

MEDTRONIC INC  
Form 10-Q  
December 05, 2012

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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 26, 2012**  
**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) (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  Accelerated filer   
Non-accelerated filer  Smaller Reporting Company

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 November 30, 2012: 1,011,357,750

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## PART I FINANCIAL INFORMATION

**Item 1. Financial Statements**

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

|  | Three months ended                   |                     | Six months ended    |                     |
|--|--------------------------------------|---------------------|---------------------|---------------------|
|  | October 26,<br>2012                  | October 28,<br>2011 | October 26,<br>2012 | October 28,<br>2011 |
|  | (in millions, except per share data) |                     |                     |                     |
| <b>Net sales</b>   | \$ 4,095                             | \$ 4,023            | \$ 8,103            | \$ 7,969            |
| <b>Costs and expenses:</b>                                     |                                      |                     |                     |                     |
| Cost of products sold  | 1,020                                | 960                 | 1,993               | 1,911               |
| Research and development expense                               | 387                                  | 371                 | 772                 | 733                 |
| Selling, general, and administrative expense                   | 1,417                                | 1,410               | 2,822               | 2,790               |
| Certain litigation charges, net                                | 245                                  |                     | 245                 |                     |
| Acquisition-related items                                      | 6                                    | (24)                | 11                  | (16)                |
| Amortization of intangible assets                              | 79                                   | 85                  | 159                 | 171                 |
| Other expense, net   | 63                                   | 140                 | 102                 | 249                 |
| Interest expense, net  | 24                                   | 38                  | 57                  | 70                  |
| <b>Total costs and expenses</b>                                | 3,241                                | 2,980               | 6,161               | 5,908               |
| <b>Earnings from continuing operations before income taxes</b> | 854                                  | 1,043               | 1,942               | 2,061               |
| <b>Provision for income taxes</b>                              | 208                                  | 179                 | 432                 | 378                 |
| <b>Earnings from continuing operations</b>                     | 646                                  | 864                 | 1,510               | 1,683               |
| <b>Discontinued operations, net of tax:</b>                    |                                      |                     |                     |                     |
| Earnings from operations of Physio-Control                     |                                      | 12                  |                     | 17                  |
| Physio-Control divestiture-related costs                       |                                      | (5)                 |                     | (8)                 |
| <b>Earnings from discontinued operations</b>                   |                                      | 7                   |                     | 9                   |
| <b>Net earnings</b>  | \$ 646                               | \$ 871              | \$ 1,510            | \$ 1,692            |
| <b>Basic earnings per share:</b>                               |                                      |                     |                     |                     |
| Earnings from continuing operations                            | \$ 0.63                              | \$ 0.82             | \$ 1.47             | \$ 1.59             |
| Net earnings   | \$ 0.63                              | \$ 0.82             | \$ 1.47             | \$ 1.60             |
| <b>Diluted earnings per share:</b>                             |                                      |                     |                     |                     |
| Earnings from continuing operations                            | \$ 0.63                              | \$ 0.81             | \$ 1.46             | \$ 1.58             |
| Net earnings   | \$ 0.63                              | \$ 0.82             | \$ 1.46             | \$ 1.59             |
| <b>Basic weighted average shares outstanding</b>               | 1,019.4                              | 1,058.1             | 1,024.4             | 1,060.6             |
| <b>Diluted weighted average shares outstanding</b>             | 1,027.8                              | 1,063.1             | 1,032.2             | 1,066.2             |
| Cash dividends declared per common share                       | \$ 0.2600                            | \$ 0.2425           | \$ 0.5200           | \$ 0.4850           |

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

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MEDTRONIC, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (Unaudited)

|   | Three months ended  |                     | Six months ended    |                     |
|---|---------------------|---------------------|---------------------|---------------------|
|   | October 26,<br>2012 | October 28,<br>2011 | October 26,<br>2012 | October 28,<br>2011 |
|   | (in millions)       |                     |                     |                     |
| <b>Net earnings</b>   | \$ 646              | \$ 871              | \$ 1,510            | \$ 1,692            |
| <b>Other comprehensive income/(loss), net of tax:</b>   |                     |                     |                     |                     |
| Unrealized gain/(loss) on investments, net of tax expense/(benefit) of \$1, \$(28), \$4, and \$28, respectively     | 1                   | (57)                | 7                   | 48                  |
| Translation adjustment  | 89                  | (97)                | (27)                | (83)                |
| Net change in retirement obligations, net of tax expense of \$6, \$6, \$19, and \$12, respectively                  | 5                   | 15                  | 35                  | 23                  |
| Unrealized gain/(loss) on derivatives, net of tax expense/(benefit) of \$(36), \$42, \$(16), and \$48, respectively | (64)                | 67                  | (26)                | 80                  |
| <b>Other comprehensive income/(loss)</b>  | 31                  | (72)                | (11)                | 68                  |
| <b>Comprehensive income</b>   | \$ 677              | \$ 799              | \$ 1,499            | \$ 1,760            |

*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 26,<br>2012                  | April 27,<br>2012 |
|---|--------------------------------------|-------------------|
|   | (in millions, except per share data) |                   |
| <b>ASSETS</b>   |                                      |                   |
| <b>Current assets:</b>  |                                      |                   |
| Cash and cash equivalents   | \$ 1,759                             | \$ 1,248          |
| Short-term investments  | 916                                  | 1,344             |
| Accounts receivable, less allowances of \$102 and \$100, respectively | 3,612                                | 3,808             |
| Inventories   | 1,877                                | 1,800             |
| Deferred tax assets, net  | 595                                  | 640               |
| Prepaid expenses and other current assets                             | 676                                  | 675               |
| <b>Total current assets</b>   | <b>9,435</b>                         | <b>9,515</b>      |
| Property, plant, and equipment  | 5,967                                | 5,796             |
| Accumulated depreciation  | (3,520)                              | (3,323)           |
| <b>Property, plant, and equipment, net</b>                            | <b>2,447</b>                         | <b>2,473</b>      |
| <b>Goodwill</b>   | <b>9,944</b>                         | <b>9,934</b>      |
| <b>Other intangible assets, net</b>                                   | <b>2,500</b>                         | <b>2,647</b>      |
| <b>Long-term investments</b>  | <b>8,816</b>                         | <b>7,705</b>      |
| <b>Long-term deferred tax assets, net</b>                             | <b>468</b>                           | <b>504</b>        |
| <b>Other assets</b>   | <b>350</b>                           | <b>305</b>        |
| <b>Total assets</b>   | <b>\$ 33,960</b>                     | <b>\$ 33,083</b>  |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                           |                                      |                   |
| <b>Current liabilities:</b>   |                                      |                   |
| Short-term borrowings   | \$ 4,097                             | \$ 3,274          |
| Accounts payable  | 551                                  | 565               |
| Accrued compensation  | 717                                  | 912               |
| Accrued income taxes  | 113                                  | 65                |
| Deferred tax liabilities, net   | 28                                   | 33                |
| Other accrued expenses  | 1,115                                | 1,008             |
| <b>Total current liabilities</b>                                      | <b>6,621</b>                         | <b>5,857</b>      |
| <b>Long-term debt</b>   | <b>7,355</b>                         | <b>7,359</b>      |
| <b>Long-term accrued compensation and retirement benefits</b>         | <b>809</b>                           | <b>759</b>        |
| <b>Long-term accrued income taxes</b>                                 | <b>985</b>                           | <b>1,005</b>      |
| <b>Long-term deferred tax liabilities, net</b>                        | <b>584</b>                           | <b>611</b>        |
| <b>Other long-term liabilities</b>                                    | <b>431</b>                           | <b>379</b>        |
| <b>Total liabilities</b>  | <b>16,785</b>                        | <b>15,970</b>     |
| <b>Commitments and contingencies (Notes 4 and 19)</b>                 |                                      |                   |
| <b>Shareholders' equity:</b>  |                                      |                   |
| Preferred stock - par value \$1.00                                    |                                      |                   |
| Common stock - par value \$0.10                                       | 101                                  | 104               |
| Retained earnings   | 17,558                               | 17,482            |
| Accumulated other comprehensive loss                                  | (484)                                | (473)             |
| <b>Total shareholders' equity</b>                                     | <b>17,175</b>                        | <b>17,113</b>     |
| <b>Total liabilities and shareholders' equity</b>                     | <b>\$ 33,960</b>                     | <b>\$ 33,083</b>  |

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 26,<br>2012 | October 28,<br>2011 |
|   | (in millions)       |                     |
| <b>Operating Activities:</b>  |                     |                     |
| Net earnings  | \$ 1,510            | \$ 1,692            |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                     |                     |
| Depreciation and amortization   | 396                 | 424                 |
| Amortization of discount on senior convertible notes                                | 46                  | 42                  |
| Acquisition-related items   | 3                   | 17                  |
| Provision for doubtful accounts   | 26                  | 32                  |
| Deferred income taxes   | 52                  | (58)                |
| Stock-based compensation  | 85                  | 90                  |
| Change in operating assets and liabilities, net of effect of acquisitions:          |                     |                     |
| Accounts receivable, net  | 123                 | (119)               |
| Inventories   | (71)                | (147)               |
| Accounts payable and accrued liabilities  | (185)               | (292)               |
| Other operating assets and liabilities  | 28                  | 606                 |
| Certain litigation charges, net   | 245                 |                     |
| Certain litigation payments   | (91)                |                     |
| <b>Net cash provided by operating activities</b>                                    | <b>2,167</b>        | <b>2,287</b>        |
| <b>Investing Activities:</b>  |                     |                     |
| Acquisitions, net of cash acquired  | (23)                | (556)               |
| Additions to property, plant, and equipment   | (211)               | (269)               |
| Purchases of marketable securities  | (5,494)             | (3,866)             |
| Sales and maturities of marketable securities                                       | 4,865               | 3,008               |
| Other investing activities, net   | (6)                 | (60)                |
| <b>Net cash used in investing activities</b>  | <b>(869)</b>        | <b>(1,743)</b>      |
| <b>Financing Activities:</b>  |                     |                     |
| Acquisition-related contingent consideration  | (15)                | (62)                |
| Change in short-term borrowings, net  | 775                 | 302                 |
| Payments on long-term debt  | (8)                 | (15)                |
| Dividends to shareholders   | (533)               | (514)               |
| Issuance of common stock  | 103                 | 45                  |
| Repurchase of common stock  | (1,084)             | (600)               |
| <b>Net cash used in financing activities</b>  | <b>(762)</b>        | <b>(844)</b>        |
| Effect of exchange rate changes on cash and cash equivalents                        | (25)                | (34)                |
| <b>Net change in cash and cash equivalents</b>                                      | <b>511</b>          | <b>(334)</b>        |
| Cash and cash equivalents at beginning of period                                    | 1,248               | 1,382               |
| <b>Cash and cash equivalents at end of period</b>                                   | <b>\$ 1,759</b>     | <b>\$ 1,048</b>     |
| <b>Supplemental Cash Flow Information</b>   |                     |                     |
| Cash paid for:  |                     |                     |
| Income taxes  | \$ 364              | \$ 99               |
| Interest  | 184                 | 161                 |

The condensed consolidated statement of cash flows for the prior period includes the activities of the discontinued operations.  
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 27, 2012.

On January 30, 2012, the Company completed its sale of Physio-Control. Beginning in the third quarter of fiscal year 2012, the results of operations, assets, and liabilities of the Physio-Control business, which were previously presented as a component of the Cardiac and Vascular Group operating segment, are classified as discontinued operations. All information in the following notes to the condensed consolidated financial statements includes only results from continuing operations (excluding Physio-Control) for all periods presented, unless otherwise noted. For further information regarding discontinued operations, see Note 3.

The Company's fiscal years 2013, 2012, and 2011 will end or ended on April 26, 2013, April 27, 2012, and April 29, 2011, respectively.

#### Note 2 New Accounting Pronouncements

##### *Recently Adopted*

In June 2011, and as subsequently amended in December 2011, the Financial Accounting Standards Board (FASB) issued final guidance on the presentation of comprehensive income. Under the newly issued guidance, net income and comprehensive income may only be presented either as one continuous statement or in two separate, but consecutive statements. The Company retrospectively adopted this guidance in the first quarter of fiscal year 2013, with comprehensive income shown as a separate statement immediately following the condensed consolidated statements of earnings. Since the new guidance only relates to presentation, its adoption did not impact the Company's financial position, results of operations, or cash flows.

In September 2011, the FASB updated the accounting guidance related to annual and interim goodwill impairment testing. 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 Company adopted this guidance in the first quarter of fiscal year 2013. The adoption did not have a material impact on the Company's consolidated financial statements.

##### *Not Yet Adopted*

In December 2011, the FASB issued new accounting guidance related to disclosures on offsetting assets and liabilities on the balance sheet. This newly issued accounting standard requires an entity to disclose both gross and net information about instruments and transactions eligible for offset in the balance sheet as well as instruments and transactions executed under a master netting or similar arrangement and was issued to enable users of financial statements to understand the effects or potential effects of those arrangements on its financial position. This accounting guidance is required to be applied retrospectively and is effective for the Company beginning in the first quarter of fiscal year 2014. Since the accounting guidance only impacts disclosure requirements, its adoption will not have a material impact on the Company's consolidated financial statements.

In July 2012, the FASB updated the accounting guidance related to annual and interim indefinite-lived intangible asset impairment testing. The updated accounting guidance allows entities to first assess qualitative factors before performing a quantitative assessment of the fair value of indefinite-lived intangible assets. If it is determined on the basis of qualitative factors that the fair value of indefinite-lived intangible assets 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 2014 with early adoption permitted under certain circumstances. The Company will adopt this accounting guidance in the first quarter of fiscal year 2014 and does not expect it to have a material impact on the Company's consolidated financial statements.



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

### Note 3 Discontinued Operations

Beginning in the third quarter of fiscal year 2012, the results of operations, assets, and liabilities of the Physio-Control business, which were previously presented as a component of the Cardiac and Vascular Group operating segment, are classified as discontinued operations.

On January 30, 2012, the Company completed the sale of the Physio-Control business to Bain Capital Partners, LLC. The Company sold \$164 million in net assets and received \$386 million in net cash, excluding potential earn-outs. Additionally, the Company entered into a Transition Services Agreement (TSA) with Physio-Control in which the Company is providing transition services to ensure continuity of operations for Physio-Control as it establishes stand-alone processes separate from Medtronic. The TSA requires the Company to continue to provide certain back-office support functions to Physio-Control in the areas of finance, facilities, human resources, customer service, IT, quality and regulatory, and operations. The timeframe for these services is expected to extend through the end of fiscal year 2013. The Company is being compensated for the services specified in the TSA. The Company records the income earned from the TSA in *other expense, net* in the condensed consolidated statements of earnings.

The following is a summary of the operating results of Physio-Control for discontinued operations for the three and six months ended October 28, 2011:

| (in millions)                                | Three months ended<br>October 28,<br>2011 | Six months ended<br>October 28,<br>2011 |
|--|---|---|
| <b>Discontinued operations:</b>              |   |   |
| Net sales                                    | \$ 109                                    | \$ 211                                  |
| Earnings from operations of Physio-Control   | \$ 17                                     | \$ 25                                   |
| Physio-Control divestiture-related costs     | (7)                                       | (12)                                    |
| Income tax expense                           | (3)                                       | (4)                                     |
| <b>Earnings from discontinued operations</b> | <b>\$ 7</b>                               | <b>\$ 9</b>                             |

As Physio-Control was sold on January 30, 2012, only the prior period results are presented in the table above.

The Company reclassified \$12 million of Physio-Control divestiture-related costs previously recorded in *acquisition-related items* within continuing operations on the condensed consolidated statements of earnings in the first and second quarters of fiscal year 2012 to discontinued operations. For further information on Physio-Control assets and liabilities sold, see Note 3 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended April 27, 2012.

### Note 4 Acquisitions and Acquisition-Related Items

The Company had no significant acquisitions during the three and six months ended October 26, 2012. The Company had various acquisitions and other acquisition-related activity during the first two quarters of fiscal year 2012. 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 is recorded based on estimates of the fair values 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. 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 26, 2012*

#### *Subsequent Acquisition*

On November 1, 2012, the Company acquired China Kanghui Holdings (Kanghui). Kanghui is a Chinese manufacturer and distributor of orthopedic products in trauma, spine, and joint reconstruction. Total consideration for the transaction was approximately \$816 million. The total value of the transaction, net of Kanghui's cash, was approximately \$755 million.



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

### *Acquisition-Related Items*

During the three and six months ended October 26, 2012, the Company recorded acquisition-related items of \$6 million and \$11 million, respectively, including income of \$2 million and charges of \$3 million, respectively, related to the change in fair value of contingent milestone payments associated with acquisitions subsequent to April 29, 2009. Additionally, during the three and six months ended October 26, 2012, the Company incurred charges of \$3 million in connection with the acquisition of Kanghui and \$5 million of transaction costs related to the divestiture of the Physio-Control business.

### *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 \$154 million of technology-based intangible assets that had an estimated useful life of 12 years at the time of acquisition, \$44 million of in-process research and development (IPR&D), \$49 million of net tangible liabilities, and \$348 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.

The Company accounted for the acquisition of Salient as a business combination. During fiscal year 2012, the Company recorded minor adjustments to other intangible assets, goodwill, and long-term deferred tax liabilities as a result of finalizing the valuation for fair value of intangible assets acquired. The Company recorded the identifiable assets acquired and liabilities assumed at fair value as follows:

| <b>(in millions)</b>                    |               |
|---|---------------|
| Current assets                          | \$ 20         |
| Property, plant, and equipment          | 11            |
| IPR&D                                   | 44            |
| Other intangible assets                 | 154           |
| Goodwill                                | 348           |
| Other assets                            | 1             |
| <b>Total assets acquired</b>            | <b>578</b>    |
| Current liabilities                     | 43            |
| Long-term deferred tax liabilities, net | 38            |
| <b>Total liabilities assumed</b>        | <b>81</b>     |
| <b>Net assets acquired</b>              | <b>\$ 497</b> |

#### *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.

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

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

| <b>(in millions)</b>                    |               |
|---|---------------|
| Current assets                          | \$ 5          |
| Property, plant, and equipment          | 5             |
| Other intangible assets                 | 74            |
| Goodwill                                | 56            |
| <b>Total assets acquired</b>            | <b>140</b>    |
| <br>                                    |               |
| Current liabilities                     | 10            |
| Long-term deferred tax liabilities, net | 17            |
| <b>Total liabilities assumed</b>        | <b>27</b>     |
| <b>Net assets acquired</b>              | <b>\$ 113</b> |
| <i>Acquisition-Related Items</i>        |               |

During the three and six months ended October 28, 2011, the Company recorded a net gain from acquisition-related items of \$24 million and \$16 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.

### *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 or achieving product development targets. Contingent consideration is recorded at the estimated fair value of the contingent milestone payments 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 8 for further information regarding fair value measurements.

Contingent consideration liabilities are remeasured to fair value each reporting period using projected revenues, discount rates, probabilities of payment, and projected payment dates. Projected contingent payment amounts are discounted back to the current period using a discounted cash flow model. Projected revenues are based on the Company's most recent internal operational budgets and long-range strategic plans. Increases in projected revenues and probabilities of payment may result in higher fair value measurements. Increases in discount rates and the projected time to payment may result in lower fair value measurements. Increases (decreases) in any of those inputs in isolation may result in a significantly lower (higher) fair value measurement.

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The recurring Level 3 fair value measurements of the contingent consideration liability include the following significant unobservable inputs:

| (\$ in millions)                   | Fair Value at<br>October 26,<br>2012 | Valuation Technique  | Unobservable Input               | Range       |
|------------------------------------|--------------------------------------|----------------------|----------------------------------|-------------|
|                                    |                                      |                      | Revenue-based payments           | \$208       |
|                                    |                                      |                      | Probability of payment           | 25% - 100%  |
|                                    |                                      |                      | Projected fiscal year of payment | 2013 - 2019 |
|                                    |                                      |                      | Discount rate                    | 5.9%        |
| Product development-based payments | \$5                                  | Discounted cash flow | Probability of payment           | 100%        |
|                                    |                                      |                      | Projected fiscal year of payment | 2013        |

At October 26, 2012, 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 \$226 million. The milestones associated with the contingent consideration must be reached in future periods ranging from fiscal years 2013 to 2018 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 26, 2012 and April 27, 2012 at \$213 million and \$231 million, respectively. As of October 26, 2012, \$195 million was reflected in *other long-term liabilities* and \$18 million was reflected in *other accrued expenses* in the condensed consolidated balance sheet. As of April 27, 2012, \$200 million was reflected in *other long-term liabilities* and \$31 million was reflected in *other accrued expenses* in the condensed consolidated balance sheet. The portion of the milestone payments related to the acquisition date fair value of contingent consideration has been reported as financing activities in the condensed consolidated statements of cash flows. Amounts paid in excess of the original acquisition date fair value of contingent consideration have been reported as operating activities in the condensed consolidated statements of cash flows. 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):

| (in millions)                                    | Three months ended  |                     | Six months ended    |                     |
|--|---------------------|---------------------|---------------------|---------------------|
|  | October 26,<br>2012 | October 28,<br>2011 | October 26,<br>2012 | October 28,<br>2011 |
| <b>Beginning Balance</b>                         | \$ 215              | \$ 343              | \$ 231              | \$ 335              |
| Purchase price contingent consideration          |                     | 2                   | 5                   | 2                   |
| Contingent milestone payments                    |                     | (66)                | (26)                | (66)                |
| Change in fair value of contingent consideration | (2)                 | 9                   | 3                   | 17                  |
| <b>Ending Balance</b>                            | \$ 213              | \$ 288              | \$ 213              | \$ 288              |

Note 5 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 26, 2012, the Company recorded certain litigation charges, net of \$245 million relating to probable and reasonably estimated damages resulting from patent litigation with Edwards Lifesciences, Inc. See Note 19 for additional information.

During the three and six months ended October 28, 2011, there were no certain litigation charges, net.



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Note 6 Restructuring Charges

During the three and six months ended October 26, 2012 and October 28, 2011, the Company did not incur any restructuring charges.

