Investor Relations Commentary
3rd Quarter FY08
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Good morning and welcome to Medtronic's third quarter Conference Call and Webcast. During the next hour, we will review the results of our third quarter of fiscal year 2008, which ended January 25, 2008. Following these introductory remarks, Bill Hawkins, Medtronic President and Chief Executive Officer, will provide comments on the third quarter results. Gary Ellis, Chief Financial Officer, will follow with a financial summary of the quarter. After our prepared remarks, we will take your questions. Joining us for the question and answer session are Michael DeMane, Chief Operating Officer, and Pat Mackin, President of our Cardiac Rhythm Disease Management business.

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 third quarter of Fiscal Year 2007.

With that, I am now pleased to turn the call over to Medtronic President and Chief Executive Officer, Bill Hawkins.

Bill Hawkins

Well good morning and thank you Martha.

This morning we released our fiscal year 2008 third quarter financial results. Revenue of $3 billion, 405 million increased 12% including a positive impact of $117 million from foreign currency.

After adjusting for special charges, certain litigation charges and acquisition related in-process research and development charges, third quarter earnings and diluted earnings per share on a non-GAAP basis were $713 million and $0.63, respectively. GAAP earnings for the third quarter were $77 million or

$0.07 per share, which reflects a number of significant charges, several of which were previously disclosed. Gary will take you through these in greater detail later in the call.

All things considered, I am pleased with the performance of our global organization. We have achieved a number of highlights since our last conference call:

- $726 million in ICD revenue reflecting the resiliency of our CRDM organization and the widespread support we've received from customers regarding our focus on patient safety during the Fidelis field action
- The successful close of the Kyphon acquisition in early November
- Double digit revenue growth in the Spinal, Neuromodulation, Diabetes and ENT businesses
- Over $750 million generated in free cash flow
- OUS growth of 20% and,
- The February announcement of the FDA approvals of the Endeavor® drug-eluting stent and RestoreULTRA™ neurostimulator

I'll touch on each of these items in more detail as I discuss the segment results, beginning with our CRDM business.

This was a difficult quarter in our CRDM business. Given all that we had to do I could not be more proud of the thousands of employees who worked tirelessly to serve the patients who have been our first priority from the very beginning. Given the business we are in, these types of situations are always a possibility, and they are never easy. How we respond is incredibly important to patients and customers. Our focus on serving patients, as stated in our company's mission, was our ultimate guide, with the size, scale and dedication of our organization allowing us to minimize the impact of this event. Many of our senior leaders, including myself, have spent a lot of time in the field this last quarter and I must say I have been gratified by the strong support we have received from our customers for the courage we displayed in doing the right thing.

Third quarter global ICD revenue was $726 million, up 2% compared to the third quarter of fiscal year 2007 and up 14% sequentially. Overall, these results reflect the organization's focus on managing the Fidelis field action and again, the resiliency of our business.

Our performance in ICD's was stronger than anticipated, but we did experience a negative impact due in part to the priority we placed on assisting customers in reprogramming their patients' devices versus focusing on new implants. Secondly, in Japan we did not have Quattro available until mid January. Finally, the lack of a single coil lead impacted lead sales and in some cases complete systems, particularly in certain Western European markets. We are on track to launch a single coil Quattro lead in the first quarter of fiscal year 2009. Development work is also underway to reduce the size of our high power leads while also assuring best in class reliability.

During the quarter we did receive the benefit of approximately $20 million in ICD revenue related to both filling the backlog of Quattro lead orders from the second quarter and reversing a portion of the Fidelis returns reserve based on actual experience with Fidelis credits in the quarter.

As you recall, at the time of the Fidelis announcement, our worldwide lead manufacturing capacity supported a product mix of approximately 75% for Fidelis and 25% for Quattro and our inventory levels reflected this same general mix. Our ability to meet customer demand following the field action was the result of multiple actions we undertook to maintain supply subsequent to our announcement on Fidelis.

We worked with our suppliers and our manufacturing operations in Puerto Rico to ramp up and transition manufacturing back to Quattro. We completely reengineered our physical distribution effectively moving from a build to forecast model to a build to order model and finally, United Parcel Service established operations within our Puerto Rico facility, enabling us to ship directly to our customers. As a result of these efforts, we were able to meet customer demand following the field action and by early January we had reached more typical manufacturing and inventory levels.

