

▶ The Creation of a New Olympus and Future Growth—Conversation with Analysts



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How has Olympus changed? After the scandals, what measures should Olympus institute, and how should it target future growth? President Hiroyuki Sasa conversed with analysts that have observed Olympus for a number of years with regard to the expectations of the Company and the challenges it faces, receiving their earnest opinions and advice. (Conversation held on June 10, 2013, in a meeting room of the Company's head office)

Incident regarding Deferred Posting of Past Losses



Sasa I would like to begin by apologizing for the great inconvenience and concern we caused through the scandals that were discovered in the year before last. I was quite surprised when this issue surfaced, and I feared Olympus

itself may cease to exist. At that time, I was a division manager in charge of marketing for the entire Medical Business. To reassure my subordinates after the issue surfaced, I reminded them of the Company's solid operating foundations exemplified by its endoscopes. There was no way this foundation would just disappear. Even if Olympus ceases to exist, endoscopes will never vanish. Drawing their attention to this fact, I encouraged them to focus on maintaining business operations and to fight for the Company's survival in their own way.

In all, the development and manufacturing staff were relatively calm. They were confident that their endoscopes would not disappear, and they continued to supply us with high-quality products and services steeped in this confidence. Meanwhile, the sales staff was subjected to a flurry of inquiries and questions from physicians, receiving both reprimand and encouragement. Even under these

harsh circumstances, they remained devoted to recovering the trust of the Company, and thus helped us pull through this difficult period. In January 2012, it was decided that Olympus would remain listed on the Tokyo Stock Exchange. At that moment, I felt assured that we could return Olympus to glory if we remained committed.



Nakanomyo With regard to the deferred posting of past losses, I feel this incident was partially due to the failure of us, as analysts, in performing our duties. I think there was an extent to which this issue could have been predicted before the

discovery of the misrepresentation from the Company's disclosed financial information. Regardless, the incident caught us all by surprise. As participants in the capital market, it is our duty to monitor such activities, and I feel responsibility in my failure to do so. At the same time, there is a nagging sense of disbelief directed toward the Company that still remains today. I believe it will be up to Olympus to dispel this disbelief through its future actions. At the very least, this disbelief partially vanished after you were appointed as president, Mr. Sasa.



Masahiro Nakanomyo
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Profile
 Mr. Nakanomyo joined The Mitsubishi Banking Corp. in 1984, where he undertook a variety of industry and corporate research projects over a 25-year period. In 2009, he joined Barclays Securities Japan and leads the precision instrument sector coverage team in the equity research section.



Toshiya Hari
 Managing Director
 Global Investment Research,
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Profile
 Mr. Hari joined Goldman Sachs Japan in 2001 after graduating from the London School of Economics and Political Science. After several years in a supporting role as junior analyst, he became the lead analyst for the Semiconductor Capital Equipment sector in 2007 and for the Precisions sector in 2009.



Hisashi Moriyama
 Senior Analyst
 Equity Research Division,
 J.P. Morgan Securities Plc.

Profile
 Mr. Moriyama began his career at New Japan Securities Inc. After eight years in sales, he was transferred to the company's investment study department. Later, he joined the Tokyo Branch of Credit Lyonnais Securities Asia, where he was responsible for the precision equipment and electronic components sectors. In 2002, he entered J.P. Morgan Securities and was placed in charge of the precision equipment sector.

Reflect



Moriyama When the issue surfaced, I was filled with disappointment and anger, as though I had been betrayed by a friend of many years or someone else I deeply trusted. To be perfectly honest, I feel that the Company's actions were greatly

disappointing, whether viewed from the perspective of the Japanese stock market or the rest of the world. I had no choice but to stop covering Olympus as a result. However, over the year that followed the change in management, a number of statements were released by Olympus. In particular, I felt that the announcement of measures for restructuring the Imaging Business in May 2013 best communicated the Company's sincerity. The announcement was simple yet moving. Quite frankly, I did not expect Olympus to put out any statements that exceeded the expectations of the market. However, when I saw the plan to halve compact camera sales targets, making for a target that is unprecedentedly low by the Company's standards, my opinion immediately took a position swing. My view of Olympus has nearly completed a 180-degree turn from a year ago.

