

MCW/TK/SGC6

11 October 2011

For the personal attention of:

Mr Tsuyoshi Kikukawa
Chairman
Olympus Corporation
PO Box 7004 Monolith
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Shinjuku-ku, Tokyo
163-0914, Japan

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Dear Tom,

**LETTER 6: SERIOUS GOVERNANCE CONCERNS RELATING TO THE COMPANY'S M&A
ACTIVITIES**

As I referred to in my communications to Mori-san and yourself in relation to the above and at the Board meeting on Friday 30 September, I gave a commitment to write to the Board and the E&Y senior global management, with the outcome of my review into the serious corporate governance concerns relating to the company's M&A activities. I have now had the opportunity to conduct a more detailed preliminary investigation into the matter, including reviewing the various materials provided by Mori-san.

As explained when we met at the Board meeting on 30 September, there are several areas which cause me considerable concern but initially I have focussed on the two main issues below, which have had the most significant negative impact on the company's financial position and detrimental effect on shareholder value:

- i) The amounts totalling in excess of USD 680 million paid to AXES/AXAM as financial advisors to Olympus in relation to the acquisition of Gyrus.
- ii) The extraordinary goodwill impairment of approaching USD 600 million in 2009, just six months after the company made the final investments necessary to acquire a majority controlling interest in Altis, Humalabo and News Chef.

In carrying out my review, due to the nature and complexity of the issues involved, it was necessary to engage the legal and forensic accounting services of PricewaterhouseCoopers (PwC) to provide me as President, with eminent independent, specialist counsel, specifically with regard to the relationship and transactions with AXES/AXAM surrounding the acquisition of Gyrus – a copy of the 30 page PwC report is herewith enclosed.

When in Tokyo ten days ago, following our discussions with Mori-san and Paul Hillman, I had sincerely hoped that we could find a common understanding and a basis on which to move forward, however the findings of the PwC report are so utterly condemning of those involved, it is now clear to me that it will be impossible for us to progress from here onwards without principal changes in the company's senior management.

Firstly, the following is a summary of the key points arising from the review in relation to the payments made to AXES America LLC (AXES) and AXAM Investments Ltd (AXAM) in respect of the purchase of Gyrus Group Limited (GGL) on 1 February 2008.

1. PAYMENTS MADE TO FINANCIAL ADVISORS IN RELATION TO THE PURCHASE OF GYRUS

1.1 Payments to AXES and AXAM

Payments were made to AXES and AXAM in respect of their services as financial advisors, by Olympus Tokyo (OT) and Olympus Finance UK Ltd (OFUK) in relation to the acquisition of GGL as follows:

Date	Amount	Description	Payer	Recipient
16 June 2006	USD 3 million	Basic Fee	OT	AXES America LLC
18 June 2007	USD 2 million	Basic Fee	OT	AXES America LLC
26 November 2007	USD 12 million	Completion Fee (Cash Compensation)	OT	AXES America LLC
30 September 2008	USD 50 million	Completion Fee (Warrants)	OT	AXAM Investments Ltd
31 March 2010	USD 620 million	Completion Fee (Preference Shares)	OFUK	AXAM Investments Ltd
TOTAL:	USD 687 million			

1.2 Initial Financial Advisor Agreement, between Olympus and AXES, dated 5 June 2006 (Agreement 1)

Olympus entered into the first agreement with AXES in June 2006 with the following principal terms:

Target companies identified for acquisition: Boston Scientific and Cook Incorporated

A fee structure was agreed as follows:

- a basic fee totalling USD 5 million
- a completion fee equal to 1% of the purchase price of any acquisition (this 1% was payable as 20% cash and 80% share options).

Review findings:

- i) Legal advice was obtained in the preparation of this agreement, but no professional advice was sought in relation to the reasonableness of the fee structure for providing such services.
- ii) There is no evidence of any due diligence having been carried out on AXES.

1.3 Second Financial Advisor Agreement, between Olympus and AXES, dated 21 June 2007 (Agreement 2)

The company entered into a second agreement with AXES in June 2007, substituting the first agreement, which contained the following principal terms:

Target companies identified for acquisition: Boston Scientific, Cook Incorporated, Tyco International and Gyrus Group.

