

Initiation of Coverage

26 September 2005

**TOMTOM NV**  
Eurolist: "TOM2"  
Rating: Buy  
Price target: 45.9 EUR

Quote	09/26/05	€ 'mn	2003A	2004A	2005E	2006E
52-Week Range		Revenue	€ 39.1	€ 192.4	€ 562.7	€ 1,115.4
Recent Price	35.86	EBITDA	10.4	44.5	131.4	244.6
Market Cap	\$3,673.0 Mn	Net Income	6.2	27.7	95.5	170.6
Shares Outstanding	102.4 Mn	Total Assets	21.0	91.1	399.2	698.3
		Total Debt	0.0	0.0	0.0	0.0
		Shareholders' Equity	7.6	37.8	249.6	422.2
		Debt/Equity	0.0	0.0	0.0	0.0
		ROE	134%	122%	66%	51%
		ROA	48%	49%	39%	31%
		EPS	€ 0.06	€ 0.26	€ 0.86	€ 1.53
		P/E			41.8	23.5

*We are initiating coverage of TomTom with BUY rating. The company has entered the commercialization phase after several years of development and reported tremendous growth of revenue, profits and cash flows. The company has the right product in the right place and at the right time, excellent operating and distribution capabilities, strong management team and a skyrocketing market.*

*In addition, the company has excellent opportunities to outperform the market in terms of growth, as currently it is the leader on the European market, has the best product according to various research entities and sufficient cash resources to acquire smaller competitors and to finance the growth.*

*TomTom's expansion initiatives will provide it with stronger revenue streams from U.S., Australia, Eastern Europe and Asia. Moreover, TomTom has developed strong relationships with leading car and mobile phone manufacturers to integrate its devices into cars, PDAs, mobile and smart phones.*

*As a result, we expect TomTom to report triple-digit revenue growth for the next two years and significant business expansion as both its market share and integrated navigation devices penetration rate increase.*

*All of the above give good reasons for premium trading. Therefore, we are initiating coverage with a Buy rating and assign a price target of 45.9 EUR per share.*

## INVESTMENT HIGHLIGHTS

### **Strong business model based on attractive product offering and well organized operations and backed by an experienced management team**

TomTom's management team is well balanced with significant experience in distribution, telecommunications, software, etc. In addition, the key executives have significant experience in working within the leading European companies like Unilever, Mars, etc.

At the same time, TomTom has a good product offering that effectively combines high quality with decent sales prices. Moreover, at the Telematics Update 2005 conference, which took place in April 2005, TomTom's product – TomTom GO – received the Best Navigation Product award. In 2004, TomTom GO received RetailVision Europe's "Best Hardware Product" award and CNET's "Best Available Choice for Quality, Performance, Design and Service" award among integrated navigation devices. TomTom Navigator has also won multiple product awards, including the PDA Essentials Killer Application and Best PDA Software awards in 2004 and Connect Magazine's Gold award in the category of PDA-based systems in 2004.

Lastly, most operations are sourced out to China, allowing TomTom to keep its operating expenses under control. Apart from design and R&D activities, most of the other operations connected with manufacturing, related engineering and assembly operations are sourced to subcontractors in Asia. As a result, TomTom can have a significant cost advantage over its competition.

### **Significant revenue growth generated by the booming personal navigation devices market**

Over the last two years, TomTom's annual revenue jumped from €7.9 million in 2002 to €192.4 million in 2004 and management expects the FY05 revenue to triple compared to 2004, as the company has already reported a revenue of €181.1 for H1FY05. The main driver of the revenue growth was the strong demand for integrated personal navigation products and services. For instance, the number of integrated devices sold increased eleven times from 22,675 units in Q2FY04 to about 262,447 in Q2FY05. The growth was also marked by the expansion of the product portfolio with smartphone applications.

#### **Income statement data**

€ millions	FY03	FY04	YoY%	H2FY04	H2FY05	YoY%
Year end December 31						
Revenue	39.1	192.4	392%	50.0	181.0	262%
Gross profit	19.4	85.2	340%	20.8	79.1	280%
Operating profit	10.0	43.4	336%	11.3	45.5	303%
Net profit	6.2	29.2	372%	7.3	52.8	623%
EPS, diluted				€0.07	€0.32	357%

Source: Company's reports

### **Leading position on the European Market for Personal Navigation devices**

TomTom's share of the European Market for Personal Navigation devices increased to 29%, based on the data provided by Canalys. The company leads the market primarily in the field of integrated navigation devices, where its share exceeds 50%. While this segment is booming we would expect TomTom's market share to expand even further.

