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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to TomTom's Third Quarter 2021 Earnings Conference Call. (Operator Instructions) Please note that this conference is being recorded. I will now turn the call over to your host for today's conference, Claudia Janssen, Head of Investor Relations and Group Control. You may begin.

Claudia Janssen - TomTom N.V. - Group Controller & Head of IR

Thank you, operator. Good afternoon, and welcome to our conference call, during which we will discuss our operational and financial highlights for the third quarter 2021. With me today are Harold Goddijn, our CEO; and Taco Titulaer, our CFO.

We will start today's call with Harold, who will discuss the key operational developments, followed by a more detailed look at the financial results and outlook from Taco. We will then take your questions. As usual, I would like to point out that Safe Harbor applies. And with that, Harold, I would like to hand over to you.

Harold C. A. Goddijn - TomTom N.V. - Co-Founder, Chairman of the Management Board & CEO

Yes. Thank you very much, Claudia. Welcome, ladies and gentlemen. Thank you for joining us today. I will briefly go over the key operational highlights for the quarter, and then Taco will provide further information on the financials and the outlook for the year.

The first 9 months of 2021 have delivered both positives and negatives. I think Enterprise continues to perform solidly, but of course the recovery of the Automotive segment disappointed, because of industry-wide semiconductor shortages. Encouragingly, the way we engage with our customers is evolving from a more traditional supplier-customer relationship to a more partner-based approach.

Carmakers, in particular, are quickly developing software engineering capabilities, and we see more effective collaboration models that turn into long-term partnerships, customer intimacy, effective and productive engineering collaboration and, most importantly, better products.

We've also developed, with our customers, mutually beneficial data exchange programs. We are structurally increasing those programs, which now involve, next to floating-car data, large-scale exchange of sensor-derived observations from vehicles, as well as map editing partnerships where we give customers direct access to our map database using friendly map editing tools. We are now at a point where we increasingly convert those data streams in our automated mapmaking processes to ensure fresher and better maps.

We extended in the quarter, our long-standing partnership with Precisely, which is formerly known as Pitney Bowes, and we'll continue to provide map and traffic data, which Precisely incorporates in their location and enrichment products.

In Automotive, we saw the launch of the new Jeep Grand Cherokee and the Jeep Compass, which both feature a full stack navigation with over-the-air updates and an array of connected services. Fiat launched the new Ducato, which is Europe's best-selling light commercial vehicle, and that car utilizes our full stack navigation, extensive connected services, ADAS. And all those products in combination enhance safety and let drivers avoid roads that are not suited for the vehicle. We also launched a real predictive traffic service in the Ford Focus.

Over the first 9 months of 2021, deal activity for both Enterprise and Automotive has been strong, and we expect further significant wins for the last quarter of the year.

This concludes my part of the presentation, and I'm handing over to Taco.

Taco J. F. Titulaer - TomTom N.V. - Member of Management Board & CFO

Thank you, Harold. I will make some comments on the reported numbers and updated outlook, and then we'll go to the Q&A. We reported group revenue of EUR 127 million for the third quarter, which is a year-on-year decrease of 14%. Location Technology decreased 10% year on year to EUR 95 million.

Let me go through revenue business by business. Automotive IFRS revenue was EUR 52 million, representing a decrease of 21% compared to the same quarter last year. Automotive operational revenue, which is IFRS revenue adjusted for the movement in deferred revenue, decreased 17% to EUR 58 million. These year-on-year decreases are primarily related to lower vehicle production, which is a result of ongoing industry-wide semiconductor shortages.

Enterprise reported revenue of EUR 43 million, a year-on-year increase of 8%. This increase is primarily due to the expansion of contracts from existing customers.

Consumer revenue decreased 24% year on year to EUR 32 million, as overall demand for the category is decreasing. That said, the production and consequently, the sales of our PNDs was also impacted by supply chain issues, implying that we could have done better if we have more product to ship.

Gross margin for the third quarter was 81%, an improvement of 5 percentage points year on year. The third quarter of 2020 was negatively impacted by the start of production of new software platforms in Automotive, which triggered the release of costs associated with non-recurring engineering. This quarter, in 2021, there were hardly any incidentals, so the north of 80% gross margin is a good proxy of what is normal.