A fee structure was agreed as follows:

- a completion fee of 5% of the purchase price (for purchases between USD 1 billion and USD 2.5 billion)

This 5% fee was payable:

- 15% in cash (up to a maximum of USD 12 million)
- 85% in share options and warrants

Significantly, the calculation used for the share option element of the completion fee was increased from 4.9% of the fully-diluted share capital in the first agreement to 9.9% in the second agreement.

Additionally, the timing of payment of the cash element of the completion fee was changed from the actual completion date of the transaction in the original agreement, to the date of the *announcement* of the transaction in the second agreement.

Review findings:

- No external legal advice was received in relation to the second agreement.
- No professional advice was obtained in relation to the reasonableness of the fee structure for providing such services.
- There was no formal Board approval prior to the signing of this agreement, which was approved on a 'ringi basis' by Mr Kikukawa, Mori-san and Mr Yamada. This agreement was only retrospectively approved at the Board of Directors meeting on 19 November 2007, some five months later.
- Prima facie, the completion fee appears to be set at a maximum of 5% of the purchase price of the company being acquired. As a result of the wording of the agreement, however, the fee was not in fact capped at 5% because the share option calculation and warrant structure allowed for this 5% maximum to be exceeded by a considerable margin.

- v) In relation to the market rate for fees for services comparable to those provided by AXES, PwC has advised that around 1% of the purchase price (up to a maximum of 2% in exceptional circumstances) would be expected for transactions of this type. Based on the purchase price of Gyrus of USD 2 billion, this would result in a fee of between USD 20 million to USD 40 million.
- vi) In the event, at the time of the acquisition of Gyrus, in February 2008, **the fee calculated under this agreement was in fact USD 189 million, equating to 10% of the purchase price**, made up of the following elements:
- | | |
|----------------|---|
| Cash: | USD 12 million |
| Share options: | USD 177 million |
| Total | USD 189 million (equivalent to 10% of the purchase value of Gyrus) |

Summary of Review Findings 1.2 and 1.3:

The Olympus officers involved entered into an agreement, i) without carrying out a due diligence exercise into the third party advisor, ii) without seeking appropriate professional advice in relation to the detail of the fee structure and iii) with no formal Board approval prior to signing, which, following the completion of the acquisition of Gyrus, created a liability of around USD 189 million (10% of the purchase price of Gyrus), compared with a market rate for the provision of such services of around 1%, up to maximum 2% (ie between USD 20 million and USD 40 million).

Despite this significant premium in the amounts calculated to be paid to AXES (ie USD 189 million, compared to the market rate of between USD 20 million and USD 40 million), the situation became significantly more punitive to the financial position of Olympus, as follows:

1.4 Capital reorganisation of GGL

On 1 April 2008, the global Olympus group was reorganised on a regional basis and, at the Board of Directors meeting on 25 April 2008, it was agreed to restructure the Gyrus business on a regional basis to:

- i) Integrate Gyrus with this new regional structure.
- ii) Ensure better co-ordination of the management of the Gyrus and Olympus Medical businesses.

As a result of this reorganisation of the Gyrus Group, there was no longer any possibility that the Gyrus business would be re-listed as a Public Company. The Olympus officers involved therefore negotiated with AXES to replace the share options with preference shares and to purchase the warrants as follows:

- preference shares to the value of USD 177 million were issued to AXAM on 30 September 2008
- the liability in relation to the warrants was settled by a cash payment to AXAM of USD 50 million on 30 September 2008.

There is no evidence of the basis upon which the calculation of this value has been made or that any professional advice was received on the reasonableness of this payment of USD 50 million to settle the liability under the warrants.

1.5 Issue of the preference shares, 30 September 2008

The objective of the issue of the preference shares was to provide AXES/AXAM with an equity interest to replace the share options in GGL granted as a result of Agreement 2. These share options had been valued at USD 177 million.

