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PRESENTATION

Operator

Good day and welcome to TomTom's Third Quarter 2023 Results Conference Call. (Operator Instructions) Please note that this conference is being recorded. I will now turn the conference call over to your host for today's conference, Freek Borst, Investor Relations. You may begin.

Freek Borst - TomTom N.V. - Investor Relations

Thank you, operator. Good afternoon, everyone, and welcome to our conference call. Today, we will be discussing key highlights from the third quarter of 2023. We are especially excited to talk about the major milestone we reached this quarter, the launch of our new maps. In Harold's absence, we're joined today by Alain De Taeye, member of our Management Board, along with Taco Titulaer, our CFO. Alain will kick off the call, giving you a comprehensive overview of our new approach to mapmaking and our new maps. Following Alain, Taco will provide detailed insight into the financial results and outlook. After that, we will take your questions. As usual, I would like to point out that safe harbor applies.

And with that, Alain, I would like to hand it over to you.

Alain De Taeye - TomTom N.V. - Member of the Management Board

Thank you, Freek, and welcome, ladies and gentlemen. I'm delighted to be here today and share my excitement about the launch of our new maps. We're embracing open data and promoting a technical standard for mapmaking, because the demand for location technology is such that no single company can meet the industry's requirements on its own.

There's an ever-growing demand for location technology. Whether operating an automated vehicle, managing a fleet of trucks, or delivering a meal to your doorstep, location technology is critical. The number of applications empowered by location technology is only growing. Importantly, these applications are becoming more and more advanced, leading the requirements for location technology to continuously increase.

At the same time, there is a large volume of location data produced in every instance. This includes automated signals from phones and cars and contributions from communities like OpenStreetMap. The OSM community built a rich database over the years, has editing capabilities that are unmatched by any other organization, and continues to grow at an accelerated pace.

All this data holds great potential, but bringing it together is hard. It is mostly non-standardized, and the maps that are available are built on proprietary formats and systems. This means that if you want to use all this data or stitch things together, there is no single solution for your needs. As such, standardization presents a profound opportunity. An opportunity that we are seizing.

We are promoting a standard specification for maps that brings uniformity and consistency across data and applications. Think of it as a shared language for maps that allows companies to easily exchange location data. We do this through the Overture Maps Foundation, which is governed by the Linux Foundation's guidelines for open-source projects. Large technology companies, including AWS, Meta, and Microsoft have adopted the Overture standard, and adoption is spreading as we speak.

Naturally, our mapmaking platform is inherently compatible with this standard and automatically ingests all relevant data. This means we can leverage data from the OpenStreetMap community and from the companies contributing data to the Overture Maps Foundation. These open data sources are supplemented by our own proprietary data, to create maps that answer the needs of today and tomorrow.

Importantly, with this new approach to mapmaking, we aim to provide a canvas for others to build on and add content to. To facilitate this, we publish a standard road network with stable IDs to which others can add content with confidence. Whether you're a technology company that wants to add points of interest or a carmaker that needs a map to which HD content can be added, it can all be done. The standard we are promoting makes this possible, and our mapmaking platform is able to integrate all these data sets, publish them as a consistent map, and expose this map to applications.

There's an increasing realization that this approach is what is right for the customer. Customers want to go with a widely supported format, one that enables standardized software and is supported by a large group of developers. That is why we are seeing promising results today already. The Overture Maps Foundation released its first data set last quarter, which contained data on almost 60 million places, along with a buildings layer, a transportation layer, and administrative boundaries.

As more contributors sign up and the ecosystem grows, these datasets will also increase in size. As our mapmaking platform automatically ingests this data, along with data for many other sources, we are able to produce maps that are greatly improved in terms of freshness, richness, and coverage.

Our previous offerings were already suitable for car-centric use cases, and our maps now also include the detail necessary for other use cases. As you can see from this example, showing the area surrounding Windsor Castle, in the U.K., our maps now include details on buildings and parks, and even land use and vegetation are now visible. These types of features are critically important to support various use cases, from pedestrian routing to beautiful map visualizations inside vehicles.

