

Olympus Corporation
3Q FY2024 Earnings Conference Q&A (Summary)

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[Q&A (Summary)]

- Q: I would like to ask about business performance from this fiscal year to the next. One of the reasons for this downward revision was an impairment loss on capitalized assets. Three months ago, there was an impairment loss on Veran Medical Technologies. Although these were negative factors for profits, I view them as constructive actions to place your company on a healthier footing for the next fiscal year and beyond. Although the current fiscal year has been difficult, I think fundamentals will improve from the next fiscal year onwards and there will be less uncertainties expected in terms of costs. What are your thoughts?
- A: As you are aware, the current fiscal year has been difficult. Although our core business was strong, both sales and profits were affected by several factors. As we indicated at the previous financial results briefing, I cannot say anything too optimistic about FY2025 since we are in the process of our quality transformation program "Elevate". Having said that, I believe that FY2025 will bring good results in both sales growth and profits, although it will be difficult to achieve an operating margin of 20% and sales growth of 5%. And I believe that in FY2026 we will be able to return to a growth path and make strategic investments aimed at profit growth.
- Q: Can you tell us more details about the impact of the Noto Peninsula Earthquake? I would like to hear about what kind of parts are experiencing supply shortages, the status of the supplier, the timing of production resumption, and any other details you can share. As it's been said that the medtech industry generally has a large pool of inventory of device components, I was a bit

surprised to see the potential impact to this extent. So, I would also like to know about inventory management from a BCP perspective. In addition, I would like to know whether the 24-billion-yen impact should be considered as the worst-case scenario.

A: Due to the complexity of the situation, I will start with the nature of this supplier. The situation is complicated because the supplier manufactures critical parts for medical endoscopes, which are further processed by us and used in more than 100 types of endoscopes. Therefore, it is necessary to look at the impact for each SKU (Stock Keeping Unit), which makes it difficult to measure the impact. For two weeks after the earthquake, the damage was extensive, and people were in a mentality unstable situation. As of the first week of January, we were aware that an important supplier was in the affected area, but it took us two weeks to get in touch with them. Since then, we have been providing the necessary support. This is the overall situation. Next, let me talk about the impact. There are various scenarios, but all of them involve a lot of uncertainties as they depend on when the supplier can resume operations and how much an alternative supplier can ramp up its production capacity. We boast a 70% market share in GI endoscopes, but that also comes with a huge responsibility. That is to ensure that doctors can perform procedures reliably, and we are working with that as our top priority. To ensure that spare parts are available for repairs and service, I ordered a temporary suspension of shipments to customers until the situation becomes more clear. From a management standpoint, there are two ways to handle this situation. One is to gamble somewhat and continue producing endoscopes, assuming the best-case scenario. This is a good scenario for sales, profits, and customers. However, we have just launched a new set of Core Values with a strong focus on "Patient Focus," and we are working in good faith to make that a reality. Our assumed scenario is that we will have more accurate information on the resumption of production, in perhaps two or three weeks, and then we will be able to resume production. Until then, we will slow down the production of new products and ensure capacity for repairs and service. Therefore, it is difficult to make a more positive outlook. The financial forecasts that were just described in the presentation is based on this scenario. While I don't think the situation will be this negative, I cannot say for certain that it won't happen. Also, since this is related to capital products, not consumables, I believe that the loss occurring in FY2024 Q4 can be recovered in Q1 or Q2 of FY2025.

Q: If you can get a more complete picture of the supplier's situation in three weeks and find out more accurate information, are you going to share that information with the capital market?

A: I can't say exactly three weeks, but it does mean that we can get a better view of the situation within the next two or three weeks. We will share the timing for the resumption of production as soon as it is known. Also, regarding the safety stock you asked earlier, after the 2011 off the Pacific coast and Tohoku Earthquake, we had been trying to maintain a safety stock of important parts for two and a half months. This time, based on the most recent situation, we will reconsider risk mapping and safety of suppliers. We will also further increase our safety stock to maximize our preparedness in case such a situation should occur again.

Q: Looking at the fourth quarter forecasts, which is calculated by subtracting nine-month results from the updated full-year guidance, sales forecast is stronger than ever, while SG&A forecast is higher, resulting in low operating profit. Perhaps in reality, both sales and SG&A expenses will not be that high, and as a result, operating profit will be at that level calculated. Can you give us your thoughts on the fourth quarter?