### **Expanding distribution network**

During H1FY05, TomTom continued to widen and deepen its distribution network both in its core European market and overseas. In Europe, TomTom started selling in Eastern Europe, namely Czech Republic and Poland, whereas in Western Europe it continued to cement its position by adding new distributors. At the same time, TomTom is actively searching for opportunities in North American, Australian and East Asian markets. In the U.S. some 2,500 outlets were involved in the sale of products through various distributors. During Q2FY05, first revenues were reported from Australia.

In addition to geographical expansion, the company entered into a number of contracts with the car manufacturers like Opel, Toyota, Lancia, etc., as well as with car dealers.

### Strong promotional campaign

The company has actively promoted its product offering, working closely with car and mobile phones manufacturers. The promotional programs have taken place on both national and regional levels in Austria with Jeep, in Belgium with Nissan and Citroen, in France with Mitsubishi and Smart, in Germany with Renault and in the Netherlands with Citroen, BMW and Alfa Romeo.

Moreover, TomTom has developed relationships with major PDA and mobile phone manufacturers, including Hewlett-Packard, palmOne, Inc. and Nokia, to sell its TomTom Navigator software products in co-branded bundles with their PDA and mobile phone hardware.

### Solid profitability and operating cash flows accompanied the revenue growth

The net profits followed the revenue acceleration maintaining roughly the same level of growth during 2004. However, the H1FY05 results proved TomTom's ability to leverage fixed costs and to get a higher operating and net margins. We expect the net margin to continue improving, with the operating and gross margins remaining rather flat.

At the same time, TomTom started generating significant cash flows from operations. During H1FY05, the operating cash flow increased four times as compared to 2003. During H1FY05, the growth pace was even higher, from €1.6 million during H1FY04 to €32.9 million during H1FY05. In addition, the recent IPO added around €116.6 million to TomTom's cash balance. Management plans to use the cash for implementing its business growth strategy. However, the previous results have shown that the growth of current assets was almost entirely financed by the growth in current liabilities. And as a result, the operating cash flows are similar to the EBITDA corrected by the amount of income taxes paid.

#### Cash Flows

€ millions	FY03	FY04	H1FY04	H1FY05
Year end December 31				
Operating cash flow	7.6	36.8	1.6	32.9
Investing cash flow	-1.0	-3.0	-1.3	-1.7
Financing cash flow	-0.6	-0.5	0	116.6
<i>Net increase in cash and cash equivalents</i>	<i>6.1</i>	<i>33.3</i>	<i>0.3</i>	<i>147.7</i>

Source: Company's reports

### Healthy balance sheet free of interest bearing debt

TomTom's balance sheet strengthened significantly since 2003. The company increased its equity to more than €191 million as of June 30'05. The cash position also grew to around €188 million and net working capital increased to more than €188 million.

#### Balance Sheet data

€ millions	31-Dec-03	31-Dec-04	30-Jun-05
Year end December 31			
Cash and cash equivalents	6.9	40.2	187.9
Net working capital	6.5	36.5	188.2
Interest bearing debt	0.0	0.0	0.0
Equity	7.6	37.8	191.1

Source: Company's reports

Proceeds obtained from the May'05 IPO provide TomTom with greater flexibility in implementing its aggressive growth strategy. The proceeds amounting to roughly €117 million should support TomTom in becoming a leading provider of high-quality personal navigation products by financing the expansion of the product portfolio, new R&D initiatives, development of distribution network, building a strong brand etc.

### **Optimistic management outlook for FY05**

Management expects that the 2005 revenue will triple versus 2004. In addition, management expects the operating leverage to alleviate the negative impact of decreasing gross margin and as a result to keep the operating margin stable. In terms of net margins, we expect a significant increase, as the company is turning into a cash cow and the interest revenue should contribute significantly to the bottom line results. The H1FY05 results sustained management's optimism.

