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TOM2.AS - Q2 2021 TomTom NV Earnings Call

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CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

Andrew Michael Gardiner Barclays Bank PLC, Research Division - Director

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

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

PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to TomTom's Second 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 Controller. 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 second 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. I will briefly go over our key operational highlights for the quarter, and then Taco will provide further information on the financials and the outlook for the year.

Looking back on the first half of 2021, our Enterprise unit showed a robust performance. We expanded our customer base in fleet, logistics and on-demand markets, where we have a strong market presence already.

Next to that, we further expanded our footprint in the insurance market. Our products for traffic, speed profiles, congestion data are used to produce hyperlocal and reliable risk profiles for drivers which help to accurately price insurance products. In Automotive, we see leading brands continue to incorporate our technology, including our mapping data for advanced driver assistance features. The all-new Nissan Qashqai launched recently featuring TomTom maps, which are delivered over the air. Our ADAS content also supports the new upgraded driver assistance features. Genesis is Hyundai-Kia's luxury brand, and they have chosen TomTom maps and real-time traffic services for their upcoming models in Europe.

We do have a long-standing relationship with Hyundai-Kia for the supply of traffic and incident data, but this is the first time Hyundai-Kia is using our maps. We expect to be able to broaden and deepen this relationship in the future, which would mark another important market share win.

Toyota launched their Teammate product last month, which will be their first commercially available Level 2 system incorporating TomTom HD Maps. The Teammate system fuses LiDAR and camera sensor information with our HD Map to localize the vehicle. The system facilitates automated lane change and intelligent speed control, particularly important for speed adjustments at exit ramps. Toyota has published a YouTube movie that explains the working of the system and the role of our map.

So far this year, deal activity for both Enterprise and Automotive has been good. We expect further significant wins for the second half of the year.

This concludes my part of the presentation. I'm now 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 financials and outlook, and then we'll go to the Q&A. Group revenue increased year-on-year by 8% as we reported revenue of EUR 133 million. Location Technology grew 10% to EUR 103 million for the second quarter. Let me go through revenue business by business. Automotive revenue was EUR 61 million, an increase of 18% compared with the same quarter last year.

Automotive operational revenue, which is IFRS revenue adjusted for the movement in deferred revenue, was EUR 63 million, an increase of 63%. The strong year-on-year growth came despite supply chain constraints in the automotive industry as a factory closures impacted the comparative quarter following COVID-19 lockdown restrictions.

Enterprise reported revenue of EUR 42 million and consumer reported revenue of EUR 30 million. Revenue from both units was flat year-on-year. As most of our Enterprise revenue is based on U.S. dollars, the year-on-year trend was negatively impacted by the effect of the U.S. dollar. On an equal currency, Enterprise was 7% up in the quarter.

Gross margin for the first quarter was 77% compared with 86% in the same quarter last year. During the quarter, one of our automotive customers started production of several car lines that utilize our software. This triggered the release of customer-specific costs from our balance sheet, temporarily lowering our gross margin. If we adjust for the release of contract costs, the gross margin would have been 84%. For the remainder of the year, we expect gross margin to be north of 80%.

Operating expenses were EUR 124 million, a decrease of EUR 46 million compared with the same quarter last year. This decrease is because of lower amortization as the Tele Atlas database acquired in 2008 were fully amortized last year. Excluding the impact of depreciation and amortization, underlying operating expenses showed a year-on-year increase of around 7%. This mainly reflects increases in research and development costs associated with our application layer.

The free cash flow for the quarter was an outflow of EUR 16 million compared with an outflow of EUR 54 million in the same quarter last year. The year-on-year improvement is mainly because of higher Automotive operational revenue.

We reported a net cash position of EUR 319 million at the end of the quarter, a decrease of EUR 33 million since the end of the first quarter. The decrease is a result of share repurchases made under the share buyback program and a negative free cash flow in the quarter.

Now moving to the next slide. In the first half of the year, we have seen that the widespread shortage in semiconductors have impacted the automotive supply chain, which impacts car production. As Automotive revenue is invoiced based on the number of cars produced that embed our software, this is expected to lead to lower Automotive operational revenue and free cash flow. Taking this into account, we have updated our guidance for the year. We now expect group revenue of around EUR 500 million to EUR 530 million and Location Technology revenue between EUR 400 million and EUR 430 million.

