MEDTRONIC INC
Form 10-Q
December 07, 2011
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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, 2011

Commission File Number 1-7707

MEDTRONIC, INC.
(Exact name of registrant as specified in its charter)

Minnesota	**41-0793183**
(State of incorporation)	(I.R.S. Employer Identification No.)

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

(763) 514-4000
(Registrant s telephone number, including area code)

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer , and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller Reporting Company o

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

Shares of common stock, $.10 par value, outstanding on December 2, 2011: 1,055,341,156

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three months ended October 28, 2011	Three months ended October 29, 2010	Six months ended October 28, 2011	Six months ended October 29, 2010
	(in millions, except per share data)			
Net sales	$ 4,132	$ 3,903	$ 8,181	$ 7,677
Costs and expenses:				
Cost of products sold	1,014	961	2,020	1,855
Research and development expense	379	373	750	743
Selling, general, and administrative expense	1,437	1,371	2,845	2,705
Certain litigation charges, net		279		279
Acquisition-related items	(17)	24	(4)	39
Amortization of intangible assets	86	85	174	167
Other expense (income)	142	(9)	251	(44)
Interest expense, net	38	67	70	141
Total costs and expenses	3,079	3,151	6,106	5,885
Earnings before income taxes	1,053	752	2,075	1,792
Provision for income taxes	182	186	383	396
Net earnings	$ 871	$ 566	$ 1,692	$ 1,396
Basic earnings per share	$ 0.82	$ 0.52	$ 1.60	$ 1.29
Diluted earnings per share	$ 0.82	$ 0.52	$ 1.59	$ 1.28
Basic weighted average shares outstanding	1,058.1	1,080.1	1,060.6	1,083.1
Diluted weighted average shares outstanding	1,063.1	1,083.7	1,066.2	1,086.7
Cash dividends declared per common share	$ 0.2425	$ 0.2250	$ 0.4850	$ 0.4500

The accompanying notes are an integral part of these condensed consolidated financial statements.

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MEDTRONIC, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

		October 28, 2011		April 29, 2011
		(in millions, except per share data)		
ASSETS				
Current assets:				
Cash and cash equivalents	$	1,048	$	1,382
Short-term investments		1,118		1,046
Accounts receivable, less allowances of $105 and $97, respectively		3,837		3,822
Inventories		1,840		1,695
Deferred tax assets, net		587		605
Prepaid expenses and other current assets		584		567
Total current assets		9,014		9,117
Property, plant, and equipment		6,065		5,817
Accumulated depreciation		(3,530)		(3,306)
Property, plant, and equipment, net		2,535		2,511
Goodwill		9,944		9,537
Other intangible assets, net		2,875		2,777
Long-term investments		7,013		6,120
Other assets		372		362
Total assets	$	31,753	$	30,424
LIABILITIES AND SHAREHOLDERS EQUITY				
Current liabilities:				
Short-term borrowings	$	2,050	$	1,723
Accounts payable		543		511
Accrued compensation		765		896
Accrued income taxes		83		50
Other accrued expenses		1,293		1,534
Total current liabilities		4,734		4,714
Long-term debt		8,222		8,112
Long-term accrued compensation and retirement benefits		505		480
Long-term accrued income taxes		841		496
Long-term deferred tax liabilities, net		293		220
Other long-term liabilities		419		434
Total liabilities		15,014		14,456
Commitments and contingencies (Notes 3 and 19)				
Shareholders equity:				
Preferred stock par value $1.00				
Common stock par value $0.10		106		107
Retained earnings		16,790		16,085
Accumulated other comprehensive loss		(157)		(224)
Total shareholders equity		16,739		15,968

Total liabilities and shareholders equity	$	31,753	$	30,424

The accompanying notes are an integral part of these condensed consolidated financial statements.

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

	Six months ended October 28, 2011	Six months ended October 29, 2010
	(in millions)	
Operating Activities:		
Net earnings	$ 1,692	$ 1,396
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	437	402
Amortization of discount on senior convertible notes	42	86
Acquisition-related items	17	15
Provision for doubtful accounts	32	18
Deferred income taxes	(58)	(77)
Stock-based compensation	90	104
Change in operating assets and liabilities, net of effect of acquisitions:		
Accounts receivable, net	(119)	(72)
Inventories	(147)	(108)
Accounts payable and accrued liabilities	(354)	(429)
Other operating assets and liabilities	606	94
Certain litigation charges, net		279
Certain litigation payments		(5)
Net cash provided by operating activities	2,238	1,703
Investing Activities:		
Acquisitions, net of cash acquired	(617)	(452)
Purchase of intellectual property	(8)	(17)
Additions to property, plant, and equipment	(282)	(258)
Purchases of marketable securities	(3,866)	(3,425)
Sales and maturities of marketable securities	3,008	2,793
Other investing activities, net	9	(80)
Net cash used in investing activities	(1,756)	(1,439)
Financing Activities:		
Change in short-term borrowings, net	302	1,181
Payments on long-term debt	(15)	(402)
Dividends to shareholders	(514)	(488)
Issuance of common stock	45	42
Repurchase of common stock	(600)	(760)
Net cash used in financing activities	(782)	(427)
Effect of exchange rate changes on cash and cash equivalents	(34)	19
Net change in cash and cash equivalents	(334)	(144)
Cash and cash equivalents at beginning of period	1,382	1,400
Cash and cash equivalents at end of period	$ 1,048	$ 1,256
Supplemental Cash Flow Information		
Cash paid for:		
Income taxes	$ 99	$ 552
Interest	161	219

The accompanying notes are an integral part of these condensed consolidated financial statements.

