

# Discussing Olympus' Ideal Form

—Conversation with an Investor and Analysts



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It has been three years since the Company instituted its new management team, and Olympus is now prepared to step onto a new growth stage, with the main proponent of its progress being the Medical Business. What must Olympus accomplish in order to create new value and achieve further growth?

President Hiroyuki Sasa talked with an investor and analysts about their evaluation of the Company over the past three years and what type of company they felt Olympus should become in the future, and listened to their earnest opinions and advice.

(Conversation held on May 20, 2015, in a meeting room of the Company's head office)

## A Look Back at Three Years under President Sasa

**Sasa:** Upon my appointment as president, it was clear to me what needed done, so my first step was to incorporate this thinking into the Company's medium-term vision. This vision served as our corporate strategic plan, and it had two main goals. The first was to regain lost trust by clearly illustrating to outside stakeholders the systems that would be employed and the path that would be followed going forward. The second was to raise motivation by providing those within the Company with a concrete roadmap describing where we were heading.

After the Company's scandals came to light, it was obvious that it would be impossible to recover the trust of our stakeholders without reconstructing corporate governance systems. For this reason, the Company replaced all members of the Board of Directors and instituted a radically different system to facilitate the new management team's wholehearted efforts to regain trust. The newly appointed outside directors pulled no punches in pointing out the Company's flaws. However, I believe it was this stern oversight that kept Olympus



### Hiroaki Owaki

T. Rowe Price Group, Inc.

#### Profile

In 2004, Mr. Owaki left his position at ABN Amro Asset Management (Asia) Ltd., to take up a position covering the Japanese technology sector at the Tokyo office of T. Rowe Price Group.



### Tomoko Yoshihara

Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.

#### Profile

In 2001, Ms. Yoshihara joined Deutsche Bank AG, where she was assigned to cover the technology sector. After later forays in the think-tank and consulting field, she assumed her current position at Mitsubishi UFJ Morgan Stanley Securities in 2014.



### Masahiro Nakanomyo

Managing Director  
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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.

on the right path, and I am ever grateful for the guidance of these individuals. Today, those viewing Olympus from the outside have come to more fully understand the Company's corporate culture, the character of its employees, and the strengths and weaknesses of its business. This understanding has fostered trust, and as a result the Board of Directors is now able to go about its duties with relative ease.

Looking at our operations, we are making headway in the Medical Business, which is steadily generating results, as demonstrated by the fact that it is progressing ahead of schedule with regard to business plans. In the Scientific Solutions Business, we have been advancing structural reforms that are matched to recent trends, and profitability has been improving smoothly. The Imaging Business, however, is not doing quite as well. We worked to improve performance in this business to the best of our ability, but the market changed to a degree that exceeded expectations. Although we attempted to respond during the first year of the medium-term vision by revising targets and instituting subsequent restructuring measures, the operating environment proved exceptionally harsh and these measures were unsuccessful. As a manager at Olympus, I feel that this outcome is most regrettable.

**Nakanomyo:** I think that Olympus needs to pick up the pace in its efforts to reform the Imaging Business. I realize this may not be easy, and that the market is changing to a degree that is much greater than expected. However, I cannot help but feel that the recovery of the Imaging Business is taking too much time. Three years have passed since you, Mr. Sasa, assumed the role of president. Including the time before you took up this mantle, the Imaging Business has recorded losses for five straight years. I believe most would agree that this is too long, and that investors are hoping for this business to break even at the earliest date possible.

Furthermore, even now, you still begin discussions with talk of corporate governance. I think it is safe to say that the

stock market has already recognized that Olympus has changed and overcome its past shortcomings. Investors are more interested in plans for the future, how the Company will develop its operations going forward with regard to M&A activities, investments in new businesses, and other such matters. I think that Olympus should be more clearly communicating its policies on these matters.

**Sasa:** Disclosing information about new businesses means also giving this information to our competitors. For this reason, it is important to consider the extent to which we reveal our plans. However, I do realize that, as shareholders choose to invest in Olympus because they approve of our plans for the future, it is vital that we release as much information on these matters as possible.

**Yoshihara:** In the past, I was responsible for covering the precision machinery industry. I now cover the medical equipment sector. Over the past two years, this sector has been undergoing a surprising change. Previously, even relatively expensive medical equipment would be accepted by the market so long as the piece of equipment was of superior quality. Now, this market is changing to the point that expensive equipment will not be well-received, no matter how superior the quality or how it excels in other areas. I believe that the merger of Medtronic, Inc., and Covidien plc is symbolic of this change. The medical equipment industry was once thought to be stable. However, we are now witnessing an upset in the form of a wave of mergers centered around European and U.S. companies. I think that Olympus needs to give the market some hint of the strategies it plans to implement in the wake of this immense change. In listening to teleconferences by European and U.S. medical equipment manufacturers, it is notable how they employ a method of disclosure that allows investors to form an impression of their business without giving away crucial details. These companies are quite skilled at providing quantitative hints with regard to factors such as market scale.



