

## Zimmer Biomet (ZBH)

**\$157.70** (As of 02/05/20)

Price Target (6-12 Months): **\$173.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 01/22/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**2-Buy**

Zacks Style Scores:

VGM:C

Value: B

Growth: D

Momentum: B

### Summary

Zimmer Biomet ended fourth quarter 2019 on a strong note with better-than-expected results. The company registered impressive results fueled by improved performance across all of the geographies and most of the operating segments. Zimmer Biomet is also executing well within its priority areas like quality remediation, supply recovery efforts and product launches. In terms of product launch, the launch of Revision system, ROSA robotics Knee, mymobility digital health platform, Avenir are among major achievements. Zimmer Biomet has outperformed its industry in the past six months. However, costs and expenses are denting the adjusted operating margin for the company. Adverse currency movements continue to be a concern. Declining Spine & CMF sales also disappoints.

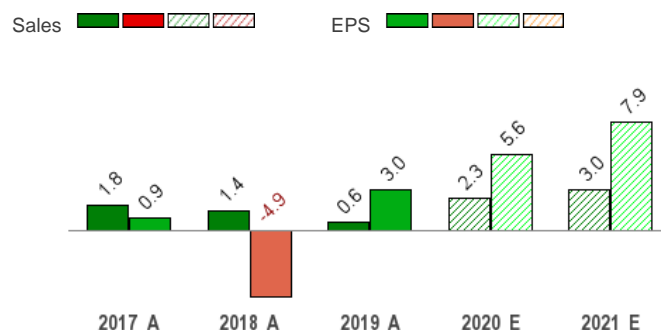
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$159.59 - \$111.17
20 Day Average Volume (sh)	1,023,428
Market Cap	\$32.4 B
YTD Price Change	5.4%
Beta	1.17
Dividend / Div Yld	\$0.96 / 0.6%
Industry	<a href="#">Medical - Products</a>
Zacks Industry Rank	Top 39% (99 out of 255)

### Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.8%
Last Sales Surprise	0.9%
EPS F1 Est- 4 week change	0.2%
Expected Report Date	04/24/2020
Earnings ESP	0.1%
P/E TTM	20.0
P/E F1	19.0
PEG F1	2.7
P/S TTM	4.1

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	2,078 E	2,096 E	1,988 E	2,226 E	8,412 E
2020	2,018 E	2,035 E	1,937 E	2,166 E	8,166 E
2019	1,976 A	1,989 A	1,892 A	2,126 A	7,982 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$2.17 E	\$2.25 E	\$2.03 E	\$2.55 E	\$8.97 E
2020	\$2.01 E	\$2.06 E	\$1.87 E	\$2.37 E	\$8.31 E
2019	\$1.87 A	\$1.93 A	\$1.77 A	\$2.30 A	\$7.87 A

\*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/05/2020. The reports text is as of 02/06/2020.

## Overview

Headquartered in Warsaw, IN, Zimmer Biomet is a leading musculoskeletal healthcare company that designs, manufactures and markets orthopedic reconstructive products; sports medicine, biologics, extremities and trauma products; spine, bone healing, craniomaxillofacial and thoracic products; dental implants; and related surgical products. With operations in over 25 countries, Zimmer markets products in more than 100 countries.

In 2015, Zimmer Holdings, Inc. (the legacy company) acquired Biomet, Inc. to form a new consolidated company.

### Zimmer Biomet's Product Portfolio

Four Zimmer product categories has been retained post the merger. These are:

**Knees** (comprising 35% of total revenues in 2019; up 1.3% from 2018): Major products include Persona personalized knee system, NexGen complete knee solution, Vanguard Knee, Oxford Partial Knee

**Hips** (24%; up 0.7%): Significant hip brands include Zimmer M/L Taper Hip Prosthesis, Taperloc Hip System, Arcos Modular Hip System, Continuum Acetabular System, G7 Acetabular System