Sasa The impacts of this issue are not limited to the Company. Rather, these impacts also weigh heavily on the Japanese stock market. As such, how Olympus should go about regaining the trust of the market was a matter we worried much over. It was determined that accomplishing the goals of the medium-term vision was of utmost priority. We realized that if we cannot accomplish the figures set out in the plan, then it will be impossible to recover trust. Now,

one year later, I still cannot say that Olympus has changed sufficiently. Looking at our financial position, the equity ratio has only recovered to around 16%, and this is far from enough. We are also faced with the major management task of returning the Imaging Business to profitability. For these reasons, I think we can say that we are still not effectively producing results. Nevertheless, what we must do remains clear. Our mission now is to steadily address the tasks we face one at a time.



Hari We upgraded our rating on Olympus two days before Michael Woodford was removed from his position as president and CEO, and I remember becoming quite emotional after the incident surfaced. At the same time,

I blamed myself for my inability to catch on to the misrepresentation through disclosure materials, which, while perhaps difficult, could not have been impossible to see. After you were appointed as president, Mr. Sasa, the speed at which the Company's governance systems and business portfolio improved has been startling, with much being accomplished in a short period. Next, I hope you will shift your focus to achieving further growth in the Medical Business. While discussion tends to be directed toward what will be done in the Imaging Business and the Others Business, I feel that the Company's core business remains as the Medical Business.

Results during First Year under New Management System and Future Challenges

Hari A number of strategic decisions have been made over the year that followed the institution of the new management system headed by President Sasa. I think one of the important changes over this period is the structural reforms that have been taken. The Company has signified that it will increase its emphasis on the Medical Business. It also sold ITX Corporation, which operated the non-core Information & Communication Business. This move was received very positively, as demonstrated by the stock market's reaction on the day after the sale. The decision to restructure the Imaging Business was also well received by the market, reflecting the belief that Olympus was orienting itself in the right direction. Another important change has to do with the balance sheet. Previously, it seemed as though Olympus was focused primarily on profits and losses, but now the Company has turned its eye to the balance sheet. While progress on this front is still slow in comparison to competitors, Olympus is actively working to repay debt and improve its balance sheet in other ways, which I believe is a very important change.

Going forward, I believe a challenge that must be addressed will be developing appropriate growth strategies for the Medical Business. The Company's flexible endoscopes have an unmatched position in their market, which is ripe with growth opportunities. As such, operations in this business will likely grow with little effort over the foreseeable future. However, Olympus still lags behind the competition in the surgical device field and must overcome challenges in this area. Structural reforms are important, but, in the end, the value that the market attributes to Olympus will be determined by the growth potential of its Medical Business. I therefore hope you will focus on ensuring the growth of this business.

Nakanomyo Change over the past year has been substantial. The Company's management is showing a clear stance toward listening to the input of the market. I also believe that the outside directors and other members of the Board of Directors are engaging in very free discussion. In these ways, the Company is gradually developing governance systems that can be deemed as ideal. I hope that governance reforms of this type will continue going forward. It is also my understanding that you will take a flexible approach toward conditions in the Imaging Business. The Medical Business will likely be solid over the next three to five years. However, this is not a given. While not a trend limited to endoscopes, the quality of products in the low-to-middle range is rapidly improving, and competition is intensifying for products in the middle-to-high range in terms of price as well as other considerations. We cannot deny the possibility of this trend advancing further for endoscopes. If this occurs, I am worried that the Company's product mix may prove less competitive. A number of Japanese technology companies are losing to such trends. Where others fail, I want Olympus to continue to succeed with unrivaled strength, and I hope

that you will develop strategies that allow this to be accomplished.

Sasa Addressing that point, similarly to magnetic resonance imaging (MRI) and computed tomography (CT) scanners, endoscopes cannot simply be installed and left for use. All of these devices are incredibly precise pieces of equipment, and they must constantly undergo maintenance. Endoscopes, in particular, are inserted directly into a patient's body and, therefore, have the potential to lead to a serious medical accident if they malfunction to even the smallest degree. For this reason, maintenance, repair, and service structures are absolutely essential. These systems present one of the key strengths for enabling Olympus to maintain its top share of the market. If other companies were to attempt to provide these systems, they would have to incur a somewhat prohibitive level of costs. In this manner, there is a very high hurdle for participation in this business. The extent to which Olympus is to deal in the low-to-middle range will be decided on a strategic basis going forward. I have a strong desire to accelerate the development of the Medical Business. Presently, we have medium-term product plans and business strategies in place that will cover us for the next five or six years. As such, I have no worries in this regard. Rather, at the moment, I think we need to invest more in sales and marketing. The main concern for these areas lies further down the line. As you stated, accelerating growth in the Medical Business will require a strategy that takes us one step further. This is actually an area we have chosen not to address in the medium-term vision. I therefore realize that one of the issues management must tackle next will be the development of such a strategy. For example, we have to be able to clearly explain what the figure for elimination or corporate represents for the Company. The ability to provide such explanations is something we must work to accomplish.

