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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 10-Q

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QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2013

Commission File Number 001-16407

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**ZIMMER HOLDINGS, INC.**

*(Exact name of registrant as specified in its charter)*

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**Delaware**  
*(State or other jurisdiction of  
incorporation or organization)*

**13-4151777**  
*(IRS Employer  
Identification No.)*

**345 East Main Street, Warsaw, IN 46580**

*(Address of principal executive offices)*

**Telephone: (574) 267-6131**

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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  No

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  No

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   
(Do not check if a 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  No

As of July 26, 2013, 169,548,714 shares of the registrant's \$.01 par value common stock were outstanding.

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ZIMMER HOLDINGS, INC.

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**Part I — Financial Information**

**Item 1. Financial Statements**

**ZIMMER HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS**  
(in millions, except per share amounts, unaudited)

	<u>Three Months Ended</u> <u>June 30,</u>		<u>Six Months Ended</u> <u>June 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
<b>Net Sales</b> .....	\$1,169.5	\$1,125.0	\$2,308.4	\$2,265.7
Cost of products sold .....	<u>323.6</u>	<u>281.9</u>	<u>616.5</u>	<u>570.6</u>
<b>Gross Profit</b> .....	<u>845.9</u>	<u>843.1</u>	<u>1,691.9</u>	<u>1,695.1</u>
Research and development .....	54.9	57.2	108.4	116.8
Selling, general and administrative .....	458.0	453.3	918.8	916.6
Certain claims .....	47.0	—	47.0	—
Special items (Note 2) .....	<u>75.6</u>	<u>30.7</u>	<u>109.1</u>	<u>64.2</u>
Operating expenses .....	<u>635.5</u>	<u>541.2</u>	<u>1,183.3</u>	<u>1,097.6</u>
<b>Operating Profit</b> .....	210.4	301.9	508.6	597.5
Interest income .....	3.9	3.8	7.6	6.9
Interest expense .....	<u>(18.3)</u>	<u>(18.1)</u>	<u>(36.5)</u>	<u>(35.7)</u>
Earnings before income taxes .....	196.0	287.6	479.7	568.7
Provision for income taxes .....	<u>44.3</u>	<u>73.6</u>	<u>110.0</u>	<u>145.8</u>
Net earnings .....	151.7	214.0	369.7	422.9
Less: Net loss attributable to noncontrolling interest .....	<u>(0.4)</u>	<u>(0.5)</u>	<u>(1.0)</u>	<u>(1.2)</u>
<b>Net Earnings of Zimmer Holdings, Inc.</b> .....	<u>\$ 152.1</u>	<u>\$ 214.5</u>	<u>\$ 370.7</u>	<u>\$ 424.1</u>
<b>Earnings Per Common Share</b> .....				
Basic .....	\$ 0.90	\$ 1.22	\$ 2.20	\$ 2.41
Diluted .....	\$ 0.89	\$ 1.22	\$ 2.17	\$ 2.39
<b>Weighted Average Common Shares Outstanding</b> .....				
Basic .....	168.8	175.2	168.8	176.3
Diluted .....	170.7	176.2	170.7	177.3
<b>Cash Dividends Declared Per Common Share</b> .....	\$ 0.20	\$ 0.18	\$ 0.40	\$ 0.18

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

**ZIMMER HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(in millions, unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net earnings .....	\$151.7	\$214.0	\$369.7	\$422.9
Other Comprehensive Income:				
Foreign currency cumulative translation adjustments .....	(31.8)	(75.2)	(96.8)	(47.1)
Unrealized cash flow hedge gains, net of tax .....	13.6	20.1	42.8	24.2
Reclassification adjustments on foreign currency hedges, net of tax .....	(2.4)	1.3	1.5	2.2
Unrealized gains/(losses) on securities, net of tax ...	(0.9)	0.1	(1.0)	0.3
Adjustments to prior service cost and unrecognized actuarial assumptions, net of tax .....	2.3	1.6	6.5	24.5
Total Other Comprehensive Gain/(Loss) .....	<u>(19.2)</u>	<u>(52.1)</u>	<u>(47.0)</u>	<u>4.1</u>
Comprehensive Income .....	132.5	161.9	322.7	427.0
Comprehensive loss attributable to the noncontrolling interest .....	<u>(0.4)</u>	<u>(0.7)</u>	<u>(1.0)</u>	<u>(1.4)</u>
Comprehensive Income attributable to Zimmer Holdings, Inc. ....	<u>\$132.9</u>	<u>\$162.6</u>	<u>\$323.7</u>	<u>\$428.4</u>

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

**ZIMMER HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in millions, unaudited)

	<u>June 30, 2013</u>	<u>December 31, 2012</u>
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and cash equivalents . . . . .	\$ 709.9	\$ 884.3
Short-term investments . . . . .	525.9	671.6
Accounts receivable, less allowance for doubtful accounts . . . . .	942.5	884.6
Inventories . . . . .	1,052.9	995.3
Prepaid expenses and other current assets . . . . .	121.3	76.3
Deferred income taxes . . . . .	239.2	196.6
<b>Total Current Assets</b> . . . . .	<u>3,591.7</u>	<u>3,708.7</u>
Property, plant and equipment, net . . . . .	1,225.2	1,210.7
Goodwill . . . . .	2,577.4	2,571.8
Intangible assets, net . . . . .	719.0	740.7
Other assets . . . . .	984.1	780.5
<b>Total Assets</b> . . . . .	<u>\$ 9,097.4</u>	<u>\$ 9,012.4</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current Liabilities:</b>		
Accounts payable . . . . .	\$ 165.2	\$ 184.1
Income taxes . . . . .	44.1	22.8
Short-term debt . . . . .	—	100.1
Other current liabilities . . . . .	595.0	559.0
<b>Total Current Liabilities</b> . . . . .	<u>804.3</u>	<u>866.0</u>
Other long-term liabilities . . . . .	715.4	559.3
Long-term debt . . . . .	1,688.1	1,720.8
<b>Total Liabilities</b> . . . . .	<u>3,207.8</u>	<u>3,146.1</u>
<b>Commitments and Contingencies (Note 14)</b>		
<b>Stockholders' Equity:</b>		
Zimmer Holdings, Inc. Stockholders' Equity:		
Common stock, \$0.01 par value, one billion shares authorized, 260.8 million shares issued in 2013 (257.1 million in 2012) . . . . .	2.6	2.6
Paid-in capital . . . . .	3,728.7	3,500.6
Retained earnings . . . . .	7,389.2	7,085.9
Accumulated other comprehensive income . . . . .	296.9	343.9
Treasury stock, 91.7 million shares in 2013 (85.5 million shares in 2012) . . . . .	(5,531.5)	(5,072.1)
<b>Total Zimmer Holdings, Inc. stockholders' equity</b> . . . . .	<u>5,885.9</u>	<u>5,860.9</u>
Noncontrolling interest . . . . .	3.7	5.4
<b>Total Stockholders' Equity</b> . . . . .	<u>5,889.6</u>	<u>5,866.3</u>
<b>Total Liabilities and Stockholders' Equity</b> . . . . .	<u>\$ 9,097.4</u>	<u>\$ 9,012.4</u>

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

**ZIMMER HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in millions, unaudited)

	For the Six Months Ended June 30,	
	2013	2012
<b>Cash flows provided by (used in) operating activities:</b>		
Net earnings	\$ 369.7	\$ 422.9
Adjustments to reconcile net earnings to cash provided by operating activities:		
Depreciation and amortization	176.5	190.2
Share-based compensation	26.2	27.8
Income tax benefit from stock option exercises	21.8	7.3
Excess income tax benefit from stock option exercises	(5.1)	(1.4)
Inventory step-up	2.4	2.0
Changes in operating assets and liabilities, net of effect of acquisitions:		
Income taxes	(47.8)	10.6
Receivables	(90.0)	(86.9)
Inventories	(86.2)	(29.7)
Accounts payable and accrued expenses	8.8	(15.7)
Other assets and liabilities	(6.1)	(88.2)
Net cash provided by operating activities	370.2	438.9
<b>Cash flows provided by (used in) investing activities:</b>		
Additions to instruments	(116.3)	(68.3)
Additions to other property, plant and equipment	(40.3)	(44.3)
Purchases of investments	(366.0)	(537.5)
Sales of investments	475.4	422.7
Investments in other assets	(74.4)	(54.7)
Net cash used in investing activities	(121.6)	(282.1)
<b>Cash flows provided by (used in) financing activities:</b>		
Net payments under revolving credit facilities	(100.1)	(145.7)
Proceeds from term loans	—	147.3
Dividends paid to stockholders	(64.5)	(31.7)
Proceeds from employee stock compensation plans	216.7	18.0
Excess income tax benefit from stock option exercises	5.1	1.4
Debt issuance costs	—	(3.3)
Purchase of additional shares from noncontrolling interest	(1.8)	—
Repurchase of common stock	(460.8)	(248.1)
Net cash used in financing activities	(405.4)	(262.1)
Effect of exchange rates on cash and cash equivalents	(17.6)	(12.0)
Decrease in cash and cash equivalents	(174.4)	(117.3)
Cash and cash equivalents, beginning of year	884.3	768.3
Cash and cash equivalents, end of period	\$ 709.9	\$ 651.0

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

## ZIMMER HOLDINGS, INC. AND SUBSIDIARIES

### NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

#### 1. Basis of Presentation

The financial data presented herein is unaudited and should be read in conjunction with the consolidated financial statements and accompanying notes included in the 2012 Annual Report on Form 10-K filed by Zimmer Holdings, Inc. The condensed consolidated financial statements for the majority of our international subsidiaries are for periods that ended on June 25, 2013 and 2012. For these international subsidiaries, the three month results included in these condensed consolidated financial statements are for the period of March 26 through June 25 and the six month results included in these condensed consolidated financial statements are for the period of December 26 through June 25 or the period of January 1 to June 25.

In our opinion, the accompanying unaudited condensed consolidated financial statements include all adjustments necessary for a fair statement of the financial position, results of operations and cash flows for the interim periods presented. The December 31, 2012 condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (GAAP). Results for interim periods should not be considered indicative of results for the full year. Certain amounts in the 2012 condensed consolidated financial statements have been reclassified to conform to the 2013 presentation.

The words “we,” “us,” “our” and similar words refer to Zimmer Holdings, Inc. and its subsidiaries. Zimmer Holdings refers to the parent company only.

#### 2. Significant Accounting Policies

*Special Items* — We recognize expenses resulting directly from our business combinations, employee termination benefits, certain R&D agreements, certain contract terminations, consulting and professional fees and asset impairment charges connected with global restructurings, operational and quality excellence initiatives, and other items as “Special items” in our condensed consolidated statement of earnings. “Special items” included (in millions):

	<u>Three Months</u> <u>Ended June 30,</u>		<u>Six Months</u> <u>Ended June 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Impairment/loss on disposal of assets . . . . .	\$ —	\$ —	\$ 0.3	\$ 0.4
Consulting and professional fees . . . . .	23.4	19.2	50.3	37.5
Employee severance and retention . . . . .	6.5	1.0	6.2	4.4
Dedicated project personnel . . . . .	11.1	3.3	16.5	6.6
Certain R&D agreements . . . . .	0.8	—	0.8	—
Relocated facilities . . . . .	1.3	—	2.6	—
Distributor acquisitions . . . . .	0.3	0.3	0.3	0.4
Certain litigation matters . . . . .	21.7	3.5	17.9	9.9
Contract terminations . . . . .	0.9	1.1	1.4	2.6
Contingent consideration adjustments . . . . .	5.6	—	5.9	(0.8)
Accelerated software amortization . . . . .	1.5	1.5	3.0	1.5
Other . . . . .	2.5	0.8	3.9	1.7
Special items . . . . .	<u>\$75.6</u>	<u>\$30.7</u>	<u>\$109.1</u>	<u>\$64.2</u>

In the second quarter of 2013, we eliminated approximately 120 positions as part of our ongoing operational excellence initiatives.

In the first six months of 2012, we announced our plans to outsource our Warsaw, Indiana distribution center to a third party service provider at a national transportation hub, among other organizational changes. Approximately 160 positions were affected by these actions.

As a result of these actions, we incurred expenses related to severance benefits, share-based compensation acceleration and other employee termination-related costs. The vast majority of these termination benefits were provided in accordance with our existing policies or local government regulations and are considered ongoing benefits. These costs were accrued when they became probable and estimable and were recorded as part of other current liabilities. The majority of these costs have been paid or will be paid in the year they were accrued.

*Medical Device Excise Tax* — As part of The Patient Protection and Affordable Care Act, in January 2013 we began paying a 2.3 percent medical device excise tax on a majority of our U.S sales. The excise tax is imposed on the first sale in the U.S. by the manufacturer, producer or importer of a medical device to either a third party or an affiliated distribution entity. We distribute a majority of our musculoskeletal products through an affiliated distribution entity. Under GAAP, excise taxes incurred to get inventory to its current location can be included in the cost of the inventory. Accordingly, we capitalize this excise tax as a part of inventory and recognize it as a cost of product sold when the inventory upon which the excise tax was assessed is sold to a third party on a first-in-first-out basis. Therefore, in the three and six month periods ended June 30, 2013, the amount of medical device excise tax recognized in our condensed consolidated statement of earnings was not material.

*Recent Accounting Pronouncements* — Effective January 1, 2013, we adopted the Financial Accounting Standard Board’s Accounting Standard Updates (ASUs) requiring reporting of amounts reclassified out of accumulated other comprehensive income (OCI) and balance sheet offsetting between derivative assets and liabilities. These ASUs only change financial statement disclosure requirements and therefore do not impact our financial position, results of operations or cash flows. See Note 7 for disclosures relating to OCI. See Note 9 for disclosures relating to balance sheet offsetting.

There are no other recently issued accounting pronouncements that we have not yet adopted that are expected to have a material effect on our financial position, results of operations or cash flows.

### 3. Inventories

	<u>June 30, 2013</u>	<u>December 31, 2012</u>
	(in millions)	
Finished goods .....	\$ 819.0	\$786.3
Work in progress .....	69.5	52.3
Raw materials .....	164.4	156.7
Inventories .....	<u>\$1,052.9</u>	<u>\$995.3</u>

### 4. Property, Plant and Equipment

	<u>June 30, 2013</u>	<u>December 31, 2012</u>
	(in millions)	
Land .....	\$ 21.8	\$ 22.1
Buildings and equipment .....	1,279.6	1,232.8
Capitalized software costs .....	254.8	241.8
Instruments .....	1,630.3	1,579.8
Construction in progress .....	82.8	117.8
	<u>3,269.3</u>	<u>3,194.3</u>
Accumulated depreciation .....	<u>(2,044.1)</u>	<u>(1,983.6)</u>
Property, plant and equipment, net .....	<u>\$ 1,225.2</u>	<u>\$ 1,210.7</u>



## 5. Investments

We invest in short and long-term investments classified as available-for-sale securities. Information regarding our investments is as follows (in millions):

	Amortized Cost	Gross Unrealized		Fair value
		Gains	Losses	
<b>As of June 30, 2013</b>				
Corporate debt securities .....	\$392.7	\$0.1	\$(0.8)	\$392.0
U.S. government and agency debt securities .....	271.6	0.1	(0.1)	271.6
Commercial paper .....	49.0	—	—	49.0
Certificates of deposit .....	87.4	0.1	—	87.5
Total short and long-term investments .....	<u>\$800.7</u>	<u>\$0.3</u>	<u>\$(0.9)</u>	<u>\$800.1</u>
<b>As of December 31, 2012</b>				
Corporate debt securities .....	\$383.6	\$0.3	\$(0.1)	\$383.8
U.S. government and agency debt securities .....	295.8	0.1	—	295.9
Foreign government debt securities .....	5.0	—	—	5.0
Commercial paper .....	138.7	—	—	138.7
Certificates of deposit .....	92.2	0.1	—	92.3
Total short and long-term investments .....	<u>\$915.3</u>	<u>\$0.5</u>	<u>\$(0.1)</u>	<u>\$915.7</u>

Unrealized gains and losses on these investments are recorded in OCI in our condensed consolidated balance sheet.

