Equity Research

August 22, 2021

BSE Sensex: 55329

ICICI Securities Limited is the author and distributor of this report

Initiating coverage

Internet

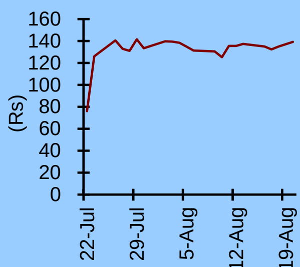
Target price: Rs220

Shareholding pattern

	Jun '21
Promoters	0.0
Institutional investors	12.8
MFs and others	3.0
Banks & Fis	0.6
Insurance Cos.	0.2
FIIs	9.0
Others	87.2

Source: BSE

Price chart



Research Analysts:

Sudheer Guntupalli
sudheer.guntupalli@icicisecurities.com
+91 22 6637 7573

Manoj Menon
manoj.menon@icicisecurities.com
+91 22 6637 7209

INDIA

Zomato

BUY

Can margins and multiples surprise? **Rs137**

Our channel checks at 150+ restaurants in 16 cities (7 / 9 from Top-20 / Next-500) hint at three key trends - (1) congruent menu prices across Zomato, Swiggy and direct ordering apps (+14% v/s dine in), (2) potential for surprise on discounts (< Rs 15 / order which is our base case) and (3) increase in delivery fee (Rs 33 / order, +22% YoY). This strengthens our conviction that industry will remain a duopoly with discount / cost discipline and demand inelasticity. Maturing customer cohorts, restaurants (esp. in Next 500) and delivery dynamics will likely lead a 'J' shaped improvement in unit economics over FY21-23E (contribution / order = ~Rs 21 to ~Rs 26). Given street's 'unreasonably' pessimistic margin estimates, we expect a big surprise by FY23 (pre ESOP EBITDA margin = 8%). Steady state EBITDA margin / ROE for the platform will likely be around 38%/20%.

On the back of strong demand tailwinds covered at depth in our food-tech thematic – (link), we expect 46% / 33% revenue CAGR over next 5 / 10 years. Unlock should not have a noticeable decelerating effect like in case of global tech (e.g. Amazon, DoorDash). Our deep dive into the regulatory framework suggests Zomato is one of the least vulnerable internet companies across the world for a regulatory tech-lash. As growth / PAT margins are yet to reach steady state, PEG is better v/s P/E for relative comparisons, in our view. At 0.5x FY24E PEG, Zomato is way cheaper v/s median food services (1.9x), technology (1.8x) or consumer (2.9x) stocks. We value it at 55x 2-year forward P/E, in-line with median consumer discretionary multiple. Upside risk to our estimates and target multiple is likely as discounts turn out to be lower v/s our base case and company scales up in attractive adjacencies. Initiate coverage with Zomato as our high conviction BUY.

- **Discount / delivery discipline. Inelastic demand. Innovative SKUs / prices.** Menu prices across online channels are noticed to be congruent. Besides, given the inferior UX and poor quality control in direct ordering, we believe concerns of disruption to the duopoly are unwarranted. Online, restaurants are marking up menu prices by ~14% (v/s dine in) before discounting. Given the absence of standardization (on grammage), we noticed innovations like new SKUs / prices by restaurants on Zomato / Swiggy with quantity change in the 'just noticeable' range.

  Both aggregators are showing good discipline on discounts / delivery fee. In the ongoing 60% off sale, average 'best' bargain discount is noticed to be Rs 100 (~25% of AOV, Rs 75 on Swiggy). Subject to longevity of such sales, Zomato's discount share will likely vary between Rs 8-15 / order. The upper end is our base case.

  Average delivery fee on Zomato increased sharply to Rs 33 / order (+22% v/s FY21, Rs 37 on Swiggy) with reasonable demand inelasticity. Currently, lower delivery fee in the Next 500 (Rs 24 / order) leaves scope for further increase. Overall, optimization of the delivery (fee & costs) will be a key driver of rise in contribution.

Market Cap	Rs1093bn/US$14.7bn
Bloomberg	ZOMATO IN
Shares Outstanding (mn)	7,845.2
52-week Range (Rs)	142/76
Free Float (%)	100.0
FII (%)	9.0
Daily Volume (US$'000)	NA
Absolute Return 3m (%)	NA
Absolute Return 12m (%)	NA
Sensex Return 3m (%)	12.3
Sensex Return 12m (%)	46.3

Year to Mar	FY21	FY22E	FY23E	FY24E
Revenue (Rs mn)	19,938	40,047	55,858	77,959
EBITDA(Rs mn)	(4,672)	(8,722)	1,167	10,123
Net Income (Rs mn)	(8,128)	(3,229)	5,553	13,095
EPS (Rs)	(1.5)	(0.5)	0.9	2.0
P/E (x)	n.a.	n.a.	157.1	66.6
CEPS (Rs)	(1.3)	(0.4)	0.9	2.1
EV/E (x)	n.a.	n.a.	637.2	71.8
Dividend Yield	0.0	0.0	0.0	0.0
RoCE (%)	(11.7)	(7.1)	0.3	3.7
RoE (%)	(18.5)	(2.6)	3.2	7.1

- **How do we think about the long-term growth drivers?** Given multiple macro and industry tailwinds detailed in our thematic (link), we expect robust 46% / 33% revenue CAGR over FY21-26 / FY21-31. This is without even counting the 65% of the rural population in the addressable market given the supply bottlenecks. Better cohort retention and contribution (vs DoorDash / Deliveroo) allay concerns around India-specific limitations (lower GDP per-capita / aversion to outside food).

  Despite limited operational history and network effect, food-tech adoption at 16% in the Next-500 towns (I-Sec est.) is encouraging. With supply interventions and stronger network effect, we see scope for further increase in adoption also given the lower restaurant density here. However, as offices resume and corporate employees return to Top-20 cities, any change in the dynamic of these markets (where Zomato leads Swiggy in market share) needs to be closely watched.

- **How can the unlock impact the business in the near term?** Contrary to its global peers (DoorDash and Amazon etc.), Zomato witnessed a sharp and artificial drop in key metrics during the first wave. Accordingly, we expect a robust recovery going ahead. This bounce back should more than offset the unlock-led uptick in physical channel activity the near term. Nevertheless, the normalisation of AOVs and increasing bargaining power of restaurants are key variables to watch out for.

- **Like the Chinese tech, is Zomato vulnerable to a regulatory tech-lash?** Our analysis of the regulatory framework for Indian internet businesses hints at five potential areas of controls – (1) fin-tech, (2) content, (3) personal data protection, (4) anti-trust and (5) gig work. Despite its applicability, Zomato should be unaffected by the former four. A minor impact 'may be' likely due to the gig work issue (e.g. 1%-2% of net revenue contribution to a social security fund). We would rate Zomato as one of the least vulnerable to a regulatory tech-lash. The actions elsewhere can be a key positive as investors indulge in regulatory arbitrage.