*Fiscal Year 2012 Initiative*

In the fourth quarter of fiscal year 2012, the Company recorded a \$118 million restructuring charge, which consisted of employee termination costs of \$66 million, asset write-downs of \$9 million, contract termination costs of \$30 million, and other related costs of \$13 million. The fiscal year 2012 initiative was designed to reduce general, administrative, and indirect distribution costs in certain organizations within the Company while prioritizing investment in research and development, and sales and marketing in those organizations within the Company where faster growth is anticipated, such as emerging markets and new therapies.

In connection with the fiscal year 2012 initiative, as of the end of the fourth quarter of fiscal year 2012, the Company had identified approximately 1,000 positions for elimination to be achieved through involuntary and voluntary separation. Of the 1,000 positions identified, approximately 600 positions have been eliminated as of October 26, 2012. The fiscal year 2012 initiative is scheduled to be substantially complete by the end of the fourth quarter of fiscal year 2013.

A summary of the activity related to the fiscal year 2012 initiative is presented below:

| (in millions)                         | Fiscal Year 2012 Initiative |                   |             |       |
|---------------------------------------|-----------------------------|-------------------|-------------|-------|
|                                       | Employee Termination Costs  | Asset Write-downs | Other Costs | Total |
| <b>Balance as of April 29, 2011</b>   | \$                          | \$                | \$          | \$    |
| Restructuring charges                 | 66                          | 9                 | 43          | 118   |
| Payments/write-downs                  | (2)                         | (9)               | (16)        | (27)  |
| <b>Balance as of April 27, 2012</b>   | \$ 64                       | \$                | \$ 27       | \$ 91 |
| Payments/write-downs                  | (26)                        |                   | (17)        | (43)  |
| <b>Balance as of July 27, 2012</b>    | \$ 38                       | \$                | \$ 10       | \$ 48 |
| Payments/write-downs                  | (17)                        |                   | (4)         | (21)  |
| <b>Balance as of October 26, 2012</b> | \$ 21                       | \$                | \$ 6        | \$ 27 |

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Note 7 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 26, 2012 is as follows:

| (in millions)  | Cost            | Unrealized Gains | Unrealized Losses | Fair Value      |
|--|-----------------|------------------|-------------------|-----------------|
| <b>Available-for-sale securities:</b>                    |                 |                  |                   |                 |
| Corporate debt securities                                | \$ 3,627        | \$ 75            | \$ (5)            | \$ 3,697        |
| Auction rate securities                                  | 153             |                  | (24)              | 129             |
| Mortgage-backed securities                               | 1,060           | 9                | (9)               | 1,060           |
| U.S. government and agency securities                    | 3,501           | 14               | (2)               | 3,513           |
| Foreign government and agency securities                 | 47              |                  |                   | 47              |
| Certificates of deposit                                  | 6               |                  |                   | 6               |
| Other asset-backed securities                            | 490             | 3                | (1)               | 492             |
| Marketable equity securities                             | 101             | 162              | (3)               | 260             |
| <b>Trading securities:</b>                               |                 |                  |                   |                 |
| Exchange-traded funds                                    | 44              | 2                | (1)               | 45              |
| <b>Cost method, equity method, and other investments</b> | 483             |                  |                   | 483             |
| <b>Total short-term and long-term investments</b>        | <b>\$ 9,512</b> | <b>\$ 265</b>    | <b>\$ (45)</b>    | <b>\$ 9,732</b> |

Information regarding the Company's short-term and long-term investments at April 27, 2012 is as follows:

| (in millions)  | Cost            | Unrealized Gains | Unrealized Losses | Fair Value      |
|--|-----------------|------------------|-------------------|-----------------|
| <b>Available-for-sale securities:</b>                    |                 |                  |                   |                 |
| Corporate debt securities                                | \$ 3,501        | \$ 47            | \$ (7)            | \$ 3,541        |
| Auction rate securities                                  | 153             |                  | (26)              | 127             |
| Mortgage-backed securities                               | 840             | 9                | (10)              | 839             |
| U.S. government and agency securities                    | 3,046           | 38               |                   | 3,084           |
| Foreign government and agency securities                 | 67              |                  |                   | 67              |
| Certificates of deposit                                  | 47              |                  |                   | 47              |
| Other asset-backed securities                            | 535             | 3                | (1)               | 537             |
| Marketable equity securities                             | 100             | 158              | (5)               | 253             |
| <b>Trading securities:</b>                               |                 |                  |                   |                 |
| Exchange-traded funds                                    | 45              | 2                | (1)               | 46              |
| <b>Cost method, equity method, and other investments</b> | 508             |                  |                   | 508             |
| <b>Total short-term and long-term investments</b>        | <b>\$ 8,842</b> | <b>\$ 257</b>    | <b>\$ (50)</b>    | <b>\$ 9,049</b> |

Information regarding the Company's available-for-sale and trading securities at October 26, 2012 and April 27, 2012 is as follows:

| (in millions)                 | October 26, 2012 |                 | April 27, 2012  |                 |
|-------------------------------|------------------|-----------------|-----------------|-----------------|
|                               | Short-term       | Long-term       | Short-term      | Long-term       |
| Available-for-sale securities | \$ 916           | \$ 8,288        | \$ 1,344        | \$ 7,151        |
| Trading securities            |                  | 45              |                 | 46              |
| <b>Total</b>                  | <b>\$ 916</b>    | <b>\$ 8,333</b> | <b>\$ 1,344</b> | <b>\$ 7,197</b> |

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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 26, 2012 and April 27, 2012:

| (in millions)                         | October 26, 2012    |                   |                     |                   |
|---------------------------------------|---------------------|-------------------|---------------------|-------------------|
|                                       | Less than 12 months |                   | More than 12 months |                   |
|                                       | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses |
| Corporate debt securities             | \$ 411              | \$ (1)            | \$ 31               | \$ (4)            |
| Auction rate securities               |                     |                   | 128                 | (24)              |
| Mortgage-backed securities            | 364                 | (2)               | 71                  | (7)               |
| U.S. government and agency securities | 1,648               | (2)               |                     |                   |
| Other asset-backed securities         |                     |                   | 2                   | (1)               |
| Marketable equity securities          | 18                  | (3)               |                     |                   |
| Total                                 | \$ 2,441            | \$ (8)            | \$ 232              | \$ (36)           |

| (in millions)                 | April 27, 2012      |                   |                     |                   |
|-------------------------------|---------------------|-------------------|---------------------|-------------------|
|                               | Less than 12 months |                   | More than 12 months |                   |
|                               | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses |
| Corporate debt securities     | \$ 664              | \$ (4)            | \$ 16               | \$ (3)            |
| Auction rate securities       |                     |                   | 127                 | (26)              |
| Mortgage-backed securities    | 218                 | (2)               | 57                  | (8)               |
| Other asset-backed securities | 55                  |                   | 9                   | (1)               |
| Marketable equity securities  | 24                  | (5)               |                     |                   |
| Total                         | \$ 961              | \$ (11)           | \$ 209              | \$ (38)           |

At October 26, 2012, 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 basis.

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

| (in millions)                | Three months ended |            |                  |               |
|------------------------------|--------------------|------------|------------------|---------------|
|                              | October 26, 2012   |            | October 28, 2011 |               |
|                              | Debt (a)           | Equity (b) | Debt (a)         | Equity (b)(c) |
| Proceeds from sales          | \$ 3,382           | \$ 41      | \$ 1,406         | \$ 12         |
| Gross realized gains         | 24                 | 29         | 14               | 50            |
| Gross realized losses        | (3)                |            | (5)              |               |
| Impairment losses recognized |                    | (4)        |                  | (4)           |

| (in millions)                | Six months ended |            |                  |               |
|------------------------------|------------------|------------|------------------|---------------|
|                              | October 26, 2012 |            | October 28, 2011 |               |
|                              | Debt (a)         | Equity (b) | Debt (a)         | Equity (b)(c) |
| Proceeds from sales          | \$ 4,800         | \$ 65      | \$ 2,967         | \$ 53         |
| Gross realized gains         | 41               | 37         | 24               | 55            |
| Gross realized losses        | (7)              |            | (7)              |               |
| Impairment losses recognized |                  | (10)       | (1)              | (4)           |

(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 26, 2012 were less than \$1 million and \$1 million, respectively, of which less than \$1 million and \$1 million, respectively, were recognized in other comprehensive income and less than \$1 million was recognized in earnings in both periods. 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 and less than \$1 million and \$1 million, respectively, were 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 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.

The following tables show 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:

| (in millions)  | Three months ended |                  |
|--|--------------------|------------------|
|  | October 26, 2012   | October 28, 2011 |
| <b>Beginning Balance</b>                                       | \$ 20              | \$ 20            |
| Credit losses recognized on securities previously not impaired |                    |                  |
| Reductions for securities sold during the period               |                    |                  |
| <b>Ending Balance</b>  | \$ 20              | \$ 20            |

| (in millions)  | Six months ended |                  |
|--|------------------|------------------|
|  | October 26, 2012 | October 28, 2011 |
| <b>Beginning Balance</b>                                       | \$ 20            | \$ 20            |
| Credit losses recognized on securities previously not impaired |                  | 1                |
| Reductions for securities sold during the period               |                  | (1)              |
| <b>Ending Balance</b>  | \$ 20            | \$ 20            |

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The October 26, 2012 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 26,<br>2012 |
|--|---------------------|
| Due in one year or less                | \$ 1,330            |
| Due after one year through five years  | 6,605               |
| Due after five years through ten years | 898                 |
| Due after ten years                    | 111                 |
| Total debt securities                  | \$ 8,944            |

As of October 26, 2012 and April 27, 2012, the aggregate carrying amount of equity and other securities without a quoted market price and accounted for using the cost or equity method was \$483 million and \$508 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 26, 2012 cost method, equity method, and other investments balance includes \$132 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, net* 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.

### Note 8 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 7 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended April 27, 2012.

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 equity securities and 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.

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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<br>as of<br>October 26,<br>2012 | Fair Value Measurements<br>Using Inputs Considered as |                 |               |
|--|--|---|-----------------|---------------|
|  |  | Level 1   | Level 2         | Level 3       |
| <b>Assets:</b>                           |  |   |                 |               |
| Corporate debt securities                | \$ 3,697                                   | \$  | \$ 3,687        | \$ 10         |
| Auction rate securities                  | 129  |   |                 | 129           |
| Mortgage-backed securities               | 1,060                                      |   | 1,033           | 27            |
| U.S. government and agency securities    | 3,513                                      | 1,647   | 1,866           |               |
| Foreign government and agency securities | 47   |   | 47              |               |
| Certificates of deposit                  | 6  |   | 6               |               |
| Other asset-backed securities            | 492  |   | 487             | 5             |
| Marketable equity securities             | 260  | 260   |                 |               |
| Exchange-traded funds                    | 45   | 45  |                 |               |
| Derivative assets                        | 283  | 88  | 195             |               |
| <b>Total assets</b>                      | <b>\$ 9,532</b>                            | <b>\$ 2,040</b>                                       | <b>\$ 7,321</b> | <b>\$ 171</b> |
| <b>Liabilities:</b>                      |  |   |                 |               |
| Derivative liabilities                   | \$ 131                                     | \$ 45   | \$ 86           | \$            |
| <b>Total liabilities</b>                 | <b>\$ 131</b>                              | <b>\$ 45</b>  | <b>\$ 86</b>    | <b>\$</b>     |

| (in millions)                            | Fair Value<br>as of<br>April 27, 2012 | Fair Value Measurements<br>Using Inputs Considered as |                 |               |
|--|---------------------------------------|---|-----------------|---------------|
|  |                                       | Level 1   | Level 2         | Level 3       |
| <b>Assets:</b>                           |                                       |   |                 |               |
| Corporate debt securities                | \$ 3,541                              | \$  | \$ 3,531        | \$ 10         |
| Auction rate securities                  | 127                                   |   |                 | 127           |
| Mortgage-backed securities               | 839                                   |   | 810             | 29            |
| U.S. government and agency securities    | 3,084                                 | 1,511   | 1,573           |               |
| Foreign government and agency securities | 67                                    |   | 67              |               |
| Certificates of deposit                  | 47                                    |   | 47              |               |
| Other asset-backed securities            | 537                                   |   | 531             | 6             |
| Marketable equity securities             | 253                                   | 253   |                 |               |
| Exchange-traded funds                    | 46                                    | 46  |                 |               |
| Derivative assets                        | 254                                   | 87  | 167             |               |
| <b>Total assets</b>                      | <b>\$ 8,795</b>                       | <b>\$ 1,897</b>                                       | <b>\$ 6,726</b> | <b>\$ 172</b> |
| <b>Liabilities:</b>                      |                                       |   |                 |               |
| Derivative liabilities                   | \$ 82                                 | \$ 37   | \$ 45           | \$            |
| <b>Total liabilities</b>                 | <b>\$ 82</b>                          | <b>\$ 37</b>  | <b>\$ 45</b>    | <b>\$</b>     |

*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.

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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 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 26, 2012, with the exception of auction rate securities, these securities were valued using third-party pricing sources 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 market participants. The fair value of auction rate securities is estimated by the Company using a discounted cash flow model, which incorporates significant unobservable inputs. The significant unobservable inputs used in the fair value measurement of the Company's auction rate securities are years to principal recovery and the illiquidity premium that is incorporated into the discount rate. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value of the securities. Additionally, 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 4 for further information regarding contingent consideration.

The following table represents the range of unobservable inputs utilized in the fair value measurement of auction rate securities classified as Level 3 as of October 26, 2012:

|                         | Valuation Technique  | Unobservable Input                                 | Range (Weighted Average)     |
|-------------------------|----------------------|--|------------------------------|
| Auction rate securities | Discounted cash flow | Years to principal recovery<br>Illiquidity premium | 2 yrs - 12 yrs (3 yrs)<br>6% |

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 26, 2012 or October 28, 2011. 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 26, 2012 and October 28, 2011:

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Three months ended October 26, 2012

| (in millions)  | Total Level 3 Investments | Corporate debt securities | Auction rate securities | Mortgage-backed securities | Other asset-backed securities |
|--|---------------------------|---------------------------|-------------------------|----------------------------|-------------------------------|
| <b>Balance as of July 27, 2012</b>                                     | \$ 173                    | \$ 10                     | \$ 129                  | \$ 28                      | \$ 6                          |
| Total unrealized gains/(losses) included in other comprehensive income | (1)                       |                           |                         |                            | (1)                           |
| Settlements  | (1)                       |                           |                         | (1)                        |                               |
| <b>Balance as of October 26, 2012</b>                                  | \$ 171                    | \$ 10                     | \$ 129                  | \$ 27                      | \$ 5                          |

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 |
|---|---------------------------|---------------------------|-------------------------|----------------------------|-------------------------------|
| <b>Balance as of July 29, 2011</b>  | \$ 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)                        |                               |
| <b>Balance as of October 28, 2011</b>   | \$ 174                    | \$ 10                     | \$ 127                  | \$ 31                      | \$ 6                          |

Six months ended October 26, 2012

| (in millions)  | Total Level 3 Investments | Corporate debt securities | Auction rate securities | Mortgage-backed securities | Other asset-backed securities |
|--|---------------------------|---------------------------|-------------------------|----------------------------|-------------------------------|
| <b>Balance as of April 27, 2012</b>                                    | \$ 172                    | \$ 10                     | \$ 127                  | \$ 29                      | \$ 6                          |
| Total unrealized gains/(losses) included in other comprehensive income | 1                         |                           | 2                       |                            | (1)                           |
| Settlements  | (2)                       |                           |                         | (2)                        |                               |
| <b>Balance as of October 26, 2012</b>                                  | \$ 171                    | \$ 10                     | \$ 129                  | \$ 27                      | \$ 5                          |

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 |
|---|---------------------------|---------------------------|-------------------------|----------------------------|-------------------------------|
| <b>Balance as of April 29, 2011</b>   | \$ 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)                        |                               |
| <b>Balance as of October 28, 2011</b>   | \$ 174                    | \$ 10                     | \$ 127                  | \$ 31                      | \$ 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 and IPR&D, 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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### MEDTRONIC, INC. NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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 \$483 million as of October 26, 2012 and \$508 million as of April 27, 2012. 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 months ended July 27, 2012, 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 \$6 million in impairment charges during the three months ended July 27, 2012. The Company did not record any impairment charges related to cost method investments during the three months ended October 26, 2012. During the three and six months ended October 28, 2011, 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. The impairment charges related to the cost method investments were recorded in *other expense, net* 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 annually in the third quarter and 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, excluding IPR&D, was \$2.132 billion as of October 26, 2012 and \$2.277 billion as of April 27, 2012. 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 26, 2012 or October 28, 2011.

The Company assesses the impairment of goodwill and IPR&D annually in the third quarter and whenever events or changes in circumstances indicate that the carrying amount may be impaired. The aggregate carrying amount of goodwill was \$9.944 billion as of October 26, 2012 and \$9.934 billion as of April 27, 2012. The aggregate carrying amount of IPR&D was \$368 million as of October 26, 2012 and \$370 million as of April 27, 2012. These assets are measured at fair value on a nonrecurring basis. The fair value of the Company's goodwill and IPR&D is not estimated if there is no change in events or circumstances that indicate the carrying amount of goodwill or IPR&D may be impaired. The Company did not record any goodwill or IPR&D impairments during the three and six months ended October 26, 2012 or October 28, 2011. However, due to the nature of IPR&D projects, the Company may experience delays or failures to obtain regulatory approvals to conduct clinical trials, failures of such clinical trials, delays or failures to obtain required market clearances or other failures to achieve a commercially viable product, and as a result, may record impairment losses in the future.

The Company assesses the impairment of property, plant, and equipment whenever events or changes in circumstances indicate that the carrying amount of property, plant, and equipment assets 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 26, 2012 or October 28, 2011.

#### *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 26, 2012 was \$10.103 billion compared to a principal value of \$9.135 billion, and as of April 27, 2012 was \$9.965 billion compared to a principal value of \$9.138 billion. Fair value was estimated using quoted market prices for the public registered senior notes and senior convertible notes, classified as Level 1 within the fair value hierarchy, and quoted market prices for similar instruments for the term loan on capital lease buyout, classified as Level 2 within the fair value hierarchy. 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 9 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.



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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 that began 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 26, 2012, warrants for 41 million shares of the Company's common stock had expired.

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.

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:

| (in millions)   | October 26,<br>2012 | April 27,<br>2012 |
|---|---------------------|-------------------|
| Carrying amount of the equity component               | \$ 547              | \$ 547            |
| Principal amount of the 2013 Senior Convertible Notes | \$ 2,200            | \$ 2,200          |
| Unamortized discount                                  | (44)                | (90)              |
| Net carrying amount                                   | \$ 2,156            | \$ 2,110          |

As of October 26, 2012, the unamortized balance of the debt discount will be amortized over the remaining life of the 2013 Senior Convertible Notes, which is less than one year. The following tables provide interest rate and interest expense amounts related to the 2013 Senior Convertible Notes.

| (in millions, except interest rate)                   | Three months ended  |                     |
|---|---------------------|---------------------|
|   | October 26,<br>2012 | October 28,<br>2011 |
| Effective interest rate                               | 6.03%               | 6.03%               |
| Interest cost related to contractual interest coupon  | \$ 9                | \$ 9                |
| Interest cost related to amortization of the discount | \$ 23               | \$ 21               |

| (in millions, except interest rate)                   | Six months ended    |                     |
|---|---------------------|---------------------|
|   | October 26,<br>2012 | October 28,<br>2011 |
| Effective interest rate                               | 6.03%               | 6.03%               |
| Interest cost related to contractual interest coupon  | \$ 18               | \$ 18               |
| Interest cost related to amortization of the discount | \$ 46               | \$ 43               |

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

#### Senior Notes

The Company has outstanding unsecured senior obligations including the \$550 million 4.500 percent 2009 Senior Notes due 2014, the \$1.250 billion 3.000 percent 2010 Senior Notes due 2015, the \$600 million 4.750 percent 2005 Senior Notes due 2015, the \$500 million 2.625 percent 2011 Senior Notes due 2016, the \$400 million 5.600 percent 2009 Senior Notes due 2019, the \$1.250 billion 4.45 percent 2010 Senior Notes due 2020, the \$500 million 4.125 percent 2011 Senior Notes due 2021, the \$675 million 3.125 percent 2012 Senior Notes due 2022, the \$300 million 6.500 percent 2009 Senior Notes due 2039, the \$500 million 5.550 percent 2010 Senior Notes due 2040, and the \$400 million 4.500 percent 2012 Senior Notes due 2042 (collectively, the Senior Notes). The Senior Notes rank equally with all other unsecured and unsubordinated indebtedness of the Company. The indentures under which the Senior Notes were issued contain customary covenants, all of which the Company remains in compliance with as of October 26, 2012. The Company used the net proceeds from the sale of the Senior Notes primarily for working capital and general corporate uses, which include the repayment of other indebtedness of the Company. For additional information regarding the terms of these agreements, refer to Note 9 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended April 27, 2012.

As of October 26, 2012, the Company had interest rate swap agreements designated as fair value hedges of certain underlying fixed rate obligations including the Company's \$1.250 billion 3.000 percent 2010 Senior Notes due 2015, \$600 million 4.750 percent 2005 Senior Notes due 2015, the Company's \$500 million 2.625 percent 2011 Senior Notes due 2016, the Company's \$500 million 4.125 percent 2011 Senior Notes due 2021, and the Company's \$675 million 3.125 percent 2012 Senior Notes due 2022. For additional information regarding the interest rate swap agreements, refer to Note 10.

#### Commercial Paper

The Company maintains a commercial paper program that allows the Company to have a maximum of \$2.250 billion in commercial paper outstanding, with maturities up to 364 days from the date of issuance. As of October 26, 2012 and April 27, 2012, outstanding commercial paper totaled \$1.650 billion and \$950 million, respectively. During the three and six months ended October 26, 2012, the weighted average original maturity of the commercial paper outstanding was approximately 87 days and 74 days, respectively, and the weighted average interest rate was 0.18 percent and 0.16 percent, respectively. The issuance of commercial paper reduces the amount of credit available under the Company's existing lines of credit.

#### Bank Borrowings

Bank borrowings consist primarily of borrowings from non-U.S. banks at interest rates considered favorable by management and where natural hedges can be gained for foreign exchange purposes and borrowings from U.S. banks.

