

Zomato

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A non-linear growth opportunity

Summary

Zomato, one of the top 5 unicorns of India, is a platform company which has successfully solved for convenience by connecting restaurants with customers. By using technology and a fleet of delivery partners, Zomato has created a capital light compounding machine which creates an eco-system wherein the best of the restaurants will make more money (as Zomato brings more customers driven by quality reviews/ratings) while customers enjoy convenience along-with right-quality product and delivery partners enjoy part-time income. Platform companies have ruled wealth creation globally. We believe, Zomato, as a platform and being category leader, will continue to drive outperformance in food services industry in India. We are not fearful of competition taking away market share; as on the internet, network effect is the mother of all competitive moats. Also, since companies are competing for limited resources (customers won't install >3 apps to do same work, limited parking space at the restaurants to accommodate bikers for order pick-ups), we believe food service industry can't be more than 2-3 horse-race. We expect losses to come down going forward driven by higher delivery charges (customers must pay for convenience) and reduction in competitive intensity (induced by consolidation). Valuation looks expensive from near term point of view (c.6x FY21 Gross order value vs 1-3x multiple for global competitors), but given the non-linear growth opportunity, we believe it's better to stay invested in such companies. We recommend SUBSCRIBE.

Key Investment Rationale

- Food services industry is highly underpenetrated in India, Zomato to lead the category growth: only 8-9% of food consumption in India is from restaurants while rest is from home-cooked food. However, in countries like China and USA food consumption from restaurants stands at 42-50%. Further; online food delivery users as percent to total number of users accessing internet for India is only 8% as compared to 53% in China and 38% in USA. These data points highlights that there is large headroom for increase in food delivery adoption in India. We like zomato's ability to drive and hence, create this category by improving convenience to customers. We expect zomato to outperform in food delivery domain driven by content and network effects.

Issuer	ZOMATO LIMITED
Transaction Type	OFS of 3,750 mn and Fresh Issue of 90,000 mn
Issue Open / Close	July 14 th 2021 / July 16 th 2021
Type of Offering	Offer for sale and Fresh Issue
Total Offer Size	Rs 93,750 mn
Price Band	Rs. 72 - 76
Total Offer Size as % of Post Issue Capital	15.7%
Percentage of Offer Size (Allocation)	<ul style="list-style-type: none"> QIB: 75% NIB: 15% Retail: 10%
Market Cap Post IPO	Rs 596bn at higher price band

Share holding pattern %

	Pre-Issue	Post-Issue
Promoter	-	-
Public	95.80	96.43
Non-promoter and non-public	4.20	3.57
Total	100%	100%

Financial Snapshot

(Rs mn)	FY19	FY20	FY21
Revenue	13,126	26,047	19,938
EBITDA	(22,438)	(23,047)	(4,672)
EBITDA Margin (%)	(171%)	(88%)	(23%)
Adj.Net Loss	(10,105)	(23,856)	(8,164)
EPS (Rs)	(2.69)	(5.46)	(1.52)
Networth	25,685	7,033	80,930
BPS (Rs)	69	19	216
PBV x	1.1	4.0	0.4

Source: RHP

- **Zomato offers unique all-in-one food service platform, this will create strong barrier to entry for competition:** As a platform, zomato is offering (i) food delivery service to customers (94% orders are delivered in c. 30mins) (ii) dine-out facility wherein customers can book table on zomato app (largest online table reservation platform in India) (iii) zomato Pro exclusive customer paid membership program where in customers get flat percentage discount across food delivery and dining out (iv) Hyperpure service (B2B platform) wherein zomato supplies raw materials to restaurants; zomato lists all such restaurants on their platform with a tag “Hyperpure Inside” to assure customers of quality of ingredients. We believe value-chain integration is a master-stroke strategy which enables zomato to offer more value to customers and restaurant partners. This is likely to create strong barriers to entry for competition.
- **Building critical mass is the mother of all competitive moats on the internet; food delivery can't be more than 2-3 horse race in the long run:** on the internet we understand that networking is the mother of all competitive moats (think; why google, facebook corners 92% market share in respective category?, why Amazon is 3-5-4x bigger than 2nd top e-com retailer in USA?, why food delivery companies in USA and China enjoys 2x the market share of 2nd top brand?). Creating critical-mass (having enough customers on the app to attract restaurant partners to onboard) is toughest on internet. Hence, we observe that internet start-ups, to build critical mass of customers, have to burn cash at the initial stage of the business through offers/promotions (Amazon took c. 10 years to report positive PAT in USA). However, once the critical-mass is reached; network-effect creates a capital-light-compounding machine. zomato being category leader is likely to be benefited through content and transaction based network-flywheels. Further, since companies (Zomato, Swiggy etc) are competing for limited resources (customers won't install >3 apps to do same work, restaurant companies will have limited space to accommodate bikers for delivery), we believe food delivery business can't be more than 2-3 horse race in the long run.
- **COVID pushed Zomato towards positive contribution margin:** Zomato's ability to scale-up the business 8x over FY18-20 is commendable. However, in FY21 business got impacted (-15% total income) due to COVID induced restrictions on mobility. Positively, in FY21 EBITDA losses have reduced significantly to 44mn USD (vs 300mn USD in FY20). Food delivery business has been contribution positive during all four quarters of FY21 driven by lower discounts, higher delivery charges and increase in gross order value (GOV). In 4QFY21 zomato achieved highest ever GOV at Rs 451.