- **8% Pre ESOP EBITDA margin likely by FY23 – surprise on street estimates.** As noticed in global peers like Doordash and reinforced in our channel checks – maturing customer cohorts, restaurants and delivery dynamics leave scope for lower CAC, higher take rates / delivery fee. As volumes rise sharply, we see scope for further fall in delivery cost. Branding & marketing costs will likely stabilize at 10% of revenue, tad higher v/s FY21 level. Over FY21-23E, we expect a 'J' shaped improvement in unit economics, translating into 8% pre ESOP EBITDA margins – a big surprise on street's expectation of EBITDA profitability by FY25.

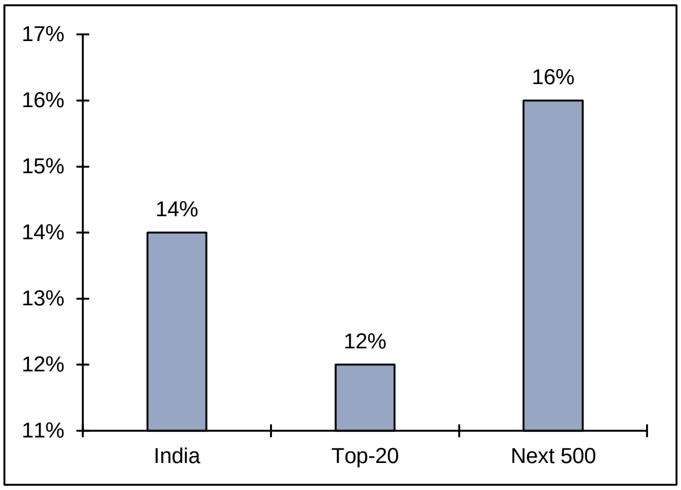
  While recovery in dine out (43% EBITDA margin in FY20) and pick up in advertising (~20% EBITDA margin in steady state) are key margin tailwinds, increasing share of Hyper pure (low margin) is a risk to watch out for. Our estimates do not factor in (1) investments in any new businesses or (2) 3rd wave-related risks. From FY23E, we assume ETR of 25% in-line with the new regime.

- **In our view Zomato is a great value stock, unlike what street believes it to be.** Our TP (Rs 220) bets on ~22mn Indians ordering ~4 times / month in FY25E! This is a low bar given that India 'today' has ~35mn / 114mn credit card / Paytm transacting users who likely fall in the super user category / user funnel. We value the stock at 55x 2-year forward P/E, in-line with a median consumer discretionary stock. Initiate coverage with Zomato as our high conviction BUY. Likely lower discounts than our base case (< Rs 15 / order) and scaling up in attractive adjacencies pose key upside risk to our estimates and target multiples.

TABLE OF CONTENTS

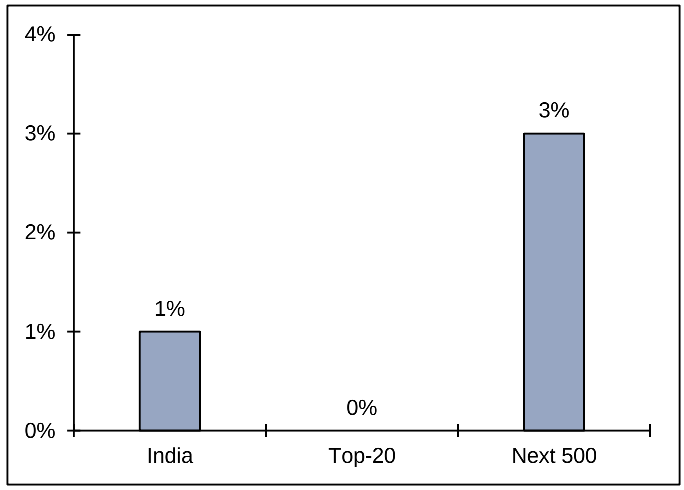
Narrative in charts

Chart 1: Menu Prices - Zomato v/s dine in



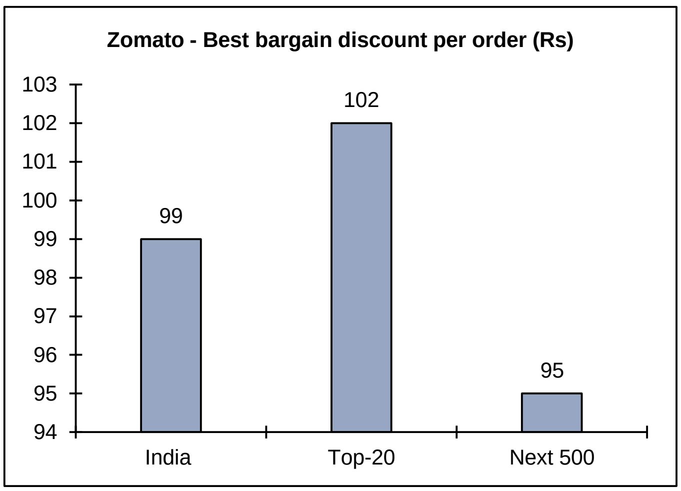
Source: I-Sec research, Primary data from 7 Tier I and 9 Tier II cities.

Chart 2: Menu prices - Zomato v/s Swiggy



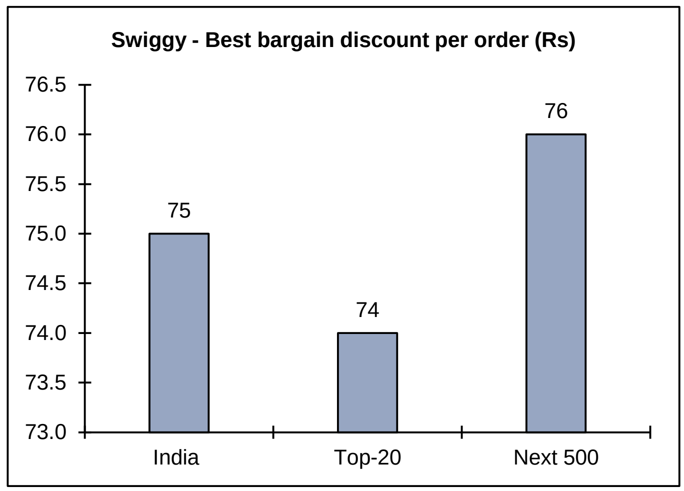
Source: I-Sec research, Primary data from 7 Tier I and 9 Tier II cities.