A: It is difficult to explain because the impact of the Noto Peninsula Earthquake is unclear. Our priority on repairs and service is not unrealistic. I believe there is upside potential for sales, but we have not made a commitment at this moment. The SG&A ratio peaked in the first quarter and has been declining each quarter, and I believe that in the fourth quarter we will be able to lower it further to protect profits, while being careful not to impact sales. This is not all factored into the new forecasts, but I believe it is a realistic outlook.

Q: Do you mean that it would be better to look at operating profit forecast, rather than each accounting item?

A: Exactly.

Q: Your current outlook for China is weaker than it was in November. While I understand that the anti-corruption campaign has had an impact, I am curious about details on why there was such a difference. In addition to the anti-corruption campaign, there are some concerns, for example, the economy is slowing down and growth potential of the market itself is weakening. Do you think that these are not having an impact and the soft outlook is due solely to the anti-corruption campaign?

A: At the time of the previous financial results briefing, I explained that we see the anti-corruption campaign as an opportunity. However, regulations are currently becoming stricter and other companies are being similarly affected. The campaign is expected to continue through June, 2024. A further risk is that the anti-corruption campaign could be extended to other sectors. Having said that, in the long term, we remain positive about China and plan to open a manufacturing facility there in response to the "Buy China" initiatives. However, the anti-corruption campaign has lasted longer than originally thought, and at ESD, at the time of the previous financial results briefing, we believed that the approval of EVIS X1 would bring an improvement in capital products sales in China toward the end-of-year business negotiations. The reality was that the campaign did not slow down, and orders did not reach peak in December. Other companies are similarly being affected, as well. In addition, in terms of year-on-year comparisons, there was an absence of last year's low-interest-rate loan programs. In the Surgical endoscopy segment, we have also been affected by the "Buy China" initiatives. The market share of GI endoscopy has not declined, but we are discussing when and how the market will recover. In TSD, 50% of sales in China are capital products, and the situation for capital products is like that of ESD. Regarding consumables, in the short to medium term, we are facing supply shortages of some products, especially in the Respiratory segment. However, from a medium to long term perspective, the number of procedures is steadily increasing in GI, Respiratory, and other areas, and we still have high hopes for the market.

Q: Is the "Career Support for External Opportunity" program, which was not mentioned in the prepared

remarks, considered a so-called restructuring? You posted 2 billion yen in the third quarter, and 800 million yen is expected to be incurred in the fourth quarter. Will this expense continue into the next fiscal year?

A: We have some areas where we need to improve, such as budgeting process, and functional and global budget accountability. A change in this fiscal year was to give all functions the opportunity to formulate their budgets in September, rather than waiting until the end of the budget cycle in May. This enabled us to prepare for the second half of the fiscal year. This is a global effort, not just in Japan, and is expected not only to foster a culture of budgeting, but also to steer SG&A expenses in the right direction. Our three defined guiding principles are "Patient safety and sustainability", "Productivity", and "Innovation for growth", and in order to invest in "Innovation for growth", more productivity improvements will be needed. The GTOM project, which will begin next year, will examine global operating models from the perspective of a pure medtech company. Although we had been operating globally as a Japanese exporter, we were not able to achieve harmony. Our project in FY2025 is aimed to establish an optimal operating model for our current status as a pure medtech company.

Q: You mentioned that the efforts to reduce SG&A expenses so far are showing results. In fact, SG&A expenses have been lowered in this forecast revision. How have you been successful in curbing SG&A expenses?

A: In order to achieve the budget in FY2025, we allocated the budget to each function early in FY2024. In FY2024, we did not neglect cost management, but took several initiatives. For example, we are reviewing our contracts with suppliers, outsourcers, and consultants to make those expenses more efficient than before. We also clarified project priorities and divided them into phases over a longer period of time. In the past, various projects were progressing simultaneously, but now we are trying to spread out the peaks of those projects. The SG&A ratio increased in the first quarter due to insufficient consideration, but it has improved in the second and third quarters, and we believe that it will improve further in the fourth quarter.