#### Lines of Credit

The Company has committed and uncommitted lines of credit with various banks. The committed lines of credit include a four-year \$2.250 billion syndicated credit facility dated December 9, 2010 that will expire on December 9, 2014 (Credit Facility). The Credit Facility provides the Company with the ability to increase its capacity by an additional \$500 million at any time during the four-year term of the agreement. The Company can also request extension of the Credit Facility maturity date for one additional year, at the first and second anniversary date of the Credit Facility. The Credit Facility provides backup funding for the commercial paper program, and therefore, the issuance of commercial paper reduces the amount of credit available under the committed lines of credit. As of October 26, 2012 and April 27, 2012, no amounts were outstanding on the committed lines of credit.

Interest rates on these borrowings are determined by a pricing matrix, based on the Company's long-term debt ratings, assigned by Standard & Poor's Ratings Services and Moody's Investors Service. Facility fees are payable on the credit facilities and are determined in the same manner as the interest rates. The agreements also contain customary covenants, all of which the Company remains in compliance with as of October 26, 2012.

#### Note 10 Derivatives and Foreign Exchange Risk Management

The Company uses operational and economic hedges, as well as currency exchange rate derivative contracts and interest rate derivative instruments to manage the impact of currency exchange and interest rate changes on earnings and cash flows. In order to minimize earnings and cash flow volatility resulting from currency exchange rate changes, the Company enters into derivative instruments, principally forward currency exchange rate contracts. These contracts are designed to hedge anticipated foreign currency transactions and changes in the value of

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specific assets, liabilities, and probable commitments. At inception of the forward contract, the derivative is designated as either a freestanding derivative or a cash flow hedge. The primary currencies of the derivative instruments are the Euro and the Japanese Yen. The Company does not enter into currency exchange rate derivative contracts for speculative purposes. The gross notional amount of all currency exchange rate derivative instruments outstanding at October 26, 2012 and April 27, 2012 was \$5.710 billion and \$5.136 billion, respectively. The aggregate currency exchange rate losses for the three and six months ended October 26, 2012 were \$25 million and \$6 million, respectively. The aggregate currency exchange rate losses for the three and six months ended October 28, 2011 were \$77 million and \$133 million, respectively. These losses represent the net impact to the condensed consolidated statements of earnings for the derivative instruments presented below, offset by remeasurement gains on foreign currency denominated assets and liabilities.

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

The information that follows explains the various types of derivatives and financial instruments used by the Company, how and why the Company uses such instruments, how such instruments are accounted for, and how such instruments impact the Company's condensed consolidated balance sheets and statements of earnings.

### *Freestanding Derivative Forward Contracts*

Freestanding derivative forward contracts are used to offset the Company's exposure to the change in value of specific foreign currency denominated assets and liabilities. These derivatives are not designated as hedges, and therefore, changes in the value of these forward contracts are recognized in earnings, thereby offsetting the current earnings effect of the related change in U.S. dollar value of foreign currency denominated assets and liabilities. The cash flows from these contracts are reported as operating activities in the condensed consolidated statements of cash flows. The gross notional amount of these contracts, not designated as hedging instruments, outstanding as of October 26, 2012 and April 27, 2012, was \$1.759 billion and \$2.039 billion, respectively.

The amount of (losses)/gains and location of the (losses)/gains in the condensed consolidated statements of earnings related to derivative instruments, not designated as hedging instruments, for the three and six months ended October 26, 2012 and October 28, 2011 are as follows:

| (in millions)                                     |                    | Three months ended |                  |
|---|--------------------|--------------------|------------------|
| Derivatives Not Designated as Hedging Instruments | Location           | October 26, 2012   | October 28, 2011 |
| Foreign currency exchange rate contracts          | Other expense, net | \$ (67)            | \$ 37            |

| (in millions)                                     |                    | Six months ended |                  |
|---|--------------------|------------------|------------------|
| Derivatives Not Designated as Hedging Instruments | Location           | October 26, 2012 | October 28, 2011 |
| Foreign currency exchange rate contracts          | Other expense, net | \$ (20)          | \$ 20            |

### *Cash Flow Hedges*

#### Foreign Currency Exchange Rate Risk

Forward contracts designated as cash flow hedges are designed to hedge the variability of cash flows associated with forecasted transactions denominated in a foreign currency that will take place in the future. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of *accumulated other comprehensive loss* and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. No gains or losses relating to ineffectiveness of cash flow hedges were recognized in earnings during the three and six months ended October 26, 2012 or October 28, 2011. No components of the hedge contracts were excluded in the measurement of hedge ineffectiveness and no hedges were derecognized or discontinued during the three and six months ended October 26, 2012 or October 28, 2011. The cash flows from these contracts are reported as operating activities in the condensed consolidated statements of cash flows. The gross notional amount of these contracts, designated as cash flow hedges, outstanding at October 26, 2012 and April 27, 2012, was \$3.951 billion and \$3.097 billion, respectively, and will mature within the subsequent three-year period.

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The amount of (losses)/gains and location of the (losses)/gains in the condensed consolidated statements of earnings and other comprehensive income (OCI) related to foreign currency exchange rate contract derivative instruments designated as cash flow hedges for the three and six months ended October 26, 2012 and October 28, 2011 are as follows:

Three months ended October 26, 2012

| (in millions)<br>Derivatives in Cash Flow<br>Hedging Relationships | Gross (Losses)/Gains Recognized in<br>OCI<br>on Effective Portion of Derivative | Effective Portion of (Losses)/Gains on Derivative Reclassified<br>from<br>Accumulated Other Comprehensive Loss into Income |              |
|--|---|--|--------------|
|  | Amount  | Location   | Amount       |
| Foreign currency exchange rate contracts                           | \$ (110)  | Other expense, net   | \$ 19        |
|  |   | Cost of products sold  | 3            |
| <b>Total</b>   | <b>\$ (110)</b>   |  | <b>\$ 22</b> |

Three months ended October 28, 2011

| (in millions)<br>Derivatives in Cash Flow<br>Hedging Relationships | Gross (Losses)/Gains Recognized in<br>OCI<br>on Effective Portion of Derivative | Effective Portion of (Losses)/Gains on Derivative Reclassified<br>from<br>Accumulated Other Comprehensive Loss into Income |                |
|--|---|--|----------------|
|  | Amount  | Location   | Amount         |
| Foreign currency exchange rate contracts                           | \$ 111  | Other expense, net   | \$ (55)        |
|  |   | Cost of products sold  | 7              |
| <b>Total</b>   | <b>\$ 111</b>   |  | <b>\$ (48)</b> |

Six months ended October 26, 2012

| (in millions)<br>Derivatives in Cash Flow<br>Hedging Relationships | Gross (Losses)/Gains Recognized in<br>OCI<br>on Effective Portion of Derivative | Effective Portion of (Losses)/Gains on Derivative Reclassified<br>from<br>Accumulated Other Comprehensive Loss into Income |              |
|--|---|--|--------------|
|  | Amount  | Location   | Amount       |
| Foreign currency exchange rate contracts                           | \$ (1)  | Other expense, net   | \$ 42        |
|  |   | Cost of products sold  | 1            |
| <b>Total</b>   | <b>\$ (1)</b>   |  | <b>\$ 43</b> |

Six months ended October 28, 2011

| (in millions)<br>Derivatives in Cash Flow<br>Hedging Relationships | Gross (Losses)/Gains Recognized in<br>OCI<br>on Effective Portion of Derivative | Effective Portion of (Losses)/Gains on Derivative Reclassified<br>from<br>Accumulated Other Comprehensive Loss into Income |                |
|--|---|--|----------------|
|  | Amount  | Location   | Amount         |
| Foreign currency exchange rate contracts                           | \$ 131  | Other expense, net   | \$ (109)       |
|  |   | Cost of products sold  | 15             |
| <b>Total</b>   | <b>\$ 131</b>   |  | <b>\$ (94)</b> |





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

#### Forecasted Debt Issuance Interest Rate Risk

Forward starting interest rate derivative instruments designated as cash flow hedges are designed to manage the exposure to interest rate volatility with regard to future issuances of fixed-rate debt. For forward starting interest rate derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of *accumulated other comprehensive loss* and beginning in the period or periods in which the planned debt issuance occurs, the gain or loss is then reclassified into *interest expense, net* over the term of the related debt. As of October 26, 2012, the Company had \$1.250 billion of pay fixed, forward starting interest rate swaps with a weighted average fixed rate of 2.78 percent, which were entered into in advance of planned debt issuances.

The market value of outstanding forward starting interest rate swap derivative instruments at October 26, 2012 and April 27, 2012 was an unrealized loss of \$86 million and \$45 million, respectively. These unrealized losses were recorded in *other long-term liabilities* with the offset recorded in OCI in the condensed consolidated balance sheets.

As of October 26, 2012 and April 27, 2012, the Company had \$(23) million and \$6 million, respectively, in after-tax net unrealized (losses)/gains associated with cash flow hedging instruments recorded in *accumulated other comprehensive loss*. The Company expects that \$29 million of unrealized gains as of October 26, 2012 will be reclassified into the condensed consolidated statements of earnings over the next 12 months.

#### Fair Value Hedges

For derivative instruments that are designated and qualify as fair value hedges, the gain or loss on the derivatives as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in current earnings.

Interest rate derivative instruments designated as fair value hedges are designed to manage the exposure to interest rate movements and to reduce borrowing costs by converting fixed-rate debt into floating-rate debt. Under these agreements, the Company agrees to exchange, at specified intervals, the difference between fixed and floating interest amounts calculated by reference to an agreed-upon notional principal amount.

As of October 26, 2012 and April 27, 2012, the Company had interest rate swaps in gross notional amounts of \$2.625 billion designated as fair value hedges of underlying fixed rate obligations. As of October 26, 2012, outstanding interest rate swap agreements were designated as fair value hedges of underlying fixed rate obligations including the Company's \$1.250 billion 3.000 percent 2010 Senior Notes due 2015, the \$600 million 4.750 percent 2005 Senior Notes due 2015, the \$500 million 2.625 percent 2011 Senior Notes due 2016, the \$500 million 4.125 percent 2011 Senior Notes due 2021, and the \$675 million 3.125 percent 2012 Senior Notes due 2022. For additional information regarding the terms of the Company's interest rate swap agreements, refer to Note 10 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended April 27, 2012.

The market value of outstanding interest rate swap agreements was a \$194 million unrealized gain and the market value of the hedged item was a \$194 million unrealized loss at October 26, 2012, which were recorded in *other assets* with the offset recorded in *long-term debt* in the condensed consolidated balance sheet. No hedge ineffectiveness was recorded as a result of these fair value hedges for the three and six months ended October 26, 2012. No hedge ineffectiveness was recorded as a result of these fair value hedges for the three months ended October 28, 2011 and less than \$1 million was recorded for the six months ended October 28, 2011, which was recorded as an increase in *interest expense, net* in the condensed consolidated statements of earnings.

During the three and six months ended October 26, 2012 and October 28, 2011, the Company did not have any ineffective fair value hedging instruments. In addition, the Company did not recognize any gains or losses during the three and six months ended October 26, 2012 or October 28, 2011 on firm commitments that no longer qualify as fair value hedges.

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*Balance Sheet Presentation*

The following table summarizes the location and fair value amounts of derivative instruments reported in the condensed consolidated balance sheets as of October 26, 2012 and April 27, 2012. The fair value amounts are presented on a gross basis and are segregated between derivatives that are designated and qualify as hedging instruments and those that are not, and are further segregated by type of contract within those two categories.

**October 26, 2012**

| (in millions)  | Asset Derivatives                         |            | Liability Derivatives       |            |
|--|---|------------|-----------------------------|------------|
|  | Balance Sheet Location                    | Fair Value | Balance Sheet Location      | Fair Value |
| <b>Derivatives designated as hedging instruments</b>     |   |            |                             |            |
| Foreign currency exchange rate contracts                 | Prepaid expenses and other current assets | \$ 71      | Other accrued expenses      | \$ 33      |
| Interest rate contracts                                  | Other assets                              | 194        | Other long-term liabilities | 86         |
| Foreign currency exchange rate contracts                 | Other assets                              | 17         | Other long-term liabilities | 12         |
| Total derivatives designated as hedging instruments      |   | \$ 282     |                             | \$ 131     |
| <b>Derivatives not designated as hedging instruments</b> |   |            |                             |            |
| Foreign currency exchange rate contracts                 | Prepaid expenses and other current assets | \$ 1       | Other accrued expenses      | \$         |
| Total derivatives not designated as hedging instruments  |   | \$ 1       |                             | \$         |
| <b>Total derivatives</b>                                 |   | \$ 283     |                             | \$ 131     |

**April 27, 2012**

| (in millions)  | Asset Derivatives                         |            | Liability Derivatives       |            |
|--|---|------------|-----------------------------|------------|
|  | Balance Sheet Location                    | Fair Value | Balance Sheet Location      | Fair Value |
| <b>Derivatives designated as hedging instruments</b>     |   |            |                             |            |
| Foreign currency exchange rate contracts                 | Prepaid expenses and other current assets | \$ 74      | Other accrued expenses      | \$ 33      |
| Interest rate contracts                                  | Other assets                              | 167        | Other long-term liabilities | 45         |
| Foreign currency exchange rate contracts                 | Other assets                              | 13         | Other long-term liabilities | 2          |
| Total derivatives designated as hedging instruments      |   | \$ 254     |                             | \$ 80      |
| <b>Derivatives not designated as hedging instruments</b> |   |            |                             |            |
| Foreign currency exchange rate contracts                 | Prepaid expenses and other current assets | \$         | Other accrued expenses      | \$ 2       |
| Total derivatives not designated as hedging instruments  |   | \$         |                             | \$ 2       |
| <b>Total derivatives</b>                                 |   | \$ 254     |                             | \$ 82      |



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*Concentrations of Credit Risk*

Financial instruments, which potentially subject the Company to significant concentrations of credit risk, consist principally of interest-bearing investments, forward exchange derivative contracts, and trade accounts receivable.

The Company maintains cash and cash equivalents, investments, and certain other financial instruments (including currency exchange rate and interest rate derivative contracts) with various major financial institutions. The Company performs periodic evaluations of the relative credit standings of these financial institutions and limits the amount of credit exposure with any one institution. In addition, the Company has collateral credit agreements with its primary derivatives counterparties. Under these agreements, either party may be required to post eligible collateral when the market value of transactions covered by the agreement exceeds specific thresholds, thus limiting credit exposure for both parties. As of October 26, 2012 and April 27, 2012, no collateral was posted by either the Company or its counterparties.

Global concentrations of credit risk with respect to trade accounts receivable are limited due to the large number of customers and their dispersion across many geographic areas. The Company monitors the creditworthiness of its customers to which it grants credit terms in the normal course of business. However, a significant amount of trade receivables are with hospitals that are dependent upon governmental health care systems in many countries. The current economic conditions in many countries outside the U.S. (particularly the recent economic challenges faced by Italy, Spain, Portugal, and Greece), have deteriorated and may continue to increase the average length of time it takes the Company to collect on its outstanding accounts receivable in these countries as certain payment patterns have been impacted. Historically, accounts receivable balances with certain customers in these countries have accumulated over time and were subsequently settled as large lump-sum payments. As of October 26, 2012 and April 27, 2012, the Company's aggregate accounts receivable balance for Italy, Spain, Portugal, and Greece, net of the allowance for doubtful accounts, was \$741 million and \$967 million, respectively. In the first quarter of fiscal year 2013, the Company received a \$212 million payment in Spain. Although the Company does not currently foresee a significant credit risk associated with the outstanding accounts receivable, repayment is dependent upon the financial stability of the economies of these countries. As of October 26, 2012 and April 27, 2012, no one customer represented more than 10 percent of the Company's outstanding accounts receivable.

Note 11 Inventories

Inventories are stated at the lower of cost or market, with cost determined on a first-in, first-out basis. Inventory balances are as follows:

| (in millions)   | October 26,<br>2012 | April 27,<br>2012 |
|-----------------|---------------------|-------------------|
| Finished goods  | \$ 1,258            | \$ 1,175          |
| Work in process | 281                 | 288               |
| Raw materials   | 338                 | 337               |
| Total           | \$ 1,877            | \$ 1,800          |

Note 12 Goodwill and Other Intangible Assets, Net

The changes in the carrying amount of goodwill for the six months ended October 26, 2012 are as follows:

| (in millions)                         | Cardiac and<br>Vascular Group | Restorative<br>Therapies Group | Total    |
|---------------------------------------|-------------------------------|--------------------------------|----------|
| <b>Balance as of April 27, 2012</b>   | \$ 2,636                      | \$ 7,298                       | \$ 9,934 |
| Goodwill as a result of acquisitions  |                               | 12                             | 12       |
| Purchase accounting adjustments, net  |                               | 1                              | 1        |
| Currency adjustment, net              | (1)                           | (2)                            | (3)      |
| <b>Balance as of October 26, 2012</b> | \$ 2,635                      | \$ 7,309                       | \$ 9,944 |



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Balances of intangible assets, net, excluding goodwill, as of October 26, 2012 and April 27, 2012 are as follows:

| (in millions)  | Purchased<br>Technology and<br>Patents | Trademarks<br>and<br>Tradenames | Acquired<br>IPR&D | Other  | Total    |
|--|--|---------------------------------|-------------------|--------|----------|
| <b>Amortizable intangible assets as of October 26, 2012:</b> |  |                                 |                   |        |          |
| Original cost  | \$ 3,591                               | \$ 373                          | \$ 368            | \$ 147 | \$ 4,479 |
| Accumulated amortization                                     | (1,555)                                | (314)                           |                   | (110)  | (1,979)  |
| Carrying value   | \$ 2,036                               | \$ 59                           | \$ 368            | \$ 37  | \$ 2,500 |
| <b>Amortizable intangible assets as of April 27, 2012:</b>   |  |                                 |                   |        |          |
| Original cost  | \$ 3,604                               | \$ 373                          | \$ 370            | \$ 148 | \$ 4,495 |
| Accumulated amortization                                     | (1,440)                                | (307)                           |                   | (101)  | (1,848)  |
| Carrying value   | \$ 2,164                               | \$ 66                           | \$ 370            | \$ 47  | \$ 2,647 |

Amortization expense for the three and six months ended October 26, 2012 was \$79 million and \$159 million, respectively, and for the three and six months ended October 28, 2011 was \$85 million and \$171 million, respectively.

Estimated aggregate amortization expense based on the current carrying value of amortizable intangible assets, excluding any possible future amortization associated with acquired IPR&D, which has not met technological feasibility, is as follows:

| (in millions)<br>Fiscal Year         | Estimated<br>Amortization<br>Expense |
|--------------------------------------|--------------------------------------|
| Remaining 2013                       | \$ 163                               |
| 2014                                 | 306                                  |
| 2015                                 | 289                                  |
| 2016                                 | 276                                  |
| 2017                                 | 255                                  |
| 2018                                 | 239                                  |
| Thereafter                           | 604                                  |
| Total estimated amortization expense | \$ 2,132                             |
| <u>Note 13 Warranty Obligation</u>   |                                      |

The Company offers a warranty on various products. The Company estimates the costs that may be incurred under its warranties and records a liability in the amount of such costs at the time the product is sold. Factors that affect the Company's warranty liability include the number of units sold, historical and anticipated rates of warranty claims, and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary. The amount of the reserve recorded is equal to the net costs to repair or otherwise satisfy the claim. The Company includes the warranty obligation in *other accrued expenses* and *other long-term liabilities* on the Company's condensed consolidated balance sheets. The Company includes the covered costs associated with field actions, if any, in *cost of products sold* in the Company's condensed consolidated statements of earnings.

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Changes in the Company's product warranty obligations during the six months ended October 26, 2012 and October 28, 2011 consisted of the following:

| (in millions)                                 | Six months ended |                  |
|---|------------------|------------------|
|   | October 26, 2012 | October 28, 2011 |
| <b>Balance at the beginning of the period</b> | \$ 31            | \$ 35            |
| Warranty claims provision                     | 12               | 10               |
| Settlements made                              | (10)             | (14)             |
| <b>Balance at the end of the period</b>       | \$ 33            | \$ 31            |

Note 14 Interest Expense, Net

Interest income and interest expense for the three and six months ended October 26, 2012 and October 28, 2011 are as follows:

| (in millions)         | Three months ended |                  | Six months ended |                  |
|-----------------------|--------------------|------------------|------------------|------------------|
|                       | October 26, 2012   | October 28, 2011 | October 26, 2012 | October 28, 2011 |
| Interest income       | \$ (71)            | \$ (47)          | \$ (127)         | \$ (92)          |
| Interest expense      | 95                 | 85               | 184              | 162              |
| Interest expense, net | \$ 24              | \$ 38            | \$ 57            | \$ 70            |

Interest income includes interest earned on the Company's cash and cash equivalents, short- and long-term investments, the net realized and unrealized gain or loss on trading securities, ineffectiveness on interest rate derivative instruments, and the net realized gain or loss on the sale or impairment of available-for-sale debt securities. See Note 7 for further discussion of these items.

Interest expense includes the expense associated with the interest on the Company's outstanding borrowings, including short- and long-term instruments, ineffectiveness on interest rate derivative instruments, and the amortization of debt issuance costs and debt discounts.

Note 15 Income Taxes

The Company's effective tax rates from continuing operations for the three and six months ended October 26, 2012 were 24.36 percent and 22.25 percent, respectively, compared to 17.16 percent and 18.34 percent, respectively, from the same periods of the prior fiscal year. The increase in the Company's effective tax rate for the three and six months ended October 26, 2012 was primarily due to the net tax impact of acquisition-related items, certain litigation charges, net, the expiration of the U.S. federal research and development tax credit on December 31, 2011, and the impact associated with the resolution of certain income tax audits. These items were partially offset by the tax impact of foreign dividend distributions recorded during the quarter ended October 26, 2012.

During the three months ended October 26, 2012, the Company recorded a \$4 million net benefit associated with foreign dividend distributions, resolution of certain income tax audits, finalization of certain income tax returns, and changes to uncertain tax position reserves. These tax adjustments are operational in nature and are recorded in *provision for income taxes* on the condensed consolidated statement of earnings.

During the six months ended October 26, 2012, the Company's gross unrecognized tax benefits decreased from \$917 million to \$915 million. In addition, the Company has accrued interest and penalties of \$74 million as of October 26, 2012. If all of the Company's unrecognized tax benefits were recognized, approximately \$878 million would impact the Company's effective tax rate. The Company records the gross unrecognized tax benefit as a long-term liability as it does not expect significant payments to occur or the total amount of unrecognized tax benefits to change significantly over the next 12 months.