### **Favourable industry outlook**

The Navigation Devices market is at the inception phase, as penetration rates have not exceeded 6% in Europe and 2% in the U.S. Therefore, the market potential is enormous. According to a Canalsys<sup>1</sup> report, the total European and U.S. market is 418 million cars. Only 10% of new cars sold have a built-in satellite navigation system. The same report highlighted that by 2007, the market for personal navigation devices in Europe would reach about 4.9 million units versus 2.6 million in 2004. The CAGR for personal navigation systems in the European market is expected to reach 24% by 2007, and for the U.S. – 57% by 2006<sup>2</sup>

Currently, there is a shift from nonintegrated navigation devices towards integrated ones. TomTom is primarily focused on integrated solutions; therefore, we expect the company to benefit more than its competitors from the projected growth and to increase further its market share.

According to several recent market surveys, the consumer interest in satellite navigation systems is increasing. Market research from Lightspeed Research in August 2004 indicated strong consumer interest in satellite navigation products, with 56% of people in the United Kingdom indicating that a car navigation product was their most desired in-car electronics gadget.

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<sup>1</sup> <http://www.tomtom.com/investor/main.php?ID=15&Language=1>

<sup>2</sup> Company's analyst's presentation

## KEY INVESTMENT NEGATIVES

### TomTom's revenue is highly dependent on one product

TomTom's revenues are highly concentrated, with TomTom GO generating a substantial portion of revenues and cash flows. Based on 2004 data, sales of TomTom GO accounted for approximately 60% of company's total revenues, reflecting approximately eight months of TomTom GO sales. TomTom has recently begun shipping its new TomTom GO 300 model and expects to begin shipping its 500 and 700 models soon. While the company has other products in its portfolio like TomTom RIDER, TomTom Navigator, TomTom MOBILE and TomTom Plus, we expect TomTom to rely further on TomTom GO.

### Decline in average selling price will decrease the profit margins

During Q2FY05, the average selling price (in Euros) of integrated devices declined by 25% versus Q2FY04. Nonintegrated devices sales price also registered a similar decline of about 23%. The reduction in the average selling price was due to the change in the product mix, whereby the cheapest device GO 300 recorded the bulk of the sales during Q2FY05. We expect the same trends to continue as the technology becomes cheaper and the competition fiercer, while productivity increases. As a result, TomTom's gross margins should decrease, however the management expects to leverage fixed expenses and to maintain a similar to 2004 level of the operating margin.

Year end December 31	FY03	FY04	YoY%	Q2FY04	Q2FY05	YoY%
<b>Gross profit margin</b>	49.5%	44.3%	-5.2 p.p.	40.8%	41.7%	+0.9 p.p.
<b>Operating profit margin</b>	25.5%	22.6%	-2.9 p.p.	24.0%	24.0%	0 p.p.
<b>Net profit margin</b>	15.8%	15.2%	-0.6 p.p.	15.1%	19.3%	+4.2 p.p.

Source: Company's reports, analysts' estimates

The slight year-over-year improvement in profit margins during Q2FY05 was not very convincing due to the fact that this improvement was a direct consequence of changes in product mix and favourable exchange rate differences.

### Limited operating history

Although TomTom was established long before it launched its products on the market, it is rather difficult to make accurate forecasts and correct assessments of the current business model and future prospects. The current business phase started in 2003 with the launch of the TomTom NAVIGATOR 2 technology followed by the hit TomTom GO device launched in 2004. During this period the company reported triple digit revenue growth, however there is no assurance that such growth rates will be maintained over a longer period.

### TomTom may be exposed to an increased level of exchange rate risk in the future

The changes in exchange rates did not have a significant impact on TomTom's net income during 2004 – a loss of €0.8 million. However, the increasing international presence and the penetration of the U.S., Australian and East Asian markets should add a greater exposure to currency risk along the increasing revenues. While the H1FY05 results contain a positive impact of exchange rates of about € 7.4 million, there is no assurance that the trend will not reverse and the company may report a currency exchange loss.

### Share price trend

Since the IPO completion in the end of May'05, the stock price doubled from €17.5 to about €35 by the end of September'05.

## VALUATION

Using a weighted average of four methodologies, we arrive at a price target of **45.9 EUR** per share. This figure represents a significant upward potential in the price of the stock (28%), therefore the stock is rated as a BUY.

Despite TomTom having multiples above those of its peers, we believe high premiums are warranted, mainly by triple digit revenue growth, as well as by the excellent market outlook.