A silver lining in this process has been the fact that our customers have come to better appreciate the value of CareLink™, which has proven to be a useful tool in helping physicians manage their Fidelis patients. We added 40,000 patients to the CareLink Network in the third quarter, which was a rate nearly 2.5 times faster than our closest competitor. CareLink is **the** largest remote patient management network in the industry with more than 225,000 patients in over 2,000 clinics and hospitals around the world.

Turning to Pacing systems, global revenue in the third quarter grew 4% to $478 million while the market as a whole grew 8%. It's important to realize that a significant portion of our field organization's attention during the quarter was focused on serving Fidelis customers and patients. Although the implant rates in the first month following the field action were down significantly for both high power and low power, by the end of the quarter they had recovered to pre-Fidelis levels.

Looking ahead, we expect our CRDM business will benefit from a robust pipeline of new products, extending what is the strongest device portfolio on the market. In the next 12 months, we expect to introduce 25 new products in the US and Europe, which includes the Vision 3-D® platform of high power and low power devices, along with two new left ventricular leads, a family of new delivery systems, and an entirely new platform for CareLink. Additionally, early in the fourth quarter we announced the start of the US clinical trial to confirm the safety and efficacy of the EnRhythm MRI SureScan™ pacing system, the first-ever pacemaker system designed for safe use in MRI machines. We anticipate launching this new product in international markets this fall and in the US in fiscal year 2010. Lastly, in Japan, we intend to start our CareLink pilot this quarter.

Turning to our Spinal business, we saw 35% growth in the quarter, driven in large part by the addition of $147 million in Kyphon revenue. We closed the Kyphon acquisition at the end of the first week of the quarter, ahead of expectations. Taking into account that we had twelve selling weeks vs. the typical thirteen, we are pleased with the result. Since then, we have made solid progress on the integration and are on-track to meet the previously stated projections of $300 to $325 million of revenue in fiscal year 2008. We are very optimistic about the long-term potential of this new platform and the opportunity to compete in the aging spine market. Our teams are currently focusing their efforts on leveraging cross-selling opportunities and driving sales and cost synergies between the two organizations. Gary will take you through the Kyphon related purchase accounting adjustments that impacted the quarter later in the call, but suffice it to say, they too are in line with expectations.

When you look at our Spinal business excluding Kyphon, revenue grew 11% in the third quarter, driven by strong double digit performance in our worldwide Biologics business along with solid growth in our Core Spinal business outside the US. Taken together, Kyphon and Biologics helped to partially offset competitive pressures on our Core Spinal products in the US.

Prestige® results have been slower than we had initially hoped due to longer than anticipated physician trialing and lack of widespread reimbursement coverage. We remain optimistic about the prospects of this product and expect updated tool sets along with continued educational efforts to increase therapy adoption. We remain confident that these implants will become a standard of care in the treatment of

cervical degenerative disc disease, giving patients an alternative to traditional motion-limiting spinal fusions.

We remain committed to our Spinal business strategy of raising the bar of competition through continuous innovation and supporting the safety, efficacy and cost effectiveness of our products with robust clinical data.

During the quarter we announced our intention to enter into a joint venture with the Shandong Weigao Group to market therapies in the spine and orthopedics sector in the Chinese market. Upon the close of this transaction later this calendar year, Medtronic will have access to Weigao's broad orthopedic and trauma product line and will be able to generate synergies from Weigao's strong presence and reputation in China. This joint venture will expand our footprint in China. We expect that China will become our largest market outside the US in the next ten years.

Let me turn now to one of our biggest near term opportunities, our CardioVascular business. Two weeks ago we announced FDA approval and launch of Endeavor in the US and we are pleased to report that we are off to a great start. Endeavor is the first new drug eluting stent approved for use in the US market in over four years and physicians are genuinely excited to have a safer and more deliverable alternative drug eluting stent for their patients with coronary artery disease.

Although it is clearly too early in the launch to share any specific metrics or results, customer reaction has been extremely positive. I spent last week visiting customers and can report first hand the excitement many have for this new product. Physicians appreciate that Endeavor offers the performance and efficacy of a first-generation drug-eluting stent while setting new standards for safety and deliverability. Physicians are telling us that Endeavor is clearly the most deliverable stent on the market. The multi-exchange (or MX) and over-the-wire systems have both received early praise and we are confident regarding Endeavor's performance in the US market.

Longer term, we remain committed to market leadership in the coronary stent space. With the strength of our portfolio - including Endeavor and Endeavor Resolute™ – we continue to gain share outside the U.S. At the end of the fourth quarter of calendar year 2007 our overall DES unit share was approximately 20% and there were over 15 markets where it exceeded 30%. We are making great progress with our DES franchise and we look forward to sharing more specifics about the Endeavor launch during our fourth quarter earnings conference call.

