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Different but complementary: Medtronic's strategic thinking

By Elizabeth Cairns

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The obvious reasons for Medtronic's buyout of Covidien are to do with accessing non-US cash and building scale, but the more detailed strategic rationale also bears examination. Medtronic has signaled its interest in the hospitals and surgery sectors repeatedly over the past few years with a deal to run cardiology services in the UK's NHS as well as several takeouts of surgery companies – though it is somewhat surprising that it is willing to pursue the single biggest medtech deal ever in order to bolster its offerings in these areas.

Covidien has been angling for a buyout since spinning off its Mallinckrodt pharmaceuticals arm last spring, and its size and focus meant that only Johnson & Johnson or Medtronic were realistic buyers. Consider Medtronic's synergies with Covidien in cardiovascular and neurology, and the merger begins to look almost inevitable (see graphs below).

Opposites attract

It is fair to say that the move was a bit of a curveball when compared with the other recent medtech megamerger. Zimmer and Biomet have a sizeable overlap and there the plan was for the buyer to build on its established products and expertise (Zimmer and Biomet hook up for second orthopaedics megamerger, April 24, 2014).

But companies do not just merge because they are similar: sometimes they do it because they are different. And, of the six medtech companies larger than Covidien, Medtronic is by far the clearest candidate as a buyer.

Siemens, GE Healthcare and Roche are all too specialised to be able to integrate Covidien successfully, and Abbott Laboratories, active in just four therapy areas, is probably in the same situation. J&J and Medtronic are both sufficiently diversified already that adding wholly new capabilities will not throw them off balance. But J&J has been moving towards specialisation rather than diversification, selling off its diagnostics business to the Carlyle Group earlier this year.

Medtronic's interest in the hospitals sector dates back at least a year, with the company signing partnerships with the UK's NHS under which it will manage the catheterisation labs of two hospitals, one in London and another in

Manchester (Fresenius deal underlines growing importance of hospital sector, September 16, 2013). Its moves to add to its surgical business date further back, to the acquisitions of Peak Surgical and Salient Surgical in 2011 – the first acquisitions the company made under its current CEO, Omar Ishrak.

The great thing about hospital supplies is that it gives the company an in with the purchasers. Post-merger, the new company will be able to offer a range of devices as varied as J&J's (see thumbnails above), and Medtronic would be able to offer hospital administrators a one-stop shop for many of their other needs: devices classified as cardiology or orthopaedics but used in a hospital, such as guidewires or spinal implants, for example.

Medtronic may be trying to position itself to actually benefit from hospital purchasing pressures: if it can cut deals with administrators for bulk purchases across different therapies, it could cut its rivals out.

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IMPORTANT ADDITIONAL INFORMATION WILL BE FILED WITH THE SEC

New Medtronic will file with the Securities and Exchange Commission (the SEC), a registration statement on Form S-4 that will include the Joint Proxy Statement of Medtronic and Covidien that also constitutes a Prospectus of New Medtronic. Medtronic and Covidien plan to mail to their respective shareholders the Joint Proxy Statement/Prospectus (including the Scheme) in connection with the transactions. **INVESTORS AND SHAREHOLDERS ARE URGED TO READ THE JOINT PROXY STATEMENT/PROSPECTUS (INCLUDING THE SCHEME) AND OTHER RELEVANT DOCUMENTS FILED OR TO BE FILED WITH THE SEC CAREFULLY WHEN THEY BECOME AVAILABLE BECAUSE THEY WILL CONTAIN IMPORTANT INFORMATION ABOUT MEDTRONIC, COVIDIEN, NEW MEDTRONIC, THE TRANSACTIONS AND RELATED MATTERS.** Investors and security holders will be able to obtain free copies of the Joint Proxy Statement/Prospectus (including the Scheme) and other documents filed with the SEC by New Medtronic, Medtronic and Covidien through the website maintained by the SEC at www.sec.gov. In addition, investors and shareholders will be able to obtain free copies of the Joint Proxy Statement/Prospectus (including the Scheme) and other documents filed by Medtronic and New Medtronic with the SEC by contacting Medtronic Investor Relations at investor.relations@medtronic.com or by calling 763-505-2696, and will be able to obtain free copies of the Joint Proxy Statement/Prospectus (including the Scheme) and other documents filed by Covidien by contacting Covidien Investor Relations at investor.relations@covidien.com or by calling 508-452-4650.

PARTICIPANTS IN THE SOLICITATION

Medtronic, New Medtronic and Covidien and certain of their respective directors and executive officers and employees may be considered participants in the solicitation of proxies from the respective shareholders of Medtronic and Covidien in respect of the transactions contemplated by the Joint Proxy Statement/Prospectus. Information regarding the persons who may, under the rules of the SEC, be deemed participants in the solicitation of the respective shareholders of Medtronic and Covidien in connection with the proposed transactions, including a description of their direct or indirect interests, by security holdings or otherwise, will be set forth in the Joint Proxy Statement/Prospectus when it is filed with the SEC. Information regarding Medtronic's directors and executive officers is contained in Medtronic's Annual Report on Form 10-K for the fiscal year ended April 25, 2014 and its Proxy Statement on Schedule 14A, dated July 12, 2013, which are filed with the SEC. Information regarding Covidien's directors and executive officers is contained in Covidien's Annual Report on Form 10-K for the fiscal year ended September 27, 2013 and its Proxy Statement on Schedule 14A, dated January 24, 2014, which are filed with the SEC.

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Statements contained in this communication that refer to New Medtronic's and/or Medtronic's estimated or anticipated future results, including estimated synergies, or other non-historical facts are forward-looking statements that reflect Medtronic's current perspective of existing trends and information as of the date of this communication. Forward looking statements generally will be accompanied by words such as anticipate, believe, plan, could, should, expect, forecast, outlook, guidance, intend, may, might, will, possible, potential, predict, words, phrases or expressions. It is important to note that Medtronic's goals and expectations are not predictions of actual performance. Actual results may differ materially from Medtronic's current expectations depending upon a number of factors affecting New Medtronic's business, Medtronic's business, Covidien's business and risks associated with the proposed transactions. These factors include, among others, the inherent uncertainty associated with financial projections; restructuring in connection with, and successful close of, the Covidien acquisition; subsequent integration of the Covidien acquisition and the ability to recognize the anticipated synergies and benefits of the Covidien acquisition; the risk that the required regulatory approvals for the proposed transactions are not obtained, are delayed or are subject to conditions that are not anticipated; the anticipated size of the markets and continued demand for Medtronic's and Covidien's products; the impact of competitive products and pricing; access to available financing (including financing for the acquisition or refinancing of Medtronic or Covidien debt) on a timely basis and on reasonable terms; the risks of fluctuations in foreign currency exchange rates; the risks and uncertainties normally incident to the medical device industry, including competition in the medical device industry; product liability claims; the difficulty of predicting the timing or outcome of pending or future litigation or government investigations; variability of trade buying patterns; the timing and success of product launches; the difficulty of predicting the timing or outcome of product development efforts and regulatory agency approvals or actions, if any; potential for adverse pricing movement; costs and efforts to defend or enforce intellectual property rights; difficulties or delays in manufacturing; reduction or interruption in supply; product quality problems; the availability and pricing of third party sourced products and

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Statement Required by the Irish Takeover Rules

The directors of Medtronic accept responsibility for the information contained in this document. To the best of the knowledge and belief of the directors of Medtronic (who have taken all reasonable care to ensure that such is the case), the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information.