About the Company:

Zomato started its journey as a platform company which provided the customers an opportunity to read, rate, review and post photos of the restaurants that they visited/want to visit. Restaurant owners got more business by listing there companies on Zomato as it helped new customers to discover the new restaurants. Over the years, Zomato expanded into adjacencies like (i) table booking and payments while dining out at restaurants. Starting 2015, zomato ventured into the food delivery business acting as a food aggregator. Food delivery is now the major growth driver for zomato contributing c. 80% to FY20 revenue. Zomato is now one of the leading food aggregators in India with an GMV of USD 1.5bn and monthly active user at c. 42mn as on FY20. The company has presence across 526 cities in India and has over 3,25,000 active restaurant listings as on Dec'20. Out of total active restaurants c. 37% restaurants participates in the delivery business of Zomato. Delivery partners are the third pillar of Zomato ecosystem. The company has over 1,69,000 delivery partners on-board (as on Mar'21) who fulfills 95% of orders placed on the platform with a median delivery time of <30 minutes.

Exhibit 1: Key data points on Zomato

	FY18	FY19	FY20	9mFY21
Average Monthly Active Users (mn)	13.8	29.3	41.5	29.6
Average Monthly Transacting Users (mn)	0.9	5.6	10.7	5.8
No. of delivery restaurants (exit month avg)	33,192	94,286	1,43,089	1,32,769
Gross Order Value (GOV) (Rs bn)	13.3	53.9	112.2	61.7
Gross Order Value (GOV) (USD bn)	0.2	0.8	1.6	0.8
No. of orders (mn)	31	191	403	155
Revenues (Rs bn)	4.9	14	27.4	13.7
Revenues + Delivery charges (Rs bn)	4.9	14.9	32.7	18
Adjusted EBITDA (Rs bn)	-0.8	-21.4	-22.1	-2
Adjusted EBITDA margin (%)	-16	-153	-80	-15

Source: RHP, IDBI Capital

Exhibit 2: Revenue streams of Zomato

Category	Revenue streams
Restaurants	Commission revenues from restaurants for delivery
	Advertisement revenues from restaurants for enhanced visibility
	Sign-up revenue from restaurant partners
Delivery partners	Subscription revenues from customers for access to membership programs like Zomato Pro
	Delivery fees paid by the customers are passed on to the delivery partners
Customers	Sign-up revenue from delivery partners
	Platform charges from delivery partners for making use of the platform for earnings
Adjacencies	Sale of products through Hyperpure and other adjacencies

Source: RHP, IDBI Capital

Exhibit 3: Drivers of key business segments

	Food delivery	Dining out	Hyper Pure (B2B Supplies)	Zomato Pro
Revenue models	1) Transaction based 2) Advertising	Advertising	Transaction based	Subscription based
Revenue drivers	1) No. of monthly transacting users 2) Order frequency 3) Average Order Value 4) Commission charged to restaurants 5) # of restaurants paying for delivery advertisement sales product	1) No. of monthly active users 2) No. of restaurant partners paying for advertisement on delivery sales product	1) # of restaurant partners 2) Value of supplies per order 3) Order frequency Cost of goods sold	1) Membership fees 2) No. of pro members
Cost drivers	1) Delivery cost 2) Discounts and marketing spend	Sales team		Marketing spend

Source: RHP, IDBI Capital

Exhibit 4: Zomato's provides earnings opportunity to 1.69 lakh delivery partners



Source: RHP, IDBI Capital

Exhibit 5: 21% orders are delivered by cyclist fleet as on Mar'21



Food service industry in India is highly underpenetrated. Zomato is primarily competing with home-cooked meals!