Turning back to our third quarter results in the CardioVascular business, revenue grew 7% with strong Coronary and Endovascular sales offset by somewhat slower growth in our Structural Heart and Revascularization businesses. Coronary growth of 8% was driven by $84 million in drug eluting stent revenue, reflecting market share gains from Endeavor and the OUS launch of Endeavor Resolute, our second drug eluting stent. Coronary revenue during the quarter also benefited from the CE mark approval and launch of our Sprinter® Legend Balloon with a revolutionary Zerofold technology enabling an exceptionally low profile with no wrapped material and no balloon shoulders. Leveraging advanced material sciences to bring this technology to market means our customers will be better able to treat their most difficult clinical challenges.

Our Endovascular business grew 9% in the quarter driven by 24% growth of our thoracic products in OUS markets. A new study published in the *New England Journal of Medicine* provides compelling evidence that endovascular intervention is the favorable choice for patients in need of AAA repair. The four-year, 23,000-patient study found that the short-term rates of death and complication were significantly lower – just 1.2 percent for endovascular repair compared to 4.8 percent for patients who underwent open surgery.

We expect continued growth in this market and we have the strongest endovascular product pipeline in the industry. In the US, during the quarter we launched the AneuRx AAAdvantage® Stent Graft on the new Xcelerant® Hydro Delivery System which features a hydrophilic coating designed to aid navigation of the device through tortuous arteries. During the third quarter we also announced that we filed the final PMA module for our Talent Abdominal Stent Graft System and we expect US launch in the first half of calendar year 2008. This will be followed by the US launch of our Talent thoracic product in the second half of calendar year 2008. Availability of the two Talent systems in the US market will accelerate Endovascular revenue in fiscal 2009 and beyond. Finally, the first human implant of the Endurant™ next generation abdominal stent graft occurred in early November and we anticipate CE mark and launch of this product in OUS markets by the end of calendar year 2008.

Turning to our Neuromodulation business, revenue grew 10% to $320 million. Adjusting for the impact of the previously announced divestitures of our diagnostics related product lines, Neuromodulation revenue grew 16% in the quarter. The overall pain market continued to show robust growth and our global pain revenue grew 13%.

Our movement disorders product lines grew 18% in the quarter driven by adoption of our Activa® therapy for Parkinson's disease. We are pursuing activities to help drive patient referrals, including strengthening Neurologists' understanding of the growing body of compelling clinical evidence. Growth in Gastro/Uro continued to be driven by revenue from our InterStim® product line, which increased 26%.

Looking ahead in the Neuromodulation business, we anticipate accelerating growth during the fourth quarter and into fiscal year 2009 driven by the launch of RestoreULTRA. We announced FDA approval for this product early in the fourth quarter and expect the first commercial implants in the US to take place later today. RestoreULTRA will be the smallest and thinnest 16 electrode rechargeable neurostimulator on the market and will offer patients the ability to customize their pain control. It offers compelling technology that is unmatched in the industry.

Our Diabetes business grew 14% on new insulin pump adoption, a robust uptake in continuous glucose sensors and strong growth in markets outside the US.

Even without widespread reimbursement coverage, continuous glucose sensor revenue is currently annualizing at nearly $60 million and we are building on this market leading franchise. For example, in the first week of this quarter we received FDA approval and launched the CGMS *i*Pro, a new physician-use diagnostic Continuous Glucose Monitoring system designed to help uncover patterns and potential problems that often go undetected with standard glucose measurements.

Going forward, we will leverage two co-marketing meter agreements we entered into with Johnson & Johnson Lifescan and Bayer earlier this fiscal year. Joint sales calls, co-marketing events and other initiatives targeting patients using multiple daily injections are beginning to generate positive referral momentum. Last week we launched our co-developed blood glucose meter with Bayer starting with initial shipments in the German market and we are on track for launching the Lifescan meter in the US market later this spring.

Our Ear, Nose and Throat business grew 15% in the third quarter driven by the successful launch of Fusion™, an advanced new Image Guidance Surgery System to facilitate sinus surgical procedures, along with strong growth of power systems and nerve monitoring disposables outside the US.

Regarding Physio-Control, our team continues to work with the FDA on appropriate corrective actions and we hope to resume full U.S. shipments as soon as possible.