The Company will continue to recognize interest and penalties related to income tax matters in the *provision for income taxes* in the condensed consolidated statements of earnings and record the liability in the current or long-term *accrued income taxes* in the condensed consolidated balance sheets, as appropriate.

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Tax audits associated with the allocation of income, and other complex issues, may require an extended period of time to resolve and may result in income tax adjustments if changes to the Company's allocation are required between jurisdictions with different tax rates. Tax authorities periodically review the Company's tax returns and propose adjustments to the Company's tax filings. The IRS has settled its audits with the Company for all years through fiscal year 2004. Tax years settled with the IRS may remain open for foreign tax audits and competent authority proceedings. Competent authority proceedings are a means to resolve intercompany pricing disagreements between countries.

In March 2009, the IRS issued its audit report for fiscal years 2005 and 2006. The Company reached agreement with the IRS on some but not all matters. On December 23, 2010, the IRS issued a statutory notice of deficiency with respect to the remaining issues. The Company filed a Petition with the U.S. Tax Court on March 21, 2011 objecting to the deficiency. During October 2012, the Company reached resolution with the IRS on the deductibility of a settlement payment. The remaining unresolved significant issue relates to the allocation of income between Medtronic, Inc. and its wholly-owned subsidiary operating in Puerto Rico, which is one of the Company's key manufacturing sites.

In October 2011, the IRS issued its audit report for fiscal years 2007 and 2008. The Company reached agreement with the IRS on some but not all matters related to these fiscal years. The significant issues that remain unresolved relate to the allocation of income between Medtronic, Inc. and its wholly-owned subsidiary in Puerto Rico, and proposed adjustments associated with the tax effects of the Company's acquisition of Kyphon. Associated with the Kyphon acquisition, Medtronic entered into an intercompany transaction whereby the Kyphon U.S. tangible assets were sold to another wholly-owned subsidiary in a taxable transaction. The IRS has disagreed with the Company's valuation and proposed that all U.S. goodwill, the value of the ongoing business, and the value of the workforce in place be included in the tangible asset sale. The Company disagrees that these items were sold, as well as with the IRS valuation of these items. The Company is currently attempting to resolve these matters at the IRS Appellate level and will proceed through litigation, if necessary.

The Company's reserve for the uncertain tax positions related to these significant unresolved matters with the IRS, as described above, is subject to a high degree of estimation and management judgment. Resolution of these significant unresolved matters, or positions taken by the IRS or foreign tax authorities during future tax audits, could have a material impact on the Company's financial results in future periods. The Company continues to believe that its reserves for uncertain tax positions are appropriate and have meritorious defenses for its tax filings and will vigorously defend them during the audit process, appellate process, and through litigation in courts, as necessary.

#### Note 16 Earnings Per Share

Basic earnings per share is computed based on the weighted average number of common shares outstanding. Diluted earnings per share is computed based on the weighted average number of common shares outstanding, increased by the number of additional shares that would have been outstanding had the potentially dilutive common shares been issued and reduced by the number of shares the Company could have repurchased from the proceeds from issuance of the potentially dilutive shares. Potentially dilutive shares of common stock include stock options and other stock-based awards granted under stock-based compensation plans and shares committed to be purchased under the employee stock purchase plan.



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The table below sets forth the computation of basic and diluted earnings per share:

| (in millions, except per share data)        | Three months ended  |                     | Six months ended    |                     |
|---|---------------------|---------------------|---------------------|---------------------|
|   | October 26,<br>2012 | October 28,<br>2011 | October 26,<br>2012 | October 28,<br>2011 |
| <b>Numerator:</b>                           |                     |                     |                     |                     |
| Earnings from continuing operations         | \$ 646              | \$ 864              | \$ 1,510            | \$ 1,683            |
| Earnings from discontinued operations       |                     | 7                   |                     | 9                   |
| Net earnings                                | \$ 646              | \$ 871              | \$ 1,510            | \$ 1,692            |
| <b>Denominator:</b>                         |                     |                     |                     |                     |
| Basic weighted average shares outstanding   | 1,019.4             | 1,058.1             | 1,024.4             | 1,060.6             |
| Effect of dilutive securities:              |                     |                     |                     |                     |
| Employee stock options                      | 2.7                 | 0.2                 | 2.1                 | 0.7                 |
| Employee restricted stock units             | 5.6                 | 4.6                 | 5.6                 | 4.7                 |
| Other                                       | 0.1                 | 0.2                 | 0.1                 | 0.2                 |
| Diluted weighted average shares outstanding | 1,027.8             | 1,063.1             | 1,032.2             | 1,066.2             |
| Basic earnings per share:                   |                     |                     |                     |                     |
| Earnings from continuing operations         | \$ 0.63             | \$ 0.82             | \$ 1.47             | \$ 1.59             |
| Earnings from discontinued operations       | \$                  | \$ 0.01             | \$                  | \$ 0.01             |
| Net earnings*                               | \$ 0.63             | \$ 0.82             | \$ 1.47             | \$ 1.60             |
| Diluted earnings per share:                 |                     |                     |                     |                     |
| Earnings from continuing operations         | \$ 0.63             | \$ 0.81             | \$ 1.46             | \$ 1.58             |
| Earnings from discontinued operations       | \$                  | \$ 0.01             | \$                  | \$ 0.01             |
| Net earnings                                | \$ 0.63             | \$ 0.82             | \$ 1.46             | \$ 1.59             |

\* - All earnings per share amounts have been rounded to the nearest \$0.01, and therefore, may not sum.

The calculation of weighted average diluted shares outstanding excludes options for approximately 41 million shares of common stock for both the three and six months ended October 26, 2012, and approximately 63 million and 53 million shares of common stock for the three and six months ended October 28, 2011, respectively, because their effect would be anti-dilutive on the Company's earnings per share. For the three and six months ended October 26, 2012 and October 28, 2011, common share equivalents related to the Company's \$2.200 billion of Senior Convertible Notes were anti-dilutive as the market price of the Company's stock was below the conversion price of the Senior Convertible Notes and, therefore, were excluded from the calculation of weighted average diluted shares.

Note 17 Stock-Based Compensation

Under the fair value recognition provisions of U.S. GAAP for accounting for stock-based compensation, the Company measures stock-based compensation expense at the grant date based on the fair value of the award and recognizes the compensation expense over the requisite service period, which is generally the vesting period.

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The following table presents the components and classification of stock-based compensation expense recognized for the three and six months ended October 26, 2012 and October 28, 2011:

| (in millions)                                      | Three months ended |                  | Six months ended |                  |
|--|--------------------|------------------|------------------|------------------|
|  | October 26, 2012   | October 28, 2011 | October 26, 2012 | October 28, 2011 |
| Stock options                                      | \$ 16              | \$ 21            | \$ 27            | \$ 36            |
| Restricted stock awards                            | 30                 | 25               | 51               | 47               |
| Employee stock purchase plan                       | 3                  | 3                | 7                | 7                |
| Total stock-based compensation expense             | \$ 49              | \$ 49            | \$ 85            | \$ 90            |
| Cost of products sold                              | \$ 4               | \$ 4             | \$ 7             | \$ 7             |
| Research and development expense                   | 10                 | 9                | 17               | 16               |
| Selling, general, and administrative expense       | 35                 | 36               | 61               | 67               |
| Total stock-based compensation expense             | \$ 49              | \$ 49            | \$ 85            | \$ 90            |
| Income tax benefits                                | (14)               | (15)             | (24)             | (26)             |
| Total stock-based compensation expense, net of tax | \$ 35              | \$ 34            | \$ 61            | \$ 64            |

Note 18 Retirement Benefit Plans

The Company sponsors various retirement benefit plans, including defined benefit pension plans (pension benefits), post-retirement medical plans (post-retirement benefits), defined contribution savings plans, and termination indemnity plans, covering substantially all U.S. employees and many employees outside the U.S. The net periodic benefit cost of the plans includes the following components for the three and six months ended October 26, 2012 and October 28, 2011:

| (in millions)                      | U.S. Pension Benefits |                      | Non-U.S. Pension Benefits |                      | Post-Retirement Benefits |                      |
|------------------------------------|-----------------------|----------------------|---------------------------|----------------------|--------------------------|----------------------|
|                                    | Three months ended    |                      | Three months ended        |                      | Three months ended       |                      |
|                                    | October 26, 2012      | October 28, 2011 (a) | October 26, 2012          | October 28, 2011 (a) | October 26, 2012         | October 28, 2011 (a) |
| Service cost                       | \$ 26                 | \$ 23                | \$ 11                     | \$ 11                | \$ 5                     | \$ 5                 |
| Interest cost                      | 23                    | 22                   | 7                         | 7                    | 4                        | 4                    |
| Expected return on plan assets     | (32)                  | (30)                 | (8)                       | (9)                  | (4)                      | (4)                  |
| Amortization of net actuarial loss | 18                    | 11                   | 2                         | 1                    | 1                        | 1                    |
| Net periodic benefit cost          | \$ 35                 | \$ 26                | \$ 12                     | \$ 10                | \$ 6                     | \$ 6                 |

| (in millions)                      | U.S. Pension Benefits |                      | Non-U.S. Pension Benefits |                      | Post-Retirement Benefits |                      |
|------------------------------------|-----------------------|----------------------|---------------------------|----------------------|--------------------------|----------------------|
|                                    | Six months ended      |                      | Six months ended          |                      | Six months ended         |                      |
|                                    | October 26, 2012      | October 28, 2011 (a) | October 26, 2012          | October 28, 2011 (a) | October 26, 2012         | October 28, 2011 (a) |
| Service cost                       | \$ 52                 | \$ 46                | \$ 22                     | \$ 22                | \$ 10                    | \$ 10                |
| Interest cost                      | 46                    | 44                   | 14                        | 14                   | 8                        | 8                    |
| Expected return on plan assets     | (64)                  | (60)                 | (16)                      | (18)                 | (8)                      | (8)                  |
| Amortization of net actuarial loss | 36                    | 22                   | 4                         | 2                    | 2                        | 2                    |
| Net periodic benefit cost          | \$ 70                 | \$ 52                | \$ 24                     | \$ 20                | \$ 12                    | \$ 12                |

(a) Components of the net periodic benefit cost for the three and six months ended October 28, 2011 include balances related to Physio-Control.

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#### Note 19 Contingencies

The Company is involved in a number of legal actions. The outcomes of these legal actions are not within the Company's complete control and may not be known for prolonged periods of time. In some actions, the claimants seek damages, as well as other relief (including injunctions barring the sale of products that are the subject of the lawsuit), that could require significant expenditures or result in lost revenues. In accordance with U.S. GAAP, the Company records a liability in the consolidated financial statements for loss contingencies when a loss is known or considered probable and the amount can be reasonably estimated. If the reasonable estimate of a known or probable loss is a range, and no amount within the range is a better estimate than any other, the minimum amount of the range is accrued. If a loss is reasonably possible but not known or probable, and can be reasonably estimated, the estimated loss or range of loss is disclosed. When determining the estimated loss or range of loss, significant judgment is required to estimate the amount and timing of a loss to be recorded. Estimates of probable losses resulting from litigation and governmental proceedings involving the Company are inherently difficult to predict, particularly when the matters are in early procedural stages, with incomplete scientific facts or legal discovery; involve unsubstantiated or indeterminate claims for damages; potentially involve penalties, fines or punitive damages; or could result in a change in business practice. While it is not possible to predict the outcome for most of the matters discussed, the Company believes it is possible that costs associated with them could have a material adverse impact on the Company's consolidated earnings, financial position, or cash flows.

#### Litigation with Wyeth and Cordis Corporation

On February 22, 2008, Wyeth and Cordis Corporation (Cordis) filed a lawsuit against the Company and its subsidiary, Medtronic AVE, Inc., in U.S. District Court for the District of New Jersey, alleging that Medtronic's Endeavor drug-eluting stent infringes three U.S. Morris patents alleged to be owned by Wyeth and exclusively licensed to Cordis. On January 19, 2012, the Court found the patent claims asserted against Medtronic to be invalid and entered an Order and Judgment in favor of Medtronic and the other defendants. Wyeth and Cordis have appealed. The Company is indemnified for the claims made by Wyeth and Cordis. The Company has not recorded an expense related to damages in connection with these matters because any potential loss is not currently probable or reasonably estimable under U.S. GAAP. Additionally, the Company cannot reasonably estimate the range of loss, if any, that may result from this matter.

#### Litigation with Edwards Lifesciences, Inc.

On March 19, 2010, the U.S. District Court for the District of Delaware added Medtronic CoreValve LLC (CoreValve) as a party to litigation pending between Edwards Lifesciences, Inc. (Edwards) and CoreValve, Inc. In the litigation, Edwards asserted that CoreValve's transcatheter aortic valve replacement product infringed three U.S.

Andersen patents owned by Edwards. Before trial, the court granted summary judgment to Medtronic as to two of the three patents. Following a trial, on April 1, 2010 a jury found that CoreValve willfully infringed a claim on the remaining Andersen patent and awarded total lost profit and royalty damages of \$74 million. On November 13, 2012, the U.S. Court of Appeals for the Federal Circuit upheld the jury verdict. Medtronic intends to file a petition for rehearing. Medtronic recorded an expense of \$245 million related to probable and reasonably estimated damages for this matter in the second quarter of fiscal year 2013.

On March 12, 2010, Edwards served a second lawsuit in the Delaware court upon CoreValve, Medtronic Vascular, and Medtronic, asserting that Medtronic's transcatheter aortic valve replacement product from CoreValve infringed three U.S. Andersen patents owned by Edwards, including two of the patents that were the subject of the first lawsuit. Medtronic has moved to dismiss the lawsuit. Also pending in the Delaware court is Edwards' claim that the CoreValve transcatheter aortic valve replacement product infringes a Cribier patent. This claim is scheduled for trial in calendar year 2014. The Company has not recorded an expense related to damages in connection with these matters because any potential loss is not currently probable or reasonably estimable under U.S. GAAP. Additionally, the Company cannot reasonably estimate the range of loss, if any, that may result from these matters.

Edwards also previously asserted that the CoreValve product infringed an Andersen patent in Germany and the United Kingdom, which is a counterpart to the U.S. Andersen patents. Courts in both countries found that the CoreValve product does not infringe the European Andersen patent. On February 11, 2010, a German appellate court issued its opinion affirming the trial court ruling that the CoreValve product does not infringe the Andersen patent in Germany.

On June 30, 2010, the United Kingdom appellate court affirmed a trial court ruling that the CoreValve product does not infringe the Andersen patent in the United Kingdom. Both cases have been dismissed. On August 30, 2012 Edwards commenced a proceeding in Mannheim, Germany, alleging that Medtronic's CoreValve transcatheter valve infringes two European patents. The Company has not recorded an expense related to damages in connection with this matter because any potential loss is not currently probable or reasonably estimable under U.S. GAAP. Additionally, the Company cannot reasonably estimate the range of loss, if any, that may result from this matter.

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#### Sprint Fidelis Product Liability Matters

In 2007, a putative class action was filed in the Ontario Superior Court of Justice in Canada seeking damages for personal injuries allegedly related to the Company's Sprint Fidelis family of defibrillation leads. On October 20, 2009, the court certified a class proceeding but denied class certification on plaintiffs' claim for punitive damages. Pretrial proceedings are underway. The Company has not recorded an expense related to damages in connection with that matter because any potential loss is not currently probable or reasonably estimable under U.S. GAAP. Additionally, the Company cannot reasonably estimate the range of loss, if any, that may result from this matter.

#### Shareholder Related Matters

On December 10, 2008, the Minneapolis Firefighters' Relief Association filed a putative class action complaint against the Company and certain current and former officers in the U.S. District Court for the District of Minnesota, alleging violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 in connection with the INFUSE bone graft product. On March 30, 2012, the Company announced that the parties had agreed to a class-wide settlement. On November 8, 2012, the court entered final judgment approving the settlement.

The Company recorded an expense of \$90 million related to probable and reasonably estimated damages under U.S. GAAP in connection with this settlement in the fourth quarter of fiscal year 2012, and paid out the applicable portion of such funds to the plaintiffs' trust account in August 2012.

On March 12, 2012, Charlotte Kococinski filed a shareholder derivative action against both the Company and certain of its current and former officers and members of the Board of Directors in the U.S. District Court for the District of Minnesota, setting forth certain allegations, including a claim that defendants violated various purported duties in connection with the INFUSE bone graft product and otherwise. In May 2012, Daniel Himmel and the Saratoga Advantage Trust commenced two other separate shareholder derivative actions in Hennepin County, Minnesota, District Court against the same defendants, and making allegations similar to those, in the *Kococinski* case. The Company has not recorded an expense related to damages in connection with these matters because any potential loss is not currently probable or reasonably estimable under U.S. GAAP. Additionally, the Company cannot reasonably estimate the range of loss, if any, that may result from these matters.

#### Mirowski

Medtronic is a licensee to the RE 38,119 patent ( '119 Patent) and RE 38,897 patent ( '897 Patent) owned by Mirowski Family Ventures, LLC (Mirowski) relating to the treatment of hemodynamic dysfunction. Medtronic and Mirowski dispute the application of the '119 and '897 Patents to certain Medtronic cardiac resynchronization products. On December 17, 2007, Medtronic filed an action in U.S. District Court for the District of Delaware seeking a declaration that none of its products infringe any valid claims of either the '119 or '897 Patents. If certain conditions are fulfilled, the '119 and/or '897 Patents are determined to be valid, and the Medtronic products are found to infringe the '119 and/or '897 Patents, Medtronic will be obligated to pay royalties to Mirowski based upon sales of certain cardiac resynchronization therapy-defibrillator (CRT-D) products. On March 30, 2011, the trial court entered a judgment of non-infringement in Medtronic's favor. On September 16, 2012, the Federal Circuit reversed and remanded the trial court's decision for a new trial, based on its holding that the trial court did not properly allocate the burden of proof in the initial proceedings. On October 16, 2012, Medtronic petitioned the Federal Circuit for rehearing. The Company has not recorded an expense pursuant to U.S. GAAP requirements in connection with this matter because any loss is not probable or reasonably estimable.

#### Other Matters

On September 25, 2007 and November 16, 2007, the Company received letters from the U.S. Securities and Exchange Commission (SEC) and the U.S. Department of Justice (DOJ), respectively, requesting information relating to any potential violations of the U.S. Foreign Corrupt Practices Act in connection with the sale of medical devices in several non-U.S. countries. A number of competitors have publicly disclosed receiving similar letters. Subsequently, the SEC and DOJ have made additional requests for information from the Company. The Company is fully cooperating with these requests.

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The Company has received subpoenas or document requests from certain government bodies seeking information regarding sales, marketing, clinical and other information relating to the INFUSE bone graft product, including civil investigative demands from the Attorneys General in Massachusetts, California, Oregon, and Illinois. The Company is fully cooperating with these requests.

On September 16, 2009, the Company received a subpoena from the Office of Inspector General for the Department of Health and Human Services in the Eastern District of California requesting production of documents relating to the Company's cardiac rhythm medical devices, including revenue, sales, marketing, and promotional documents, documents relating to reimbursement communications to customers pertaining to the devices, documents relating to scientific studies and registries pertaining to the devices, and documents relating to payments or items of value provided to customers. The Company is fully cooperating with this inquiry. Allegations relating to post-market clinical studies in this matter were resolved as part of the settlement agreement reached with the DOJ, on behalf of the U.S. Attorney's Office for the District of Minnesota, in November 2011.

On March 12, 2010, the Company received a civil investigative demand from the DOJ pursuant to the federal False Claims Act seeking information regarding the Company's knowledge about claims to Medicare for the implantation of implantable cardioverter defibrillators (ICDs), including reimbursement advice given by the Company, payments to persons or entities involved in decisions about implantation of ICDs, and the national coverage determination relating to ICDs. The Company is fully cooperating with this inquiry.

On October 14, 2010, the Company received a subpoena issued by the U.S. Attorney's Office for the Western District of New York pursuant to the Health Insurance Portability & Accountability Act of 1996, relating to the Company's sales, marketing, and reimbursement support practices regarding certain neurostimulation devices. The Company is fully cooperating with this inquiry.

On November 9, 2010, the French Competition Authority commenced an investigation of the Company, along with a number of other medical device companies, and the companies' trade association, Syndicat National de l'Industrie des Technologies Medicales (SNITEM), to determine whether such companies or SNITEM engaged in any anticompetitive practices in responding to tenders to purchase certain medical devices. The Company is fully cooperating with the investigation.

On August 24, 2011, the Company received a letter from the DOJ requesting information relating to the Company's practices regarding the replacement of insulin pumps for Medicare beneficiaries. The Company is fully cooperating with this inquiry.

The Company has not recorded an expense related to losses in connection with these matters because any potential loss is not currently probable or reasonably estimable under U.S. GAAP. Additionally, the Company cannot reasonably estimate the range of loss, if any, that may result from these matters.

In the normal course of business, the Company periodically enters into agreements that require it to indemnify customers or suppliers for specific risks, such as claims for injury or property damage arising out of the Company's products or the negligence of its personnel or claims alleging that its products infringe third-party patents or other intellectual property. The Company's maximum exposure under these indemnification provisions cannot be estimated, and the Company has not accrued any liabilities within the consolidated financial statements. Historically, the Company has not experienced significant losses on these types of indemnifications.

#### Note 20 Segment and Geographic Information

##### Segment information

On January 30, 2012, the Company completed its sale of Physio-Control. Beginning in the third quarter of fiscal year 2012, the results of operations, assets, and liabilities of the Physio-Control business, which were previously presented as a component of the Cardiac and Vascular Group operating segment, are classified as discontinued operations for all periods presented, and therefore, are no longer presented in the Cardiac and Vascular Group operating segment. See Note 3 for further information regarding discontinued operations.

The Company's Cardiac and Vascular Group consists of four businesses: Cardiac Rhythm Disease Management (CRDM), Coronary, Structural Heart, and Endovascular. The primary products sold by this operating segment include those for cardiac rhythm disorders and cardiovascular disease. The Company's Restorative Therapies Group consists of four businesses: Spine, Neuromodulation, Diabetes, and Surgical Technologies. The primary products sold by this operating segment include those for spinal conditions and musculoskeletal trauma, neurological disorders, urological and digestive disorders, diabetes, and ear, nose, and throat conditions.



