August 9, 2022

Olympus Corporation
1Q FY2023 Earnings Conference Q&A (Summary)

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Q: The full-year forecasts remain unchanged excluding forex. How did 1Q progress against the internal plan? There were various risks such as the Shanghai lockdown, parts shortages (semiconductors, etc.), and the war in Ukraine. What kind of impact did you have?

A: The 1Q performance largely progressed in line with plan. Regarding the risks such as the Shanghai lockdown, parts shortages (semiconductor, etc.), and the situation in Ukraine, we factored an impact of around 1-2% of revenue into the plan at the beginning of the fiscal year. According to internal analyses, the opportunity loss due to these risks was around ¥10-15 billion in revenue. If the opportunity loss in revenue were around JPY15 billion, the impact in gross profit would have been around JPY10 billion.

Q: In 1Q, ESD in Japan and Europe showed a large increase in sales, even excluding forex. What were the factors behind this other than the effect of EVIS X1?

A: In addition to the EVIS X1 effect, the order backlog had accumulated at the end of the previous fiscal year due to the supply shortage of parts such as semiconductors etc., and it was a positive factor in a YoY comparison that they were shipped in 1Q. Moreover, in Europe, sales were boosted by a order from NHS in UK, a tailwind particularly in GI endoscope in ESD. Also, some of the shipments to Russia scheduled for the previous fiscal year did in 1Q. In U.S., although EVIS X1 has not yet been launched, sales were solid in 1Q due in part to strong customer loyalty and a recovery from the COVID-related slowdown. Overall, sales in the GI endoscope segment were robust except for China, which was affected by the Shanghai lockdown. In the meantime, TSD's three focus areas - GI-ET, Urology and Respiratory - went well in all regions expect for China, and we expect this trend to continue in 2Q onward.

Q: On page 21 of the presentation material, it is stated that changes in the cost of sales ratio had an impact on operating profit of JPY4 billion. Can you tell us the quantitative impact of the cost increase for all parts, including semiconductors? Also, what were the specific measures taken to minimize multiple risks?

A: The impact due to the increase in cost for all components, including semiconductors, was JPY1.5 billion. One way to mitigate this risk was to hike product prices. In terms of parts procurement, we are strengthening our approach to suppliers and vendors on a global scale and are also conducting top-level negotiations. We are also making a more refined approach in planning the allocation of the parts we obtained. We were able to secure transportation routes to Russia because of a consideration by the European team to deliver products to patients and healthcare professionals.

Q: Has Olympus returned to the normal mode in terms of procuring parts such as semiconductors? Do you think the impact will diminish in the future? Also, do you accept price increases when procuring parts such as semiconductors? Is it necessary to pay close attention to changes in COGS in the future?
A: The situation remains uncertain because it is difficult to place orders for all parts required for the future, but I think we were able to secure more parts in 1Q than expected at the beginning of the period, and we expect this situation to continue in the future. As you would expect, we also procure necessary parts from the spot market as needed to secure the quantity. The impact of the price hikes for parts in 1Q is estimated to be around JPY1.0-1.5 billion. Although we have factored the impact of price hikes expected at this point into our forecasts, there is a possibility that this will change in the future. On the other hand, we are striving to keep costs down by requesting zero-based reviews of SG&A internally and, in some cases, requiring the approval of executive officers.

Q: Why was the progress of SG&A expenses for ESD in 1Q high compared to the full-year forecast?
A: In addition to an increase in outsourcing expenses related to the strengthening of QARA, personnel expenses also increased due to an increase in incentive compensation for sales and bonus provisions in Japan based on the performance in the previous fiscal year. We are aware that SG&A expenses were a little high in 1Q and will work to optimize overall SG&A expenses in the remaining nine months.

Q: Why did TSD only grow at +1% in North America in 1Q despite strong products such as SOLTIVE and Plasma?
A: TSD's North American operations in 1Q were affected by supply chain challenges in connection with sourcing non-semiconductor components and packaging. We are working to eliminate delays in delivery, and the situation is improving. We will continue working on this in 2Q. The number of procedures has shown a recovery trend, and we have no particular concern. We believe that once the supply chain issues stabilize, a stable growth trend for TSD will be achieved.

Q: Performance in SSD was weak in 1Q. Do you think it might have an impact on your potential plan to divest the business in the future?
A: Although 1Q results were weak, we expect to eliminate the order backlog and achieve the plan for the full year. At this point, we are going to refrain from commenting about our considerations, including the transfer of the business.