Finally, in terms of our geographic performance, our growth outside the US was 20%, or 9% on a constant currency basis. Strong growth in our Diabetes and Spinal businesses of more than 25% was offset by the impact of Fidelis, particularly in the Japanese market. China revenue increased 24% in the quarter led by CardioVascular. We will continue our focus on geographic expansion as it remains one of the most significant opportunities for us in the long-term.

I will now turn the call over to Gary and then I will conclude with a few closing remarks.

So Gary…

Gary Ellis
Thanks Bill.

As you heard earlier, third-quarter revenue of $3 billion, 405 million grew 12%. Breaking this out geographically, revenue in the US was $2 billion, 98 million, up 7%. Outside the U.S., revenue of $1 billion, 307 million increased 20% including a $117 million positive impact of foreign currency.

Net earnings for the third quarter after adjusting for special charges, certain litigation charges and in-process research and development charges were $713 million and diluted earnings per share on a non-GAAP basis were $0.63. GAAP earnings and diluted EPS were $77 million and $.07, respectively. The various charges and required purchase accounting for the Kyphon acquisition complicate this quarter's income statement. I will first provide additional details on the three charges that impacted our quarterly results, each of which is listed as a separate income statement line item. Then I'll discuss in greater detail the impact of Kyphon purchase accounting before going through the rest of the income statement:

- First, we recorded the required purchase accounting IPR&D charges of $310 million comprised primarily of a $290 million charge related to the Kyphon acquisition. In addition, there was a charge of $20 million related to the purchase of intellectual property from Setagon, Inc.
- Second, we recorded certain litigation charges of $366 million, $123 million related to the settlement of certain lawsuits relating to our Marquis® line of ICD's, which we announced previously, and $243 million related to reserve established for litigation with Cordis. The Cordis litigation originated in 1997 and pertains to a patent infringement claim on a previous generation of bare metal stents that are no longer on the market. In January the Federal Appeals Court made certain decisions that necessitated the recognition of an estimate for our expected liability in this case.
- Third, we recorded a special charge of $78 million related to the impairment of intangible assets associated with our benign prostatic hyperplasia product line acquired in fiscal year 2002. After carefully evaluating the development of the market relative to our original assumptions and analyzing our estimated future cash flows utilizing this technology, we determined that the carrying value of these intangible assets was impaired and a write-down was necessary.

Collectively, these charges, including the respective tax impacts, had a $.56 negative impact on our third quarter diluted earnings per share.

In addition to these charges, there were two purchase accounting adjustments related to the Kyphon acquisition that had an impact on our quarterly results:

- First, we recorded $996 million in various Intangible Assets which will be amortized over an average life of 10.5 years. The impact of this amortization was recorded in Net Other Expense beginning this quarter.
- Second, a $34 million inventory adjustment consisting of the markup of finished goods and work-in-process inventory that is required for purchase accounting was fully amortized to cost of goods sold during the third quarter. This item was a third quarter event only and will have no impact on future quarters.

Excluding the impact of IPR&D, there was a $.05 dilutive impact in the third quarter of fiscal year 2008 from the closing of the Kyphon acquisition. We expect another $.02 to $.03 of dilution this quarter, earnings neutral in fiscal year 2009 and accretive thereafter.

Let me now turn to the rest of the income statement. As previously discussed, this quarter's gross profit margin of 74.4% included the $34 million charge for the fair value adjustment of the acquired inventory of Kyphon. This charge negatively impacted the gross margin by approximately 100 basis points. Looking ahead, we would expect a gross margin in the fourth quarter closer to 76% with the potential for further improvements in fiscal year 2009.

Third quarter R&D spending of $329 million represents 9.7% of revenue, up 12.3% compared to $293 million in the prior year third quarter. We continue to be very committed to investing in new technologies to drive future growth.

SG&A expenditures of $1 billion, 207 million represented 35.4% of sales. SG&A as a percentage of sales excluding the Kyphon business was 34.5%. In the fourth quarter we expect SG&A as a percentage of sales to be approximately 33% as we further integrate Kyphon and as investments such as the build-out of the sales organization in preparation for the US Endeavor launch begin to pay off. We have several additional initiatives underway to leverage this cost structure even more as we enter FY09.

Net Other Expense for the quarter was $119 million compared to $44 million in the prior year third quarter. This change is primarily due to $41 million in currency losses from our hedging programs, amortization of intangible assets related to the Kyphon acquisition, and the prior year inclusion of $26 million of accelerated deferred income. The currency losses on our hedging contracts reflect the fact that the weak US dollar has benefited the translation of the rest of the income statement, but we have hedged at less favorable rates. Looking ahead to the fourth quarter, Net Other Expense will be further impacted by an increase in Endeavor royalty expenses recognized upon the sale of units in the US market.

