Investor Relations Commentary
1st Quarter FY08
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Good Afternoon and welcome to Medtronic's first quarter Conference Call and Webcast. During the next hour, we will review the results of our first quarter of fiscal year 2008, which ended July 27, 2007. Following these introductory remarks, you will hear from Medtronic Chairman and Chief Executive Officer, Art Collins. Next, Bill Hawkins, President and Chief Operating Officer, will provide comments on the first quarter results. Chief Financial Officer, Gary Ellis, will follow with a financial summary and comments on guidance. After our prepared remarks, we will take your questions, concluding the conference call around 4:30 pm Central time.

A few logistical comments: this call is being webcast via our website, www.medtronic.com. Our press release, earnings statement, balance sheet, cash flow, revenue-by-business-summaries, non-GAAP to GAAP reconciliations, as well as a transcript of the prepared remarks will all be posted on our website. The transcript will remain available on our website until our next earnings call. Today's commentary should be considered and evaluated in light of the important disclosures and reconciliations contained within our press release, as filed with the Securities and Exchange Commission. Please telephone Medtronic Investor Relations or Corporate Communications if you are unable to access the press release or the transcript.

Today's webcast includes statements regarding Medtronic's anticipated financial results, market growth, acquisitions, divestitures, product acceptance and regulatory approvals, as well as other forward-looking statements based on management's current expectations. It's important to note that our actual results may differ materially from those anticipated. Information on factors that could cause actual results to differ materially from these forward-looking statements is contained in Medtronic's Form 10-K for the year ended April 27th, 2007, filed with the Securities and Exchange Commission. We encourage you to review this carefully. All statements are made as of today's date, and we undertake no duty to update the information provided in this call.

Unless we say otherwise, the comparisons we make today will be on an "as reported" basis, not on a constant currency basis, and references to quarterly results increasing or decreasing are in comparison to the first quarter of Fiscal Year 2007.

With that, I am now pleased to turn the call over to Medtronic Chairman and Chief Executive Officer, Art Collins.

Art Collins

Thank you Martha and good afternoon everyone.

By now, most of you should have seen the press release discussing our fiscal 2008 first quarter financial results. Compared to the first quarter last fiscal year, revenue of $3 billion, 127 million increased 8%. If you exclude Physio-Control from both periods, the revenue growth was 10%.

Net earnings for the first quarter of $675 million resulted in diluted earnings per share of $0.59, which grew 16% over the first quarter a year ago. After adjusting for restructuring, certain litigation and in-process research and development charges in both the current and prior year quarters, first quarter diluted earnings per share on a pro-forma non-GAAP basis of $0.62 grew 13% and met consensus estimates. During the quarter, four of our eight business segments and each major geography outside the United States saw double digit revenue growth.

Our quarterly performance again reflected successful initiatives to further enhance leverage throughout the P&L and the benefits of Medtronic's diverse business portfolio. As mentioned last quarter, we anticipate an acceleration of growth as we move into the back half of this fiscal year. Bill Hawkins will highlight some of the upcoming product launches and other initiatives that we believe will help drive growth and continue to improve operating performance.

It has been a very busy time since we kicked off our new fiscal year on April 30th. Throughout the quarter we worked constructively with the Centers for Medicare and Medicaid Services as IPPS reimbursement rates were finalized, resulting in a neutral to positive outcome versus last year.

A successful FDA panel for the Bryan® cervical disc was concluded and our Prestige cervical disc has just been launched in the United States with very favorable initial results. We also continued to prepare for the Endeavor® drug eluting stent launch in the U.S., with two key milestones being met – first, the successful attainment of the primary end point for the ENDEAVOR IV clinical trial; and second, the much anticipated FDA panel review for Endeavor is now set to occur in October.

We continued to roll out new products and move forward on a number of key clinical trials, while at the same time selectively pruning our product portfolio. On July 27th we announced an agreement to acquire Kyphon and, throughout the quarter, we successfully continued the CEO and COO transition that will be completed at our annual shareholders meeting on Thursday with the election of Bill Hawkins as President and CEO and Michael DeMane as COO.

Since announcing the CEO transition in February, I have traveled extensively inside and outside the United States. I've had the chance to speak with a number of our customers and the patients they serve, together with regulators, payers and other government officials. And, I can tell you that Medtronic is well positioned with all of these groups. I've also met with a broad cross-section of our employees and, as you'll hear from Bill in just a few moments, we're looking forward to the remainder of this year with a great deal of excitement and optimism.