Operating expenses were EUR 126 million, representing a decrease of EUR 53 million compared with the same quarter last year. This decrease results from lower amortization since the Tele Atlas databases that were acquired in 2008 were fully amortized last year. Excluding the impact of depreciation and amortization, operating expenses are roughly flat. Increased research and development relating to our application layer were offset by savings in sales and marketing.

The free cash flow for the quarter was an outflow of EUR 14 million compared with an outflow of EUR 20 million in the same quarter last year. This improvement reflects the timing of cash receipts from our customers. We reported a net cash position of EUR 302 million at the end of the third quarter.

Now moving to the next slide. Looking ahead, we reiterate our revenue guidance, although we anticipate full year revenue to come in at the low end of the range for both the group and Location Technology. Shortages of semiconductors continued to hamper car production volumes, which impacts Automotive revenue.

For the year, we expect group revenue of around EUR 500 million to EUR 530 million and Location Technology revenue between EUR 400 million and EUR 430 million. As a result of lower-than-anticipated operational Automotive revenue, we are adjusting our free cash flow guidance. We now expect full year free cash flow to be around 2% of group revenue.

Though we had a cash outflow in the first 3 quarters of the year, we want to emphasize that our cash inflow this year is weighted towards the last quarter of the year due to the timing of various customer payments.

Operator, we would now like to start the Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question, sir, comes from the line of Marc Hesselink from ING.

Marc Hesselink - ING Groep N.V., Research Division - Research Analyst

First, on the collaboration that you mentioned, the close collaboration with the OEMs. What does that mean that more strategic improvement? What does it mean for the position that you have on pricing and maybe also joint R&D? Does that change the unit economics of your business? Second question is -- Okay, please go ahead.

Harold C. A. Goddijn - TomTom N.V. - Co-Founder, Chairman of the Management Board & CEO

Okay, I'll take the first question first then. Sorry, there is a small delay online, so apologies.

No, it doesn't change the unit economics necessarily, but what it does do is it improves the efficiency and the value creation. I think one of the key issues that we want to address is to get the end-user experience for in-built navigation systems at a higher level, where we can successfully compete with mobile phone usage. And we see a number of positive trends. First of all, there's more glass in cars. So the screens are getting bigger and there are more screens. And those screens have a completely different form factor from the mobile phone.

Secondly, we see deeper integration with other systems in the vehicle, ADAS, safety systems and so forth. And thirdly, we see deeper integration, because of electrification. And in order to come up with the right product, we see that more and more OEMs are kind of moving away slightly from the typical RFQ process, which is a horrible process. I understand why it's there, but it is not helping in efficiency, efficient collaboration, discovery, experimentation, integration of user feedback in the final product, A/B testing, that kind of things.

A typical RFQ process cannot provide for those subtleties. And if you base your collaboration with a carmaker on a different footing, more, deeper integration, closer collaboration allowing for discovery and innovation, that significantly reduces the cost on both sides. So, it reduces cost for carmaker, reduces cost for us, and it will lead to better products and a better end-user experience. And for us, it's important because we enter a more trusted longer-term relationship where it's not just all about money, but also about innovation, quality and end-user satisfaction.

And I think that's a relevant development for survival and growth of embedded navigation information systems in general. And we seem to be particularly well placed to be the trusted party for -- with more and more carmakers. So net-net, I see this as a long-term positive, not necessarily affecting the unit economics, but certainly affecting the value creation, which we can achieve in collaboration with our customers.

Marc Hesselink - ING Groep N.V., Research Division - Research Analyst

Okay, clear. And then the second question was actually quite some questions in one. And it's all about, how do you expect this industry to normalize? So first, we had COVID, and then we have the -- also the second lag effect, the semiconductor shortages. Do you believe that the lost production over the last 2 years will be caught up at some stage? What order did you see in the underlying trends of, for example, take rates, if you go back to like a normal situation with supply chains again? Do you think that take rates will be higher again?