Net Interest Income for the quarter was $9 million, a significant decline compared to $36 million in the prior year period reflecting the utilization of cash balances to finance the Kyphon acquisition. As of January 25, 2008, we had approximately $3.3 billion in cash and cash investments compared to debt of $7.0 billion. We generated in excess of $750 million of free cash flow during the quarter, defined as operating cash flow minus capital expenditures. Looking ahead we expect our cash to continue to increase, however lower interest rates will negatively impact our return on this cash.

Let's now turn to our tax rate. In the third quarter, our effective tax rate was 42.77%. Excluding the tax impact of special charges, certain litigation charges, and IPR&D charges as identified on the income statement, our effective tax rate in the third quarter was 19.84%. This rate includes a $30 million tax

benefit related to the finalization of certain fiscal 2007 tax returns and the reversal of reserves for uncertain tax positions. Excluding this $30 million benefit, our third quarter effective tax rate would have been 23.25%, consistent with the rate in the first and second quarters of FY08. Exclusive of one time adjustments, we expect our fiscal year 2008 tax rate to be in the range of 23.0% to 23.5%.

Third quarter weighted average shares outstanding, on a diluted basis, were 1 billion, 135 million shares. During the quarter, we repurchased $564 million of our common stock, which represents over 11.4 million shares. As of January 25, 2008, we had remaining capacity to repurchase over 39 million shares under our Board authorized stock repurchase plan. Going forward, we remain committed to continuing to return capital to shareholders while ensuring a sufficiently strong balance sheet to execute on our strategies. This will continue to include opportunistic but disciplined stock repurchasing activities.

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

Let me conclude by commenting on analyst estimates for the full 2008 fiscal year. As you recall at the beginning of the fiscal year, we decided to limit our guidance to one year at a time and keep our guidance more directional in nature. Keeping that in mind while looking ahead to the remainder of the fiscal year, it is important to consider the following two factors.

First, we expect Medtronic revenue growth to accelerate in the fourth quarter due to:

- Stability and gradual strengthening of the global ICD market coupled with our return to more normal sales operations as Fidelis related activities subside
- Launch of Endeavor in the US
- Launch of Restore Ultra Neurostimulator
- Contribution of the Kyphon revenue

Second, as I mentioned previously, although we expect the Kyphon transaction to be earnings neutral in fiscal year 2009, we estimate it will have a $.07 to $.08 dilutive impact in fiscal year 2008, the bulk of which was recognized in the third quarter.

Current Wall Street fiscal 2008 Earnings Per Share consensus is $2.52. Taking into account the above factors, and the fact that our third quarter EPS of $.63 was above the quarterly consensus of $.61, we would not be surprised to see fiscal year 2008 Earnings Per Share consensus increase by $.02.

We have assumed Physio-Control is included for the remainder of the fiscal year, although we are committed to the eventual spin-off of that business. As in the past, all of my comments on analyst estimates do not include any unusual charges or gains that might occur.

I'll now turn things back over to Bill who will conclude our prepared remarks.

Bill…

Bill Hawkins

Thanks Gary.

Before we open it up to Q&A let me make a few closing remarks. While my first full quarter as Medtronic's CEO was characterized by some unanticipated challenges, in no way do these events change our long term outlook for the opportunities we have to deliver market leading performance. We operate in a dynamic environment. Looking ahead it's clear we need to continue to adjust our business model in several areas recognizing that some of our prior years' assumptions have changed. We will focus on reallocating investments to those markets where we see strong growth and streamlining other areas where market conditions have slowed.

The near term prospects are bright with the Endeavor launch, Kyphon integration, Diabetes and Neuro momentum, steady growth in ENT and an ongoing emphasis on our OUS markets. The focus going forward will be on relentless execution. I look forward to our next conference call and the opportunity to further update you on our journey ahead.

I'd now like to open things up for Q&A. As Martha mentioned at the beginning of the call, Michael DeMane and Pat Mackin have joined Gary and me to address your questions.

Operator, first question please.

Following Q&A:

Bill Hawkins
While there are many moving parts in a company of our size, the sum total of those parts is poised to do what we do best, to serve more patients. We are confident that the ingredients are in place for us to deliver top tier performance in the years ahead. Our heightened efforts to identify pan Medtronic cost synergies will allow us to fund new products that are essential to serving more patients while generating leveraged earnings growth.

And now, on behalf of our entire management team, many thanks again for your interest and continued support.