Chart 3: Currently, best bargain discount on…



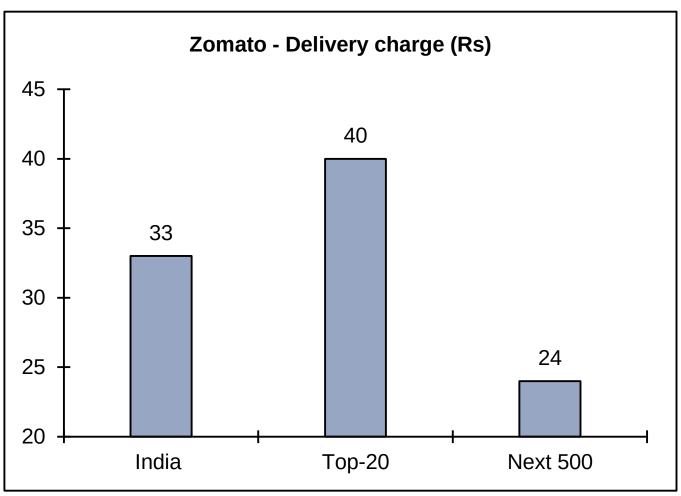
Source: I-Sec research, Primary data from 7 Tier I and 9 Tier II cities.

Chart 4: …Zomato is higher than that of Swiggy



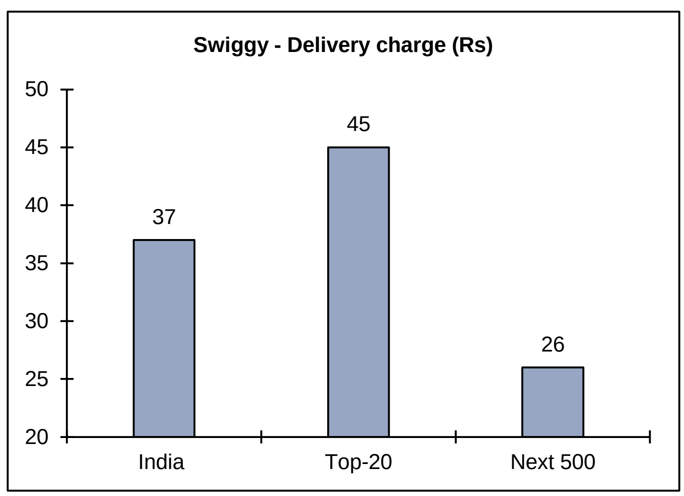
Source: I-Sec research, Primary data from 7 Tier I and 9 Tier II cities.

Chart 5: Average delivery fee charged by both…



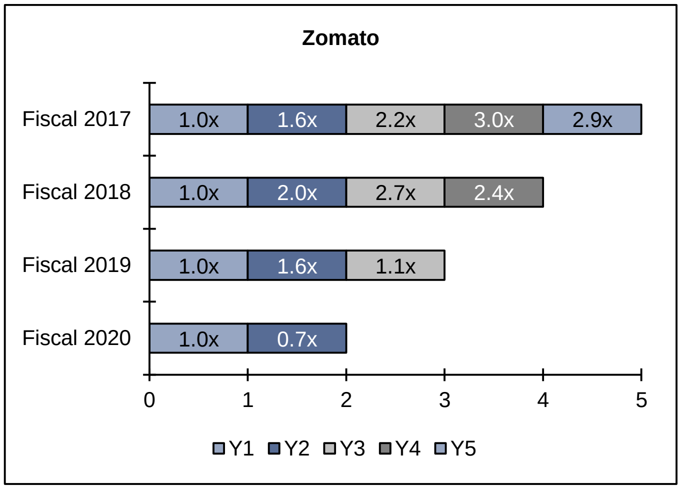
Source: I-Sec research, Primary data from 7 Tier I and 9 Tier II cities.

Chart 6: …players increased in FY22 (v/s FY21)



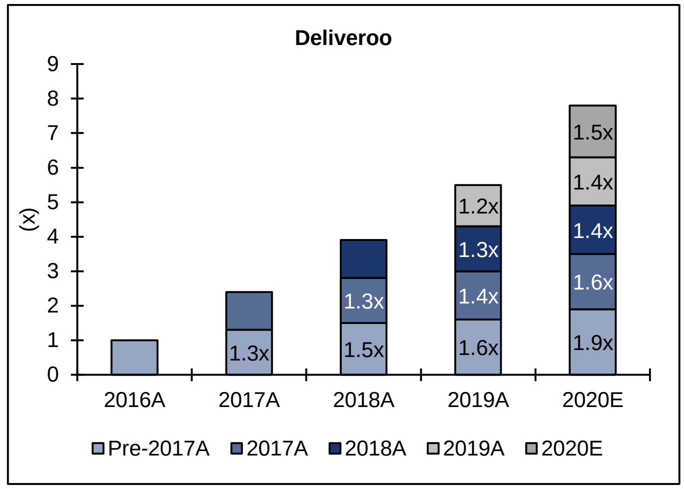
Source: I-Sec research, Primary data from 7 Tier I and 9 Tier II cities.