Exhibit 6: Only 8-9% of food consumption in India is from restaurants

2020	Restaurant food	Home Cooked Food
India	8-9%	91-92%
China	42-45%	55-58%
USA	47-50%	50-53%

Source: RHP, IDBI Capital

Exhibit 7: Large headroom for increasing food delivery adoption

2020	Online food delivery users/Access to Internet	Online food delivery users (mn)
India	8%	50-55
China	53%	500-550
USA	38%	100-125

Total income including delivery charges rose 7x during FY18-20 while EBITDA losses declined significantly.

Exhibit 8: Total income including delivery charges (USD mn)

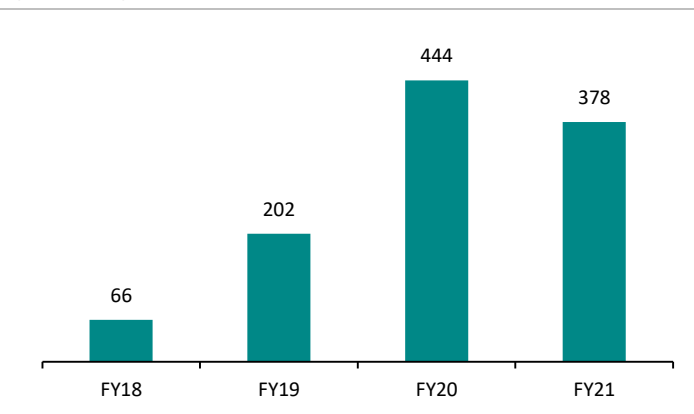
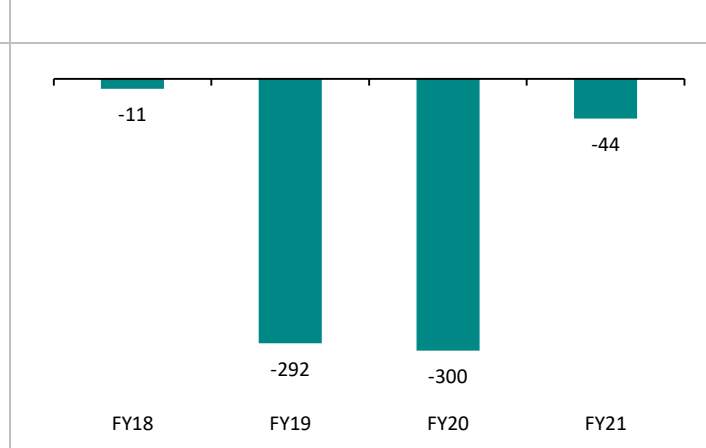


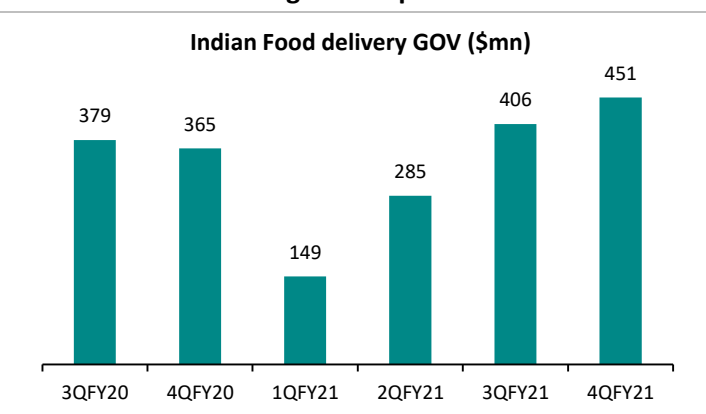
Exhibit 9: Adjusted EBITDA (USD mn)



Source: RHP, IDBI Capital

Food delivery business is not back to pre-covid while contribution margin turned positive since 1QFY21 driven by higher delivery charges and reduced competitive intensity

Exhibit 10: Zomato’s food delivery business in India recovered from the negative impact of COVID19



Source: RHP, IDBI Capital

Exhibit 11: Food delivery business has been contribution positive since last 4 quarters

