February 4, 2022

Olympus Corporation
3Q FY2022 Earnings Conference Call Q&A (Summary)

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Q: Why did the operating margin of ESD and TSD in the third quarter (Oct-Dec) decline from the same period of the previous year? Will the trend in operating margin stay unchanged in the fourth quarter (Jan-Mar)?

A: In ESD, COGS did not fluctuate significantly except for the forex impact. As for SG&A expenses, in addition to increased expenses associated with the resumption of activities that had been restricted due to the COVID-19 pandemic, R&D outsourcing expenses also increased. In TSD, COGS did not fluctuate significantly either, except for the ¥2.0 billion charge for the recall of sterilization packs of GI endotherapy devices in the same period of the previous year. In SG&A expenses, personnel expenses rose due to an increase in incentive compensations for sales following the recovery in performances and due to M&A. This trend is expected to continue in the fourth quarter.

Q: What was the business environment by region for ESD in the third quarter (Oct-Dec)? Did you face a high competition from the previous year in Europe and the U.S.? Do you expect that the stagnation in budget execution in China will be prolonged?

A: Looking at the results by region, for Japan and Asia-Pacific, where EVIS X1 has already been launched, results were favorable. In Europe, compared to the same period of the previous year, when large-scale projects supported by government subsidies in multiple regions made a positive effect, this fiscal year showed a softness. In China, demand is temporarily weakening in some areas, but we recognize the business environment for other companies is the same as ours. While it is difficult to predict when the top line will recover at this time, we believe that our technologies and products will continue to be needed to strengthen the healthcare infrastructure of China and that demand will recover in the medium term. In the U.S., sales were strong in the third quarter of the previous year. Because we plan to launch EVIS X1 in FY2023 in the U.S., customers, being aware of the plan, may be refraining from buying to some extent in this fiscal year.

Q: On P6 of the presentation material, it is commented that the business of surgical endoscopes in China was under a “tough competitive environment, etc.". Was the competition with local Chinese manufacturers intensified due to the “Buy China’ policy, etc.?

A: The severe competitive environment is seen worldwide, but we recognize that it is particularly so in China. We compete not only with Chinese local manufacturers, but also with manufacturers from other countries. Given this situation, we will enhance our competitive advantage through R&D efforts and technological superiority.

Q: We understand that in China there are delays in budget execution in the business of capital products, such as GI endoscopes and bronchoscopes. Regarding GI endoscopes, I think business will return to a growth trend if new products are launched, but for surgical endoscopes and bronchoscopes, do you think it is difficult to return to growth?

A: In China like other regions, our competitive advantage and market shares in the field of GI endoscopes and bronchoscopes are high. On the other hand, we are seeing more competition in the field of surgical endoscopes, and the competitive environment is severe. In surgical endoscopes, we hope to strengthen our competitive advantage by adding fluorescent observation and other functions, as well as launching new products. The environment has not changed dramatically in the third quarter, compared to the previous quarters.

Q: What is the launch schedule for EVIS X1 in China?

A: The launch schedule in China is undecided and it will be a while away. In China, it is not long since the previous generation of GI endoscopy system was launched. Also, it is anticipated that it will take longer time to obtain approval in China than in other regions.

Q: I heard that 1Q and 3Q tend to have slower sales activities compared with 2Q and 4Q. Was the weakness in China during 3Q due to this seasonality?

A: It is not that sales activities slow down in 1Q and 3Q. Rather, we recognize a trend that sales tend to be relatively high in 2Q while expenses are being held down. However, the trend in budget execution is changing due to the COVID-19 pandemic, making it difficult for us to capture seasonality. In China, ESD weakened YoY in 3Q. However, in the first nine months, it still showed robust growth, compared with the pre-COVID level, and we believe we can achieve our forecasts. Especially in China, the budget is currently tight, but we recognize that strengthening the medical system will continue to be a medium to long term trend.

Q: I heard that the guidelines for the Buy China policy, which were announced in May last year, were the 2021 edition. If customers were in a wait-and-see stance for budget execution in the past year, do you expect that demand will recover in the next fiscal year?

A: We do not believe that the recent budget situation will continue over the medium to long term. We have traditionally provided a high level of products and services for China and have built cooperative relationships with academia and doctors in China to contribute to the improvement of medical standards. We will continue these efforts in the future as ever.