The following table shows the fair value and gross unrealized losses for all available-for-sale securities in an unrealized loss position deemed to be temporary (in millions):

	June 30, 2013		December 31, 2012	
	Fair Value	Unrealized Losses	Fair value	Unrealized Losses
Corporate debt securities .....	\$251.6	\$(0.8)	\$144.2	\$(0.1)
U.S. government and agency debt securities .....	161.5	(0.1)	—	—
Total .....	<u>\$413.1</u>	<u>\$(0.9)</u>	<u>\$144.2</u>	<u>\$(0.1)</u>

All securities in the table above have been in an unrealized loss position for less than twelve months. A total of 147 securities were in an unrealized loss position as of June 30, 2013.

The unrealized losses on our investments in corporate debt securities were caused by increases in interest yields in the global credit markets. We believe the unrealized losses associated with our available-for-sale securities as of June 30, 2013 are temporary because we do not intend to sell these investments, and we do not believe we will be required to sell them before recovery of their amortized cost basis.

The amortized cost and fair value of our available-for-sale fixed-maturity securities by contractual maturity are as follows (in millions):

	June 30, 2013	
	Amortized Cost	Fair Value
Due in one year or less .....	\$525.9	\$525.9
Due after one year through two years .....	274.8	274.2
Total .....	<u>\$800.7</u>	<u>\$800.1</u>

## 6. Debt

Our debt consisted of the following (in millions):

	<u>June 30, 2013</u>	<u>December 31, 2012</u>
Short-term debt		
Senior Credit Facility .....	\$ —	\$ 100.0
Other short-term debt .....	—	0.1
Total short-term debt .....	<u>\$ —</u>	<u>\$ 100.1</u>
Long-term debt		
Senior Notes due 2014 .....	\$ 250.0	\$ 250.0
Senior Notes due 2019 .....	500.0	500.0
Senior Notes due 2021 .....	300.0	300.0
Senior Notes due 2039 .....	500.0	500.0
Term Loan .....	119.9	138.6
Debt discount .....	(1.6)	(1.7)
Adjustment related to interest rate swaps .....	19.8	33.9
Total long-term debt .....	<u>\$1,688.1</u>	<u>\$1,720.8</u>

The estimated fair value of our Senior Notes as of June 30, 2013, based on quoted prices for the specific securities from transactions in over-the-counter markets (Level 2), was \$1,654.6 million. The estimated fair value of the Term Loan as of June 30, 2013, based upon publicly available market yield curves and the terms of the debt (Level 2), was \$119.9 million.

## 7. Accumulated Other Comprehensive Income

OCI refers to certain gains and losses that under GAAP are included in comprehensive income but are excluded from net earnings as these amounts are initially recorded as an adjustment to stockholders' equity. Amounts in OCI may be reclassified to net earnings upon the occurrence of certain events.

Our OCI is comprised of foreign currency translation adjustments, unrealized gains and losses on cash flow hedges, unrealized gains and losses on available-for-sale securities, and amortization of prior service costs and unrecognized gains and losses in actuarial assumptions on our defined benefit plans. Foreign currency translation adjustments are reclassified to net earnings upon sale or upon a complete or substantially complete liquidation of an investment in a foreign entity. Unrealized gains and losses on cash flow hedges are reclassified to net earnings when the hedged item affects net earnings. Unrealized gains and losses on available-for-sale securities are reclassified to net earnings if we sell the security before maturity or if the unrealized loss in a security is considered to be other-than-temporary. We typically hold our available-for-sale securities until maturity and are able to realize their amortized cost and therefore we do not have reclassification adjustments to net earnings on these securities. Amounts related to defined benefit plans that are in OCI are reclassified over the service periods of employees in the plan. The reclassification amounts are allocated to all employees in the plans and therefore the reclassified amounts may become part of inventory to the extent they are considered direct labor costs. See Note 11 for more information on our defined benefit plans.

The following table shows the changes in the components of OCI, net of tax (in millions):

	<u>Foreign Currency Translation</u>	<u>Cash Flow Hedges</u>	<u>Unrealized Gains on Securities</u>	<u>Defined Benefit Plan Items</u>
Balance December 31, 2012 .....	\$445.5	\$ 4.1	\$ 0.4	\$(106.1)
OCI before reclassifications .....	(96.8)	42.8	(1.0)	—
Reclassifications .....	—	1.5	—	6.5
Balance June 30, 2013 .....	<u>\$348.7</u>	<u>\$48.4</u>	<u>\$(0.6)</u>	<u>\$ (99.6)</u>

The following table shows the reclassification adjustments from OCI (in millions):

Component of OCI	Amount of Gain / (Loss) Reclassified from OCI				Location on Statement of Earnings
	Three Months Ended June 30,		Six Months Ended June 30,		
	2013	2012	2013	2012	
<i>Cash flow hedges</i>					
Foreign exchange forward contracts . . . . .	\$ 3.7	\$(3.7)	\$(1.7)	\$(7.8)	Cost of products sold
Foreign exchange options . . . . .	(0.1)	(0.1)	(0.2)	(0.1)	Cost of products sold
Cross-currency interest rate swaps . . .	—	—	—	0.2	Interest expense
	3.6	(3.8)	(1.9)	(7.7)	Total before tax
	1.2	(2.5)	(0.4)	(5.5)	Provision for income taxes
	<u>\$ 2.4</u>	<u>\$(1.3)</u>	<u>\$(1.5)</u>	<u>\$(2.2)</u>	Net of tax
<i>Defined benefit plans</i>					
Prior service cost . . . . .	\$ 0.9	\$ 1.2	\$ 1.9	\$ 1.4	*
Unrecognized actuarial (loss) . . . . .	(4.6)	(3.3)	(9.3)	(6.7)	*
	(3.7)	(2.1)	(7.4)	(5.3)	Total before tax
	(1.4)	(0.5)	(0.9)	(1.7)	Provision for income taxes
	<u>\$(2.3)</u>	<u>\$(1.6)</u>	<u>\$(6.5)</u>	<u>\$(3.6)</u>	Net of tax
Total reclassifications . . . . .	<u>\$ 0.1</u>	<u>\$(2.9)</u>	<u>\$(8.0)</u>	<u>\$(5.8)</u>	Net of tax

\* These OCI components are included in the computation of net periodic pension expense (see Note 11).

The following table shows the tax effects on each component of OCI recognized in our condensed consolidated statements of comprehensive income (in millions):

	Three Months Ended June 30, 2013			Three Months Ended June 30, 2012		
	Before Tax	Tax	Net of Tax	Before Tax	Tax	Net of Tax
Foreign currency cumulative translation adjustments . . . . .	\$(31.8)	\$ —	\$(31.8)	\$(75.2)	\$ —	\$(75.2)
Unrealized cash flow hedge gains . . . .	22.9	9.3	13.6	22.7	2.6	20.1
Reclassification adjustments on foreign currency hedges . . . . .	(3.6)	(1.2)	(2.4)	3.8	2.5	1.3
Unrealized gains on securities . . . . .	(0.9)	—	(0.9)	0.1	—	0.1
Adjustments to prior service cost and unrecognized actuarial assumptions . . . . .	3.7	1.4	2.3	2.1	0.5	1.6
Total Other Comprehensive Gain/ (Loss) . . . . .	<u>\$ (9.7)</u>	<u>\$ 9.5</u>	<u>\$(19.2)</u>	<u>\$(46.5)</u>	<u>\$ 5.6</u>	<u>\$(52.1)</u>
	Six Months Ended June 30, 2013			Six Months Ended June 30, 2012		
	Before Tax	Tax	Net of Tax	Before Tax	Tax	Net of Tax
Foreign currency cumulative translation adjustments . . . . .	\$(96.8)	\$ —	\$(96.8)	\$(47.1)	\$ —	\$(47.1)
Unrealized cash flow hedge gains . . . .	67.7	24.9	42.8	30.7	6.5	24.2
Reclassification adjustments on foreign currency hedges . . . . .	1.9	0.4	1.5	7.7	5.5	2.2
Unrealized gains on securities . . . . .	(1.0)	—	(1.0)	0.3	—	0.3
Adjustments to prior service cost and unrecognized actuarial assumptions . . . . .	7.4	0.9	6.5	43.0	18.5	24.5
Total Other Comprehensive Gain/ (Loss) . . . . .	<u>\$(20.8)</u>	<u>\$26.2</u>	<u>\$(47.0)</u>	<u>\$ 34.6</u>	<u>\$30.5</u>	<u>\$ 4.1</u>

## 8. Fair Value Measurement of Assets and Liabilities

The following assets and liabilities are recorded at fair value on a recurring basis (in millions):

Description	As of June 30, 2013			
	Fair Value Measurements at Reporting Date Using:			
	Recorded Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets</b>				
Available-for-sale securities				
Corporate debt securities . . . . .	\$392.0	\$—	\$392.0	\$—
U.S. government and agency debt securities . . . . .	271.6	—	271.6	—
Commercial paper . . . . .	49.0	—	49.0	—
Certificates of deposit . . . . .	87.5	—	87.5	—
Total available-for-sale securities . . . . .	800.1	—	800.1	—
Derivatives, current and long-term				
Foreign currency forward contracts and options . . . . .	74.2	—	74.2	—
Interest rate swaps . . . . .	19.8	—	19.8	—
	<u>\$894.1</u>	<u>\$—</u>	<u>\$894.1</u>	<u>\$—</u>
<b>Liabilities</b>				
Derivatives, current and long-term				
Foreign currency forward contracts and options . . . . .	\$ 2.2	\$—	\$ 2.2	\$—
	<u>\$ 2.2</u>	<u>\$—</u>	<u>\$ 2.2</u>	<u>\$—</u>
<b>As of December 31, 2012</b>				
Fair Value Measurements at Reporting Date Using:				
Description	Recorded Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets</b>				
Available-for-sale securities				
Corporate debt securities . . . . .	\$383.8	\$—	\$383.8	\$—
U.S. government and agency debt securities . . . . .	295.9	—	295.9	—
Foreign government debt securities . . . . .	5.0	—	5.0	—
Commercial paper . . . . .	138.7	—	138.7	—
Certificates of deposit . . . . .	92.3	—	92.3	—
Total available-for-sale securities . . . . .	915.7	—	915.7	—
Derivatives, current and long-term				
Foreign currency forward contracts and options . . . . .	28.4	—	28.4	—
Interest rate swaps . . . . .	33.9	—	33.9	—
	<u>\$978.0</u>	<u>\$—</u>	<u>\$978.0</u>	<u>\$—</u>
<b>Liabilities</b>				
Derivatives, current and long-term				
Foreign currency forward contracts and options . . . . .	\$ 10.8	\$—	\$ 10.8	\$—
	<u>\$ 10.8</u>	<u>\$—</u>	<u>\$ 10.8</u>	<u>\$—</u>

We value our available-for-sale securities using a market approach based on broker prices for identical assets in over-the-counter markets and we perform ongoing assessments of counterparty credit risk.

We value our foreign currency forward contracts and foreign currency options using a market approach based on foreign currency exchange rates obtained from active markets and we perform ongoing assessments of counterparty credit risk.

We value our interest rate swaps using a market approach based on publicly available market yield curves and the terms of our swaps and we perform ongoing assessments of counterparty credit risk.

## **9. Derivative Instruments and Hedging Activities**

We are exposed to certain market risks relating to our ongoing business operations, including foreign currency exchange rate risk, commodity price risk, interest rate risk and credit risk. We manage our exposure to these and other market risks through regular operating and financing activities. Currently, the only risks that we manage through the use of derivative instruments are interest rate risk and foreign currency exchange rate risk.

### **Interest Rate Risk**

#### ***Derivatives Designated as Fair Value Hedges***

We use interest rate derivative instruments to manage our exposure to interest rate movements by converting fixed-rate debt into variable-rate debt. Under these agreements, we agree to exchange, at specified intervals, the difference between fixed and variable interest amounts calculated by reference to an agreed-upon notional principal amount. The objective of the instruments is to more closely align interest expense with interest income received on cash and cash equivalents. These derivative instruments are designated as fair value hedges under GAAP. Changes in the fair value of the derivative instrument are recorded in current earnings and are offset by gains or losses on the underlying debt instrument.

We have multiple nine-year fixed-to-variable interest rate swap agreements with a total notional amount of \$250 million. These interest rate swap agreements were designated as fair value hedges of the fixed interest rate obligation of our Senior Notes due 2019. We receive a fixed interest rate of 4.625 percent and pay variable interest equal to the three-month LIBOR plus an average of 133 basis points on these interest rate swap agreements.

### **Foreign Currency Exchange Rate Risk**

We operate on a global basis and are exposed to the risk that our financial condition, results of operations and cash flows could be adversely affected by changes in foreign currency exchange rates. To reduce the potential effects of foreign currency exchange rate movements on net earnings, we enter into derivative financial instruments in the form of foreign currency exchange forward contracts and options with major financial institutions. We are primarily exposed to foreign currency exchange rate risk with respect to transactions and net assets denominated in Euros, Swiss Francs, Japanese Yen, British Pounds, Canadian Dollars, Australian Dollars, Korean Won, Swedish Krona, Czech Koruna, Thai Baht, Taiwan Dollars, South African Rand, Russian Rubles and Indian Rupees. We do not use derivative financial instruments for trading or speculative purposes.

#### ***Derivatives Designated as Cash Flow Hedges***

Our revenues are generated in various currencies throughout the world. However, a significant amount of our inventory is produced in U.S. Dollars. Therefore, movements in foreign currency exchange rates may have different proportional effects on our revenues compared to our cost of products sold. To minimize the effects of foreign currency exchange rate movements on cash flows, we hedge intercompany sales of inventory expected to occur within the next 30 months with foreign currency exchange forward contracts and options. We designate these derivative instruments as cash flow hedges.

We perform quarterly assessments of hedge effectiveness by verifying and documenting the critical terms of the hedge instrument and that forecasted transactions have not changed significantly. We also assess on a quarterly basis whether there have been adverse developments regarding the risk of a counterparty default. For derivatives which qualify as hedges of future cash flows, the effective portion of changes in fair value is temporarily recorded in other comprehensive income and then recognized in cost of products sold when the hedged item affects net earnings. The ineffective portion of a derivative's change in fair value, if any, is immediately reported in cost of products sold.

For forward contracts and options outstanding at June 30, 2013, we had obligations to purchase U.S. Dollars and sell Euros, Japanese Yen, British Pounds, Canadian Dollars, Australian Dollars, Korean Won, Swedish Krona, Czech Koruna, Thai Baht, Taiwan Dollars, South African Rand, Russian Rubles and Indian Rupees and purchase Swiss Francs and sell U.S. Dollars at set maturity dates ranging from July 2013 through December 2015. As of June 30, 2013, the notional amounts of outstanding forward contracts and options entered into with third parties to purchase U.S. Dollars were \$1,505.1 million. As of June 30, 2013, the notional amounts of outstanding forward contracts and options entered into with third parties to purchase Swiss Francs were \$334.3 million.