Harold C. A. Goddijn - TomTom N.V. - Co-Founder, Chairman of the Management Board & CEO

It's -- it's as hard for us as for anyone else, is the honest answer, to predict where this will go and what the net effect will be for the remainder of this year and even for 2022. The real answer is, there is historically a very low level of visibility. If you look at the macro, then we see that delivery times for new vehicles are at their all-time longest. We see prices of secondhand vehicles at their all-time high. So you would expect that there is -- and those numbers suggest there is undersupply and to an extent, pent-up demand.

When carmakers can start to address that demand, and not being knocked off course by component and supply chain issues, is anybody's best guess. But unfortunately, what we have not seen in Q3 and what we're also not seeing in Q4 is an easing of the situation for the remainder of the year. And there's also nothing in the market reports, in the press releases from various players, that are active in the -- particularly in the semiconductor market that suggests that the shortages will disappear anytime soon.

We hope, of course, in 2023, things will ease and people will be able to deal with those issues in a better way. But I think everybody is trying to figure out what it means for '22 and when those shortages will stop compromising total production output.

Marc Hesselink - ING Groep N.V., Research Division - Research Analyst

Okay. What does that mean for your '23 target? If I'm correct, it was more like a top-down approach, you're really looking at car volumes and take rates and then taking your share. If everything is back to normal, does it mean that the '23 targets are still -- that is still possible?

Harold C. A. Goddijn - TomTom N.V. - Co-Founder, Chairman of the Management Board & CEO

Yes. Yes. And yes, that is -- that would still be possible. If in '23, you're talking '23 now particular, Marc, I take it. If in '22, we can leave all this behind us and things are back to normal and everybody has adjusted their systems, then indeed we could be looking at some tailwind instead of headwind for '23 going forward. It's also a question to what extent the pent-up demand will translate into extra production. Various models, various ways to model that, nobody really knows, but there will be an effect that the underserved market in '21 and potentially '22, will then strongly recover in '23.

Operator

(Operator Instructions) We do have a question, sir, we are just taking the name for you, one moment. (Operator Instructions) We do have a question, and it's from the line of Francois-Xavier Bouvignies.

Francois-Xavier Bouvignies - UBS Investment Bank, Research Division - Technology Analyst

I have a couple, if I may. The first one is on the 2022 is a bit of a follow-up of the previous question. Can you maybe give us a sense of how should we think about the Automotive revenue growth for TomTom in 2022? And I don't expect you to give a quantification here, but more like a qualitative, what are the main drivers that will be in 2022 on top of the production forecast from IHS that we are seeing for double-digit percentage growth on the production in 2022? So how should we think about TomTom's growth related to that? And what are the drivers, you're looking into 2022? That's my first question.

Taco J. F. Titulaer - TomTom N.V. - Member of Management Board & CFO

Yes. No, yes, Francois. Let me take the first question. The -- we expect Automotive to grow next year, double digit indeed. The exact number we need to see that it also depends of course on how we end the year. Best estimate is that it starts with the 2 -- double digits starting with 2, but it's a bit too early for us to call it. That's based on our assessment of global data suppliers and the input that we get from our customers directly.

Francois-Xavier Bouvignies - UBS Investment Bank, Research Division - Technology Analyst

Okay. That's very helpful. Thank you, Taco. And maybe on the order booking side or your backlog since now you disclosed the backlog. How should we think about TomTom's market share? I mean -- and the market size this year. If I remember last quarter -- I mean, the last 2 quarters, you were talking about some strong year possibly that could -- in terms of deals that could be signed. How should we think about the market share of TomTom and how you think you are competing with your competitors, i.e., HERE or Google, based on what you are seeing on your design wins?

Taco J. F. Titulaer - TomTom N.V. - Member of Management Board & CFO

Well, yes, a couple of comments that we want to make is that, first of all, you've seen our product offering, we are expanding our product offering from traditionally only maps, or only traffic, or a combination of traffic and maps, to more whole suite of offerings. So it is -- if we compare ourselves against HERE, then we tend to compare ourselves only on the map business and not so much on navigation software and traffic, because there -- on those areas, we see different competition.

But one of the trends that for us is happening is that we are taking definitely more share in the application layer, so more on a navigation software than we had before. That used to be -- or still is very fragmented market with over a dozen players, a lot of the Tier 1s used to operate there. And there is -- that's an area where we we're probably the biggest market share player today, but we are going from strength to strength. And on the deal wins, yes. If we look at the deals that -- where we participate, we have a good ratio of where we win and where we do not win. But we also need to realize that we're not seeing everything as some deals don't come to us, because they're an extension of the existing contract. But I think, if anything, the win rate is stable or even going up over the last period.