Review findings:

- i) Prior to offering preference shares to AXES, the Olympus officers involved examined several options to satisfy the liability to AXES in relation to the share options including:
 - Settling the liability by making a cash payment of around USD 200 million
 - Issuing loan notes
 - Issuing fixed-rate preference shares
- ii) Professional advice was received from KPMG and Weil, Gotshal & Manges (WGM) and, in their advice of 31 July 2008 in relation to the option of making a cash payment, they stated that *“this would be preferable route for KPMG and Weil”*, as this was *“clearly ‘cleanest’ way for Olympus to deal with”* and it would *“overcome any issues with future minority stake in the business”*.

In their advice, KPMG and WGM state that *“we understand FA [ie AXES] has strongly resisted the cash payment on the grounds that this will crystallise an immediate tax liability for US purposes”*.

The Olympus officers involved chose not to accept this advice but moved forward with the issue of preference shares as, through negotiation with AXES, they were insistent that they wanted to share in the future growth of the company and postpone recognition of their income tax liability.

- iii) A calculation was made to establish the value of the preference shares that should be issued to AXES to substitute for the liability in respect of the share options under Agreement 2, valued at USD 177 million.

The Olympus officers involved determined that preference shares with a face value of USD 177 million with a dividend of 10% of the face value (USD 18 million) in perpetuity should be issued. This was subsequently changed to base the dividend on the profits after tax of GGL and the dividend was fixed as 85% of the estimated after-tax profits, ie USD 21 million x 85% = USD 18 million.

The preference shares were issued on this basis in a share subscription agreement between Olympus Corporation, GGL, AXES and AXAM, dated 30 September 2008.

- iv) Critically, on 3 October 2008, three days after the execution of the share subscription agreement, the Olympus officers involved agreed to a variation of the agreement, by a separate exchange of letters with AXAM, which granted AXAM certain rights of control, in particular a veto power over GGL's decision on important matters.
- v) There is no evidence of the Olympus officers involved carrying out a due diligence exercise into the investors behind AXAM, a company registered in the Cayman Islands, prior to the issue to them of the preference shares.
- vi) The Olympus officers involved took no professional advice in relation to a) the calculation of the value of preference shares nor b) the annual rate of return which should be applied to these to achieve a value equivalent to the liability under the share options.
- vii) On 25 November 2008, less than two months after entering into the share subscription agreement with AXES/AXAM, Olympus was approached by AXAM who explained that they were seeking to liquidate AXAM's entire investment assets and requested Olympus to either assign the agreements to another party or buy back the preferred shares entirely. Attached to AXAM's communication were two valuations from them placing a value on the preference shares of between USD 532 million and USD 592 million.

On 26 November 2008, the Olympus officers involved obtained their own valuation from Shinko Securities Co Ltd, which confirmed a value of USD 557 million.

On 28 November 2008, the Olympus Board of Directors' meeting approved for the company to buy back the preference shares in the range USD 530 million to USD 590 million.

Summary of Review Findings 1.5:

The Olympus officers involved went against the advice of professional advisors to settle the liability for the share options with a cash payment and decided to issue preference shares instead. In calculating the value of the preference shares that should be issued and the annual rate of return that should be applied, the Olympus officers involved took no professional advice. Additionally, there is no evidence of the Olympus officers involved carrying out any due diligence on the parties connected with AXAM based in the Cayman Islands prior to granting them preference shares in the company.

Significantly, the issue of the preference shares (with a dividend of 85% of the after-tax profits of GGL in perpetuity) **converted a liability in respect of share options, under Agreement 2, of USD 177 million to a liability of between USD 530 million to USD 590 million.**

Taking into account the payments already made in respect of the basic fee (USD 5 million), the cash element of the completion fee (USD 12 million) and the settlement of the warrants (USD 50 million), the **total fees on the purchase of GGL, payable or paid, at this point were between USD 597 million and USD 657 million**, compared with the market rate for the provision of such services of around 1%, up to a maximum 2% (ie between USD 20 million and USD 40 million).

1.6 Final settlement of liability in respect of preference shares

On 16 March 2010, Mr Sagawa, on behalf of AXAM, wrote to Olympus requesting the immediate buy back of the entire AXAM holding of preference shares at a value of USD 730 million and requested for the cash to be remitted by the end of March 2010.

