

Olympus Corporation
3Q FY2021 Earnings Conference Call Q&A (Summary)

(Disclaimer)

For your reference, please find an English translation of the question and answer session at the conference call for financial results for the third quarter of the fiscal year ending March 31, 2021 below. This transcript has been edited/modified from the original Q&A conversations for the sake of clarity.

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[Q&A (Summary)]

Q: You didn't disclose the 3Q forecasts. How were the actual results compared to the internal plan? The OPM for 4Q appears conservative. What assumptions do you have?

A: 3Q operating profit was approx. ¥16 to 17 billion higher than our internal assumption. In the UK and Eastern Europe, there were government supports for strengthening of their healthcare systems, and many of our products did well thanks to favored budget allocation. Also, in China, the government budget was allocated to areas other than COVID-19 measures in December, which is the final month of the fiscal year for hospitals, resulting in unprecedented monthly revenue. In addition, strict cost control and constraints on activities due to COVID-19 enabled us to cut expenses more than expected, resulting in very good operating profit in 3Q. For 4Q, it is assumed that revenue will continue to grow gradually, and in particular, ESD, which performed well in the first nine months, is expected to maintain the momentum to a certain extent. In light of this, we revised full-year operating profit forecast upwardly by ¥23 billion. Expenses for 4Q are expected to increase as in the previous years. This is partly attributable to various structural factors because March is the last month of our fiscal year, but also because we plan to post additional bonus reserve in line with upward performance revisions, costs for strengthening QA/RA and IT infrastructures, and for GBS (Global Business Services: efforts to outsource routine operations) in 4Q. Although the expense baseline is lower now, due to these special factors we expect 4Q SG&A expenses to be about the same as last year's, and as a result, the quarterly operating margin is estimated to be lower than previous quarters this year.

Q: Looking at the presentation material on pages 7-8 and the reference material on page 4, it turns out that the medical business is doing very well. Do you think that strong performance in Japan and China will continue? In Japan, did the government supplementary budget make a contribution, or is it going to contribute in the future?

A: Situations vary by region, but overall there is no doubt that business is staying on a recovery trend. With respect to Japan in 3Q, it was a growth against low base after the consumption tax hike last year, so it cannot be said that it is a real positive growth, but we expect it to grow moderately moving forward with the tailwind of government subsidies, etc. China's December figures were extremely good and January was also good. We see the momentum continue to a certain extent, partly supported by the government budget granted in some regions for purchasing respiratory products as a measure for COVID-19.

Q: I would like to review one-time items in the current fiscal year. On a full-year basis, IMD-related restructuring costs are ¥5 billion, recall costs for bronchoscope and choledochoscope are ¥ 6 billion, expenses related to the career support for the external opportunity are ¥12 billion, and FA costs are about ¥1 billion. Can one-time costs be understood to be about ¥23-24 billion in total? If I add back these costs to the full-year operating profit forecast, real operating profit turns out to be over ¥100 billion with OPM of 14-15%. So there is a 5-6 % point gap compared to the FY2023 target of over 20%. How do you plan to achieve narrowing the gap?

A: You understand one-time costs correctly. In terms of how to achieve the target, multiple projects are currently being implemented. One example is GBS although it needs to incur costs as an upfront investment. With many initiatives including GBS, we are working hard to achieve the OPM target of over 20% in FY3/2023.

Q: I remember that CEO Mr. Takeuchi mentioned procurement cost as one of the key items contributing to achieving the OPM target at the meeting in Dec last year. How do you view procurement cost reduction?

A: Parts and indirect materials costs are the theme in the project. Not only procurement, but also other projects are important. With all those projects combined, we aim to achieve the OPM target of over 20%.

Q: With regard to the career support for the external opportunity, ¥12 billion has been reserved for 950 employees. Is it possible to disclose the breakdown per business unit?

A: It is still in the application period and we must refrain from commenting.

Q: You reduced full-year SG&A expenses forecast by ¥12 billion. Can you give us the breakdown? You reduced the forecast for R&D expenses by ¥5.5 billion and for others by ¥6.5 billion. What will enable you to reduce by those amounts? Is it possible to say that the normalized SG&A level went down? Also, is it possible to say that R&D is becoming more efficient?

A: We are expecting overall cost reductions in many areas. Activities constrained by COVID-19, such as sales marketing and travel, led to the reduction. In terms of R&D, some projects are behind the schedule, which is attributable to the reduction. In addition to COVID-19 constraints, we have significantly revised travel policy, making it difficult to assume that SG&A expenses will return to the pre-COVID levels.

Q: Are there any other initiatives than travel policy that could lead to an improvement in SG&A efficiency?

- A: We plan to take further steps to reduce costs theme by theme.
- Q: In ESD, Europe and China were strong in October-December. How much was the one-time contribution?
- A: In the UK, we received orders for adding and renewing the capital products. In Russia, revenue grew, supported by the national policy of aiming for early detection through oncology. There were also large-scale projects in Eastern Europe, which led to larger-than-expected orders. It is difficult to determine which one was one-time, but looking at the situation up to 3Q, it is certain that national backup made a significant contribution to our revenue.
- Q: What are the specific measures for GBS? Do you mean to consolidate some of the decentralized operations into one base and outsource it? When will the effects of the measures be positive?
- A: GBS is the project that we have started in Europe. It outsources personnel, general affairs, and accounting-related routine operations to BPO (business process outsourcing) at sites with low labor costs. For non-routine operations (a.k.a. captive), which are not add-ons, internal units are created in areas with low labor costs. Currently, we have a European site in Poland. We expect to incur production costs for expanding on a global scale and personnel costs that double during the transition period in this fiscal year and next. We think personnel expenses will be saved in and after the next fiscal year.
- Q: Will the US launch of EVIS X1 be delayed to the first half of 2022, meaning about one year behind initial expectations? It took time for surgery endoscopy system to get an approval from the US FDA. Are there any problems occurring in the same way in the approval process? Is it due to the impact of duodenoscope issue or COVID-19?
- A: The schedule has been revised and we are now targeting the first half of 2022. The situation is different from what we had in surgical endoscopy system. The main reason this time is technical issues we found in EDOF scopes of EVIS X1. R&D team is working diligently to address the issues and we believe it will soon be resolved as we are testing it in the final stage, but it will need to be cleared in advance for FDA filing. That is why we assume that it will affect the US approval schedule.
- Q: EVIS X1's EDOF scopes have already been introduced in Japan and Europe. Any impact to the products that have been placed in the market?
- A: In Japan, Europe, and Asia, we have informed doctors who plan to use those products of precautions for use.
- Q: You mentioned that the budgets of each country were executed at the end of 2020. Does this mean that demand came out early? Are there any special demand prospects in the next fiscal year?
- A: We expect to grow at a moderate pace in 4Q compared to 3Q from 2Q. If it is not for government subsidies, that means the economy is recovering and we can grow, accordingly. If the economy returns to normal, with new product effects, we think we are able to return to the growth trend as it should be under normal conditions.

(End)