#### *Derivatives Not Designated as Hedging Instruments*

We enter into foreign currency forward exchange contracts with terms of one month to manage currency exposures for monetary assets and liabilities denominated in a currency other than an entity's functional currency. As a result, any foreign currency remeasurement gains/losses recognized in earnings are generally offset with gains/losses on the foreign currency forward exchange contracts in the same reporting period. These offsetting gains/losses are recorded in cost of products sold as the underlying assets and liabilities exposed to remeasurement include inventory-related transactions. These contracts are settled on the last day of each reporting period. Therefore, there is no outstanding balance related to these contracts recorded on the balance sheet as of the end of the reporting period. The notional amounts of these contracts are typically in a range of \$1.2 billion to \$1.7 billion per quarter.

### **Foreign Currency Exchange and Interest Rate Risk**

#### *Derivatives Designated as Cash Flow Hedges*

In previous years, we entered into cross-currency interest rate swap agreements that matured in the first quarter of 2012. We designated these swaps as cash flow hedges of the foreign currency exchange and interest rate risks. We have not entered into any other similar swap agreements since the first quarter of 2012.

### **Income Statement Presentation**

#### *Derivatives Designated as Fair Value Hedges*

Derivative instruments designated as fair value hedges had the following effects on our condensed consolidated statements of earnings (in millions):

<u>Derivative Instrument</u>	<u>Location on Statement of Earnings</u>	<u>Gain / (Loss) on Instrument</u>				<u>Gain / (Loss) on Hedged Item</u>			
		<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>		<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
		<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Interest rate swaps . . . . .	Interest expense	\$(10.8)	\$8.3	\$(14.1)	\$5.1	\$10.8	\$(8.3)	\$14.1	\$(5.1)

We had no ineffective fair value hedging instruments during the three and six month periods ended June 30, 2013 and 2012.

### *Derivatives Designated as Cash Flow Hedges*

Derivative instruments designated as cash flow hedges had the following effects, before taxes, on OCI and net earnings on our condensed consolidated statements of earnings, condensed consolidated statements of comprehensive income and condensed consolidated balance sheets (in millions):

<u>Derivative Instrument</u>	<u>Amount of Gain / (Loss) Recognized in OCI</u>				<u>Location on Statement of Earnings</u>	<u>Amount of Gain / (Loss) Reclassified from OCI</u>			
	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>			<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>		<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Foreign exchange forward contracts . . .	\$22.7	\$23.8	\$68.0	\$31.8	Cost of products sold	\$ 3.7	\$(3.7)	\$(1.7)	\$(7.8)
Foreign exchange options . . . . .	0.2	(1.1)	(0.3)	(1.1)	Cost of products sold	(0.1)	(0.1)	(0.2)	(0.1)
Cross-currency interest rate swaps . . . .	—	—	—	—	Interest expense	—	—	—	0.2
	<u>\$22.9</u>	<u>\$22.7</u>	<u>\$67.7</u>	<u>\$30.7</u>		<u>\$ 3.6</u>	<u>\$(3.8)</u>	<u>\$(1.9)</u>	<u>\$(7.7)</u>

The net amount recognized in earnings during the three and six month periods ended June 30, 2013 and 2012 due to ineffectiveness and amounts excluded from the assessment of hedge effectiveness was not significant.

The fair value of outstanding derivative instruments designated as cash flow hedges and recorded on the balance sheet at June 30, 2013, together with settled derivatives where the hedged item has not yet affected earnings, was a net unrealized gain of \$74.7 million, or \$48.4 million after taxes, which is deferred in OCI. Of the net unrealized gain, \$31.1 million, or \$20.0 million after taxes, is expected to be reclassified to earnings over the next twelve months.

### *Derivatives Not Designated as Hedging Instruments*

The following gains/(losses) from these derivative instruments were recognized on our condensed consolidated statements of earnings (in millions):

<u>Derivative Instrument</u>	<u>Location on Statement of Earnings</u>	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
		<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Foreign exchange forward contracts . . .	Cost of products sold	\$(0.3)	\$10.5	\$7.6	\$8.6

This impact does not include any offsetting gains/losses recognized in earnings as a result of foreign currency remeasurement of monetary assets and liabilities denominated in a currency other than an entity's functional currency.

### **Balance Sheet Presentation**

As of June 30, 2013 and December 31, 2012, all derivative instruments designated as fair value hedges and cash flow hedges are recorded at fair value on the balance sheet. On our condensed consolidated balance sheets, we recognize individual forward contracts and options with the same counterparty on a net asset/liability basis if we have a master netting agreement with the counterparty. Under these master netting agreements, we are able to settle derivative instrument assets and liabilities with the same counterparty in a single transaction, instead of settling each derivative instrument separately. We have master netting agreements with almost all of our counterparties. The fair value of derivative instruments on a gross basis is as follows (in millions):

	June 30, 2013		December 31, 2012	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
<b>Asset Derivatives</b>				
Foreign exchange forward contracts . . .	Other current assets	\$ 55.2	Other current assets	\$29.7
Foreign exchange options . . . . .	Other current assets	—	Other current assets	0.6
Foreign exchange forward contracts . . .	Other assets	31.9	Other assets	19.8
Interest rate swaps . . . . .	Other assets	19.8	Other assets	33.9
<b>Total asset derivatives . . . . .</b>		<u>\$106.9</u>		<u>\$84.0</u>
<b>Liability Derivatives</b>				
Foreign exchange forward contracts . . .	Other current liabilities	\$ 9.6	Other current liabilities	\$20.2
Foreign exchange forward contracts . . .	Other long-term liabilities	5.5	Other long-term liabilities	12.3
<b>Total liability derivatives . . . . .</b>		<u>\$ 15.1</u>		<u>\$32.5</u>

The table below presents the effects of our master netting agreements on our condensed consolidated balance sheets (in millions):

Description	Location	As of June 30, 2013			As of December 31, 2012		
		Gross Amount	Offset	Net Amount in Balance Sheet	Gross Amount	Offset	Net Amount in Balance Sheet
<b>Asset Derivatives</b>							
Cash flow hedges . . .	Other current assets	\$55.2	\$7.6	\$47.6	\$30.3	\$15.2	\$15.1
Cash flow hedges . . .	Other assets	31.9	5.3	26.6	19.8	6.5	13.3
<b>Liability Derivatives</b>							
Cash flow hedges . . .	Other current liabilities	9.6	7.6	2.0	20.2	15.2	5.0
Cash flow hedges . . .	Other long-term liabilities	5.5	5.3	0.2	12.3	6.5	5.8

## 10. Income Taxes

We operate on a global basis and are subject to numerous and complex tax laws and regulations. Our income tax filings are regularly under audit in multiple federal, state and foreign jurisdictions. Income tax audits may require an extended period of time to reach resolution and may result in significant income tax adjustments when interpretation of tax laws or allocation of company profits is disputed. The net amount of tax liability for unrecognized tax benefits may change within the next twelve months due to changes in audit status, expiration of statutes of limitations and other events which could impact our determination of unrecognized tax benefits. Currently, we cannot reasonably estimate the amount by which our unrecognized tax benefits may change.

During the second quarter of 2011, the IRS concluded their examination of our U.S. federal returns for years 2005 through 2007 and issued income tax assessments reallocating profits between certain of our U.S. and foreign subsidiaries. In July 2013, the IRS examination division issued a Notice of Proposed Adjustment (NOPA) for tax years 2008 and 2009. This NOPA also relates to intercompany pricing between certain of our U.S. and foreign subsidiaries. We continue to pursue resolution of the disputed tax matters for years 2005 through 2009 with the IRS. The ultimate resolution of this matter is uncertain and could have a material impact on our income tax expense, results of operations, and cash flows for future periods.

In the three and six month periods ended June 30, 2013, our effective tax rate was 22.6 percent and 22.9 percent, respectively. Our effective tax rate was lower than the U.S. statutory income tax rate of 35 percent primarily due to income earned in foreign locations with lower tax rates.

## 11. Retirement Benefit Plans

We have defined benefit pension plans covering certain U.S. and Puerto Rico employees. The employees who are not participating in the defined benefit plans receive additional benefits under our defined contribution



plans. Plan benefits are primarily based on years of credited service and the participant's compensation. In addition to the U.S. and Puerto Rico defined benefit pension plans, we sponsor various foreign pension arrangements, including retirement and termination benefit plans required by local law or coordinated with government sponsored plans.

The components of net periodic pension expense for our U.S. and foreign defined benefit retirement plans are as follows (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Service cost .....	\$ 7.0	\$ 6.1	\$ 14.1	\$ 12.9
Interest cost .....	4.7	4.6	9.4	9.6
Expected return on plan assets .....	(8.9)	(8.2)	(17.8)	(16.5)
Settlement .....	—	0.7	—	0.7
Amortization of prior service cost .....	(0.9)	(1.2)	(1.9)	(1.4)
Amortization of unrecognized actuarial loss .....	4.6	3.3	9.3	6.7
Net periodic pension expense .....	<u>\$ 6.5</u>	<u>\$ 5.3</u>	<u>\$ 13.1</u>	<u>\$ 12.0</u>

We contributed \$20.0 million during the six month period ended June 30, 2013 to our U.S. and Puerto Rico defined benefit plans and do not expect to contribute additional funds to these plans during the remainder of 2013. We contributed \$7.8 million to our foreign-based defined benefit plans in the six month period ended June 30, 2013 and expect to contribute \$6.9 million to these foreign-based plans during the remainder of 2013.

In March 2012, we amended our U.S. defined benefit pension plan which led us to remeasure our plan assets and obligations. Accordingly, the resulting remeasurement was reflected in our condensed consolidated statements of earnings and condensed consolidated statements of comprehensive income.

## 12. Earnings Per Share

The following is a reconciliation of weighted average shares for the basic and diluted shares computations (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Weighted average shares outstanding for basic net earnings per share .....	168.8	175.2	168.8	176.3
Effect of dilutive stock options and other equity awards .....	1.9	1.0	1.9	1.0
Weighted average shares outstanding for diluted net earnings per share .....	<u>170.7</u>	<u>176.2</u>	<u>170.7</u>	<u>177.3</u>

During the three and six month periods ended June 30, 2013, an average of 4.9 million options and 5.6 million options, respectively, to purchase shares of common stock were not included in the computation of diluted earnings per share because the exercise prices of these options were greater than the average market price of the common stock. During the three and six month periods ended June 30, 2012, an average of 12.8 million options and 12.6 million options, respectively, were not included in the computation.

In the three month period ended June 30, 2013, we repurchased 0.9 million shares of our common stock at an average price of \$78.16 per share for a total cash outlay of \$68.8 million, including commissions. In the six month period ended June 30, 2013, we repurchased 6.2 million shares of our common stock at an average price of \$73.88 per share for a total cash outlay of \$460.8 million, including commissions. As of June 30, 2013, \$553.9 million remained authorized under a \$1.5 billion repurchase program, which will expire on December 31, 2014.

### 13. Segment Information

We design, develop, manufacture and market orthopaedic reconstructive implants, biologics, dental implants, spinal implants, trauma products and related surgical products which include surgical supplies and instruments designed to aid in surgical procedures and post-operation rehabilitation. We also provide other healthcare-related services. We manage operations through three major geographic segments – the Americas, which is comprised principally of the U.S. and includes other North, Central and South American markets; Europe, which is comprised principally of Europe and includes the Middle East and African markets; and Asia Pacific, which is comprised primarily of Japan and includes other Asian and Pacific markets. This structure is the basis for our reportable segment information discussed below. Management evaluates reportable segment performance based upon segment operating profit exclusive of operating expenses pertaining to share-based payment expense, inventory step-up and certain other inventory and manufacturing related charges, “Certain claims,” goodwill impairment, “Special items,” and global operations and corporate functions. Global operations and corporate functions include research, development engineering, medical education, brand management, corporate legal, finance, and human resource functions, U.S., Puerto Rico and Ireland-based manufacturing operations and logistics and intangible asset amortization resulting from business combination accounting. Intercompany transactions have been eliminated from segment operating profit.

Net sales and segment operating profit are as follows (in millions):

	<u>Net Sales</u>		<u>Operating Profit</u>	
	<u>Three Months Ended June 30,</u>		<u>Three Months Ended June 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Americas . . . . .	\$ 660.1	\$ 614.3	\$ 324.9	\$ 315.7
Europe . . . . .	307.5	305.2	92.5	94.5
Asia Pacific . . . . .	201.9	205.5	87.0	79.0
Total . . . . .	<u>\$1,169.5</u>	<u>\$1,125.0</u>		
Share-based compensation . . . . .			(12.2)	(15.0)
Inventory step-up and other inventory and manufacturing related charges . . . . .			(11.7)	(1.0)
Certain claims . . . . .			(47.0)	—
Special items . . . . .			(75.6)	(30.7)
Global operations and corporate functions . . . . .			<u>(147.5)</u>	<u>(140.6)</u>
Operating profit . . . . .			<u>\$ 210.4</u>	<u>\$ 301.9</u>
	<u>Net Sales</u>		<u>Operating Profit</u>	
	<u>Six Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Americas . . . . .	\$1,294.8	\$1,248.7	\$ 645.8	\$ 636.5
Europe . . . . .	615.0	606.0	180.4	189.2
Asia Pacific . . . . .	398.6	411.0	162.6	156.7
Total . . . . .	<u>\$2,308.4</u>	<u>\$2,265.7</u>		
Share-based compensation . . . . .			(26.2)	(27.8)
Inventory step-up and other inventory and manufacturing related charges . . . . .			(13.9)	(2.0)
Certain claims . . . . .			(47.0)	—
Special items . . . . .			(109.1)	(64.2)
Global operations and corporate functions . . . . .			<u>(284.0)</u>	<u>(290.9)</u>
Operating profit . . . . .			<u>\$ 508.6</u>	<u>\$ 597.5</u>

Beginning in 2013, our Knees product category net sales include certain early intervention products that are primarily used in knee procedures. In 2012, these products were included in the Surgical and other product category. Net sales in the three and six month periods ended June 30, 2012 related to these products have been reclassified to conform to the 2013 presentation. Net sales by product category are as follows (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Reconstructive				
Knees .....	\$ 481.0	\$ 464.6	\$ 952.0	\$ 939.2
Hips .....	338.4	340.0	669.2	684.5
Extremities .....	48.6	42.5	96.4	87.3
	<u>868.0</u>	<u>847.1</u>	<u>1,717.6</u>	<u>1,711.0</u>
Dental .....	61.4	61.5	121.1	121.7
Trauma .....	74.1	73.9	156.1	149.4
Spine .....	54.2	52.4	101.9	105.6
Surgical and other .....	111.8	90.1	211.7	178.0
Total .....	<u>\$1,169.5</u>	<u>\$1,125.0</u>	<u>\$2,308.4</u>	<u>\$2,265.7</u>

#### 14. Commitments and Contingencies

On a quarterly and annual basis, we review relevant information with respect to loss contingencies and update our accruals, disclosures and estimates of reasonably possible losses or ranges of loss based on such reviews. We establish liabilities for loss contingencies when it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. For matters where a loss is believed to be reasonably possible, but not probable, no accrual has been made.

#### Litigation

*Durom*<sup>®</sup> Cup-related claims: On July 22, 2008, we temporarily suspended marketing and distribution of the *Durom* Acetabular Component (*Durom* Cup) in the U.S. Subsequently, a number of product liability lawsuits and other claims have been asserted against us. We have settled some of these claims and the others are still pending. Additional claims may be asserted in the future.

Since 2008, we have recognized expense of \$450.2 million for *Durom* Cup-related claims, including \$47.0 million during the three and six month periods ended June 30, 2013. We did not record any expense for *Durom* Cup-related claims during the three and six month periods ended June 30, 2012. Based on our review of the most recent claims information available, we increased our estimate of our total liability for these claims as of June 30, 2013.