Our full year free cash flow is expected to be around 5% of group revenue. In the first half of the year, we have had a cash outflow. We want to reiterate that our cash inflow is weighted to the second half of the year, particularly in the last quarter of the year, due to the timing of certain customer paybacks. Operator, we would now like to start the Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question is from the line of Francois-Xavier Bouvignies from UBS.

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

I have a couple of questions. So maybe if we look at TomTom and from a high-level perspective, you had the pandemic impacting you last year. And now you have the shortage that basically the recovery is not happening maybe as much as you expected. You had your backlog that you had to revise down because of some long-term contracts that have been revised because of the pandemic.

So maybe Harold or Taco, any of you, what can you give to the market to think that the worst is behind basically? I mean, any data points you can share that makes you confident that from here, we will see an acceleration and particularly your Location Technology revenues to go back to this 10% growth, some in double-digit growth and free cash flow margin of double-digit as well as percentage. So can you share with us what makes you confident that the worst is behind and we should see recovery from here would be very helpful to reassure the investor community. And I have one after.

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

So maybe I can take that, Francois. As Harold already said in his narrative is that we are very confident with the level of deal activity that we've seen in the first half of the year, and we are especially optimistic about the second half of the year. For us, deal activity is a leading indicator for how the future will look like. And although the pandemic and also the chip shortages have hit us hard and even harder than we hoped or expected. With that deal activity, we share the confidence with the sector that this is a temporary phenomenon and that we will recover from this.

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

Okay. Okay. And on the deals, I mean, that you see in the market, is it because of the market that is recovery, or is recovering, or is it because you are winning market share, or because you add some content. Can you give a bit more flavor of how you see the deal activity playing on, with TomTom and the market separately?

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

Yes. I think it's a combination of all of the above. I think we have a very strong application layer now, especially for the automotive industry that's well received. I think we, by now, are the largest vendor of software in the automotive industry. We see good potential in the EV market. We're particularly strong there also with our routing algorithms and our EV products.

And we expect high attachment rates there. So that's also, I think, a positive. And then I think we're generally doing well in the marketplace. And it's a bit of a disappointment and a slightly frustrating that it hasn't materialized in Q1 and Q2 as we had hoped. But I'm quietly confident that there will be a level of pent-up demand. Carmakers are struggling to meet demands. Prices are good. Second car prices are at an all-time high. All that are indicators that the volume we have missed in Q1 and Q2, we may recover in the future to at least, to an extent.

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

That's very clear. And you have been investing in application layer for a bit more. And especially, like you said, like the OpEx is up 7%. I mean, year-over-year, mainly driven by the application layer. Can you explain a bit more what the fruit of this work -- I mean, what's the results? And -- I

mean, do you see -- I guess it's a bit long -- it takes a bit of time, but do you see any impact on your deal activity or interest from the customers? Anything you can give around the return on your investment on the application layer, basically.

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

Yes. I think we've said it for a couple of quarters now that the market is moving to an online presence with an embedded fall-back position. We have been investing in that technology, and we see that carmakers are buying that from us. You don't see it in the figures now, but we will start shipping, we have won contracts for that new application layer. We call it internally NavKit2. It's gone down well with the carmakers.

And especially in the second half, I expect to be able to sign more customers for that application layer with or without content, but at least in any case, the application layer is doing really well. And it translates in a better user experience over the air updates, up-to-date maps. Our traffic is really good. Our instant data is leading in the industry. At an end user level, those are the things that really matter. And we are increasingly capable of meeting those end user requirements and I say the carmakers recognize that.

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

And how should we think about the OpEx? I mean, going forward with application in layer. I mean, is it something that's going to continue growing? Or is it going to stay there for a bit of time. I mean, flattening, how should we think about the OpEx spend or run rate that you are running at, at the moment?

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

Well, so the application -- you have always that it's difficult to predict. I think it won't grow enormously at the application layer, but there's much more going on as well. There is a big change going on in mapmaking. We see the availability of all sorts of digital data also some super sources coming through that will enable us also to completely rethink and redesign the whole mapmaking process.

