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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to today's TomTom Q2 2020 Results Call. (Operator Instructions) I must advise you that this call is being recorded today, Wednesday, July 15, 2020. I would now like to hand the call over to your host today, Claudia. Please go ahead.

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

Thank you, operator, and good afternoon, and welcome to our conference call during which we will discuss our operational and financial highlights for the second quarter of 2020. 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 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

Well, thank you, Claudia. Welcome, ladies and gentlemen. Thank you for joining. So the consequences of the pandemic remain a challenge for the global economy, but our revenue is now on the road to recovery from the lows that we experienced in April. We've seen a very good upward trend in the second half of the quarter, both for automotive and for retail products, and we expect the second half of this year to be cash flow positive. We have put strict cost control measures in place without compromising our development and engineering capacity. I am very pleased to see how our employees have been able to deal with the situation with no material loss in productivity and very good communication. We also continue to recruit top talent to TomTom, who are helping us to achieve our strategic objectives. We saw a large volume of deal activity, combined with high success rate, especially in automotive, which will contribute to our future revenue. It's great to see that we have good traction with online products for the automotive industry, and that's a clear sign that our customers see us as a partner for a truly connected future. And that online future is helping us to simplify and harmonize our product portfolio across multiple customer segments and deliver a better end-user experience as a result.

Let's now turn to the key operational highlights for the quarter. We've been awarded a global multiyear contract in traffic information and dynamic routing to Ford's SYNC platform. This contract further expands our footprint in North America and will contribute to further improvements of our traffic product.

Together with Delphi Technologies, we could demonstrate fuel savings of up to 10% in passenger cars by combining Delphi's technology and our ADAS Map to control gearbox and motor management. Vehicles were tested on a variety of real-world driving conditions to validate the systems fuel efficiency, and we expect this technology to contribute to the development of safer and more sustainable costs. Our Enterprise business recently announced an extension of our global deals with ViaMichelin to provide maps and traffic information services. And finally, we made improvements to our search API by significantly improving the number and quality of our POIs.

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

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

Thank you, Harold. Let me make a couple of comments on the financials and outlook, and then we will go to the Q&A. In the second quarter of 2020, we reported group revenue of EUR 124 million, which is 41% lower compared with last year. Our Location Technology business, which represented roughly 75% of our group revenue, in the second quarter decreased by 19% year-on-year to EUR 94 million. The quarter started with factory and retail closures impacting trading conditions for Automotive and Consumer. In May, the gradual reopening of automotive factories and the return to retail activity led to improving conditions, which continued throughout the quarter. June was by far the strongest month and contributed about half of the quarter's operational revenue in Automotive and Consumer. Operational revenue is defined as reported revenue adjusted for the movement in deferred and unbilled revenue.

Let me go through the details business by business. Automotive reported revenue was down by 32% to EUR 52 million in the quarter, and operational revenue was down by 47% to EUR 48 million. Both of these decreases reflect the impact of the closure of automotive factories during the quarter as revenue is based on car production volumes. Enterprise revenue was up by 5% to EUR 42 million in the quarter, reflecting increased revenue from new and existing customers. Operational revenue was EUR 20 million, 7% higher than in the same quarter last year. COVID-19 has had a limited impact on our Enterprise business due to the nature of contracts, typically longer-term fixed fee contracts and the nature of our B2B customers who are mainly active in the technology space.

Consumer revenue was down by 68% to EUR 30 million in the quarter, and operational revenue was down by 76% to EUR 22 million. The closure of retail stores has impacted consumer revenue. And while conditions have been tough, it is important to note that the year-on-year decline in consumer revenue is exaggerated by the strong reference quarter.

Gross margin was strong at 86% during the quarter, representing an increase of 19 percentage points year-on-year. This high gross margin in the first quarter -- in this quarter, sorry, can be explained by 3 things. Firstly, the ongoing change of higher Location Technology and lower Consumer revenue will lead to a positive mix effect as consumer products have lower margins. Secondly, costs incurred for custom engineering work for some of the automotive customers is placed on the balance sheet. These costs are taken as a whole in the quarter when the car line reaches the start of production. This lowers the margin. In the current quarter, planned of start productions were postponed to the second half of the year given the COVID situation. Last year, the second quarter included the impact of some large start of productions, making this quarter's margin higher by comparison.

The third item that can affect the margin is normal movements in provisions, such as warranty. You can see from our cash flow statement that we have a net release from all our provisions of EUR 3 million. Most of these will impact the gross margin positively. Total operating expenses in the quarter was EUR 170 million, a decrease of EUR 55 million compared with the same quarter last year. The decrease is larger because the reference quarter includes catch-up amortization of EUR 41 million relating to the first quarter of 2019, following the change in the estimated usual life of the map database implemented in Q2 2019.

