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October 18, 2004

Gabelli & Company, Inc.

INITIAL REPORT
Medical Devices
BUY

Zimmer Holdings, Inc.
(ZMH – NYSE)

Investment Summary

Zimmer Holdings, Inc. (ZMH), headquartered in Warsaw, Indiana, manufacturers reconstructive implants, spinal products, fracture management products and orthopedic surgical products. Approximately 82% of its nearly $3.0 billion in revenues come from its reconstructive segment consisting primarily of knee implants and hip implants, but also includes shoulder/ elbow implants and dental implants. The company was founded in 1927, acquired by Bristol Myers Squibb in 1972 and spun-off as a public company in Aug. 2001.

We believe that Zimmer Holdings is an attractive, long term investment for the following reasons:

- **Sales Growth of ~ 14%**
  - 2004 worldwide orthopedic market of $19+ billion, growing 10%-13% over next decade due to:
    - Aging baby boomers
    - Increased active lifestyles
    - Desire for treatments and solutions to ease pain/ discomforts once tolerated
  - Share gain amid industry consolidation with Centerpulse acquisition in October 2003
- **Leading Market Share Positions**
  - #1 share position in worldwide knee and hip implant market
  - #3 share position in the worldwide orthopedic market behind Stryker and DePuy division of Johnson & Johnson.
- **Continuous Margin Improvement & Solid Financial Condition**
  - Continuous margin improvement from current level of 29.6% (excluding inventory step-up costs and integration charges)
  - Debt reduction of $490 million since Oct. 2003 closing of Centerpulse acquisition

($Millions)	2003A	2004E	2005E	2006P	2007P	2008P	04-'08 CAGR
Rev.	$1,901	2,955	3,365	3,836	4,362	4,960	13.8%
EPS	$1.66	2.25-2.35	2.85-2.95	3.60-3.70	4.40-4.50	5.20-5.30	22.5%
							TOTAL
Ops CF		730.9	961.6	1,191.5	1,443.5	1,688.9	6,016.4
- Capex		(70.0)	(85.0)	(100.0)	(115.0)	(130.0)	(500.0)
- Instrum. Sets		(150.0)	(120.0)	(100.0)	(115.0)	(132.3)	(617.3)
FCF		$511	756.6	991.5	1,213.5	1,426.6	4,899.1

Current Price:	$71.31
52 Week Range:	$89.44-55.68

Earnings Per Share:	
2006P	$3.60-3.70
2005P	2.85-2.95
2004E	2.25-2.35[a]
2003A	$1.66

[a] Excludes inventory step-up charges and integration costs related to Centerpulse acquisition of approx. $100 million net of tax or $0.40 in earnings

Price/Earnings Ratio:	
2006P	19.6
2005P	24.7
2004E	31.0
2003A	43.0

Indicated Dividend:	nil

Capitalization (6/30/04):	($ mils.)
Net Debt	$ 781.6
Common Stock (248 million diluted shares)	3,488.2
Total Capitalization	$4,269.8

Jennie Tsai

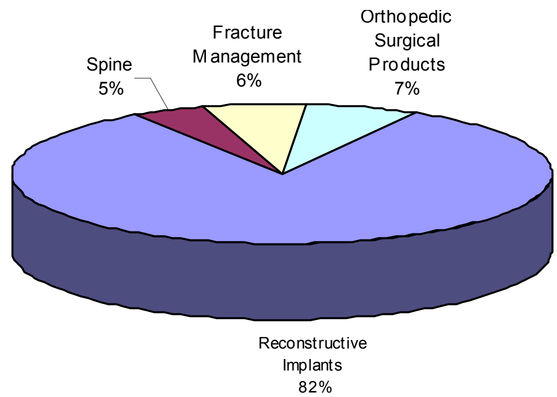
COMPANY OVERVIEW

Zimmer Holdings, Inc. (ZMH), headquartered in Warsaw, Indiana, is a manufacturer of reconstructive implants and other orthopedic products. The company was spun-off from Bristol-Myers Squibb in Aug. 2001 with an initial price of $28 per share. The company was founded in 1927 by Justin O. Zimmer and acquired by Bristol-Myers Squibb in 1972. The company employs more than 2,000 sales representatives to sell its product in more than 80 countries. The company has grown by developing new products in-house and acquiring complimentary businesses and selling products directly to health care institutions and via independent distributors. International sales contributed 42% of total sales in YTD 2004. The company currently has several product categories: a) reconstructive implants, b) spine products, c) fracture management/ trauma products, and d) orthopedic surgical products.