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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.) (U.S. GAAP) 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 U.S. GAAP. 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 U.S. GAAP 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 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, 2011.

The Company s fiscal years 2012, 2011, and 2010 will end or ended on April 27, 2012, April 29, 2011, and April 30, 2010, respectively.

Note 2 New Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) updated the accounting guidance related to fair value measurements. The updated guidance results in a consistent definition of fair value and common requirements for measurement of, and disclosure about, fair value between U.S. GAAP and International Financial Reporting Standards (IFRS). The updated guidance is effective for the Company beginning in the fourth quarter of fiscal year 2012. The adoption of this accounting guidance will not have a material impact on the Company s consolidated financial statements.

In June 2011, the FASB updated the disclosure requirements for comprehensive income. The updated guidance requires companies to disclose the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The updated guidance does not affect how earnings per share is calculated or presented. The updated guidance is effective for the Company retrospectively beginning in the first quarter of fiscal year 2013. Since the accounting guidance only impacts disclosure requirements, its adoption will not have a material impact on the Company s consolidated financial statements.

In September 2011, the FASB updated the accounting guidance related to annual and interim goodwill impairment tests. The updated accounting guidance allows entities to first assess qualitative factors before performing a quantitative assessment of the fair value of a reporting unit. If it is determined on the basis of qualitative factors, that the fair value of the reporting unit is more-likely-than-not less than the carrying amount, the existing quantitative impairment test is required. Otherwise, no further impairment testing is required. The updated guidance is effective for the Company beginning in the first quarter of fiscal year 2013 with early adoption permitted under certain circumstances. The adoption of this accounting guidance will not have a material impact on the Company s consolidated financial statements.

Note 3 Acquisitions and Acquisition-Related Items

The Company had various acquisitions and other acquisition-related activity during the first two quarters of fiscal years 2012 and 2011. Certain acquisitions were accounted for as business combinations as noted below. In accordance with authoritative guidance on business combination accounting, the assets and liabilities of the company acquired were recorded as of the acquisition date, at their respective fair values, and consolidated with the Company. The purchase price allocation is based on estimates of the fair value of assets acquired and liabilities assumed. The pro forma impact of these acquisitions was not significant, individually or in the aggregate, to the results of the Company for the three and six months ended October 28, 2011 or October 29, 2010. The results of operations related to each company acquired have been included in the Company s consolidated statements of earnings since the date each company was acquired.

Three and six months ended October 28, 2011

Salient Surgical Technologies, Inc.

On August 31, 2011, the Company acquired Salient Surgical Technologies, Inc. (Salient). Salient develops and markets devices for haemostatic sealing of soft tissue and bone incorporating advanced energy technology. Salient s devices are used in a variety of surgical procedures including orthopedic surgery, spine, open abdominal, and thoracic procedures. Total consideration for the transaction was approximately $497 million. Medtronic had previously invested in Salient and held an 8.9 percent ownership position in the company. Net of this ownership position, the transaction value was approximately $452 million. Based upon the acquisition valuation, the Company acquired $162 million of technology-based intangible assets that had an estimated useful life of 12 years at the time of acquisition, $46 million of in-process research and development (IPR&D), $53 million of net tangible liabilities, and $342 million of goodwill. The value attributable to IPR&D has been capitalized as an indefinite-lived intangible asset. The IPR&D primarily relates to the future launch of Salient s concentric wire product. Acquired goodwill is not deductible for tax purposes.

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MEDTRONIC, INC.
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(Unaudited)

The Company accounted for the acquisition of Salient as a business combination. The Company recorded the identifiable assets acquired and liabilities assumed at fair values on the acquisition date as follows:

(in millions)		
Current assets	$	20
Property, plant, and equipment		11
IPR&D		46
Other intangible assets		162
Goodwill		342
Other assets		1
Total assets acquired		582
Current liabilities		43
Long-term deferred tax liabilities, net		42
Total liabilities assumed		85
Net assets acquired	$	497

PEAK Surgical, Inc.

On August 31, 2011, the Company acquired PEAK Surgical, Inc. (PEAK). PEAK develops and markets tissue dissection devices incorporating advanced energy technology. Total consideration for the transaction was approximately $113 million. Medtronic had previously invested in PEAK and held an 18.9 percent ownership position in the company. Net of this ownership position, the transaction value was approximately $96 million. Based upon the acquisition valuation, the Company acquired $74 million of technology-based intangible assets that had an estimated useful life of 12 years at the time of acquisition, $17 million of net tangible liabilities, and $56 million of goodwill. Acquired goodwill is not deductible for tax purposes.

The Company accounted for the acquisition of PEAK as a business combination. The Company recorded the identifiable assets acquired and liabilities assumed at fair values on the acquisition date as follows:

(in millions)		
Current assets	$	5
Property, plant, and equipment		5
Other intangible assets		74
Goodwill		56
Total assets acquired		140
Current liabilities		10
Long-term deferred tax liabilities, net		17
Total liabilities assumed		27
Net assets acquired	$	113

Other Acquisitions and Acquisition-Related Items

During the three and six months ended October 28, 2011, the Company recorded a net gain from acquisition-related items of $17 million and $4 million, respectively. In connection with the acquisitions of Salient and PEAK, the Company recognized gains of $32 million and $6 million, respectively, during the three months ended October 28, 2011 on its previously held investments. In connection with these acquisitions, the Company began to assess and formulate a plan for the elimination of duplicative positions and the termination of certain contractual obligations. As a result, the Company incurred approximately $5 million of certain acquisition-related costs, which include legal fees, severance costs, change in control costs, and contract termination costs. Additionally, during the three and six months ended October 28, 2011 the Company recorded charges of $9 million and $17 million, respectively, related to the change in fair value of contingent milestone payments associated with acquisitions subsequent to April 29, 2009 and transaction costs of $7 million and $12 million, respectively, related to the pending divestiture of the Physio-Control business. These amounts are included within *acquisition-related items* in the condensed consolidated statement of earnings.

