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Olympus Corporation
FY2022 Earnings Conference Q&A (Summary)

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For your reference, please find an English translation of the question and answer session at the conference for financial results for the fiscal year ended March 31, 2022 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: Concerns arose in the stock market regarding the Medical Business in China, as 3Q sales declined YoY and there was an explanation of structural factors such as the Buy China policy as the backdrop. It seems that 4Q recovered to a high level. Please tell us about the current situation in the Chinese market and the outlook for 1Q (April to June).

A: In China, although we are temporarily affected by the COVID resurgence in Shanghai and some other areas in April and May, we expect to continue growing, following 4Q, when we returned to growth despite the impact of the Buy China policy. With a long history of business in the Chinese market, we boast a strong market position in each product category and expect to continue to benefit from it. Although the competitive environment is intensifying, we would like to remain motivated and continue to lead the market by developing technologies.

Q: The Chinese market has a lot of ups and downs every quarter. Are there any concerns about the outlook for 1Q (April-June)?

A: Currently, we are seeing supply chain disruptions in some areas such as Shanghai due to the resurgence of COVID. It is difficult to predict when this situation will improve in the future. Since we have strong order momentum, we would like to focus on delivering those products to the market. Our team in China are doing their best to deliver to our customers.

Q: Both ESD and TSD are expected to grow double-digit. Is the risk of supply constraints factored into the sales outlook?

A: Unlike usual years, it is difficult to predict the outlook accurately with not all semiconductors we would need for this fiscal year secured at this moment, but certain risks are included in the forecast figures.

Q: In SSD, what is the reason why the operating profit guidance for FY2023 is as high as ¥24.5 billion with OP margin of approx. 18%? Is there any change in the cost structure of SSD after the separation in April this year?

A: The separation was carried out to increase the potential of SSD. We think the guidance reflects good business momentum in the previous fiscal year, although there are some positive effects from the separation. We had many orders in the previous fiscal year, but due in part to the impact of semiconductor shortages, we entered this fiscal year with a considerable amount of backlog. We expect significant OP growth due mainly to the effect of increased sales, rather than the effect of improving cost efficiency.

Q: The depreciation cost of SSD is about ¥7 billion. If you add this to operating profit, its EBITDA will exceed ¥30 billion. So I think that the sale amount of ¥300 billion will be in your sight. Please tell us about the use of the cash obtained by this.

A: Regarding the transfer of SSD, there is no update to share because we haven't decided anything yet.

Q: As of the end of March 2022, Net Debt was more than ¥80 billion, the consolidated EBITDA forecast for the current fiscal year is ¥270 billion, and Net Debt/EBITDA ratio is at a low level of 0.3 times. So there is increasing room for additional borrowing. How much are you willing to make strategic investments, at maximum?

A: It is becoming increasingly important for us to consider business acquisitions, etc. to grow in the future, but it is very difficult to show the maximum scale of investment due to the wide range of considerations, including timing. We recognize that our Net Debt/EBITDA multiple is at a low level in comparison with global peers. We will consider various funding methods depending on the project.

Q: Over the last three years, Transform Olympus has implemented a number of reforms, mainly on the cost side. What growth stage should we look forward to in the future? On page 13 of the presentation material, there is a statement that "To capture growing value pools that drive long-term sustainability". Are you going to maintain the current execution structure by six executive officers even in a new growth stage that differs from the past?

A: From April 2022, the execution structure has been changed from five to six, and the operating model has been strengthened so that the roles that had previously been entrusted to each region could be under global governance. The key point of this change is to accelerate cross-regional product development, business exploration, and quality assurance activities. I think the execution structure should be changed depending on the challenge that we face at that time.

Q: In the VISERA series of surgical endoscopy system in the past, although the contribution to sales was large, the gross margin was relatively small, and I remember that it was cited as a factor that deteriorated the product mix. Will the next-generation surgical endoscopy system contribute to profits? Please also tell us about the profitability challenges of the past products?

A: Surgical endoscopy is not in our focus areas which are GI, Urology and Respiratory, but we are strengthening it by adding more functions through the acquisition of Quest, etc. Although there are large differences from GI endoscope in terms of technology and competitiveness, we are working to make surgical endoscopy as profitable as other categories, as shown at Investor Day. We would like to improve profitability through two directions in the future – 1) introducing new-generation products based on Quest's technology, aiming for business growth, 2) reducing the development cost of new products by generating synergies between product categories.

Q: Previously, you have set out a strategy to increase market share in the surgical endoscopy field. Please tell us about your approach to market share over the medium term.

A: Of course, we would like to increase our market share. To this end, products and technologies are required, so we will continue to launch new products. I think the competitive environment over the next two to three years will be tough, but we would like to increase our market share by developing next-generation products. Over the long term, we would like to continue to expand our market share with outstanding technologies.

Q: Regarding shareholder returns, will dividends be increased regardless of the transfer of SSD?