In this communication, AXAM provided a calculation to support this request, which included an uplift of 20% in respect of a 'control premium', based on:

- i) The rights of veto on important decisions granted to AXAM in the letter dated 3 October 2008.
- ii) The rights to 85% of the corporate value granted through the dividend of 85% of the profit after tax attached to the preference shares.

The Olympus officers involved carried out their own valuation indicating a value of the preference shares of USD 519 million, taking into account the net asset value of the company, the rights of veto power of AXAM and a control premium.

Following negotiation, the Olympus officers involved agreed with AXAM to settle on USD 620 million, being the mid-point of the two values (USD 730 million and USD 519 million). This balance of USD 620 million was paid to AXAM in the Cayman Islands through OFUK on 31 March 2010.

Review findings:

- i) There is no evidence of the Olympus officers involved taking professional advice in relation to the calculation of the valuation of USD 519 million used in the negotiations with AXAM.
- ii) The Board of Directors' meeting, on 19 March 2010, approved the repurchase of the preference shares at USD 620 million.
- iii) The repurchase of the preference shares increased the goodwill at 31 March 2010 by JPY39.5 billion (USD 435 million).

1.7 Financial assistance, false accounting and audit report qualification

i) Financial assistance:

Under the UK Companies Act 1985, it was unlawful for a Private Limited Company to give financial assistance for the purposes of assisting a purchaser in relation to the acquisition of shares in that company. In issuing preference shares to AXAM, Gyrus was giving such financial assistance to Olympus.

At the time this transaction took place, **such financial assistance constituted a criminal offence with the result that the company is liable to a fine and its Directors liable to a fine or up to two years imprisonment.**

Furthermore, the **Directors involved are at risk of having breached their fiduciary duties and are therefore liable to account for any losses suffered by the company and for disqualification under the Company Directors' Disqualification Act.**

ii) False accounting:

There was misrepresentation in the filed financial statements of GGL for the period ended March 2009 in relation to both a) the value of the preference share liability (at face value) in the balance sheet and supporting note, and b) the statement in the Directors' Report that, "*in the opinion of the Directors, it is not meaningful to estimate a fair value for these preference shares*". This is clearly a misrepresentation by the Directors of GGL, as the Olympus Board had already approved, at its meeting on 28 November 2008, the buy-back of the preference shares at a value significantly in excess of the face value of the shares.

iii) Audit report qualification:

In expressing an audit opinion on the accounts of GGL for the period ended 31 March 2009, KPMG state:

"we are unable to form an opinion as to whether the financial statements give a true and fair view"

and, significantly, in relation to the issue of preference shares concluded,

"in our opinion proper accounting records have not been maintained."

1.8 Overall summary of review findings in relation to the fees paid to financial advisors in connection with the purchase of Gyrus

I believe it is important to summarise the overall findings to date which should be read in conjunction with the PwC report:

- i) There is no evidence of any due diligence having been carried out on AXES or AXAM, a company registered in the Cayman Islands and struck off in June 2010 for non-payment of licence fees. Furthermore, according to a note filed at the local corporate registry, as such, the company is not legally authorised to continue being active.

- ii) No professional advice was obtained in relation to the reasonableness of the fee structure within Agreement 2, to establish whether this was competitive in relation to the market rate for such financial advisor services.
- iii) There was no formal Board approval prior to the signing of Agreement 2 on 21 June 2007, which was approved on a 'ringi basis' by Mr Kikukawa, Mori-san and Mr Yamada and only retrospectively approved by the Board of Directors' meeting on 19 November 2007, some five months later.
- iv) The terms of Agreement 2 resulted in a liability for the company of USD 244 million for fees in respect of financial advice, equivalent to 12% of the purchase price of GGL and around ten times the market rate for such services.
- v) The Olympus officers involved chose not to accept the professional advice provided by KPMG and Weil, Gotshal & Manges to settle the liability for the share options by making a cash payment and decided instead to proceed with the issue of preference shares as requested by AXES/AXAM.
- vi) The Olympus officers involved took no professional advice in relation to the calculation of the value of preference shares and the annual rate of return applied to these shares. The calculation basis employed resulted in the liability in respect of the share options granted under the terms of Agreement 2, increasing from USD 177 million to a liability of between USD 530 million and USD 590 million.
- vii) The company eventually settled on a value of USD 620 million to repurchase the preference shares.
- viii) **The total fees paid to AXAM/AXES in respect of the acquisition of GGL totalled USD 687 million, equivalent to approaching 35% of the purchase price of GGL. This compares with a market rate for services of this type of around 1% (USD 20 million), up to a maximum of 2% (USD 40 million).**

2. ALTIS, HUMALABO AND NEWS CHEF

The following is a summary of the key points arising from a review in relation to the acquisition of Altis, Humalabo and News Chef (A H & N).