Q: Looking at P5 of the “Financial Data” material, for the third quarter (Oct-Dec), China appears to be weak in both ESD and TSD. How much quantitative impact do you assume for the fourth quarter?

A: In addition to the severe budget for hospitals due to the impact of COVID-19, there are also impacts of stagnated budget execution and intensifying competition. We anticipate that budget execution will recover to a certain extent and that China will be able to achieve larger growth than the previous year. We also anticipate that even if the recovery in China is slightly delayed, that will be covered by an increase in sales in other regions. Therefore, the full-year consolidated revenue forecast remained unchanged.

Q: How do you evaluate the progress made in the third quarter (Oct-Dec) compared with the full-year forecasts announced in November?

A: Revenue was slightly below our internal plan. The main reason was that sales in China did not reach the target. Expenses were generally in line with expectations, so the shortfall in revenue affected profit. By business segment, ESD was weaker than planned. In TSD and SSD, revenue also fell short of the forecasts, but profits were better than planned due to cost control.

Q: Is it correct to understand that the full-year revenue forecast announced in November left unchanged excluding the forex impact, although 3Q ended below the target?

A: In 4Q we plan to cover the decrease in 3Q.

Q: Please tell us about the reasons why the Elimination & Corporate expenses increased by ¥6.0 billion in the revised full-year forecasts. Is it correct to understand that when profit levels are likely to be high, large expenses associated with corporate reforms tend to be incurred, but those will be properly controlled so as not to affect the trend of consolidated profit growth?

A: This increase in the forecasts was due to an increase in expenses for the company split of Scientific Solutions Division and other corporate reforms. In the past 1-2 years, large expenses have been booked to proceed the reform of the operating model globally. We believe that similar expenses will continue to be incurred in the future, but we recognize that the current level is likely to be the peak in terms of amount. Please note that in the revised full-year forecasts we left consolidated profit forecasts unchanged, while incorporating an increase in Elimination and Corporate. We have priorities among expense items and want to ensure that consolidated profit continues to grow by controlling expenses while monitoring performance trends.

Q: In terms of expenses related to the company split of the Scientific Solutions Division, how much was recorded in the first nine months? What is your outlook for the fourth quarter?

A: ¥800 million in the second quarter and ¥3.3 billion in the third quarter, totaling ¥4.1 billion. It is expected to incur approximately ¥5 billion in the fourth quarter, for a total of approximately ¥9.1 billion for this fiscal year. Expenses related to this matter are being recorded as other expenses for Elimination and Corporate.

Q: We understand that the full-year forecasts remained unchanged except for the forex impact. How do you evaluate the impact of the semiconductor shortages on your performance for the current and next fiscal years? Are changes in the external environment, including semiconductor supply chain, considered to be posing a major risk to achieve a milestone of operating profit margin of over 20% in the next fiscal year?

A: When we announced the 2Q results, we explained that we don’t anticipate any impact for the current fiscal year. However, things are not going as expected at that time, and we are currently aware that there is a possibility to have an impact for the current fiscal year. Although we anticipate that there will also be some impact in the next fiscal year, we cannot assess at this time how large the quantitative impact will be. We are considering all possible countermeasures, based on the assumption that there may be a larger impact in the next fiscal year, particularly in the first half, than in the current fiscal year. We are also paying close attention to worldwide inflation concerns, but we don’t expect this to have a significant impact on operating margin. If risks become prominent, appropriate measures will be taken.

Q: I understand that the fourth quarter operating profit in ESD is expected to increase by approximately ¥10 billion from the third quarter (Oct-Dec) and by approximately ¥15 billion from the same period of the previous year. What are the assumptions behind that? In comparison with the previous year, do you think it is attributable to the absence of the expenses for the career support for external opportunity program?

A: The fourth quarter revenue in ESD is expected to up 7% YoY and 10% QoQ. We have a seasonality that sales tend to show highest growth in 4Q. Other than the absence of the expenses for the career support for external opportunity program, there are no major items currently expected to be a positive factor for an increase in operating profit YoY.

Q: In today’s corporate disclosure on changes of outside directors, candidates for the next fiscal year were announced. I was impressed by Mr. Gary John Pruden, who has rich experiences in surgery, including his experience at Ethicon, a provider of surgical energy devices. Is it correct to understand that Olympus plans to reinforce its surgery business, including energy devices?

A: We understand that this is the result of our review based on the Board's skill matrix in striving to become a global medtech company, and this is not a nomination for any particular strategy.

(End)