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Three and six months ended October 29, 2010

ATS Medical, Inc.

On August 12, 2010, the Company acquired ATS Medical, Inc. (ATS Medical). ATS Medical is a leading developer, manufacturer, and marketer of products and services focused on cardiac surgery, including heart valves and surgical cryoablation technology. Under the terms of the agreement, ATS Medical shareholders received $4.00 per share in cash for each share of ATS Medical common stock that they owned. Total consideration for the transaction was $394 million which includes $30 million of ATS Medical debt and acquired contingent consideration of $10 million. In connection with the acquisition, the Company acquired $101 million of technology-based intangible assets that had an estimated useful life of 11 years at the time of acquisition, $6 million of IPR&D, $78 million of net tangible assets, and $209 million of goodwill. The value attributable to IPR&D, which relates to the future launch of ATS Medical s next generation surgical ablation and 3f tissue valve products, has been capitalized as an indefinite-lived intangible asset. The goodwill is not deductible for tax purposes.

The Company accounted for the acquisition of ATS Medical as a business combination. The Company recorded the identifiable assets acquired and liabilities assumed at fair values on the acquisition date as follows:

(in millions)		
Current assets	$	51
Property, plant, and equipment		7
IPR&D		6
Other intangible assets		101
Goodwill		209
Long-term deferred tax assets, net		34
Total assets acquired		408
Current liabilities		14
Total liabilities assumed		14
Net assets acquired	$	394

Axon Surgical

On June 2, 2010, the Company acquired substantially all of the assets of Axon Surgical (Axon), a privately-held company. Prior to the acquisition, the Company distributed a large portion of Axon s products. The agreement will allow the Company to bring to market the next generation of surgeon-directed and professionally supported spinal neuromonitoring technology and expand the availability of this technology. Total consideration for the transaction, net of cash acquired, was $62 million, which includes the settlement of existing Axon debt. In connection with the acquisition of Axon, the Company acquired $41 million of technology-based intangible assets that had an estimated useful life of 10 years at the time of acquisition, $5 million of tangible assets, and $16 million of goodwill. The goodwill is deductible for tax purposes. The Company accounted for the acquisition of Axon as a business combination.

Other Acquisitions and Acquisition-Related Items

On September 14, 2010, the Company acquired a developer of vascular suturing products used in connection with cardiovascular and vascular procedures that require a puncture or incision to the artery. The terms of the transaction included an upfront payment of $15 million and additional payments of up to $10 million contingent upon achievement of certain milestones. Total consideration for the transaction was valued at approximately $21 million, which includes the estimated fair value of additional milestone-based contingent consideration of $6 million. The Company accounted for this acquisition as a business combination.

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During the six months ended October 29, 2010, the Company incurred a $15 million IPR&D charge related to a milestone payment under the existing terms of a royalty bearing, non-exclusive patent cross-licensing agreement with NeuroPace, Inc. Product commercialization related to this technology had not yet been achieved. As a result, in accordance with authoritative guidance, the payments for these transactions were immediately expensed as IPR&D since technological feasibility had not yet been reached and such technology has no future alternative use. This amount was recorded within *acquisition-related items* in the condensed consolidated statement of earnings.

In connection with the ATS Medical acquisition, the Company began to assess and formulate a plan for the elimination of duplicative positions and the termination of certain contractual obligations. As a result, during the three and six months ended October 29, 2010 the Company incurred approximately $24 million of certain acquisition-related costs, which include acquisition-related legal fees and severance costs, change in control costs, and contract termination costs which were recorded within *acquisition-related items* in the condensed consolidated statement of earnings.

Contingent Consideration

Certain of the Company s business combinations or purchases of intellectual property involve the potential for the payment of future contingent consideration upon the achievement of certain product development milestones and/or various other favorable operating conditions. Payment of the additional consideration is generally contingent on the acquired company reaching certain performance milestones, including attaining specified revenue levels, achieving product development targets, or obtaining regulatory approvals. As a result of the Company adopting new authoritative guidance in fiscal year 2010 related to business combinations, contingent consideration is recorded at the estimated fair value of the contingent milestone payment on the acquisition date for all acquisitions subsequent to April 24, 2009. The fair value of the contingent milestone consideration is remeasured at the estimated fair value at each reporting period with the change in fair value recognized as income or expense within *acquisition-related items* in the condensed consolidated statements of earnings. The Company measures the initial liability and remeasures the liability on a recurring basis using Level 3 inputs as defined under authoritative guidance for fair value measurements. See Note 7 for further information regarding fair value measurements.

At October 28, 2011, the estimated maximum potential amount of undiscounted future contingent consideration that the Company is expected to make associated with all completed business combinations or purchases of intellectual property prior to April 24, 2009 was approximately $235 million. The milestones associated with the contingent consideration must be reached in future periods ranging from fiscal years 2012 to 2016 in order for the consideration to be paid.