We maintain insurance for product liability claims, subject to self-insurance retention requirements. In 2008, we notified our insurance carriers of potential claims related to the *Durom* Cup. Based upon our most recent estimates for liabilities associated with the *Durom* Cup, we believe we may exhaust our self-insured retention under our insurance program. In this event, we would have a claim for insurance proceeds for ultimate losses which exceed the self-insured retention amount, subject to a 20 percent co-payment requirement and a cap. We believe our contracts with the insurance carriers are enforceable for these claims and, therefore, we believe it is probable that we would recover some amount from our insurance carriers if our ultimate losses exceed our self-insured retention. We have recognized a \$218.0 million receivable in "Other assets" on our condensed consolidated balance sheet as of June 30, 2013 for estimated insurance recoveries, which reduced "Certain claims" expense. As is customary in this process, our insurance carriers have reserved all rights under their respective policies and could still ultimately deny coverage for some or all of our insurance claims.

Our estimate as of June 30, 2013 of the remaining liability for all *Durom* Cup-related claims is \$400.8 million, of which \$50.0 million is classified as short-term in “Other current liabilities” and \$350.8 million is classified as long-term in “Other long-term liabilities” on our consolidated balance sheet. We expect to pay the majority of the *Durom* Cup-related claims within the next five years.

Our understanding of clinical outcomes with the *Durom* Cup continues to evolve. We rely on significant estimates in determining the provisions for *Durom* Cup-related claims, including the number of claims that we will receive and the average amount we will pay per claim. The actual number of claims that we receive and the amount we pay per claim may differ from our estimates. Among other factors, since our understanding of the clinical outcomes is still evolving, we cannot reasonably estimate the possible loss or range of loss that may result from *Durom* Cup-related claims in excess of the losses we have accrued.

*Margo and Daniel Polett v. Zimmer, Inc. et al.*: On August 20, 2008, the Poletts filed an action against us and an unrelated third party, Public Communications, Inc. (PCI), in the Court of Common Pleas, Philadelphia, Pennsylvania seeking an unspecified amount of damages for injuries and loss of consortium allegedly suffered by Mrs. Polett and her spouse, respectively. The complaint alleged that defendants were negligent in connection with Mrs. Polett’s participation in a promotional video featuring one of our knee products. The case was tried in November 2010 and the jury returned a verdict in favor of plaintiffs. The jury awarded \$27.6 million in compensatory damages and apportioned fault 30 percent to plaintiffs, 34 percent to us and 36 percent to PCI. Under applicable law, we may be liable for any portion of the damages apportioned to PCI that it does not pay. On December 2, 2010, we and PCI filed a Motion for Post-Trial Relief seeking a judgment notwithstanding the verdict, a new trial or a remittitur. On June 10, 2011, the trial court entered an order denying our Motion for Post-Trial Relief and affirming the jury verdict in full and entered judgment for \$20.3 million against us and PCI. On June 29, 2011, we filed a Notice of Appeal to the Superior Court of Pennsylvania and posted a bond for the verdict amount plus interest. Oral argument before the appellate court in Philadelphia, Pennsylvania was held as scheduled on March 13, 2012. On March 1, 2013, the Superior Court of Pennsylvania vacated the \$27.6 million judgment and remanded the case for a new trial. On March 15, 2013, plaintiffs filed a motion for re-argument *en banc*, and on March 28, 2013, we filed our response in opposition. On May 9, 2013, the Superior Court of Pennsylvania granted plaintiffs’ motion for re-argument *en banc*. The parties have filed their respective briefs to the *en banc* panel. No date for the re-argument has been set. Although we are defending this lawsuit vigorously, its ultimate resolution is uncertain.

*NexGen*<sup>®</sup> Knee System claims: Following a wide-spread advertising campaign conducted by certain law firms beginning in 2010, a number of product liability lawsuits have been filed against us in various jurisdictions. The majority of the cases are currently pending in a federal Multidistrict Litigation in the Northern District of Illinois. Other cases are pending in other state and federal courts, and additional lawsuits may be filed. As of June 30, 2013, discovery in these lawsuits was underway and no trial dates had been set. We have not accrued an estimated loss relating to these lawsuits because we believe the plaintiffs’ allegations are not consistent with the record of clinical success for these products. As a result, we do not believe that it is probable that we have incurred a liability, and we cannot reasonably estimate any loss that might eventually be incurred. Although we are vigorously defending these lawsuits, their ultimate resolution is uncertain.

### **Intellectual Property-Related Claims**

**Royalty arrangements:** As previously disclosed, we have been party to contractual and other disputes pertaining to certain royalty arrangements. These matters, which were in varying stages of dispute resolution processes, were resolved through a settlement agreement reached in June 2013 and memorialized in July 2013. We recorded \$21.7 million during the three month period ended June 30, 2013 for the liability incurred in excess of amounts we had previously accrued.

**Patent infringement lawsuit:** On December 10, 2010, Stryker Corporation and related entities (Stryker) filed suit against us in the U.S. District Court for the Western District of Michigan, alleging that certain of our *Pulsavac* Plus Wound Debridement Products infringe three U.S. patents assigned to Stryker. The case was tried beginning on January 15, 2013, and on February 5, 2013, the jury found that we infringed certain claims of the subject patents. The jury awarded \$70.0 million in monetary damages for lost profits. The jury also found that we

willfully infringed the subject patents. Final judgment has not yet been entered. We filed post-trial motions challenging the verdict. Following the trial court's rulings on these post-trial motions and entry of final judgment, we intend to appeal the unfavorable verdict. We have not accrued an estimated loss related to this matter in our consolidated statement of earnings for the quarter ended June 30, 2013 or any prior period because we do not believe that it is probable that we have incurred a liability. Although we believe we have strong grounds to reverse the jury's verdict, the ultimate resolution of this matter is uncertain. In the future we could be required to record a charge of up to \$70.0 million that could have a material adverse effect on our results of operations.

### **Regulatory Matters**

In September 2012, we received a warning letter from the U.S. Food and Drug Administration (FDA) citing concerns relating to certain manufacturing and validation processes pertaining to *Trilogy*<sup>®</sup> Acetabular System products manufactured at our Ponce, Puerto Rico manufacturing facility. We have provided detailed responses to the FDA as to our corrective actions and will continue to work expeditiously to address the issues identified by the FDA during recent inspections in Ponce. As of June 30, 2013, the warning letter remains pending. Until the violations are corrected, we may be subject to additional regulatory action by the FDA, including seizure, injunction and/or civil monetary penalties. Additionally, requests for Certificates to Foreign Governments related to products manufactured at the Ponce facility may not be granted and premarket approval applications for Class III devices to which the quality system regulation deviations are reasonably related will not be approved until the violations have been corrected. In addition to responding to the warning letter described above, we are in the process of addressing various FDA Form 483 inspectional observations at certain of our manufacturing facilities. The ultimate outcome of these matters is presently uncertain.

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

The following discussion and analysis should be read in conjunction with the condensed consolidated financial statements and corresponding notes included elsewhere in this Form 10-Q. Certain percentages presented in this discussion and analysis are calculated from the underlying whole-dollar amounts and therefore may not recalculate from the rounded numbers used for disclosure purposes. In addition, certain amounts in the 2012 condensed consolidated financial statements have been reclassified to conform to the 2013 presentation.

### **Executive Level Overview**

#### **Results for the Three and Six Month Periods ended June 30, 2013 (Current Periods)**

Our sales results for the Current Periods reflect increased growth as compared with recent trends. Sales from new product introductions as well as a stable or slightly improved joint replacement market drove sales growth. Sales compared to the same prior year periods increased more as a percentage of year-over-year growth in the second quarter compared to the first quarter, due in part to new product penetration and improved pricing dynamics. For the six month period ended June 30, 2013, sales growth from increased volume and changes in the mix of product sales was partially offset by continued pricing pressure and unfavorable foreign currency exchange rates.

Despite increased sales, our net earnings for the Current Periods were lower than the prior year periods primarily due to lower gross margins, a \$47.0 million charge for "Certain claims" and a \$21.7 million charge for a legal settlement. Additionally, we continue to incur expenses related to our operational excellence initiatives and such charges were higher in the Current Periods compared to the same prior year periods. Our operational excellence initiatives are intended to improve our future operating results and include centralizing or outsourcing certain functions and improving quality, distribution, sourcing, manufacturing and our information technology systems. Research and development (R&D) expenses decreased in the Current Periods due to the completion of certain projects in 2012, such as *Persona*<sup>™</sup> The Personalized Knee System. Selling, general and administrative expenses (SG&A) were slightly higher in the Current Periods compared to the prior year periods due to sales growth. However, SG&A as a percentage of sales decreased in the Current Periods as a result of savings from our operational excellence initiatives. Our effective tax rate (ETR) benefited from changes in the mix of income between taxing jurisdictions, as the significant expenses for "Certain claims" and "Special items" were primarily incurred in jurisdictions with higher rates of tax, which lowers taxable income in those jurisdictions.

#### **2013 Outlook**

We estimate our net sales will grow between 2 and 3 percent in 2013. This assumes the market for knee and hip procedures will remain stable and grow in low single digits. We expect pricing to have a negative effect on sales growth of approximately 2 percent, and foreign currency exchange rates to have a negative effect on sales growth of approximately 2 percent based upon June 30, 2013 rates.

Assuming currency rates remain at June 30, 2013 levels, we expect our gross margin to be approximately 73.5 percent of sales in 2013, which includes inventory step-up and other inventory and manufacturing charges related to acquisitions and operational excellence initiatives. This range assumes that foreign currency hedge losses will be lower in 2013 than in 2012. The range also takes into consideration the impact of the new 2.3 percent medical device excise tax on a majority of our U.S. sales. While we started paying the excise tax in January 2013, it will not significantly increase our cost of products sold expense in our consolidated statement of earnings until the second half of 2013. Once our cost of products sold starts reflecting this excise tax, we estimate the cost to be \$10 million to \$15 million on a quarterly basis.

We do not expect to be able to offset the full impact of the U.S. medical device excise tax on net earnings through higher pricing on our products or through higher sales volumes resulting from the expansion of health insurance coverage. However, we do expect to offset the tax with cost savings from our operational excellence initiatives.

We expect R&D as a percentage of sales in 2013 will be approximately 4.5 percent. SG&A expenses as a percent of sales are expected to be approximately 39.5 percent in 2013 as we realize efficiencies from our operational excellence initiatives and further leverage revenue growth.

For the year, we expect to incur approximately \$250 million of expenses related to inventory step-up and other inventory and manufacturing related charges, “Certain claims” and “Special items.” We have already recognized \$47 million as “Certain claims” in the six month period ended June 30, 2013, and do not anticipate recognizing any more “Certain claims” expense in 2013 unless our estimated liability for *Durom* Cup-related claims changes as discussed in Note 14. Of the remaining \$203 million of expense, the majority will be recognized as “Special items” on our statement of earnings, but some will be related to inventory and will be reflected in costs of products sold.

Assuming variable interest rates remain at June 30, 2013 levels, we expect interest expense, net of interest income, to be approximately \$56 million in 2013, which is similar to 2012.

### *Net Sales by Operating Segment*

The following table presents net sales by operating segment and the components of the percentage changes (dollars in millions):

	Three Months Ended June 30,		% Inc (Dec)	Volume/ Mix	Price	Foreign Exchange
	2013	2012				
Americas .....	\$ 660.1	\$ 614.3	7%	10%	(2)%	(1)%
Europe .....	307.5	305.2	1	1	(1)	1
Asia Pacific .....	201.9	205.5	(2)	7	—	(9)
Total .....	<u>\$1,169.5</u>	<u>\$1,125.0</u>	4	7	(1)	(2)
	Six Months Ended June 30,		% Inc (Dec)	Volume/ Mix	Price	Foreign Exchange
	2013	2012				
Americas .....	\$1,294.8	\$1,248.7	4%	6%	(2)%	—%
Europe .....	615.0	606.0	1	2	(1)	—
Asia Pacific .....	398.6	411.0	(3)	6	(1)	(8)
Total .....	<u>\$2,308.4</u>	<u>\$2,265.7</u>	2	5	(2)	(1)

“Foreign Exchange,” as used in the tables in this report, represents the effect of changes in foreign currency exchange rates on sales.

### *Net Sales by Product Category*

The following table presents net sales by product category and the components of the percentage changes (dollars in millions):

	Three Months Ended June 30,		% Inc (Dec)	Volume/ Mix	Price	Foreign Exchange
	2013	2012				
<u>Reconstructive</u>						
Knees .....	\$ 481.0	\$ 464.6	4%	6%	(1)%	(1)%
Hips .....	338.4	340.0	—	4	(2)	(2)
Extremities .....	48.6	42.5	14	16	(1)	(1)
	868.0	847.1	2	6	(2)	(2)
Dental .....	61.4	61.5	—	(1)	—	1
Trauma .....	74.1	73.9	—	3	—	(3)
Spine .....	54.2	52.4	3	6	(2)	(1)
Surgical and other .....	111.8	90.1	24	28	—	(4)
Total .....	<u>\$1,169.5</u>	<u>\$1,125.0</u>	4	7	(1)	(2)

	Six Months Ended June 30,		% Inc (Dec)	Volume/ Mix	Price	Foreign Exchange
	2013	2012				
<b>Reconstructive</b>						
Knees .....	\$ 952.0	\$ 939.2	1%	4%	(2)%	(1)%
Hips .....	669.2	684.5	(2)	2	(2)	(2)
Extremities .....	96.4	87.3	10	13	(2)	(1)
	<u>1,717.6</u>	<u>1,711.0</u>	—	4	(2)	(2)
Dental .....	121.1	121.7	—	(1)	—	1
Trauma .....	156.1	149.4	4	7	—	(3)
Spine .....	101.9	105.6	(3)	(1)	(2)	—
Surgical and other .....	211.7	178.0	19	22	—	(3)
Total .....	<u>\$2,308.4</u>	<u>\$2,265.7</u>	2	5	(2)	(1)

Beginning in 2013, our Knees product category net sales include certain early intervention products that are primarily used in knee procedures. In 2012, these products were included in the Surgical and other product category. Net sales in the three and six month periods ended June 30, 2012 related to these products have been reclassified to conform to the 2013 presentation. The following table presents net sales by product category by region (dollars in millions):

	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	% Inc (Dec)	2013	2012	% Inc (Dec)
<b>Reconstructive</b>						
<b>Knees</b>						
Americas .....	\$ 281.8	\$ 268.5	5%	\$ 557.3	\$ 551.0	1%
Europe .....	117.6	116.9	1	240.1	235.0	2
Asia Pacific .....	81.6	79.2	3	154.6	153.2	1
<b>Hips</b>						
Americas .....	156.7	151.8	3	308.6	305.7	1
Europe .....	113.7	115.9	(2)	225.5	229.9	(2)
Asia Pacific .....	68.0	72.3	(6)	135.1	148.9	(9)
<b>Extremities</b>						
Americas .....	37.4	32.3	16	74.7	67.5	11
Europe .....	8.4	7.6	11	16.2	14.6	11
Asia Pacific .....	2.8	2.6	9	5.5	5.2	5
	<u>868.0</u>	<u>847.1</u>	2	<u>1,717.6</u>	<u>1,711.0</u>	—
<b>Dental</b>						
Americas .....	35.3	34.8	2	70.8	70.1	1
Europe .....	21.4	21.1	2	41.0	41.2	—
Asia Pacific .....	4.7	5.6	(18)	9.3	10.4	(10)
<b>Trauma</b>						
Americas .....	37.0	37.5	(1)	78.2	74.7	5
Europe .....	18.2	17.0	6	37.0	33.0	12
Asia Pacific .....	18.9	19.4	(2)	40.9	41.7	(2)
<b>Spine</b>						
Americas .....	35.0	35.4	(1)	65.7	72.0	(9)
Europe .....	13.7	12.7	8	25.9	25.1	3
Asia Pacific .....	5.5	4.3	25	10.3	8.5	20
<b>Surgical and other</b>						
Americas .....	76.9	54.0	43	139.5	107.7	30
Europe .....	14.5	14.0	3	29.3	27.2	8
Asia Pacific .....	20.4	22.1	(8)	42.9	43.1	(1)
Total .....	<u>\$1,169.5</u>	<u>\$1,125.0</u>	4	<u>\$2,308.4</u>	<u>\$2,265.7</u>	2



### Demand (Volume and Mix) Trends

Increased volume and changes in the mix of product sales contributed 7 percentage points of year-over-year sales growth during the three month period ended June 30, 2013, which is 3 percentage points better than the three month period ended June 30, 2012, and 4 percentage points better than the three month period ended March 31, 2013. Sales in the three month period ended June 30, 2013 benefited mostly from new products as well as an additional billing day in our largest operating segment compared to the prior year.