Nobody expects Olympus to release information that would diminish its competitiveness, but it would be nice to have some sort of basis on which to gauge the Company's growth potential. If, for example, you were to provide quantitative information on how THUNDERBEAT should be viewed, this would be enough of a hint for investors to work with.

**Owaki:** In evaluating Olympus, I believe that the Company has advanced beyond the stage in which it should be concerned merely with survival. The focus now needs to be on beating out the competition. As well, while it is true that Olympus has regained some degree of trust, a number of issues of varying degrees have been surfacing. This situation is making investors anxious. For example, we have learned that the Medical Business was subject to inspections by the U.S. Department of Justice. This might cause one to worry that Olympus may need to reform its business model. For this reason, I think it is important for the Company to strengthen its compliance systems in order to prevent such non-business occurrences from lowering its reputation. This is a crucial task for competing medical equipment manufacturers as well, but it is especially important for Olympus.

**Sasa:** I agree completely. We must look to the future, and advance our business based on more rigorous standards. Moreover, we need to address future issues before they occur to alleviate concerns for the future, give us a clear view of where we are headed, and ensure that there are no more issues to be uncovered, no matter how deeply someone may look. The new management team is treating this matter with the utmost seriousness. When the inspection of our U.S. operations was initiated in 2011, we instituted a massive restructuring of organizations in North America with the aim of preventing the recurrence of such issues, and a substantial improvement has already been witnessed. For example, we have established a medical affairs division to function as an independent third party with regard to the provision of donations and subsidies. We have thereby installed controls to ensure the transparency of these activities, and to weigh the pros and cons and thereby determine appropriateness. The Company also implemented massive reforms in other areas, including practicing strict management of demo products and the substitutes provided when purchased products are undergoing repairs, thoroughly enforcing regulations through regular in-house training, and stepping up third-party monitoring and internal audits. Moreover, we are fully aware of the fact that strengthening compliance systems and managing risks is something that must be done not only in the United States but on a global scale.

**Owaki:** What are your thoughts on the empowerment of female employees? I understand that one of the Company's outside directors is a woman. However, just the one seems rather low for a company that claims to care for people's physical and mental health.

**Sasa:** Looking at the Olympus Group as a whole, there are countless women working throughout our organization, particularly in Europe and the United States, and female employees hold many high-ranking positions and represent a large portion of our overall staff. In Japan, however, the situation is a bit different, and your criticism is quite valid. Olympus' operations have long been focused on manufacturing and development, and we have a history of having limited access to new hires. Of course, this is a situation that requires improvement. Olympus is not closed off to women.

## Future Areas of Focus and Medium- to Long-Term Vision for Olympus

**Sasa:** In fiscal 2016, we will formulate the next corporate strategic plan. At the moment, discussions are proceeding within the Company to determine what exactly the essence of Olympus is and what constitutes our corporate genes.

Olympus' technologies are No. 1, and we stand unmatched on this front. Being able to say this with confidence is our greatest strength. It is therefore crucial that we position customers capable of understanding and appreciating our

technological prowess as our main targets. If not, we run the risk of being judged based on overall competitiveness or financial capabilities, and we cannot beat the massive companies seen in Europe and the United States with this respect. In this manner, Olympus will not attempt to compete with these companies in the areas in which they excel. Rather, we will accurately respond to the needs of specialists in niche markets, and endeavor to become the leader in this area. This approach will be adopted in all businesses. In the Medical Business, for example, if a customer cannot understand the benefits and superior performance of THUNDERBEAT, they will no doubt purchase a less expensive product. For this reason, cultivating this type of understanding among customers is crucial. In the Imaging Business as well, I believe that Olympus' target demographic is specialists as opposed to the broad general consumer market. Gone are the days in which effective commercials were enough to guarantee sales. In this manner, we have analyzed the Company's business, and formulated an idea of the type of customer we should cater to as we develop our operations.

In the Medical Business, we judged that our greatest deficiency was sales capabilities, and thus determined that this was the area in which we should first devote investments. However, the full benefits of sales investments do not appear immediately. Realizing this, our plan was to first invest in strengthening our sales forces, and then to take advantage of these investments when we launch our next new product. This has been a focus for the past two years. Looking ahead, we can expect a certain degree of cash to be generated when we release the technologies we have been developing or the products we have been planning. At this point, we should be able to invest in other areas.