Since Bill Hawkins will be elected President and CEO at our Board of Directors meeting on Thursday, I'm going to let Bill and Gary run the rest of the call and the question and answer session. However, since this is my last investor's call as CEO of Medtronic, I'd like to again say that I've enjoyed my interaction with the investment community for more than 25 years, the past 15 while I have been at Medtronic. I also want to reinforce how good I feel about the company and its future, and how confident I am in the leadership that Bill, Michael, Gary and the rest of their team will bring to the business going forward.

Bill, it's all yours….

Bill Hawkins

Well, thank you Art.

First, on behalf of the entire executive team, I'd like to thank you for your leadership. Medtronic is on very solid ground and I am highly confident that we will continue to deliver top tier growth and industry leadership in the years ahead. Rest assured that all 38,000 employees are dedicated to continuing the

legacy of leadership that is the foundation of this great company. Art, we wish you and your wife, Anne, all the best for the future.

I'm now going to focus my comments around three areas: new products; market development; and geographic expansion--including some of the key achievements and challenges of the first quarter, along with some insights into what I believe will strengthen our growth as we move through this fiscal year.

Innovation continues to be the lifeblood of Medtronic. We saw significant progress during the first quarter with the approval and launch of several new products. We received FDA approval for the Prestige® Cervical Disc. Not only is Prestige the first commercially available cervical disc in the U.S., it is also the first artificial disc to receive an FDA labeling claim of "superiority." To date, we have trained over 800 physicians, and plan to train about 200 more each weekend for the next several weeks. With regard to reimbursement, we are working closely with commercial payers on a case by case basis and thus far, we are encouraged by early reimbursement coverage.

Also in the artificial disc arena, our Bryan cervical disc received a positive recommendation for approval from an FDA panel in July. We expect to launch this product before the end of our fiscal year. Following Bryan in the product pipeline is the Maverick™ lumbar disc, which is currently working its way through the FDA approval process. Taken together, these products will form a market leading artificial disc portfolio that will bring more treatment options to patients changing the basis of competition by raising the bar.

In the Coronary Vascular market, we experienced a quarter of market turbulence. This continues to be a very attractive market and one we believe will strengthen over the long run as next generation products come on the market. Procedure rates for percutaneous coronary interventions and penetration rates for drug eluting stents both declined during the first quarter, however our performance continued to be strong with coronary stent sales growing 27% and Endeavor revenue of $81 million, an increase of 22%. We believe that with the anticipated introduction of Endeavor in the United States later this calendar year, we will see the market rebound as there continues to be a lot of excitement about this product given its unique safety and strong efficacy profile.

With regard to the timing of Endeavor, you may remember that we announced earlier in the quarter that the ENDEAVOR IV clinical study met its primary endpoint and was submitted to the FDA for review. We have been notified by the FDA that the ENDEAVOR Dossier, including results from ENDEAVOR I, II, III and IV will be reviewed at an FDA panel meeting in October. The FDA will announce the exact date and location four to six weeks prior to the meeting in accordance with standard FDA procedures. We expect the full ENDEAVOR IV results to be presented at the TCT Congress in Washington D.C. in late October, and we plan to hold an Investor Briefing there on Monday, October 22. At that time, Scott Ward and his team will provide a full update on the Endeavor program as well as an overview of our CardioVascular business.

Another strong growth component of our CardioVascular franchise is our Endovascular business which continues to grow in double digits. We expect this growth to accelerate as we expand into the Thoracic segment in the United States. Last month, we submitted the PMA for our Talent Thoracic product, and we expect to submit the PMA for our Talent AAA stent graft later this quarter.

In our Diabetes business, the introduction of continuous glucose monitoring continued to drive strong sales growth of 23% and it continues to generate considerable interest among both physicians and patients. We saw quite an enthusiastic response to our launch of the MiniLink™, a rechargeable, low-profile sensor transmitter that enables Continuous Glucose Monitoring capabilities for both our Paradigm® insulin pumps and stand-alone Guardian monitors. And we received FDA approval and

launched the Paradigm and Guardian® systems for pediatric indications during the first quarter. I am also pleased to announce that we just signed two agreements that enable Johnson and Johnson's Lifescan glucose meters to wirelessly communicate with our pumps in the United States, and for Bayer glucose meters to do so in other geographic markets. We believe that these agreements will provide compelling benefits for our patients and further enhance the appeal of insulin-pump therapy.

