

MEDTRONIC INC
Form 10-Q
December 06, 2005

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

FORM 10-Q

**x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended October 28, 2005**

Commission File Number 1-7707

MEDTRONIC, INC.

(Exact name of registrant as specified in its charter)

Minnesota
(State of incorporation)

41-0793183
(I.R.S. Employer
Identification No.)

**710 Medtronic Parkway
Minneapolis, Minnesota 55432**
(Address of principal executive offices)

Telephone number: **(763) 514-4000**

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Shares of common stock, \$.10 par value, outstanding on November 30, 2005: **1,209,595,362**

PART I FINANCIAL INFORMATION**Item 1. Financial Statements**

MEDTRONIC, INC.
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited)

	Three months ended		Six months ended	
	October 28, 2005	October 29, 2004	October 28, 2005	October 29, 2004
	(in millions, except per share data)			
Net sales	\$ 2,765.4	\$ 2,399.8	\$ 5,455.8	\$ 4,745.9
Costs and expenses:				
Cost of products sold	694.8	584.8	1,348.6	1,135.1
Research and development expense	275.4	232.7	538.6	462.4
Selling, general and administrative expense	903.2	772.0	1,785.6	1,541.7
Purchased in-process research and development (IPR&D)			363.8	
Special charges	100.0		100.0	
Other expense, net	40.5	62.9	91.5	117.5
Interest income, net	(13.4)	(7.1)	(28.8)	(11.4)
Total costs and expenses	2,000.5	1,645.3	4,199.3	3,245.3
Earnings before income taxes	764.9	754.5	1,256.5	1,500.6
Income tax (benefit) provision	(51.6)	218.8	119.4	435.2
Net earnings	\$ 816.5	\$ 535.7	\$ 1,137.1	\$ 1,065.4
Earnings per share:				
Basic	\$ 0.68	\$ 0.44	\$ 0.94	\$ 0.88
Diluted	\$ 0.67	\$ 0.44	\$ 0.93	\$ 0.87
Weighted average shares outstanding:				
Basic	1,208.6	1,209.5	1,209.6	1,209.3
Diluted	1,222.5	1,221.4	1,222.4	1,221.2

See accompanying notes to the condensed consolidated financial statements.

MEDTRONIC, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	<u>October 28, 2005</u>	<u>April 29, 2005</u>
(dollars in millions, except per share data)		
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,947.8	\$ 2,232.2
Short-term investments	2,229.5	1,159.4
Accounts receivable, less allowances of \$175.5 and \$174.9, respectively	2,316.2	2,292.7
Inventories	1,126.6	981.4
Deferred tax assets, net	81.5	385.6
Prepaid expenses and other current assets	417.4	370.2
	<u>8,119.0</u>	<u>7,421.5</u>
Total current assets	8,119.0	7,421.5
Property, plant and equipment	3,707.2	3,628.6
Accumulated depreciation	(1,825.0)	(1,769.3)
	<u>1,882.2</u>	<u>1,859.3</u>
Net property, plant and equipment	1,882.2	1,859.3
Goodwill	4,331.1	4,281.2
Other intangible assets, net	1,632.8	1,018.0
Long-term investments	1,346.0	1,565.7
Other assets	456.4	471.7
	<u>17,767.5</u>	<u>16,617.4</u>
Total assets	\$ 17,767.5	\$ 16,617.4
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Short-term borrowings	\$ 2,835.1	\$ 478.6
Accounts payable	340.7	371.8
Accrued compensation	598.3	542.2
Accrued income taxes	674.7	923.3
Other accrued expenses	450.3	1,064.1
	<u>4,899.1</u>	<u>3,380.0</u>
Total current liabilities	4,899.1	3,380.0
Long-term debt	1,001.2	1,973.2
Deferred tax liabilities, net	370.9	478.1
Long-term accrued compensation	171.9	157.9
Other long-term liabilities	190.7	178.7
	<u>1,634.7</u>	<u>2,787.9</u>

Edgar Filing: MEDTRONIC INC - Form 10-Q

	October 28, 2005	April 29, 2005
Total liabilities	6,633.8	6,167.9
Commitments and contingencies (Note 16)		
Shareholders' equity:		
Preferred stock - par value \$1.00		
Common stock - par value \$0.10	120.7	121.0
Retained earnings	10,843.8	10,178.5
Accumulated other non-owner changes in equity	169.2	150.0
	<u>11,133.7</u>	<u>10,449.5</u>
Total shareholders' equity		
Total liabilities and shareholders' equity	<u>\$ 17,767.5</u>	<u>\$ 16,617.4</u>

See accompanying notes to the condensed consolidated financial statements.