Chart 7: Stronger cohort retention in Zomato …



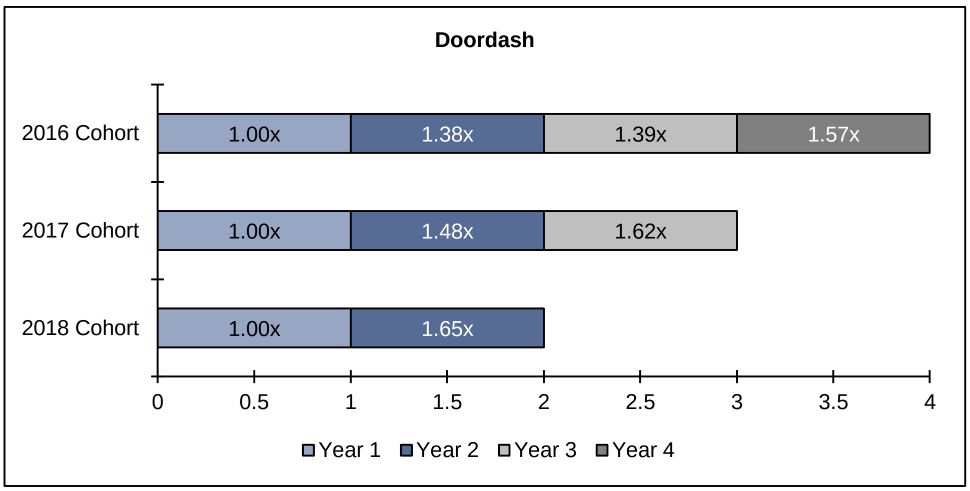
Source: I-Sec research, Company

Chart 8: …signifies neither lower per-capita nor…



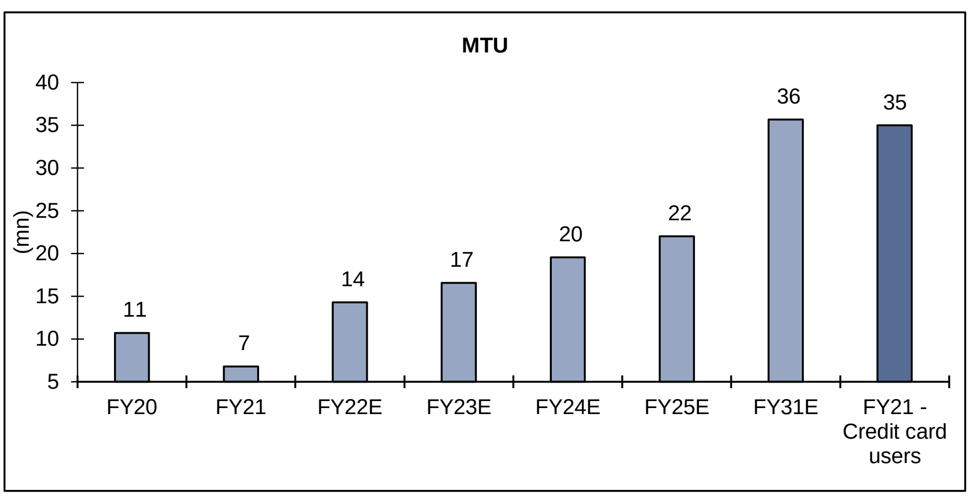
Source: I-Sec research, Company

Chart 9: …reluctance of Indians to eat outside food are limitations



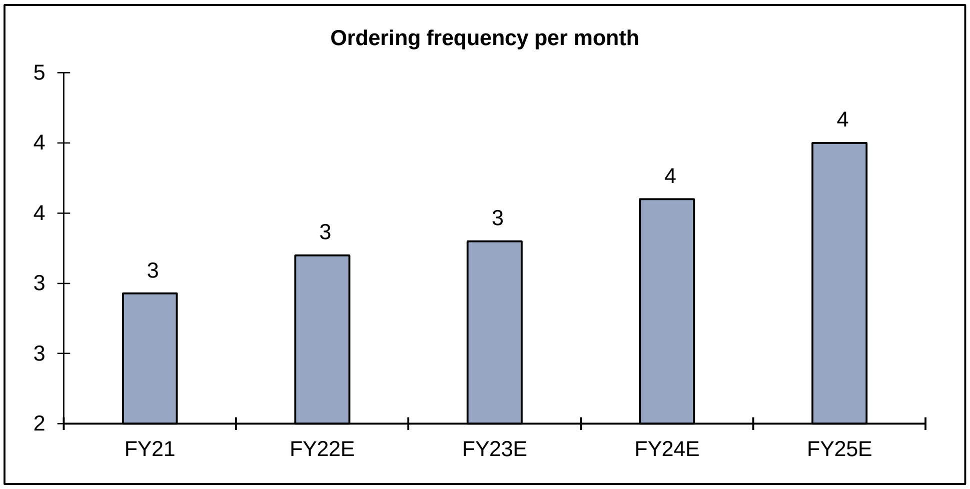
Source: I-Sec research, Company

Chart 10: MTUs we are projecting in FY31 is close to number of credit card users in India in FY21