The fair value of contingent milestone payments associated with acquisitions subsequent to April 24, 2009 was remeasured as of October 28, 2011 and April 29, 2011 at $288 million and $335 million, respectively. As of October 28, 2011, $263 million was reflected in *other long-term liabilities* and $25 million was reflected in *other accrued expenses* in the condensed consolidated balance sheet. As of October 29, 2010, $269 million was reflected in *other long-term liabilities* and $66 million was reflected in *other accrued expenses* in the condensed consolidated balance sheet. The following table provides a reconciliation of the beginning and ending balances of contingent milestone payments associated with acquisitions subsequent to April 24, 2009 measured at fair value that used significant unobservable inputs (Level 3):

	Three months ended		Six months ended	
(in millions)	**October 28, 2011**	**October 29, 2010**	**October 28, 2011**	**October 29, 2010**
Beginning Balance	$ 343	$ 120	$ 335	$ 118
Purchase price contingent consideration	2	16	2	16
Contingent milestone payments	(66)		(66)	
Change in fair value of contingent consideration	9		17	2
Ending Balance	$ 288	$ 136	$ 288	$ 136

Note 4 Certain Litigation Charges, Net

The Company classifies material litigation reserves and gains recognized as certain litigation charges, net. During the three and six months ended October 28, 2011, there were no certain litigation charges, net.

During the three months ended October 29, 2010, the Company recorded certain litigation charges, net of $279 million related primarily to a settlement involving the Sprint Fidelis family of defibrillation leads and an accounting charge for Other Matters litigation. The Sprint Fidelis settlement related to the resolution of certain outstanding product liability litigation related to the Sprint Fidelis family of defibrillation leads that were subject to a field action announced October 15, 2007. The parties subsequently reached an adjusted settlement agreement to pay a total of $221 million to resolve over 14,000 filed and unfiled claims. See Note 19 for additional information.

During the first quarter of fiscal year 2011, there were no certain litigation charges, net.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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Note 5   Restructuring Charges

During the three and six months ended October 28, 2011, the Company did not incur any restructuring charges.

Fiscal Year 2011 Initiative

In the fourth quarter of fiscal year 2011, the Company recorded a $272 million restructuring charge, which consisted of employee termination costs of $177 million, asset write-downs of $24 million, contract termination fees of $45 million, and other related costs of $26 million. The fiscal year 2011 initiative was designed to restructure the business to align its cost structure to current market conditions and to continue to position the Company for long-term sustainable growth in emerging markets and new technologies. Included in the $177 million of employee termination costs were severance and the associated costs of continued medical benefits and outplacement services, as well as $15 million of incremental defined benefit pension and post-retirement related expenses for employees that accepted voluntary early retirement packages. These costs are not included in the table summarizing the restructuring costs below because they are associated with costs that are accounted for under the pension and post-retirement rules. For further discussion on the incremental defined benefit pension and post-retirement related expenses, see Note 14 of the Company s Annual Report on Form 10-K for the year ended April 29, 2011. Of the $24 million of asset write-downs, $11 million related to inventory write-offs of discontinued product lines and production-related asset impairments, and therefore, was recorded within cost of products sold in the consolidated statement of earnings. Additionally, included in the other related costs was a $19 million intangible asset impairment related to the discontinuance of a product line within the CardioVascular business.

In connection with the fiscal year 2011 initiative, as of the end of the fourth quarter of fiscal year 2011, the Company had identified approximately 2,100 net positions for elimination to be achieved through voluntary early retirement packages offered to employees, voluntary separation, and involuntary separation. Of the 2,100 net positions identified, approximately 1,700 positions have been eliminated as of October 28, 2011. The fiscal year 2011 initiative is scheduled to be substantially complete by the end of the fourth quarter of fiscal year 2012.

A summary of the activity related to the fiscal year 2011 initiative is presented below:

	Fiscal Year 2011 Initiative			
(in millions)	**Employee Termination Costs**	**Asset Write-downs**	**Other Costs**	**Total**
Balance as of April 30, 2010	**$**	**$**	**$**	**$**
Restructuring charges	162	24	71	257
Payments/write-downs	(5)	(24)	(24)	(53)
Balance as of April 29, 2011	$ 157	$	$ 47	$ 204
Payments/write-downs	(63)		(13)	(76)
Balance as of July 29, 2011	$ 94	$	$ 34	$ 128
Payments/write-downs	(43)		(15)	(58)
Balance as of October 28, 2011	$ 51	$	$ 19	$ 70

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MEDTRONIC, INC.
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(Unaudited)

Note 6 Investments

The Company holds short-term and long-term investments, which consist primarily of marketable debt and equity securities.

Information regarding the Company s *short-term* and *long-term investments* at October 28, 2011 is as follows:

(in millions)	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-sale securities:				
Corporate debt securities	$ 2,512	$ 24	$ (13)	$ 2,523
Auction rate securities	167		(40)	127
Mortgage-backed securities	933	10	(12)	931
U.S. government and agency securities	2,842	45	(2)	2,885
Foreign government and agency securities	90	1		91
Certificates of deposit	97			97
Other asset-backed securities	437	2	(1)	438
Marketable equity securities	79	111	(26)	164
Trading securities:				
Exchange-traded funds	45	1	(2)	44
Cost method, equity method, and other investments	831			831
Total short-term and long-term investments	$ 8,033	$ 194	$ (96)	$ 8,131

Information regarding the Company s *short-term* and *long-term investments* at April 29, 2011 is as follows:

(in millions)	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-sale securities:				
Corporate debt securities	$ 1,947	$ 20	$ (6)	$ 1,961
Auction rate securities	167		(34)	133
Mortgage-backed securities	783	10	(8)	785
U.S. government and agency securities	2,731	26	(1)	2,756
Foreign government and agency securities	130	1		131
Certificates of deposit	119			119
Other asset-backed securities	351	1	(3)	349
Marketable equity securities	73	164		237
Trading securities:				
Exchange-traded funds	33	6		39
Cost method, equity method, and other investments	656			656
Total short-term and long-term investments	$ 6,990	$ 228	$ (52)	$ 7,166