3

MEDTRONIC, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six months ended	
	October 28, 2005	October 29, 2004
	(dollars in millions)	
OPERATING ACTIVITIES:		
Net earnings	\$ 1,137.1	\$ 1,065.4
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	268.7	223.7
Purchased in-process research and development	363.8	
Provision for doubtful accounts	3.5	10.0
Tax benefit from exercise of stock options	66.0	39.0
Deferred income taxes	191.5	17.1
Change in operating assets and liabilities:		
Accounts receivable	(73.7)	(90.4)
Inventories	(189.2)	(54.2)
Accounts payable and accrued liabilities	(798.5)	139.7
Other operating assets and liabilities	45.0	(28.8)
	<u>1,014.2</u>	<u>1,321.5</u>
Net cash provided by operating activities		
INVESTING ACTIVITIES:		
Acquisitions, net of cash acquired	(285.2)	(54.1)
Purchase of intellectual property	(793.6)	
Additions to property, plant and equipment	(228.9)	(196.7)
Purchases of marketable securities	(1,921.9)	(456.6)
Sales and maturities of marketable securities	1,012.9	439.1

Edgar Filing: MEDTRONIC INC - Form 10-Q

	Six months ended	
Other investing activities, net	(12.0)	39.5
Net cash used in investing activities	(2,228.7)	(228.8)
FINANCING ACTIVITIES:		
Increase in short-term borrowings, net	386.3	4.0
Increase in long-term debt, net	993.9	
Dividends to shareholders	(232.5)	(202.5)
Issuance of common stock	258.4	116.3
Repurchase of common stock	(564.0)	(245.6)
Net cash provided by (used in) financing activities	842.1	(327.8)
Effect of exchange rate changes on cash and cash equivalents	88.0	(61.2)
Net change in cash and cash equivalents	(284.4)	703.7
Cash and cash equivalents at beginning of period	2,232.2	1,593.7
Cash and cash equivalents at end of period	\$ 1,947.8	\$ 2,297.4

Supplemental Cash Flow Information

Cash Paid For:		
Income taxes	\$ 106.1	\$ 230.1
Interest	44.0	27.5
Supplemental Noncash Investing and Financing Activities:		
Deferred payments for purchases of intellectual property	\$ 30.0	\$
Reclassification of debentures from short-term to long-term debt		1,973.2
Reclassification of debentures from long-term to short-term debt	1,971.4	

See accompanying notes to the condensed consolidated financial statements.

MEDTRONIC, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S.) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information necessary for a fair presentation of results of operations, financial condition, and cash flows in conformity with accounting principles generally accepted in the U.S. In the opinion of management, the condensed consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the results of Medtronic, Inc. and its subsidiaries (Medtronic or the Company) for the periods presented. Operating results for interim periods are not necessarily indicative of results that may be expected for the fiscal year as a whole. The preparation of the financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses, and the related disclosures at the date of the financial statements and during

Edgar Filing: MEDTRONIC INC - Form 10-Q

the reporting period. Actual results could materially differ from these estimates. For further information, refer to the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended April 29, 2005.

Note 2 Stock-Based Compensation

The Company accounts for stock-based employee compensation using the intrinsic value method as prescribed under Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB Opinion No. 25) and related Interpretations. Accordingly, the Company would record compensation expense if the quoted market price on the date of grant exceeds the exercise price. Compensation expense for stock options and other equity based awards is calculated as the number of options or shares granted multiplied by the amount the market price exceeds the exercise price. For options or shares with a vesting period, the expense is recognized over the vesting period. Compensation expense is recognized immediately for options or shares that are fully vested on the date of grant. Performance shares are expensed over the performance period based on the probability of achieving the performance objectives. The Company has not recognized any stock option related employee compensation expense during the three and six months ended October 28, 2005 or October 29, 2004. Stock-based compensation expense included in reported net earnings relates primarily to restricted stock awards.