A: Our approach to capital allocation remains the same as introduced before. The priority is to make business investments in growth areas and then to return to shareholders on the premise of ensuring a certain level of financial soundness. Regarding dividends, we have continued to increase dividends for the past few years under the policy of raising dividends in a stable manner, and basically, the way of thinking does not change regardless of any management event. Therefore, regardless of the transfer of SSD, the dividend for FY2023 is planned to be ¥16.

Q: Is it correct to understand that the current cash holding in the Evident's balance sheet is around ¥200 billion?

A: As we do not disclose detailed information on each subsidiary, we are going to refrain from commenting.

Q: Please explain the outlook for China in detail, separately in ESD and TSD.

A: Our business in China is expected to grow in FY2023 due mainly to an increase in hospital budgets. Over the past few years, our market share has not changed despite constraints, and we have maintained a solid position in the GI field. In the Chinese market, where competition is intensifying, we will continue to collaborate with Chinese HCPs and authorities with a focus on medical outcomes and economy, and to differentiate ourselves from competitors in terms of total, including services. TSD has not only energy devices, but also a wide portfolio of products for complicated procedures such as ERCP and ESD, as well as urology and respiratory products. We believe that we can compete with local manufacturers in China.

Q: Please tell us about the background behind the growth of Plasma button, resection electrodes for BPH (benign prostatic hyperplasia). Are you replacing the past Olympus product TURis? Or are you taking market shares from holmium lasers and Boston Scientific products?

A: Plasma button is an additional function of TURis, which is the standard care for BPH. We will continue to secure a high market share by providing additional solutions to doctors in the future.

Q: Compared with the existing Holmium YAG laser devices, SOLTIVE SuperPulsed Laser System, laser lithotripsy for kidney stones, has great advantages - water cooling is not required, laser fiber is thinner, and the operation time can be shortened by about 13 minutes. No other company has introduced thulium laser technology, but how far do you think SOLTIVE will grow in the future? At Investor Day last year, we heard that the stone management market is about ¥180 billion yen. Do you think you can dominate this market?

A: SOLTIVE's technology clearly has an advantage, and customer satisfaction is also high. As a pioneer, we have launched products ahead of peers, but we assume that they will catch up with similar technologies in the future. We would like to overcome the competition by continuing to introduce new products to market as quickly as possible.

Q: Fiber laser technology was developed by IPG Photonics. Couldn't other companies enter this market unless they acquire this company? Will other companies come up with thulium laser technology after Olympus?

A: We are not in a position to talk about the situation of competitors, but we believe that we are a pioneer and have clinical advantages as the first company to bring thulium laser technology to market. We will continue to introduce as many products as possible and further improve customer satisfaction by adding new functions in the next-generation SOLTIVE. We would like to continue to appeal to our customers that we offer the best solution.

Q: Please tell us about the M&A strategy after the transfer of SSD. Are you ready to expand your resources as you pursue more acquisitions in the future?

A: Regardless of the transfer of SSD, there is no change in the direction of becoming a medtech company, and we think that the importance and scale of investment in business development centered on M&A will increase due to the need to enhance capabilities in the future. We recognize that there are still many challenges to the M&A strategy, including the post-merger integration process, etc. We do not expect this to be completed at some point, but we think that by gaining experience in the future, the ability to proceed projects more efficiently and to carry out PMI process, etc. will be improved. While we believe that we have a system for organic growth compared to peers, we continue to consider acquisitions in line with our strategic goal of improving the standard of care and expand our portfolio to complement this solid organic growth. The M&A in the past two years was based on this strategy. We are actively pursuing business development, including market exploration.

Q: Do you plan to hire new people or create a dedicated team to prepare for larger acquisitions in the future?

A: Since starting Transform Medical activities three years ago, we have been strengthening the dedicated team in the US and Europe. At this moment, there is no plan to further reinforce it.

Q: Is there any problem in the development of ESD by separating SSD?

A: Like as the divestiture of the Imaging Business, we have been carefully considering the impact of the intellectual property and manufacturing technologies, etc. by completely separating SSD. So, it is ok to understand that there is no such concern.

Q: Has ESD returned to the past trend of weakness in 1Q and 3Q, and strong performance in 2Q and 4Q? The question includes the Chinese market. In China, did an advance delivery, which happened in 2Q, happen in 4Q?

A: In China, the demand comes out was different due to the impact of COVID. Demand was low in 3Q and recovered in 4Q. For FY2023, growth is expected, judging from the status of business negotiations with customers, but there are temporary restrictions on the supply chain due to the Shanghai lockdown and other factors. Due to the Shanghai lockdown, shipments stopped at the end of 4Q, so in 4Q there were no advance delivery that would affect the 1Q results.

Q: Are there any risk factors in hospital's capital expenditures, considering the recent macro environment besides the lockdown in Shanghai?

A: The lockdown in Shanghai has spilled over into other regions in terms of supply chains. It is unclear how China's efforts to curb COVID cases will affect supply chain constraints and hospital budget execution which is expected to increase in the future.

(End)