Or have a look at this example, showing an industrial area in Houston, Texas. Our new maps now offer a lot more detail on building footprints and pathways, thereby providing stronger support to fleet and logistics use cases. With our new maps, truck drivers will not only be able to easily navigate to industrial areas, but also accurately find their way within them.

Our new maps continue to improve on all metrics. We were already testing with a group of selected partners in important verticals but have now launched our maps of North America and Europe for a broader audience. Partners and prospects that are testing our new maps are seeing meaningful results. The maps enable new use cases, increase operational efficiency, and allow these customers to focus their engineering resources on differentiation.

Over the coming period, we will use the input from our partners to further improve the product, reduce cycle times, and improve platform scalability and efficiency. We also aim to significantly expand the coverage of the maps. Commercially, our sales organization has a promising funnel of prospects whom we aim to gradually convert into customers over time.

To conclude, the future of location technology demands a standardized approach, and we are at the forefront of this shift. Together with industry partners, we're crafting a universal map standard. This standard provides a scalable way to collect and manage location data, allows us to create greatly improved maps that are growing faster than any other map, and gives customers and partners the ability to add their own data to these maps. As such, we are now better able to create value for customers and their end users, and drive business growth.

And with that, I would like to hand over to Taco.

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

Thank you, Alain. Now I would like to provide some insights into our financials and outlook for the year. After that, we will move on to your questions.

Group revenue for the third quarter saw a 6% year-on-year increase, reaching EUR 144 million. Our Location Technology revenue grew to EUR 119 million, a 10% increase compared to the same quarter last year.

Let me break this down further and discuss revenue business by business, starting with Automotive. Automotive IFRS revenue was EUR 82 million, marking a considerable 32% increase compared to revenues of EUR 62 million in the same period last year. Part of this increase is due to the change in revenue recognition for new maps subscription contracts, which started in Q4 of last year. Correcting for this effect, our Automotive business demonstrated healthy underlying performance. This is further underscored by our Automotive operational revenue, which settled at EUR 85 million, marking a significant year-on-year increase of 13%. At the same time, car production in our core markets of Europe and North America increased by roughly 8%. As such, our performance exceeded car production growth in our core markets for yet another quarter.

Further, our Enterprise business recorded revenues of EUR 37 million, showing stable quarter-on-quarter performance. As highlighted by Alain, we expect our new maps to bring considerable value to our customers, both in Enterprises as well as the Automotive sector. The enthusiasm we have witnessed from the market is promising. With our new maps available, we will target a growing pool of prospects. We expect to gradually convert these prospects into paying customers. We are optimistic that our new maps will lead to growth in Enterprise revenues from 2024 onward.

Lastly, Consumer revenue was EUR 25 million, representing an 11% decrease year-on-year.

Gross margin improved in the third quarter compared to last year, from 81% to 83%. This improvement is a result of a higher proportion of content and software in our revenue mix. The gross margin this quarter was slightly below our normal run-rate due to the start of production of certain car lines. For the full year, we expect gross margin to be around 84%.

Our operating expenses were EUR 128 million in the third quarter, similar to last year. It's important to note that this quarter's operating expenses were affected by an exceptionally high subsidy contribution. While operating expenses were lower as a result, spend levels in the previous quarter are a better proxy for further cost projections.

Free cash flow was an inflow of EUR 13 million this quarter, an improvement compared with the same quarter last year. This improvement was driven by continued revenue growth with a stable cost base, enabling us to achieve operating leverage.

With our results for the third quarter, now, let's move on to the outlook. We performed well in the third quarter and remain confident we can deliver on the upgraded guidance we gave with our Q2 results. For full year 2023, we continue to expect group revenue of between EUR 570 million and EUR 600 million. Location Technology revenue is expected to range between EUR 480 million and EUR 505 million. Free cash flow is expected to come in at around 5% of group revenue.