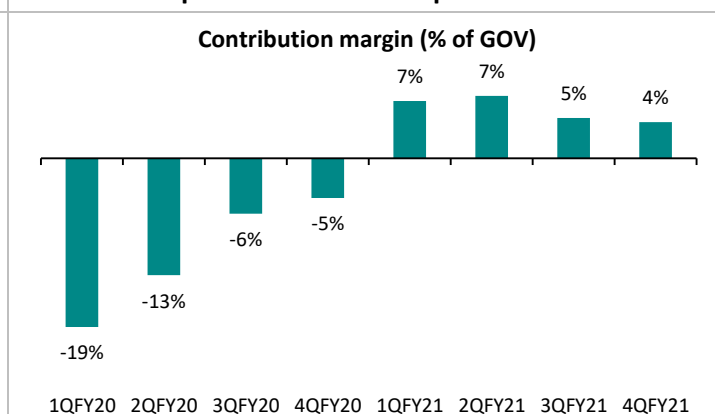
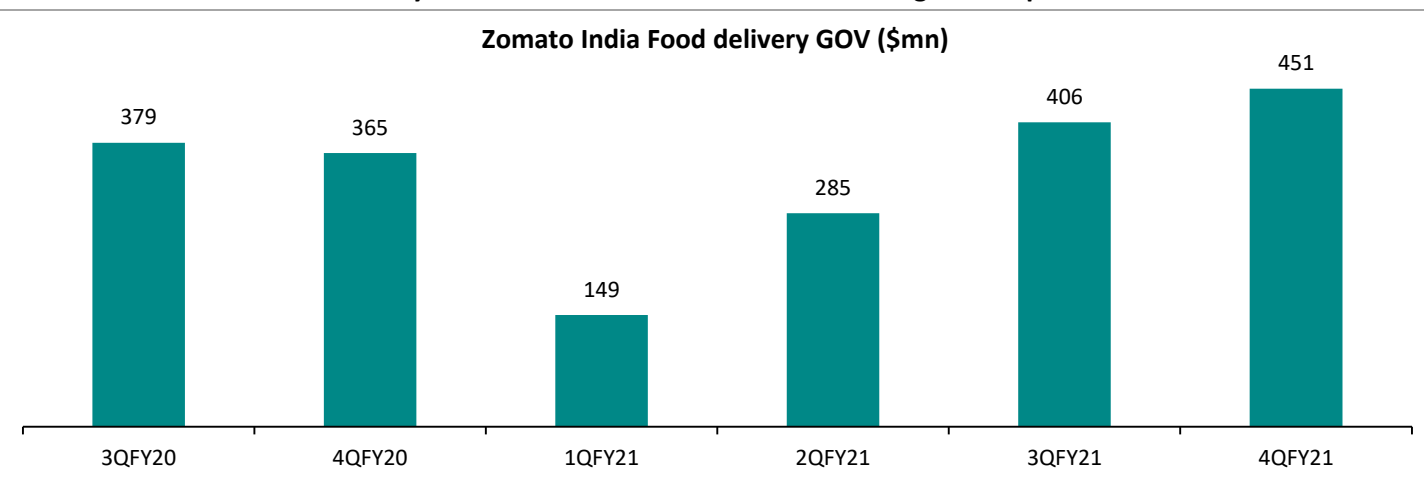