	Price	Market cap	TTM EV/EBITDA	P/E 2005	P/E 2006	P/S 2005	P/S 2006
GRMN	61.27	6,610.00	17.90	24.41	21.42	6.81	5.80
LEIX	25.09	128.84	7.58	11.72	10.68	0.71	0.59
TRMB	32.50	1,740.00	13.21	23.55	19.94	2.23	1.97
VOXX	16.52	382.74	NM	28.98	21.74	NA	0.59
Median			<b>13.21</b>	<b>23.98</b>	<b>20.68</b>	<b>2.23</b>	<b>1.28</b>

Source: <http://finance.yahoo.com/>

Discounted Cash Flow		P/S valuation	
DCF stream	829,305	Revenues FY06E	1,115,440
DC terminal value	4,192,482	Peers multiple, FY06E	1.3
Total DC Enterprise Value	5,021,787	Premium assumed	200%
(Less) Net Debt	(187,904)	Target Multiple	3.8
Equity Value	5,209,691	Equity value	4,281,461
Equity Value Per Share	<b>€ 46.66</b>	Price target	<b>€ 38.35</b>

EV / EBITDA valuation		P/E valuation	
EBITDA FY06E	244,641	EPS FY06E	€ 1.53
Peers multiple, TTM	13.2	Peers multiple, FY06E	20.7
Premium assumed	55%	Premium assumed	65%
Target Multiple	20.5	Target Multiple	34.1
EV	5,008,017		
(Less) Net Debt	(187,904)		
Equity value	5,195,921		
Price target	<b>€ 46.54</b>	Price target	<b>€ 52.15</b>

Source: analyst estimates

	Weight	Target
DCF	25%	\$46.7
P/S valuation	25%	\$38.3
EBITDA valuation	25%	\$46.5
P/E valuation	25%	\$52.1
Weighted target price		<b>\$45.92</b>

Source: analyst estimates

## INDUSTRY OVERVIEW

### Industry Highlights

- The initial growth of the industry was slow, but is accelerating as prices fall and the consumers become more technology-aware.
- New versions of GPS navigation devices, GPS positioning applications and software constantly emerge in the market.
- The development of Location based services (LBS) by wireless operators is expected to drive the further growth of personal navigation market.
- The introduction of LBS by mobile operators will create new opportunities for personal navigation market players, but at the same time will toughen the competitive environment.

### Industry Trends and Outlook

Although the market for personal navigation services has been developing rather slowly, experts expect the growth rate to pick up, as competition and consumer demand intensify. Thus, researchers at SBD<sup>3</sup> note that as consumers have become more sophisticated in their understanding of electronic gadgets, the market for portable navigation equipment has soared. The company expects the European market to exceed six million units in 2005.

SBD's research shows that at present only around 10% of new cars in Europe are sold with satellite navigation. Customer take-up is low due to the fact that the equipment is usually offered as an expensive option or is provided as standard mainly on premium or luxury models. If present trends continue, fitment rates could reach a modest 12% in 2006.

This contrasts with the performance of portable systems, which have doubled sales levels in 2004-2005. Rapid growth has been fuelled by the success of new personal navigation devices (PNDs), which are smartly designed, simple to use and competitively priced. The portable market also includes personal digital assistants (PDAs) and newly introduced smartphones. SBDs report anticipates PNDs will claim more than 50% of the European portable market, as more new products reach stores and prices continue to fall. David McClure, SBD's head of Telematics, said: "If car makers are willing to adopt more cohesive marketing and technical strategies, we think there is an opportunity for fitment rates on new cars to rise as high as 30% by 2008-2009."

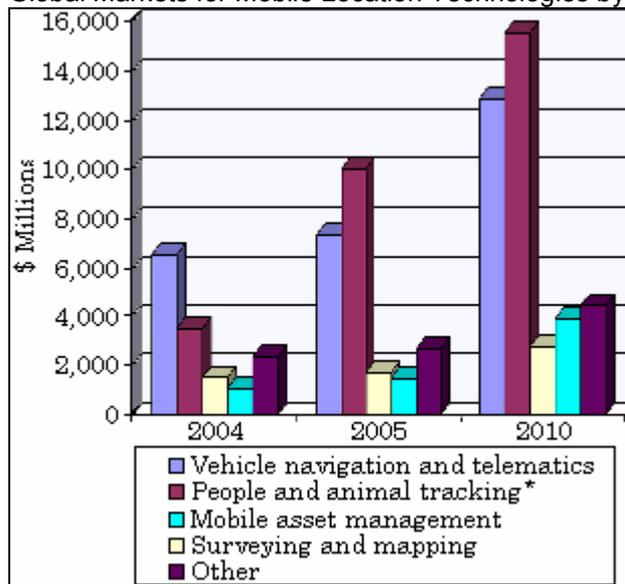
Research firm Business Communications Co. reports the following for the mobile location market<sup>4</sup>:

