

Olympus Corporation
2Q FY2023 Earnings Conference Q&A (Summary)

(Disclaimer)

For your reference, please find an English translation of the question and answer session at the conference for financial results for the second quarter of the fiscal year ending March 31, 2023 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: How do you evaluate the progress against the internal plan for the first half of the fiscal year? Also, what is your view for the second half?

A: Consolidated revenue in the first half progressed largely as expected. The YoY growth rate after FX adjustment may seem low, but that is because we were negatively affected by multiple risks as foreseen - namely, supply shortages of semiconductors and other components, the Shanghai lockdown, and the war in Ukraine. If there had been no such impact, we believe we could have achieved 5-6% growth.

Regarding revenue in the second half, ESD is expected to grow, driven by the new product effect of EVIS X1 in Japan, Europe and APAC, the planned launch of EVIS X1 in the US, VISERA ELITE III in Japan and Europe. TSD is expected to grow, driven by continued momentum of SOLTIVE and Plasma, as well as a recovery in procedure volume. China is expected to grow at a high rate as budget execution progresses and a delay in some product delivery is being resolved. We are seeing a trend of recovery in tenders as the number has turned to year-on-year growth since August. Also, the Chinese government's planned low interest loan program for medical devices is expected to support budget execution in the second half.

Cost of sales was slightly larger than expected, even though rising raw materials prices were factored in at the beginning of the period. In addition, due to the impact of inflation and other factors, we are seeing less flexibility in cost management, and as a result, SG&A expenses were slightly larger than expected, too. As a result, we have added extra on the cost side in the revised forecasts. Although some increases in cost are unavoidable to achieve the forecasts, we are strengthening internal cost-cutting measures and will continue to optimize expenses.

Q: Can you tell us your analysis of change in cost of sales for the July-September quarter?

A: Of the approx. ¥4 billion change in COGS, half was due to rising materials costs and approx. ¥1 to ¥1.5 billion was due to a decrease in sales in China. On the other hand, improvements are being planned, and an improvement of approx. ¥1 to ¥1.5 billion is expected on an annual basis, but the effect has been limited at this point.

Q: I believe that an increase in materials prices is not limited to semiconductors. What is the item of the increase and what is the expected impact? Is it correct to understand that an improvement of ¥1 to ¥1.5 billion means a pass-through to sales prices?

A: Semiconductors account for most of the impact of rising materials costs, but prices of other components are also increasing. The items of the ¥1 to ¥1.5 billion include volume increases and

cost improvement activities. It will take time to see the effect of selling price hikes to appear. Since the nature of our business is to negotiate and set prices to be in effect for a certain period of time, we will mark up the prices at contract renewals. So it is correct to understand that the effect of selling price hikes has not yet appeared at this point.

Q: Why did you revise down operating profit forecast by ¥1.5 billion? Wasn't this too small to revise?

A: We think forecasts should be reviewed and presented faithfully each quarter. We have determined that the forecasts should reflect an increase in rising materials costs and less flexibility in SG&A expenses. There were various positive and negative factors considered before leading up to that amount.

Q: On Slide 18, operating profit from Discontinued Operation in the August 9 forecast has changed from ¥26.5 billion to ¥17.5 billion. What is the reason? Also, why has revenue of ¥145.0 billion remained unchanged?

A: Since those figures represent the August 9 release, which was for the full-year, revenue includes figures up to the fourth quarter. Originally, the expenses associated with the reorganization of Discontinued Operation (Scientific Solutions Division) was included in the Elimination and Corporate line, but since it was disclosed retroactively this time, the expenses were subtracted from the ¥26.5 billion operating profit of Discontinued Operation to arrive at ¥17.5 billion.

Q: Please give us a breakdown of the ¥1.5 billion reduction in the operating profit forecast.

A: Our internal budget has been made excluding FX impact. If FX assumptions were the same as those in the August 9 forecasts, revenue was changed by +¥3.6 billion, gross profit -¥3.6 billion, operating profit -¥8.7 billion, and adjusted operating profit -¥8.3 billion. After FX adjustment, operating profit was changed by -¥1.5 billion. The main factors were rising materials costs and an increase in SG&A expenses. The increase in SG&A expenses is largely due to an increase in various projects (e.g., QARA) and an increase in R&D expenses reflected in P&L due to a delay in R&D capitalization.

Q: What is the impact of rising materials costs in the July-September quarter?

A: We estimate the impact to be approx. ¥2 billion.

Q: What has been the progress of your corporate transformation initiatives? You have indicated large investments for "Compete to grow" in the future. Is there any change in this phase?

A: (CEO) We have been undergoing a corporate transformation under the management concept of "Transform Olympus". Various effects have been achieved, such as the transition to a company with a nominating committee, etc. and an improvement in efficiency. While we continue to pursue innovations with optical and precision processing technologies at the core of our operations, transforming into a medical device company is not something that can be done overnight. In order to become a truly global medtech company, we continue our efforts and investments in R&D, QARA, and other areas to strengthen our capabilities.

(CAO) As we are currently in the process of formulating our next strategy and cannot discuss "Compete to grow" in detail, I would like to keep it general today. We have announced a change in the structure of the Executive Officers at this time in order to implement our future strategy. We will be engaging with innovation through organic growth, M&As, and expanding our reach to unmet needs in order to achieve future growth. I am currently visiting Singapore and had a discussion with doctors at ELSA (Endoscopic and Laparoscopic Surgeons of Asia) and felt the need to increase healthcare access in emerging markets. Areas for "Compete to grow" are not hard to find, and we are determined to make progress toward realizing our business philosophy. We expect to announce the details of our strategy next year.

(COO) As COO, I have implemented various changes in ESD and TSD and believe that we are ready to enter a new era of "Compete to grow". I have discussed about product developments and business portfolios in various competitive areas and recognize that the results of the past three years have been excellent. Going forward, I would like to focus on implementing our strategy in each of our businesses from a more company-wide perspective and exploring areas where we can grow even more. I hope to contribute to becoming a leading company in the medical technology field through company strategy.

Q: Regarding a rise in raw material prices and the supply shortages for semiconductors and other parts, we hear from other companies which deal with capital products that they will be affected in

the second half of the fiscal year, meaning they will be affected by the parts procured at higher prices, which now became inventories and will be sold in the second half. What is the situation at Olympus?

A: Having recognized the risk of supply shortages of semiconductors and other key components even before this fiscal year, a task force has been formed and necessary actions have been taken. In order to secure quantities, we procure from the spot market in addition to normal channels. We use the moving average method in inventory, and the procurement prices are reflected sequentially as we purchased. Although procuring through the spot market has the largest impact, this has been taken since the first half of the fiscal year, so we don't recognize that there is a difference in impact between the first and second half of the fiscal year.

Q: On Slide 12, it was only the surgical endoscope segment that was mentioned as being affected by the supply shortages of semiconductors and other components. So, you had no impact in the GI endoscope segment?

A: No, GI endoscope was also affected.

(End)