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

The Company's management evaluates performance and allocates resources based on profit and loss from operations before income taxes and interest expense, net, not including restructuring charges, net, certain litigation charges, net, and acquisition-related items. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies in Note 1 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended April 27, 2012.

Net sales of the Company's reportable segments include end-customer revenues from the sale of products they each develop and manufacture or distribute. Net sales and earnings before income taxes by reportable segment are as follows:

| (in millions)               | Three months ended  |                     | Six months ended    |                     |
|-----------------------------|---------------------|---------------------|---------------------|---------------------|
|                             | October 26,<br>2012 | October 28,<br>2011 | October 26,<br>2012 | October 28,<br>2011 |
| Cardiac and Vascular Group  | \$ 2,137            | \$ 2,098            | \$ 4,252            | \$ 4,201            |
| Restorative Therapies Group | 1,958               | 1,925               | 3,851               | 3,768               |
| <b>Total Net Sales</b>      | <b>\$ 4,095</b>     | <b>\$ 4,023</b>     | <b>\$ 8,103</b>     | <b>\$ 7,969</b>     |

| (in millions)  | Three months ended  |                     | Six months ended    |                     |
|--|---------------------|---------------------|---------------------|---------------------|
|  | October 26,<br>2012 | October 28,<br>2011 | October 26,<br>2012 | October 28,<br>2011 |
| Cardiac and Vascular Group                                     | \$ 668              | \$ 640              | \$ 1,406            | \$ 1,350            |
| Restorative Therapies Group                                    | 553                 | 481                 | 1,042               | 971                 |
| Total Reportable Segments Earnings Before Income Taxes         | 1,221               | 1,121               | 2,448               | 2,321               |
| Certain litigation charges, net                                | (245)               |                     | (245)               |                     |
| Acquisition-related items                                      | (6)                 | 24                  | (11)                | 16                  |
| Interest expense, net  | (24)                | (38)                | (57)                | (70)                |
| Corporate  | (92)                | (64)                | (193)               | (206)               |
| <b>Earnings From Continuing Operations Before Income Taxes</b> | <b>\$ 854</b>       | <b>\$ 1,043</b>     | <b>\$ 1,942</b>     | <b>\$ 2,061</b>     |

The following table presents the Company's net assets by reportable segment:

| (in millions)                           | October 26,<br>2012 | April 27,<br>2012 |
|---|---------------------|-------------------|
| Cardiac and Vascular Group              | \$ 6,880            | \$ 7,004          |
| Restorative Therapies Group             | 11,328              | 11,313            |
| Total Net Assets of Reportable Segments | 18,208              | 18,317            |
| Short-term borrowings                   | (4,097)             | (3,274)           |
| Long-term debt                          | (7,355)             | (7,359)           |
| Corporate                               | 10,419              | 9,429             |
| <b>Total Net Assets</b>                 | <b>\$ 17,175</b>    | <b>\$ 17,113</b>  |



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

Geographic information

Net sales to external customers by geography are as follows:

| (in millions)          | Three months ended  |                     | Six months ended    |                     |
|------------------------|---------------------|---------------------|---------------------|---------------------|
|                        | October 26,<br>2012 | October 28,<br>2011 | October 26,<br>2012 | October 28,<br>2011 |
| United States          | \$ 2,289            | \$ 2,237            | \$ 4,516            | \$ 4,383            |
| Europe and Canada      | 970                 | 1,027               | 1,978               | 2,091               |
| Asia Pacific           | 655                 | 603                 | 1,266               | 1,186               |
| Other Foreign          | 181                 | 156                 | 343                 | 309                 |
| <b>Total Net Sales</b> | <b>\$ 4,095</b>     | <b>\$ 4,023</b>     | <b>\$ 8,103</b>     | <b>\$ 7,969</b>     |

Note 21 Subsequent Events

On November 1, 2012, the Company acquired China Kanghui Holdings (Kanghui). Kanghui is a Chinese manufacturer and distributor of orthopedic products in trauma, spine, and joint reconstruction. Total consideration for the transaction was approximately \$816 million. The total value of the transaction, net of Kanghui's cash, was approximately \$755 million.

On December 3, 2012, the Company and Shandong Weigao Group Medical Polymer Company Limited, the Company's partner in a joint venture to distribute spinal and orthopedic products in China, signed a Separation Agreement to terminate early their joint venture established in 2007. The proposed termination of the joint venture is contingent upon receipt of the requisite approvals from the relevant Chinese regulatory authorities. Pursuant to the terms of the agreement, the Company's exclusive distribution agreement with the joint venture to distribute the Company's spinal products in China will terminate effective December 31, 2012.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**UNDERSTANDING OUR FINANCIAL INFORMATION**

The following discussion and analysis provides information management believes to be relevant to understanding the financial condition and results of operations of Medtronic, Inc. and its subsidiaries (Medtronic or the Company). For a full understanding of financial condition and results of operations, you should read this discussion along with management's discussion and analysis of financial condition and results of operations in our Annual Report on Form 10-K for the year ended April 27, 2012. In addition, you should read this discussion along with our condensed consolidated financial statements and related notes thereto as of October 26, 2012.

Beginning in the third quarter of fiscal year 2012, the results of operations, assets, and liabilities of the Physio-Control business, which were previously presented as a component of the Cardiac and Vascular Group operating segment, are classified as discontinued operations. All information in the following management's discussion and analysis of financial condition and results of operations includes only results from continuing operations (excluding Physio-Control) for all periods presented, unless otherwise noted. For further information regarding discontinued operations, see Note 3 to the current period's condensed consolidated financial statements.

**Financial Trends**

Throughout this management's discussion and analysis, you will read about transactions or events that materially contribute to or reduce earnings and materially affect financial trends. We refer to these transactions and events as special charges (such as asset impairments), restructuring charges, net, certain litigation charges, net, acquisition-related items, or certain tax adjustments. These charges, or benefits, result from facts and circumstances that vary in frequency and/or impact to operations. While understanding these charges or benefits is important to understanding and evaluating financial trends, other transactions or events may also have a material impact on financial trends. A complete understanding of the special charges, restructuring charges, net, certain litigation charges, net, acquisition-related items, and certain tax adjustments is necessary in order to estimate the likelihood that financial trends will continue.

**EXECUTIVE LEVEL OVERVIEW**

We are the global leader in medical technology - alleviating pain, restoring health, and extending life for millions of people around the world. We develop, manufacture, and market our medical devices in more than 120 countries. Our primary products include those for cardiac rhythm disorders, cardiovascular disease, neurological disorders, spinal conditions and musculoskeletal trauma, urological and digestive disorders, diabetes, and ear, nose, and throat conditions.

We operate under two reportable segments and two operating segments, the Cardiac and Vascular Group (composed of the CRDM, Coronary, Structural Heart, and Endovascular businesses) and the Restorative Therapies Group (composed of the Spine, Neuromodulation, Diabetes, and Surgical Technologies businesses).

Net earnings for the second quarter of fiscal year 2013 were \$646 million, or \$0.63 per diluted share, as compared to net earnings (including Physio-Control) of \$871 million, or \$0.82 per diluted share for the same period in the prior fiscal year, representing a decrease of 26 percent and 23 percent, respectively. Net earnings for the three months ended October 26, 2012 included certain litigation charges, net and acquisition-related items that decreased net earnings by \$241 million after-tax (\$251 million pre-tax). Net earnings (including Physio-Control) for the three months ended October 28, 2011 included acquisition-related items, net that increased net earnings by \$24 million after-tax (\$24 million pre-tax). See further discussion of these charges in the Certain Litigation Charges, Net, Restructuring Charges and Acquisition-Related Items section of this management's discussion and analysis.

Net earnings for the six months ended October 26, 2012 were \$1.510 billion, or \$1.46 per diluted share, as compared to net earnings (including Physio-Control) of \$1.692 billion, or \$1.59 per diluted share for the same period in the prior fiscal year, representing a decrease of 11 percent and 8 percent, respectively. Net earnings for the six months ended October 26, 2012 included certain litigation charges, net and certain acquisition-related items that decreased net earnings by \$246 million after-tax (\$256 million pre-tax). Net earnings (including Physio-Control) for the six months ended October 28, 2011 included acquisition-related items, net that increased net earnings by \$16 million after-tax (\$16 million pre-tax). See further discussion of these charges in the Certain Litigation Charges, Net, Restructuring Charges and Acquisition-Related Items section of this management's discussion and analysis.

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The table below illustrates net sales by operating segment for the three and six months ended October 26, 2012 and October 28, 2011:

| (dollars in millions)       | Three months ended  |                     |           | Six months ended    |                     |           |
|-----------------------------|---------------------|---------------------|-----------|---------------------|---------------------|-----------|
|                             | October 26,<br>2012 | October 28,<br>2011 | % Change  | October 26,<br>2012 | October 28,<br>2011 | % Change  |
| Cardiac and Vascular Group  | \$ 2,137            | \$ 2,098            | 2%        | \$ 4,252            | \$ 4,201            | 1%        |
| Restorative Therapies Group | 1,958               | 1,925               | 2         | 3,851               | 3,768               | 2         |
| <b>Total Net Sales</b>      | <b>\$ 4,095</b>     | <b>\$ 4,023</b>     | <b>2%</b> | <b>\$ 8,103</b>     | <b>\$ 7,969</b>     | <b>2%</b> |

Net sales for the three and six months ended October 26, 2012 were \$4.095 billion and \$8.103 billion, respectively, an increase of 2 percent for both periods over the same periods in the prior fiscal year. Foreign currency translation had an unfavorable impact of \$118 million and \$238 million on net sales for the three and six months ended October 26, 2012, respectively, when compared to the same periods in the prior fiscal year. The net sales increase for the three and six months ended October 26, 2012 was driven by 2 percent and 1 percent growth, respectively, in our Cardiac and Vascular Group and 2 percent growth for both periods in our Restorative Therapies Group. The Cardiac and Vascular Group's performance for the three and six months ended October 26, 2012 was primarily a result of strong net sales in Coronary, Endovascular, and AF Solutions, and solid growth in Structural Heart, partially offset by declines in CRDM defibrillation and pacing systems. The Cardiac and Vascular Group's performance for the three and six months ended October 26, 2012 was favorably impacted by new products, partially offset by competitive pricing pressures and continued negative growth of certain markets, particularly defibrillation and pacing systems. However, in the first and second quarters of fiscal year 2013, the U.S. defibrillation systems market continued to show signs of stabilization. Our Restorative Therapies Group's performance for the three and six months ended October 26, 2012 was favorably impacted by strong net sales in Surgical Technologies, as well as solid growth in Neuromodulation and Diabetes, partially offset by declines in Spine, primarily driven by BMP (comprised of INFUSE bone graft (InductOs in the European Union) sales). The Restorative Therapies Group's performance for the three and six months ended October 26, 2012 was favorably impacted by the recent launch of notable products, the acquisitions of Salient and PEAK in the second quarter of fiscal year 2012, signs of stabilization in the U.S. Core Spine market, and negatively impacted by continued payer scrutiny and competition. See our discussion in the Net Sales section of this management's discussion and analysis for more information on the results of our significant operating segments.

We remain committed to our Mission of developing lifesaving and life-enhancing therapies to alleviate pain, restore health, and extend life.

### CRITICAL ACCOUNTING ESTIMATES

We have adopted various accounting policies to prepare the condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (U.S.) (U.S. GAAP). Our most significant accounting policies are disclosed in Note 1 to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended April 27, 2012.

The preparation of the condensed consolidated financial statements, in conformity with U.S. GAAP, requires us to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Our estimates and assumptions, including those related to bad debts, inventories, intangible assets, asset impairment, legal proceedings, IPR&D, contingent consideration, warranty obligations, product liability, self-insurance, pension and post-retirement obligations, sales returns and discounts, stock-based compensation, valuation of equity and debt securities, and income tax reserves are updated as appropriate, which in most cases is quarterly. We base our estimates on historical experience, actuarial valuations, or various assumptions that are believed to be reasonable under the circumstances.

Estimates are considered to be critical if they meet both of the following criteria: (1) the estimate requires assumptions about material matters that are uncertain at the time the accounting estimates are made, and (2) material changes in the estimates are reasonably likely to occur from period to period. Our critical accounting estimates include the following:

#### Legal Proceedings

We are involved in a number of legal actions involving product liability, intellectual property disputes, shareholder derivative actions, securities class actions, and other class actions. The outcomes of these legal actions are not within our complete control and may not be known for prolonged periods of time. In some actions, the claimants seek damages, as well as other relief (including injunctions barring the sale of products that are the subject of the lawsuit), that could require significant expenditures or result in lost revenues. In accordance with U.S. GAAP, we record a liability in our condensed consolidated financial statements for loss contingencies when a loss is known or considered probable and the amount can be reasonably estimated. If the reasonable estimate of a known or probable loss is a range, and no amount within the range is a better estimate than any other, the minimum amount of the range is accrued. If a loss is reasonably possible, but not known or probable, and can be reasonably estimated, the estimated loss or range of loss is disclosed in the notes to the condensed consolidated financial statements. When determining the estimated loss or range of loss, significant judgment is required to estimate the amount and timing of a loss to be recorded. Estimates of probable losses resulting from litigation and governmental proceedings involving the Company are inherently difficult to predict, particularly when the matters are in early procedural stages, with incomplete scientific facts or legal discovery; involve unsubstantiated or

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indeterminate claims for damages; potentially involve penalties, fines, or punitive damages; or could result in a change in business practice. Our significant legal proceedings are discussed in Note 19 to the current period's condensed consolidated financial statements. While it is not possible to predict the outcome for most of the matters discussed in Note 19 to the current period's condensed consolidated financial statements, we believe it is possible that costs associated with them could have a material adverse impact on our consolidated earnings, financial position, or cash flows.

## Tax Strategies

Our effective tax rate is based on income, statutory tax rates, and tax planning opportunities available to us in the various jurisdictions in which we operate. We establish reserves when, despite our belief that our tax return positions are fully supportable, we believe that certain positions are likely to be challenged and that we may or may not prevail. These reserves are established and adjusted in accordance with the principles of U.S. GAAP. Under U.S. GAAP, if we determine that a tax position is more likely than not of being sustained upon audit, based solely on the technical merits of the position, we recognize the benefit. We measure the benefit by determining the amount that is greater than 50 percent likely of being realized upon settlement. We presume that all tax positions will be examined by a taxing authority with full knowledge of all relevant information. We regularly monitor our tax positions and tax liabilities. We reevaluate the technical merits of our tax positions and recognize an uncertain tax benefit, or derecognize a previously recorded tax benefit, when (i) there is a completion of a tax audit, (ii) there is a change in applicable tax law including a tax case or legislative guidance, or (iii) there is an expiration of the statute of limitations. Significant judgment is required in accounting for tax reserves. Although we believe that we have adequately provided for liabilities resulting from tax assessments by taxing authorities, positions taken by these tax authorities could have a material impact on our effective tax rate in future periods.

In the event there is a special charge, restructuring charge, net, certain litigation charge, net, and/or certain acquisition-related items recognized in our operating results, the tax cost or benefit attributable to that item is separately calculated and recorded. Because the effective rate can be significantly impacted by these discrete items that take place in the period, we often refer to our tax rate using both the effective rate and the non-GAAP nominal tax rate. The non-GAAP nominal tax rate is defined as the income tax provision as a percentage of earnings before income taxes, excluding special charges, restructuring charges, net, certain litigation charges, net, certain acquisition-related items, and certain tax adjustments. We believe this resulting non-GAAP financial measure provides useful information to investors because it excludes the effect of these discrete items so that investors can compare our recurring results over multiple periods. Investors should consider this non-GAAP measure in addition to, and not as a substitute for, financial performance measures prepared in accordance with U.S. GAAP. In addition, this non-GAAP financial measure may not be the same or similar to measures presented by other companies.

Tax regulations require certain items to be included in the tax return at different times than when those items are required to be recorded in the condensed consolidated financial statements. As a result, our effective tax rate reflected in our condensed consolidated financial statements is different than that reported in our tax returns. Some of these differences are permanent, such as expenses that are not deductible on our tax return, and some are temporary differences, such as depreciation expense. Temporary differences create deferred tax assets and liabilities. Deferred tax assets generally represent items that can be used as a tax deduction or credit in our tax return in future years for which we have already recorded the tax benefit in our consolidated statements of earnings. We establish valuation allowances for our deferred tax assets when the amount of expected future taxable income is not likely to support the use of the deduction or credit. Deferred tax liabilities generally represent tax expense recognized in our condensed consolidated financial statements for which payment has been deferred or expense has already been taken as a deduction on our tax return but has not yet been recognized as an expense in our condensed consolidated statements of earnings.

The Company's overall tax rate from continuing operations including the tax impact of certain litigation charges, net, and certain acquisition-related items resulted in an effective tax rate of 24.36 percent and 22.25 percent for the three and six months ended October 26, 2012, respectively. Excluding the impact of the certain litigation charges, net, and certain acquisition-related items for the three and six months ended October 26, 2012, our operational and tax strategies have resulted in a non-GAAP nominal tax rate of 19.72 percent and 20.11 percent, respectively, versus the U.S. Federal statutory rate of 35.0 percent. An increase in our nominal tax rate of 1 percent would result in an additional income tax provision for the three and six months ended October 26, 2012 of approximately \$11 million and \$22 million, respectively. See discussion of our tax rate and the tax adjustments in the [Income Taxes](#) section of this management's discussion and analysis.

## Valuation of Other Intangible Assets, Including IPR&D, Goodwill, and Contingent Consideration

When we acquire a business, the purchase price is allocated, as applicable, among identifiable intangible assets, including IPR&D, net tangible assets, and goodwill as required by U.S. GAAP. Our policy defines IPR&D as the value assigned to those projects for which the related products have not received regulatory approval and have no alternative future use. Determining the portion of the purchase price allocated to other intangible assets and IPR&D requires us to make significant estimates. These estimates include the amount and timing of projected future cash flows, the discount rate used to discount those cash flows to present value, the assessment of the asset's life cycle, and the consideration of legal, technical, regulatory, economic, and competitive risks. The amount of the purchase price allocated to other intangible assets, including IPR&D, and net tangible assets is determined by estimating the future cash flows of each project or technology and discounting the net cash flows back to their present values. The discount rate used is determined at the time of measurement in accordance with accepted valuation standards.

IPR&D included in a business combination is capitalized as an indefinite-lived intangible asset. Development costs incurred after the acquisition are expensed as incurred. Upon receipt of regulatory approval, the indefinite-lived intangible asset is then accounted for as a finite-lived intangible asset and amortized on a straight-line basis over its estimated useful life. If the research and development project is abandoned, the indefinite-lived asset is charged to expense. IPR&D acquired outside of a business combination is expensed immediately.

Due to the uncertainty associated with research and development projects, there is risk that actual results will differ materially from the original cash flow projections and that the research and development project will result in a successful commercial product. The risks associated with achieving commercialization include, but are not limited to, delay or failure to obtain regulatory approvals to conduct clinical trials, delay or failure to obtain required market clearances, delays or issues with patent issuance, or validity and litigation.

Contingent consideration is recorded at the acquisition date at the estimated fair value of the contingent consideration milestone payments for all acquisitions subsequent to April 24, 2009. The acquisition date fair value is measured based on the consideration expected to be transferred (probability-weighted), discounted back to present value. The discount rate used is determined at the time of measurement in accordance with accepted valuation methods. 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 our condensed consolidated statements of earnings. Changes to the fair value of contingent consideration liability can result from changes in discount rates and periods as well as changes in the timing and amount of revenue estimates or in the timing or likelihood of achieving the milestones which trigger payment. Using different valuation assumptions including revenue or cash flow projections, growth rates, discount rates, or probabilities of achieving the milestones could result in different purchase price allocations, amortization expense, and contingent consideration expense in the current or future periods.

Goodwill is the excess of the purchase price over the fair value of net assets, including IPR&D, of acquired businesses. Goodwill is tested for impairment annually or whenever an event occurs or circumstances change that would indicate that the carrying amount may be impaired. The test for impairment requires us to make several estimates about fair value, most of which are based on projected future cash flows. Our estimates associated with the goodwill impairment test are considered critical due to the amount of goodwill recorded on our condensed consolidated balance sheets and the judgment required in determining fair value, including projected future cash flows. Goodwill was \$9.944 billion and \$9.934 billion as of October 26, 2012 and April 27, 2012, respectively.

Other intangible assets include patents, trademarks, purchased technology, and IPR&D (since April 25, 2009). Intangible assets with a definite life are amortized on a straight-line or accelerated basis, as appropriate, with estimated useful lives ranging from three to 20 years. We review all intangible assets for impairment annually or whenever events or circumstances indicate that the carrying amount of an asset (asset group) may not be recoverable. Our impairment reviews are based on an estimated future cash flow approach that requires significant judgment with respect to future revenue and expense growth rates, selection of appropriate discount rate, asset groupings, and other assumptions and estimates. We use estimates that are consistent with our business plans and a market participant view of the assets being evaluated. Actual results may differ from our estimates. Other intangible assets, net of accumulated amortization, were \$2.500 billion and \$2.647 billion as of October 26, 2012 and April 27, 2012, respectively.

## NEW ACCOUNTING PRONOUNCEMENTS

Information regarding new accounting pronouncements is included in Note 2 to the current period's condensed consolidated financial statements.

## DISCONTINUED OPERATIONS

On January 30, 2012, we completed the sale of the Physio-Control business to Bain Capital Partners, LLC. We have classified the results of operations of the Physio-Control business, which were previously presented as a component of the Cardiac and Vascular Group operating segment, as discontinued operations in the consolidated statements of earnings for all periods presented. For more information regarding discontinued operations, refer to Note 3 to the current period's condensed consolidated financial statements.



**SUBSEQUENT ACQUISITION**

On November 1, 2012, we acquired China Kanghui Holdings (Kanghui). Kanghui is a Chinese manufacturer and distributor of orthopedic products in trauma, spine, and joint reconstruction. Total consideration for the transaction was approximately \$816 million. The total value of the transaction, net of Kanghui's cash, was approximately \$755 million.

**ACQUISITIONS**

We had no significant acquisitions during the three and six months ended October 26, 2012.