- The global market for mobile location technologies is projected to rise from \$23 billion in 2005 to surpass \$39 billion by 2010, at an AAGR of 11.3%.
- Vehicle navigation systems and telematics, the largest application segments in 2004 with more than 44% of the market, should be superseded before 2010 by people and animal tracking.
- Surveying and mapping and mobile asset management are the other two largest applications, and will represent 8% and 11.5%, respectively, by 2010.
- Complete or integrated GPS solutions increasingly dominate the market and accounted for an estimated 90% of the market in 2004, a share expected to increase to 94% by 2010.

<sup>3</sup> Source: [http://www.the-infoshop.com/press/sbd32284\\_en.shtml](http://www.the-infoshop.com/press/sbd32284_en.shtml)

<sup>4</sup> Source: <http://www.mindbranch.com/products/R2-911.html>

Global Markets for Mobile Location Technologies by Application Segment, 2004-2010 (\$ Millions)



\*Includes GPS and other location-aware mobile phone handsets.

Source: BCC, Inc.

Gartner predicts that GPS-based car navigation will grow from 8.7 million cars today to 16 million by 2006.<sup>5</sup>

### Recent market trends

According to a report by Canalys<sup>6</sup>, the first half of 2004 saw a marked rise in the shipments of GPS navigation solutions for handhelds in EMEA (Europe, Middle East & Africa). Out of 843 thousand mobile GPS solutions sold during the period under review, the number of handhelds was over 720,000, compared to less than 700,000 for the whole of the previous year. Around 40% of all handhelds shipped in the six-month period were shipped as GPS navigation solutions.

The research company noted that competition is emerging in several forms. As in other application areas, such as personal information management (PIM) and mobile e-mail, Canalys expects smart phone vendors to take an increasing share. Solutions designed for Symbian or Microsoft based smart phones are available from companies such as Route 66, Wayfinder and Webraska, and although adoption of navigation on smart phones is low today the huge volumes being shipped of this class of device make it an attractive target for software providers. Mobile network operators will increasingly promote off-board solutions, paid for by subscription, that always offer the most recent available maps and dynamic routing capabilities to help motorists avoid problem areas. Some operators have already started to establish their navigation market credentials by advertising solutions based on own-brand wireless handhelds, such as the O2 xda II.

The company estimated that transferable solutions made up 9% of the market in H1 2004, compared to 4% for smart/feature phones and 87% for handhelds/wireless handhelds. The leading vendors overall were TomTom, with 26% share by units, followed by Navigon on 20% and ViaMichelin on 12%.

The researchers noted that demand for handheld solutions in Germany, the Netherlands, Belgium, the UK and France has been strong while demand in North America has lacked behind<sup>7</sup>.

<sup>5</sup> Source: [http://news.com.com/After+years+of+struggle,+GPS+is+taking+off/2100-1033\\_3-5187758.html](http://news.com.com/After+years+of+struggle,+GPS+is+taking+off/2100-1033_3-5187758.html)

<sup>6</sup> Source: <http://www.canalys.com/pr/2004/r2004093.htm>

<sup>7</sup> Source: [http://www.findarticles.com/p/articles/mi\\_moFGI/is\\_10\\_15/ai\\_n8563827](http://www.findarticles.com/p/articles/mi_moFGI/is_10_15/ai_n8563827)

## Competitive Situation

The numerous awards that TomToms products have received confirm TomTom's leading position in the market. Thus, at the Telematics Update 2005 conference, which took place in April 2005, the Best Navigation Product Award finalists were<sup>8</sup>:

- TomTom – TomTom GO (the Winner of the award);
- ALK Technologies – CoPilot Live Smartphone;
- Siemens VDO – MS5500 Navigation System;
- Telcontar – Drill Down Server.

Below are the profiles of main competitors in the GPS personal navigation field. There are a number of smaller ones, like Lowrance, Pharos etc., but their small size and/or different business focus reduce their significance in terms of competitive threat for TomTom.

