

Olympus Corporation
Investor Day 2021 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 Investor Day 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: For the next three years from FY2024, what kind of range are you aiming for in terms of profitability?

A: The current OPM target of over 20% was set in 2019. At the time, we also announced the corporate strategy, under which we aimed to become a global medtech company. To do so, we thought we have to achieve over 20% in order to obtain such a position. I believe that the things that have to be done were done as I mentioned in the presentation. Beyond the current mid-term period, in terms of profitability we are not thinking about specific numerical targets. But the business should grow by several percentage and we wish to increase profitability, as well. Achieving over 20% is a milestone of the current three-year strategy. So an assumption is that we will maintain for the time being.

Q: In September you announced a change in the executive team. I understand that you want to achieve something with this. What are they? What are other challenges and issues behind the change?

A: Currently, CTO supervises a huge area from technology development to operation team. So we decided to separate those two roles. Executive members are going to be changed accordingly. Those who are most suited for new positions will start in April next year. We wanted to shift the governance of organizational management from regional level to global level. This is a transformation that is currently ongoing in technology development, product development, and global operation such as running factories, production planning and PSI-related. In the past, Companies with new technology and products were acquired in many locations, but we didn't have standardized quality system and operation system across the board. Of course, operation-wise we were integrated, but different sites were run by different systems. Going forward, we want to see an end-to-end process on a global level. That is our vision.

Q: I have a question on the Urology strategy. I understand you have a strong position in capital products, but competitors such as Boston Scientific are strong on the consumable side. Can you explain what kind of opportunities (e.g., total addressable market), especially in the consumable area for Urology? How much do you capture in the market at this moment, and how much in the future?

A: As you said, we are quite strong in capital equipment, particularly in endoscopy platform. But we also hold quite significant positions in some areas of the therapeutic area, where we have strong competitors like Boston Scientific. We can continue to gain market shares in those areas. In

Urology, we are significantly increasing our positions in the lithotripsy and laser treatment. So growth is not only coming from our endoscopy position but also there are significant opportunities in capturing additional market share and revenue in single-use products for TSD. Our aspiration is to increase our market shares by expanding our product portfolio.

Q: In my view, you need to acquire some technology to compete with competitors. For example, Boston Scientific has a superior technology in cardiology catheter products, and I think they are transferring the technology to GI or urology consumables. Given you don't have such a technology, how do you fill the gap in the consumable area?

A: Our growth in TSD was quite significant over the last few years, and we think we can continue. We view M&A as a necessary complement. It is impossible for a company to keep up with all necessary technologies, so M&A is a useful tool to include the technologies that we don't own to our portfolio. We will look at M&A like we did in the past two years, for example, Medi-Tate in Urology and Veran Medical Technologies in Respiratory. As this is an important part of our strategy, we will continue to look for opportunities in the market.

Q: I have a question about other therapeutic areas in TSD. Is selling those areas an option in the future? You are maintaining the businesses that you are not really pursuing. What is the rationale behind it?

A: This is outside of the three focus areas in TSD. But in some regions, we have leading positions. And over the past many years we have been focusing on these areas. So each business is deeply rooted in each geographical area. Our direction is that rather than delivering devices and capital equipment, we want to approach this with care pathway as a main focus. For that perspective, we have to focus on certain things and loosen focus from others in terms of resource allocation. So basic assumption is that we will continue those businesses and run more efficiently.

Q: Unlike the reorganization of SSD, because products are deeply rooted in each market, it is difficult to separate them out?

A: Yes, that is one reason. And another reason is they share the same technologies. Technology-wise, it is difficult to separate these things. We haven't really thought about separating them.

Q: I understand that the profitability target is on the track. But the progress in FCF is slow. Can you explain why this is happening?

A: In the past, we were focusing on operating margin and dramatically improved the target related to P&L. With regard to balance sheet items, although we indicated some numbers as KPIs as reference two years ago, as of today there is still room for improvement. So in the next year and beyond, we would like to continue the improvement.

Q: Regarding TSD, the revenue CAGR target has been ~8%, but there is no such mention in the presentation. Will that target be sustained?

A: We are not making any change on it, so you understand correctly.

Q: Based on that comment, you are going to grow higher than market. The three focus areas are on the right track. For other therapeutic areas, which accounts for one quarter of the TSD revenue, what growth are you assuming?

A: Although our focus areas have been described in our presentation, a significant amount of investment was done in other areas. So we plan to harvest those. One of the areas is energy device. We have launched POWERSEAL in the US, which is an advanced bipolar solution that many customers have been waiting. And we plan to launch in other markets starting from next year. This will complement our portfolio and we think it will contribute to increasing market share and provide additional revenue. So we believe other areas such as energy device will also contribute to our growth. We are not abandoning that area. A combination of focused areas and other areas, we will be able to obtain ~8% growth.

Q: For focus areas, M&As have been done. But for energy device, I understand there is no M&A planned. So you need to win market share from others to achieve high single-digit growth. What are your thoughts?

