August 9, 2023

Olympus Corporation

1Q FY2024 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 first quarter of the fiscal year ended March 31, 2024 below.
This transcript has been edited/modified from the original Q&A conversations for the sake of clarity.
This material contains forward-looking statements that reflect management's current views, plans, and expectations based on information available at the time of preparation. These forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties, future business decisions, and other internal and external factors that may cause the Company's actual results, performance, achievements, or financial position to be materially different from any future results expressed or implied by these forward-looking statements.
Additionally, this information is subject to change without notice. Accordingly, other information should be used in addition to this material when making investment decisions.
Olympus Corporation assumes no responsibility for any damage resulting from the use of this material.

[Q&A (Summary)]

Q: You mentioned that 1Q was a slow start compared to the internal plan. How much did revenue and profit fall short of the plan, respectively, and what were the reasons for each?

A: Revenue missed about 3% compared to the plan. That was due mainly to an opportunity loss in sales stemming from product ship hold and parts supply shortages, which represented about 1.5-2% points out of the total miss of 3%. This was particularly noticeable in TSD, the growth of which was inhibited by 3-4%. In addition, the accuracy of our quarterly internal planning was somewhat relevant. For example, in the U.S., more customers refrained from purchasing in anticipation of the EVIS X1 launch than we expected. Also, in China, sales didn't grow as fast as the increase in procedure volume due to higher-than-expected customer inventories. COGS was in line with expectations, while SGA exceeded the plan by about 4 billion yen. The breakdown is as follows. Half of the excess was due to timing difference in expense recognition (upfront spending for some projects). The remainder was due to the higher-than-expected number of QARA-related complaint handling cases, which led to a cost over-run.

Q: Regarding TSD, Urology segment seems a bit weak. You mentioned that the reason was product ship hold, but I would appreciate more details. Also, I would like to know more about the impact of the shipment restraint on business. In particular, I think Urology segment has been weaker than competitors in the past two or three quarters. What were the reasons for the weakness in the first quarter?

A: We talked about product ship hold and parts supply shortages. Those issues happened in major products in Urology. There was an impact in Plasma (resection electrodes) and SOLTIVE, especially in Europe and the U.S. On the other hand, we see momentum in Australia, partially offsetting the headwind.

Looking back on the past two to three quarters, there have been shipment restraint due to supply shortages. We have seen a recovery in some products, but it has not been a full recovery yet. We will continue to work with our suppliers to improve the situation. On the other hand, shipments have not been able to keep up with growing demand in key areas, suggesting sales growth in the future.

Q: Why are shipments being suspended? When exactly do you expect a recovery? Has the impact in some major products been factored into this fiscal year's forecasts?

A: There are several factors. One of the issues is related to supply chain and components, and it would be difficult for us to see an improvement soon. There is a time lag before parts arrive at our manufacturing sites, and capacity is limited. We are trying to increase production volume as much as possible in coordination with our manufacturing sites. In some cases, we also use contract manufacturers as a countermeasure in cooperation with our suppliers. In terms of resolution time, although we are striving to fulfill some back orders, it is difficult to tell you about the specific timing for improvement since we are involved in multiple regions and products. Note that the ship hold for “Plasma” electrodes has already been lifted, and we hope we continue to deliver smoothly in the future. We expect a full recovery in the second quarter.

Q: I would like to ask your annual projection for the QARA cost for responding to the FDA Warning Letters. How much is the full year forecast at this point? In addition to the QARA cost, how much do you estimate for the cost related to the efficiency improvement projects, in the first quarter and the full year forecast, respectively?

A: The total remediation cost (the QARA cost for responding to the FDA Warning Letters) for this fiscal year remains unchanged at 22 billion yen. Our views remain unchanged, while conducting reviews and monitoring progress frequently. In the first quarter, about 5 billion yen was booked in Other Expenses and several hundred million yen in SG&A. Progress is basically on-track. The remainder of the budget (22 billion yen minus about 5 billion yen) will be allocated from the second through fourth quarters. Since progress of the SG&A part is slow, we expect that part to increase in the remaining nine months.

For your information, we expect SG&A expenses (before FX adjustment) for the current fiscal year to be about 30 billion yen higher than the previous year. Of this 30-billion-yen increase, 8.5 billion yen has already been accrued in the first quarter, so we would say expenses are a little ahead of schedule. The excess in the first quarter vs. our plan was about 4 billion yen (4%). Half of it (2 billion yen) was due to a timing issue and will be absorbed in the remainder of the year, but the remaining 2 billion yen was a cost over-run vs. the plan. We plan to take actions to keep the full year increase in SG&A within our budget of about 30 billion yen (increase vs. the previous year).

Q: GI endoscope business in North America declined compared to the previous year. I think rising

interest rates may have affected lease sales. Is the weakness due solely to customers refraining from purchasing before EVIS X1's launch, or is the decline also attributable to the overall capex environment in the market?