Over the period between May 2006 and April 2008, the company acquired the majority controlling interest of A H & N, completing the final tranche of purchases in April 2008.

The total purchase price paid for the three companies was as follows:

Company	Purchase Price	Purchase Dates
Altis	JPY 28,812 million	May 2006 – April 2008
Humalabo	JPY 23,199 million	Sept 2007 – April 2008
News Chef	JPY 21,408 million	May 2006 – April 2008
TOTAL	JPY 73,419 million Approx USD 773 million	

As part of the year-end closing for the year ending 31 March 2009, the investment in these three companies was written down as follows:

Company	Purchase Price	Purchase Dates	31 March 2009 Impairment	% of value amortised
Altis	JPY 28,812 million	May 2006 – April 2008	JPY 19,614 million	68%
Humalabo	JPY 23,199 million	Sept 2007 – April 2008	JPY 18,370 million	79%
News Chef	JPY 21,408 million	May 2006 – April 2008	JPY 17,699 million	83%
TOTAL	JPY 73,419 million USD 773 million		JPY 55,683 million USD 586 million	76%

In summary, approaching USD 600 million, 76% of the value of these companies, was impaired in the same fiscal period as the final tranches of shares were purchased.

Review findings:

- i) There is no evidence of the Olympus officers involved carrying out appropriate due diligence on the third party shareholders (Dynamic Dragons II SPC, Neo Strategic Venture, Tensho Limited, Global Target SPC, New Investments Limited, Class Fund IT Venture), from which the shares of Altis, Humalabo and News Chef were purchased.
- ii) The details of the impairment were presented to the meeting of the Board of Directors for the 141P annual closing on 12 May 2009, and the write down of the values were approved by the meeting.
- iii) The Third Party Report prepared by Messrs Matsumoto, Takahashi and Nakagawa, dated 17 May 2009, was presented to me to justify that there had been no breach of duty of care by the Directors involved in the decision making. However, there is no reference in the Report to the decision to write down the value of the investments in the three companies by such a significant amount, and the minutes of the Board meeting of 12 May 2009, which approved the write down, are not stated in the list of materials reviewed by the Report's authors.

The fact that the values had been written down by such a material amount would have been principal in reaching the conclusion stated in the report that the Directors involved had not breached their duty of care.

Furthermore, the report makes reference to discussions between its authors and Mori-san, Mr Onishi and Mr Matushita which took place on 14 May, 17 May and 18 May, after the impairment had been approved by the Board on 12 May 2009, raising concerns that this information may have been withheld from the Report's authors.

- iv) The company made investments totalling approaching USD 800 million with the final share purchases being made in April 2008, yet, **the value of this investment was written down by almost USD 600 million, to only 25% of the value, within the same fiscal period that these last share purchases were made.**

3. OTHER CONCERNS PREVIOUSLY RAISED

In my first letter to Mori-san dated 23 September 2011, in addition to the concerns in relation to the financial advisor fees for the acquisition of Gyrus, and the goodwill impairment relating to the three companies, I raised a number of other concerns. As you will appreciate, while the focus has been on the issues highlighted in Sections 1 and 2 above, I would still like answers to the questions raised in my communication in relation to the following:

- A full impairment test of the goodwill & intangible assets resulting from the Gyrus acquisition
- BioTech
- ITX & other companies
- The background to the change of Auditors from KPMG AZSA & Co to E&Y Shin-Nihon LLC

4. CONCLUSION

As evidenced by the PwC report in relation to the acquisition of Gyrus, there has been a catalogue of calamitous errors and exceptionally poor judgement which, when taken together with the purchase of Altis, Humalabo and News Chef, has resulted in the shocking destruction of shareholder value of USD 1.3 billion. This has parallels to the recent scandal at UBS where a rogue trader in London lost the bank large sums of money and the senior management resigned in recognition of the lack of adequate controls. In my view, the issues associated with Gyrus and the acquisition of companies with no real value are, in many senses, more disturbing, in that the transactions were carried out by the most senior officers of Olympus and not by a junior member of staff.