A: Your assumption is correct as not many M&A opportunities exist in the surgical device area. Our growth comes from capturing market share. Our position in the area is not so strong today with two dominant competitors in the market. But we believe that a combination of ultrasound and

advanced bipolar solutions will give us opportunities to capture some market share. We also believe that two other players will continue to be the market leaders, but it does not mean we cannot increase market share and grow the business.

Q: You mentioned that Olympus is a global company. How do you pursue and promote global HQ and R&D to grow into a global medtech company?

A: It is not about our head office per se, and we are considering global functions. Some headquarter function in Olympus Tokyo transferred somewhere in our group. In the last two years, approximately half of senior management in our headquarter function are diversified and globalized. In terms of R&D, the management itself will be truly global starting from next April, although engineering and R&D functions are based on the products that they oversee.

Q: Shinjuku and Hachioji will not be controlling everything globally. Will you use appropriate personnel at the appropriate places?

A: The global headquarter locations don't necessarily link or match global R&D functions. Most of them are based in Hachioji, but there are various functions located in Shinjuku. The global compliance manager is in Germany, and for the legal it is the U.S. Function is not necessarily attached with location or nationality.

Q: As for product development, is it better to do in Hachioji or better to do less in Hachioji? I will suspect moving from Hachioji will reduce costs.

A: Manufacturing locations cannot simply be shifted from location A to B. At least for unique products like ours, that will not be easily transferred. Accumulation and aggregation of technologies were doing in a particular region.

Each region has technologies and products that they are responsible for. And the number of such technologies and products are growing. Whether it is development of technology or product, 70% is doing in Japan. The remaining 30% is already developing outside of Japan. And we will have new CTO and CMSO starting from April 2022. The R&D functions will be viewed more globally under the new structure. We have a concept of care pathway, so the products portfolio will be changed. Accordingly, the 70/30 ratio may also change over time.

Q: My question is about Transform Olympus initiatives on slide 10. How much did cost reduction contributed to improving operating margin since FY2020. Can we expect these efforts to continue for the next several years?

A: When we started the corporate strategy, we had Transform Olympus initiatives to transform the company itself. In a broad sense, operational efficiency improvement was covered in that, and in addition, we changed the governance system such as the nominating committee etc. In terms of operational efficiency, we identified and addressed the issues, set the targets, and monitored the progress on a monthly basis. That cadence is continuing.

When we announced Transform Olympus in 2019, we expressed two targets. One was to improve the financial performance of the company and the other was to improve organizational health. The latter included a transformation of operating model by globalizing management. The GBS project serves both purposes. We started about two years ago with quite ambitious targets of establishing global infrastructure, which serves five regions, within two years. It covers five core company functions, namely Finance, HR, Supply Chain, Procurement and Sales Administration. The progress we have made so far is very encouraging although we faced headwinds mainly because of COVID. We have a captive center running in the Americas. In EMEA, where we are starting GBS in 2018, we are looking to expand the scope of administration, and we gained first experience automate RPA. In Dalian, China, we already have our BPO partner running, serving Japan and some parts of Asia for the finance functions. In the captive center in Dalian, we assume the first services for Japan for HR in the coming weeks. Establishing global business service structure required the initial investment. But from next year, we expect to benefit from run-rate savings, which will increase year by year. We are now delivering, but when you compare the maturity level of GBS with competitors, it is still an early stage with huge potential over years to come.

Q: Is there any area that you haven't started yet?

A: There is no such area. When we look at the potential of Transform Olympus, we have now reached to the halfway, and there is more potential in the next two years.

Q: I have a question about re-usable and single-use scopes. How do you view these two things? In your presentation, you have already launched single-use bronchoscope and more types to come. But the competitor has been active. You are strong in re-usable. Is pursuing those two a kind of double-edged sword?

A: We plan to continue to be a leader in endoscopy with a simple strategy, which is to offer the right scope for every case and every need. This can be re-usable or single-use. This is our fundamental strategy to make investment decisions in our portfolio. We are very much aware of the development in competitors, and the number of procedures that they are capturing. The number of procedures that they captured is quite minimal compared to the overall number of endoscopy procedures we are involved with. Having said that, there is a significant business opportunity that we don't want to miss. So we will continue to work with customers to provide the best solutions. The main goal here is to provide patient needs and procedure needs. Based on that, we will continue to provide what the market wants, whether re-usable or single-use.

Q: What is your company's own growth prospect for single-use?

A: At this moment, we are only in the bronchoscopy area. Over the course to next year, we plan to launch in other areas such as cholangioscope and ureteroscopy. Obviously, we are growing significantly, but the starting point is very low, so showing figures is not relevant. Our products have only been in the market for several months. We are paying strong attention to the development of the market and don't want to miss any opportunity, so at the right time we will be expanding our single-use portfolio.

Single-use is new but has become popular recently, and the growth will be very fast. We don't think single-use completely replace re-usable. Single-use solution is limited in range and will be used depending on situation and patient. Doctors will choose solution depending on their needs. We are the only company that we can provide both.

Q: To be closer to tailored medicine, I think you have to transform your business model. Am I looking at this correctly? Can you elaborate the vision? What kind of changes should be expected in terms of business model?