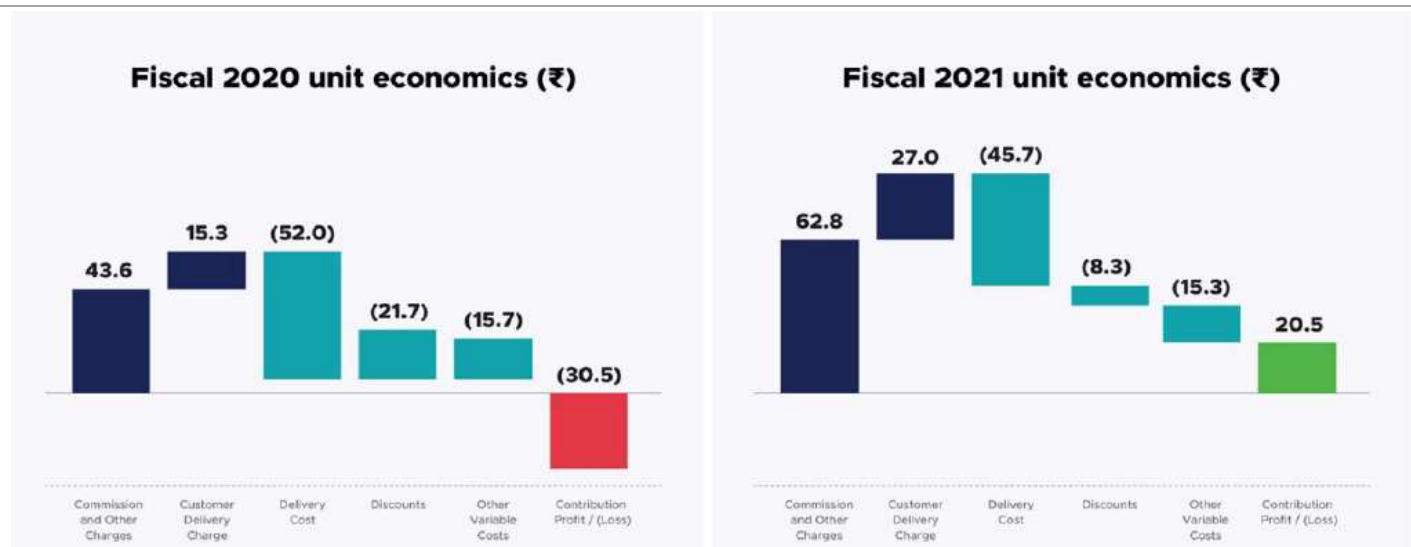
Exhibit 12: Zomato’s food delivery business in India recovered from the negative impact of COVID19



Source: RHP, IDBI Capital

COVID has helped Zomato to improve gross order value on its platform by 19-23% compared to pre-covid

Zomato turned contribution positive in FY21 driven by higher take rate (fees and commission), higher delivery charges, lower delivery cost (due to increase in gross order value), and lower discounts (due to reduction in discounting intensity)

Exhibit 13: Zomato unit economics (FY20 vs FY21)


Source: RHP, IDBI Capital

Financial Summary - Consolidated

Profit & Loss Account				(Rs mn)
Year-end: March	FY19	FY20	FY21	
Net sales	13,126	26,047	19,938	
<i>Growth (%)</i>		98.4	(23.5)	
Operating expenses	(35,564)	(49,094)	(24,610)	
EBITDA	(22,438)	(23,047)	(4,672)	
<i>Growth (%)</i>		NA	NA	
Depreciation	(431)	(842)	(1,377)	
EBIT	(22,869)	(23,889)	(6,049)	
Interest paid	(86)	(126)	(101)	
Other income	851	1,380	1,246	
Pre-tax loss	(22,104)	(22,636)	(4,904)	
Tax	-	-	(13)	
<i>Effective tax rate (%)</i>	-	-	(0.3)	
<i>Minority Interest</i>	-	-	-	
Net loss	(22,104)	(22,636)	(4,917)	
Exceptional items	11,999	(1,220)	(3,248)	
Reported net loss	(10,105)	(23,856)	(8,164)	
<i>Growth (%)</i>		NA	NA	
<i>Shares o/s (mn nos)</i>	3,753	4,368	5,366	

Balance Sheet				(Rs mn)
Year-end: March	FY19	FY20	FY21	
Net fixed assets	398	364	234	
Investments	924	668	605	
Other non-curr assets	3,094	15,338	44,692	
Current assets	29,718	12,634	41,505	
Inventories	21	37	148	
Sundry Debtors	703	1,231	1,299	
Cash and Bank	2,387	3,599	9,037	
Other financial asset	3,973	1,111	6,295	
Other current assets	22,634	6,655	24,727	
Total assets	34,134	29,004	87,035	
Shareholders' funds	25,685	7,033	80,930	
Share capital	0	0	0	
Reserves & surplus	25,685	7,033	80,930	
Total Debt	13	15	0	
Loans	13	15	0	
Provisions	143	167	259	
Other liabilities	1,232	14,581	669	
Curr Liab & prov	7,061	7,208	5,177	
Current liabilities	7,010	7,116	5,108	
Provisions	51	93	70	
Total liabilities	8,449	21,971	6,105	
Total equity & liabilities	34,134	29,004	87,035	
Book Value (Rs)	69	19	216	

Source: Company; IDBI Capital Research



Notes

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Key to Ratings Stocks:

BUY: 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below

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