*Three and six months ended October 28, 2011*

On August 31, 2011, we 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. We had previously invested in Salient and held an 8.9 percent ownership position in the company. In connection with the acquisition of Salient, we recognized a gain on our previously held investment of \$32 million, which was recorded within *acquisition-related items* in the condensed consolidated statement of earnings in the second quarter of fiscal year 2012. Net of this ownership position, the transaction value was approximately \$452 million.

On August 31, 2011, we 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. We had previously invested in PEAK and held an 18.9 percent ownership position in the company. In connection with the acquisition of PEAK, we recognized a gain on our previously held investment of \$6 million, which was recorded within *acquisition-related items* in the condensed consolidated statement of earnings in the second quarter of fiscal year 2012. Net of this ownership position, the transaction value was approximately \$96 million.

In addition to the acquisitions above, we periodically acquire certain tangible and intangible assets from enterprises that do not otherwise qualify for accounting as a business combination. These transactions are largely reflected in the condensed consolidated statements of cash flows as a component of investing activities under *other investing activities, net*.

**NET SALES**

The table below illustrates net sales by product line and operating segment for the three and six months ended October 26, 2012 and October 28, 2011:

| (dollars in millions)                        | Three months ended  |                     |             | Six months ended    |                     |             |
|--|---------------------|---------------------|-------------|---------------------|---------------------|-------------|
|  | October 26,<br>2012 | October 28,<br>2011 | %<br>Change | October 26,<br>2012 | October 28,<br>2011 | %<br>Change |
| Defibrillation Systems                       | \$ 689              | \$ 708              | (3)%        | \$ 1,365            | \$ 1,404            | (3)%        |
| Pacing Systems                               | 480                 | 511                 | (6)         | 943                 | 1,019               | (7)         |
| AF and Other                                 | 58                  | 49                  | 18          | 112                 | 97                  | 15          |
| <b>CARDIAC RHYTHM DISEASE<br/>MANAGEMENT</b> | 1,227               | 1,268               | (3)         | 2,420               | 2,520               | (4)         |
| CORONARY                                     | 429                 | 376                 | 14          | 862                 | 766                 | 13          |
| STRUCTURAL HEART                             | 271                 | 266                 | 2           | 551                 | 541                 | 2           |
| ENDOVASCULAR                                 | 210                 | 188                 | 12          | 419                 | 374                 | 12          |
| <b>TOTAL CARDIAC AND VASCULAR<br/>GROUP</b>  | 2,137               | 2,098               | 2           | 4,252               | 4,201               | 1           |
| Core Spine                                   | 649                 | 675                 | (4)         | 1,294               | 1,325               | (2)         |
| BMP  | 133                 | 164                 | (19)        | 274                 | 338                 | (19)        |
| SPINE  | 782                 | 839                 | (7)         | 1,568               | 1,663               | (6)         |
| NEUROMODULATION                              | 454                 | 421                 | 8           | 873                 | 818                 | 7           |
| DIABETES                                     | 378                 | 367                 | 3           | 742                 | 722                 | 3           |
| SURGICAL TECHNOLOGIES                        | 344                 | 298                 | 15          | 668                 | 565                 | 18          |
| <b>TOTAL RESTORATIVE THERAPIES<br/>GROUP</b> | 1,958               | 1,925               | 2           | 3,851               | 3,768               | 2           |
| <b>TOTAL</b>                                 | \$ 4,095            | \$ 4,023            | 2%          | \$ 8,103            | \$ 7,969            | 2%          |



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Net sales for the three and six months ended October 26, 2012 were unfavorably impacted by foreign currency translation of \$118 million and \$238 million, respectively, when compared to the same periods of the prior fiscal year. The primary exchange rate movements that impacted our consolidated net sales growth were the U.S. dollar as compared to the Euro and the Japanese Yen. The impact of foreign currency fluctuations on net sales was not indicative of the impact on net earnings due to the offsetting foreign currency impact on operating costs and expenses and our hedging activities. See Item 3 Quantitative and Qualitative Disclosures About Market Risk and Note 10 to the current period's condensed consolidated financial statements for further details on currency exchange rate derivative instruments and our related risk management strategies.

### Cardiac and Vascular Group

The Cardiac and Vascular Group is composed of the CRDM, Coronary, Structural Heart, and Endovascular businesses. The Cardiac and Vascular Group's products include pacemakers, implantable defibrillators, leads and delivery systems, ablation products, electrophysiology catheters, products for the treatment of atrial fibrillation (AF), information systems for the management of patients with CRDM devices, coronary and peripheral stents and related delivery systems, therapies for uncontrolled hypertension, endovascular stent graft systems, heart valve replacement technologies, cardiac tissue ablation systems, and open heart and coronary bypass grafting surgical products. The Cardiac and Vascular Group's net sales for the three and six months ended October 26, 2012 were \$2.137 billion and \$4.252 billion, an increase of 2 percent and 1 percent, respectively, over the same periods in the prior fiscal year. Foreign currency translation had an unfavorable impact on net sales for the three and six months ended October 26, 2012 of approximately \$81 million and \$161 million, respectively, when compared to the same periods in the prior fiscal year. The Cardiac and Vascular Group's performance for the three and six months ended October 26, 2012 was primarily a result of strong net sales in Coronary, Endovascular, and AF Solutions, and solid growth in Structural Heart, partially offset by declines in CRDM defibrillation and pacing systems. Additionally, the Cardiac and Vascular Group's performance was favorably impacted by new products, partially offset by competitive pricing pressures and continued negative growth of certain markets, particularly defibrillation and pacing systems. See the more detailed discussion of each business's performance below.

CRDM net sales for the three and six months ended October 26, 2012 were \$1.227 billion and \$2.420 billion, a decrease of 3 percent and 4 percent, respectively, over the same periods in the prior fiscal year. In fiscal year 2012, CRDM net sales were unfavorably impacted by a declining U.S. defibrillation systems market. However, in the first and second quarters of fiscal year 2013, the U.S. defibrillation systems market continued to show signs of stabilization. In the second quarter of fiscal year 2013, the market declined similarly to the first quarter of 2013, when it experienced the lowest level of decline in the previous six quarters. In addition, U.S. procedure volumes and the rate of pricing declines were relatively stable. Net sales of our defibrillation system products for the three and six months ended October 26, 2012 declined primarily due to unfavorable foreign currency translation and market declines in the U.S. and Western Europe. The markets were impacted by a number of factors, including competition and the continued trend of reduced hospital inventory levels. The continued acceptance of our Protecta SmartShock (Protecta) family of devices, improved lead-to-port ratios, and worldwide share gains partially offset the decline in net sales of our defibrillation products. Worldwide net sales of our pacing system products for the three and six months ended October 26, 2012 declined primarily due to unfavorable foreign currency translation and declines in the U.S. market caused by pricing pressures, declining implant volumes, and the continued trend of reduced hospital inventory levels. The decline in net sales of our pacing system products was partially offset by international share gains driven in part by the launch of our Advisa MRI pacemaker in Japan late in the second quarter of fiscal year 2013. Worldwide net sales of our AF Solutions products increased for the three and six months ended October 26, 2012 primarily due to the continued acceptance in the U.S., and in certain markets outside the U.S., of the Arctic Front Cardiac CryoAblation Catheter system.

Coronary net sales for the three and six months ended October 26, 2012 were \$429 million and \$862 million, an increase of 14 percent and 13 percent, respectively, over the same periods in the prior fiscal year. The increase in Coronary net sales for the three and six months ended October 26, 2012 was primarily due to the continued strength of our Resolute Integrity drug-eluting coronary stent. We launched Resolute Integrity in the U.S. in the fourth quarter fiscal year 2012 and in Japan in late August 2012. Resolute Integrity's deliverability and unique diabetes indication has received strong customer acceptance to date. Growth was partially offset by unfavorable foreign currency translation as well as economic challenges in Western Europe.

Structural Heart net sales for the three and six months ended October 26, 2012 were \$271 million and \$551 million, respectively, an increase of 2 percent for both periods over the same periods in the prior fiscal year. The increase in Structural Heart net sales for the three and six months ended October 26, 2012 was primarily driven by strong sales of the CoreValve transcatheter aortic heart valves and growth in our cardiopulmonary product lines. Growth was partially offset by unfavorable foreign currency translation and slowing market growth rates in Western Europe.

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Endovascular net sales for the three and six months ended October 26, 2012 were \$210 million and \$419 million, respectively, an increase of 12 percent for both periods over the same periods in the prior fiscal year. The increase in Endovascular net sales for the three and six months ended October 26, 2012 was led by recent new product launches in our primary markets. Growth was driven by the Endurant Abdominal Aortic Aneurysm (AAA) Stent Graft System, which launched in Japan in the third quarter of fiscal year 2012, as well as the Endurant II AAA Stent Graft System, which launched in Europe in the third quarter of fiscal year 2012 and in the U.S. in the first quarter of fiscal year 2013, and the Valiant Captivia Thoracic Stent Graft System, which was launched in the U.S. in the fourth quarter of fiscal year 2012 and in Japan and China in the first quarter of fiscal year 2013. Strong worldwide sales of our peripheral stent products also contributed to the growth.

Looking ahead, we expect our Cardiac and Vascular Group could be impacted by the following:

Increasing pricing pressures, competition, and declining hospital inventory levels.

Fluctuations in U.S. market growth rates for our defibrillation system products.

Continued market acceptance of our Protecta family of devices, which was launched in the U.S. in the fourth quarter of fiscal year 2011. The Protecta portfolio leverages the already established Vision 3D platform to deliver a full suite of single, dual, and triple chamber defibrillators that include SmartShock Technology, a family of new Medtronic-exclusive algorithms that reduces the delivery of inappropriate shocks, which is a leading clinical request from physicians.

Future growth from the Viva/Brava family of CRT-D devices. The Viva/Brava family of CRT-D devices features a new algorithm, called AdaptivCRT, which improves patients' response rate to CRT-D therapy by preserving the patients' normal heart rhythms and continually adapting to individual patient needs. Our Viva/Brava CRT-D devices received Conformité Européenne (CE) Mark approval in August 2012.

Continued and future unit growth of pacing systems developed specifically for use in magnetic resonance imaging (MRI) machines. We launched Advisa MRI SureScan, our next generation MRI pacing system, in Europe during the fourth quarter of fiscal year 2010, and in Japan late in the second quarter of fiscal year 2013. Our first generation MRI pacing system in the U.S., Revo MRI SureScan, was launched in the fourth quarter of fiscal year 2011. Both Advisa MRI SureScan and Revo MRI SureScan are designed to address and mitigate interactions between the pacing system and the magnetic resonance imaging environment. We believe that these MRI compatible products will continue to protect recent share gains.

Continued and future growth from the Arctic Front system. The Arctic Front system is a cryoballoon indicated for the treatment of drug refractory paroxysmal atrial fibrillation. The cryoballoon treatment involves a minimally invasive procedure that efficiently creates circumferential lesions around the pulmonary vein, which is the source of erratic electrical signals that cause irregular heartbeat.

Continued and future acceptance of the Resolute Integrity drug-eluting coronary stent and the Integrity bare metal stent. The Resolute Integrity drug-eluting coronary stent was launched in the U.S. in February 2012, Europe in August 2010, and Japan at the end of August 2012. The Integrity platform features a laser-fused sinusoidal technology that is designed to significantly improve flexibility and conformability compared to other technologies. While the global stent market continues to experience year-over-year declines, to date we have been successful in gaining share with this stent platform in those geographies where the product has been approved.

Continued and future acceptance of renal denervation therapies. Commercially, we are still in the pre-reimbursement phase in many countries, and will likely remain in that phase until we obtain additional clinical data. Our Symplicity Catheter System, which addresses uncontrolled hypertension through renal denervation, or ablation of the nerves lining the renal arteries, has received CE Mark approval and Australia's Therapeutic Goods Administration listing, and was approved in Canada by the Therapeutic Products Directorate in the fourth quarter of fiscal year 2012. We continue to enroll patients in our U.S. pivotal study and remain on track for U.S. approval in fiscal year 2015.

Continued growth in Japan from the Endurant AAA Stent Graft System, and continued growth worldwide of the Valiant Captivia Thoracic Stent Graft System. The Endurant AAA Stent Graft System received

Pharmaceuticals and Medical Devices Agency approval and was launched in Japan during the third quarter of fiscal year 2012. The Valiant Captivia Thoracic Stent Graft System was launched in the U.S. in the fourth quarter of fiscal year 2012 and in Japan and China in the first quarter of fiscal year 2013.

Continued and future acceptance of the Endurant II AAA Stent Graft System. Our Endurant II AAA Stent Graft System was launched in Europe in the third quarter of fiscal year 2012 and in the U.S. in the first quarter of fiscal year 2013.

Continued acceptance of our CoreValve transcatheter heart valve technologies for the replacement of the aortic valve. The CoreValve System has received CE Mark approval and is currently available outside the U.S. The CoreValve 31 millimeter received CE Mark approval in the first quarter of fiscal year 2012. We are continuing to roll out our CoreValve Evolut 23 millimeter valve, which was launched in Europe late in the first quarter of fiscal year 2013, and promotes better sealing and provides future recapturability. Additionally, we continue to make progress on the CoreValve System in the U.S. pivotal study; we finished enrollment in the extreme risk arm in January 2012 and finished enrollment in the high risk arm in late August 2012. Also, we started our CoreValve pivotal trial in Japan during November 2011.

## Restorative Therapies Group

The Restorative Therapies Group is composed of the Spine, Neuromodulation, Diabetes, and Surgical Technologies businesses. Products in the Restorative Therapies Group include products for various areas of the spine, bone graft substitutes, biologic products, implantable neurostimulation therapies, and drug delivery devices for the treatment of chronic pain, movement disorders, obsessive-compulsive disorder (OCD), overactive bladder, urinary retention, fecal incontinence and gastroparesis, external insulin pumps, subcutaneous continuous glucose monitoring (CGM) systems, products to treat conditions of the ear, nose, and throat, and devices that incorporate advanced energy technology. Additionally, this group manufactures and sells image-guided surgery and intra-operative imaging systems. The Restorative Therapies Group's net sales for three and six months ended October 26, 2012 were \$1.958 billion and \$3.851 billion, respectively, an increase of 2 percent for both periods over the same periods in the prior fiscal year. Foreign currency translation had an unfavorable impact on net sales for the three and six months ended October 26, 2012 of approximately \$37 million and \$77 million, respectively, compared to the same periods in the prior fiscal year. The Restorative Therapies Group's performance for the three and six months ended October 26, 2012 was favorably impacted by strong net sales in Surgical Technologies, as well as solid growth in Diabetes and Neuromodulation, partially offset by declines in Spine, primarily driven by BMP. The Restorative Therapies Group's performance was favorably impacted by the recent launch of notable products, the acquisitions of Salient and PEAK in the second quarter of fiscal year 2012, and signs of stabilization in the U.S. Core Spine market, and negatively impacted by continued heightened payer scrutiny and competition. See the more detailed discussion of each business's performance below.

Spine net sales for the three and six months ended October 26, 2012 were \$782 million and \$1.568 billion, a decrease of 7 percent and 6 percent, respectively, over the same periods in the prior fiscal year. Spine's performance for the three and six months ended October 26, 2012 was negatively impacted by continued pricing and competitive pressures, unfavorable foreign currency translation, and a challenging reimbursement environment in certain of our major markets. The U.S. Core Spine market showed signs of stabilization in the first half of fiscal year 2013, as supported by the flat first quarter market and modest improvement over the prior three quarters. While the U.S. Core Spine market declined in the second quarter, it did not show significant changes in the underlying market conditions, including procedure trends, pricing pressure, or competitive dynamics. A strong contributing factor to the decline in Spine's sales for the three and six months ended October 26, 2012 was a 20 percent decline in U.S. sales of INFUSE bone graft for both periods over the same periods in the prior fiscal year. The decline in INFUSE bone graft sales was primarily driven by the June 2011 articles in *The Spine Journal* as further described below. A slight decline in Core Spine net sales also negatively impacted Spine's performance, primarily driven by negative performance in Kyphon Balloon Kyphoplasty (BKP) products. BKP's sales for the second quarter of fiscal year 2013 declined 10 percent when compared to the same period in the prior fiscal year. The decline in BKP sales was due to the continued decrease in demand and competitive pricing pressures. Core Spine benefited from the second quarter launch of Bryan ACD Instrument Set, AMT implants, and the Capstone Control, as well as the continued adoption of Solera, Atlantis Vision Elite cervical plates, and other biologics products, including MAGNIFUSE and GRAFTON.

Neuromodulation net sales for the three and six months ended October 26, 2012 were \$454 million and \$873 million, an increase of 8 percent and 7 percent, respectively, over the same periods in the prior fiscal year. The increase in net sales for the three and six months ended October 26, 2012 was primarily due to the continued launch of RestoreSensor spinal cord stimulator and implant growth of both InterStim Therapy for overactive bladder, urinary retention, and bowel control, and Activa PC and RC deep brain stimulation (DBS) systems for movement disorders. This growth was partially offset by unfavorable foreign currency translation.

Diabetes net sales for the three and six months ended October 26, 2012 were \$378 million and \$742 million, respectively, an increase of 3 percent for both periods over the same periods in the prior fiscal year. The increase in net sales for the three and six months ended October 26, 2012 was led by international sales growth from our MiniMed Paradigm Veo System (Veo) and Enlite CGM sensor, partially offset by unfavorable foreign currency translation.

Surgical Technologies net sales for the three and six months ended October 26, 2012 were \$344 million and \$668 million, an increase of 15 percent and 18 percent, respectively, over the same periods in the prior fiscal year. The increase in net sales for the three and six months ended October 26, 2012 was driven by strong U.S. sales of capital equipment, including our StealthStation S7 and O-Arm, and from the second quarter fiscal year 2012 acquisitions of Salient and PEAK. Additionally, net sales were positively impacted by balanced growth of disposables and service revenue across our Power Systems, Monitoring, Imaging, and Navigation platforms.

Looking ahead, we expect our Restorative Therapies Group could be impacted by the following:

Growth in procedural volumes, mix impacts from changes in our product offerings, and competitive and pricing dynamics.

Market acceptance of innovative new products, such as our Solera product line, Bryan ACD Instrument Set, and other biologics products, including MAGNIFUSE and GRAFTON products. In the second quarter of fiscal year 2012, we had a limited launch of Solera Sextant, our minimally invasive product, and are continuing to add capacity with additional Solera 5.5/6.0 sets to address the complex/deformity segment, as well as POWEREASE, a powered instrument solution for Solera.

Continued market penetration with our BKP technology. We anticipate additional competitors to continue to enter the U.S. market in the future, while numerous competitors offer alternatives in Europe.

Market acceptance of new high pressure BKP balloons and syringes, curettes, and fixation materials in the Spine business. We expect a positive impact over time from the improvement in certain international markets, such as Japan. Market growth potential in Japan will be dependent upon additional investment and development by market participants. Additionally, we remain focused on generating evidence to better demonstrate the clinical and economic benefits for BKP.

In the third quarter of fiscal year 2011, the U.S. Food and Drug Administration (FDA) sent us a letter advising that the agency was not able to approve AMPLIFY rhBMP-2 Matrix at that time without additional information from us. In a letter dated December 2, 2011, the agency upheld its initial decision but invited us to submit further information in support of the application. On June 22, 2012, the U.S. FDA disapproved our revised investigational device exemption application. We are evaluating our options for obtaining approval of single-level, posterolateral spinal fusion procedures in patients with degenerative disc disease.

Spine sales growth was negatively impacted from the June 2011 articles in *The Spine Journal*, and by the reaction from inquiries by governmental authorities relating to our INFUSE bone graft product. The Spine Journal articles suggested that some physicians' peer-reviewed studies may have underreported complications and adverse events associated with INFUSE. These articles did not question the integrity of the data provided by Medtronic to the FDA for product approval or the disclosure of safety issues on the product's Instructions for Use for approved indications. Medtronic believes that the safety data reported to the FDA supports the safe use of INFUSE bone graft for the approved indications. However, because questions have been raised about the peer-reviewed literature, we announced in August 2011 that we provided a grant to Yale University (Yale) to oversee two independent, systematic reviews of data from completed clinical studies of INFUSE bone graft, as well as data from other Medtronic studies of rhBMP-2, the protein used in INFUSE. While the timing is controlled by Yale, we expect the systematic reviews to be published in the first calendar quarter of 2013. INFUSE bone graft U.S. net sales declined 20 percent in the second quarter of fiscal year 2013 when compared to the same period in the prior fiscal year.

Integration of China Kanghui Holdings (Kanghui), a leading Chinese orthopedics company, into our Spine business. Kanghui was acquired on November 1, 2012. Kanghui has a broad portfolio of trauma and spine products focused on the growing value segment, and are just beginning to expand into large-joint reconstruction. We believe this acquisition should increase our competitive position in this market.

On December 3, 2012 Medtronic and Shandong Weigao Group Medical Polymer Company Limited, Medtronic's partner in a joint venture to distribute spinal and orthopedic products in China, signed a Separation Agreement to terminate early their joint venture established in 2007. The proposed termination of the joint venture is contingent upon receipt of the requisite approvals from the relevant Chinese regulatory authorities. Pursuant to the terms of the agreement, Medtronic's exclusive distribution agreement with the joint venture to distribute Medtronic's spinal products in China will terminate effective December 31, 2012. We believe this Separation Agreement will not materially impact the financial results of the Company.

Continued acceptance of the Restore family of pain stimulators to treat chronic pain, including RestoreSensor, which is currently available in the U.S. and certain international markets. RestoreSensor is a neurostimulator for chronic pain that automatically adjusts to the patients' position changes. We fully launched this product late in the third quarter of fiscal year 2012. Results to date

indicate strong market acceptance.

Continued and future acceptance of our current indications for Medtronic DBS Therapy for the treatment of movement disorders, Epilepsy (approved in Europe) and OCD. The DBS Therapy portfolio includes Activa PC, our small and advanced primary cell battery, and Activa RC, a rechargeable DBS device. Additionally, Activa SC, a single-channel primary cell device, was approved in the U.S. and Europe in fiscal year 2011 and launched in Japan during the fourth quarter of fiscal year 2012.

Continued acceptance of InterStim Therapy for the treatment of the symptoms of overactive bladder, urinary retention, and bowel control.