Product Categories

- Reconstructive (82% of est. 2004 sales)
  - Knee implants – 40% of sales
  - Hip implants – 36 ‘ ‘
  - Dental implants – 4 ‘ ‘
  - Shoulder & Elbow – 2 ‘ ‘
- Spine segment (5% of sales) – Products used for spine fusion surgery to relieve back pain.
- Fracture management/ Trauma (6% of sales) – Products used to reattach or stabilize damaged bone and tissue to support the body's natural healing process. Common trauma cases include accidents, fights, falls, and other injuries.
- Orthopedic surgical products (7% of sales) – Products used during orthopedic or general surgery procedures such as autotransfusion system, surgical tourniquet systems, and wound debridement systems.

Chart 1: 2004E Sales by Segment



Product Categories	2004E	%
Reconstructive Imp	2,434.24	82.3 %
Spine segment	135.00	4.6
Fracture Managem	177.00	6.0
Orthopedic Surgica	209.80	7.1
Total	2,956.04	100.0

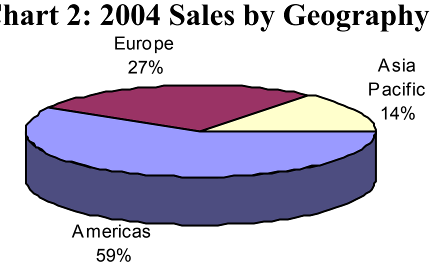
Source: Company data.

Sales by Geographic Area

Zimmer sells its products in more than 80 countries worldwide and operates in more than 24 countries. The following highlights Zimmer's sales by geographic region.

- Americas – 59% of sales
  - Includes US, North, Central and South America
  - Has contracts with buying groups such as Novation, Premier, and Health Trust
- Europe – 27% of sales
  - Six countries collectively accounted for more than 80% of European sales in 2003
- Asia Pacific – 14% of sales

Chart 2: 2004 Sales by Geography



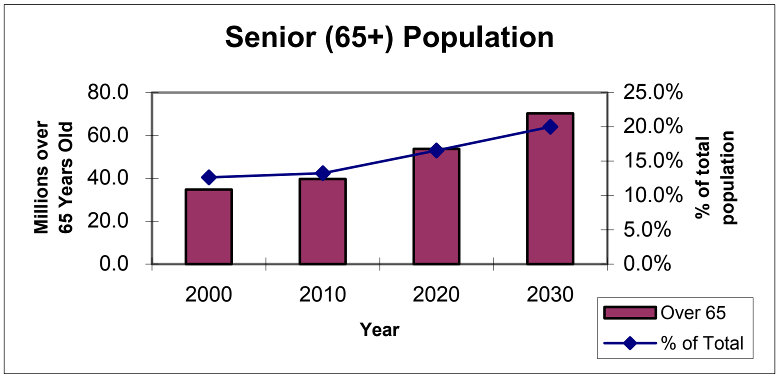
Geographic Area	2004E	%
Americas	1,726.18	58.4 %
Europe	805.20	27.2
Asia Pacific	424.71	14.4
Total	2,956.09	100.0

Source: Company data.

INDUSTRY OVERVIEW

Zimmer participates in the fast-growing orthopedic market driven by the aging population with those over 65 representing 13% of the US population in 2000 and growing to 20% in 2030.

Figure 1: US Demographics - Increase in "Active Seniors"



Source: US Census Bureau.