Information regarding the Company s available-for-sale and trading securities at October 28, 2011 and April 29, 2011 is as follows:

	October 28, 2011		April 29, 2011	
(in millions)	Short-term	Long-term	Short-term	Long-term
Available-for-sale securities	$ 1,118	$ 6,138	$ 1,046	$ 5,425
Trading securities		44		39
Total	$ 1,118	$ 6,182	$ 1,046	$ 5,464

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

The following tables show the gross unrealized losses and fair values of the Company s available-for-sale securities that have been in a continuous unrealized loss position deemed to be temporary for less than 12 months and for more than 12 months, aggregated by investment category as of October 28, 2011 and April 29, 2011:

	October 28, 2011			
	Less than 12 months		More than 12 months	
(in millions)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate debt securities	$ 793	$ (10)	$ 10	$ (3)
Auction rate securities			127	(40)
Mortgage-backed securities	308	(3)	62	(9)
U.S. government and agency securities	679	(2)		
Other asset-backed securities			16	(1)
Marketable equity securities	53	(26)		
Total	$ 1,833	$ (41)	$ 215	$ (53)

	April 29, 2011			
	Less than 12 months		More than 12 months	
(in millions)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate debt securities	$ 256	$ (1)	$ 16	$ (5)
Auction rate securities			133	(34)
Mortgage-backed securities	161	(1)	67	(7)
U.S. government and agency securities	267	(1)		
Other asset-backed securities	74	(1)	12	(2)
Total	$ 758	$ (4)	$ 228	$ (48)

At October 28, 2011 the Company concluded that the unrealized losses associated with the available-for-sale securities detailed above were not other-than-temporary as the Company does not have the intent to sell, nor is it more likely than not that the Company will be required to sell, before recovery of the amortized cost.

Activity related to the Company s *short-term* and *long-term investment* portfolio is as follows:

	Three months ended			
	October 28, 2011		October 29, 2010	
(in millions)	Debt (a)	Equity (b)(c)	Debt (a)	Equity (b)
Proceeds from sales	$ 1,406	$ 12	$ 1,609	$
Gross realized gains	14	50	10	
Gross realized losses	(5)		(3)	
Impairment losses recognized		(4)	(2)	(2)

	Six months ended			
	October 28, 2011		October 29, 2010	
(in millions)	Debt (a)	Equity (b)(c)	Debt (a)	Equity (b)
Proceeds from sales	$ 2,967	$ 53	$ 2,793	$
Gross realized gains	24	55	17	
Gross realized losses	(7)		(7)	
Impairment losses recognized	(1)	(4)	(5)	(5)

(a) Includes available-for-sale debt securities.
(b) Includes marketable equity securities, cost method, equity method, exchange-traded funds, and other investments.
(c) As a result of the Salient and PEAK acquisitions, the Company recognized a non-cash gain of $38 million during the three months ended October 28, 2011 on its previously held minority investments.

The total other-than-temporary impairment losses on available-for-sale debt securities for the three and six months ended October 28, 2011 were $1 million and $3 million, respectively, of which $1 million and $2 million, respectively, were recognized in other comprehensive income resulting in less than $1 million and $1 million, respectively, of charges being recognized in earnings. The total other-than-temporary impairment losses on available-for-sale debt securities for the three and six months ended October 29, 2010 were $8 million and $17 million, respectively, of which $6 million and $12 million, respectively, were recognized in other comprehensive income resulting in $2 million and $5 million, respectively, of charges being recognized in earnings. These charges relate to credit losses on certain mortgage-backed securities and other asset-backed securities. The amount of credit losses represents the difference between the present value of cash flows expected to be collected on these securities and the amortized cost. Based on the Company s assessment of the credit quality of the underlying collateral and credit support available to each of the remaining securities in which it invested, the Company believes it has recorded all necessary other-than-temporary impairments as the Company does not have the intent to sell, nor is it more likely than not that the Company will be required to sell, before recovery of the amortized cost.

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The following table shows the credit loss portion of other-than-temporary impairments on debt securities held by the Company as of the dates indicated and the corresponding changes in such amounts:

	Three months ended	
(in millions)	**October 28, 2011**	**October 29, 2010**
Beginning Balance	$ 20	19
Additional credit losses recognized on securities previously impaired		1
Credit losses recognized on securities previously not impaired		1
Ending Balance	$ 20	$ 21

	Six months ended	
(in millions)	**October 28, 2011**	**October 29, 2010**
Beginning Balance	$ 20	17
Additional credit losses recognized on securities previously impaired		3
Credit losses recognized on securities previously not impaired	1	2
Reductions for securities sold during the period	(1)	(1)
Ending Balance	$ 20	$ 21

The October 28, 2011 balance of available-for-sale debt securities by contractual maturity is shown in the following table at fair value. Within the table, maturities of mortgage-backed securities have been allocated based upon timing of estimated cash flows, assuming no change in the current interest rate environment. Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

(in millions)	**October 28, 2011**
Due in one year or less	$ 1,333
Due after one year through five years	4,936
Due after five years through ten years	669
Due after ten years	154
Total debt securities	$ 7,092

As of October 28, 2011 and April 29, 2011, the aggregate carrying amount of equity and other securities without a quoted market price and accounted for using the cost or equity method was $831 million and $656 million, respectively. The total carrying value of these investments is reviewed quarterly for changes in circumstance or the occurrence of events that suggest the Company s investment may not be recoverable. The fair value of cost or equity method investments is not adjusted if there are no identified events or changes in circumstances that may have a material adverse effect on the fair value of the investment. The October 28, 2011 cost method, equity method, and other investments balance includes $464 million of investments in a public company which have trading restrictions through December 31, 2013. These investments will be reclassified to available-for-sale marketable equity securities when the restriction is within one year of lapsing.