Looking ahead to the remainder of the year, I continue to be excited about our plans to launch many more new products in various parts of the world. These products include Resolute™, our next generation drug eluting stent, the Bryan cervical disc, the RestoreUltra™ neurostimulator, Reveal XT™, a subcutaneous diagnostic for atrial fibrillation, and the Consulta™/Secura™/Advisa™ family of CRDM devices, our next generation of pacing and defibrillator products and the first to be built on a common platform. I am confident that these new products, along with many others, will enable us to gain market share and expand markets.

In addition to the steady cadence of new product introductions, our market development efforts are critical to our growth going forward. Let me start by commenting on the growth of the ICD market and our performance during the first quarter. Over the last five quarters, the U.S. market has been essentially flat. Outside the United States, the market continued to be strong, growing approximately 22% versus last year's first quarter. We believe the worldwide market grew approximately 7% versus last year. While we remain confident in the long-term growth prospects, we continue to be cautious about the exact timing and degree of rebound of the U.S. ICD market. As we discussed previously, we remain focused on market development and being opportunistic in gaining profitable share.

We continue to work on gathering the evidence that reinforces clinical guidelines which demonstrate that many patients in the healthcare system are not benefiting from optimal treatment, including ICD therapy. Many of these potential patients are already being seen by cardiologists. Along those lines, the IMPROVE HF study is designed to raise this awareness. Initial data from this 160 center study will be presented at the upcoming Heart Failure Society of America Congress in September.

In regards to our Sudden Cardiac Arrest Awareness campaign which we launched in January, we are pleased that the effort has successfully helped to raise the public's awareness of SCA and bolstered confidence in the benefits of ICD therapy. We have received positive feedback from both physicians and patients. As we indicated when we launched this campaign, there are many facets to the campaign beyond the television and print consumer media components, so we will now be building upon the efforts to date by shifting our focus into the other components of the campaign, specifically in the areas of protocol and guideline adoption as well as physician and patient education.

Our pacing business remains healthy as we saw the market grow 6% during the first quarter. One final remark on CRDM: we completed the leadership transition in this business on August 1, when Pat Mackin assumed the role of Senior Vice President and President, Cardiac Rhythm Disease Management, succeeding Steve Mahle. Pat brings tremendous customer focus, energy, competitive drive and discipline to his new role. Steve has done an exceptional job in leading our CRDM business for nine years and contributing to Medtronic for 35 years. He will take on a new role assisting in the area of health policy.

Turning to Neuromodulation, this past quarter, we changed the name of this business to more accurately reflect our areas of focus in this segment. Even though we continue to believe this will be one of Medtronic's most attractive long term growth platforms, we did fall short this quarter in our pain and movement disorder product lines. In response, we are stepping up our efforts to reach more patients and find new applications with clinical studies, referring physician education and focused local marketing activities. Although we lost market share this quarter, the US Pain Stimulation market continues to grow at a healthy double digit rate. On a positive note, we received FDA approval for our

new surgical lead and the initial customer reaction has been very favorable. We continue to work through the FDA approval process for the smaller, Restore Ultra neurostimulator, as well as additional leads, which we believe will even better position us to regain market share. During the quarter, we also completed a reorganization of the business to provide more focus on chronic pain and movement disorders. In our InterStim® product line, recent market development efforts to reach out to new implanting physicians resulted in 26% revenue growth this quarter.

Next, I want to talk about growth outside the United States. All of our businesses, excluding Physio-Control, posted double digit growth. ICDs grew 25% outside the United States, or 19% on a constant currency basis. In the CardioVascular business, thoracic products outside the U.S., along with drug eluting stents in parts of Asia drove very strong growth. We continue to make progress towards bringing Endeavor to the Japanese market, having filed our Shonin in May.