Tom, aside from the poor judgement you acknowledged to me in our meeting on Thursday 29 September in relation to the acquisition of Altis, Humalabo and News Chef, it is truly extraordinary and frankly unbelievable that Olympus, a major Nikkei listed public company, made a series of payments approaching USD 700 million in fees (equivalent to approaching 35% of the purchase price of Gyrus) to a company in the Cayman Islands, whose ultimate ownership is still unknown to us, preventing the auditors from verifying that no related parties were involved. If the facts, both in relation to the absolute amount paid in fees and that we don't know to whom these payments were made, were openly known by all our shareholders in Japan and around the world, it would be profoundly damaging to the company's reputation. As the PwC report highlights, three months after Olympus made the final payment to AXAM of USD 620 million, AXAM Investments Limited was struck off in June 2010 for non-payment of licence fees.

In relation to the Japanese shareholders, as you may know I have had an exchange with Mori-san because I was concerned that the announcement of my appointment as CEO had not yet been published in Japanese on the company website. Mr Mori commented to me on the sensitivities in relation to the banks but, subject to the appropriate legal clearances, please do consult with them and for that matter, all the major shareholders, forwarding them copies of my communications and the PwC report. I have absolutely no sensitivity in meeting with them and discussing the issues involved openly and directly. These institutions obviously have their own responsibilities to their shareholders in that their investments are being managed in a correct and proper manner.

In putting the company first, the honourable way forward would be for you and Mori-san to face the consequences of what has taken place, which is a shameful saga by any stretch of the imagination. It is clear that the current situation is now untenable and to move forward positively the necessary course of action is for you both to tender your resignations from the Board. This approach would allow the situation to be managed in a discreet manner and minimise the reputational damage to both Olympus and yourselves. If your resignations are not forthcoming, then there is a principal obligation upon me in respecting my fiduciary duties, to raise, with the appropriate parties, my fundamental concerns in relation to the governance of the company.

I return to Japan tomorrow but am then visiting Tohoku and therefore suggest that I meet with you and Mori-san on Friday to discuss exactly where we go from here.

Yours sincerely,

MICHAEL C WOODFORD, MBE
President and CEO
Olympus Corporation

Enc: Interim report on Governance Concerns in relation to the acquisition of Gyrus Group Ltd by Olympus Corporation, dated 11 October 2011

cc: Olympus Corporation Board:

Mr Hisashi Mori, Group President – Group Management Office
Mr Haruhito Morishima, Group President – Medical Business Group
Mr Kazuhisa Yanagisawa, Group President – Corporate R&D Center
Mr Shuichi Takayama, Group President – Imaging Business Group
Mr Takashi Tsukaya, Group President – Corporate Monozukuri Innovation Center
Mr Makoto Nakatsuka, Group President – Corporate Center
Mr Masataka Suzuki, Group President – Asia & Oceania Management Group
Mr Shinichi Nishigaki, Group President – Life & Industrial Business Group
Mr Hironobu Kawamata, Group Vice President – Corporate Center
Mr Karl Watanabe, President – Corporate, Olympus Corporation of the Americas
Mr Hideo Yamada, Standing Corporate Auditor
Mr Tadao Imai, Standing Corporate Auditor
Mr Hiroshi Kuruma, Outside Director
Mr Yasuo Nakamura, Outside Corporate Auditor

Ernst & Young managing partners, Japan, Europe and the United States:

Mr J Turley, Global Chairman & CEO
Ms V Cochrane, Global Managing Partner, Global Quality & Risk Management
Mr Y Kato, Area Managing Partner – Japan Area
Mr S Howe Jr, Area Managing Partner – Americas
Mr M Otty, Area Managing Partner – EMEIA

Mori Hamada & Matsumoto:

Mr Takashi Miyatani, Partner, Attorney at Law