We believe procedure volumes in the broader musculoskeletal market remained stable or slightly improved in the second quarter of 2013 relative to the first quarter of 2013, consistent with our expectations. We believe long-term indicators point toward sustained growth driven by an aging global population, growth in emerging markets, obesity, proven clinical benefits, new material technologies, advances in surgical techniques and more active lifestyles, among other factors. In addition, the ongoing shift in demand to premium products and the introduction of patient specific devices is expected to continue to positively affect sales growth.

### Pricing Trends

Global selling prices had a negative effect of 1 percent on year-over-year sales during the three month period ended June 30, 2013, which is 1 percentage point better than the three month period ended June 30, 2012, and the three month period ended March 31, 2013. Our Americas and Europe reporting segments and certain countries of our Asia Pacific reporting segment continued to experience pricing pressure from governmental healthcare cost containment efforts and from local hospitals and health systems. Pricing in our Asia Pacific reporting segment improved as we reached the anniversary of a biennial negative price adjustment in Japan that went into effect in April 2012. For the entire year, we expect lower prices will continue to have a negative effect on sales of approximately 2 percent.

### Foreign Currency Exchange Rates

For the three month period ended June 30, 2013, foreign currency exchange rates resulted in a 2 percent decrease in sales, primarily from the strengthening of the U.S. Dollar versus the Japanese Yen in the period. If foreign currency exchange rates remain consistent with June 30, 2013 rates, we estimate that a stronger dollar versus foreign currency exchange rates will have a negative effect on sales in 2013 of approximately 2 percent. We address currency risk through regular operating and financing activities and through the use of forward contracts and foreign currency options solely to manage foreign currency volatility and risk. Changes to foreign currency exchange rates affect sales growth, but due to offsetting gains/losses on hedge contracts and options, which are recorded in cost of products sold, the effect on net earnings in the near term is expected to be minimal.

### Sales by Product Category

#### *Knees*

Knee sales increased 4 percent and 1 percent in the three and six month periods ended June 30, 2013, respectively, when compared to the same prior year periods. Our Knee product category has benefited from new product introductions.

In the first half of 2013, we continued a broader launch of our new knee system, *Persona* The Personalized Knee System. We intend to continue to deploy implant and instrument sets to all geographic regions in 2013 and beyond. In the meantime, our *NexGen*<sup>®</sup> Complete Knee Solution product line is still our leading knee system in sales. Products driving growth in this category in addition to *Persona* The Personalized Knee System, included *Zimmer*<sup>®</sup> Patient Specific Instruments, the *Zimmer*<sup>®</sup> Unicompartmental High Flex Knee and our early intervention products.

In Europe, changes in foreign currency exchange rates positively affected knee sales in the three month period ended June 30, 2013 by 1 percent and had a minimal effect in the six month period ended June 30, 2013. In Asia Pacific, changes in foreign currency exchange rates negatively affected knee sales in the three and six month periods ended June 30, 2013 by 7 percent and 6 percent, respectively.

### *Hips*

Hip sales were flat and decreased 2 percent in the three and six month periods ended June 30, 2013, respectively, when compared to the same prior year periods. The decreases in the 2013 periods compared to the prior year periods were primarily from changes in foreign currency exchange rates.

Leading hip stem sales were the *Zimmer*<sup>®</sup> M/L Taper Hip Prosthesis, the *Zimmer*<sup>®</sup> M/L Taper Hip Prosthesis with *Kinectiv*<sup>®</sup> Technology, the *CLS*<sup>®</sup> *Spotorno*<sup>®</sup> Stem from the *CLS* Hip System and the *Alloclassic*<sup>®</sup> *Zweymüller*<sup>®</sup> Hip Stem. Products experiencing growth in this category included the *Wagner SL Revision*<sup>®</sup> Hip Stem, the *Continuum*<sup>®</sup> Acetabular System, the *Trilogy*<sup>®</sup> IT Acetabular System, the *Allofit*<sup>®</sup> IT *Alloclassic*<sup>®</sup> Acetabular System, *Vivacit-E*<sup>®</sup> Highly Crosslinked Polyethylene Liners and *BIOLOX*<sup>®1</sup> *delta* Heads.

In Europe, changes in foreign currency exchange rates had a minimal effect on hip sales in the three and six month periods ended June 30, 2013. In Asia Pacific, changes in foreign currency exchange rates negatively affected hip sales in the three and six month periods ended June 30, 2013 by 10 percent and 8 percent, respectively.

### *Extremities*

Extremities sales increased by 14 and 10 percent in the three and six month periods ended June 30, 2013, respectively, when compared to the same prior year periods. The *Zimmer Trabecular Metal*<sup>™</sup> Reverse Shoulder System, the *Sidus*<sup>®</sup> Stem-Free Shoulder and the *Zimmer Trabecular Metal* Total Ankle drove sales growth. *Trabecular Metal* Technology continues to be an effective way to address clinical needs in the extremities market.

### *Dental*

Dental sales were flat in the three and six month periods ended June 30, 2013 when compared to the same prior year periods. This was the result of improved sales of dental reconstructive implants and digital solutions, offset by decreases in restorative products and regenerative products. We believe the dental market continues to be challenged both in the U.S. and internationally. Sales were led by the *Tapered Screw-Vent*<sup>®</sup> Implant System.

### *Trauma*

Trauma sales were flat and increased 4 percent in the three and six month periods ended June 30, 2013, respectively, when compared to the same prior year periods. The *Zimmer Natural Nail*<sup>®</sup> System continued to increase sales significantly. In addition to the *Zimmer Natural Nail* System, the *Zimmer*<sup>®</sup> Periarticular Locking Plates System led Trauma sales. Sales in this product category in the three month period ended June 30, 2013 reflected less benefits from certain competitive product issues when compared to the three month periods ended March 31, 2013 and December 31, 2012. Additionally, we encountered internal supply delays in the June period that we hope to resolve in the second half of 2013.

### *Spine*

Spine sales increased by 3 percent and decreased by 3 percent in the three and six month periods ended June 30, 2013, respectively, when compared to the same prior year periods. The return to sales growth in the three month period ended June 30, 2013 was led by our focus on core fusion solutions, such as the *Trinica*<sup>®</sup> Select Anterior Cervical Plate System, as well as growth in the *Dynesys*<sup>®</sup> Dynamic Stabilization System and *Trabecular Metal* Technology products.

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<sup>1</sup> Registered trademark of CeramTec GmbH

### *Surgical and other*

Surgical and other sales increased 24 percent and 19 percent in the three and six month periods ended June 30, 2013, respectively, when compared to the same prior year periods. The primary driver of sales growth in this product category was the *Transposal*<sup>®</sup> Fluid Waste Management System, which we acquired in October 2012 through our Dornoch Medical Systems, Inc. acquisition. Other contributing products were *PALACOS*<sup>®2</sup> Bone Cement, tourniquets and wound debridement devices.

### *Expenses as a Percent of Net Sales*

	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	Inc (Dec)	2013	2012	Inc (Dec)
Cost of products sold . . . . .	27.7%	25.1%	2.6	26.7%	25.2%	1.5
Research and development . . . . .	4.7	5.1	(0.4)	4.7	5.2	(0.5)
Selling, general and administrative . . . .	39.2	40.3	(1.1)	39.8	40.5	(0.7)
Certain claims . . . . .	4.0	—	4.0	2.0	—	2.0
Special items . . . . .	6.5	2.7	3.8	4.7	2.8	1.9
Operating profit . . . . .	18.0	26.8	(8.8)	22.0	26.4	(4.4)

### *Cost of Products Sold*

The increase in cost of products sold as a percentage of net sales for the three month period ended June 30, 2013 compared to the same prior year period was due to higher average costs per unit sold as a result of changes in product and geographic mix and lower average selling prices, increased excess and obsolescence charges from product rationalization initiatives as well as other factors, and certain inventory and manufacturing related charges connected to quality enhancement and remediation efforts. These negative effects were partially offset by hedge gains recorded in the 2013 period versus hedge losses recorded in the 2012 period.

The increase in cost of products sold as a percentage of net sales for the six month period ended June 30, 2013 compared to the same prior year period was due to similar reasons as the three month period.

### *Operating Expenses*

R&D expenses and R&D as a percentage of sales decreased in both the three and six month periods ended June 30, 2013 when compared to the same prior year periods. Lower spending reflected the effects of our operational excellence initiatives, as well as a natural decline from certain large projects that achieved full commercialization, including *Persona* The Personalized Knee System. We expect R&D spending in 2013 to be approximately 4.5 percent of sales for the full year.

SG&A expenses increased, but SG&A as a percentage of sales decreased in the three and six month periods ended June 30, 2013 when compared to the same prior year periods. The dollar increase in both periods was primarily due to higher selling and distribution expenses from higher sales and increased intangible amortization from acquisitions. This was partially offset by lower bad debt expense in both periods as well as savings from our operational excellence initiatives. The six month period ended June 30, 2013 also included lower legal expenses due to the conclusion of certain matters in the same prior year period for which we are no longer incurring outside counsel fees, as well as normal variations in the phases of litigation, including product liability litigation. As a percent of sales, SG&A has improved in the Current Periods as our operational excellence initiatives have produced lower variable and fixed costs in SG&A.

<sup>2</sup> Registered trademark of Heraeus Kulzer GmbH

“Certain claims” expense is for estimated liabilities to *Durom* Cup patients undergoing revision surgeries. We recorded expense of \$15.0 million, \$157.8 million, \$75.0 million, \$35.0 million and \$69.0 million during 2012, 2011, 2010, 2009 and 2008, respectively. We recorded additional expense of \$47.0 million during the three and six month periods ended June 30, 2013, bringing the total expense to \$398.8 million for these claims, excluding a subset of *Durom* Cup claims that were recorded in SG&A. The additional expense in 2013 was driven primarily by higher estimated claims than were previously expected. For more information regarding these claims, see Note 14 to the condensed consolidated financial statements.

“Special items” for the three and six month periods ended June 30, 2013 increased significantly compared to the same prior year periods. We continue to implement our operational excellence initiatives, which are intended to improve our future operating results by centralizing or outsourcing certain functions and improving quality, distribution, sourcing, manufacturing and our information technology systems. “Special items” expenses include consulting and professional fees, dedicated personnel costs, severance benefits as well as other costs for those programs. In addition to expenses for our operational excellence programs, we recognize expenses related to integration of acquired businesses, impairment of assets, certain R&D agreements, certain litigation settlements and other items as “Special items.” See Note 2 to the condensed consolidated financial statements for more information regarding “Special items” charges.

### ***Interest Income, Interest Expense, Income Taxes and Net Earnings***

Interest income and expense, net, were similar in the three and six month periods ended June 30, 2013 when compared to the same prior year periods.

The ETR on earnings before income taxes for the three and six month periods ended June 30, 2013 decreased to 22.6 percent and 22.9 percent, respectively, from 25.6 percent in both prior year periods. The decrease was primarily due to “Certain claims” and “Special items.” Since most of the “Special items” and “Certain claims” expense is recorded in jurisdictions with higher rates of tax, this favorably affects our ETR because it lowers the income in those jurisdictions. We anticipate that the outcome of various federal, state and foreign audits, as well as expiration of certain statutes of limitations, could potentially impact our 2013 ETR in future quarters. Currently, we cannot reasonably estimate the impact of these items on our financial results.

Net earnings of Zimmer Holdings, Inc. of \$152.1 million and \$370.7 million for the three and six month periods ended June 30, 2013, respectively, decreased 29 percent and 13 percent compared to the same prior year periods, respectively, as a result of the changes in revenues and expenses discussed above. In the three month period ended June 30, 2013, basic and diluted earnings per share decreased 26 percent and 27 percent, respectively, compared to the same prior year period. In the six month period ended June 30, 2013, basic and diluted earnings per share both decreased 9 percent compared to the same prior year period. The disproportional change in earnings per share as compared with net earnings is attributed to the effect of share repurchases.

### ***Non-GAAP operating performance measures***

We use non-GAAP financial measures to evaluate our operating performance that differ from financial measures determined in accordance with GAAP. Our non-GAAP financial measures exclude the impact of inventory step-up, certain inventory and manufacturing related charges connected to quality enhancement and remediation efforts, inventory obsolescence charges associated with product rationalization initiatives, “Certain claims,” “Special items,” and any related effects on our income tax provision associated with these items. We use this information internally and believe it is helpful to investors because it allows more meaningful period-to-period comparisons of our ongoing operating results, it helps to perform trend analysis and to better identify operating trends that may otherwise be masked or distorted by these types of items, and it provides a higher degree of transparency of certain items. Certain of these non-GAAP financial measures are used as metrics for our incentive compensation programs.

Our non-GAAP adjusted net earnings used for internal management purposes for the three and six month periods ended June 30, 2013 were \$243.4 million and \$484.2 million, respectively, compared to \$235.6 million and \$466.9 million in the same prior year periods, respectively. Our non-GAAP adjusted diluted earnings per

share for the three and six month periods ended June 30, 2013 were \$1.43 and \$2.84, respectively, compared to \$1.34 and \$2.63 in the same prior year periods, respectively.

The following are reconciliations from our GAAP net earnings and diluted earnings per share to our non-GAAP adjusted net earnings and non-GAAP adjusted diluted earnings per share used for internal management purposes.

<u>(In millions)</u>	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Net Earnings of Zimmer Holdings, Inc. ....	\$152.1	\$214.5	\$370.7	\$424.1
Inventory step-up and other inventory and manufacturing related charges .....	11.7	1.0	13.9	2.0
Certain claims .....	47.0	—	47.0	—
Special items .....	75.6	30.7	109.1	64.2
Taxes on above items* .....	(43.0)	(10.6)	(56.5)	(23.4)
Adjusted Net Earnings .....	<u>\$243.4</u>	<u>\$235.6</u>	<u>\$484.2</u>	<u>\$466.9</u>

\* The tax effect is calculated based upon the statutory rates for the jurisdictions where the items were incurred.

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Diluted EPS .....	\$ 0.89	\$ 1.22	\$ 2.17	\$ 2.39
Inventory step-up and other inventory and manufacturing related charges .....	0.07	0.01	0.08	0.01
Certain claims .....	0.28	—	0.28	—
Special items .....	0.44	0.17	0.64	0.36
Taxes on above items* .....	(0.25)	(0.06)	(0.33)	(0.13)
Adjusted Diluted EPS .....	<u>\$ 1.43</u>	<u>\$ 1.34</u>	<u>\$ 2.84</u>	<u>\$ 2.63</u>

\* The tax effect is calculated based upon the statutory rates for the jurisdictions where the items were incurred.