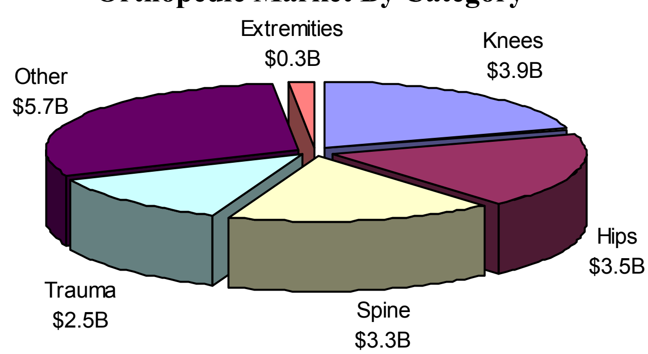
The overall orthopedic market is also benefiting from several factors:

- Strong desire to remain active in later years – "Active Seniors"
- Strong demand for treatments and solutions to chronic and degenerative diseases which causes pain, discomfort and lack of mobility
- 20+ history of clinical data demonstrating efficacy of knee and hip implants
- Growth in revision implants
- Growth in minimally invasive procedures for joint or bone related conditions and ailments

WORLDWIDE ORTHOPEDIC MARKET

The worldwide orthopedic market is estimated at $19.0+ billion in 2004. The orthopedic market consists of the knee implant market, hip implant market, spine market, trauma market and other, which includes instruments, arthroscopy and orthobiologics. The estimated market size of each category is shown in the pie chart to the right.

Chart 3: $19.0+ Billion - 2004E Worldwide Orthopedic Market By Category



Source: Gabelli & Company, Inc. estimates.

The major manufacturers are Stryker (NYSE: SYK), JNJ DePuy (NYSE: JNJ), Zimmer (NYSE: ZMH), Biomet (NYSE: BMET), Smith & Nephew (NYSE: SNN), Medtronic Sofamor Danek (NYSE: MDT), and Synthes-Stratec (SWX: SYST). This table shows the various product categories/ segments within the orthopedic market and the market share positions of the participants.

Table 1: Top Orthopedic Companies

Companies	2004E Share
Stryker	19.0%
JNJ DePuy	18.0
Zimmer	16.0
Synthes-Stratec	9.0
Smith & Nephew	8.5
Biomet	8.0
Medtronic	7.0
Others	14.5
Total	**100.0%**

Source: Company data and Gabelli & Company, Inc. estimates.

The orthopedic companies previously listed participate in different segments within the orthopedic market. In the table below, we break out the sales of each company by product category. Three companies, Zimmer, Biomet and Synthes-Stratec, are pure play orthopedic companies with 100% of its sales derived from orthopedic markets.

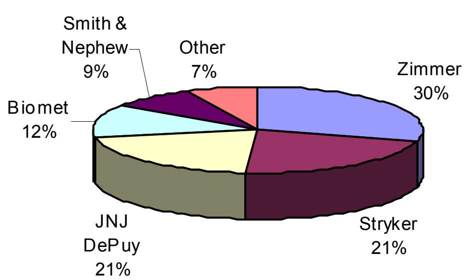
Company	Recon-structive	Spine	Trauma	Other Orthopedic	Other Medical	Total
Stryker	40.4%	5.6%	8.7%	33.0%	13.0%	100%
JNJ DePuy(1)	3.5	1.5	<1.0	1.5	93.0	100
Zimmer	82.4	5.0	6.0	7.0	--	100
Synthes-Stratec	--	27.0	73.0	--	--	100
Smith & Nephew	33.0	<1.0	14.0	25.0	28.0	100
Biomet	65.0	8.0	14.0	13.0	--	100
Medt. Sofamor Danek(2)	--	18.0	--	--	82.0	100

(1) DePuy division with sales of $3.0 billion makes up only 7.2% of JNJ total sales.
(2) Sofamor Danek division with sales of $1.6 billion makes up 18% of Medtronic's total sales.
Source: Company data and Gabelli & Company, Inc. estimates.

RECONSTRUCTIVE MARKET – Zimmer's #1 Position

The reconstructive category consisting primarily of knee implants and hip implants is the mainstay of orthopedics with products lasting 15 to 20 years in patients. Out of all the orthopedic products, knee and hip implants are being affected the most by the aging population with increasing rates of arthritis, osteoporosis and obesity causing diseased and/or damaged joints. It is also the core of Zimmer's business, comprising 77% of its total sales.

