

## Zimmer Biomet (ZBH)

**\$111.07** (As of 05/13/20)

Price Target (6-12 Months): **\$104.00**

Long Term: 6-12 Months

**Zacks Recommendation:** Underperform

(Since: 04/07/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

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

**4-Sell**

Zacks Style Scores:

VGM:D

Value: D

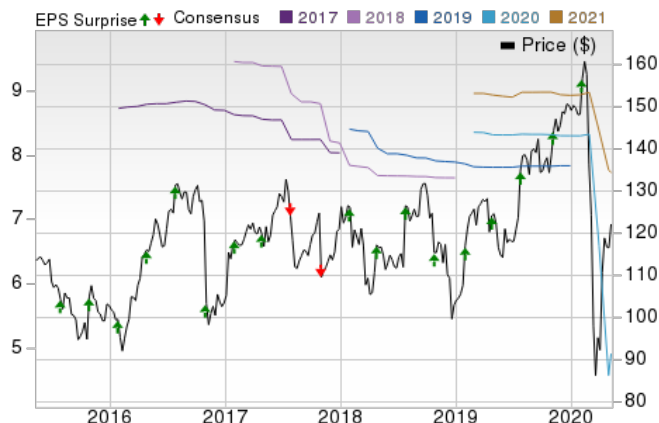
Growth: C

Momentum: D

### Summary

Zimmer Biomet ended the first quarter of 2020 on a dismal note with disappointing sales performances across all operating segments and geographies. The company noted that first-quarter performance was negatively impacted by COVID-19, which reached a pandemic level in March and resulted in a significant and sudden decline in elective procedure volumes across all regions. However, Zimmer Biomet expects its strong fundamentals and capital structure to position it well to overcome the ongoing challenges. However, its expectation of a further decline in elective procedure volumes in the second quarter raises concern. The company did not provide any update on its full-year guidance at present. Over the past six months, Zimmer Biomet underperformed its industry.

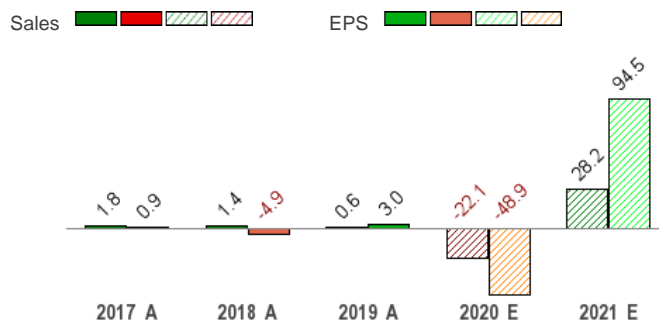
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	<b>\$161.11 - \$74.37</b>
20 Day Average Volume (sh)	<b>1,545,083</b>
Market Cap	<b>\$22.9 B</b>
YTD Price Change	<b>-25.8%</b>
Beta	<b>1.32</b>
Dividend / Div Yld	<b>\$0.96 / 0.9%</b>
Industry	<b><a href="#">Medical - Products</a></b>
Zacks Industry Rank	<b>Top 19% (49 out of 253)</b>

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



Last EPS Surprise	<b>22.3%</b>
Last Sales Surprise	<b>-0.3%</b>
EPS F1 Est- 4 week change	<b>-12.6%</b>
Expected Report Date	<b>07/24/2020</b>
Earnings ESP	<b>-68.2%</b>

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,961 E	2,005 E	1,928 E	2,214 E	7,964 E
2020	1,784 A	978 E	1,549 E	2,042 E	6,214 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	\$1.84 E	\$1.95 E	\$1.83 E	\$2.38 E	\$7.82 E
2020	\$1.70 A	-\$0.52 E	\$0.95 E	\$2.06 E	\$4.02 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.

P/E TTM	<b>14.4</b>
P/E F1	<b>27.6</b>
PEG F1	<b>4.0</b>
P/S TTM	<b>2.9</b>

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 05/13/2020. The reports text is as of 05/14/2020.