Francois-Xavier Bouvignies - UBS Investment Bank, Research Division - Technology Analyst

Okay. That's helpful. And what's -- on the software or application layer, you can mention, what do you think -- why do you think you are getting market share? What is the -- your assessment of the reason behind it?

Harold C. A. Goddijn - TomTom N.V. - Co-Founder, Chairman of the Management Board & CEO

Well, we have a couple of class-leading products in -- especially in navigation and traffic and traffic services is an important one. We are typically better positioned to integrate those services in the application layer. We can do that faster, cheaper, better. And as a result, you get a class-leading end-user experience. And so that's going well. We spend a lot of time and effort in designing those navigation services and that is also paying off.

We're in the process of developing a new suite that's even easier to integrate, easier to customize. We'll launch some new important components in the product portfolio towards the end of this year. It is going well. We see that the movement to online service delivery is accelerating. That's good for us. Again, from an end-user perspective, you get a better product. From a production perspective, it's a lot easier to integrate and to build and to -- and it leads to simplification of our product portfolio.

So we see -- across the board, if you look at the product portfolio, it's going online. We are well underway in that transition that leads to better products, simplification of product portfolio, more common components, more common products and simplification of the product portfolio. If you look at distribution between Enterprise and Automotive, all in all, there is room for simplification both of our product portfolio and of our organizational structure. And that is exactly what we need and I see that simplification accelerating over '22 and '23.

Francois-Xavier Bouvignies - UBS Investment Bank, Research Division - Technology Analyst

And maybe the last one for me is on HD maps. So can you give us an update on where you are in the HD maps? It has been maybe delayed from your previous comments with COVID, but any revival there or should I think about this?

Harold C. A. Goddijn - TomTom N.V. - Co-Founder, Chairman of the Management Board & CEO

It's alive and kicking, and we had some wins this year for HD. I think we are now the -- one of the largest vendors in terms of market share of HD Maps, from what we can see. So that is going well. But the overall take rate is not where we had expected to be, to be quite frank. So in terms of market share -- well, the number of cars that are fully reliant on -- the take rate in terms of moving up to level 3.5, 4, fully supported by lane-level maps, is still very much a niche part of the market.

Francois-Xavier Bouvignies - UBS Investment Bank, Research Division - Technology Analyst

So still not significant at the revenues or bookings level?

Harold C. A. Goddijn - TomTom N.V. - Co-Founder, Chairman of the Management Board & CEO

No, it's not -- well, it is and it isn't. It's not significant in terms of revenue, not in this year. We'll see an uptick in 2022. But in terms of market share and technology, if you -- if it will happen, we're very well positioned to capture the momentum.

Francois-Xavier Bouvignies - UBS Investment Bank, Research Division - Technology Analyst

Makes sense. Thank you very much.

Harold C. A. Goddijn - TomTom N.V. - Co-Founder, Chairman of the Management Board & CEO

So I'm happy about that. And then the other thing is that the new technologies are becoming available now to produce those maps in a more cost-effective way, in a more automated way. And that's also a very significant. I think the first version of the maps we built were all mobile mapping car-driven. That's expensive and you get low frequency. And that's good enough for the type of applications we're talking about now. But to take this to the next step, you need much more sources and high-frequency sources. We're getting those now. And it's very exciting to work on those new signals to produce those maps at scale in a highly automated way.

Francois-Xavier Bouvignies - UBS Investment Bank, Research Division - Technology Analyst

Yes. It's interesting what you're saying, because I mean, it was supposed to be my last question, sorry, I will squeeze one quickly. But the automation, I mean, how much cost improvement versus the old -- I mean how much can you get in terms of cost improvement versus nonautomated maps, did you quantify the benefits of this automation that is going through?