Chart 4: $7.8 Billion - 2004E Reconstructive Market(1) By Share Positions



	2004E Sales ($bils)	%
Zimmer	$2.30	30%
Stryker	1.67	21%
JNJ DePuy	1.65	21%
Biomet	0.95	12%
Smith & Nephew	0.68	9%
Wright Medical	0.23	3%
Other	0.30	4%
Total	$7.78	100%

1) Includes extremities, but excludes dental implants. Source: Company data and Gabelli & Company, Inc.

With its acquisition of Centerpulse in October 2003, Zimmer gained the #1 position in the worldwide reconstructive market. It is followed by Stryker and JNJ DePuy with the second and third leading positions. Overall, the top five manufacturers have more than 90% of the worldwide reconstructive market. We provide some basic information about knee implants and hip implants below:

Knee Implants 101

There are several conditions which necessitate a total knee surgery ("arthroplasty") or partial knee replacement ("unicompartmental"). These conditions essentially wear away the knee's articular cartilage and include the following:

- Osteoarthritis – cartilage breakdown which causes bones to rub against one another
- Rheumatoid arthritis – inflammation of the lining of the joints
- Knee fractures, torn cartilage, or torn ligaments - cause the knee to function abnormally

The articular cartilage separates the femur from the tibia and prevents bone on bone friction. When the cartilage wears away due to the above conditions, the ends of the femur and the tibia will rub against each other, which is painful and sometimes causes the bones to fragment, causing damage to the femur, tibia, and/or patella.

Knee Implant Procedure

In a total knee arthroplasty, three parts of the knee are replaced: the bottom of the femur (thighbone), the top of the tibia (shinbone), and the patella (kneecap). These three parts are replaced by protheses made of metal titanium and/ or high-grade plastics.

– Femur: the bottom end of the femur, or thighbone, is cut off and replaced by a fitted metal replication of the removed area with a groove in the middle.
– Tibial: the top end of the tibia, or shin, is cut off and replaced by a fitted metal plate. An articulating surface is placed on the tibial plate where the femoral component will lie.
– Patella: the bottom end of the patella is replaced with a dome-shaped polyethylene button anchored to a flat metal plate, duplicating the shape of the kneecap.

Source: Zimmer website.

In addition, an orthopedic surgeon has to decide whether to use a cemented or uncemented implant. A cemented implant uses bone cement to bind the implant components together. An uncemented implant relies on one's own bone to eventually grow into the implant components to hold them in place. Uncemented components usually require screws or pegs to stabilize the implant until bone ingrowth occurs.

Hip Implants 101

The conditions that cause knee replacements also cause hips to deteriorate:

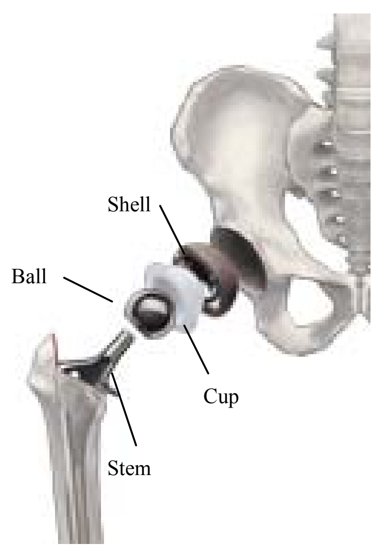
– Osteoarthritis – articular cartilage cushioning the bones of the hips wear away, causing pain and stiffness as the bones rub against one another
– Rheumatoid arthritis – inflammation of the lining of the joints, causing swelling and pain
– Hip fractures – also known as avascular necrosis and occurs frequently among elderly women due to accidental falls

Hip Implant Procedure

The hip joint is a ball and socket joint consisting of the spherical head of the femur (thighbone) which moves inside the cup-shaped hollow socket of the pelvis (acetabulum).

In a total hip arthroplasty, there are three components of the hip implant which combined creates the ball and socket movement of a hip:

– Stem: lengthy portion of the implant that fits into the upper cavity of femur and provides stability
– Ball: circular ball which replaces the top of the femur and provides rotating motion
– Cup: semicircular cup which replaces the socket of the hip and holds the ball in for rotation; in addition, the cup will also have an outer shell.



Source: Zimmer website.