A: When the corporate strategy was announced two years ago, leading global medtech company was our aspirational goal, but the specifics of that were not being explained so far. Leading medtech company that we have in our mind was presented today. Our image is that we are strong in re-usable, and the values that we can provide through that has been deployed. But in the future, care pathway of patients would be the center. Of course, we have looked at care pathway and provided many solutions in the past, but that was on a limited scale. Going forward, we are going to focus more on care pathway.

This direction is an evolution of the current or existing strategy. We would like to put more focus or intention to execute the entire or a large part of care pathway, rather than one device. We believe that the healthcare or society expectations to device companies are not just one device, one technology or one solution that can only fit one problem. For example, colorectal cancer is the one Olympus has been participating for very long in the early diagnosis that have led to early treatment and that has avoided number of complications in the future. Recently in the respiratory area we are contributing to the lung cancer staging and sampling, trying to combine procedures in one.

We repeat that our treatment of every stage in different patient and situation is optimizing the care pathway. We don't want to guess also one solution for one specific disease. but we want to complement our solutions really taking wider view and focus on benefit on healthcare system and also patient experience.

Q: Do you mean that it is not really about the business model change but that the business application area is going to expand?

A: Yes. Our intention is to help optimize the care pathway. Regarding the business model, it is not the present topic, but this penetration of the care pathway might be left to discussion with healthcare providers, and we are considering about more convenient model for the system.

Future direction we don't have a clear business model yet. We want to change individual sales of devices to solution provider. The point of service we provide is to remove the pain points. In that sense, the business model is going to change essentially.

Q: Specifically about iTind. We think iTind can be a competitive device in the field. What is Olympus's intention with iTind in revenue?

- A: We have a lot of expectations in iTind. We do believe that our solution is non-invasive and it doesn't leave any implants after the treatments. iTind is regarded as a very confident solution. We have already assigned a code but it is a limited code and provided limited reimbursement. So, we keep working on obtaining better reimbursement with clinical doctors, providers and CMS. We greatly expect that iTind will reach the high level of successful devices like UroLift. We know their revenue and this is our target. It is achievable target with big opportunity and big market achieving a commercial milestone.
- Q: About GBS in Poland. How many employees now are there and what are they exactly doing? What is its function? I don't think it's halfway done but only 20%, because U.S. and Asia has just started.
- A: GBS is one of the main initiatives of Transform Olympus. The answer is related to this when we look at the P&L impact of all our transform initiatives and we are about halfway. This is more to expect in two years. It has more than 300 employees in Poland, covering finance, sales support, supply chain, HR and procurement. Potentially covering fields are automatization of transactional task and function as a global center of competence. When we look at three years ahead, there are many areas that GBS can be utilized and benefit of the entire company. To be precise, BPO providers in Dalian is servicing for finance Japan and Korea etc. Regarding captive center in Dalian, it will be transferred tasks in the area of procurement, HR, and finance. The first chapter of GBS will be closed at the end of next year and the next chapter will be embarked.
- Q: In TSD, some products unique enough to deploy new market areas, namely iTind, need different marketing strategy. What are going to be the focal areas? What will be the biggest challenge in developing the market? Other than the insurance, do you have any measures to promote the adaption in certain therapeutic areas?
- A: Undoubtedly, new solutions need to be proven and revalued their clinical value by the authorities. We have many existing growth drivers and also a healthy combination of good products offering. In addition, other technologies can drive such growth in years to come. Of course time and efforts are needed for new innovation.
- Q: What is the breakdown for achieving the targeted over 20% operating margin? What improvements will you need to make to achieve this goal?
- A: We don't have updated details of the analysis here. But the basic thinking is mostly unchanged: cost of goods portion, sales and commercial portion, back office corporate function portion. As for some corporate functions, we are trying to outsource many of them, which will be accelerated, reducing the corporate expenses, but other areas need to be strengthened as a medtech company for the quality assurance, which is more important. Overtime, with the corporate portion going down, managing the product cost will be more important. As a manufacturer, we always have to continue with the cost reduction efforts. We can expect to add a big kind of reduction in a single year about overall direction of the management.
- Q: About more products for care pathway and more solution-based selling above discussed. How practical and realistic is this? What are the obstacles to achieve this in terms of competitors and sales for resources? Which area is easier to tackle?
- A: About care pathway, the basic concept is a shape based on focus, that is, we should focus on areas where we have our competencies. Technological challenges in terms of delivering services really exist. But comprehensive strengthening of care pathway will afford us a high likelihood of success.
- In the field of colorectal cancer, Olympus has been very active for many years. The main challenge is the one related to how we look about the technological development. We have to use, for instance, lenses that the patients need, not to show off of the differentiation of technology. We need to have a very deep understanding of very specific diseases. We cannot pretend that we can optimize pathway for many different diseases, but we have to focus on deciding where we can make difference and devote all our technologies to identify solutions to help in our care pathway. This is the biggest challenge. As for competition, obviously many rival companies have developed their own devices and treatments and they are trying to optimize care pathway. In our view the trends are showing needs for medical device company to focus in these optimizations of the care pathway because that was what the society and the health care providers are demanding from us. So we will focus more in this area that we have done in the past.

(End)