Harold C. A. Goddijn - TomTom N.V. - Co-Founder, Chairman of the Management Board & CEO

No, I can't do it at this stage. I can do that in 2022. But we are working really, really hard to really optimize and to really fully capitalize on those new ways of mapmaking. And I've said it before as well, there's a whole new class of open source data, there is a whole new class of sensors, there's a whole new class of data that are hitting our servers continuously in continuous streams. That asks for a different way of looking at mapmaking. And I'm talking not about an evolution, but more about a revolution. And -- so that's very exciting to work on that. And we have a good basis. We spend

-- we've been talking about it for years now. We spent considerable amount of money of building the transactional mapmaking system. That will be the core of our automation efforts going forward.

So we feel that from a market perspective, technology perspective and capability perspective, we are in a very good position to truly leverage those new data sources and create something that is better, has better coverage, is fresher and is a more accurate representation of what's happening in the real world.

Operator

(Operator Instructions) And your next question comes from the line of Wim Gille.

Wim Gille - ABN AMRO Bank N.V., Research Division - Head of Research & Equity Research Analyst

Yes. Wim Gille from ABN ODDO. I got a few questions as well. First, let's say, on the order book development. I think we have alluded to and discussed kind of the, let's say, order intake and kind of the commercial success that you have in that area. So, it's going to be a good year in terms of order intake, both in terms of the quantity as the win rate. But obviously, we also have the other side of the -- one of the other components that eventually dictates the order book, which is the fact that the OEMs might reassess their volumes going into the future, which might have an impact on the order book as well.

So can you give us a bit of a feeling where you think that this will basically end up? Is that, let's say, positive contribution on the order intake, large enough to offset the, let's say, changes that you might see in terms of kind of the deviation from the original plan? That will be my first question.

The second question, as you mentioned quite a few quarters that you're taking share in the software part, which obviously is good, because it grows your total addressable market, but obviously, what it requires is connectivity, and to have cars on the road that are actually connected. So if you look at kind of new car launches into 2022, '23, what is the percentage of cars that is actually connected where you basically can offer a navigation software experience, which is equivalent to or better than smartphones?

And also in relation thereof, the idea was always, let's say, you would reduce the spend on expanding the geographic layer through automation and that you would increase the spend on the application layer, basically coming up with new products and innovations and basically improve the time to market there as well. But I haven't seen this filtering through in the P&L just yet. So can you give us -- it's been relatively stable for, what is it, the past 8 quarters. Can you give us an indication on when we actually see that shift happening in the P&L?

Taco J. F. Titulaer - TomTom N.V. - Member of Management Board & CFO

Okay. Let me take -- let me take the first question on the backlog. So we reported EUR 1.8 billion with Q4 numbers. If we do a preview of what we can report in February, then we will deduct from that EUR 1.8 billion, roughly EUR 235 million, let's say, of Automotive revenue. Then you add the order intake. There is a potential that that is a higher number than the EUR 235 million. And then you need indeed to correct -- and the third driver is the correction or an assessment of what is then remaining in the order book, now.

Up until now, we haven't seen major reassessments from our customers. Sometimes lines are pushed out a little bit, but so well -- that will run a half year longer at -- and maybe the first period has slightly lower numbers, but overall, the volumes will stay intact. I agree with you that it is probably more likely than not that there might be a reassessment, although we don't have any data to support that at this point. So we haven't heard from our customers that they -- that they're moving to the next platform earlier or as scheduled, and in between the volumes will be lower.

So where we are now -- I will be positive about the backlog with that caveat that the reassessment that tends to take place in December and January, hasn't happened yet, and we need to have a look on what kind of effect that has.

On the last question...

Wim Gille - ABN AMRO Bank N.V., Research Division - Head of Research & Equity Research Analyst

Before we move on. And because essentially, Q3 and Q4 were hampered by supply chain issues. So the factories are basically not producing on the right levels. So car registrations are down, what is it, 25%-ish. If we would assume that these are lost revenues, et cetera, what will be the impact on your order book?

Taco J. F. Titulaer - TomTom N.V. - Member of Management Board & CFO

Yes, that is hard to say, because what you don't know is what will happen with the programs that we're serving. So -- the contracts are not time-bound in any way. It is just -- it's more related and is -- what we get as input is an indication on what the time period is and the total volumes. But what could also happen is and what we already kind of received as feedback, that the model can be later introduced or will serve longer in the market. So I understand your question, but I'm hesitant to do that calculation, because it gives the wrong signal.