Similar to knee implant surgery, an orthopedic surgeon has to decide whether to use a cemented or uncemented implant. A cemented implant uses bone cement to bind the implant components together. An uncemented implant relies on one's own bone to eventually grow into the implant components to hold them in place. Uncemented hip implants takes time for bone to grow into the implant, so patients cannot put their full weight on the implant immediately after surgery. Lastly, a partial hip replacement may be done instead of a total hip replacement if only a part of the joint is damaged or diseased.

Cost and Reimbursement

According to Orthopedic Network News, the DRG payment for major joint replacement for FY2004 is approximately $10,000. This includes the cost of the implant, physician services, and the hospital surgery room. The total cost of the implant surgery plus the typical 4-5 day hospital stay is approximately $25,000. Total joint replacement is covered by Medicare for those over 65 years old and covered by most private insurance plans. Essentially, joint replacement surgery is viewed as a low-risk, highly beneficial procedure since it significantly improves the quality of life for patients.

ZIMMER's PRODUCT GROUPS

- **Reconstructive -** Representing 82.4% of total revenues, this product category consists of knee, hip, shoulder/ elbow implants which restore function to diseased or damaged joints. With the acquisition of Centerpulse, Zimmer also inherited a dental implant product line.

Implant	Product Name	Product Details
Knees	NexGen® Knee system	Comprehensive system
	Natural-Knee® system	Interchangeable, anatomically designed
	M/G® and Allegretto™ Unicompartmental knee system	Conserving bone uni systems
	Prolong™ Cross-linked polyethylene articular surface	Bearing surface material
Hips	VerSys® Hip system	Family of hip products for design specific options
	Natural-Hip™ Prosthesis system	Various hip stem options
	Alloclassic Hip prosthesis	Primary, cementless hip
	ZMR® and Revitan® Revision hip system	Revision patients
	Trilogy® Acetabular system	Family of shells, liners and cups
	Metasul® Metal on metal implant	Wear minimalization
	Durom™ hip resurfacing system	Bone preserving
Shoulder/ Elbow	Coorad/ Mooray Total elbow	Family of elbow products
	Bigliani/Flatow® Complete shoulder	Family of shoulder products
	Anatomical Shoulder implant	Tailor to specific anatomy
Dental	Tapered Screw-Vent® system	Internal hex connection
	AdVent™	Transgingival, one stage
	Tapered SwissPlus™ system	Multiple lead threads, tight interdental space
	PureForm™ system	Natural look, custom fabricate the crown

- **Spine** - Representing 5% of total revenues, the spine product category includes the following products:

Spine	BAK™ Vista Interbody fusion system	Allows for radiologic visualization
	Trinica™ Select anterior cervical plate system	Multiple screw options
	Puros® Cervical specialty allograft	Machined radius allograft
	ST360™ Spinal fixation system	Polyaxial screw technology with offset connector
	Dynesys® dynamic stabilization system	Flexible material to stabilize the spine sold in Europe; clinical trials in the US

- **Trauma** - Representing 6% of total sales, the trauma category includes the following products:

Trauma	TransFx™ External fixation system	Comprehensive system of external fixators
	M/DN Intramedullary fixation	For long bone fractures
	ITST™ Intertrochanteric/ subtrochanteric fixation system	For proximal femoral fractures
	Zimmer® Periarticular plating system	Plating to stabilize fractures near joints
	Zimmer® Plates and screws (ZPS™)	Comprehensive system of places, screws and instruments for internal fracture compression
	Cable-Ready® Cable grip system	Encircles bone fragments with wire
	Zimmer® Cannulated screws	Stainless steel
	Sirus® system	Nails, screws and instruments for long bone fractures

- **Orthopedic Surgical Products (OSP)** - Representing 7% of total sales, orthopedic surgical products category includes the following products:

OSP	OrthoPAT® perioperative autotransfusion system	Collect and prepares a patient's own blood for re-fusion during open surgery
	Pulsavac® Plus™ wound debridement	Disposable debridement system
	A.T.S.® Tourniquet system	Family of tourniquet machines and cuffs

COMPETITIVE STRENGTHS

Since Zimmer competes with various large medical device companies, it needs to maintain its competitive edge in the marketplace by continuing to invest heavily in research & development, to differentiate itself from its competitors and to maintain its strong sales and distribution channel.