Moriyama Management's ability to escape for the first time from the plans targeting growth in the Imaging Business through the pursuit of sales expansion could be considered one accomplishment of this year. A concern for the future is whether or not the Company can institute profit structure reforms that take it further than simply meeting its goals. I think this is an area that markets are watching carefully. Implementing such reforms will entail strengthening monitoring functions. Is management now actually able to urge business divisions to rethink the plans they have developed? Also, is it now possible for plans to be changed swiftly in the middle of fiscal years?

Sasa Let me start by saying that we are already conducting periodic monitoring, and these efforts are not limited to the Imaging Business. Based on such efforts, management discusses the conditions of individual businesses

while also taking a more comprehensive view. In addition, we monitor the Imaging Business on an individual basis. The business division is asked to report sales data, how it interprets this data, and what its future policies are. Further, we expect the division to inform us about the risks that are present as well as any delays in development or production. At the same time, we discuss how these matters are being interpreted by the corporate divisions conducting the monitoring and how we should proceed. Based on such considerations, we work to implement necessary measures when they are needed, and we do this on a Groupwide basis if appropriate. The Board of Directors as well has been instructed to maintain an understanding of the risks in the Imaging Business and to think of ways that these risks can be addressed by the Group. As such, the Board of Directors also plays a role in performing checks and balances and in supervision.

Nakanomyo Personally, I do not feel completely at rest with regard to the Imaging Business. The substantial reduction in sales volume targets is a significant shift, but I think it is still possible that these targets will not be met and losses will be recorded as a result. I can understand why you wish to continue the Imaging Business, and I feel that there is no need to withdraw. Still, is there any way you could further reduce risks?

Sasa Over the past year, we have evaluated all possible options. This issue was discussed in depth, and we received advice from the outside directors before finally arriving at our decision. However, as the operating environment changes, we will of course have to reevaluate the path we have chosen, and we are thus prepared to take additional steps as necessitated by the conditions we face. As you say, controlling risks, including those related to mirrorless cameras, will be an important task going forward. Moreover, if we are unable to complete the shift to mirrorless cameras, the very continuation of the Imaging Business will be threatened. Some risks can be addressed by reducing SG&A expenses while others vary in conjunction with sales. I do not think I have to list off the risks we face.

Moriyama I believe the degree to which you can communicate the changes in corporate governance systems on a global basis will be an important consideration. There is a limit to which the Company's efforts can be seen and understood from outside, and I therefore think Olympus should work to communicate these efforts more. Once a company has lost the trust of the market, it must work harder than other companies if it hopes to regain its former level of trust. One way Olympus might accomplish this is by taking steps that other Japanese companies do not. For example, the Company could disclose compensation amounts for all corporate officers, show the market everything that can be shown. In other words, if the Company goes forward where



others hesitate, I think its efforts will inspire investors and others in the market to rethink their evaluation of Olympus.

Sasa This is a consideration, and it might be possible to disclose the activities of the Compensation Committee and the Nominating Committee.

Hari In your daily work as president, do you devote more time to securing profitability or to formulating growth strategies centered on the Medical Business? I expect that you plan to shift your focus to growth strategies over the medium-to-long term. Is this the case?

Sasa Just as you say, one of my main focuses is how we will restructure our operations. The Medical Business will form a central pillar of our future operations. As such, it will be important to consider the extent to which we can accelerate growth in that business while effectively controlling costs in other businesses. For this reason, I think it is critical that we develop a clear medium-to-long-term direction for the Medical Business. This will entail deciding how we will position human resources and allocate management resources. Going forward, I hope to devote my time as president to addressing these tasks.

Nakanomyo Where will the life science operations be positioned in the future? Will you pursue coordination with the Medical Business?

Sasa Such coordination is a possibility. However, we have to be aware of the lack of profitability in our life science operations, regardless of the fact Olympus commands the largest share of the market for biological microscopes. We were successful in generating profit by reorganizing production sites and implementing other structural reforms, but the profitability issues still remain. Competitors are surely facing a similar situation. Nevertheless, I believe that microscopes are absolutely necessary to the world. I recognize the importance of microscopes, and I think it is possible to improve profitability. Therefore, I am encouraging business divisions to continue these operations.