A: Although we are aware that hospital management is getting tougher and the capex environment turned a bit negative, we still understand that the impact on our endoscope business remains limited. Since we announced the launch of EVISX1 in North America at DDW in May, we have seen customers refraining from purchasing.
Customers are excited about EVIS X1 very much, and the GI community is waiting for it. We have not been affected too much from the pressure for capex environment.

Q: You explained about ship hold and parts supply issues with a focus on Urology. As I heard that there were also similar issues in Respiratory, I am curious about what the background is and what products are affected. Also, there was a news release in July regarding the bronchoscopes with using laser device. I wonder if this issue had an impact in the first quarter.

A: In Respiratory, we have seen a series of issues such as ship hold for Veran-related products, shipment delay in bronchoscopes, and order backlog for Endo Therapy products. Ongoing supply chain issues have also impacted the respiratory area, and backorders are piling up for needle products. These issues are not happening in all product categories, but some products related to EVIS X1, which has seen double-digit growth in the past, have been in this state of constraint for about a year. There have been some material-related issues, too, and we have talked with suppliers. The overall respiratory products are waiting for the launch of EVIS X1, and in some regions, this capital constraint is having an impact. In addition, some hospitals in Europe and Japan are slowing down their capital investments, which is also having an impact. Regarding the bronchoscopes with using laser device , we haven't had a significant impact on the business so far and don't expect it to have a major impact in the future.

Q: You mentioned that revenue missed roughly 3% compared to the internal plan, out of which 1.5 to 2% points came from supply chain issues such as product ship hold and recalls. What other factors were attributable to the miss? You mentioned that TSD in China didn't increase as much as the number of procedures. Does that explain the reason? I would appreciate more details.

A: Consolidated revenue growth of 1.5-2% was hampered mainly by ship hold and parts supply shortages. The remaining factors were numerous, but to give you an example, there were more U.S. customers refrained from purchasing than we thought. The customers' inventories in China were higher than expected, leading to a mismatch between procedure volume and our product shipments.

Q: Do you think those various factors are likely to be resolved?

A: Measures are being taken for product ship hold. For example, we resumed shipping some products by revising their instructions for use. We are taking countermeasures in many ways and can catch up with the market. As for the U.S. customers' behavior, we will try to recover in the second half after launching EVIS X1. In China, as soon as customers' inventories are consumed, we expect

stronger growth than in the first quarter as the number of procedures is increasing.

Q: Is the ship hold problem due to structural issue at Olympus (changing the internal structure and raising standards and other hurdles in quality management system)?

A: The difficult situation on the suppliers' side has been impacting parts supply shortages. Regarding QARA, we are checking various products and processes and focusing on patient safety with high standards. In addition, we need to keep a close eye on compliance. We need to make sure that all processes and documentation are in place, and if there is a problem, we need to make ship hold for the product until we take corrective actions, change the instruction for use, etc. We make sure that we meet the high standards of all regulatory agencies as well as patient safety levels.

Q: How much did operating profit fall short of the internal plan? Do you have a breakdown for ESD/TSD?

A: Adjusted operating profit was about 9 billion yen lower than the plan. Regarding segment breakdown, as SG&A allocations differ between a reporting basis and a managerial basis, we are going to refrain from commenting on details.

Q: I heard that the tender process in China is slow due to the anti-corruption campaign. Do you see any impact? Please tell us about any changes in China.

A: We haven't heard that the anti-corruption campaign is affecting our business so far, but we see anti-corruption activities emerging around our ESD's capital business. So we are closely monitoring this issue, as a similar event in China quite some time ago had an impact on our business for several months. Although China has shown significant growth compared to the previous year, that was due to a low comparison because the previous year was affected by lockdowns. We will closely monitor the impact of anti-corruption in the coming months. We are also closely working with our management in China to keep an eye on the impact of the absence of the low interest rate policy on our business in the future. At this moment, it is still early to provide further details.

Q: Regarding weakening capex sentiment at hospitals, you mentioned that ESD has not been affected much. But at the same time, you also mentioned that there is some impact in Japan and Europe. Would you tell us about color of each region and whether they have been factored into your forecasts?

A: It is difficult to provide accurate numbers for each region. We see Europe experiencing a slight decline in overall economic conditions, which is putting pressure on hospital budgets. In addition, we benefitted from large investment projects in the U.K. and Russia in the previous year, and thus we have a high comparison this year. In addition, there is a lingering impact from COVID. Although the external environment in Europe and Japan is not very positive at present, it has been factored into our plan. In the meantime, robust growth is expected in APAC and Latin America. Currently, events such as ship hold, QARA-related responses, and geopolitical risks, are impacting our business, but those have been factored into our full year forecasts. However, it is difficult to provide a regional breakdown.

Q: You mentioned that adjusted operating profit was about 9 billion yen lower compared to the plan. The breakdown is about 2 billion yen for QARA costs, about 2 billion yen for timing difference in expense recognition. So, is the remaining 5 billion yen attributable to ship hold and supply chain issues?

A: Your understanding is correct.

(End)