- **Strength of Distribution Channel.** Zimmer has one of the largest sales forces in orthopedics with over 2,000 dedicated sales associates, sales managers, product managers, and other sales professionals. With this massive sales force, it covers virtually all geographic areas – 80+ countries worldwide. Sale representatives typically have strong relationships with surgeons and will oftentimes be present in the operating room with the surgeons during a procedure. Also, most of the sales personnel employed by the independent distributors sell Zimmer's products exclusively.

- **Continued Investment in R&D – New Products.** Zimmer continuously invests in its future product pipeline with R&D spending ranging between 5.5% to 6.0% of sales historically. It currently has 146 projects in development as follows: 38 in hips, 35 in knees, 7 in extremities, 22 in trauma, 4 in ortho guidance, 6 in OSP, 18 in spine, 9 in dental and 6 in biologics. Each year, 18%-20% of Zimmer's sales comes from new products that were introduced over the past three years.

  In addition, Zimmer is investing in its spine segment, which is experiencing lackluster growth due to lack of R&D investment historically by Centerpulse. Recently, it introduced trabecular metal spine products in Europe and has grown its Dynesys® dynamic stabilization sales. In the US, Zimmer is conducting clinical trials for Dynesys® and has ongoing development work on artificial disc and nucleus projects.

  Zimmer also formed an Orthobiologics group to explore and develop bone regeneration products for the spine market in the near term and work on soft tissue and articular cartilage projects for the longer term.

- **Differentiation.** Most orthopedic companies are trying to differentiate itself with its surgeon customers by emphasizing certain products, techniques or direct to consumer marketing campaigns. Zimmer is known for its Minimally Invasive Solutions (MIS) procedures and techniques and Trabecular Metal based products.

  – **MIS Program**: The Zimmer Institute was developed to train surgeons to perform surgery in a minimally invasive manner, by sparing muscles, tissues, and cuts. Surgeons and other healthcare professionals are trained on the MIS 2-Incision, MIS Mini-hip, MIS Quad-Sparing knee, etc. Zimmer's goal is to train 1,400 surgeons and staff in 2004.

- **Trabecular Metal:** Zimmer has introduced many of its implant components using trabecular metal, which resembles bone both physically and mechanically. Trabecular metal is highly porous, allowing for bone ingrowth. It also possesses a high strength to weight ratio, which allows for physiologic loading. Zimmer's commitment to trabecular metal was solidified with its April 2004 acquisition of Implex Corp., the developer of trabecular metal, for $104 million in cash. Trabecular metal has been incorporated into Zimmer's tibial, patella, acetabular cup, and trauma offerings. Zimmer will continue to expand the use of this material to its other product categories including spine.

INVESTMENT MERITS

Solid Revenue Growth

Zimmer's sales have been growing at north of 15% annually since its spin-off from Bristol-Myers Squibb. This growth was all internally generated and has continued up to the most recent quarter (Zimmer standalone revenue growth of 18% in 2Q2004 excluding Centerpulse). With its acquisition of Centerpulse beginning in Oct 2003 and continuing through 2004, Zimmer has added approx. $950 million in sales, but is also experiencing some sales dissynergies (est. at $50 million in 2004) with its sales/ distribution overlap and realignment.

Going forward, Zimmer is expected to generate solid sales growth (approximately 14% compounded annually, internally generated over the next four years in our model) due to continuously developing and launching new products and the favorable volume growth of the attractive markets that it currently participates in.

Improving Margins

We believe that Zimmer is one of the best-managed companies in the world. Prior to its acquisition of Centerpulse, it had increased its operating margin from 27.7% experienced in 3Q01 when it spun-off from Bristol-Myers Squibb to 32.7% in 3Q2003, a 500bps improvement in operating margin in two years due to manufacturing improvements, favorable product mix, higher average selling prices, and sales leverage. Zimmer's operating margin currently stands at 29.6%, pulled down by Centerpulse's lower margin. Zimmer should be able to improve its operating margin over the next 3-4 years as it realizes expense synergies and benefits from improved manufacturing processes and implementation of shared best practices.