In formulating the next corporate strategic plan, we will determine the best use for all of the Company's resources, including those currently associated with the problematic Imaging Business. With the strong conviction to realize further growth, we will turn our eyes to the future of Olympus.

**Nakanomyo:** After hearing this explanation, I think probably 80% of people would nod in agreement. While I would generally place myself among this 80%, you must also consider the responses of the remaining 20%. Several of Olympus' products have established solid market positions, and these will likely retain their differentiated competitive edge for at least the next 3–5 years. I believe that your talk of strengthening sales forces presumes this fact, and most people will understand this. However, a common opposing opinion might be that, from a technological perspective, you have to consider China, which is gradually catching up with rest of the world in terms of technologies. Meanwhile, at the other end of the spectrum, we see a shift toward radically different imaging technologies, namely 3D and 4K imaging. Given these two threats, are you not a bit concerned?

**Sasa:** Quite frankly, I see little need for concern. We have carefully examined nearly all conceivable risks, and the technology trends that are expected to occur in the market, and the new products that will likely appear were not viewed as significant threats affecting Olympus' playing field. This judgment was made after thorough evaluation of how the Company would be impacted if these trends come to pass as well as the likelihood of their passing.

**Yoshihara:** Mr. Nakanomyo raises a point that I have found concerning as well. When visiting a European investor recently, it was brought to my attention that companies releasing disposable endoscopes are on the rise. A decade ago, I suspect that these companies would not have received much attention. Today, however, amidst the aging of populations in Europe, the United States, and Japan, and the resulting government movements to limit medical expenses, the trend toward choosing more affordable equipment over higher-priced, high-quality equipment can be seen in developed countries as well. The endoscope field is relatively resilient to such price sensitivity, and it may therefore be one of the last bulwarks against this trend. However, this trend has already begun to impact certain examination apparatuses. Olympus may remain safe for the next three years or so, but looking 5–10 years down the road it is possible that the Company may need to address this threat as well. With this perspective, I must stand with the remaining 20% that Mr. Nakanomyo spoke of, and say that I am concerned.

**Sasa:** The medical industry will not change to any great extent in just five years. This may not hold true when talking about a decade, and we must therefore consider the possibility of a substantial change occurring. However, I still believe that

endoscopes are different than digital imaging equipment, such as ultrasound, CT, and MRI scanners. The benefits of digital imaging can be recreated to a certain degree regardless of what company makes the equipment. For this reason, it may be only natural for more affordable equipment to be chosen. As there is a drive to limit medical expenses, this goes without saying, unless a given piece of equipment features a substantial advantage. Meanwhile, the endoscope field, as you mentioned, may be the most resilient to this type of price sensitivity. Endoscopes are an amalgamation of various technologies and expertise that have been brought together through minute adjustments. This is a feat that not any company can accomplish. As the drive to reduce medical expenses limits capital expenditures by hospitals, it will become increasingly difficult to increase the number of facilities using Olympus products, and we therefore cannot hope to expand our business purely through sales of capital products, by which I mean existing systems. For this reason, we will focus our efforts on helping hospitals reduce overall expenses through improved efficiency. This efficiency will be realized by enhancing certain parts of a hospital's existing systems or increasing the number of examination rooms in which these systems can be used, for example. If operating rooms are able to perform a greater number of procedures, it will mean greater efficiency for the hospital. At the same time, such an increase will also create business opportunities for Olympus as a greater number of procedures leads to higher consumption of disposable medical devices. Treatment fields are also expected to expand going forward. Accordingly, we have formulated the overarching plan of growing our business by strengthening our lineup of endotherapy devices for use with energy devices and endoscopes. Looking at the next 10 years, I believe that



Olympus will be able to continue growing by shifting the focus of its business. This, and the recognition that this shift is something that must be undertaken, represent the Company's medium- to long-term standpoint.

**Nakanomyo:** From that standpoint, I think that endoscopes have a great deal of potential as a business platform. Olympus has stated its plans to invest in new businesses in the regenerative medicine and orthopedics fields. Whether in these fields or the conventional imaging field, the endoscope business platform will create opportunities to provide various devices and disposable products.

**Sasa:** You are right on that point. In addition, endoscopes can be used for early diagnosis, and then for conducting minimally invasive therapies. As such, endoscopes can eliminate the need for opening abdominal surgeries, which are accompanied by heavy hospitalization costs, and thereby alleviate both the financial and physical burden placed on patients. I do not think anyone would oppose such a win-win situation.