Gains and losses realized on trading securities and available-for-sale debt securities are recorded in *interest expense, net* in the condensed consolidated statements of earnings. Gains and losses realized on marketable equity securities, cost method, equity method, and other investments are recorded in *other expense (income)* in the condensed consolidated statements of earnings. In addition, unrealized gains and losses on available-for-sale debt securities are recorded in *accumulated other comprehensive loss* in the condensed consolidated balance sheets and unrealized gains and losses on trading securities are recorded in *interest expense, net* in the condensed consolidated statements of earnings. Gains and losses from the sale of investments are calculated based on the specific identification method.

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Note 7 Fair Value Measurements

The Company follows the authoritative guidance on fair value measurements and disclosures, with respect to assets and liabilities that are measured at fair value on both a recurring and nonrecurring basis. Under this guidance, fair value is defined as the exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. The authoritative guidance also establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs market participants would use in valuing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company s assumptions about the factors market participants would use in valuing the asset or liability developed based upon the best information available in the circumstances. The hierarchy is broken down into three levels. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). Descriptions of the three levels of the fair value hierarchy are discussed in Note 6 of the Company s Annual Report on Form 10-K for the year ended April 29, 2011.

See the section below titled *Valuation Techniques* for further discussion of how the Company determines fair value for financial assets and liabilities.

Assets and Liabilities That Are Measured at Fair Value on a Recurring Basis

The authoritative guidance is principally applied to financial assets and liabilities such as marketable debt and equity securities that are classified and accounted for as trading, available-for-sale, and derivative instruments. Derivatives include cash flow hedges, freestanding derivative forward contracts, and interest rate swaps. These items are marked-to-market at each reporting period. The information in the following paragraphs and tables primarily addresses matters relative to these financial assets and liabilities.

The following tables provide information by level for assets and liabilities that are measured at fair value on a recurring basis.

(in millions)	Fair Value as of October 28, 2011	Fair Value Measurements Using Inputs Considered as Level 1	Level 2	Level 3
Assets:				
Corporate debt securities	$ 2,523	$	$ 2,513	$ 10
Auction rate securities	127			127
Mortgage-backed securities	931		900	31
U.S. government and agency securities	2,885	1,556	1,329	
Foreign government and agency securities	91		91	
Certificates of deposit	97		97	
Other asset-backed securities	438		432	6
Marketable equity securities	164	164		
Exchange-traded funds	44	44		
Derivative assets	177	41	136	
Total assets	$ 7,477	$ 1,805	$ 5,498	$ 174
Liabilities:				
Derivative liabilities	$ 190	$ 180	$ 10	$
Total liabilities	$ 190	$ 180	$ 10	$

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(in millions)	Fair Value as of April 29, 2011	Fair Value Measurements Using Inputs Considered as Level 1	Level 2	Level 3
Assets:				
Corporate debt securities	$ 1,961	$	$ 1,944	$ 17
Auction rate securities	133			133
Mortgage-backed securities	785		750	35
U.S. government and agency securities	2,756	1,453	1,303	
Foreign government and agency securities	131		131	
Certificates of deposit	119		119	
Other asset-backed securities	349		343	6
Marketable equity securities	237	237		
Exchange-traded funds	39	39		
Derivative assets	130	21	109	
Total assets	$ 6,640	$ 1,750	$ 4,699	$ 191
Liabilities:				
Derivative liabilities	$ 303	$ 303	$	$
Total liabilities	$ 303	$ 303	$	$

Valuation Techniques

Financial assets that are classified as Level 1 securities include highly liquid government bonds within the U.S. government and agency securities, marketable equity securities, and exchange-traded funds for which quoted market prices are available. In addition, the Company has determined that foreign currency forward contracts will be included in Level 1 as these are valued using quoted market prices in active markets which have identical assets or liabilities.

The valuation for most fixed maturity securities are classified as Level 2. Financial assets that are classified as Level 2 include corporate debt securities, U.S. government and agency securities, foreign government and agency securities, certificates of deposit, other asset-backed securities, and certain mortgage-backed securities whose value is determined using inputs that are observable in the market or can be derived principally from or corroborated by observable market data such as pricing for similar securities, recently executed transactions, cash flow models with yield curves, and benchmark securities. In addition, interest rate swaps are included in Level 2 as the Company uses inputs other than quoted prices that are observable for the asset. The Level 2 derivative instruments are primarily valued using standard calculations and models that use readily observable market data as their basis.

Financial assets and liabilities are considered Level 3 when their fair values are determined using pricing models, discounted cash flow methodologies, or similar techniques, and at least one significant model assumption or input is unobservable. Level 3 financial assets also include certain investment securities for which there is limited market activity such that the determination of fair value requires significant judgment or estimation. Level 3 investment securities primarily include certain corporate debt securities, auction rate securities, certain mortgage-backed securities, and certain other asset-backed securities for which there was a decrease in the observability of market pricing for these investments. At October 28, 2011, these securities were valued primarily using broker pricing models that incorporate transaction details such as contractual terms, maturity, timing, and amount of expected future cash flows, as well as assumptions about liquidity and credit valuation adjustments of marketplace participants. The Company uses level 3 inputs in the measurement of contingent milestone payments and related liabilities for all acquisitions subsequent to April 24, 2009. See Note 3 for further information regarding contingent consideration.