Solid Financial Metrics

Along with solid organic revenue growth, Zimmer has a solid balance sheet with approx. $780 million in net debt. Over the next few years, the company is expected to generate sales growth in the low to mid teens, 20%+ growth in earnings and approx. $5 billion in free cash flow. This cash flow should enable the company to pay down its debt in the near term, if the company does not find any strategic acquisitions to augment its product portfolio at reasonable value. In addition, we feel that Zimmer will continue to invest in new products through its own internal R&D efforts. Our earnings per share for Zimmer is estimated at $2.25-$2.35 for 2004, growing to $5.15-$5.25 for 2008.

Table 2 **Zimmer Holdings, Inc.**
Income Statement

($Millions, except per share data)	2003A	2004E	2005P	2006P	2007P	2008P	04-'08 CAGR
Revenue	$1,901.0	$2,955.0	$3,365.0	$3,835.7	$4,362.2	$4,959.8	13.8%
Expenses	1,361.0	2,085.2	2,307.2	2,534.0	2,794.6	3,127.8	
Operating income	540.0	869.8	1,057.8	1,301.7	1,567.6	1,831.9	
Other income (expense)	(13.2)	(32.0)	(12.1)	9.6	26.2	46.0	
Pre-tax income	526.8	837.8	1,045.8	1,311.3	1,593.8	1,877.9	22.4%
Income taxes (a)	176.5	268.1	324.2	393.4	462.2	544.6	
Net income - cont. ops. (b)	350.3	569.7	721.6	917.9	1,131.6	1,333.3	
Diluted shares outstanding	211.2	247.5	250.0	252.5	255.0	257.5	
Diluted EPS	$1.66	$2.25-$2.35	$2.85-$2.95	$3.60-$3.70	$4.40-$4.50	$5.15-$5.25	22.5%

a) Assumes 32% tax rate in 2004, 31% in 2005, 30% in 2006 and 29% afterwards.
b) Excludes one-time charges such as inventory step-up charges and integration costs estimated at $0.40 after-tax EPS in 2004.
Source: Company data and Gabelli & Company, Inc. estimates.

Excluded from our financial model are the inventory step-up charges and integration charges associated with the recent acquisitions as noted below:

- **Inventory Step-Up Charges –** With its Centerpulse and Implex acquisitions, Zimmer is required by US GAAP to step up the inventory to market values as of the date of acquisition. These non-cash inventory step-up charges are estimated at $35 million, net of tax, in 2004. This equates to $0.14 per share after-tax.
- **Integration Charges –** For 2004, Zimmer is estimated to spend $65 million, net of tax, to integrate both Centerpulse and Implex. This equates to $0.26 per share after-tax.

Table 3 **Projected Free Cash Flow**

($Millions, except per share data)	2003A	2004E	2005P	2006P	2007P	2008P	04-'08 SUM
Revenue	$1,901.0	$2,955.0	$3,365.0	$3,835.7	$4,362.2	$4,959.8	
Net Income (a)	346.0	469.7	721.6	917.9	1,131.6	1,333.3	4,920.2
+ Dep & Amort., Noncash Items	103.3	261.2	240.0	273.6	311.9	355.6	1,545.6
Operating CashFlow	449.3	730.9	961.6	1,191.5	1,443.5	1,688.9	6,465.7
- Capital Expenditures	(44.9)	(70.0)	(85.0)	(100.0)	(115.0)	(130.0)	(500.0)
- Instrument Sets	(113.6)	(150.0)	(120.0)	(100.0)	(115.0)	(132.3)	(617.3)
Free Cash Flow	290.8	510.9	756.6	991.5	1,213.5	1,426.6	4,899.1

a) 2004 net Income includes $55 million of integration expenses and $35 million of non-cash inventory step up costs.
Source: Company data and Gabelli & Company, Inc. estimates.