If we exclude the amortization of technology and databases, OPEX decreased by 11% to EUR 106 million. The decrease, mainly in selling, general and administrative expenses, shows the effect of discretionary cost control measures taken in the quarter. The free cash flow was an outflow of EUR 54 million in the quarter. This reflects lower operational revenue and higher working capital usage. At the end of Q2 2020, we reported a net cash position of EUR 373 million.

We will not provide guidance at this outlook -- sorry, we will not provide guidance at this time. As market conditions develop, we will reassess this position and also whether to resume our share buyback program. What we can say is that we expect our revenue to continue its recovery path in the second half of the year. In OPEX, our expenses in R&D are expected to increase quarter-on-quarter. However, we will continue to control our discretionary spend. The recovery of revenue combined with our OPEX expectations and seasonal customer receipts means that we expect to have a positive free cash flow in the second half of 2020.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Francois Bouvignies from UBS.

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

Hi, thank you very much for taking my questions. I have a couple. And the first one is on your comments around the deal activity. Harold, I mean, every year, you give comments, qualitative comments around these kind of deals, and how is the order intake for the year and backlog. And if I look at your comment for H1, it seems fairly positive or constructive compared to previous years. So I was just wondering how should we think about for the full year deal activity, not only H1, but how do you compare it versus the previous years? And more importantly, why is it you see it better? Is it because of a market share? Is it because of the penetration of in-dash going? What is driving these high volumes?

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

Well, thank you, Francois. The year order intake is always lumpy, especially in the automotive industry. It's black and white. Deals are available, you win them, you lose them. The first half, it went well, better than typically for comparable periods. We wanted to share with the community that despite all the doom and gloom that we're seeing in production land, in car land, business is going on as usual. And actually on the order intake side, it’s been strong, and better than what we typically see at this stage in the calendar, I would say.

Now again, asking me what second half will look like is a tough one. I just don't know. It's difficult for us to say something about the whole year and the order activity and the order intake. I'm not going to do that. But I do want to share that the first half was good, not only in terms of volume, but also strategically. So another OEM signed up, which is important and also strategically important because we started to get contracts for online technologies. And that is very significant for us. Because the mode of moving to online is important in multiple ways. And one opportunity we see is that by going online, we can really simplify, unify our technologies, make them available to different customer segments. We can start reducing the complexity associated to deals in the automotive industry, the branching and the forking, the maintaining of legacy systems. There is now a clear trend to go online and that's a good one. So I'm happy with what we have achieved in the first half of this year and looking forward to the second half. But qualitatively, I can't say much what a second half is likely to look like.

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

And should we think that this strong activity is in market overall? Or is it also mainly driven by your high win rates, i.e., market share gain?

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

I think it will result in market share gains over time when those contracts come online. So happy with that. They're not necessarily linked to a larger addressable market. Although the market will grow with a higher percentage of electrical vehicles in the mix because electrical vehicles will all have Location Technology onboard, a 100% attachment rate. That's something you still don't see in petrol cars or diesel cars. There the attachment rates are relatively low still. And if the EV vehicles take a meaningful proportion to total production volumes, then the total attachment rate of Location Technology in vehicles will improve -- will go up

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

Okay. That's very clear, Harold. The second one is on the HD Maps. I mean you usually give some comments. This quarter, you're a bit more quiet on this side. I know that last quarter, you said there may be some pushouts because of what's going on with the pandemic. Could you give some update there?

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

Well, we don't see an acceleration. We haven't seen an acceleration in HD demand in Q2. And carmakers are still hesitant. Not clear about the volumes, not clear about the introduction date. So we are very active with HD Maps. We have a number of RFQs outstanding. But it's a bit disappointing if we talk about take-up and clarity that we're getting from the market at this stage.

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

And do you think it could be structural with the issue of HD Maps, I don't know, because it's too expensive or because the industry is not really ready? Or is it mainly due to short-term uncertainty because of the crisis?

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

I can't say that. It's difficult for me to judge. I don't think the pandemic is helping, but I see nervousness with carmakers to add at scale all the hardware and all the kit that is needed to get it to work and their ability to charge that bill of material to the end customer.

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

Okay. And the last one is maybe for Taco. If we look at the Automotive revenues for this year, you mentioned in the release that hit a trough basically in April and that you see a recovery. So should we expect a gradual improvement in your Automotive quarter-on-quarter in Q3 and Q4 as it recovers slightly? I mean, reported revenues.

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

Yes. So I think that both Q3 and Q4, we will be able to report higher numbers than we've seen in Q1 and Q2. The operational revenue will see a stronger recovery. We also think that the operational revenue is more skewed towards Q4. So Q3 will be better than Q2 in operational point of view, but Q4 will be even better than Q3, again, operational revenue.

But to answer your first question, yes, reported revenue will be higher in Q3 and Q4, that is our current expectation.