**Nakanomyo:** Having accepted that explanation, I think the next questions asked by the remaining 20% would be "What about earnings in the short term?" and "How will the Imaging Business be handled?" For this reason, if Olympus is able to minimize the negative aspects of its operations, such as the recent investigation by the U.S. Department of Justice, I think you would be able to win over this remaining 20%, and have them too looking forward to the future of Olympus.

**Owaki:** If you take the perspective of social responsibility, rather than financial gain, then maybe the Company should continue its camera operations in order to protect the interests of customers who prefer using Olympus' products. From the perspective of competition, however, each company has its strengths, and profit will not come easily even if the Company targets niche markets. As an investor, I believe if the Company intends to adopt a more realistic approach then the decision should probably be made soon. It is my hope that Olympus will become the type of company that focuses more on its core businesses to practice management in an efficient manner, a company that does not warrant debates about its Imaging Business.

**Yoshihara:** The wave of mergers among European and U.S. companies is resulting in the creation of increasingly larger companies, which are realizing heightened cost competitiveness by leveraging sales-front synergies to reduce costs. Olympus has expressed that its strategies do not entail aggressively expanding scale. Given these trends, however, there is concern as to whether or not the Company can maintain its current level of competitiveness through these strategies. I think overseas investors, in particular, might be worrisome when considering the current state of the medical equipment industry. I realize that Olympus has a one-of-a-kind business model with endoscope operations that encompass

systems and disposable products for gastrointestinal endoscopes and even surgical endoscopes. You, President Sasa, have stated that you have no intention of directly competing with other manufacturers. Do you really believe that Olympus can continue to operate under this business model over the next 10 or 20 years?

**Sasa:** I do believe that we can continue to operate with this model, although growth will slow if this all is we do. For this reason, it is important that we branch out, leveraging the business platform we have constructed to date in order to expand into new fields in which we can win out over the competition, such as the orthopedics and ENT fields. Making progress in the Medical Business requires a great deal of time. Accordingly, we decided to first examine the option of focusing investments and resource allocation on those fields, and then clarify our policies in the next corporate strategic plan. This, I feel, is the approach Olympus should adopt in the future. We lack the competencies necessary to acquire large numbers of companies and manage these effectively, as is done by our European and U.S. rivals. Of course, we will utilize M&A activities as a means to accomplish our objectives. Nevertheless, Olympus will pursue growth while firmly rooted in the manufacturing sector. I believe this type of growth to be the Company's



essence. At the very least, we recognize that Olympus cannot beat European and U.S. companies by mimicking them. Rather, we must proceed while considering where Olympus' strengths lie, and how we should build upon these.

## Opinions, Advice, and Hopes for Olympus

**Owaki:** Despite the various negative incidents that have surfaced, Olympus' stock price is on the rise. I am convinced this is because the market has highly evaluated the strength of the Company's Medical Business, which is founded on endoscopes. My hopes for Olympus involve removing the roots of concern in the Medical Business, and then addressing the Imaging Business. In this business even your new ideas have been, in actuality, old ideas. Quite frankly, I do not feel that sales of cameras to consumers is a necessary business for Olympus. Another area needing improvement is how the Company presents itself. The medical equipment business contributes to a better existence for humanity, and you should be proud of your involvement in this business. Make the market understand that the future is promising and that your course is correct, and then explain your targets, results, and business strategies from this standpoint.

**Nakanomyo:** I think that you are completely correct about what constitutes Olympus' core strength. The analog aspects of endoscopes are quite difficult to understand for people outside of the Company. Perhaps this is something I will need to learn at the upcoming plant tour\*, as this is probably the area in which Olympus is strongest. Moreover, this will most

likely remain an area of strength into the future, and today's discussion made me realize that I should pay more attention to this element of your business.

\* Tours of Olympus endoscope plants in Aizu and Shirakawa in Fukushima Prefecture where held in the week following this discussion.

**Yoshihara:** Olympus' business is one that makes substantial contributions to society, and this fact is something you should advertise more. Many investors have already stated this opinion. Endoscopes have saved tens of thousands of lives by finding cancers in their early stages. You should have more pride in Olympus' business and its products. There are not many Japanese medical equipment manufacturers that can compete on the global stage to the extent that Olympus does. I want you to develop your operations with a sense of confidence in the Company's business and its people, and to transmit messages to this extent. This is an opinion I have heard from others as well, and I hope that you will take it to heart.

**Sasa:** Thank you for joining us today. I hope to draw on your valuable input and insight in management to create an Olympus that lives up to your expectations.