Q: Are the critical parts affected by the Noto Peninsula Earthquake the ones that make up the body of the endoscope? I would also like to know the probability that supply will return in the first or second quarter of the next fiscal year. Regarding the resumption of production, is the supplier itself expected to restart, or will production be done by another supplier? In addition, I would like to hear your thoughts on supply management, given that important parts used in 100 types of endoscopes were entrusted to one company.

A: Regarding supply management, although the supplier that was affected is not the single source for the parts, 80% of the parts were supplied by this supplier. Something processed from the parts are used in endoscopes. Unlike the automotive industry, it is not unusual for the medtech industry to rely on a single supplier. Because of the special nature of the parts and small quantities, it is not easy to outsource them to a large company. Specialized suppliers are needed. However, it is undeniable that we were more dependent on them than other medtech companies, and this was a lesson learned. First, in the short term, I think it is necessary to review supplier risk mapping. In case an

important supplier is in crisis like this, we have to increase our inventory. In the short to medium term, we must prepare for situations like this and improve our BCP. In the medium to long term, I believe that the fundamental cause lies in the way endoscopes are designed, and we would like to consider modularizing endoscopes while maintaining similar quality. This will not be something that can be done overnight; it will be a big project. I would like to view any crisis as an opportunity for change and take advantage of it.

Q: Regarding the revised full-year forecast on Slide 27 of the presentation, how would it look if it were divided into the third and fourth quarters? How much actually happened in the third quarter and how much is expected to happen in the fourth quarter?

A: Regarding sales, the impact of the Noto Peninsula Earthquake will be included in the fourth quarter. It is difficult to divide between the third and fourth quarters for "External factors (Impact off purchasers' decisions to delay tenders as they manage the effects of the anti-corruption campaign in China, etc.)" and "Supply shortages due to supply chain issues" listed at the bottom of the slide. In the meantime, regarding costs, "Expenses related to compensation for some products in Surgical Endoscopy" will be incurred in the fourth quarter. The impact of "Change in product mix" will be in both the third and fourth quarters, and "Impact of the 2024 Noto Peninsula Earthquake" will be in the fourth quarter. Regarding SG&A expenses, they are mostly concentrated in the fourth quarter.

Q: To what extent did the third quarter sales and profits fall short of internal forecasts?

A: Regarding sales, in normal years, the progress rate exceeds 70% by the end of the third quarter, but this year it was only around 70%. The delay was more noticeable with ESD. As a result, although year-on-year sales growth was expected to be 3% at the time of the second quarter briefing, this time, taking into account the progress in the third quarter and the impact of the Noto Peninsula Earthquake, the new forecast is -0.7% excluding foreign exchange.

Q: What are "Expenses related to compensation for some products in Surgical Endoscopy"?

A: That is about UHI-4 high-speed insufflator. As announced in October last year, the use of this device has been suspended in the U.S. As a comprehensive response to this situation, we have incorporated the cost into our COGS forecast for the fourth quarter.

Q: I am curious about when you expect China business to recover. If it was only a delay in tenders due to the anti-corruption campaign, I expected an early recovery. But given many uncertainties such as real estate issues, unpaid wages, bank loan problems, the Buy China initiatives, etc., should I expect it to take some time?

A: The Chinese market is highly uncertain and volatile. It was thought that the anti-corruption campaign would end at the end of March, but it is expected to continue for a long time. There are also effects from VBP (Volume Based Procurement) and the Buy China initiatives. Growth recovery to high single digits in FY2025 cannot be said to be certain. Rather than a V-shaped recovery once the anti-corruption campaign ends, I think it will be a gradual recovery. There is demand for endoscopes themselves, so long-term growth is expected to be in the high single digits, but the timing cannot be predicted.

Q: Is there any change in the China's growth scenario itself?

A: As can be seen from KPIs such as the number of endoscopists per capita and the mortality rate for colorectal cancer, unmet needs in China is very high. Therefore, we believe that the Chinese market has high growth potential and are focusing on it positively. We have about 50 years of history in China and have provided training to Chinese doctors and nurses in cooperation with Japanese doctors. However, volatility is high, and the outlook is uncertain. We do not necessarily expect a V-shaped recovery in FY2025, but we do expect high single-digit growth over the medium to long term.

(End)