If the Company had elected to recognize compensation expense for its employee stock-based compensation plans based on the fair values at the grant dates, consistent with the methodology prescribed by Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, (SFAS No. 123) net earnings and earnings per share would have been reported as follows (dollars in millions, except per share amounts):

	Three months ended		Six months ended	
	October 28, 2005	October 29, 2004	October 28, 2005	October 29, 2004
Net earnings as reported	\$ 816.5	\$ 535.7	\$ 1,137.1	\$ 1,065.4
Add: Stock-based compensation expense included in reported net earnings (1)	4.4	3.4	7.6	6.4
Deduct: Stock-based compensation expense determined under fair value method for all awards (1)	(29.6)	(104.2)	(64.9)	(140.8)
Pro forma	\$ 791.3	\$ 434.9	\$ 1,079.8	\$ 931.0
Basic Earnings Per Share:				
As reported	\$ 0.68	\$ 0.44	\$ 0.94	\$ 0.88
Pro forma	0.65	0.36	0.89	0.77
Diluted Earnings Per Share:				
As reported	\$ 0.67	\$ 0.44	\$ 0.93	\$ 0.87
Pro forma	0.65	0.36	0.89	0.76

(1) Compensation cost under the fair value method is net of related tax effects.

Most of the Company's stock option awards provide for immediate vesting upon retirement, death or disability of the participant. The Company has traditionally accounted for the pro forma compensation expense related to stock-based awards made to retirement eligible individuals using the nominal vesting period of the grant. The nominal vesting approach requires recognition of the compensation expense over the vesting period except in the instance of the participant's actual retirement. The Financial Accounting Standards Board (FASB) clarified the accounting for stock-based awards made to retirement eligible individuals with the issuance of SFAS No. 123(R), Share Based Payment (SFAS No. 123(R)). SFAS No. 123(R) explicitly provides that the vesting period for a grant made to a retirement eligible employee is considered non-substantive and should be ignored when determining the period over which the award should be expensed. Upon adoption of SFAS No. 123(R) in the first quarter of fiscal year 2007, the Company will be required to expense stock-based awards over the period between grant date and retirement eligibility or immediately if the employee is retirement eligible at the date of grant. If the Company had historically accounted for stock-based awards made to retirement eligible individuals under the requirements of SFAS No. 123(R), the pro forma expense disclosed above would have been decreased by \$2.9 million and \$1.4 million for the three months ended October 28, 2005 and October 29, 2004, respectively and would have been decreased by \$6.9 million and \$7.5 million for the six months ended October 28, 2005 and October 29, 2004, respectively.

In response to numerous external factors, including rising medical benefit costs and evolving workforce demographics, the Company completed an extensive study to realign its portfolio of employee benefits. As a result of this study and the planned changes to employee benefits, including the cessation of the Employee Stock Ownership Plan contribution at the end of fiscal year 2005 and changes to both the U.S. defined benefit pension and post-retirement medical plans, the Company awarded fully vested, nonqualified stock options to eligible employees as part of its annual broad employee-based stock option award, which took place during the second quarter of fiscal year 2005. Due to the immediate vesting provisions, this award, with an aggregate fair value, net of tax, of \$64.2 million, resulted in increased pro forma compensation expense for the three and six months ended October 29, 2004 as compared to the typical grant that is expensed over a four-year vesting period. Executive officers who received stock options in connection with the annual grant did not receive fully vested awards, but instead received awards subject to the Company's standard policy on option vesting, which is generally over a four-year period. The broad employee-based stock option award granted during the second quarter of fiscal year 2006 carried the standard four-year vesting provisions.

Note 3 New Accounting Pronouncements

In November 2005, the FASB issued FASB Staff Position (FSP) FAS 115-1 and FAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," (FSP FAS 115-1) which replaces the measurement and recognition guidance set forth in the Emerging Issues Task Force (EITF) Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," and codifies certain existing guidance on investment impairment. FSP FAS 115-1 clarifies that an investor should recognize an impairment loss no later than when the impairment is deemed other-than-temporary, even if a decision to sell the security has not been made, and also provides guidance on the subsequent accounting for an impaired debt security. FSP FAS 115-1 is effective for the Company beginning in the fourth quarter of fiscal year 2006. Adoption of FSP FAS 115-1 is not expected to have a material impact on the Company's consolidated earnings, financial condition or cash flows.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs," an amendment of Accounting Research Bulletin No. 43, Chapter 4, which adopts wording from the International Accounting Standards Board's (IASB) IAS 2 "Inventories" in an effort to improve the comparability of cross-border financial reporting. The FASB and IASB both believe the standards have the same intent; however, an amendment to the wording was adopted to avoid inconsistent application. The new standard indicates that abnormal freight, handling costs, and wasted materials (spoilage) are required to be treated as current period charges rather than as a portion of inventory cost. Additionally, the standard clarifies that