Wim Gille - ABN AMRO Bank N.V., Research Division - Head of Research & Equity Research Analyst

Very clear.

Taco J. F. Titulaer - TomTom N.V. - Member of Management Board & CFO

On the mix in geographical data and application layer. Well, what you see happening is that the application layer is growing, although perhaps not as fast, but it is growing. The geographical data layer isn't declining yet as much to really create that shift. Harold spoke about it already, the revolution of map making that is about to happen. The effects on our costs, that will take a little bit more time. Higher quality, lower costs, lower latency -- latency is also a clear benefit of the automation and the new technology. I expect a significantly different cost base in geographical data, we will start to see that in 12 to 18 months from now.

Wim Gille - ABN AMRO Bank N.V., Research Division - Head of Research & Equity Research Analyst

Good, good. And then the percentage of connected cars looking at the pipeline of your customers? How is that evolving?

Harold C. A. Goddijn - TomTom N.V. - Co-Founder, Chairman of the Management Board & CEO

So for electrical vehicles, it's 100%. But also for combustion engines, you see nearly all new programs have some form of connectivity on board.

Wim Gille - ABN AMRO Bank N.V., Research Division - Head of Research & Equity Research Analyst

Okay. So that basically means that it could accelerate quite fast in that sense.

Harold C. A. Goddijn - TomTom N.V. - Co-Founder, Chairman of the Management Board & CEO

Yes, it can. And I think the carmakers got the message now. If you don't have connectivity, you -- it's not possible to compete. You don't get the dynamic information. You can't find the electrical charging points. You don't get the traffic information. And if you don't have those things, then you cannot deliver a complete end-user experience.

Wim Gille - ABN AMRO Bank N.V., Research Division - Head of Research & Equity Research Analyst

That is indeed very clear. Maybe a follow-up question on what you mentioned. Because basically, you say the relationship with our clients is changing on the back of kind of the changing nature in the market in itself. We don't have to fill in 1,000 pages of lawyer mumbo-jumbo and an RFQ, but we have instead a partner relationship where we jointly with our customers are developing new products and new platforms, et cetera. So you don't enter into any kind of competitive bidding per program anymore. But how do -- does a client, let's say, choose you or competitor in this process? And how does that work? Do they kind of work together with you exclusively? Or are you working in some sort of kind of consortium type of stuff where you basically add a few components and you might be kind of in there together with HERE, where HERE is doing the map and you are doing the navigation software, et cetera. So how does it work?

Harold C. A. Goddijn - TomTom N.V. - Co-Founder, Chairman of the Management Board & CEO

Well, so don't get me wrong. The RFQ is still there. So you still need to pitch and you're still in a competitive environment, and that's to be expected. No one is signing up to one single supplier for the rest of his life. That's just not the way the world works. But the -- the way the RFQs are now constructed is more reasonable. So you said it was traditionally feature-driven. So you've got a long list of -- a spreadsheet with tick boxes and god knows what, you had to deliver all those things and then that was the end of it. And then you would forget about that product. We ship it -- ship and forget, that's what we would call it. That doesn't work.

And what you now see is a more shared goal that has more to do with Net Promoter Score, J.D. Power Score, end-user satisfaction, where you have a lot more flexibility in collaboration with your customer to make solutions that are actually hitting the spot head-on. And if that works -- and we are particularly well positioned to play that role, because of our heritage in consumer products, our focus on end-user design, industrial design, we've done that as well. We have a strong heritage in all those things. We understand what it takes to make successful end-user products. We have the right technology stack.

So in those contexts, our relative competitive position is improving. And if we then do a good job, then the chances are that you will be reselected are higher than when you come from far. You build intimacy with the other engineering teams and suppliers and all the rest of that. So you kind of have different incentives to make those collaborations work than in the olden days. That doesn't mean that competition is not there anymore, not involved anymore. But we, as TomTom, are particularly well positioned to win in that context.

Claudia Janssen - TomTom N.V. - Group Controller & Head of IR

Since there are no further questions, I would like to thank you all for joining us this afternoon. Operator, you can close the call.

Operator

Thank you. Ladies and gentlemen, that does conclude our conference for today. Thank you all for participating. You may now disconnect.

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