November 13, 2020

Olympus Corporation

2Q FY2021 Earnings Conference Call Q&A (Summary)

(Disclaimer)

For your reference, please find an English translation of the question and answer session at the conference call for financial results for the second quarter of the fiscal year ending March 31, 2021 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: Can you tell us about business performance in 2Q? How was it compared to your forecasts three months ago?

A: Both revenue and operating profit were better than expected. This was due to quicker-than-expected recovery in the market, as well as tighter cost control. However, the situation varies by region. For example, China, where performance was good in 1Q, was struggling a bit in 2Q due to stagnation of hospital budget execution.

Q: The company posted ¥47 billion in 2Q as the expense associated with the divestiture of discontinued operation. Can you give us the breakdown of the expense? And out of the expense, what is the ¥3.3 billion recorded in continuing operation (in Corporate and Elimination) about?

A: The breakdown of the ¥43.7 billion recorded in discontinued operation includes the impairment loss of fixed assets and inventories, and the working capital of the new company (the ratio of the two is approximately 4:6). And it also includes one-shot costs such as extra severance payments and expenses for establishing the new company. Advisory fees of ¥3 billion were recorded as expenses for continuing operation.

Q: Where is the cost of voluntary recall of endoscopic products recorded? How did you cut SG&A expenses? Why has the SG&A ratio of continuing operation not declined so much? Do you see any achievements in the "Transform Olympus" corporate reform plan?

A: The cost of voluntary recall was charged to COGS. Strict cost control and a decrease in marketing expenses such as T&E and sales promotion due to constraints on sales activities owing to COVID-19 contributed to lower SG&A expenses. Transform Olympus also had a positive impact. We would like to share the progress at an appropriate time as we continue to implement various measures in the future. The SG&A ratio has not improved so much because decline in revenue was larger than reduction in SG&A expenses.

Q: In China, both ESD and TSD were down YoY in 2Q. Do you think the deterioration in hospital budget execution will continue for a while? Is the government continuing to grant budget to hospitals for strengthening preventive medicine?
A: The COVID-19 situation, including the risk of the second wave, remains uncertain, and it is necessary to continue to closely monitor the state of hospital budget execution in the future. We think the Chinese government's policy of raising healthcare quality provided at hospitals remains unchanged, and we will continue to implement measures to expand business from Class III hospitals (top-tier large hospitals) to Class II hospitals.

Q: SG&A expenses in continuing operation decreased by ¥23.5 billion in the first half, while they are expected to increase by ¥8.3 billion in the second half. Can you give us the breakdown of the reduction in the first half and the factors behind the increase in the second half?
A: The main components of the reduction in SG&A expenses in the first half were foreign exchange benefit of ¥1.7 billion, personnel expenses of ¥3 billion, advertising and sales promotion expenses of ¥6 billion, T&E expenses of ¥5 billion, and R&D outsourcing of ¥4 billion. Expenses are expected to increase in the second half as business activities become normalized, and R&D expenses are also estimated to be relatively high in order to catch up with some delays in the first half. Furthermore, a decrease in capitalized R&D expense, an increase in spending on IT infrastructure, and advisory fees related to global efficiency projects, which are scheduled to begin next year, are expected to push up expenses. Expenses for strengthening QA/RA functions are also one of the factors behind the increase.

Q: Regarding "Structural reform of fixed costs" on page 17 of the presentation, can we assume that some kind of events are likely to occur during the current fiscal year?
A: Some measures are already underway. We will disclose if there is something we need to share with you in the future.

Q: Can you tell us the synergy between FH ORTHO, which you recently acquired, and Olympus? There are leading companies in the field of artificial joints in the US, so I wonder if it might be difficult to capture this market. Would it be correct to understand that this M&A is focused on gaining a distribution network rather than products?
A: We are already active in the business of artificial bone substitutes, etc. through our subsidiary Olympus Terumo Biomaterials. In order to scale up the business in orthopedics, we were looking for a partner with compatible product portfolio and distribution channels. That’s how we acquired FH ORTHO. The company's extensive distribution channels enable us to market the surgical ultrasound device that we recently developed. In order to increase profitability in the future, it is essential to expand globally, targeting not only the Japanese market but also European and the US markets. We know the US is a difficult market with some competitive leading companies. We would like you to view this investment as focused for growth for the long term, not for the short term.

Q: Regarding iTind, can you tell us about how it can be differentiated from TURis, Olympus’s existing product, and UroLift, a competitor’s product? Also, can you give us more color on the potential of iTind? I wonder if iTind in the first generation is difficult to compete against UroLift. Do you need to wait for the second generation to be competitive in the market?

A: Medication is the main stream for treatment of BPH (benign prostatic hyperplasia) and resection surgery is required in severe cases. We have TURis, which is used in surgical procedures, and are already in a leading position in this field. On top of that, we would like to market iTind in the office market as a choice that does not require resection surgery and is highly effective in treatment. We believe that iTind can gain traction in the US, the leading market in this field, with its unique benefits as a new procedure, such as no risk of foreign object remaining in the body and a wide range of re-treatment options. In the US, we have already begun to penetrate the doctors' community. Currently, direct face-to-face activities have some constraints owing to COVID-19, but given the potential we would like to push the new product more aggressively in the future. We believe we can aim for the top position in the urology field. The current product is the first generation, but we think it already offers great value. We will continue to enhance medical value through future developments. A competitive advantage in our technology lies in being minimally invasive, not an implant-type product. Therefore, we will continue to develop future products by making full use of this strength.

(End)