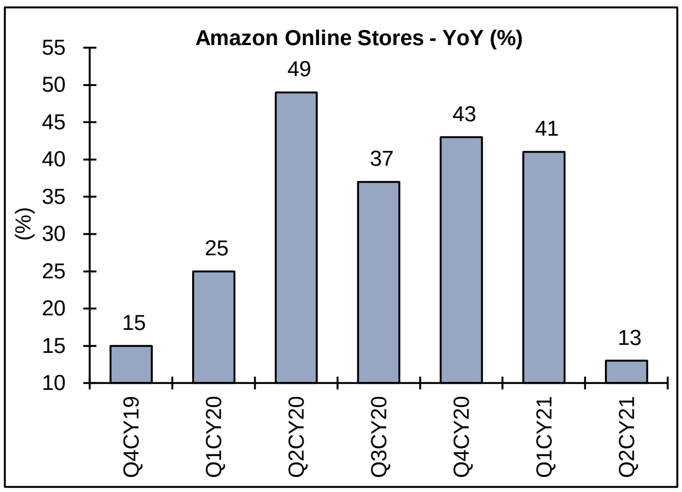
Source: I-Sec research, Company

Chart 11: We expect a slight increase in ordering frequency of users



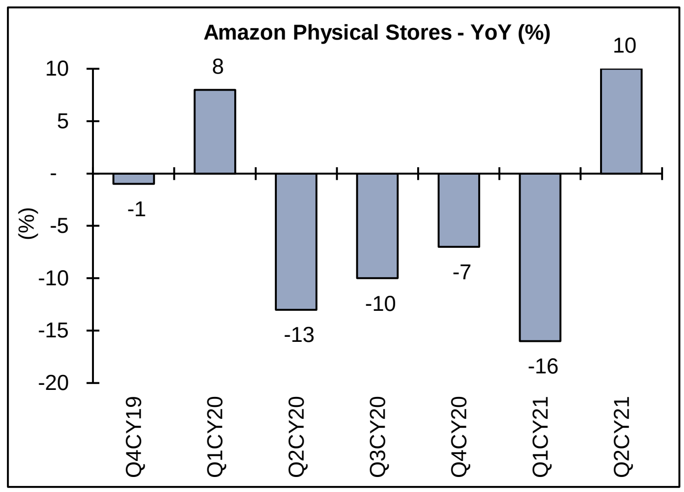
Source: I-Sec research, Company

Chart 12: Traffic shift from digital to physical channels…



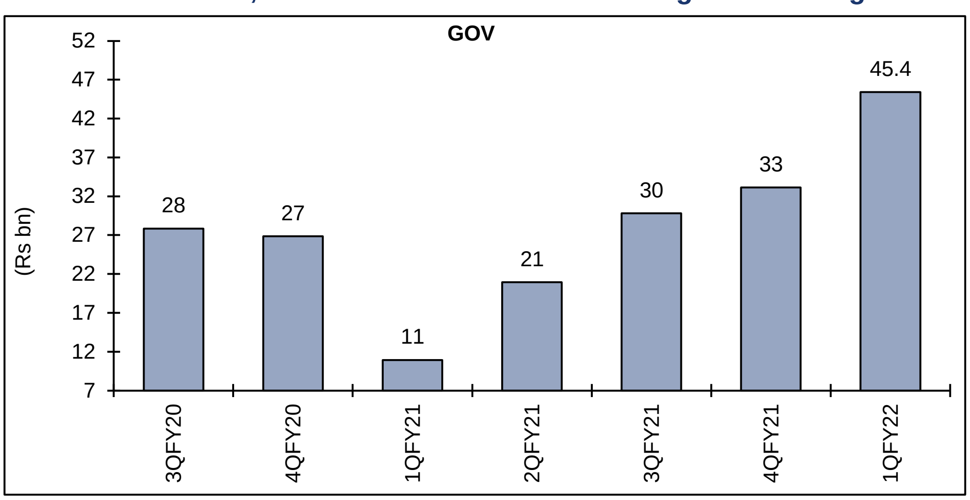
Source: I-Sec research, Company

Chart 13: …is driving growth deceleration at internet firms like Amazon



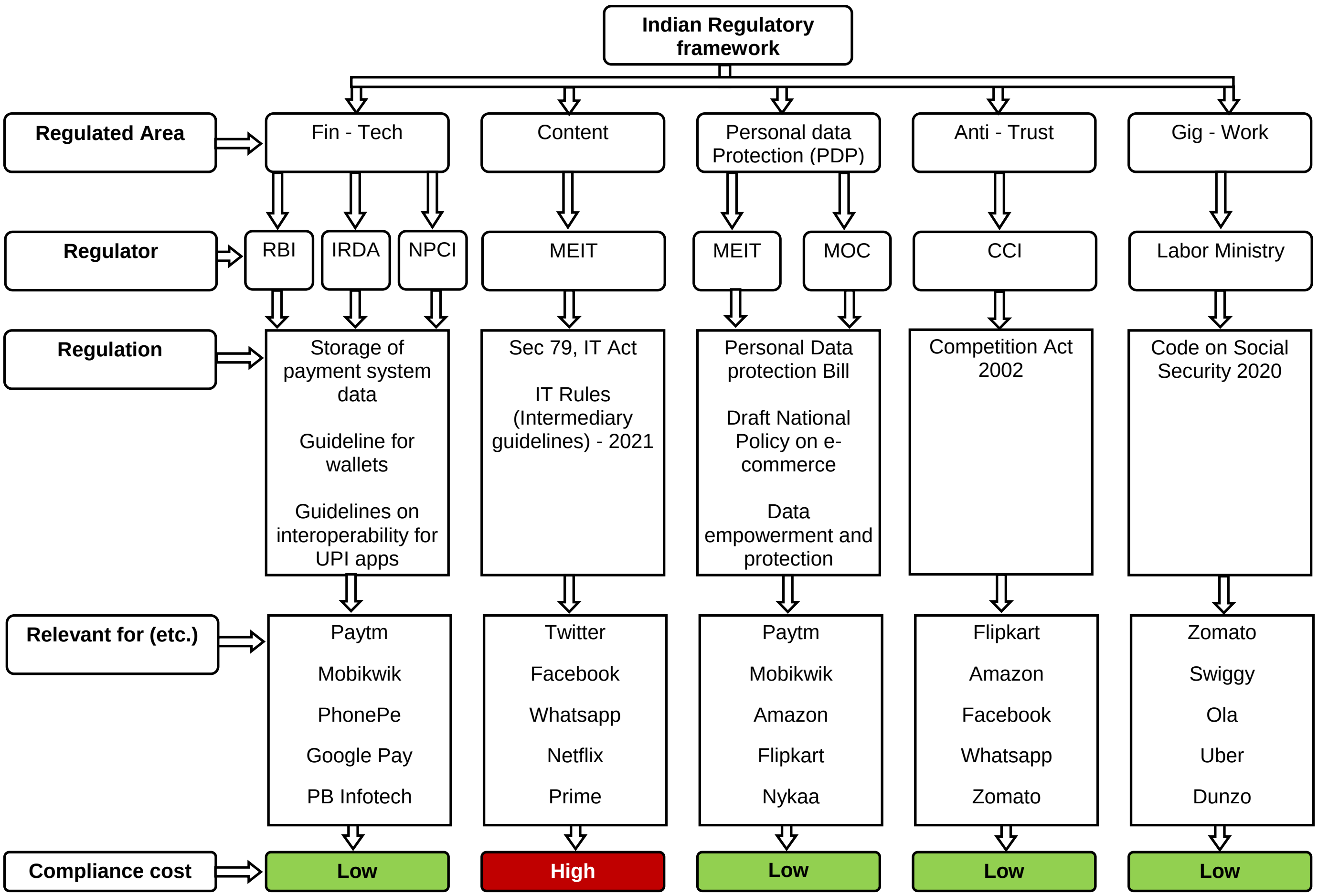
Source: I-Sec research, Company

Chart 14: However, Zomato witnessed a contrasting trend during FY21



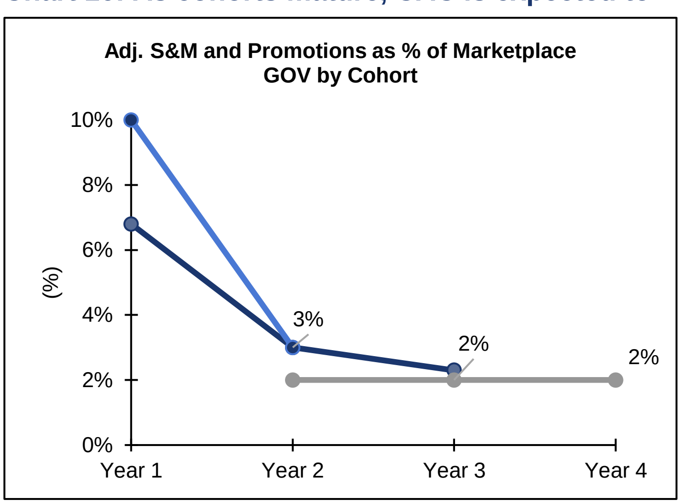
Source: I-Sec research, Company

Chart 15: India's regulatory framework around internet companies is more conducive vs the world



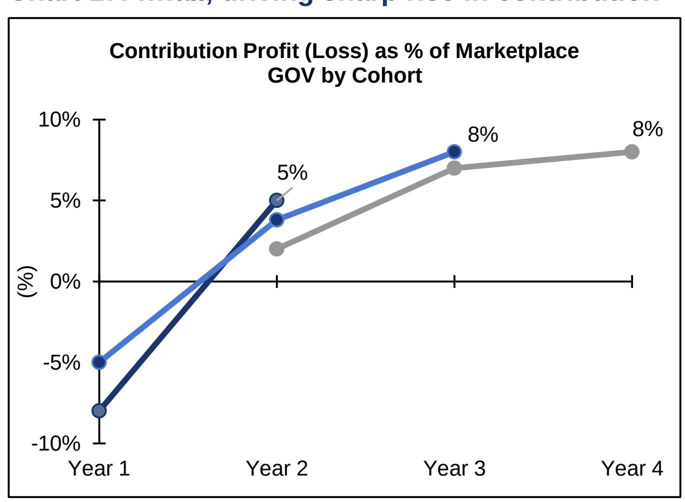
Source: I-Sec research, RBI, IRDA. NPCI, Ministry of Electronics and Information Technology (MEIT), Ministry of Corporate Affairs (MOC), CCI, Ministry of Parliamentary Affairs, Competition Commission of India