This guidance excludes the charges related to the Maps realignment announced in June of last year. Of the total restructuring charge, we paid out EUR 12 million in 2022. Up until the end of the third quarter, a further EUR 11 million was paid out in 2023. The remaining EUR 1 million is expected to be paid out over the coming months. Operator, we are now ready to address any questions from our listeners. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Now we're going to take our first question. And the question comes from the line of Marc Hesselink from ING.

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

So, I have 3 questions. Maybe the first one on the platform. Now that it's operational -- the feedback that you're getting from your clients, is it what they want? Are there still things that you need to change or improve or make better and are your clients already comparing it to the alternative of Google? And then what do they think stands out? And what is a thing to still improve?

Alain De Taeye - TomTom N.V. - Member of the Management Board

Yes. Thanks for your question, Marc. The feedback from clients is very positive on two levels. One is that everybody understands, especially the big tech companies, that it's roughly impossible for any company to satisfy the needs regarding maps for the future. So, the whole idea of having what I would call collaborative mapmaking is a complete novelty in the market and they get that principle. They also are capable of understanding that that, and only that, can create actually the map of the future. So that's on the principal side.

But more importantly, they have looked at the data itself and especially the richness of the current product that we bring in the market surpasses everything that is currently in the market. And if you compare it with Google, well, on certain aspects, we were already better than Google. Not on all, so there's still a road to go.

And as you say, is there anything else we should be doing? Well, now it's a question to basically mature the map and create more coverage, so more countries. We just released North America and Europe. Obviously, we want to release the global map. But also, in terms of the POI offering, for example, we will further improve that. That's still a big difference with Google, who is number one in that search area, but we will get there. We will get there, because there's a credible path to that.

And as you know, Microsoft and Meta have contributed their POIs to the initiative. And that's a very valuable contribution, obviously. Also, building footprints have been contributed. And that's only the beginning. The fact is that we have created a new ecosystem for mapmaking. So, in that respect, the mapmaking of tomorrow is completely different from what we used to have in the past.

I hope that answers your question.

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

Yes. Yes. Maybe then the second question on this. If you talk about monetizing this opportunity, what do you think about the timing of the opportunity to do that? And then also maybe how do you think that will work out? Is it going to be license payments or it grows over time? Or will you also have like big bulk from one major contract that starts to adjust it and then they pay a bulk amount every year?

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

Yes, it is all of the above. I think that with the new mapping platform that we provide, we can cast our net wider than ever before. So, we will see more customers than what we saw traditionally. That means also that there will be more customers in the mix that bring less revenue on an annual basis, but we can service those via SDKs and APIs.

And it is, per customer, we will look at what best suits them as well. And sometimes that is an annual commitment or it's transaction-based. We have both business models, and we use both business models. The run-up to see revenue coming from this maps platform will start next year and will gradually improve. So, during the Capital Markets Day, we gave targets for the combined Automotive and Enterprise group. And if you compare that to where we think we are today, or where we will end this year, the absolute increase that we expect from this will be both coming from Automotive and Enterprise. And we expect a lot coming in from Enterprise in the coming two years.

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

And the final question is on the Automotive side of the business, can you say something on how the backlog is progressing, also taking into account maybe lowering production volumes a bit for the '24 period?

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

Yes. So, there are 3 drivers, if you look at our Automotive revenue. The first is car sales, the second is adoption rates, and the third is market share gains. Now as we've seen traditionally, market share gain is not easy in this segment due to the long product lead times. And for car sales, we saw car sales peaking in 2019, and since then they have been on a lower level. There are some catch-up demands happening, but what the coming years will bring -- we can rely on the industry analysts to give us an expectation there.

But for us, the biggest driver for growth is take rates. It's not so much car sales, because one million extra or one million lower for total market size doesn't have that much of an effect. It's more the adoption rates. And if you look at the adoption rates where we are today, it's roughly 40%. We think it can double by the end of this decade.