Going forward, we expect to see strong results continue from Japan with the help of our EnRhythm® pacemaker. EnRhythm received regulatory and reimbursement approvals in Japan during the first quarter, with premium C1 pricing, which reflects the Japanese regulators' acknowledgment of the benefits of our unique MVP® algorithm. Along with EnRhythm, we launched Concerto® and Virtuoso® in Japan during the first quarter. In Western Europe, we continue to lead the market in the Cervical Dynamic Stabilization segment with both the Prestige LP and the Bryan Cervical discs. This is another example of Medtronic utilizing technology to lead the transformation to a new standard of care. Also, in Europe during the quarter, neuropathic pain treatment guidelines were published, which we believe will be another key growth driver for the neuromodulation market.

Next, let me update you on Physio-Control®. We continue to address the issues that led us to suspend U.S. shipments in January, and we are constructively working with the FDA regarding appropriate corrective actions. We have recently resumed limited shipments to critical need U.S. customers. Assuming resolution of the issues, we anticipate resuming full U.S. shipments in the back half of the fiscal year. I want to re-emphasize that we remain committed to the spin-off of Physio-Control at the appropriate time.

As we've discussed before, we are continually evaluating our entire business portfolio, and during the first quarter, we did divest two non-strategic product lines -- Neuro Diagnostics and Gastro Diagnostics, which together had annualized net sales of approximately $40 million.

On the flip side, we are moving forward with obtaining the necessary regulatory approvals around the world to close the Kyphon transaction. A few weeks ago, I had the opportunity to meet with the Kyphon sales force and it reinforced why we are so enthusiastic and encouraged about the prospect of our two companies working together. We expect to complete the acquisition in the first calendar quarter of 2008.

I will conclude by saying that I am proud of our teams around the globe who, despite challenging market conditions in some businesses, delivered solid financial results, particularly on the bottom line.

With that, I will now turn the call over to Gary Ellis. Gary….

Gary Ellis

Thanks Bill.

In my remarks, I'll review this quarter's revenue performance, and then discuss the income statement, balance sheet and cash flow statement. I will also provide detail on the unusual items that complicate

the understanding of our income statement this quarter. Finally, I'll close the call by discussing our financial guidance for fiscal year 2008.

As you heard earlier, first-quarter revenue was $3 billion, 127 million, while net earnings were $675 million, or $0.59 diluted earnings per share. These earnings and diluted Earnings Per Share represent increases of 13% and 16%, respectively, over the prior year. After adjusting for certain reconciling items, our adjusted first quarter non-GAAP net earnings and diluted Earnings Per Share were $711 million and $0.62, respectively, an increase of 11% and 13% over FY07 first quarter adjusted results. Excluding Physio-Control in both periods, revenue growth was 10%. Physio-Control also had a negative impact of a penny on Earnings Per Share in Q1, however we still expect Physio-Control to be earnings neutral in this fiscal year.

The reconciling adjustments are comprised of a $33 million pre-tax charge for in-process R&D, primarily representing a milestone payment on a previously negotiated licensing agreement, and a $14 million pre-tax restructuring charge related to the initiatives we began in the fourth quarter of last year which could not be recorded at that time.

First quarter revenue in the United States was $1 billion, 948 million, up 3%. Outside the U.S., revenue of $1 billion, 179 million, which represents nearly 38% of the corporation's total revenue, increased 16%, including a $49 million positive impact of foreign currency. As you heard from Art and Bill, we are particularly pleased with the growth of our operations outside the United States.

In our on-going efforts to streamline and focus our commentary, I will not reiterate the revenue detail by business, as that information is in our press release and corresponding tables. I do want to highlight several reporting changes we are making this quarter which are reflected in the tables attached to the press release. With the creation of the CardioVascular business, we are splitting out five components on the revenue tables: Coronary Stents, Other Coronary/Peripheral and Endovascular, which together comprise the former Vascular segment; Revascularization and Surgical Therapies, along with Structural Heart Disease comprise the former Cardiac Surgery segment.

We are also reporting Navigation separate from Spinal as it has become part of our newly formed Corporate Technologies and New Ventures group. Our Navigation business focuses on technologies that we expect to leverage across many of our businesses and thus you will see it reported separately.

Now, let's turn to the rest of the income statement.

This quarter's gross profit margin of 74.7% is consistent with the prior first quarter, but was negatively impacted by 30 basis points for obsolescence reserves associated with product phase-outs, especially in our neuromodulation business. In addition, scrap and other product costs at Physio-Control added 30 basis points to our cost of sales. We do not anticipate these costs continuing and we expect our gross profit margins to be in line with our previously communicated guidance. I would also like to remind you, as we discussed at the June analyst and investor meeting, that we have numerous actions underway across the organization to reduce our product costs by 25% over the next five years.