Q: What was monthly momentum in China during 1Q? Also, when we look at the annual trend, at the beginning of the fiscal year, you expected that hospitals' capital budgets would improve year-on-year. Has this trend changed somehow?
A: Sales were almost zero in April, recovered to 50-60% of the same period of the previous year in May, and double-digit growth in June. Since the lockdown was lifted, sales have trended accordingly. There was the Shanghai lockdown in April and May, but the impact was not limited to orders, but also overall. Due to the lockdown, product demonstrations and the shipment of products from our Shanghai warehouse to customers were affected, as well as delays in the tender process throughout China. It affected our business not only around Shanghai, but throughout China. The number of tenders is expected to recover over the next few months, and it is expected to make a significant contribution to sales from September onward. Similarly, capital investment in hospitals will recover.

Q: Do you see any reduction in budgets at Chinese hospitals?
A: Budgets have fluctuated significantly over the past 2-3 years but will likely recover moving forward. Tenders are trending back, at least for GI endoscope, and we are confident that our performance will recover.

Q: You said China grew double-digit in June YoY. Is it because the "Buy China" policy was announced in May last year, and the comparison was low?
A: We strive to ensure that our customers understand and evaluate the strengths of our products. (In June of FY2022, we achieved double-digit growth in both ESD and TSD compared to June of FY2021, and we do not recognize that the comparison was low.)

Q: Regarding the outlook for China from 2Q onward, you mentioned that demand is currently recovering from 1Q. Please tell us about the status of demand in hospitals for each ESD and TSD. I understand that there was a decline in prices for Surgical endoscope in ESD and several areas in TSD in the previous fiscal year. How is it trending recently?

A: Currently, the number of procedures has been recovering, and the tender process, which had been delayed during lockdowns, has become active. The situation will improve significantly, particularly after September. We will see a sign of recovery in 2Q and a positive impact on performance, particularly in 3Q.

Q: Regarding the outlook for ESD and TSD in China, do you expect a delay in the tender process in 2Q?

A: Sales declined in April and May and recovered in June and July. We believe that the results of tenders will lead to sales in 3Q, which will support a stronger recovery than 2Q.

Q: Is it correct to understand that the full-year forecasts for revenue and operating profit take into account risks such as supply shortages of semiconductors and other parts, the situation in Ukraine, and lockdowns in China, and that changes in forex assumptions explain the upward revisions?

A: As you understand correctly, basically only exchange rate assumptions have been changed from the initial forecasts. The full-year forex outlook is based on the actual results for the three-month period and takes into account recent forex trends.

Q: Please tell us about the outlook for the level of full-year operating margin. ESD's operating margin in 1Q was 21.3%, and I estimate that the operating margin for the remaining nine months will need to be around 36% to achieve the full-year forecast. Also, in TSD, the operating margin in 1Q was 18.5%. And the operating margin for the remaining nine months will need to be around 24%. Can you tell us about the points where we can expect an improvement in profit margin moving forward?

A: In 1Q, each business division was affected by a sales decline in China due to the Shanghai lockdown. In China, ESD margins were particularly good compared to other regions, and the sales decline had a large impact on profit margins. Therefore, we think an improvement in sales in China from 2Q onward will be a major prerequisite. To achieve the plan, excluding forex, ESD needs to achieve the same growth rate as 1Q from 2Q onward and maintain COGS ratio at the same level as the previous fiscal year. As for SG&A expenses, many expenses were incurred in 1Q, so we believe that we need to control expenses in the next nine months. Similarly, TSD had sales growth of nearly 3% in 1Q, but needs to double the growth rate over the next nine months. Sales are expected to increase in growth driver areas such as Urology. And regionally, in addition to sales recovery in China, we expect sales growth particularly in Europe and North America, as well as in Japan. Regarding COGS ratio and SG&A expenses, we aim to keep those on par with normal years in the remaining nine months. In SSD, progress was slow compared to the plan, due in part to the Shanghai lockdown and parts shortages (semiconductors etc.). However, the order backlog has doubled from last year. And the supply chain environment for parts and materials is currently showing signs of improvement. We believe that we will be able to achieve the plan if orders can be shipped as usual.

Q: You are forecasting that the growth rate for ERCP products in the GI-ET segment of TSD will be high single digit in the future. I personally estimate that the annual sales of these products are around JPY20 billion. Of these, guidewires and sphincterotomes have strengths, and I recognize that VisiGlide, a guidewire manufactured by Terumo, is one of the factors that has successfully differentiated you from competitors. Can you tell us the background why you have strengths in these two products and can achieve above-market growth in such a highly competitive field like ERCP?

A: In GI-ET, we have strengths in products that are used in particularly complicated procedures, and we expect higher-than-market growth. For this reason, we have strengths in the ERCP and ESD product groups, and we believe that guidewires, including VisiGlide, and sphincterotomes, have been favorably received by doctors and that we have been able to gain market share. As a point of differentiation, in addition to product strength, we have actively engaged in sales activities such as increasing touchpoints with customers. Another reason is that we have become able to provide a more complete portfolio in the ERCP product group.

(End)