### Liquidity and Capital Resources

Cash flows provided by operating activities were \$370.2 million for the six month period ended June 30, 2013, compared to \$438.9 million in the same prior year period. The principal source of cash from operating activities was net earnings. Non-cash items included in net earnings accounted for another \$205.1 million of operating cash. All other items of operating cash flows reflect a use of \$204.6 million of cash in the six month period ended June 30, 2013, compared to a use of \$204.0 million in the same 2012 period. The lower cash flows provided by operating activities in the 2013 period were primarily due to increases in inventory value for our U.S. inventory caused by the medical device excise tax and inventory to support new product launches.

At June 30, 2013, we had 69 days of sales outstanding in trade accounts receivable, which represents an increase of 1 day compared to March 31, 2013 and is a decrease of 3 days from June 30, 2012. At June 30, 2013, we had 293 days of inventory on hand. This is a decrease of 26 days compared to March 31, 2013 and a decrease of 13 days from June 30, 2012.

Cash flows used in investing activities were \$121.6 million for the six month period ended June 30, 2013, compared to \$282.1 million in the same prior year period. Additions to instruments increased in the 2013 period compared to the 2012 period due to purchases related to some significant product launches, such as *Persona* The Personalized Knee System. Spending on other property, plant and equipment was relatively consistent between the 2013 period and the 2012 period, reflecting cash outlays necessary to complete new product-related investments and replace older machinery and equipment. We invest some of our cash and cash equivalents in highly-rated debt securities. The purchases and any sales or maturities of these investments are reflected as cash

flows from investing activities. The timing of these investments can vary from quarter to quarter depending on the maturity of the debt securities and other cash and cash equivalent needs. Investments in other assets in the 2013 period related primarily to small business acquisitions we have executed.

Cash flows used in financing activities were \$405.4 million for the six month period ended June 30, 2013, compared to \$262.1 million in the same 2012 period. In the 2013 period, we returned cash to our stockholders in the form of cash dividends of \$64.5 million and share repurchases of \$460.8 million. In the 2013 period, we paid off the amount we had borrowed under our senior credit facility in the fourth quarter of 2012. Additionally, an increase in our stock price in 2013 resulted in many employees exercising stock options, which provided us with additional cash.

In February and May of 2013, our Board of Directors declared cash dividends of \$0.20 per share that were paid in April and July of 2013, respectively. We expect to continue paying cash dividends on a quarterly basis; however, future dividends are subject to approval of the Board of Directors and may be adjusted as business needs or market conditions change. The 2013 dividend declarations equate to an annual rate of \$0.80 per share, which represents an 11 percent increase over the 2012 annualized rate.

We have four tranches of senior notes outstanding: \$250 million aggregate principal amount of 1.4 percent notes due November 30, 2014, \$500 million aggregate principal amount of 4.625 percent notes due November 30, 2019, \$300 million aggregate principal amount of 3.375 percent notes due November 30, 2021 and \$500 million aggregate principal amount of 5.75 percent notes due November 30, 2039. Interest on each series is payable on May 30 and November 30 of each year until maturity.

We may redeem the senior notes at our election in whole or in part at any time prior to maturity at a redemption price equal to the greater of 1) 100 percent of the principal amount of the notes being redeemed; or 2) the sum of the present values of the remaining scheduled payments of principal and interest (not including any portion of such payments of interest accrued as of the date of redemption), discounted to the date of redemption on a semi-annual basis at the Treasury Rate (as defined in the debt agreement), plus 15 basis points in the case of the 2014 notes, 20 basis points in the case of the 2019 and 2021 notes, and 25 basis points in the case of the 2039 notes. We will also pay the accrued and unpaid interest on the senior notes to the redemption date.

We have a five year \$1,350 million revolving, multi-currency, senior unsecured credit facility maturing May 9, 2017 (Senior Credit Facility). There were no borrowings outstanding under the Senior Credit Facility at June 30, 2013.

We and certain of our wholly owned foreign subsidiaries are the borrowers under the Senior Credit Facility. Borrowings under the Senior Credit Facility bear interest at a LIBOR-based rate plus an applicable margin determined by reference to our senior unsecured long-term credit rating and the amounts drawn under the Senior Credit Facility, at an alternate base rate, or at a fixed-rate determined through a competitive bid process. The Senior Credit Facility contains customary affirmative and negative covenants and events of default for an unsecured financing arrangement, including, among other things, limitations on consolidations, mergers and sales or transfers of assets. Financial covenants include a maximum leverage ratio of 3.0 to 1.0. If we fall below an investment grade credit rating, additional restrictions would result, including restrictions on investments, payment of dividends and stock repurchases. We were in compliance with all covenants under the Senior Credit Facility as of June 30, 2013. Commitments under the Senior Credit Facility are subject to certain fees, including a facility fee and a utilization fee.

We have a term loan agreement (Term Loan) with one of the lenders under the Senior Credit Facility for 11.7 billion Japanese Yen that will mature on May 31, 2016. Borrowings under the Term Loan bear interest at a fixed rate of 0.61 percent per annum until maturity.

We also have available uncommitted credit facilities totaling \$74.3 million.

We place our cash and cash equivalents in highly-rated financial institutions and limit the amount of credit exposure to any one entity. We invest only in high-quality financial instruments in accordance with our internal investment policy.

As of June 30, 2013, we had short-term and long-term investments in debt securities with a fair value of \$800.1 million. These investments are in debt securities of many different issuers and therefore we have no significant concentration of risk with a single issuer. All of these debt securities remain highly-rated and we believe the risk of default by the issuers is low.

As of June 30, 2013, \$1,237.9 million of our cash and cash equivalents and short-term and long-term investments were held in jurisdictions outside of the U.S. and are expected to be indefinitely reinvested for continued use in foreign operations. Repatriation of these assets to the U.S. may have tax consequences. \$966.6 million of this amount is denominated in U.S. Dollars and therefore bears no foreign currency translation risk. The balance of these assets is denominated in currencies of the various countries where we operate.

Our concentrations of credit risks with respect to trade accounts receivable is limited due to the large number of customers and their dispersion across a number of geographic areas and by frequent monitoring of the creditworthiness of the customers to whom credit is granted in the normal course of business. Substantially all of our trade receivables are concentrated in the public and private hospital and healthcare industry in the U.S. and internationally or with distributors or dealers who operate in international markets and, accordingly, are exposed to their respective business, economic and country specific variables.

Our ability to collect accounts receivable in some countries depends in part upon the financial stability of these hospital and healthcare sectors and the respective countries' national economic and healthcare systems. Most notably, in Europe healthcare is typically sponsored by the government. Since we sell products to public hospitals in those countries, we are indirectly exposed to government budget constraints. The ongoing financial crisis in the Euro zone impacts the indirect credit exposure we have to those governments through their public hospitals. We have experienced an increasing number of days sales outstanding in some European countries compared to levels in 2010. As of June 30, 2013, in Greece, Italy, Portugal and Spain, countries that have been widely recognized as presenting the highest risk, our gross short-term and long-term trade accounts receivable combined were \$233.4 million. With allowances for doubtful accounts of \$9.0 million recorded in those countries, the net balance was \$224.4 million, representing 25 percent of our total consolidated short-term and long-term trade accounts receivable balance, net. Italy and Spain accounted for \$215.3 million of that net amount. We are actively monitoring the situations in these countries. We maintain contact with customers in these countries on a regular basis. We continue to receive payments, albeit at a slower rate than in the past. We believe our allowance for doubtful accounts is adequate in these countries, as ultimately we believe the governments in these countries will be able to pay. To the extent the respective governments' ability to fund their public hospital programs deteriorates, we may have to record significant bad debt expenses in the future.

We may use excess cash to repurchase common stock under our share repurchase program. As of June 30, 2013, \$553.9 million remained authorized under a \$1.5 billion repurchase program, which will expire on December 31, 2014.

Management believes that cash flows from operations and available borrowings under the Senior Credit Facility are sufficient to meet our working capital, capital expenditure and debt service needs, as well as return cash to stockholders in the form of dividends and share repurchases. Should investment opportunities arise, we believe that our earnings, balance sheet and cash flows will allow us to obtain additional capital, if necessary.

### **Recent Accounting Pronouncements**

There are no recently issued accounting pronouncements that we have not yet adopted that are expected to have a material effect on our financial position, results of operations or cash flows.

### **Critical Accounting Estimates**

There were no changes in the three month period ended June 30, 2013 to the application of critical accounting policies as described in our Annual Report on Form 10-K for the year ended December 31, 2012. As discussed in that Annual Report on Form 10-K, our annual impairment test of goodwill occurs in the fourth quarter every year. In 2012, the annual impairment test resulted in an impairment charge related to our

U.S. Spine reporting unit, resulting in a remaining balance of goodwill in that reporting unit of \$41.0 million. Accordingly, the estimated fair value of that reporting unit does not substantially exceed its carrying value. If the U.S. Spine reporting unit is not able to achieve its operating plans or if that market deteriorates beyond our expectations, we may have to record another goodwill impairment charge in the future. We have other reporting units with goodwill assigned to them. As of the annual impairment test in 2012, the estimated fair values for those reporting units substantially exceeded their carrying values.

### **Forward-Looking Statements**

This quarterly report contains certain statements that are forward-looking statements within the meaning of federal securities laws. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. When used in this report, the words “may,” “will,” “should,” “would,” “could,” “anticipate,” “expect,” “plan,” “seek,” “believe,” “predict,” “estimate,” “potential,” “project,” “target,” “forecast,” “intend,” “strategy,” “future,” “opportunity,” “assume,” “guide” and similar expressions are intended to identify forward-looking statements. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties that could cause actual results to differ materially from such forward-looking statements. These risks and uncertainties include, but are not limited to:

- competition;
- pricing pressures;
- the impact of the federal healthcare reform legislation, including the impact of the excise tax on medical devices;
- reductions in reimbursement levels by third-party payors and cost containment efforts of healthcare purchasing organizations;
- challenges relating to changes in and compliance with governmental laws and regulations affecting our U.S. and international businesses, including regulations of the U.S. Food and Drug Administration (FDA) and foreign government regulators, such as more stringent requirements for regulatory clearance of our products;
- our ability to remediate matters identified in any inspectional observations or warning letters issued by the FDA;
- the success of our quality and operational improvement initiatives;
- changes in tax obligations arising from tax reform measures or examinations by tax authorities;
- changes in general domestic and international economic conditions, including interest rate and currency exchange rate fluctuations;
- changes in general industry and market conditions, including domestic and international growth rates;
- changes in customer demand for our products and services caused by demographic changes or other factors;
- dependence on new product development, technological advances and innovation;
- product liability claims;
- our ability to protect proprietary technology and other intellectual property and claims for infringement of the intellectual property rights of third parties;
- retention of our independent agents and distributors;
- our dependence on a limited number of suppliers for key raw materials and outsourced activities;
- the possible disruptive effect of additional strategic acquisitions and our ability to successfully integrate acquired companies;
- our ability to form and implement strategic alliances;



- the impact of the ongoing financial crisis on countries in the Euro zone on our ability to collect accounts receivable in affected countries;
- changes in prices of raw materials and products and our ability to control costs and expenses; and
- shifts in our product category sales mix or our regional sales mix away from products or geographic regions that generate higher operating margins.

Our Annual Report on Form 10-K for the year ended December 31, 2012 contains a detailed discussion of these and other important factors under the heading “Risk Factors” in Part I, Item 1A of that report. You should understand that it is not possible to predict or identify all factors that could cause actual results to differ materially from forward-looking statements. Consequently, you should not consider any list or discussion of such factors to be a complete set of all potential risks or uncertainties.

Readers of this report are cautioned not to place undue reliance on these forward-looking statements. While we believe the assumptions on which the forward-looking statements are based are reasonable, there can be no assurance that these forward-looking statements will prove to be accurate. This cautionary statement is applicable to all forward-looking statements contained in this report.

We expressly disclaim any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our Form 10-Q, 8-K and 10-K reports and our other filings with the Securities and Exchange Commission.

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

There have been no material changes from the information provided in our Annual Report on Form 10-K for the year ended December 31, 2012.

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

#### **Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (Exchange Act)) that are designed to provide reasonable assurance that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures. Because of inherent limitations, disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of disclosure controls and procedures are met.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective at a reasonable assurance level.

#### **Changes in Internal Control Over Financial Reporting**

During the quarter ended June 30, 2013, we continued transitioning work to a third-party service provider to outsource certain finance functions that historically have been performed internally in multiple countries throughout Europe and in the U.S. We also continued centralizing other finance functions that historically have been performed in a decentralized manner. This outsourcing and centralization are part of our ongoing operational excellence initiatives, and we plan to continue transitioning work to the service provider and the centralized finance departments over the course of 2013.

In connection with the outsourcing and centralization of finance functions and the resulting business process changes, we continue to enhance the design and documentation of our internal control processes to ensure suitable controls over our financial reporting. There were no other changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the quarter ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## Part II — Other Information

### Item 1. *Legal Proceedings*

Information pertaining to legal proceedings can be found in Note 14 to the interim condensed consolidated financial statements included in Part I, Item 1 of this report.

### Item 1A. *Risk Factors*

There have been no material changes from the risk factors disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2012.

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

The following table summarizes repurchases of common stock settled during the three month period ended June 30, 2013:

	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs*</u>	<u>Approximate Dollar Value of Shares that May Yet Be Purchased Under Plans or Programs</u>
April 2013 .....	—	\$ —	—	\$622,684,428
May 2013 .....	192,700	78.46	192,700	607,565,095
June 2013 .....	687,200	78.07	687,200	553,912,488
Total .....	<u>879,900</u>	<u>\$78.16</u>	<u>879,900</u>	<u>\$553,912,488</u>

\* Includes repurchases made under the current program authorizing \$1.5 billion of repurchases through December 31, 2014.

### Item 3. *Defaults Upon Senior Securities*

None

### Item 4. *Mine Safety Disclosures*

Not applicable

### Item 5. *Other Information*

During the three month period ended June 30, 2013, the Audit Committee of our Board of Directors approved the engagement of PricewaterhouseCoopers LLP, our independent registered public accounting firm, to perform certain non-audit services related to certain tax matters. This disclosure is made pursuant to Section 10A(i)(2) of the Exchange Act, as added by Section 202 of the Sarbanes-Oxley Act of 2002.

**Item 6. Exhibits**

The following exhibits are filed or furnished as part of this report:

10.1*	Zimmer Holdings, Inc. Executive Performance Incentive Plan (as Amended May 7, 2013) (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed May 13, 2013)
10.2*	Zimmer Holdings, Inc. 2009 Stock Incentive Plan (as Amended May 7, 2013) (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed May 13, 2013)
10.3*	Change in Control Severance Agreement by and between Zimmer GmbH and Katarzyna Mazur-Hofsaess
10.4*	Confidentiality, Non-Competition and Non-Solicitation Agreement by and between Zimmer GmbH and Katarzyna Mazur-Hofsaess
31.1	Certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934 of the Chief Executive Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934 of the Chief Financial Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

\* Management contract or compensatory plan or arrangement

**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.

ZIMMER HOLDINGS, INC.  
(Registrant)

Date: August 7, 2013

By: /s/ James T. Crines  
James T. Crines  
*Executive Vice President, Finance and  
Chief Financial Officer*

Date: August 7, 2013

By: /s/ Derek M. Davis  
Derek M. Davis  
*Vice President, Finance and Corporate  
Controller and Chief Accounting Officer*



### Change in Control Severance Agreement

This Change in Control Severance Agreement (“**Agreement**”) is made by and between Zimmer GmbH (“**Employer**” or “**Company**” as case may be) and **Katarzyna Mazur-Hofsäss** (“**Executive**”).