Chart 16: As cohorts mature, CAC is expected to



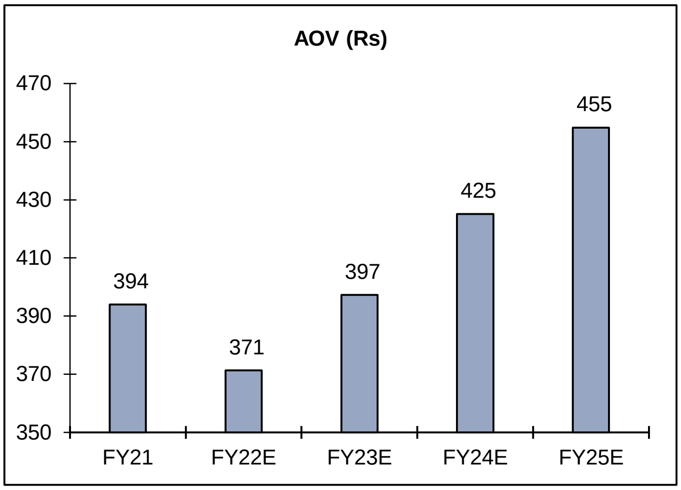
Source: I-Sec research, Company (Doordash)

Chart 17: …fall, driving sharp rise in contribution



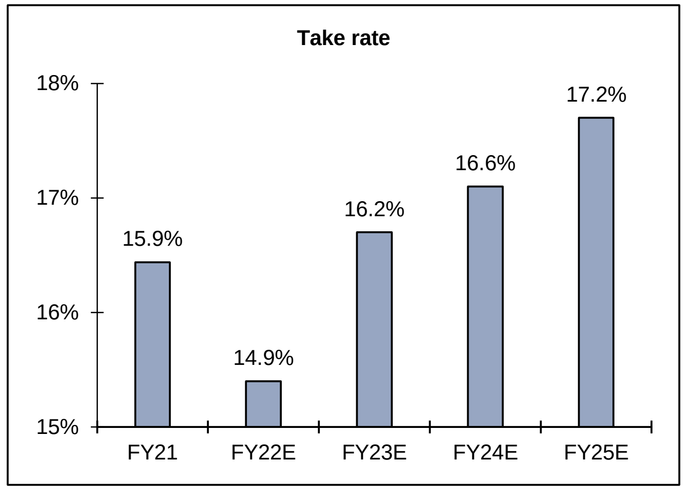
Source: I-Sec research, Company (Doordash)

Chart 18: We expect a 'J' shaped improvement in..



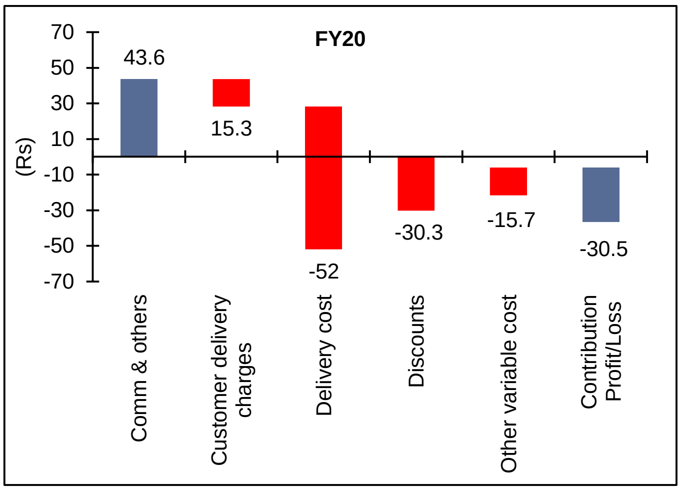
Source: Company data, I-Sec research.

Chart 19: …AOV and take rates going ahead



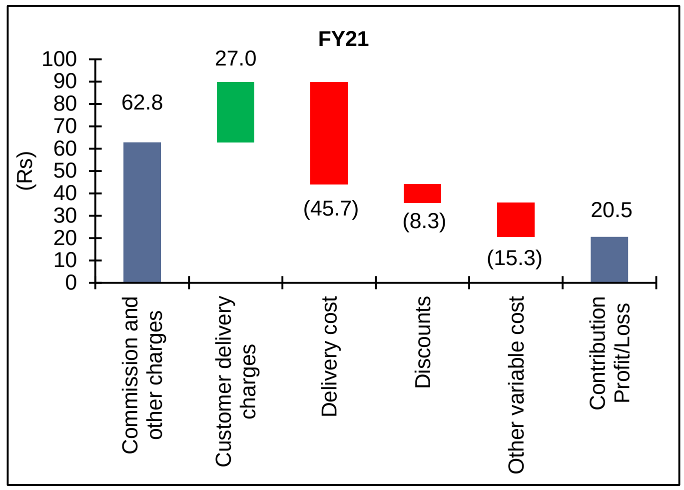
Source: Company data, I-Sec research.

Chart 20: Even assuming higher discount v/s FY21



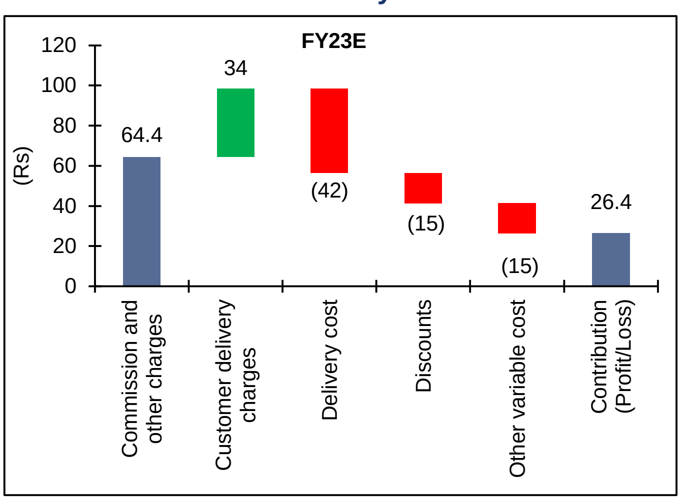
Source: Company data, I-Sec research.

Chart 21: contribution will see a sharp rise led by..



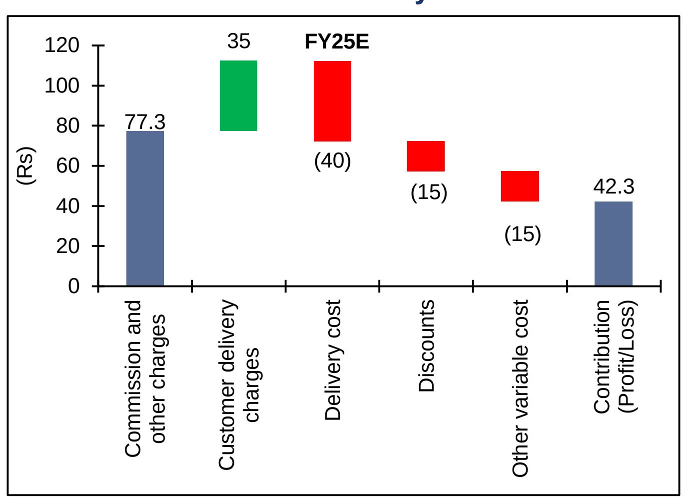
Source: Company data, I-Sec research.