## 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

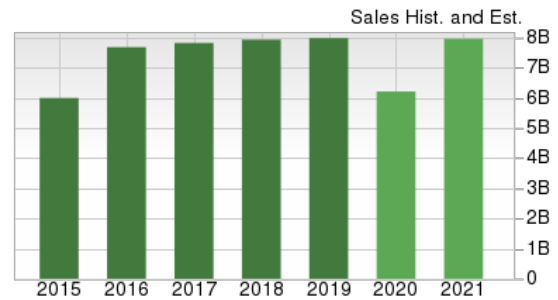
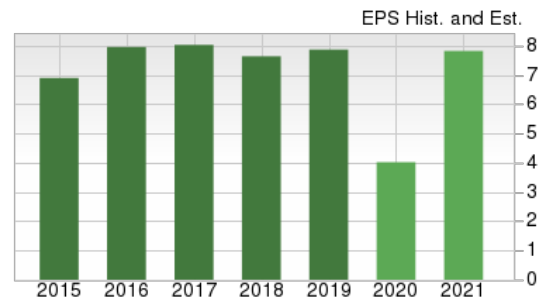
**S.E.T.** (22%; up 2.5%): This product category has been created comprising Surgical, Sports Medicine, Foot and Ankle, Extremities and Trauma. The brands include Intellicart System, A.T.S. Tourniquet Systems, Juggernaut Soft Anchor System, Gel-One 1 Cross-linked Hyaluronate, Trabecular Metal TM Reverse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



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## Reasons To Sell:

▼ **Share Price Movement:** Over the past six months, Zimmer Biomet underperformed its industry. The stock has declined 24.4% compared with the 0.6% drop of the industry. Zimmer Biomet ended the first quarter on a dismal note with disappointing sales performances across all operating segments and geographies. The company noted that first-quarter performance was negatively impacted by COVID-19, which reached a pandemic level in March and resulted in a significant and sudden decline in elective procedure volumes across all regions.

Zimmer Biomet expects the decline in elective procedure volumes to intensify in the second quarter of 2020. Given the uncertainty related to the scope and duration of the pandemic and its ongoing impact on the deferral of elective procedures, the company is currently unable to gauge the expected impact on its overall all business in 2020. Accordingly, it did not provide any update on its full-year guidance.

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

▼ **COVID-19 to Hurt Sales in Near Term:** According to Zimmer Biomet, COVID-19 will continue to have a significant unfavorable impact in the near term. The deferral of elective procedures as a result of hospitals redeploying resources to COVID-19 is expected to have a meaningful negative impact through the company's 2020 performance. Zimmer Biomet noted that, this impact became pronounced in mid- to late March. That trend extended into the first part of the second quarter. April revenues were down about 70% year over year on the pandemic intensifying in submarkets.

Asia Pacific business decreased 9.5% in the first quarter as the company began to see procedure deferrals in early February at varying levels across the region and at varying times during the quarter. While China experienced some deep declines, Japan, Zimmer Biomet's largest market in Asia Pacific, did not see a material impact from COVID-19 in the first quarter. However, there has been a modest decline in procedures in April since the country announced the state of emergency. In April, procedures and revenue in Japan are down about 15% and have been stable at that level. Across EMEA, in April, the company saw procedures or revenue down about 75% versus the prior year. In Americas, through April, Zimmer Biomet continued to see a decline in procedures with deferral rates of about 75% to 85% and revenue being down about 80% versus the prior year.

▼ **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 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. In the first quarter, adverse currency translation impacted sales by 0.8%.

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## Risks

- **Long-term Strategy Looks Promising:** in 2019, Zimmer Biomet pitched its 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 so far. Post the COVID-19 mayhem gets past; banking on a cadence of product launches and strong customer adoptions, Zimmer Biomet is expected to continue with this trend.

- **Overall Healthy Solvency Structure:** Zimmer Biomet exited the first quarter with cash and cash equivalents of \$2.43 billion compared with \$617.9 million at 2019 end. Meanwhile, total debt came up to \$9.67 billion, a rise from the sequentially-last-reported figure of \$8.22 billion. The reported quarter's total debt was much higher than the corresponding cash and cash equivalent level indicating tough solvency position. However, the company has near-term-payable debt of \$1.95 billion on its balance sheet, much lower than the present level of cash in hand. This is a relief for the investors as during the year of global pandemic when the company is facing procedural deferrals and low demand for non-COVID-19 musculoskeletal products, it is holding sufficient cash for debt repayment.

On the other hand, the quarter's total debt-to-capital ratio stands at 0.44 indicating a moderately leveraged balance sheet. It also represents a sequential rise from 39.9% in the fourth quarter.

In the first quarter, the company also paid \$50 million in dividends and declared a dividend of 24 cents per share.