We have a very strong foundation with our CPP mapmaking system. But the input to that system is going to be more and more automated as a result of much more data that are becoming available. So we are also on the content side, we're investing to make mapmaking better, more efficient. We are hoping to, as a result of that, to have much more coverage in more countries, many more attributes, and that is not just important for the automotive industry, but particularly important for the enterprise market.

And as a result of a better database, also in the Enterprise market, we'll be able to expand the type of customers and the type of use cases we go after. And we will be able to do it in more countries than ever before. So there's a lot of change. We're firing them all cylinders to deliver that change. I don't think that over the short term, the expenses in R&D will go down. But on the longer and midterm, there are clear opportunities for massive improvements in efficiency.

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

And how long is it going to take? I mean this investment and this change?

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

Well, it's never done, but we started already to see the effects of that approach. We are producing more data than ever. We do that mostly in automated processes. But that is an ongoing transition. It will never be finished. There will be more data that becomes available.

There will be higher requirements on the database. But based on those new technologies, that new platform, we are confident that we can create much better maps in a much more efficient way than ever before.

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

Okay. That's clear. And maybe last one for me. HD Maps. I mean you mentioned Toyota HD Maps. Can you tell a bit more about HD Maps? what's -- How is it changing versus last quarter? Is it more activity there? Anything you can give around that?

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

Yes, there's a lot of activity. I would like to include the whole ADAS development that's going faster than HD. The 2 are linked. They form, in a way, continuum, and especially on the ADAS side, we see a lot of activity taking place there. There is a new European directive called ISA which requires for proper traffic speed indication in the vehicle. There's a bit of a scramble going on to get that data into the vehicle.

So we see a lot of activity on that side as well. So you see a steady increase in ADAS functionality, steady increase in the level of automation of vehicles, the reliability of that -- of those systems is going up. I think the full automated car is still elusive. We still don't know and as when that will happen. But the degree of automation that's taking place in vehicles is definitely increasing and improving rapidly. And a lot of those functions are based on databases and map content.

Operator

Your next question is from the line of Andrew Gardiner from Barclays.

Andrew Michael Gardiner - Barclays Bank PLC, Research Division - Director

I had 2, please. First, perhaps for Taco. Just on the updated guidance you've given us for location technology, I was just hoping to dive a bit deeper in terms of some of the drivers there. I can completely understand what you're saying about the semiconductor shortages and therefore the limitations on volumes -- car volumes in over the course of well, recent quarters and the coming quarters.

But if I look at what you guys have actually guided to at the midpoint, it's about 6% revenue growth for Location Technology. Enterprise looks like it's doing well, flat to maybe up a little bit this year, depending on the second half, which then leaves the Automotive business similar sort of up maybe mid- to high single digits.

And of course, then from an operational standpoint, I know you've got the movement in deferred revenue, which we don't have perfect visibility into. But even so, if we say operational revenue for this year, you're effectively guiding to mid- to high single-digit growth. It feels like that's underperforming the end market.

If I look at IHS calling for 11% growth -- unit volume growth this year. I'm a little surprised that you guys would be below that given the content gain for your type of a product. So can you help me understand why that might be?

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

Well, first of all, you're right in the breakdown. We see similar trends. So a modest increase in Enterprise revenue of low single-digit percentage and a high single-digit percentage growth for Automotive. Operationally, we expect Automotive to grow with a double-digit number, very similar to what you say, what IHS is indicating.

A compounded effect of the semiconductor shortage is that for certain car lines, prioritization by the OEMs has led to less silicon in the car affecting the take rate of our products. We're confident that it's a temporary phenomenon. But with some of the OEMs, they say, well, there's so large a shortage of semiconductors, let's try to push cars out that either have a high margin or that we can actually produce.

And for the latter, that has a compound effect on our sales. But anyway, we believe that, that will be behind us, give another 2 quarters or so, but that's affecting us. So again, we agree with your breakdown of Enterprise and Automotive on an IFRS basis, operationally the strength of Automotive will be double digit.

Andrew Michael Gardiner - Barclays Bank PLC, Research Division - Director

Okay. So perhaps a bit more coming through the deferred revenue movement in the second half to boost that to more market levels of growth?

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

Yes.