Chart 22: increase in delivery fee and scale driven



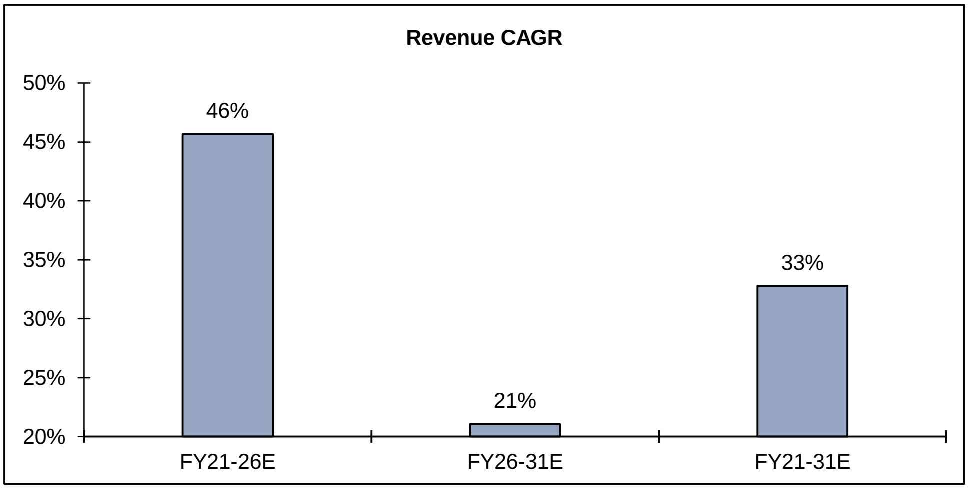
Source: Company data, I-Sec research.

Chart 23:…reduction in delivery costs



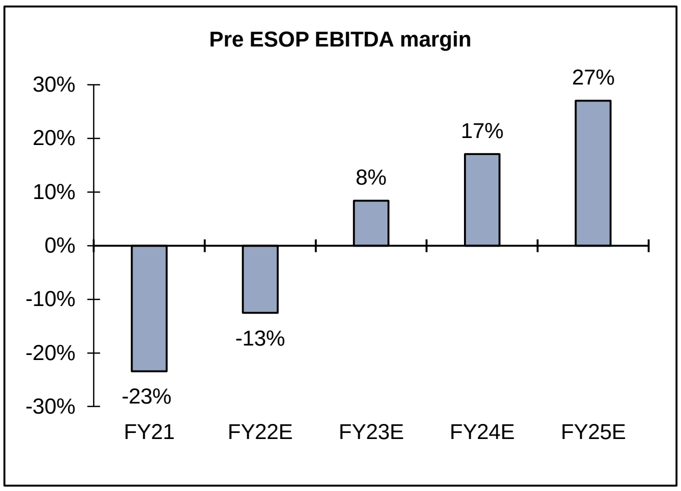
Source: Company data, I-Sec research.

Chart 24: We expect robust 33% revenue CAGR over next decade



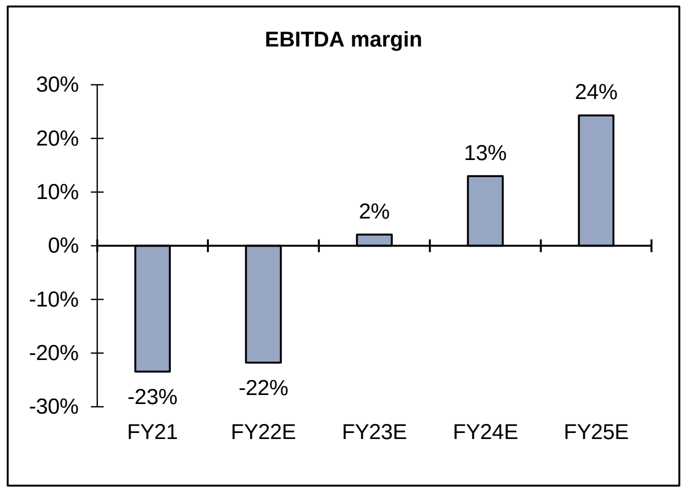
Source: I-Sec research, Company

Chart 25: EBITDA margin will likely turn positive



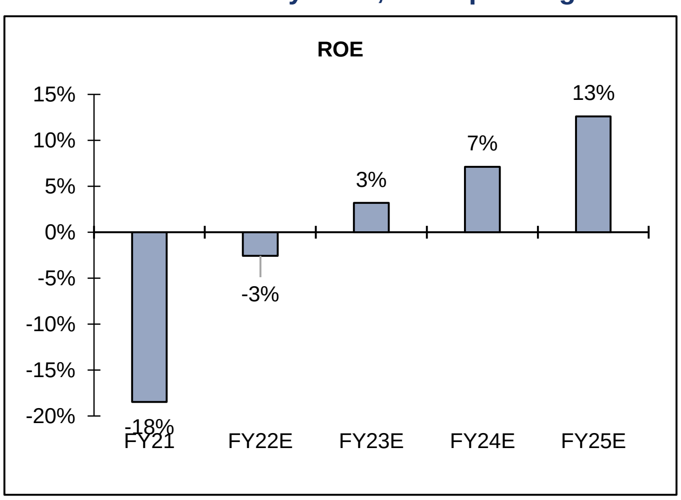
Source: Company data, I-Sec research.

Chart 26: …earlier than street expectations



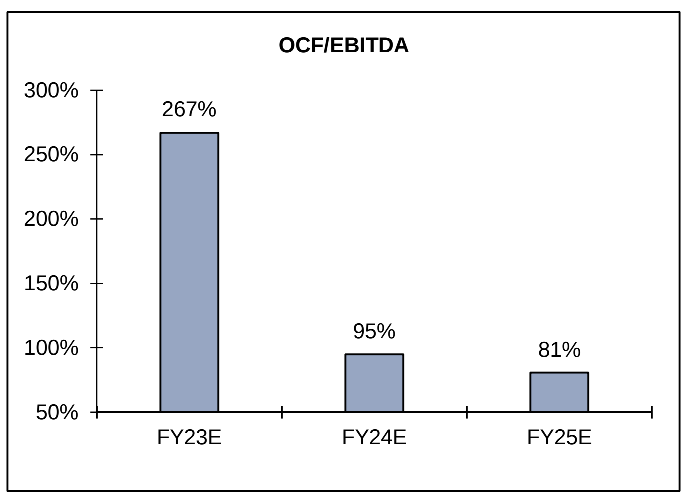
Source: Company data, I-Sec research.

Chart 27: In the steady state, we expect high ROE



Source: Company data, I-Sec research.

Chart 28: …and robust cash conversion



Source: Company data, I-Sec research.