Operator

Our next question comes from the line of Marc Hesselink from EFA (sic) [ING].

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

First question is also coming back on the commercial traction comment. You've seen success both on the Automotive and the Enterprise side. But if you mentioned it in this release, is that also on both sides or is it any of the 2 more particular?

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

No, it's on both sides. So both in Enterprise and in Automotive.

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

Okay. Your position today in North America, we've seen the success with previous quarter Verizon and this quarter Ford. What's your feel on your relative position in that market? And do you have to feel that because of the recent wins that you are now even in a better position going forward also to show to other North American clients.

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

Yes. We -- I'm kind of happy what we have achieved there. We have a number of very big names in our client portfolio. It's really good to see that we managed to pull that off. So you see Uber and Microsoft, Apple to name a few. Those are leading companies. And we seem to have the right mix of products and people and connections to be successful in that space. We've recently managed to extend that success also into the automotive industry with FCA wins and now Ford as well. And that's an important for us because -- like it or not, most innovations come from the West Coast, that's where we learned the most from our customers where they ask us to keep up and move fast. It has a very positive effect on our visibility and gives us access to talent in the West Coast. So I'm happy that we are where we are, and we can build from that position further. I'm convinced of that.

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

Great. And if -- coming back on that, if -- in Automotive, you see that lead times are pretty long and then also it still takes quite a long time before the others actually go into production. Is it possible in the Enterprise side that this all moves a bit quicker, that people move towards your platform and that you actually see the revenues coming in?

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

Well, also in Enterprise, you need to have patience. So it takes some time between the sales cycles are long, and also before technology is actually used can also take quite a while. I wouldn't say the sales cycles in Enterprise are that different. It's starting to change now with bigger uptake of our APIs. So we see a larger community of developers using our APIs. And that goes much more gradual and faster. But also there, there's a sales cycle time in terms of developing the applications. And then the application itself needs to gain traction. And not all those applications that are powered with our technology make it or are scaled well. So don't count on overnight success or explosion of sales. It's a gradual step-by-step approach, but we're building, we're going from strength to strength. We have a much larger community of developers now using our APIs. Some of those developers will turn into big accounts in the future.

Operator

Our next question comes from the line of Wim Gille from ABN AMRO.

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

Wim Gille from ABN AMRO. I got 3 questions. First is, if we look at the discussions that you have with your automotive clients, obviously, they're a bit stuck at the moment between, on the one hand, ongoing development for electric vehicles and robo-taxis, especially Waymo, Cruise and Aptiv, et cetera, were all making quite a decent progress on autonomous driving in their own field, where simultaneously these OEMs are also scrambling for survival at this point in time. So what is your current feeling on how they look at their own road maps? Are they still on track with the launches of the new models that they have been planning for years? Or do you see a lot of push-outs where OEMs are basically considering to push out product launches and real innovations because of the uncertainty that they currently face? And in relation to that, during the Capital Markets Day, you gave quite a decent guidance on the mid-term future, especially on the Automotive side, where there was basically an inflection point in 2021, where we could be seeing an acceleration of growth because adoption rates are going up because of all these aforementioned trends in electrification, et cetera, et cetera. Is that inflection point still going to be there? Or would it be likely that, that inflection point will pushed out a year because of COVID? So that will be my first question.

The second is more on exit rates. Obviously, you've shown great improvement during the quarter with June being significantly better than May and May being better than April. But in terms of year-over-year comparison on an operational level, if I make my calculations, I would argue that in June, Automotive revenues had an exit rate of, roughly speaking, minus 20%. Is that a correct calculation? Is that in line with what you guys are looking at? And what should we be expecting in terms of run rate for June as an exit rate on the Consumer side because there, obviously, we have 2 factors playing a role being retail closures and also the difficult comparable base. So how should I look at an exit rate, a normalized exit rate for June on the Consumer side?

And then lastly, on the commercial activity, you've been quite successful, both in terms of number of RFPs and orders in the market as well as your win rate. Is it fair to assume, and I understand there's multiple things influencing the order book, but is it fair to assume that we will see a significant double-digit increase in the order book by year-end?

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

Yes. Thanks, Wim. So yes, the automotive industry, as you rightly say, the inbox of the Automotive CEO is rather full. And it's not easy to plan as a number of industry developments contribute to that. You put COVID into the mix, and you have a fairly fluid situation. So my impression is that carmakers are seeing this as a temporary dip. And their longer term planning, their strategic choices are not really influenced by this pandemic, although their cash balances are. So there may be kind of a hard choices between what they can and cannot afford. But I don't see a strategic shift in the priorities as such. And I see more and more carmakers investing in software development capabilities as well. I think the EV train has left the station. I don't think there's any carmaker now who is not taking it serious and is not putting out models in the coming years. So I think that's going. I do think that at some point in the near future, we do see an inflection point where EV vehicle sales will take up faster than what we have seen so far.