Risks

- **Risk of Recall –** The medical device industry is subject to the possibility of product recall due to manufacturing oversight, surgeon misuse/ abuse of products, product malfunction and other unintentional mishap. The risk of product recall is a huge potential liability for any company, causing damage to its reputation and customer relationships. In 2000, Centerpulse suffered one of the largest implant recalls in history, costing the company $1 billion. Currently, in the medical device space, Boston Scientific has recalled thousands of its drug-eluting stents and Wright Medical recently recalled a hip component. Both these recalls have caused the respective companies' stock prices to drop.
- **Reimbursement Risk –** Any medical device or product whose reimbursement code is set by Centers for Medicare & Medicaid Services (CMS) is subject to a potential decline in reimbursement rate. In recent years, joint replacement products under code DRG 209 have experienced favorable increases. However, any cessation in rate increases or any adverse event affecting the codes could affect the reimbursement levels for joint replacement surgeries.

Private Market Value

Zimmer is currently trading at 24.7x FYE 2005E earnings and 14.2x FYE 2005E EBITDA. This equates to a 20% discount to our 2005E PMV. We feel that this discount is unwarranted for a company with solid sales growth and higher earnings growth. Zimmer is a leader in orthopedics managed by strong and experienced management team. Using a 17.0x EBITDA multiple, the PMV for Zimmer is $89 in 2005, rising to $164 in 2008. As such, we view Zimmer as an attractive, long-term investment whose stock price is currently undervalued.

Table 4 **Zimmer Holdings, Inc.**
Private Market Value (PMV)

($Millions, except per share data)	2003A	2004E	2005P	2006P	2007P	2008P	04-'08 CAGR
Revenue	$1,901.0	$2,955.0	$3,365.0	$3,835.7	$4,362.2	$4,959.8	
EBITDA	643.3	1,096.0	1,297.8	1,575.3	1,879.5	2,187.5	18.9%
Valuation Multiple	17.0	17.0	17.0	17.0	17.0	17.0	
Total Private Market Value	10,936.1	18,632.5	22,063.1	26,779.5	31,951.7	37,187.6	
Plus/ (Less): Net Cash (Debt)	(1,031.6)	(609.7)	146.9	1,138.4	2,351.9	3,778.5	
Less: Net Options Payments [(a)]	(118.8)	(262.0)	(366.7)	(509.3)	(669.0)	(835.5)	
Equity PMV	9,785.7	17,760.8	21,843.3	27,408.6	33,634.6	40,130.7	
Shares (basic)	211.0	245.0	245.0	245.0	245.0	245.0	
PMV Per Share	$46	$72	$89	$112	$137	$164	

a) Payment to option holders at PMV, net of taxes. Source: Company data and Gabelli & Company, Inc. estimates.

Companies Mentioned:	Biomet, Inc.	(NASD: BMET)
	Boston Scientific, Corp.	(NYSE: BSX)
	Bristol-Myers Squibb	(NYSE: BMY)
	Johnson & Johnson, Inc.	(NYSE: JNJ)
	Medtronic, Inc.	(NYSE: MDT)
	Smith & Nephew, plc	(NYSE: SNN)
	Stryker Corp.	(NYSE: SYK)
	Synthes, Inc.	(SWX: SYST)
	Wright Medical Group, Inc.	(NASD: WMGI)

Orthopedic Reports:

"Orthofix International, N.V. – 2Q2004 Update – BUY" – 7/29/2004
"ArthroCare Corp." – BUY – 4/29/2004
"First Annual ORTHOPEDIC Conference Highlights" – 3/29/2004
"Interpore International – Going! Going . . . . . " – 3/18/2004
"Orthopedics: Bone Graft & Synthetic Bone" – 1/27/2004
"2003 Orthopedic Transactions Report" – 12/23/2003
"Orthofix International – BREG Acquisition" – 11/24/2003
"Synthes-Stratec & Mathyes" – Another Major Deal – 8/14/2003
"Orthopedics Deal Update" – Corporate Cupid in Action – 6/30/2003
"Centerpulse Ltd." – A Major Deal – 3/27/2003
"Small Cap/ Microcap Opportunities in Orthopedics" – 2/26/2003
"Orthofix International, N.V." – Initial Report – 1/20/2003

IMPORTANT DISCLOSURES

I, Jennie Tsai, the Research Analyst who prepared this report, hereby certify that the views expressed in this report accurately reflect the analyst's personal views about the subject companies and their securities. The Research Analyst has not been, is not and will not be receiving direct or indirect compensation for expressing the specific recommendation or view in this report.

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