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## Last Earnings Report

### Zimmer Biomet Q1 Sales Suffer on Procedural Deferrals

Zimmer Biomet posted first-quarter 2020 adjusted earnings per share (EPS) of \$1.70, which surpassed the Zacks Consensus Estimate by 22.3%. The figure however declined 9.1% year over year.

On a reported basis, the company registered loss of \$2.46 per share, a significant decline from the year-ago earnings of \$1.20 per share.

A significant year-over-year decline in the company's first-quarter revenues and operating margin, negatively impacted by the coronavirus outbreak, resulted in poor earnings performance of Zimmer Biomet.

Quarter Ending **03/2020**

Report Date	May 11, 2020
Sales Surprise	-0.34%
EPS Surprise	22.30%
Quarterly EPS	1.70
Annual EPS (TTM)	7.70

### Revenue Details

First-quarter net sales of \$1.78 billion decreased 9.7% (down 8.9% at constant exchange rate or CER) year over year. The figure also missed the Zacks Consensus Estimate by 0.3%. The company noted that the coronavirus pandemic resulted in the deferral of elective procedures during the quarter.

During the first quarter, sales generated in the Americas totaled \$1.10 billion (down 7.7% year over year at CER) while the same in EMEA (Europe, the Middle East and Africa) grossed \$398 million (down 11.7% year over year at CER). Asia-Pacific registered 9.5% decline at CER to \$285 million.

### Segments

Sales in the Knees unit declined 8.3% year over year at CER to \$630 million. Hips recorded a 9.7% drop at CER to \$433 million. Revenues in the S.E.T. (Sports Medicine, Extremities and Trauma) unit declined 6.5% year over year to \$333 million.

Among other segments, Dental, Spine & CMFT (Cranio-maxillofacial and Thoracic) dropped 11.8% at CER to \$252 million. Other revenues were down 11% to \$136 million.

### Margins

Gross margin after excluding intangible asset amortization came in at 72.7%, reflecting an expansion of 71 basis points (bps) in the first quarter. Selling, general and administrative expenses increased 4.1% to \$828.9 million. Research and development expenses declined 3.2% to \$98.4 million. Adjusted operating margin contracted 582 bps to 20.1% during the quarter.

### Cash Position

Zimmer Biomet exited the first quarter with cash and cash equivalents of \$2.43 billion compared with \$617.9 million at 2019 end. Long-term debt at the end of the quarter totaled \$7.72 billion, reflecting a rise from \$6.72 billion at the end of 2019.

At the end of the first quarter, net cash provided by operating activities was \$450.9 million compared with \$283.6 million in the year-ago period.

### 2020 Guidance

Zimmer Biomet expects the decline in elective procedure volumes to intensify in the second quarter of 2020. Given the uncertainty related to the scope and duration of the pandemic and its ongoing impact on the deferral of elective procedures, the company is currently unable to gauge the expected impact on its overall all business in 2020. Accordingly, it did not provide any update on its full-year guidance.

## Valuation

Zimmer Biomet shares are down 25.8% and down 6.3% in the year-to-date period and the trailing 12-month periods, respectively. Stocks in the Zacks subindustry are down 9% while the Zacks Medical sector is down 4.7% in the year-to-date period. Over the past year, the subindustry is down 1.9% and sector is up 1.4%.

The S&P 500 index is down 12.4% in the year-to-date period and down 1.4% in the past year.

The stock is currently trading at 18.7X Forward 12-months earnings, which compares to 30.9X for the Zacks sub-industry, 22.1X for the Zacks sector and 22.4X for the S&P 500 index.

Over the past five years, the stock has traded as high as 21X and as low as 9.5X, with a 5-year median 14.4X. Our Underperform recommendation indicates that the stock will perform below with the market. Our \$104 price target reflects 17.5x 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 F 12M	Current	18.7	30.97	22.14	22.44
	5-Year High	21.02	30.97	22.14	20.79
	5-Year Low	9.53	17.01	15.81	15.19
	5-Year Median	14.39	19.73	18.81	17.45
P/S F12M	Current	3.22	3.33	2.68	3.18
	5-Year High	4.18	3.99	3.84	3.44
	5-Year Low	2.01	2.88	2.24	2.54
	5-Year Median	3.03	3.22	2.96	3.02
P/B TTM	Current	1.85	3.06	3.69	3.7
	5-Year High	2.96	4.25	5.05	4.55
	5-Year Low	1.34	2.21	2.92	2.84
	5-Year Median	2.19	2.77	4.28	3.65