And there are two drivers to drive that growth. One is EV adoption, because we see that with EV cars, there's almost a one-on-one correlation with taking navigation in-built. And the other one is self-driving features and safety features. What we communicated, for example, last year with our customer Hyundai-Kia, who has decided to -- due to the requirements and safety, they have decided to go fully in on navigation, and insert navigation, no longer as an option when they sell a car, but as a standard feature. So, the biggest driver for our Automotive revenue is take rates and not so much the fluctuations in car sales.

Operator

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

Wim Gille - ODDO BHF Corporate & Markets, Research Division - Analyst

Yes. So, I hope you can hear me. I have a question around the Enterprise funnel. If you look at the sales opportunity that we have there in 2024 and 2025, you expect growth in Enterprise. Where would you see most of that growth coming from? Is it from, let's say, new customers that are new to the market in their entirety, or are you increasingly looking to steal customers from Google and, or from HERE Technologies? So, where is that growth going to come from? Are we expanding the market, or are we stealing market share from others?

The second thing is if, we look at the Enterprise growth, if we look at the current Enterprise revenues, it's mainly in uncompiled maps, which is in essence, a few large clients buying in a single transaction. The other business models are obviously driven by API calls and, or the usage of the platform. So, how would you split that growth? Is it more coming from the long tail of smaller customers, the typical Google Maps customers that are volume-driven, like on API cost? Or are we talking about a few larger accounts that are going to get uncompiled maps from you?

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

Yes. So indeed, the pie or the total size of the Enterprise market continues to grow. It's also what Alain said, there is a never-stopping increase in demand for these applications, and use cases, and the richness of the data. So, that continues to be the reality.

The interest that we're seeing today is mainly from customers that are already using mapping data in their applications and in their products. That can come from OSM users or that can also come from the names that you just mentioned. So, it's indeed more market share growth story than a market size story that is fueling our growth.

Wim Gille - ODDO BHF Corporate & Markets, Research Division - Analyst

Is that growth mainly coming from OSM, from Google, or from HERE? Just to get a feel about the type of customers you're targeting.

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

There is a high correlation with the people that are using OSM today because they understand the richness, et cetera, but they also understand the flaws of using the raw OSM data. And with the added layers that we add on top of that, we are solving that.

But there are also a number of cases -- I think the longer tail is more coming from OSM, I would say, but there are some big accounts that are doing business today with our competition.

The other one is that, what we're doing with this is also creating and launching a technology on which it is much easier for companies to build on top of that, to let their own proprietary data communicate with our mapping platform. And that is also very interesting for developers. So, I think the API use case is indeed minimal as a percentage of sales, but we expect a lot of growth in that area.

Operator

(Operator Instructions) And the next question comes the line of Nikos Kolokotronis from Van Lanschot Kempen.

Nikos Kolokotronis - Kempen & Co. N.V., Research Division - Research Analyst

I have one question with regards to the new maps evolution. I mean, in the last quarter, I think Harold mentioned that we should expect new contract announcements related to the new maps in the second half of this year with some revenue expected in 2024, which you kind of confirmed already. But then looking into today's press release, it seems like there is still work that needs to be done based on the feedback that you have received from customers and prospects.

So yes, my question is, have your expectations changed in terms of signing new contracts with clients or prospects in 2023?

Alain De Taeye - TomTom N.V. - Member of the Management Board

No, no. Expectations have not changed at all. And by the way, with regard to things that we still need to do on our new map, a map is something that continuously grows. There's nothing abnormal, also nothing that we didn't expect. So, in that respect, there is no change of expectations, maybe even on the contrary.

One of the things we see is that, while we thought that our new map was especially attractive for the Enterprise market, we have seen a bigger than expected interest from Automotive customers, who also see the benefits of that. So, I would say that the reactions that we have gotten from the market are extremely positive and convince us we're on the right track there. So, no change there. And on the product itself, we have all the quality metrics that actually show objectively that the product is just much better than what we have so far. So, there's no change in expectations at all.

Freek Borst - TomTom N.V. - Investor Relations

As it appears there are no further questions, I'd like to thank you all for joining us this afternoon. Operator, you may now close the call.

Operator

That does conclude our conference for today. Thank you for participating. You may now all disconnect. Have a nice day.