Opinions and Advice

Hari I can imagine Olympus presented a very stressful environment for employees after the scandal. Are you taking steps to address employees' mental health? Also, there is concern of a possible outflow of human resources. What is the case on this front?

Sasa We have not noticed any particular outflow of human resources. After the scandal, we came to feel the importance of employee morale. This was especially true in light of the restructuring in the Imaging Business and the pressures placed on the Medical Business. With Chairman Yasuyuki Kimoto, I held numerous meetings with employees, which we call town hall meetings. We also spoke with overseas employees. For example, town hall meetings were conducted at our U.S. operating sites in Center Valley, Pennsylvania; Boston, Massachusetts; Maple Grove, Minnesota; and San Jose, California; as well as in Vietnam, China, India, and other countries. We also held meetings with a large number of employees in Tokyo. I feel that the type of two-way communication practiced in these meetings is incredibly important. It is easy to simply transmit messages to employees. However, this type of one-sided communication does not guarantee that our feelings will be fully communicated, nor does it allow us to hear the voices of employees. While we may not be able to implement drastic reforms based on employee feedback, listening to the feelings of employees helps us take the next step in the right direction, and I think this is crucial. Going forward, I hope we can deliver more good news to employees. Up until now, the primary focus of such communication has been how we are fixing areas in need of improvement. In the future though, we will work to use communication activities as opportunities to convey positive information to our stakeholders, inside and outside of the Company, to show them how Olympus is changing. I think this type of communication will help to invigorate the Company.

Nakanomyo Looking at Apple Inc., I feel that the birth of this company's extraordinarily successful iPad was not so much the result of its technological prowess as it was a testament to Apple's ability to latch onto the dissatisfaction users had toward the status quo for PCs. In this manner, what a company needs to realize is explosive growth is not necessarily technology. Even when it comes to endoscopes, I think users have a number of needs that are not being met. Mr. Moriyama and I have both had laparoscopic surgery, and we understand that these are minimally invasive procedures. However, the day before an endoscopic examination, I get anxious nonetheless. For colonoscopies especially, I think there is room for improvement, even with regard to the skill levels of physicians. In other words, if you have any ideas for realizing improvements in these areas, then I think you will be able to create significant value and clearly differentiate Olympus from manufacturers in China and other areas. It is

my hope that Olympus will become a company that demonstrates unrivaled strength in this field.

Sasa From the perspective of existing business, I think it is important that we prepare for the potential appearance of innovations of the so-called disruptive technology nature. While we of course also aim to create such innovations ourselves, we are lacking certain resources. For this reason, I believe it is crucial that we establish a clear investment plan that contains both a medium-term perspective and a long-term perspective. Such an investment plan is not contained within the medium-term vision, but I hope to make one in the future.

Moriyama I think that globally minded investors primarily look at two types of change in companies. One is changes in performance; the other is changes in managers or management itself. Some investors will look at Olympus and its endoscope business over the long term and come to the conclusion that it is a worthy investment target no matter what incidents may have occurred. Others will focus on past management scandals and judge that the Company is not a valuable investment even today. If the governance systems for Olympus management truly have taken a change for the better, I expect that potential investors of the latter type may choose to invest in Olympus. One way in which investors are able to detect such management changes is through measures to step up IR and disclosure activities. It is often the case for companies that display improvements in such activities to also have undergone improvements in terms of management. From this perspective, I think the Company's IR activities have improved greatly over the past year, with the most significant changes being seen just recently. The Company conducts active disclosure, holds panels with its senior management, and even offers tours of endoscope factories. In light of these advancements, I believe Olympus is rapidly becoming the leading company in the precision equipment sector from the standpoint of disclosure. If the Company continues these activities, developing them globally while enhancing systems allowing for flexible contact with overseas investors, I am confident that Olympus will come to be more highly evaluated as a global company.

Sasa Strengthening information disclosure and IR activities, including those targeting overseas investors, is a must if we are to recover the trust of the market. Accordingly, we have advanced initiatives in this area over the past year, and we will continue strengthening these efforts into the future. Thank you for taking time out of your busy schedules to join us today. I hope to draw on your valuable input in management to drive the future development of Olympus.