The Company reviews the fair value hierarchy classification on a quarterly basis. Changes in the ability to observe valuation inputs may result in a reclassification of levels for certain securities within the fair value hierarchy. The Company s policy is to recognize transfers into and out of levels within the fair value hierarchy at the end of the fiscal quarter in which the actual event or change in circumstances that caused the transfer occurs. There were no significant transfers between Level 1, Level 2, or Level 3 during the three or six months ended October 28, 2011 or October 29, 2010. When a determination is made to classify an asset or liability within Level 3, the determination is based upon the significance of the unobservable inputs to the overall fair value measurement. The following tables provide a reconciliation of the beginning and ending balances of items measured at fair value on a recurring basis that used significant unobservable inputs (Level 3) for the three and six months ended October 28, 2011 and October 29, 2010:

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Three months ended October 28, 2011

(in millions)	Total Level 3 Investments	Corporate debt securities	Auction rate securities	Mortgage-backed securities	Other asset-backed securities
Balance as of July 29, 2011	$ 190	$ 17	$ 134	$ 33	$ 6
Total realized losses and other-than-temporary impairment losses included in earnings	(1)	(1)			
Total unrealized gains/(losses) included in other comprehensive income	(7)	1	(7)	(1)	
Settlements	(8)	(7)		(1)	
Balance as of October 28, 2011	$ 174	$ 10	$ 127	$ 31	$ 6

Three months ended October 29, 2010

(in millions)	Total Level 3 Investments	Corporate debt securities	Auction rate securities	Mortgage-backed securities	Other asset-backed securities
Balance as of July 30, 2010	$ 198	$ 16	$ 138	$ 37	$ 7
Total realized losses and other-than-temporary impairment losses included in earnings	(2)	(1)		(1)	
Total unrealized gains/(losses) included in other comprehensive income	9	2	5	2	
Settlements	(3)			(2)	(1)
Balance as of October 29, 2010	$ 202	$ 17	$ 143	$ 36	$ 6

Six months ended October 28, 2011

(in millions)	Total Level 3 Investments	Corporate debt securities	Auction rate securities	Mortgage-backed securities	Other asset-backed securities
Balance as of April 29, 2011	$ 191	$ 17	$ 133	$ 35	$ 6
Total realized losses and other-than-temporary impairment losses included in earnings	(2)	(1)			(1)
Total unrealized gains/(losses) included in other comprehensive income	(5)	1	(6)	(1)	1
Settlements	(10)	(7)		(3)	
Balance as of October 28, 2011	$ 174	$ 10	$ 127	$ 31	$ 6

Six months ended October 29, 2010

(in millions)	Total Level 3 Investments	Corporate debt securities	Auction rate securities	Mortgage-backed securities	Other asset-backed securities
Balance as of April 30, 2010	$ 213	$ 16	$ 142	$ 39	$ 16
Total realized losses and other-than-temporary impairment losses included in earnings	(4)	(2)		(2)	
	7	4	1	2	

Total unrealized gains/(losses) included in other comprehensive income										
Settlements		(14)		(1)				(3)		(10)
Balance as of October 29, 2010	$	202	$	17	$	143	$	36	$	6

Assets and Liabilities that are Measured at Fair Value on a Nonrecurring Basis

Non-financial assets such as equity and other securities that are accounted for using the cost or equity method, goodwill, intangible assets, and property, plant, and equipment are measured at fair value when there is an indicator of impairment and recorded at fair value only when an impairment is recognized.

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The Company holds investments in equity and other securities that are accounted for using the cost or equity method, which are classified as *long-term investments* in the condensed consolidated balance sheets. The aggregate carrying amount of these investments was $831 million as of October 28, 2011 and $656 million as of April 29, 2011. These cost or equity method investments are measured at fair value on a nonrecurring basis. The fair value of the Company s cost or equity method investments is not estimated if there are no identified events or changes in circumstance that may have a significant adverse effect on the fair value of these investments. During the three and six months ended October 28, 2011 and October 29, 2010, the Company determined that the fair values of certain cost method investments were below their carrying values and that the carrying values of these investments were not expected to be recoverable within a reasonable period of time. As a result, the Company recognized $4 million in impairment charges during the three and six months ended October 28, 2011, and $2 million and $5 million in impairment charges during the three and six months ended October 29, 2010, respectively. The impairment charges related to the cost method investments were recorded in *other expense (income)* in the condensed consolidated statements of earnings. These investments fall within Level 3 of the fair value hierarchy due to the use of significant unobservable inputs to determine fair value, as the investments are privately held entities without quoted market prices. To determine the fair value of these investments, the Company used all pertinent financial information that was available related to the entities, including financial statements and market participant valuations from recent and proposed equity offerings.

The Company assesses the impairment of intangible assets whenever events or changes in circumstances indicate that the carrying amount of an intangible asset may not be recoverable. The aggregate carrying amount of intangible assets was $2.875 billion as of October 28, 2011 and $2.777 billion as of April 29, 2011, respectively. These assets are measured at fair value on a nonrecurring basis. The fair value of the Company s intangible assets is not estimated if there is no change in events or circumstances that indicate the carrying amount of an intangible asset may not be recoverable. The Company did not record any intangible asset impairments during the three and six months ended October 28, 2011 or October 29, 2010.