Yes, the exit rates that you're referring to, I think I'll hand it over to Taco to see if he can shine some light on the specific numbers. When you look at the overall order book for how we want to finish that at the end of this year, again, Wim, I find it difficult to make further comments other than that the first half was good. How the whole year will pan out, -- we need to see that. But there's quite some stuff in the pipeline that we can win, or that we cannot win, or that can be postponed, I don't know. We'll see. But so far, it's been a strong first half year for contracts and new contracts. I can't say much more than that.

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

Yes. So on the rates of decline that we saw at the end of the quarter, both for Automotive and Consumer, these decline rates were lower than we saw for the whole quarter, as you said yourself, obviously. I think Automotive, will probably start with a high 3 or 4. So it's our numbers are a bit less optimistic than yours. And for Consumer, the comparison is very difficult, as you said, as well as we had the week number rollover last year. And also June traditionally more stronger month in the quarter anyway. But the year-on-year decline is probably 50% or so in Consumer at the end of the quarter. But that's including the great results of last year.

So I think for from a planning point of view, if you continue the improvement in Consumer, and in 1 or 2 months, the WNRO effect will be gone out from the 2019 number, so it didn't have a big effect as of September anymore. We think that we're trending towards 25% decline – 25% to 30% decline in Consumer for the rest of the year.

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

For the rest of the year, okay. Okay, fair. And then maybe as a follow-up or based on the strategic choices that carmakers have been forced to make, et cetera, and also the model launches that they are planning, is it still fair to assume that all other things being equal that, that inflection point that you showed during the Capital Markets Day somewhere around 2021, where growth rates in the industry should accelerate based on higher take rates that, that inflection point is still close.

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

Well, as I remember, we gave a CAGR for the current period that we were in, and we gave CAGR beyond that at the time. I don't want to pinpoint the inflection moment on that year. But based on the deal activity that we've seen in the first half of the year and also the content of the RFQs and ROIs that we are receiving, also on the OEM side, they are working with higher take up ratios.

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

Very good. And then a last question from my end would be on Google. Obviously, it's been quite a while before -- when they announced the deals with Volvo and with Renault-Nissan. Volvo, we've now seen that car coming to the market, so that has been launched. But it's been fairly quiet on that front from Renault-Nissan. So what are you seeing in terms of your discussions and the volumes that they are planning to do with you guys? Is there any sign that you or your contract with or the volumes that you are shipping to Renault-Nissan will come to an end soon? Or is that still not something for the near future?

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

Well, I think the Renault situation is different from Volvo because in Renault cars, only a small percentage of cars will be equipped with the Google solution, it's at the high end of their range. So there's a very significant portion of business still to be done there in the volume segment.

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

Okay. And is there any sign that they will be shipping any Google equipped cars anytime soon? I haven't seen anything from them recently.

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

It does not for us, Wim, I am afraid, to comment on. No, I don't feel that we should do that.

Operator

Our next question comes from the line of Francois Bouvignies from UBS.

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

I just had another one. I thought I wanted to ask you. It's on Apple. I mean, if we look at Apple, they did their developer event and they announced that the Map is done in the U.S. basically, and now they are starting to roll out in Europe, including the U.K. If we look at -- it's been 2 years since they announced that they will do their own map. And when I look at your track record, you renew the contract with Apple in 2015. So it's been 5 years now, maybe you signed even before you announced it. So maybe at least 5 years. And if we look at the average length of the contract, I mean, I think we are around this 5, 6 or 7 years. So my question is since they are rolling out, we didn't see an impact from Apple on your Enterprise business at all so far *(technical difficulty)* impact from this in the next future either because the contract is coming to an end, and we should expect some impact that the fact that they create their own maps. Just trying to -- now you know it's been 2 years since they announced that. You never explain if there is any impact on you. So just wanting to ask you.

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

Yes. Again, it's a commercially sensitive topic. We have a long-term relationship with Apple. The nature of that relationship is changing, as you rightly comment. But it's too early to say if, how, that relationship will end or what shape that relationship will take in longer term future. So its very difficult to comment on that. It's commercially sensitive. We all know what Apple is doing. We still have a very good relationship. We're sharing a lot of data and information. I think that relationship is intact. And I think there will be opportunities for extending that relationship, but it will be of a different nature than it used to be.

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

Okay. And just to be clear, the fact that they finished the U.S., for example, do they still use TomTom maps in the U.S. or it's now over?

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

No. In the U.S., they don't use our maps anymore. They're still relying on some of the content that we have provided. Their mapping system has completely moved to their proprietary mapping effort.

Operator

There are no further questions. (Operator Instructions)

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. And that does conclude today's conference. Thank you to everyone who has participated in today's call. You may now all disconnect.