#### Recitals

- (A) The Company considers it essential to the best interests of its ultimate shareholders to foster the continuous employment of key management personnel.
- (B) The Company and the Board recognize that, as is the case with many publicly held corporations, the possibility of a Change in Control in the Ultimate Parent Company exists and that such a possibility, and the uncertainty and questions that it may raise among management, may result in the departure or distraction of management personnel to the detriment of the Company and its shareholders.
- (C) The Board has determined that appropriate steps should be taken to reinforce and encourage the continued attention and dedication of members of the Company’s management, including the Executive, to their assigned duties without distraction in the face of potentially disturbing circumstances arising from the possibility of a Change in Control.
- (D) The parties intend that no amount or benefit will be payable under this Agreement unless a termination of the Executive’s employment with the Company occurs following a Change in Control, or is deemed to have occurred following a Change in Control, as provided in this Agreement.

Defined terms as used herein and not defined elsewhere in this Agreement, shall have the meaning as described to them in **Annex 1** to this Agreement.

#### 1. Term of Agreement

This Agreement will commence on the date stated below and will continue in effect through December 31, 2013. Beginning on January 1, 2014, and each subsequent January 1, the term of this Agreement will automatically be extended for one additional year, unless either party gives the other party written notice not to extend this Agreement at least 30 days before the extension would otherwise become effective or unless a Change in Control occurs. If a Change in Control occurs

during the term of this Agreement, this Agreement will continue in effect for a period of 24 months from the end of the month in which the Change in Control occurs. Notwithstanding the foregoing provisions of this Article, this Agreement will terminate on the Executive's retirement date, as defined under Swiss law.

## **2. Compensation other than Severance Payments**

### **2.1 Compensation Previously Earned**

If the Executive's employment is terminated for any reason following a Change in Control and during the term of this Agreement, the Company will pay the Executive's salary accrued through the Date of Termination, at the rate in effect at the time the Notice of Termination is given, together with all other compensation and benefits payable to the Executive through the Date of Termination under the terms of any compensation or benefit plan, program, or arrangement maintained by the Company during that period.

### **2.2 Normal Post-Termination Compensation and Benefits.**

Except as provided in Section 3.1, if the Executive's employment is terminated for any reason following a Change in Control and during the term of this Agreement, the Company will pay the Executive the normal compensation and benefits payable to the Executive under the terms of the Company's compensation or benefit plans, programs, and arrangements, as in effect immediately prior to the Change in Control, including but not limited to the Non Competition Period Payments (if any). This provision does not restrict the Company's right to amend, modify, or terminate any plan, program, or arrangement prior to a Change in Control.

### **2.3 No Duplication.**

Notwithstanding any other provision of this Agreement to the contrary, the Executive will not be entitled to duplicate benefits or compensation under this Agreement and the terms of any other plan, program, or arrangement maintained by the Company or any affiliate.

## **3. Severance Payments**

### **3.1 Payment Triggers**

In addition to the payments as set out in Section 2 above, but in lieu of any other severance compensation or benefits to which the Executive may otherwise be entitled under any plan, program, policy, or arrangement of the Company or by law in particular due to abusive termination under Art. 336a Swiss Code of Obligations (and which the Executive hereby expressly waives), the Company will pay the Executive the Severance Payments described in Section 3.2 upon termination of the Executive's employment following a Change in Control and during the term of this Agreement, unless the termination is (1) by the Company for Cause, (2) by reason of the Executive's death, or (3) by the Executive without Good Reason.

For purposes of this Section 3.1, the Executive's employment will be deemed to have been terminated following a Change in Control by the Company without Cause or by the Executive with Good Reason if (1) the Executive's employment is terminated without Cause prior to a Change in Control at the direction of a Person who has entered into an agreement with the Ultimate Parent Company, the consummation of which will constitute a Change in Control; or (2) the Executive terminates her employment with Good Reason prior to a Change in Control (determined by treating a Potential Change in Control as a Change in Control in applying the definition of Good Reason), if the circumstance or event that constitutes Good Reason occurs at the direction of such a Person.

The Severance Payments described in this Article 3 are subject to the conditions stated in Section 4 below and shall be reduced in part or in their totality if and to the extent the Severance Payments were, at the time of their payment, to be deemed a golden parachute or similar arrangement prohibited under the laws where the Company is incorporated and has its registered office or the costs associated with the Severance Payments could no longer be booked as expenditures in the Company's profit and loss statement.

### **3.2 Severance Payments.**

The following are the Severance Payments referenced in Section 3.1:

#### **(a) Lump Sum Severance Payment**

In lieu of any further salary payments to the Executive for periods after the Date of Termination, and in lieu of any severance benefits otherwise payable to the Executive, the Company will pay to the Executive, in accordance with Section 3.3, a lump sum severance payment, in cash, equal to (a) two times the sum of (1) the higher of the Executive's annual base salary in effect immediately prior to the event or circumstance upon which the Notice of Termination is based or in effect immediately prior to the Change in Control, plus (2) the amount of the Executive's target annual bonus entitlement under the Cash Incentive Plan (or any other bonus plan of the Company then in effect) as in effect immediately prior to the event or circumstance giving rise to the Notice of Termination, less (b) the amount of any statutory payment to which the Executive is entitled related to any statutory notice period. If the Board determines that it is not workable to determine the amount that the Executive's target bonus would have been for the year in which the Notice of Termination was given, then, for purposes of this paragraph (a), the Executive's target annual bonus entitlement will be the average of annual bonus paid to the Executive with respect to the three years immediately prior to the year in which the Notice of Termination was given.



**(b) Options and Restricted Shares**

All outstanding Options will become immediately vested and exercisable (to the extent not yet vested and exercisable as of the Date of Termination). To the extent not otherwise provided under the written agreement evidencing the grant of any restricted Shares to the Executive, all outstanding Shares that have been granted to the Executive subject to restrictions that, as of the Date of Termination, have not yet lapsed will lapse automatically upon the Date of Termination, and the Executive will own those Shares free and clear of all such restrictions. Notwithstanding the foregoing, Options and restricted Shares remain subject to any forfeiture or clawback claims under the applicable option plan or award agreement.

**3.3 Time of Payment**

Except as otherwise expressly provided in Section 3.2, payments provided for in that Section will be made as follows:

No later than the fifth business day following the Date of Termination, the Company will pay to the Executive an estimate, as determined by the Company in good faith, of 90% of the payments under Section 3.2 (a) to which the Executive is clearly entitled.

The Company will pay to the Executive the remainder of the payments due to her under Section 3.2 not later than 90 business days after the Date of Termination.

At the time that payment is made under this Section 3.3, the Company will provide the Executive with a written statement setting forth the manner in which all of the payments to her under this Agreement were calculated and the basis for the calculations.

**3.4 Outplacement Services**

For a period not to exceed six (6) months following the Date of Termination, the Company will provide the Executive with reasonable outplacement services consistent with past practices of the Company prior to the Change in Control or, if no past practice has been established prior to the Change in Control, consistent with the prevailing practice in the medical device manufacturing industry.

**4. The Executive's Covenants****4.1 Confidentiality, Non-Competition and Non-Solicitation Agreement**

The Executive herewith acknowledges and affirms her continuing obligations under the existing Confidentiality, Non-Competition and Non-Solicitation Agreement dated 22 February 2012 and re-affirms her agreement to honor the obligations as set forth therein.

**4.2 General Release**

The Executive agrees that, notwithstanding any other provision of this Agreement, the Executive will not be eligible for any Severance Payments under this Agreement unless the Executive timely signs a General Release in substantially the form attached to this Agreement as Annex 2. The Executive will be given 30 days to consider the terms of the General Release. If the Executive does not return the executed General Release to the Company by the end of the 30 day period that failure will be deemed a refusal to sign, and the Executive will not be entitled to receive any Severance Payments under this Agreement.

**5. Notices**

For the purpose of this Agreement, notices and all other communications provided for in the Agreement will be in writing and will be deemed to have been duly given when delivered or mailed by Swiss registered mail, return receipt requested, addressed to the respective addresses set forth below, or to such other address as either party may furnish to the other in writing in accordance with this Article 5, except that notice of change of address will be effective only upon actual receipt:

To the Company:

Zimmer GmbH.  
Attention: Vice President EMEA Counsel  
Sulzer-Allee 8  
8404 Winterthur

To the Executive:

Katarzyna Mazur-Hofsäss

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**6. Miscellaneous**

This Agreement constitutes and expresses the entire agreement between the Parties pertaining to the subject matter contained herein and supersedes all prior and contemporaneous oral or written agreements, representations, understandings and the like between the Parties.

This Agreement may not be modified, amended, altered or supplemented, in whole or in part, except by a written agreement signed by the Parties.

If any provision of this Agreement is found by any competent authority to be void, invalid or unenforceable, such provision shall be deemed to be deleted from this

## Change in Control Severance Agreement

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Agreement and the remaining provisions of this Agreement shall continue in full force. In this event, the Agreement shall be construed, and, if necessary, amended in a way to give effect to, or to approximate, or to achieve a result which is as close as legally possible to the result intended by the provision hereof determined to be void, illegal or unenforceable.

### **7. Governing Law and Jurisdiction**

This Agreement shall be governed by, interpreted and construed in accordance with the substantive laws of Switzerland.

The ordinary courts and at the registered office of the Company shall have exclusive jurisdiction for all disputes arising out of or in connection with this Agreement.

This Agreement enters into force on the later date set-out below.

Winterthur, 6 March 2013

Zimmer GmbH

/s/ Guillaume Génin

Guillaume Génin  
Vice President EMEA Counsel

Executive

/s/ Katarzyna Mazur-Hofsäss

Katarzyna Mazur-Hofsäss

Date: 13 March 2013

/s/ Asif Hussain

Asif Hussain  
Vice President Human Resources EMEA

**Annex 1: Definitions**

“**Beneficial Owner**” has the meaning stated in Rule 13d-3 under the Exchange Act.

“**Board**” means the Board of Directors of the Ultimate Parent Company.

“**Cash Incentive Plan**” means the Ultimate Parent Company’s Executive Performance Incentive Plan.

“**Cause**” for termination by the Company of the Executive’s employment, after any Change in Control, means (1) any reason being deemed good reason in the sense of Art. 336d Swiss Code of Obligations; (2) the willful and continued failure by the Executive to substantially perform the Executive’s duties with the Company (other than any such failure resulting from the Executive’s incapacity due to physical or mental illness or any such actual or anticipated failure after the issuance of a Notice of Termination for Good Reason by the Executive) for a period of at least 10 consecutive days after a written demand for substantial performance is delivered to the Executive by the Company, which demand specifically identifies the manner in which the Company believes that the Executive has not substantially performed the Executive’s duties; or (3) the Executive willfully engages in conduct that is demonstrably and materially injurious to the Company, the Ultimate Parent Company or its subsidiaries, monetarily or otherwise.

A “**Change in Control**” will be deemed to have occurred if any of the following events occur:

- (a) any Person is or becomes the Beneficial Owner, directly or indirectly, of securities of the Ultimate Parent Company (not including in the securities beneficially owned by that Person any securities acquired directly from the Ultimate Parent Company or its affiliates) representing 20% or more of the combined voting power of the Ultimate Parent Company’s then outstanding securities; or
- (b) during any period of two consecutive years (not including any period prior to the execution of this Agreement), individuals who at the beginning of the period constitute the Board and any new director (other than a director designated by a Person who has entered into an agreement with the Ultimate Parent Company to effect a transaction described in clause (a), (c) or (d) of this paragraph whose election by the Board or nomination for election by the Ultimate Parent Company’s stockholders was approved by a vote of at least two-thirds (2/3) of the directors then still in office who either were directors at the beginning of the period or whose election or nomination for election was previously approved), cease for any reason to constitute a majority of the Board; or
- (c) the shareholders of the Ultimate Parent Company approve a merger or consolidation of the Ultimate Parent Company with any other corporation, other than (A) a merger or consolidation that would result in the voting securities of the Ultimate Parent Company outstanding immediately prior to the merger or

## Change in Control Severance Agreement

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consolidation continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity), in combination with the ownership of any trustee or other fiduciary holding securities under an employee benefit plan of the Ultimate Parent Company, at least 75% of the combined voting power of the voting securities of the Ultimate Parent Company or the surviving entity outstanding immediately after the merger or consolidation; or (B) a merger or consolidation effected to implement a recapitalization of the Ultimate Parent Company (or similar transaction) in which no Person acquires more than 50% of the combined voting power of the Ultimate Parent Company's then outstanding securities; or

- (d) the shareholders of the Ultimate Parent Company approve a plan of complete liquidation of the Ultimate Parent Company or an agreement for the sale or disposition by the Ultimate Parent Company of all or substantially all the Ultimate Parent Company's assets.

Notwithstanding the foregoing, a Change in Control will not include any event, circumstance, or transaction occurring during the six-month period following a Potential Change in Control that results from the action of any entity or group that includes, is affiliated with, or is wholly or partly controlled by the Executive; provided, further, that such an action will not be taken into account for this purpose if it occurs within a six-month period following a Potential Change in Control resulting from the action of any entity or group that does not include the Executive.

**"Date of Termination"** means the date on which the Notice of Termination under the Employment Agreement has lapsed.

**"Employment Agreement"** means the employment agreement between the Executive and the Company dated February 1<sup>st</sup> 2010 as further modified.

**"Exchange Act"** means the U.S. Securities Exchange Act of 1934, as amended from time to time, and interpretive rules and regulations.

**"Good Reason"** for termination by the Executive of the Executive's employment means the occurrence (without the Executive's express written consent) of any one of the following acts by the Company, or failures by the Company to act following a Change in Control:

- (a) the assignment to the Executive of any duties inconsistent with the Executive's status as an executive officer of the Company or a substantial adverse alteration in the nature or status of the Executive's responsibilities from those in effect immediately prior to a Change in Control;
- (b) the Company's failure, without the Executive's consent, to pay to the Executive any portion of the Executive's current compensation (which means, for purposes of this paragraph (b), the Executive's annual base salary as in effect on the date of this Agreement, or as it may be increased from time to time, and the

awards earned pursuant to the Cash Incentive Plan) or to pay to the Executive any portion of an installment of deferred compensation under any deferred compensation program of the Company, within 30 days of the date the compensation is due;

- (c) the Company's failure to continue in effect any compensation plan in which the Executive participates immediately prior to a Change in Control, which plan is material to the Executive's total compensation, including, but not limited to, the Cash Incentive Plan and the Zimmer Holdings, Inc. 2009 Stock Incentive Plan or any substitute plans adopted prior to the Change in Control, unless an equitable arrangement (embodied in an ongoing substitute or alternative plan) has been made with respect to that plan, or the Company's failure to continue the Executive's participation in such a plan (or in a substitute or alternative plan) on a basis not materially less favorable, both in terms of the amount of benefits provided and the level of the Executive's participation relative to other participants, as existed at the time of the Change in Control.

Notwithstanding the foregoing, the occurrence of an event that would otherwise constitute Good Reason will cease to be an event constituting Good Reason if the Executive does not timely provide a Notice of Termination to the Company within 120 days of the date on which the Executive first becomes aware (or reasonably should have become aware) of the occurrence of that event.

**"Non Competition Period Payments"** has the meaning as defined in the Confidentiality, Non-Competition and Non-Solicitation Agreement dated 22 February 2012, between the Company and the Executive.

**"Notice of Termination"** has the meaning as defined in section 2.2 of the Employment Agreement (i.e : notice period of 6 months from the end of the month in which the notice is given).