In July 2012, we received an FDA warning letter regarding findings related primarily to our Neuromodulation corrective and preventative action (CAPA) and complaint handling processes. We are currently working with the FDA to resolve the issues. While this warning letter may limit our ability to launch new Neuromodulation products in the U.S. until it is resolved, it is not expected to have a material impact on our financial results.

Continued acceptance from both physicians and patients of insulin-pump therapy and CGM therapy and continued acceptance and improved reimbursement of CGM technologies. The Veo insulin pump is available in certain international markets and offers low-glucose suspend, which assists in protecting against the risk of hypoglycemia by automatically suspending insulin delivery when glucose falls below a specified threshold set by the user. In the U.S., we are anticipating FDA approval of the MiniMed 530G insulin pump and Enlite sensor by the end of fiscal year 2013. The Enlite sensor has been available in certain international markets since the fourth quarter of fiscal year 2011. We expect to launch our next-generation MiniMed 640G pump system in Western Europe early next fiscal year.

Given the elective nature of an insulin pump and CGM for the management of diabetes and the possible high out-of-pocket costs to the customer, macroeconomic pressures could negatively impact the near-term sales growth for the Diabetes business.

Continued integration of Salient and PEAK into our Surgical Technologies business. Salient and PEAK were acquired in August 2011. 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. PEAK develops and markets tissue dissection devices incorporating advanced energy technology. PEAK's PlasmaBlade tissue dissection device is based on proprietary technology that represents an important advance in radiofrequency surgical technologies. We believe these acquisitions have increased our competitive position in this market.

Continued acceptance of the Surgical Technologies StealthStation S7 and O-Arm Imaging Systems, especially with Synergy Spine 2.0 and the O-Arm 3.1.4.

Continued acceptance of the Surgical Technologies NIM 3.0 Nerve Monitoring System.

#### COSTS AND EXPENSES

The following is a summary of major costs and expenses as a percent of net sales:

|                                      | Three months ended |                  | Six months ended |                  |
|--------------------------------------|--------------------|------------------|------------------|------------------|
|                                      | October 26, 2012   | October 28, 2011 | October 26, 2012 | October 28, 2011 |
| Cost of products sold                | 24.9%              | 23.9%            | 24.6%            | 24.0%            |
| Research and development             | 9.5                | 9.2              | 9.5              | 9.2              |
| Selling, general, and administrative | 34.6               | 35.0             | 34.8             | 35.0             |
| Certain litigation charges, net      | 6.0                |                  | 3.0              |                  |
| Acquisition-related items            | 0.1                | (0.6)            | 0.1              | (0.2)            |
| Amortization of intangible assets    | 1.9                | 2.1              | 2.0              | 2.1              |
| Other expense, net                   | 1.5                | 3.5              | 1.3              | 3.1              |
| Interest expense, net                | 0.6                | 0.9              | 0.7              | 0.9              |
| <b>Cost of Products Sold</b>         |                    |                  |                  |                  |

Cost of products sold for the three and six months ended October 26, 2012, as a percent of net sales, increased 1.0 percentage point for the three months ended October 26, 2012 to 24.9 percent and increased 0.6 of a percentage point for the six months ended October 26, 2012 to 24.6 percent. Cost of products sold as a percent of net sales in the three months ended October 26, 2012 was negatively impacted by 0.5 of a percentage point of unfavorable currency impact and 0.7 of a percentage point of unfavorable spending impact primarily driven by unfavorable revaluation variance, partially offset by 0.2 of a percentage point of favorable variance due to shift in product mix. Cost of products sold as a percent of net sales in the six months ended October 26, 2012 was negatively impacted by 0.4 of a percentage point of unfavorable foreign currency impact and 0.4 of a percentage point of unfavorable spending impact primarily driven by unfavorable revaluation variance, partially offset by 0.2 of a percentage point of favorable variance due to shift in product mix. We continue to focus on mitigating pricing pressure through our five-year, \$1.2 billion cost of products sold reduction program.

## Research and Development

We have continued to invest in new technologies to drive long-term future growth. For the three and six months ended October 26, 2012, research and development spending was \$387 million and \$772 million, respectively, or 9.5 percent of net sales for both periods. For both the three and six months ended October 26, 2012, research and development increased 0.3 of a percentage point, as compared to the same periods of the prior fiscal year.

We remain committed to developing technological enhancements and new indications for existing products, and less invasive and new technologies for new and emerging markets to address unmet medical needs. That commitment leads to our initiation and participation in many clinical trials each fiscal year as the demand for clinical and economic evidence remains high. Furthermore, we expect our development activities to help reduce patient care costs and the length of hospital stays in the future. In addition to our investment in research and development, we continue to access new technologies in areas served by our existing businesses, as well as in new areas, through acquisitions, licensing agreements, alliances, and certain strategic equity investments.

## Selling, General, and Administrative

Selling, general, and administrative expense for the three and six months ended October 26, 2012 was \$1.417 billion and \$2.822 billion, respectively, which as a percent of net sales decreased by 0.4 of a percentage point to 34.6 percent and by 0.2 of a percentage point to 34.8 percent, respectively, as compared to the same periods of the prior fiscal year. For the three and six months ended October 26, 2012, selling, general, and administrative expense was positively impacted by our continued focus on several initiatives to leverage our expenses while continuing to invest in new product launches and adding to our sales force in faster growing businesses and geographies. The impact of these initiatives was partially offset in the six months ended October 26, 2012 by incremental bad debt from a single distributor in Greece. For the three and six months ended October 28, 2011, we incurred incremental bad debt expense in our Diabetes business and in Italy.

## Certain Litigation Charges, Net, Restructuring Charges and Acquisition-Related Items

Certain litigation charges, net and acquisition-related items for the three and six months ended October 26, 2012 and October 28, 2011 were as follows:

| (in millions)   | Three months ended  |                     | Six months ended    |                     |
|---|---------------------|---------------------|---------------------|---------------------|
|   | October 26,<br>2012 | October 28,<br>2011 | October 26,<br>2012 | October 28,<br>2011 |
| Certain litigation charges, net   | \$ 245              | \$                  | \$ 245              | \$                  |
| Acquisition-related items   | 6                   | (24)                | 11                  | (16)                |
| Net tax impact of certain litigation charges, net and acquisition-related items | (10)                |                     | (10)                |                     |
| Total certain litigation charges, net and acquisition-related items, net of tax | \$ 241              | \$ (24)             | \$ 246              | \$ (16)             |

### Restructuring

During the three and six months ended October 26, 2012 and October 28, 2011, we did not incur any restructuring charges.

### *Fiscal Year 2012 Initiative*

In the fourth quarter of fiscal year 2012, the Company recorded a \$118 million restructuring charge, which consisted of employee termination costs of \$66 million, asset write-downs of \$9 million, contract termination costs of \$30 million, and other related costs of \$13 million. The fiscal year 2012 initiative was designed to reduce general, administrative, and indirect distribution costs in certain organizations within the Company while prioritizing investment in research and development, and sales and marketing in those organizations within the Company where faster growth is anticipated, such as emerging markets and new therapies.

In connection with the fiscal year 2012 initiative, as of the end of the fourth quarter of fiscal year 2012, the Company had identified approximately 1,000 positions for elimination to be achieved through involuntary and voluntary separation. Of the 1,000 positions identified, approximately 600 positions have been eliminated as of October 26, 2012. The fiscal year 2012 initiative is scheduled to be substantially complete by the end of the fourth quarter of fiscal year 2013 and is expected to produce annualized operating savings of approximately \$100 to \$125 million. These savings will arise mostly from reduced compensation expense.



Certain Litigation Charges, Net

We classify material litigation reserves and gains recognized as certain litigation charges, net. During the three and six months ended October 26, 2012 and October 28, 2011, the Company recorded certain litigation charges, net of \$245 million relating to probable and reasonably estimated damages resulting from patent litigation with Edwards Lifesciences, Inc. See Note 19 for additional information.

During the three and six months ended October 28, 2011, there were no certain litigation charges, net.

Acquisition-Related Items

During the three months ended October 26, 2012, we recorded net charges from acquisition-related items of \$6 million. In connection with the acquisition of China Kanghui Holdings, we recorded transaction costs of \$3 million. In the second quarter of fiscal year 2013, we also recorded a net charge of \$5 million for transaction costs related to the divestiture of the Physio-Control business. Additionally, we recorded \$2 million of net income related to the change in fair value of contingent milestone payments associated with acquisitions subsequent to April 29, 2009.

During the three months ended October 28, 2011, we recorded income from acquisition-related items of \$24 million. In connection with the acquisitions of Salient and PEAK, we recognized gains of \$32 million and \$6 million, respectively, on our previously-held investments. In connection with these acquisitions, we began to assess and formulate a plan for the elimination of duplicative positions and the termination of certain contractual obligations. As a result, we incurred approximately \$5 million of certain acquisition-related costs, which included legal fees, severance costs, changes in control costs, and contract termination costs. Additionally, we recorded \$9 million of charges related to the change in fair value of contingent milestone payments associated with acquisitions subsequent to April 29, 2009.

During the six months ended October 26, 2012, we recorded acquisition-related items of \$11 million. In connection with the acquisition of China Kanghui Holdings, we recorded transaction costs of \$3 million. In the second quarter of fiscal year 2013, we also recorded a net charge of \$5 million for transaction costs related to the divestiture of the Physio-Control business. Additionally, we recorded \$3 million of net charges related to the change in fair value of contingent milestone payments associated with acquisitions subsequent to April 29, 2009.

During the six months ended October 28, 2011, we recorded income from acquisition-related items of \$16 million. In connection with the acquisitions of Salient and PEAK, we recognized gains of \$32 million and \$6 million, respectively, on our previously-held investments. In connection with these acquisitions, we began to assess and formulate a plan for the elimination of duplicative positions and the termination of certain contractual obligations. As a result, we incurred approximately \$5 million of certain acquisition-related costs, which included legal fees, severance costs, changes in control costs, and contract termination costs. Additionally, we recorded \$17 million of charges related to the change in fair value of contingent milestone payments associated with acquisitions subsequent to April 29, 2009.

**Amortization of Intangible Assets**

Amortization of intangible assets includes the amortization expense of our definite-lived intangible assets consisting of patents, trademarks, tradenames, purchased technology, and other intangible assets. For the three and six months ended October 26, 2012, amortization expense was \$79 million and \$159 million, respectively, as compared to \$85 million and \$171 million for the same periods of the prior fiscal year. The \$6 million and \$12 million decreases in amortization expense for the three and six months ended October 26, 2012 were primarily due to certain intangible assets that became fully amortized, thereby reducing ongoing amortization expense, partially offset by amortization expense related to the second quarter fiscal year 2012 acquisitions of Salient and PEAK.

**Other Expense, Net**

Other expense, net includes royalty income and expense, realized equity security gains and losses, realized foreign currency transactions and derivative gains and losses, impairment charges on equity securities, and the Puerto Rico excise tax. For the three and six months ended October 26, 2012, other expense, net was \$63 million and \$102 million, respectively, as compared to \$140 million and \$249 million, respectively, for the same periods in the prior fiscal year. For the three and six months ended October 26, 2012, the net expense decreased \$77 million and \$147 million, respectively, primarily due to the impact of foreign currency gains and losses and gains on certain available-for-sale marketable equity securities realized during the second quarter of fiscal year 2013, partially offset by higher royalty expense in our Coronary business. For the three and six months ended October 26, 2012, total foreign currency losses recorded in other expense, net were \$27 million and \$7 million, respectively, compared to losses of \$84 million and \$148 million, respectively, in the same periods in the prior fiscal year.

**Interest Expense, Net**

Interest expense, net includes interest earned on our cash and cash equivalents, short- and long-term investments, interest paid on our outstanding borrowings, amortization of debt issuance costs and debt discounts, the net realized and unrealized gain or loss on trading securities, ineffectiveness on interest rate derivative instruments, and the net realized gain or loss on the sale or impairment of available-for-sale debt securities. For the three and six months ended October 26, 2012, we had interest expense, net of \$24 million and \$57 million, respectively, as compared to interest expense, net of \$38 million and \$70 million for the same periods of the prior fiscal year. The decreases in interest expense, net during the three and six months ended October 26, 2012 were primarily the result of realized gains during the second quarter of fiscal year 2013 on sales of available-for-sale debt securities and the result of increased interest income from higher investment balances in comparison to the same periods of the prior fiscal year, partially offset by increased interest expense from higher outstanding debt balances as compared the same periods of the prior fiscal year.

**Medical Device Excise Tax**

The Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act of 2010 impose significant new taxes on medical device makers in the form of a 2.3 percent excise tax on U.S. medical device sales, with certain exemptions, beginning in January 2013. We currently estimate that our fiscal year 2013 excise tax fee (impacting only the last four months for fiscal year 2013) could be up to \$50 million after-tax, and will be included within other expense, net in the Company's consolidated statements of earnings. We currently estimate that our annual excise tax fee would be within the range of \$125 to \$175 million after-tax. The final IRS regulations are pending and thus our estimates may change based on the final regulations.

**INCOME TAXES**

| (dollars in millions)   | Three months ended |                  | Six months ended |                  |
|---|--------------------|------------------|------------------|------------------|
|   | October 26, 2012   | October 28, 2011 | October 26, 2012 | October 28, 2011 |
| Provision for income taxes  | \$ 208             | \$ 179           | \$ 432           | \$ 378           |
| Effective tax rate  | 24.36%             | 17.16%           | 22.25%           | 18.34%           |
| Net tax impact of acquisition-related items and certain litigation charges, net | (4.64)             | 0.46             | (2.14)           | 0.20             |
| Non-GAAP nominal tax rate (1)   | 19.72%             | 17.62%           | 20.11%           | 18.54%           |

- (1) Non-GAAP nominal tax rate is defined as the income tax provision as a percentage of earnings before income taxes, excluding special charges, restructuring charges, net, certain litigation charges, net, acquisition-related items, and certain tax adjustments. We believe that the resulting non-GAAP financial measure provides useful information to investors because it excludes the effect of these discrete items so that investors can compare our recurring results over multiple periods. Investors should consider this non-GAAP measure in addition to, and not as a substitute for, financial performance measures prepared in accordance with U.S. GAAP. In addition, this non-GAAP financial measure may not be the same or similar to measures presented by other companies.

Our effective tax rates from continuing operations for the three and six months ended October 26, 2012 were 24.36 percent and 22.25 percent, respectively, compared to 17.16 percent and 18.34 percent, respectively, from the same periods of the prior fiscal year. The increase in our effective tax rate for the three and six months ended October 26, 2012 was primarily due to, the net tax impact of acquisition-related items, certain litigation charges, net, the expiration of the U.S. federal research and development tax credit on December 31, 2011, and the impact associated with the resolution of certain income tax audits. These items were partially offset by the tax impact of foreign dividend distributions recorded during the quarter ended October 26, 2012.

Our non-GAAP nominal tax rates for the three and six months ended October 26, 2012 were 19.72 percent and 20.11 percent, respectively, compared to 17.62 percent and 18.54 percent, respectively, from the same periods of the prior fiscal year. The increase in our non-GAAP nominal tax rates for the three and six months ended October 26, 2012 as compared to the same period of the prior fiscal year was primarily due to the expiration of the U.S. federal research and development tax credit on December 31, 2011 and the impact associated with the resolution of certain income tax audits. These items were partially offset by the tax impact of foreign dividend distributions recorded during the quarter ended October 26, 2012.

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Tax audits associated with the allocation of income, and other complex issues, may require an extended period of time to resolve and may result in income tax adjustments if changes to our allocation are required between jurisdictions with different tax rates. Tax authorities periodically review our tax returns and propose adjustments to our tax filings. The U.S. Internal Revenue Service (IRS) has settled its audits with us for all years through fiscal year 2004. Tax years settled with the IRS may remain open for foreign tax audits and competent authority proceedings. Competent authority proceedings are a means to resolve intercompany pricing disagreements between countries.

In March 2009, the IRS issued its audit report for fiscal years 2005 and 2006. We reached agreement with the IRS on some but not all matters. On December 23, 2010, the IRS issued a statutory notice of deficiency with respect to the remaining issues. We filed a Petition with the U.S. Tax Court on March 21, 2011 objecting to the deficiency. During October 2012, we reached resolution with the IRS on the deductibility of a settlement payment. The remaining unresolved significant issue relates to the allocation of income between Medtronic, Inc. and its wholly-owned subsidiary operating in Puerto Rico, which is one of our key manufacturing sites.

In October 2011, the IRS issued its audit report for fiscal years 2007 and 2008. We reached agreement with the IRS on some but not all matters related to these fiscal years. The significant issues that remain unresolved relate to the allocation of income between Medtronic, Inc. and its wholly-owned subsidiary in Puerto Rico, and proposed adjustments associated with the tax effects of our acquisition of Kyphon. Associated with the Kyphon acquisition, we entered into an intercompany transaction whereby the Kyphon U.S. tangible assets were sold to another wholly-owned subsidiary in a taxable transaction. The IRS has disagreed with our valuation and proposed that all U.S. goodwill, the value of the ongoing business, and the value of the workforce in place be included in the tangible asset sale. We disagree that these items were sold, as well as with the IRS valuation of these items. We are currently attempting to resolve these matters at the IRS Appellate level and will proceed through litigation, if necessary.

Our reserve for the uncertain tax positions related to these significant unresolved matters with the IRS, as described above, is subject to a high degree of estimation and management judgment. Resolution of these significant unresolved matters, or positions taken by the IRS or foreign tax authorities during future tax audits, could have a material impact on our financial results in future periods. We continue to believe that our reserves for uncertain tax positions are appropriate and have meritorious defenses for our tax filings and will vigorously defend them during the audit process, appellate process, and through litigation in courts, as necessary.

See Note 15 to the condensed consolidated financial statements for additional information.

### LIQUIDITY AND CAPITAL RESOURCES

| (dollars in millions)   | October 26,<br>2012 | April 27,<br>2012 |
|---|---------------------|-------------------|
| Working capital   | \$ 2,814            | \$ 3,658          |
| Current ratio*  | 1.4:1.0             | 1.6:1.0           |
| Cash, cash equivalents, and short-term investments                        | \$ 2,675            | \$ 2,592          |
| Long-term investments in debt, marketable equity and trading securities** | 8,333               | 7,197             |
| Total   | \$ 11,008           | \$ 9,789          |
| Short-term borrowings and long-term debt                                  | \$ 11,452           | \$ 10,633         |
| Net cash position***  | \$ (444)            | \$ (844)          |

\* Current ratio is the ratio of current assets to current liabilities.

\*\* Long-term investments include debt securities with a maturity date greater than one year from the end of the period, marketable equity and trading securities and exclude minority investments.

\*\*\* Net cash position is the sum of cash, cash equivalents, short-term investments, and long-term investments in debt, marketable equity and trading securities less short-term borrowings and long-term debt.

As of October 26, 2012, we believe our strong balance sheet and liquidity provide us with flexibility in the future. We believe our existing cash and investments, as well as our \$2.250 billion syndicated credit facility and related commercial paper program (\$1.650 billion of commercial paper outstanding as of October 26, 2012), will satisfy our foreseeable working capital requirements for at least the next 12 months. However, we periodically consider various financing alternatives and may, from time to time, seek to take advantage of favorable interest rate environments or other market conditions. We also generally expect to refinance maturities of long-term debt. At October 26, 2012, our Standard & Poor's Ratings Services and Moody's Investors Service ratings remain unchanged as compared to those ratings at April 27, 2012 with long-term debt ratings of A+ and A1, respectively, and short-term debt ratings of A-1+ and P-1, respectively.

Our net cash position in the second quarter of fiscal year 2013, as defined above, increased by \$400 million as compared to the fiscal year ended April 27, 2012.



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We have future contractual obligations and other minimum commercial commitments that are entered into in the normal course of business. We believe our off-balance sheet arrangements do not have a material current or anticipated future effect on our consolidated earnings, financial position, or cash flows. See the [Off-Balance Sheet Arrangements and Long-Term Contractual Obligations](#) section of this management's discussion and analysis for further information.

Note 19 to the current period's condensed consolidated financial statements provides information regarding amounts we have accrued related to significant legal proceedings. In accordance with U.S. GAAP, we record a liability in our consolidated financial statements for these actions when a loss is known or considered probable and the amount can be reasonably estimated.

A significant amount of our earnings occur outside the U.S., and are deemed to be indefinitely reinvested in non-U.S. subsidiaries, resulting in a majority of our cash, cash equivalents, and investments being held by such non-U.S. subsidiaries. As of October 26, 2012 and April 27, 2012, approximately \$10.432 billion and \$9.882 billion, respectively, of cash, cash equivalents, and short- and long-term investments in marketable debt and equity securities were held by our non-U.S. subsidiaries. These funds are available for use by our worldwide operations; however, if these funds were repatriated to the U.S. or used for U.S. operations, the amounts would generally be subject to U.S. tax. As a result, we continue to accumulate earnings overseas for investment in our business outside the U.S. and to use cash generated from U.S. operations and short- and long-term borrowings to meet our U.S. cash needs. Should we require more capital in the U.S. than is generated by our domestic operations, we could elect to repatriate earnings from our non-U.S. subsidiaries or raise additional capital in the U.S. through debt or equity issuances. These alternatives could result in higher effective tax rates, increased interest expense, or other dilution of our earnings.

Cash, cash equivalents, and short-term investments at April 27, 2012 also include \$153 million of cash invested in short-term instruments held in an indemnification trust established for self-insurance coverage for our directors and officers. In August 2012, we purchased \$300 million of directors and officers insurance coverage and commenced termination of the previously established self-insurance indemnification trust. The termination of the Company's indemnification trust, including the liquidation of approximately \$153 million thereunder, was completed during the second quarter of fiscal year 2013.

We have investments in marketable debt securities that are classified and accounted for as available-for-sale. Our debt securities include U.S. government and agency securities, foreign government and agency securities, corporate debt securities, certificates of deposit, mortgage-backed securities, other asset-backed securities, and auction rate securities. Some of our investments may experience reduced liquidity due to changes in market conditions and investor demand. Our auction rate security holdings have experienced reduced liquidity in recent years due to the change in investor demand. Although our auction rate securities are currently illiquid and other securities could become illiquid, we believe we could liquidate a substantial amount of our portfolio without incurring a material impairment loss.