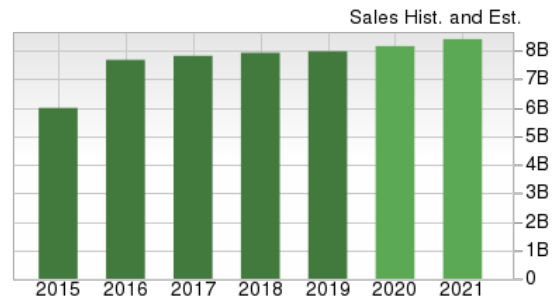
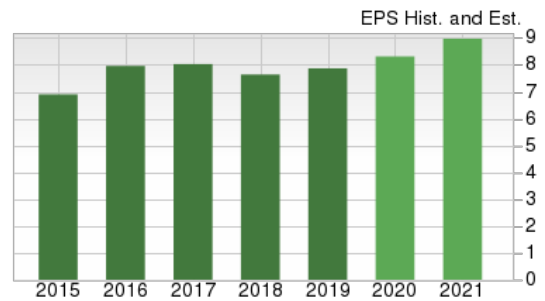
**S.E.T.** (22%; up 2.5%): This product category has been created comprising Surgical, Sports Medicine, Foot and Ankle, Extremities and Trauma. The brands include Intellicart System, A.T.S. Tourniquet Systems, JuggerKnot Soft Anchor System, Gel-One 1 Cross-linked Hyaluronate, Trabecular Metal TM Reverse Shoulder System , Comprehensive Shoulder among others.

**SPINE and CMF** (9.4%; down 2.2%): Major brands include Polaris Spinal System, Mobi-C Cervical Disc.

**Dental** (5.2%; up 0.7%): Significant dental brands are Tapered Screw-Vent Implant System and 3i T3 Implant

In addition, there is a standalone '**Other**' category that includes bone cement and office based technology products.

Zimmer Biomet's geographic segments are the Americas, Europe, Middle East & Africa (EMEA) and Asia Pacific.



## Reasons To Buy:

- ▲ **Share price movement:** Over the past six months, Zimmer Biomet outperformed its industry. The stock has rallied 15.8% compared with the 3.5% rise of the industry. During the fourth quarter, Zimmer Biomet registered strong growth with better-than-expected numbers fueled by improved performance across all of the geographies and most of the operating segments. According to the company revenue growth was slightly above the weighted average market growth rate expectations and earnings per share grew faster than revenue. This was driven by improved year-over-year performance across all geographic regions as well as most of the businesses.

Zimmer's strategic acquisitions like Biomet and LDR, recent focus on emerging markets to drive growth, strong balance sheet position, stabilizing market trend bolstered our confidence in this stock.

Zimmer Biomet is also executing well within its short-term priority areas like quality remediation, supply recovery efforts and product launches. In terms of product launch, the launch of Revision system, ROSA robotics Knee, mymobility digital health platform (developed in partnership with Apple), Avenir are among major achievements.

- ▲ **Successful Execution of Short-term priorities:** Zimmer Biomet is successfully continuing with its short-term priorities to address several near-term challenges. These priorities include supply recovery, supply efficiency, quality remediation, new product launches and providing customer-centric solutions among others. In terms of supply, the company is currently focusing on meeting customer demand and improve service levels.

With respect to quality, the FDA has recently concluded re-inspection of the company's Warsaw North facility. The latest FDA inspection validates the significant improvement and progress that has been made at the Warsaw North facility. In terms of supply, the company is consistently meeting customer demand and improving service levels to enhance its global sales teams. With respect to supply stabilization, the company is focusing more on opportunities to decrease the complexity and increase the efficiency of supply chain.

Relative to product, over the past several months, Zimmer Biomet secured a number of important regulatory clearances for knee, brain and spine applications under its ROSA platform. This apart, the company's mymobility digital health platform (developed in partnership with Apple) and the flagship Persona Partial and Cementless are among other major launches of recent times.

- ▲ **Long-term strategy looks promising:** Zimmer Biomet plans to begin delivering 2-3% growth in 2020 and stabilize its business. In order to achieve the goal, the company has designed a three-pillar strategy for 2020 and beyond. First, the company is targeting to be labeled as the most preferred organization to work in. Second, Zimmer Biomet is trying to build the brand image as a trusted partner to its stakeholders. Third, the company wants to deliver high shareholder return. For this, Zimmer Biomet is planning to implement a five-year plan that will help improve the company's financials.

- ▲ **Gradually stabilizing market:** Despite challenging market conditions in the form of pricing pressure, the last few quarters witnessed gradual stability in the global musculoskeletal market with better-than-expected sales growth in certain geographies, banking on improved procedural volume. This was driven by favorable demographics and growing utilization of musculoskeletal healthcare in emerging markets and under-penetrated developed markets. The focused execution of the company's global sales teams amid a stable global musculoskeletal market also helped accelerate global sales for Persona, the personalized knee system.