### ALK Technologies

ALK is a privately held company headquartered in Princeton, NJ. ALK's commercial trucking applications are used by more than 20,000 companies throughout the world. In 1997 ALK's CoPilot became the first in-vehicle GPS navigation system to provide door-to-door directions anywhere in the United States. CoPilot went on to win 4 consecutive Innovations Awards from the Consumer Electronics Association for excellence in design and engineering. The first version of Pocket CoPilot was released in 2000 and was the first solution of its kind. Providing door-to-door directions to any address and including spoken turn instructions and route recalculation, Pocket CoPilot again led the market and received numerous industry awards.

On July 27, 2005, ALK Technologies Ltd, the European Division of ALK Technologies Inc, announced it had won the 2005 Mobility Solutions Sales & Marketing Partner of the Year Award at the Microsoft Worldwide Partner conference in Minneapolis.

Earlier this year, ALK Technologies announced its CoPilot Live Satellite Navigation Software would be featured on some of Motorola's newest converged mobile devices.

In January 2005 ALK announced that its CoPilot Live personal GPS navigation solution for Smartphone, Pocket PC, laptop and Tablet PC systems received the E-Gear Magazine Editor's Choice award for the second consecutive year. In the fall of 2004, CoPilot Live was also awarded top honors by Pocket PC magazine.

### Garmin International

Garmin International Inc. is a member of the Garmin Ltd. (Nasdaq: GRMN) group of companies that designs, manufactures, and markets navigation and communications equipment for the aviation and consumer markets. Its products serve aviation, marine, automotive, wireless, OEM, and general recreation applications.

On September 15, 2005 Garmin International Inc. announced the nüvi – a Personal Travel Assistant that combines a GPS navigator, language translator and travel guide capability, an MP3 player, an audio book player, a currency and measurement converter, a world clock, and a digital photo organizer – all in one slim, sleek, and easy-to-use device.

On September 8, 2005 Garmin International announced that Garmin Mobile – a new suite of applications delivering maps, directions, and turn-by-turn navigation – will be offered by Sprint Nextel on select handsets.

On July 15, 2005 Garmin International introduced the StreetPilot i2™ and i3™, a new line of small, inexpensive automotive GPS navigators.

<sup>8</sup> Source: <http://www.telematicsdetroit.com/awards/>,  
[http://findarticles.com/p/articles/mi\\_pwwi/is\\_200503/ai\\_n13485248](http://findarticles.com/p/articles/mi_pwwi/is_200503/ai_n13485248)

**Telcontar**

Founded in 1996 and headquartered in San Jose, CA, Telcontar is a privately funded worldwide provider of total location-based solutions for in-vehicle, Internet and wireless platforms. Telcontar solutions are source, platform, and device-independent, with the flexibility to be integrated with a variety of in-dash and handheld devices, as well as with traditional PC computing arrangements. Our solutions are highly scalable and can be changed in real-time and deliver information in real-time. Delivery of information to the user is seamless.

In March 2005 Lucent Technologies signed an agreement with Telcontar to collaborate on fully integrated Location-Based Services for mobile operators.

Also in March, Telcontar announced the close of a \$10.6 million round of funding led by Norwest Venture Partners (NVP) of Palo Alto, California. Telcontar will use the funds for increased sales and marketing, international expansion and new product development.

**Magellan (Thales Navigation)**

Magellan Corporation was founded in 1986 as an independent consumer GPS company. In 1997 Magellan Systems expanded its portfolio of GPS solutions with the acquisition of Ashtech, a leader in the professional GPS category. The two formed Magellan Corporation. In 2001, Thales Group (traded on Euronext and Deutsche Börse), an electronics company with a significant presence in global markets for defense, aerospace and information technology and services acquired Magellan Corporation and merged it with its subsidiary, Thales Navigation, S.A.

In June 2005, Thales' navigation business, global provider of Magellan GPS products, introduced in North America the new Magellan RoadMate 760 with SayWhere(tm), an industry-first text-to-speech option that announces street names for upcoming maneuvers.

In May 2005, Thales announced that its Magellan® RoadMate™ 700 was the number-one selling aftermarket portable vehicle navigation solution in America for the 17th consecutive month with an average dollar share of 36% over that period, according to research findings by NPD Techworld®, a division of NPD Group. In March, this product received the iF Product Design Award in Hanover, Germany.