As of 05/13/2020

## Industry Analysis Zacks Industry Rank: Top 19% (49 out of 253)



## Top Peers

Company (Ticker)	Rec	Rank
Danaher Corporation (DHR)	Neutral	3
Globus Medical, Inc. (GMED)	Neutral	4
JohnsonJohnson (JNJ)	Neutral	3
Medtronic PLC (MDT)	Neutral	4
SmithNephew SNATS, Inc. (SNN)	Neutral	4
Stryker Corporation (SYK)	Neutral	4
NuVasive, Inc. (NUVA)	Underperform	5
DENTSPLY SIRONA Inc. (XRAY)	Underperform	5

Industry Comparison Industry: Medical - Products				Industry Peers		
	ZBH	X Industry	S&P 500	JNJ	MDT	SYK
Zacks Recommendation (Long Term)	Underperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	4	-	-	3	4	4
VGM Score	D	-	-	C	B	C
Market Cap	22.93 B	299.04 M	18.76 B	387.63 B	125.01 B	67.90 B
# of Analysts	14	3	14	9	14	14
Dividend Yield	0.86%	0.00%	2.23%	2.58%	2.32%	1.27%
Value Score	D	-	-	C	C	D
Cash/Price	0.02	0.10	0.06	0.05	0.09	0.06
EV/EBITDA	13.60	-0.01	11.39	16.02	14.85	21.93
PEG Ratio	3.98	4.04	2.54	3.20	2.39	3.18
Price/Book (P/B)	1.93	3.55	2.56	6.32	2.41	5.18
Price/Cash Flow (P/CF)	8.45	16.38	10.04	12.77	12.83	17.30
P/E (F1)	27.67	31.40	18.48	19.17	18.44	29.22
Price/Sales (P/S)	2.94	4.76	1.91	4.69	4.02	4.54
Earnings Yield	3.62%	0.09%	5.09%	5.22%	5.42%	3.42%
Debt/Equity	0.65	0.10	0.75	0.41	0.48	0.72
Cash Flow (\$/share)	13.14	-0.01	7.01	11.52	7.27	10.47
Growth Score	C	-	-	C	B	A
Hist. EPS Growth (3-5 yrs)	3.66%	12.07%	10.82%	9.40%	6.24%	12.22%
Proj. EPS Growth (F1/F0)	-48.92%	-2.41%	-10.51%	-11.57%	-1.99%	-24.94%
Curr. Cash Flow Growth	-24.63%	4.32%	5.83%	3.68%	6.26%	11.85%
Hist. Cash Flow Growth (3-5 yrs)	13.79%	7.74%	8.52%	7.62%	15.58%	12.35%
Current Ratio	1.69	2.73	1.27	1.31	2.75	2.58
Debt/Capital	39.40%	16.31%	44.25%	29.29%	32.25%	41.76%
Net Margin	4.84%	-27.05%	10.59%	24.47%	17.11%	14.47%
Return on Equity	13.29%	-9.05%	16.36%	39.71%	14.76%	24.90%
Sales/Assets	0.32	0.56	0.54	0.53	0.34	0.53
Proj. Sales Growth (F1/F0)	-22.16%	0.00%	-2.55%	-2.59%	0.30%	-8.43%
Momentum Score	D	-	-	B	A	D
Daily Price Chg	-2.22%	-2.08%	-2.85%	-0.01%	-2.02%	-3.74%
1 Week Price Chg	4.83%	1.78%	3.23%	0.28%	4.09%	6.34%
4 Week Price Chg	0.86%	1.87%	-0.28%	-0.36%	-4.15%	4.98%
12 Week Price Chg	-30.59%	-11.19%	-23.80%	-1.22%	-18.01%	-19.53%
52 Week Price Chg	-6.31%	-6.08%	-13.31%	7.46%	5.68%	-2.44%
20 Day Average Volume	1,545,083	256,892	2,552,088	8,757,802	5,334,646	1,738,997
(F1) EPS Est 1 week change	-8.24%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-12.62%	-2.06%	-6.15%	-4.85%	-5.73%	-15.97%
(F1) EPS Est 12 week change	-51.69%	-11.89%	-16.21%	-15.00%	-16.11%	-31.92%
(Q1) EPS Est Mthly Chg	-345.91%	-4.23%	-12.28%	-12.00%	-12.87%	-48.26%

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## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

### Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

### Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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### 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	D
Growth Score	C
Momentum Score	D
VGM Score	D

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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