First quarter R&D spending of $300 million represented 9.6% of revenue. We saw a decline in clinical costs this quarter versus the prior year as the enrollment phases of several large clinical trials in CardioVascular and Spinal were completed. This is a timing issue and we expect R&D spending to return to approximately 10% of revenue in future quarters.

First quarter SG&A expenditures of $1 billion, 96 million increased 11% over the prior year, mostly in marketing and selling, and represented 35.0% of sales. We continued to build the sales organization in the U.S. for the Endeavor and Prestige launch, and we continue to invest in our ERP implementation

where we have been preparing for the large scale conversion of our U.S. distribution systems to SAP at the end of this month. We expect to leverage these investments and are taking steps to reduce our cost structure such that SG&A will exit the fiscal year at approximately 33% of sales as we have previously discussed.

Net Other Expense for the quarter was $57 million compared to $66 million in the prior year first quarter. The improvement is primarily a result of $16 million in gains from the sale of certain equity investments during the quarter partially offset by lower currency gains from our hedging programs.

Net Interest Income for the quarter was $44 million compared to $39 million in the prior year period. As of July 27, 2007, we had approximately $6.1 billion in cash and cash investments compared to debt of $6.0 billion. We continue to generate in excess of $700 million of free cash flow per quarter, defined as operating cash flow minus capital expenditures.

Let's now turn to our tax rate. Our effective tax rate of 23.25% compares to an effective tax rate of 25.25% in the prior year first quarter and 24.5% for the prior fiscal year, excluding unusual charges in all periods. Our current tax position reflects the continued success of a number of actions taken over the last several years, and we continue to make investments and put into place strategies that have the potential to further reduce our tax rate. These efforts are designed to provide additional funds to invest in growth initiatives and to help improve return to our shareholders. We expect our fiscal year 2008 effective tax rate, excluding unusual charges, to fall in the range of 23.0% to 23.5%.

First quarter **weighted average shares outstanding**, on a diluted basis, were 1 billion, 153 million shares. During the quarter, we repurchased $500 million of our common stock, which represents over 9.6 million shares. Even though the repurchase of our shares reduces our net earnings because of the foregone interest income, it is accretive to Earnings Per Share and remains a very compelling use of our cash. As of July 27, 2007, we had remaining capacity to repurchase over 55 million shares under our Board authorized stock repurchase plan. We will continue to be opportunistic with our stock repurchasing activities.

As before, we have attached an unaudited balance sheet and cash flow statement to this quarter's press release, and I direct your attention to these statements for additional financial details.

That's all for our financial overview. Let me now turn to financial guidance for the remainder of fiscal year 2008.

As you recall, last quarter, we made several decisions regarding guidance. Let me review these with you:

- First, we will not provide guidance past one year. We have long term objectives, but guidance will be limited to the fiscal year we are in.
- Second, we will not provide quarterly guidance. Timing of new product introductions and market shifts can have a material impact on quarterly results that make precise guidance difficult to predict and less meaningful.
- Third, our annual guidance will be general and directional in nature.

FY08 guidance remains unchanged from last quarter.

With respect to revenue, most analyst estimates have our revenue growth in FY08 in the low double digits and we remain comfortable with that view. I want to remind you that we did expect the first half of the year to be softer, and then to see an acceleration in the back half of the year as Endeavor, Physio-Control, Prestige and other product lines pick up speed.

Regarding Earnings Per Share, we have communicated our intent and action plans to continue to improve our overall operating leverage and, as a result, we would expect Earnings Per Share to grow somewhat faster than revenue in FY08. We have assumed Physio-Control is included for the full year, although we still intend to spin off that business. As in the past, the guidance that I just provided excludes the impact of any unusual charges or gains that might occur, and also excluding any impact of the pending acquisition of Kyphon.

That's all for our prepared remarks.

We will now answer your questions. Please limit your questions to only one or two per firm. We would like to end the call by about 4:30 p.m. central time. Operator, please initiate the question and answer period.

Bill Hawkins (Post Q&A)

Well, that concludes this afternoon's Q&A portion of the call. We hope you will join us on Thursday for our annual shareholders meeting, and thanks for joining us today.