Andrew Michael Gardiner - Barclays Bank PLC, Research Division - Director

Okay. And then just on looking at a little bit further. I mean, Harold, you talked about deal activity being strong and the potential or even likelihood of pent-up demand from this year being realized in future periods. Earlier this year, you guys gave us 2023 guidance for Location Technology revenue of EUR 550 million. Do you think that's still achievable? Is this a sort of temporary setback this year that you can make up next year and the year beyond?

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

Yes. I think that is still achievable. I don't see anything fundamental that is pushing us off course. So no, I don't see -- at this point, I don't see any reason why that would not be achievable.

Operator

(Operator Instructions) And your next question is from the line of Marc Hesselink from ING.

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

Firstly, on the significant wins that you expect in the second half '21. How come you have that visibility? If these deals are -- are those very close? Or are you such in the process that it's indeed very likely that you will win them?

And then what kind of deals are they? Are they new clients that you win from the competition? And then if you can split it up between Automotive and Enterprise that will be very useful.

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

Yes. So the deal structure in the sales process for Automotive contracts, in particular is long. So we have good visibility on which contracts will be awarded when. That's always subject to change, and it can push out, it can be brought forward. But by and large, we have kind of a timetable and intimate involvement with our customers of when those deals will be awarded and what we need to do to win them.

And that results in a pipeline, that results in a total market that we can see. And then we apply our expectations and weigh those opportunities and that results us in believing that there's a good opportunity for strong order intake in this year. First half was already good. And I think in the second half of this year, there are major opportunities available to us.

And the problem, of course, is they need to materialize. It's 0 or 1 at the end of the day. So it's very difficult to give you a number. That's also not what we do. We do that in beginning of next year. We give you an overview of the order backlog and how that has changed in 2021. But if I would be a gambling man, then I say it's going to be a good year for order intake in 2021.

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

Okay. And is it extension of contracts that you already have? Is it new contract that you win from the competition? And is there -- you said both in Automotive and Enterprise, right?

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

Well, I'm specifically referring to Automotive because that's where you have a more structured deal process, so you have a good visibility of the pipeline. Whereas in Enterprise, it's more short term and more event driven, I would say. I think in Enterprise, there are good opportunities as well for us to further improve our customer base.

And when I talk about the Automotive opportunities, I would say it's probably half-half. So half of the opportunities are existing customers with extensions and new awards. And the other 50% will be clear market share wins.

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

Okay. Clear. And the extensions are those -- what's the dynamic there? Is that more for the same price, you're offering your new products with more functionality, but pricing remains relatively stable?

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

Yes, typically, it's related to a new generation of hardware and a new generation of vehicles that are planned for. So, you typically win or lose, but we hope to win the software and the content for the next generation of vehicle models for a particular brand. So that's kind of how it works.

And then in between, there are bits and pieces and things are moving and extensions and what not. But the big deals tend to be linked to a new generation of vehicles with a new generation of in-vehicle technology.

I think what we also see is -- I think there is a trend visible. I think a couple of years back, OEMs would really go from deal to deal and generation to generation and everything would be reset to 0. And then the vendor with the best product price combination would typically win.

What we see is more longevity and more strategic alignment and the willingness of carmakers to start from scratch is reducing. And I think that's a good thing for us because we have a, I think with our customers, a good reputation of doing what we promised to do, being on time, on quality, being collaborative.

Typically, the working relationships our engineers and product people have with their counterparts in the OEM industry could be characterized by good, and on a high level of trust. And that helps us, of course, in expanding and deepening those partnerships further. And because software is getting more complex and there's more moving parts, there is a clear economic rationale, also to keep building and deepen those relationships further, and make them more strategic in their nature. Does that make sense?

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

Yes. Yes. Clear. And then maybe then I think a bit on the Enterprise side, just to be 100% sure, the underlying business is actually growing a bit more, right? I mean the U.S. dollar is still pushing it down a bit, so it's more like mid-single-digit like-for-like?

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

For Q2, you mean?

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

Yes, yes. Or maybe in general, the trend that you see for the...

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

Yes, for IFRS, we think it is a modest increase for full year. Q2 specific, the increase was like-for-like currency 8%.

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. That concludes the presentation today. Thank you for participating. You may now disconnect.

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