.45	3.96	2600	2800
CAREFUSION CFN	1.0	-	NR	1.85	2.05	3700	3800
KINE CONCEPTS KCI	1.3	-	NR	4.99	5.41	2100	2200
RESMED RMD	1.1	-2.0	B+	1.55	1.82	1400	1600
IDEXX LABS IDXX	1.9	-1.1	B+	2.73	3.07	1200	1300
HOLOGIC HOLX	1.3	-	C	1.25	1.41	1800	1900

MDT, now trading at 9X estimates for next year, is one of three names in this industry that we recommended in August -- SYK and ZMH are the other two names. ZMH is now trading at just under 11X estimates for next year and SYK is trading at 12X. EPS at MDT should rise by 6%-8% in 2012 ... for SYK and ZMH it may be a bit higher and that explains (part of) the differences between the multiples on these respective names. SYK gets one-third of its revenues from overseas but is vulnerable in a weak economy because it is levered towards high-priced surgical equipment items.

Updated 9/8/2011		rec			orig	current		change
company	date	price	current	% chg	S&P	S&P	% chg	vs S&P
STRYKER SYK	05-Aug-11	49.37	48.68	-1.40%	1193.93	1185.90	-0.67%	-0.73%
MEDTRONIC MDT	15-Aug-11	31.78	34.63	8.97%	1195.29	1185.90	-0.79%	9.75%
ZIMMER HLDNG ZMH	19-Aug-11	51.04	56.90	11.48%	1132.71	1185.90	4.70%	6.79%

ZMH has been making a push of late in the orthopedic market where it is seeing opportunity. As is the case with MDT, Zimmer generates more than 40% of its revenues from overseas and that will offset weakness in the US (and in the musculoskeletal segment where ZMH has been seeing pressure recently). ZMH market share should stabilize/improve going forward, and operational improvements should support/increase margins. Cash flows are solid and may be used to repurchase shares. There have been problems growing revenues in some segments that are more levered to the economy, but that weakness can be offset elsewhere.

**SYK has been upgraded at four other firms since our recommendation** ... on August 15 and 22 ... and twice on September 6. SYK was slow out-of-the-gate for us, but the shares have jumped by more than 10% in the last two weeks. SYK has been diversifying away from maturing segments and is shifting its focus towards higher margin technologies via acquisitions.

## Credits

1. Retrieved Sep 2011, from Centers for Medicare & Medicaid Services (CMS): <http://cms.hhs.gov>
2. Retrieved Sep 2011, from European Medicines Agency (EMA): <http://www.emea.europa.eu>
3. Retrieved Sep 2011, from Food and Drug Administration (FDA): <http://www.fda.gov>
4. Retrieved Sep 2011, from IMS Health Inc.: <http://www.imshealth.com>
5. Retrieved Sep 2011, from Biospace.com: <http://www.biospace.com>
6. Retrieved Sep 2011, from American Society of Clinical Oncology (ASCO): <http://www.asco.org>
7. (2010). Retrieved Sep 2011, from The Biotechnology Industry Organization (BIO): <http://www.bio.org>
8. *BusinessMonitor*. (n.d.). Retrieved Sep 2011, from [www.businessmonitor.com](http://www.businessmonitor.com)
9. *Pharma News*. (n.d.). Retrieved Sep 2011, from [www.inpharm.com](http://www.inpharm.com)
10. CardioVascular Devices. (2011). Retrieved Sep 2011, from <http://cardiovasculardevices.medicaldevices-business-review.com/news/cardiovascular-devices-market-to-reach-12bn-by-2017-report-080611>
11. Research. (2011). Retrieved Sep 2011, from <http://www.remtecsearch.com/news-article.html?item=industrynews&article=201108101250038911>

## End of Report

## Updated Report Schedule

Sep 03: ADR / International-170 \_ # 786  
 Sep 06: Discretionary-300 \_ # 787  
 Sep 09: Individual write-up **MDT** \_ # 788  
 Sep 14: Technology-300 \_ # 789  
 Sep 18: Energy-150 \_ # 790  
 Sep 22: Industrials-300 \_ # 791  
 Sep 25: Individual write-up **BLK** \_ # 792  
 Sep 29: Short Interest-1000 \_ # 793

Oct 05: Utilities-100 \_ # 794  
 Oct 08: S&P-500 \_ # 795  
 Oct 12: High-Dividends-200 \_ # 796  
 Oct 14: Individual write-up **TBD** \_ # 797  
 Oct 16: Russell-1000 \_ # 798  
 Oct 20: Russell-2000 \_ # 799  
 Oct 24: Individual write-up **TBD** \_ # 800  
 Oct 28: Financials-180 \_ # 801

## Disclaimer:

*Standpoint Research, Inc. is an independent research provider, is not a member of the NASD or SIPC, and is not a registered securities broker or dealer. The information contained in this report and on the Standpoint Research website is produced by Standpoint Research and may not be published, broadcast, rewritten or distributed in any other manner without prior written consent from Standpoint Research. Any unauthorized use, duplication, redistribution or disclosure is prohibited by law and may lead to prosecution. The materials, opinions, and ideas expressed herein, are for general informational purposes only, do not specifically address individual financial objectives, financial situation or particular needs of the person purchasing them, and are subject to change without notice. Standpoint Research does not intend for any person or entity to rely on any such facts, opinions, and ideas, as we do not assure the accuracy or completeness of this report, or any of the materials or information set forth in it. Nothing in this report constitutes individual investment, legal or tax advice. Although the information and opinions contained herein have been obtained from sources believed to be reliable, Standpoint Research makes no representations as to accuracy, completeness or timeliness and does not assume any liability or responsibility for any loss to any person or entity that may result from any act or omission by such person or entity, or by any other person or entity, based upon this report and the information and opinions expressed herein. Standpoint Research may issue other reports that are inconsistent with this report and is under no obligation to bring these reports to the recipient's attention. All opinions in this report reflect judgments made as of the original date of publication and past performance should not be taken as an indication or guarantee of future performance. Standpoint Research, its affiliates, directors, officers and employees may have long or short positions, or buy/sell options, with respect to one or more of the securities and companies mentioned in this report, may be engaging in transactions based on ideas relating to the securities and companies mentioned herein and/or may also hold positions in the securities and companies mentioned herein. Such positions and/or transactions may be contrary to the opinions and ideas expressed in this report and may have been established or engaged in prior to the writing of this report. This report shall not be construed as a solicitation or invitation to buy or sell securities relating to any of the companies mentioned herein.*

## Contact Us:

### Standpoint Research

Flamingo South Beach, Center Tower  
 1504 Bay Road # 2210  
 Miami Beach, FL 33139

Web: [www.standpointresearch.com](http://www.standpointresearch.com)  
 E-mail: [ronnie@standpointresearch.com](mailto:ronnie@standpointresearch.com)  
 Tel: 786.768.2317 Cell: 212.752.0330

Prepared by Ronnie Moas