With its expectation that the market will stabilize further, Zimmer Biomet is confident about its differentiated portfolio that comprises both premium and value-based offerings.

- ▲ **Favorable long-term trends:** Zimmer Biomet should benefit from favorable long term trends that point toward sustained growth driven by obesity, wear and tear of joints from more active lifestyles, growth in emerging markets, new material technologies, advances in surgical techniques and proven clinical benefits of joint replacement procedures.

More importantly, the percentage of population over the age of 65 in the United States, Europe, Japan and other regions is expected to nearly double by the year 2030. In the United States, the oldest baby boomers are now pushing retirement age. We believe Zimmer Biomet is benefiting from this aging demography since knee and hip joints tend to wear out with age and therefore require replacement.

Zimmer Biomet is operating on a more comprehensive and diversified musculoskeletal portfolio with the target of 17% market share and attractive cross selling opportunities. The combined company's research and development spending capability is expected to reach approximately \$360 million.

- ▲ **Focus on emerging markets to drive growth:** Over the recent past, Zimmer Biomet has been working to strengthen its foothold in emerging markets that provide long-term opportunities for growth. The company's strategic investments in these regions over the past several quarters to improve operational and sales performance are yielding results. While the integration of Biomet is over, the combined company has started to get benefitted from strong presence in the emerging markets with an extended portfolio that includes upper and lower joints. According to the combined company, this will help develop the extremities and trauma business going forward. Zimmer Biomet expects to establish critical mass in both spine and dental that will position the company to compete effectively and gain share in these significant markets.

Markets opportunity is expected to grow to \$66.6 billion by 2025 for the orthopedic implants globally. Within emerging market, we note that strength in Asia Pacific and EMEA markets continued to drive revenue growth. In the fourth quarter, sales generated by Zimmer Biomet in EMEA (Europe, the Middle East and Africa) were up 1.4% year over year at CER led by strength in developed markets. Also, Asia-Pacific registered 8.6% year-over-year growth at CER driven by continued strength across both developed and emerging markets. Banking on a cadence of product launches and strong customer adoptions, Zimmer Biomet expects this strength in the APAC and EMEA markets to continue through 2020.

- ▲ **Strong cash position:** Zimmer Biomet exited the year with cash and cash equivalents of \$617.9 million compared with \$542.8 million at 2018 end. Long-term debt at the end of 2019 totaled \$8.22 billion, reflecting a reduction from \$8.94 billion at the end of 2018. Year to date, net cash provided by operating activities was \$1.16 billion compared with \$1.37 billion a year ago. Cumulative net cash provided by operating activities

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at the end of 2019 was \$1.59 billion compared with \$1.75 billion a year ago.

We note that, with a strong cash balance, Zimmer Biomet earlier intended to return half of its net income to stockholders through share repurchases and suitable acquisitions in the musculoskeletal space.

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## Reasons To Sell:

- ▼ **Pricing pressure continues to persist:** Pricing continues to remain a major headwind for Zimmer Biomet. The company's top-line growth in the reported quarter was partially offset by continued pricing pressure, mostly in the Americas and Europe operating segments. We remain concerned about the pricing scenario as it will be affected by cost containment efforts by governmental healthcare, local hospitals and health systems. In the fourth quarter of 2019, pricing pressure was negative 2.6%, in line with the company's expectations.
- ▼ **Competitive landscape:** The presence of a large number of players has made the medical devices market intensely competitive. The orthopedic industry in particular is highly competitive with the presence of players like Stryker, Johnson & Johnson's DePuy, Smith & Nephew and Medtronic. Zimmer Biomet needs to constantly introduce or acquire new products to withstand the competitive pressure and maintain its market share.
- ▼ **Exposed to currency movement:** Zimmer Biomet records a significant portion its sales from the international market. This makes it highly exposed to currency fluctuations. Per management, projected sales growth figures in 2020 include an expected negative currency impact in the first half of the year and slightly positive in the second half.

Factors like macroeconomic uncertainties, pricing pressure and unfavorable currency fluctuations adversely impacted Zimmer Biomet's sales during the reported quarter.

## Last Earnings Report

### Zimmer Biomet Gains From Strength in Knee Arm in Q4

Zimmer Biomet posted fourth-quarter 2019 adjusted earnings per share (EPS) of \$2.30, surpassing the Zacks Consensus Estimate by 1.8%. The figure also improved 5.5% year over year.

On a reported basis, EPS came in at \$1.54 against the year-ago loss of \$4.42 per share.