For the three months and six months ended October 26, 2012, other-than-temporary impairment losses on available-for-sale debt securities were less than \$1 million and \$1 million, respectively, of which less than \$1 million and \$1 million were recognized in other comprehensive income resulting in less than \$1 million of charges being recognized in earnings in both periods. In determining these other-than-temporary impairment losses, U.S. GAAP specifies that we consider a variety of factors, including the quality and estimated value of the underlying credit support for our holdings and the financial condition and credit rating of the issuer in estimating the credit loss portion of other-than-temporary impairment losses. Based on our assessment of the credit quality of the underlying collateral and credit support available to each of the remaining securities in which we are invested, we believe we have recorded all necessary other-than-temporary impairments as we do not have the intent to sell, nor is it more likely than not that we will be required to sell, before recovery of the amortized cost. However, as of October 26, 2012, we have \$41 million of gross unrealized losses on our aggregate short-term and long-term available-for-sale debt securities of \$8.944 billion; if market conditions deteriorate, some of these holdings may experience other-than-temporary impairment in the future which could have a material impact on our financial results. Management is required to use estimates and assumptions in its valuation of our investments, which requires a high degree of judgment, and therefore, actual results could differ materially from those estimates. See Note 8 to the current period's condensed consolidated financial statements for additional information regarding fair value measurements.

### SUMMARY OF CASH FLOWS

| (in millions)  | Six months ended    |                     |
|--|---------------------|---------------------|
|  | October 26,<br>2012 | October 28,<br>2011 |
| Cash provided by (used in):                                  |                     |                     |
| Operating activities   | \$ 2,167            | \$ 2,287            |
| Investing activities   | (869)               | (1,743)             |
| Financing activities   | (762)               | (844)               |
| Effect of exchange rate changes on cash and cash equivalents | (25)                | (34)                |
| Net change in cash and cash equivalents                      | \$ 511              | \$ (334)            |

### **Operating Activities**

Our net cash provided by operating activities was \$2.167 billion for the six months ended October 26, 2012 compared to \$2.287 billion provided by operating activities for the six months ended October 28, 2011. The \$120 million decrease in net cash provided by operating activities was primarily attributable to a decrease in accrued income taxes due to the timing of certain tax payments and disbursement of certain litigation charges for Shareholder Related Matters partially offset by a slight decrease in accounts receivable during the six months ended October 26, 2012, compared to the six months ended October 28, 2011.

### **Investing Activities**

Our net cash used in investing activities was \$869 million for the six months ended October 26, 2012 compared to \$1.743 billion used in investing activities for the six months ended October 28, 2011. The \$874 million decrease in net cash used in investing activities was primarily related to the prior year acquisitions of PEAK and Salient.

### **Financing Activities**

Our net cash used in financing activities was \$762 million for the six months ended October 26, 2012 compared to \$844 million used in financing activities for the six months ended October 28, 2011. The \$82 million decrease in net cash used in financing activities was primarily attributable to \$503 million of increased cash returned to shareholders in the form of dividends and repurchase of common stock for the six months ended October 26, 2012 compared to the same period in the prior fiscal year, partially offset by increased levels of short-term borrowings.

### **OFF-BALANCE SHEET ARRANGEMENTS AND LONG-TERM CONTRACTUAL OBLIGATIONS**

We acquire assets still in development, enter into research and development arrangements, and sponsor certain clinical trials that often require milestone and/or royalty payments to a third-party, contingent upon the occurrence of certain future events. Milestone payments may be required contingent upon the successful achievement of an important point in the development life cycle of a product or upon certain pre-designated levels of achievement in clinical trials. In addition, if required by the arrangement, we may have to make royalty payments based on a percentage of sales related to the product under development or in the event that regulatory approval for marketing is obtained. In situations where we have no ability to influence the achievement of the milestone or otherwise avoid the payment, we have included those milestone or minimum royalty payments in the following table. However, the majority of these arrangements give us the discretion to unilaterally make the decision to stop development of a product or cease progress of a clinical trial, which would allow us to avoid making the contingent payments. Although we are unlikely to cease development if a device successfully achieves clinical testing objectives, these payments are not included in the table of contractual obligations because of the contingent nature of these payments and our ability to avoid them if we decided to pursue a different path of development or testing. See Note 4 to the current period's condensed consolidated financial statements for additional information regarding contingent consideration.

In the normal course of business, we periodically enter into agreements that require us to indemnify customers or suppliers for specific risks, such as claims for injury or property damage arising out of our products or the negligence of our personnel or claims alleging that our products infringe third-party patents or other intellectual property. Our maximum exposure under these indemnification provisions cannot be estimated, and we have not accrued any liabilities within our condensed consolidated financial statements or included any indemnification provisions in our commitments table. Historically, we have not experienced significant losses on these types of indemnification obligations.

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We believe our off-balance sheet arrangements do not have a material current or anticipated future effect on our consolidated earnings, financial position, or cash flows. Presented below is a summary of contractual obligations and other minimum commercial commitments as of October 26, 2012. See Note 9 to the current period's condensed consolidated financial statements for additional information regarding long-term debt. Additionally, see Note 15 to the current period's condensed consolidated financial statements for additional information regarding accrued income tax obligations, which are not reflected in the table below.

| (in millions)  | Maturity by Fiscal Year |                   |               |                 |                 |               |                 |
|--|-------------------------|-------------------|---------------|-----------------|-----------------|---------------|-----------------|
|  | Total                   | Remaining<br>2013 | 2014          | 2015            | 2016            | 2017          | Thereafter      |
| <i>Contractual obligations related to off-balance sheet arrangements:</i>                    |                         |                   |               |                 |                 |               |                 |
| Operating leases <sup>(1)</sup>  | \$ 307                  | \$ 70             | \$ 88         | \$ 56           | \$ 34           | \$ 19         | \$ 40           |
| Inventory purchases <sup>(2)</sup>   | 174                     | 80                | 76            | 11              | 1               |               | 6               |
| Commitments to fund minority investments/contingent acquisition consideration <sup>(3)</sup> | 358                     | 27                | 17            | 99              | 12              | 102           | 101             |
| Interest payments <sup>(4)</sup>   | 3,029                   | 162               | 289           | 264             | 212             | 185           | 1,917           |
| Other <sup>(5)</sup>   | 158                     | 44                | 56            | 34              | 3               | 2             | 19              |
| <b>Total</b>   | <b>\$ 4,026</b>         | <b>\$ 383</b>     | <b>\$ 526</b> | <b>\$ 464</b>   | <b>\$ 262</b>   | <b>\$ 308</b> | <b>\$ 2,083</b> |
| <i>Contractual obligations reflected in the balance sheet:</i>                               |                         |                   |               |                 |                 |               |                 |
| Long-term debt, including current portion <sup>(6)</sup>                                     | \$ 9,221                | \$ 2,210          | \$ 550        | \$ 1,250        | \$ 1,100        |               | \$ 4,111        |
| Capital leases   | 170                     | 6                 | 13            | 13              | 12              | 30            | 96              |
| <b>Total</b>   | <b>\$ 9,391</b>         | <b>\$ 2,216</b>   | <b>\$ 563</b> | <b>\$ 1,263</b> | <b>\$ 1,112</b> | <b>\$ 30</b>  | <b>\$ 4,207</b> |

- (1) Certain leases require us to pay real estate taxes, insurance, maintenance, and other operating expenses associated with the leased premises. These future costs are not included in the schedule above.
- (2) We have included inventory purchase commitments which are legally binding and specify minimum purchase quantities. These purchase commitments do not exceed our projected requirements and are in the normal course of business. These commitments do not include open purchase orders.
- (3) Certain commitments related to the funding of cost or equity method investments and/or previous acquisitions are contingent upon the achievement of certain product-related milestones and various other favorable operational conditions. While it is not certain if and/or when these payments will be made, the maturity dates included in this table reflect our best estimates. In accordance with authoritative accounting guidance on business combinations effective in fiscal year 2010, we are required to record the fair value of contingent acquisition considerations as a liability on the consolidated balance sheets on a prospective basis, therefore, contingent acquisition considerations are not included in the off-balance sheet disclosure for acquisitions subsequent to April 24, 2009.
- (4) Interest payments in the table above reflect the contractual interest payments on our outstanding debt, and exclude the impact of the debt discount amortization on the Senior Convertible Notes and impact of interest rate swap agreements. See Note 9 to the current period's condensed consolidated financial statements for additional information regarding our debt agreements.
- (5) These obligations include certain research and development arrangements.
- (6) Long-term debt in the table above includes the \$1.075 billion of 2012 Senior Notes, \$1.000 billion of 2011 Senior Notes, \$3.000 billion of 2010 Senior Notes, \$1.250 billion of 2009 Senior Notes, \$2.200 billion of Senior Convertible Notes, \$600 million of 2005 Senior Notes, and certain bank borrowings. The table above excludes the debt discount, the fair value impact of outstanding interest rate swap agreements, and the unamortized gains from terminated interest rate swap agreements. See Notes 9 and 10 to the current period's condensed consolidated financial statements for additional information regarding the interest rate swap agreements.

### DEBT AND CAPITAL

Our capital structure consists of equity and interest-bearing debt. Interest-bearing debt as a percentage of total interest-bearing debt and equity was 40 percent as of October 26, 2012 and 38 percent as of April 27, 2012.

### Share Repurchase Program

As part of our focus on returning value to our shareholders, shares are repurchased from time to time. In June 2011, our Board of Directors authorized the repurchase of 75 million shares of our common stock. During the three and six months ended October 26, 2012, we repurchased approximately 14.8 million and 27.3 million shares, respectively, at an average price per share of \$41.46 and \$39.72, respectively. As of October 26, 2012, we had approximately 31.1 million shares remaining under current buyback authorizations approved by the Board of Directors.

## Financing Arrangements

We use a combination of bank borrowings and commercial paper issuances to fund our short-term financing needs. Short-term debt, including the current portion of our long-term debt and capital lease obligations, as of October 26, 2012, was \$4.097 billion compared to \$3.274 billion as of April 27, 2012. We utilize a combination of Senior Convertible Notes and Senior Notes to meet our long-term financing needs. Long-term debt as of October 26, 2012 was \$7.355 billion compared to \$7.359 billion as of April 27, 2012. For more information on our financing arrangements, see Note 9 to the current period's condensed consolidated financial statements.

## Credit Arrangements and Debt Ratings

We maintain a commercial paper program that allows us to have a maximum of \$2.250 billion in commercial paper outstanding, with maturities up to 364 days from the date of issuance. As of October 26, 2012 and April 27, 2012, outstanding commercial paper totaled \$1.650 billion and \$950 million, respectively. During the three and six months ended October 26, 2012, the weighted average original maturity of the commercial paper outstanding was approximately 87 days and 74 days, respectively, and the weighted average interest rate was 0.18 percent and 0.16 percent, respectively. The issuance of commercial paper reduces the amount of credit available under our existing lines of credit.

We have committed and uncommitted lines of credit with various banks. The existing committed lines of credit include a four-year \$2.250 billion syndicated credit facility dated December 9, 2010 that will expire on December 9, 2014 (Credit Facility). The Credit Facility provides backup funding for the commercial paper program and may also be used for general corporate purposes. The Credit Facility provides us with the ability to increase its capacity by an additional \$500 million at any time during the four-year term of the agreement. As of October 26, 2012 and April 27, 2012, no amounts were outstanding on the committed lines of credit.

In connection with the issuance of the 2012 Senior Notes, Standard and Poor's Ratings Services and Moody's Investors Service issued long-term debt ratings of A+ and A1, respectively, and short-term debt ratings of A-1+ and P-1, respectively. These ratings remain unchanged as compared to those at April 27, 2012. For more information on credit arrangements, see Note 9 to the current period's condensed consolidated financial statements.

## OPERATIONS OUTSIDE OF THE UNITED STATES

The table below illustrates U.S. net sales versus net sales outside the U.S. for the three and six months ended October 26, 2012 and October 28, 2011:

| (in millions)      | Three months ended |                  | Six months ended |                  |
|--------------------|--------------------|------------------|------------------|------------------|
|                    | October 26, 2012   | October 28, 2011 | October 26, 2012 | October 28, 2011 |
| U.S. net sales     | \$ 2,289           | \$ 2,237         | \$ 4,516         | \$ 4,383         |
| Non-U.S. net sales | 1,806              | 1,786            | 3,587            | 3,586            |
| Total net sales    | \$ 4,095           | \$ 4,023         | \$ 8,103         | \$ 7,969         |

For the three and six months ended October 26, 2012, consolidated net sales outside the U.S. increased 1 percent and less than 1 percent, respectively, over the same periods of the prior fiscal year. Foreign currency had an unfavorable impact of \$118 million and \$238 million on net sales during the three and six months ended October 26, 2012, respectively. For the three and six months ended October 26, 2012, our performance outside the U.S. was primarily a result of strong net sales in Endovascular and solid growth in our Structural Heart, Neuromodulation, Diabetes, and Surgical Technologies businesses, offset by unfavorable foreign currency translation and declines in CRDM and Spine.

Net sales outside the U.S. are accompanied by certain financial risks, such as collection of receivables, which typically have longer payment terms. We monitor the creditworthiness of our customers to which we grant credit terms in the normal course of business. However, a significant amount of our outstanding accounts receivable are with national health care systems in many countries. The current economic conditions in many countries outside the U.S. (particularly the recent economic challenges faced by Italy, Spain, Portugal, and Greece) have deteriorated and may continue to increase the average length of time it takes to collect on our outstanding accounts receivable in these countries. We continue to monitor the creditworthiness of customers located in these and other geographic areas. In the past, accounts receivable balances with certain customers in these countries have accumulated over time and were subsequently settled as large lump sum payments. Although we do not currently foresee a significant credit risk associated with a material portion of these receivables, repayment is dependent upon the financial stability of the economies of those countries. Beginning in fiscal year 2012, we concluded that collectability was not reasonably assured for revenue transactions with certain Greece distributors, and therefore, deferred revenue recognition until all revenue recognition criteria are met in the future. As of October 26, 2012 and April 27, 2012, our remaining deferred revenue balance for certain Greece distributors was \$17 million and \$15 million, respectively. Outstanding gross receivables from customers outside the U.S. totaled \$2.248 billion as of October 26, 2012, or 61 percent of total outstanding accounts receivable, and \$2.408 billion as of April 27, 2012, or 62 percent of total outstanding accounts receivable.





## OTHER MATTERS

The Company was a party to an Indemnification Trust Agreement (the Agreement) dated April 29, 2004, as amended September 5, 2006 and April 27, 2009, by and among the Company, as grantor, Wells Fargo Bank, N.A., as trustee (the Trustee) and D. Cameron Findlay, as the representative of the beneficiaries (the Beneficiaries Representative) of the trust (the Trust) created by the Agreement. Mr. Findlay is also Senior Vice President, General Counsel, and Corporate Secretary of the Company. The Trust, with a fund amount of \$153 million, provided a source of funds for payment of certain indemnification and expense advancement claims by the Trust's beneficiaries, which the Agreement defined as all past, present and future members of the Board of Directors and all past, present and future officers of the Company.

In August 2012, we purchased \$300 million of directors and officers insurance coverage. On October 12, 2012, the Company provided notice (the Notice) to the Trustee and the Beneficiaries Representative of the Company's authorization to terminate the Agreement and the Trust, effective as of October 15, 2012, the scheduled termination date set forth in the Notice.

## CAUTIONARY FACTORS THAT MAY AFFECT FUTURE RESULTS

This Quarterly Report on Form 10-Q, and other written reports and oral statements made by or with the approval of one of the Company's executive officers from time to time, may include forward-looking statements. Forward-looking statements broadly involve our current expectations or forecasts of future results. Our forward-looking statements generally relate to our growth and growth strategies, financial results, product development, research and development strategy, regulatory approvals, competitive strengths, restructuring initiatives, intellectual property rights, litigation and tax matters, mergers and acquisitions, divestitures, market acceptance of our products, accounting estimates, financing activities, ongoing contractual obligations, working capital adequacy, our effective tax rate, and sales efforts. Such statements can be identified by the use of terminology such as anticipate, believe, could, estimate, expect, forecast, intend, looking ahead, may, potential, project, should, will, and similar words or expressions. One must carefully consider forward-looking statements and understand that such statements may be affected by inaccurate assumptions and may involve a variety of risks and uncertainties, known and unknown, including, among others, risks related to competition in the medical device industry, reduction or interruption in our supply, quality problems, liquidity, decreasing prices, adverse regulatory action, litigation results, self-insurance, commercial insurance, health care policy changes, and international operations, as well as those discussed in the sections entitled Risk Factors and Government Regulation and Other Considerations in our Annual Report on Form 10-K for the year ended April 27, 2012. Consequently, no forward-looking statement can be guaranteed and actual results may vary materially. We intend to take advantage of the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995 regarding our forward-looking statements, and are including this sentence for the express purpose of enabling us to use the protections of such safe harbor with respect to all forward-looking statements.

We undertake no obligation to update any statement we make, but investors are advised to consult all other disclosures by us in our filings with the Securities and Exchange Commission, especially on Forms 10-K, 10-Q, and 8-K, in which we discuss in more detail various important factors that could cause actual results to differ from expected or historical results. In addition, actual results may differ materially from those anticipated due to a number of factors, including, among others, those discussed in the section entitled Risk Factors in our Annual Report on Form 10-K for the year ended April 27, 2012. It is not possible to foresee or identify all such factors. As such, investors should not consider any list of such factors to be an exhaustive statement of all risks, uncertainties, or potentially inaccurate assumptions.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Due to the global nature of our operations, we are exposed to currency exchange rate changes. In a period where the U.S. dollar is strengthening/weakening as compared to other currencies, our revenues and expenses denominated in foreign currencies are translated into U.S. dollars at a lower/higher value than they would be in an otherwise constant currency exchange rate environment.

We use operational and economic hedges, as well as currency exchange rate derivative instruments, to manage the impact of currency exchange rate changes on earnings and cash flows. In order to minimize earnings and cash flow volatility resulting from currency exchange rate changes, we enter into derivative instruments, principally forward currency exchange rate contracts. These contracts are designed to hedge anticipated foreign currency transactions and changes in the value of specific assets, liabilities, and probable commitments. At inception of the contract, the derivative is designated as either a freestanding derivative or a cash flow hedge. The primary currencies of the derivative instruments are the Euro and Japanese Yen. We do not enter currency exchange rate derivative instruments for speculative purposes.

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We had foreign exchange rate derivative contracts outstanding in notional amounts of \$5.710 billion and \$5.136 billion as of October 26, 2012 and April 27, 2012, respectively. At October 26, 2012, these contracts were in an unrealized gain position of \$43 million. A sensitivity analysis of changes in the fair value of all foreign currency exchange rate derivative contracts at October 26, 2012 indicates that, if the U.S. dollar uniformly strengthened/weakened by 10 percent against all currencies, the fair value of these contracts would increase/decrease by approximately \$536 million, respectively. Any gains and losses on the fair value of derivative contracts would be largely offset by gains and losses on the underlying transactions. These offsetting gains and losses are not reflected in the above analysis. We are also exposed to interest rate changes affecting our investments in interest rate sensitive instruments, which include our fixed-to-floating interest rate swap agreements. A sensitivity analysis of the impact on our interest rate sensitive financial instruments of a hypothetical 10 percent change in short-term interest rates, compared to interest rates as of October 26, 2012, indicates that the fair value of these instruments would correspondingly change by \$23 million.

We have investments in marketable debt securities that are classified and accounted for as available-for-sale. Our debt securities include U.S. government and agency securities, foreign government and agency securities, corporate debt securities, certificates of deposit, mortgage-backed securities, other asset-backed securities, and auction rate securities. For a discussion of current market conditions and the impact on our financial condition and results of operations, please see the Liquidity and Capital Resources section of the current period's management's discussion and analysis.

For additional discussion of market risk, see Notes 7 and 10 to the current period's condensed consolidated financial statements.

### **Item 4. Controls and Procedures**

#### **Evaluation of disclosure controls and procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) and changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this quarterly report, our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) are effective.

#### **Changes in internal control over financial reporting**

There have been no changes in the Company's internal control over financial reporting during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **Item 1. Legal Proceedings**

A discussion of the Company's policies with respect to legal proceedings is included in the management's discussion and analysis and our legal proceedings and other loss contingencies are described in Note 19 to the current period's condensed consolidated financial statements.

### **Item 1A. Risk Factors**

In addition to the updated risk factor set forth below and the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended April 27, 2012, as updated in the Company's Quarterly Report on Form 10-Q for the period ended July 27, 2012, which could materially affect our business, financial condition, or future results.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds****Issuer Purchases of Equity Securities**

The following table provides information about the shares repurchased by the Company during the second quarter of fiscal year 2013:

| Fiscal Period    | Total Number of Shares Purchased <sup>(1)</sup> | Average Price Paid per Share | Total Number of Shares Purchased as a Part of Publicly Announced Program | Maximum Number of Shares that May Yet Be Purchased Under the Program |
|------------------|---|------------------------------|--|--|
| 7/28/12-8/24/12  | 5,792,599                                       | \$ 40.07                     | 5,792,599  | 40,164,026   |
| 8/25/12-9/28/12  | 5,578,378                                       | 41.60                        | 5,578,378  | 34,585,648   |
| 9/29/12-10/26/12 | 3,436,836                                       | 43.56                        | 3,436,836  | 31,148,812   |
| Total            | 14,807,813                                      | \$ 41.46                     | 14,807,813   | 31,148,812   |

- (1) In June 2011, the Company's Board of Directors authorized the repurchase of 75 million shares of the Company's common stock. As authorized by the Board of Directors our program expires when its total number of authorized shares has been repurchased.

**Item 6. Exhibits**

- (a) Exhibits
- 12.1 Medtronic, Inc. Computation of Ratio of Earnings to Fixed Charges.
  - 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  - 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  - 101.INS XBRL Instance Document
  - 101.SCH XBRL Schema Document
  - 101.CAL XBRL Calculation Linkbase Document
  - 101.DEF XBRL Definition Linkbase Document
  - 101.LAB XBRL Label Linkbase Document
  - 101.PRE XBRL Presentation Linkbase Document

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: December 5, 2012

Medtronic, Inc.  
(Registrant)

/s/ Omar Ishrak  
Omar Ishrak  
Chairman and Chief Executive Officer

Date: December 5, 2012

/s/ Gary L. Ellis  
Gary L. Ellis  
Senior Vice President and  
Chief Financial Officer