The Company assesses the impairment of goodwill annually or whenever an event occurs or circumstances change that would indicate that the carrying amount may be impaired. The aggregate carrying amount of goodwill was $9.944 billion as of October 28, 2011 and $9.537 billion as of April 29, 2011, respectively. These assets are measured at fair value on a nonrecurring basis. The fair value of the Company s goodwill is not estimated if there is no change in events or circumstances that indicate the carrying amount may be impaired. The Company did not record any goodwill impairments during the three and six months ended October 28, 2011 or October 29, 2010.

The Company assesses the impairment of property, plant, and equipment whenever events or changes in circumstances indicate that the carrying amount of a property, plant, and equipment asset may not be recoverable. The Company did not recognize any significant impairments of property, plant, and equipment during the three and six months ended October 28, 2011 or October 29, 2010.

Financial Instruments Not Measured at Fair Value

The estimated fair value of the Company s long-term debt, including the short-term portion, as of October 28, 2011 was $8.784 billion compared to a principal value of $8.078 billion, and as of April 29, 2011 was $8.524 billion compared to a principal value of $8.096 billion. Fair value was estimated using quoted market prices for the same or similar instruments. The fair values and principal values consider the terms of the related debt and exclude the impacts of debt discounts, and derivative/hedging activity.

Note 8 Financing Arrangements

Senior Convertible Notes

In April 2006, the Company issued $2.200 billion of 1.500 percent Senior Convertible Notes due 2011 (2011 Senior Convertible Notes) and $2.200 billion of 1.625 percent Senior Convertible Notes due 2013 (2013 Senior Convertible Notes) (collectively, the Senior Convertible Notes). The Senior Convertible Notes were issued at par and pay interest in cash semi-annually in arrears on April 15 and October 15 of each year. The 2011 Senior Convertible Notes were repaid in April 2011. The 2013 Senior Convertible Notes are unsecured unsubordinated obligations and rank equally with all other unsecured and unsubordinated indebtedness.

Concurrent with the issuance of the Senior Convertible Notes, the Company purchased call options on its common stock in private transactions. The call options allow the Company to receive shares of the Company s common stock and/or cash from counterparties equal to the amounts of common stock and/or cash related to the excess conversion value that it would pay to the holders of the 2013 Senior Convertible Notes upon conversion.

In separate transactions, the Company sold warrants to issue shares of the Company s common stock at an exercise price of $76.56 per share in private transactions. Pursuant to these transactions, warrants for 41 million shares of the Company s common stock may be settled over a specified period beginning in July 2011 and warrants for 41 million shares of the Company s common stock may be settled over a specified period beginning in July 2013. As of October 28, 2011, warrants for 31 million shares of the Company s common stock expired.

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Under the authoritative guidance, the Company concluded that the purchased call options and sold warrants were indexed to its own stock and should continue to be classified in shareholders equity and not be separated as a derivative.

Authoritative guidance provides that contracts are initially classified as equity if (1) the contract requires physical settlement or net-share settlement, or (2) the contract gives the Company a choice of net-cash settlement or settlement in its own shares (physical settlement or net-share settlement). The settlement terms of the Company s purchased call options and sold warrant contracts provide for net cash settlement for the particular contract or net share settlement, depending on the method of settlement, as discussed above, which is at the option of the Company. Based on existing guidance, the purchased call option contracts were recorded as a reduction of equity and the warrants were recorded as an addition to equity as of the trade date. Existing guidance states that a reporting entity shall not consider contracts to be derivative instruments if the contract issued or held by the reporting entity is both indexed to its own stock and classified in shareholders equity in its statement of financial position. The Company concluded the purchased call option contracts and the warrant contracts should be accounted for in shareholders equity.

The Company accounted for the Senior Convertible Notes in accordance with the authoritative guidance for convertible debt, which requires the proceeds from the issuance of the Senior Convertible Notes to be allocated between a liability component (issued at a discount) and an equity component. The resulting debt discount is amortized over the period the 2013 Senior Convertible Notes are expected to be outstanding as additional non-cash interest expense.

The following table provides equity and debt information for the 2013 Senior Convertible Notes under the convertible debt guidance.

	2013 Senior Convertible Notes	
(in millions)	**October 28, 2011**	**April 29, 2011**
Carrying amount of the equity component	$ 547	$ 547
Principal amount of the 2013 Senior Convertible Notes	$ 2,200	$ 2,200
Unamortized discount	(134)	(177)
Net carrying amount	$ 2,066	$ 2,023

As of October 28, 2011, the unamortized balance of the debt discount will be amortized over the remaining life of the 2013 Senior Convertible Notes, which is approximately two years. The following table provides interest rate and interest expense amounts related to the Senior Convertible Notes.

	2011 Senior Convertible Notes Three months ended		**2013 Senior Convertible Notes Three months ended**	
(in millions, except interest rate)	**October 28, 2011**	**October 29, 2010**	**October 28, 2011**	**October 29, 2010**
Effective interest rate	%	5.97%	6.03%	6.03%
Interest cost related to contractual interest coupon	$	$ 8	$ 9	$ 9
Interest cost related to amortization of the discount	$	$ 23	$ 21	$ 20

	2011 Senior Convertible Notes Six months ended		**2013 Senior Convertible Notes Six months ended**	
(in millions, except interest rate)	**October 28, 2011**	**October 29, 2010**	**October 28, 2011**	**October 29, 2010**
Effective interest rate	%	5.97%	6.03%	6.03%
Interest cost related to contractual interest coupon	$	$ 16	$ 18	$ 18
Interest cost related to amortization of the discount	$	$ 46	$ 43	$ 40