For the full year, adjusted earnings improved 3% to \$7.87 from the 2018-level and also exceeded the Zacks Consensus Estimate by 0.5%.

Quarter Ending **12/2019**

Report Date	Feb 04, 2020
Sales Surprise	0.92%
EPS Surprise	1.77%
Quarterly EPS	2.30
Annual EPS (TTM)	7.87

### Revenue Details

Fourth-quarter net sales of \$2.13 billion increased 3% (up 3.9% at constant exchange rate or CER) year over year. The figure also exceeded the Zacks Consensus Estimate of \$2.11 billion by 0.8%.

Full-year net sales of \$7.98 billion increased 0.6% from the 2018 figure (up 2.2% at CER). This too topped the Zacks Consensus Estimate by 1%.

During the fourth quarter, sales generated in the Americas totaled \$1.29 billion (up 2.4% year over year at CER) while the same in EMEA (Europe, the Middle East and Africa) grossed \$471 million (up 1.4% year over year at CER). Asia-Pacific registered 8.6% growth at CER to \$367 million.

### Segments

Sales in the Knees unit improved 4.9% year over year at CER to \$761 million. Hips recorded a 3.2% increase at CER from the prior-year quarter's \$511 million. Revenues in the S.E.T. (Surgical, Sports Medicine, Foot and Ankle, Extremities and Trauma) unit rose 3.1% year over year to \$474 million.

Among other segments, Spine & CMF (Cranio-maxillofacial) inched up 0.2% at CER to \$197 million while Dental rose 5% to \$109 million. Other revenues were down 7.7% to \$74 million.

### Margins

Gross margin after excluding intangible asset amortization came in at 72.6%, reflecting an expansion of 78 bps in the fourth quarter. Selling, general and administrative expenses dropped 11.7% to \$882.2 million. Research and development expenses rose 19.7% to \$121.1 million. Adjusted operating margin grew 669 bps to 25.4% during the quarter.

### Cash Position

Zimmer Biomet exited the year with cash and cash equivalents of \$617.9 million compared with \$542.8 million at 2018 end. Long-term debt at the end of 2019 totaled \$8.22 billion, reflecting a reduction from \$8.94 billion at the end of 2018.

Cumulative net cash provided by operating activities at the end of 2019 was \$1.59 billion compared with \$1.75 billion a year ago.

### 2020 Guidance

The company provided its 2020 guidance. Full-year sales growth is projected in the range of 2.5-3.5% compared with the 2019 expectation. Management noted that there will be an overall neutral impact from currency movement in 2020 (expected to be negative in the first half of the year and slightly positive in the second half). Adjusted EPS for 2020 is envisioned in the \$8.15-\$8.45 band.

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## Valuation

Zimmer Biomet shares are up 21.6% and up 41.8% in the past-six-month period and the trailing 12-month periods, respectively. Stocks in the Zacks subindustry are up 3.7% while the Zacks Medical sector is up 8.8% in the past six- month period. Over the past year, the subindustry is up 15.4% and sector is up 4.5%.

The S&P 500 index is up 12.3% in the past-six-month period and up 23.8% in the past year.

The stock is currently trading at 18.9X Forward 12-months earnings, which compares to 25.5X for the Zacks sub-industry, 21.6X for the Zacks sector and 19.1X for the S&P 500 index.

Over the past five years, the stock has traded as high as 19.1X and as low as 11.4X, with a 5-year median 14.5X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$173 price target reflects 20.59x forward 12-months earnings.

The table below shows summary valuation data for ZBH.

Valuation Multiples - ZBH					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	18.87	25.54	21.56	19.09
	5-Year High	19.11	25.54	21.56	19.34
	5-Year Low	11.39	17	15.84	15.18
	5-Year Median	14.47	19.57	18.9	17.46
P/S F12M	Current	3.96	4.07	2.89	3.54
	5-Year High	4.43	4.07	3.82	3.54
	5-Year Low	2.46	2.87	2.44	2.54
	5-Year Median	3.05	3.21	2.95	3
P/B TTM	Current	2.68	3.24	4.64	4.11
	5-Year High	3.15	3.15	5.03	4.16
	5-Year Low	1.62	1.62	3.43	2.85
	5-Year Median	2.22	2.22	4.29	3.57