**"Options"** means options to purchase Shares awarded to the Executive during her employment with the Company.

**"Person"** has the meaning stated in section 3(a)(9) of the Exchange Act, as modified and used in sections 13(d) and 14(d) of the Exchange Act; however, a Person will not include (1) the Ultimate Parent Company or any of its subsidiaries, (2) a trustee or other fiduciary holding securities under an employee benefit plan of the Ultimate Parent Company or any of its subsidiaries, (3) an underwriter temporarily holding securities pursuant to an offering of those securities, or (4) a corporation owned, directly or indirectly, by the stockholders of the Ultimate Parent Company in substantially the same proportions as their ownership of stock of the Ultimate Parent Company.

**“Potential Change in Control”** will be deemed to have occurred if any one of the following events occurs:

- (a) the Ultimate Parent Company enters into an agreement, the consummation of which would result in the occurrence of a Change in Control;
- (b) the Ultimate Parent Company or any Person publicly announces an intention to take or to consider taking actions that, if consummated, would constitute a Change in Control;
- (c) any Person who is or becomes the Beneficial Owner, directly or indirectly, of securities of the Ultimate Parent Company representing 10% or more of the combined voting power of the Ultimate Parent Company’s then outstanding securities, increases that Person’s beneficial ownership of those securities by 5% or more over the percentage so owned by that Person on the date of this Agreement; or
- (d) the Board adopts a resolution to the effect that, for purposes of this Agreement, a Potential Change in Control has occurred.

**“Shares”** means shares of the common stock, \$0.01 par value, of the Ultimate Parent Company.

**“Severance Payments”** means the payments described in Section 3.2.

**“Ultimate Parent Company”** means Zimmer Holdings, Inc., a Delaware corporation, and any successor to its business and/or assets.

**Annex 2****GENERAL RELEASE**

Name: \_\_\_\_\_

Notification Date: \_\_\_\_\_

Zimmer GmbH. (the “Company”) has offered me certain severance benefits (the “Severance Benefits”) pursuant to a Change in Control Severance Agreement (“Agreement”) between the Company and me. I will only be able to receive the Severance Benefits in consideration for my signing this General Release.

The Company has advised me of, and I acknowledge the following:

I have 30 days from the date I receive this General Release to consider and sign it. If I do not return this signed General Release in 30 days (INSERT DATE), the Company will consider this my refusal to sign, and I will not receive the Severance Benefits. If I do sign this General Release, it will become immediately effective.

By signing this General Release I am giving up my right to sue the Company, and any affiliates, parent companies and subsidiaries, and their past, present and future officers, directors, employees, and agents (collectively, the “Released Parties”) based upon any act or event occurring prior to my signing this General Release, to the fullest extent permitted by law. Without limitation, and again to the fullest extent permitted by law, I specifically release the Company from any and all claims arising out of my employment and termination, including claims based on the Swiss Code of Obligations, the Labour Act and all applicable federal, cantonal and local laws.

For the sake of clarification, I acknowledge that this General Release shall not affect my legal obligation to protect the confidentiality of the Company’s information or any of my existing obligations under the Confidentiality, Non-Competition and Non-Solicitation Agreement that I executed during my employment with the Company (the “Non-Competition Agreement”), and I hereby reaffirm my covenants and obligations under the Non-Competition Agreement.

By signing this General Release, none of my benefits will be affected to which I am entitled under the Agreement or any claim arising out of the enforcement of the Agreement.

My signature below acknowledges that I have read the above, understand what I am signing, and am acting of my own free will. The Company has advised me to consult with an attorney and any other advisors of my choice prior to signing this General Release.

SIGNATURE \_\_\_\_\_

DATE \_\_\_\_\_

PRINT NAME \_\_\_\_\_





### Confidentiality, Non-Competition, and Non-Solicitation Agreement

This Confidentiality, Non-Competition and Non-Solicitation Agreement (“**Agreement**”) is made by and between Zimmer GmbH (“**Employer**”) and Katarzyna Mazur-Hofsäss (“**Employee**”).

#### Recitals

- (A) For purposes of this Agreement, “**Parent**” means an entity which is a holding company of or holds a controlling interest in Zimmer, Inc. (“**Company**” or “**ZINC**”); “**Affiliate**” means a subsidiary of Company or the Parent of Company or a company over which Company or any holding company of Company has control, including but not limited to Employer; and the definition of each of Company; Parent and Affiliates, includes any of their successors-in-interest, including, but not limited to, ZINC.
- (B) Company, Parent and the Affiliates (collectively, and each individually “**Zimmer Group**”) are part of the global holdings of Zimmer Holdings, Inc., a publicly traded corporation incorporated under the laws of the state of Delaware, U.S.A., the primary purpose of which is to serve as the umbrella entity for ZINC. Zimmer Group is engaged in the development, manufacture, distribution, and sale of orthopedic medical and/or oral rehabilitation devices, products, and services.
- (C) By virtue of her position as President EMEA Reconstructive and General Manager of the Employer and with direct reporting responsibilities from the General Managers responsible for the following markets of Germany, Switzerland, Austria and the Netherlands and overall responsibility for the EMEA Regions, the Employee has been and will continue to be granted access and introduced to major customers of Zimmer Group in Europe, Middle East and Africa and will be prominently involved in strategic decision making processes including but not limited to strategic acquisitions, product development, business and marketing strategies as well as price strategies and similar measures, restructuring projects etc. Therefore Zimmer Group has an imminent interest, to protect this information, know-how and its business secrets throughout the term of the Employee’s employment and for a certain period after its termination has taken effect.

**1. Confidentiality**

- 1.1 As used herein, “**Confidential Information**” shall include, but not be limited to, all business, trade, and technical information of Zimmer Group, and of any third party, whether patentable or not, which is of a confidential, trade secret and/or proprietary character and which is either developed by Employee (alone or with others) or to which Employee has had access during its employment with the Zimmer Group.
- 1.2 Confidential Information includes, without limitation, the following:
- (a) Marketing, sales, and advertising information such as lists of actual or potential customers; customer preference data, marketing and sales techniques, strategies, efforts, and data; merchandising systems and plans; confidential customer information including identification of purchasing personnel, account status, needs and ability to pay; business plans, product development and delivery schedules; market research and forecasts; marketing and advertising plans, techniques, and budgets; overall pricing strategies; the specific advertising programs and strategies utilized, and the success or lack of success of those programs and strategies;
  - (b) Organizational information such as personnel and salary data; merger, acquisition and expansion information; restructuring plan information, information concerning methods of operation; and divestiture information;
  - (c) Financial information such as product costs; supplier information; overhead costs; profit margins; banking and financing information; and pricing policy practices;
  - (d) Technical information such as product specifications, compounds, formulas, improvements, discoveries, developments, designs, inventions, techniques, new products and surgical training methods;
  - (e) Information disclosed to Employee as part of a training process;
  - (f) Information of third parties provided to Employee subject to non-disclosure restrictions for use in Employee’s business for the Zimmer Group; and
  - (g) Any work product created by Employee in rendering services for the Zimmer Group.
- 1.3 Employee shall not at any time during the continuance of his/her employment with the Zimmer Group or at any time thereafter directly or indirectly use for his/her own purposes or for any purposes other than those of the Zimmer Group, record, divulge, disclose or communicate to any person, company, business entity or other organization or, through any failure to exercise due care and diligence, cause any unauthorized disclosure of, any trade secrets or Confidential Information except as may be necessary for the proper performance of Employee’s duties or as may be specifically authorized in writing by the Employer.

## Confidentiality, Non-Competition, and Non-Solicitation Agreement

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- 1.4 Employee will notify Employer in writing of any circumstances which may constitute unauthorized disclosure, transfer, or use of Confidential Information. Employee will use best efforts to protect Confidential Information from unauthorized disclosure, transfer, or use. Employee will implement and abide by all procedures adopted by the Zimmer Group to prevent unauthorized disclosure, transfer, or use of Confidential Information.
- 1.5 Upon termination of his/her employment with the Zimmer Group (for whatever reason), and at any other time at Employer's request, Employee shall, without retaining any copies or other record thereof, deliver to Employer or any person Employer may nominate each and every document and all other material of whatever nature in the possession or under the control of Employee containing or relating directly or indirectly to any Confidential Information.
- 1.6 The confidentiality undertaking set forth in this Section 1 shall cease to apply to any information which shall become available to the public generally otherwise than through the default of Employee.

## 2. Non-Competition, Non-Solicitation

- 2.1 Employee shall not, for as long as he/she remains an employee of the Zimmer Group and during a period of 18 months from the taking effect of the termination of his/her employment with the Zimmer Group ("**Non-Competition Period**"), alone, or jointly with, or as manager, agent for, or employee of any person or as a shareholder directly or indirectly carry on or be engaged, concerned or interested in any business competitive to the business of Zimmer Group with an effect in Switzerland, the European Community and the EFTA States or any other country for which Employee possesses and will possess knowledge of Confidential Information. Without limiting the generality of the foregoing, the non-compete undertaking set forth in this Section 2.1 shall apply to any product competing with the Zimmer Group's product lines and in particular but not limited to products of Johnson & Johnson (DePuy, Synthes), Stryker, Smith & Nephew, Biomet, Mathys, Wright Medical, Tornier and Exactech including their respective affiliates and subsidiaries, assignees, and successors (also as a consequence of de-mergers or spin-offs). The Employee acknowledges and agrees that the making available of Confidential Information to competitors of Zimmer Group will considerably harm Zimmer Group's business.
- 2.2 Employee shall not during the Non-Competition Period (i) solicit, induce or attempt to induce any person who is an employee of the Zimmer Group to leave the Zimmer Group or to engage in any business that competes with the Zimmer Group; (ii) hire or assist in the hiring of any person who is an employee of the Zimmer Group to work for any business that competes with the Zimmer Group, or (iii) solicit, induce or attempt to induce any person or company that is a customer of the Zimmer Group to discontinue or modify its customer relationship with the Zimmer Group.

### 3. Non-Competition Period Payments

- 3.1 To the extent Employee is unable to obtain employment consistent with Employee's training and education solely because of the provisions of this Agreement, the following terms will apply upon expiration of any severance benefits to which Employee is otherwise eligible to receive ("**Non-Competition Period Payments**"):
- (a) Employer will make payments to Employee equal to Employee's monthly base pay at the time of Employee's termination (exclusive of bonus, extra compensation and, any other employee benefits) for each month of such unemployment through the end of the Non-Competition Period which shall in no event be less than 50% of the Employees pro-rated annual income on a monthly basis (inclusive of bonus, extra compensation and, any other employee benefits);
  - (b) to the extent Employee is able to obtain employment which does not violate this Agreement, but solely because of this Agreement, the monthly base pay for the replacement employment is less than Employee's monthly base pay at the time of Employee's termination (as calculated in accordance with 3.1 (a) above), Employer agrees to pay the difference for each such month through the end of the Non-Competition Period. A reduction of the Non-competition Period Payments shall only take place to the extent the aggregate compensation exceeds 110% of the Employee's former monthly income (inclusive of bonus, extra compensation and, any other employee benefits);
  - (c) on the 15<sup>th</sup> day of each month of such unemployment, Employee will give Employer a detailed written account of Employee's efforts to obtain employment and an explanation exclusively attributing Employee's inability to obtain replacement employment to the provisions of this Agreement.
- 3.2 In the event of Employee's breach, Employee agrees that Employee will still be bound by all of the provisions set forth in this Agreement, including, but not limited to, the non-competition, non-solicitation, non-disparagement and non-disclosure covenants, until the end of the Non-Competition Period. Zimmer Group reserves the right to release Employee from Employee's non-competition obligations set forth in this Agreement during the Non-Competition Period respecting a notice period of six (6) months after which Employer's payment obligations under this Section 3 shall cease immediately and Employee shall not be entitled to any Non-Competition Period Payment or other compensation.

### 4. Remedies

- 4.1 For each violation of the covenants set forth in Section 1 and/or 2, Employee shall pay to Employer or, at Employer's instruction, any other affiliate of the Zimmer Group, and amount corresponding to 50 % of the Employee's last annual salary at the time of Employee's termination (inclusive bonus payments, extra compensation and any other employee benefits) as liquidated damages plus such additional

damages as may be incurred by Employer and/or any other affiliate of the Zimmer Group. The payment of this sum shall not operate as a waiver of the above obligations. Employer and/or any other affiliate of the Zimmer Group shall, in addition to all other damages, be entitled to obtain a court's order for specific performance, as well as adequate injunctive relief or any other adequate judicial measure, to immediately stop such violation.

- 4.2 To the extent that Employee breaches any provision of this Agreement during the Non-Competition Period and/or fails to timely submit the written account required by Section 3, Employer reserves, in addition to all other relief to which Employer shall be entitled, the right to cease making any Non-Competition Period Payments.

## **5. Miscellaneous**

- 5.1 This Agreement constitutes and expresses the entire agreement between the Parties pertaining to the subject matter contained herein and supersedes all prior and contemporaneous oral or written agreements, representations, understandings and the like between the Parties.
- 5.2 This Agreement may not be modified, amended, altered or supplemented, in whole or in part, except by a written agreement signed by the Parties.
- 5.3 If any provision of this Agreement is found by any competent authority to be void, invalid or unenforceable, such provision shall be deemed to be deleted from this Agreement and the remaining provisions of this Agreement shall continue in full force. In this event, the Agreement shall be construed, and, if necessary, amended in a way to give effect to, or to approximate, or to achieve a result which is as close as legally possible to the result intended by the provision hereof determined to be void, illegal or unenforceable.

## **6. Waiver**

The Employer may at his sole discretion waive all or certain of the restrictions under this Agreement within 2 weeks after it has received or issued the notice of termination by/to the Employee. In case the Non-Competition restriction is waived, the Employee is aware that there will be no entitlements to Non-Competition Period Payments under clause 3 of this Agreement.

## **7. Governing Law and Jurisdiction**

- 7.1 This Agreement shall be governed by, interpreted and construed in accordance with the substantive laws of Switzerland.
- 7.2 The ordinary courts and the domicile of Employer competent shall have exclusive jurisdiction of all disputes arising out of or in connection with this Agreement.

Confidentiality, Non-Competition, and Non-Solicitation Agreement

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Employee's signature below indicates that Employee has read the entire Agreement, Employee understands what Employee is signing, and is signing it voluntarily. Employee agrees that Zimmer Group advised Employee to consult with an attorney prior to signing the Agreement. This Agreement replaces and restates the agreement with the same subject matter concluded on February 1, 2010, and taking into account the Employee's increasing knowledge of and access to Confidential Information.

This Agreement enters into force on the later date set-out below.

Winterthur, February 22, 2010

**Zimmer GmbH**

/s/ Guillaume Génin

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**Guillaume Génin**

Vice President I EMEA Counsel

/s/ Asif Hussain

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**Asif Hussain**

VP Human Resources EMEA

**“Employee”**

/s/ Katarzyna Mazur-Hofsäss

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**Katarzyna Mazur-Hofsäss**

Date: 29 February 2012

**CERTIFICATION PURSUANT TO RULE 13a-14(a)/15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, David C. Dvorak, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Zimmer Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 7, 2013

/s/ David C. Dvorak

David C. Dvorak

*President and Chief Executive Officer*

**CERTIFICATION PURSUANT TO RULE 13a-14(a)/15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James T. Crines, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Zimmer Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 7, 2013

/s/ James T. Crines

James T. Crines  
*Executive Vice President, Finance and Chief  
Financial Officer*



**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Zimmer Holdings, Inc. (the “Company”) on Form 10-Q for the period ending June 30, 2013 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), each of the undersigned certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ David C. Dvorak

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David C. Dvorak  
*President and Chief Executive Officer*  
August 7, 2013

/s/ James T. Crines

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James T. Crines  
*Executive Vice President, Finance and Chief  
Financial Officer*  
August 7, 2013