As of 02/05/2020

## Industry Analysis Zacks Industry Rank: Top 39% (99 out of 255)



## Top Peers

Danaher Corporation (DHR)	Neutral
Globus Medical, Inc. (GMED)	Neutral
Johnson & Johnson (JNJ)	Neutral
Medtronic PLC (MDT)	Neutral
NuVasive, Inc. (NUVA)	Neutral
Smith & Nephew SNATS, Inc. (SNN)	Neutral
Stryker Corporation (SYK)	Neutral
DENTSPLY SIRONA Inc. (XRAY)	Neutral

Industry Comparison Industry: Medical - Products				Industry Peers		
	ZBH Neutral	X Industry	S&P 500	JNJ Neutral	MDT Neutral	SYK Neutral
<b>VGM Score</b>	<b>C</b>	-	-	<b>C</b>	<b>B</b>	<b>B</b>
Market Cap	32.44 B	280.61 M	24.26 B	405.28 B	161.68 B	81.45 B
# of Analysts	16	2	13	9	13	16
Dividend Yield	0.61%	0.00%	1.75%	2.47%	1.79%	1.06%
<b>Value Score</b>	<b>B</b>	-	-	<b>B</b>	<b>C</b>	<b>C</b>
Cash/Price	0.02	0.08	0.04	0.05	0.07	0.06
EV/EBITDA	18.96	0.16	14.19	15.97	18.93	28.34
PEG Ratio	2.73	2.78	2.04	2.56	2.93	2.41
Price/Book (P/B)	2.62	4.02	3.31	6.96	3.19	6.36
Price/Cash Flow (P/CF)	12.00	20.25	13.70	14.12	16.59	20.80
P/E (F1)	18.98	28.14	19.17	17.00	21.54	23.92
Price/Sales (P/S)	4.06	5.49	2.67	4.94	5.23	5.47
Earnings Yield	5.27%	0.35%	5.22%	5.88%	4.64%	4.18%
Debt/Equity	0.54	0.11	0.71	0.46	0.49	0.80
Cash Flow (\$/share)	13.14	-0.01	6.92	10.90	7.27	10.47
<b>Growth Score</b>	<b>D</b>	-	-	<b>C</b>	<b>C</b>	<b>B</b>
Hist. EPS Growth (3-5 yrs)	4.62%	10.31%	10.80%	9.27%	6.06%	12.31%
Proj. EPS Growth (F1/F0)	5.63%	13.59%	7.35%	4.39%	7.30%	10.22%
Curr. Cash Flow Growth	-24.63%	4.01%	10.12%	13.87%	6.26%	11.85%
Hist. Cash Flow Growth (3-5 yrs)	21.63%	9.59%	8.55%	7.92%	15.58%	12.35%
Current Ratio	1.37	2.77	1.20	1.26	2.77	2.58
Debt/Capital	35.16%	15.02%	42.91%	31.62%	32.80%	44.41%
Net Margin	14.18%	-15.64%	11.79%	22.18%	15.11%	13.99%
Return on Equity	13.64%	-6.74%	17.21%	39.30%	14.52%	25.75%
Sales/Assets	0.33	0.63	0.54	0.53	0.34	0.55
Proj. Sales Growth (F1/F0)	2.27%	11.88%	4.15%	4.68%	3.17%	7.18%
<b>Momentum Score</b>	<b>B</b>	-	-	<b>F</b>	<b>A</b>	<b>D</b>
Daily Price Chg	0.59%	0.00%	1.40%	1.58%	0.53%	0.64%
1 Week Price Chg	0.07%	-2.14%	-2.60%	0.37%	-3.20%	-1.65%
4 Week Price Chg	5.42%	0.53%	1.96%	6.23%	3.54%	3.34%
12 Week Price Chg	9.23%	6.39%	6.04%	17.31%	10.65%	7.93%
52 Week Price Chg	33.44%	0.00%	16.68%	15.78%	35.74%	20.49%
20 Day Average Volume	1,023,428	157,733	1,966,046	6,775,179	4,121,854	1,608,845
(F1) EPS Est 1 week change	0.20%	0.00%	0.00%	0.00%	0.00%	0.06%
(F1) EPS Est 4 week change	0.20%	0.00%	0.00%	-0.46%	0.00%	0.84%
(F1) EPS Est 12 week change	0.20%	0.00%	-0.08%	-0.93%	0.69%	0.82%
(Q1) EPS Est Mthly Chg	1.13%	0.00%	0.00%	-4.85%	0.06%	1.56%



## Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	<b>B</b>
Growth Score	<b>D</b>
Momentum Score	<b>B</b>
VGM Score	<b>C</b>

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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