Table 1: We are ahead of consensus on both revenue and margins

		I-sec estimates	Consensus estimates	Difference (%)
Revenue (Rs mn)	FY22E	40,047	35,792	11.9
	FY23E	55,858	51,595	8.3
	FY24E	77,959	72,960	6.9
EBITDA (Rs mn)	FY22E	-8,722	-8,175	n.a.
	FY23E	1,167	-8,284	n.a.
	FY24E	10,123	-298	n.a.
PAT (Rs mn)	FY22E	-3,229	-7,486	n.a.
	FY23E	5,553	-4,386	n.a.
	FY24E	13,095	1,195	995.8
EPS (Rs)	FY22E	-0.50	-0.89	n.a.
	FY23E	0.86	-0.55	n.a.
	FY24E	2.03	0.21	882.2

Source: Bloomberg, I-Sec research.

Table 2: On PEG, Zomato is significantly cheaper than global food services, tech and consumer stocks

	Sales Growth (%)			EBITDA Margins (%)			EPS Growth (%)			P/E (x)			P/S (x)			PEG		PSG	
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Zomato	**101**	**39**	**40**	**-22**	**2**	**13**	**n.a.**	**n.a.**	**136**	**n.a.**	**157**	**67**	**22**	**16**	**11**	**n.a.**	**0.5**	**0.4**	**0.3**
Global Food Services																			
Restaurant Brands	16	8	5	39	41	42	73	14	13	23	20	18	5	5	5	1.4	1.4	0.6	1.0
Doordash	58	20	27	6	8	13	n.a.	n.a.	297	n.a.	513	129	14	12	9	n.a.	0.4	0.6	0.4
Dominos Pizza	8	8	8	20	21	21	8	15	13	38	33	29	4	4	4	2.2	2.3	0.5	0.5
Jubilant	37	22	16	26	26	26	105	38	23	104	75	61	11	9	8	1.9	2.6	0.4	0.5
Deliveroo	56	27	20	-10	-6	-2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	4	3	2	n.a.	n.a.	0	0.1
Median	**37**	**20**	**16**	**20**	**21**	**21**	**73**	**15**	**18**	**38**	**54**	**45**	**5**	**5**	**5**	**1.9**	**1.9**	**0.5**	**0.5**
Big Tech																			
Apple	33	3	5	33	31	31	68	1	6	27	27	25	7	7	6	35.2	4.5	1.9	1.2
Microsoft	16	15	13	48	49	50	34	12	15	38	33	29	13	12	10	2.7	1.9	0.8	0.8
Google	13	17	16	48	47	46	n.a.	9	18	26	24	20	9	8	7	2.8	1.1	0.5	0.4
Netflix	19	15	15	23	24	27	75	19	27	47	40	31	8	7	6	2.1	1.2	0.5	0.4
Facebook	38	20	18	55	54	54	58	15	14	23	20	17	9	7	6	1.3	1.2	0.4	0.3
Amazon	24	19	17	15	16	17	61	21	38	48	40	29	3	3	3	1.8	0.7	0.2	0.1
Median	**21**	**16**	**15**	**40**	**39**	**39**	**61**	**14**	**17**	**32**	**30**	**27**	**8**	**7**	**6**	**2.4**	**1.2**	**0.5**	**0.4**
Consumer Discretionary																			
Kansai	19	14	-3	16	18	17	11	28	-1	58	45	45	6	5	6	1.6	-79.1	0.4	-2.1
Asian Paints	22	14	12	21	22	23	17	23	14	77	63	55	11	10	9	2.7	3.8	0.7	0.7
Berger	25	15	12	18	19	19	26	23	17	87	71	61	10	8	8	3.0	3.7	0.6	0.6
Jubilant	37	22	16	26	26	26	105	38	23	104	75	61	11	9	8	1.9	2.6	0.4	0.5
Page	20	22	14	20	21	22	34	32	15	74	56	49	10	8	7	1.7	3.3	0.4	0.5
Titan	29	23	16	11	13	13	108	38	20	89	65	54	7	5	5	1.7	2.8	0.2	0.3
Bata	43	39	13	22	27	26	n.a.	143	20	117	48	40	9	6	6	0.3	2.0	0.2	0.4
Avenue	29	40	24	8	9	9	42	53	26	142	93	74	8	6	4	1.8	2.9	0.1	0.2
Median	**27**	**22**	**13**	**19**	**20**	**20**	**34**	**35**	**18**	**88**	**64**	**55**	**9**	**7**	**6**	**1.7**	**2.8**	**0.4**	**0.5**
Consumer Staples																			
Nestle	12	11	12	24	25	25	15	16	14	74	63	56	12	11	10	3.9	4.1	0.9	0.8
Colgate	9	9	9	31	31	31	5	10	10	42	38	35	9	8	7	3.9	3.5	0.9	0.8
HUL	13	11	11	25	26	27	15	18	13	62	53	47	11	10	9	2.9	3.5	0.9	0.8
Dabur	14	12	11	21	22	22	11	16	13	55	48	42	10	9	8	3.0	3.3	0.7	0.7
Emami	12	10	9	30	30	31	56	16	11	36	31	28	8	7	7	2.0	2.5	0.7	0.7
GCPL	12	11	11	22	23	23	14	16	13	52	45	40	8	7	7	2.8	3.1	0.7	0.6
Marico	18	11	11	19	20	21	13	17	13	50	43	38	7	6	6	2.5	2.8	0.6	0.5
Britannia	9	11	10	17	18	18	-4	15	13	49	42	37	6	6	5	2.8	2.8	0.5	0.5
ITC	16	10	9	36	37	37	18	12	8	17	15	14	5	5	4	1.3	1.7	0.5	0.5
Median	**12**	**11**	**11**	**24**	**25**	**25**	**14**	**16**	**13**	**50**	**43**	**38**	**8**	**7**	**7**	**2.8**	**3.1**	**0.7**	**0.7**
IT Services																			
TCS	16	12	10	28	28	28	22	12	9	33	29	27	7	6	5	2.5	2.9	0.5	0.5
Infosys	17	13	12	27	27	27	15	14	13	33	29	25	6	5	5	2.0	2.0	0.4	0.4
Accenture	14	10	8	19	19	19	10	11	10	37	33	30	4	4	3	2.9	3.1	0.4	0.5
Wipro	24	11	10	22	22	22	15	11	12	28	25	22	4	4	4	2.3	1.8	0.4	0.3
HCLT	12	12	6	25	25	25	9	14	10	22	20	18	4	3	3	1.4	1.8	0.3	0.5
TechM	13	12	11	19	19	19	22	10	10	22	20	18	3	3	3	1.9	1.7	0.2	0.2
Median	**15**	**12**	**10**	**23**	**23**	**24**	**15**	**12**	**10**	**30**	**27**	**24**	**4**	**4**	**4**	**2.1**	**1.9**	**0.4**	**0.4**

Source: Bloomberg, I-Sec research

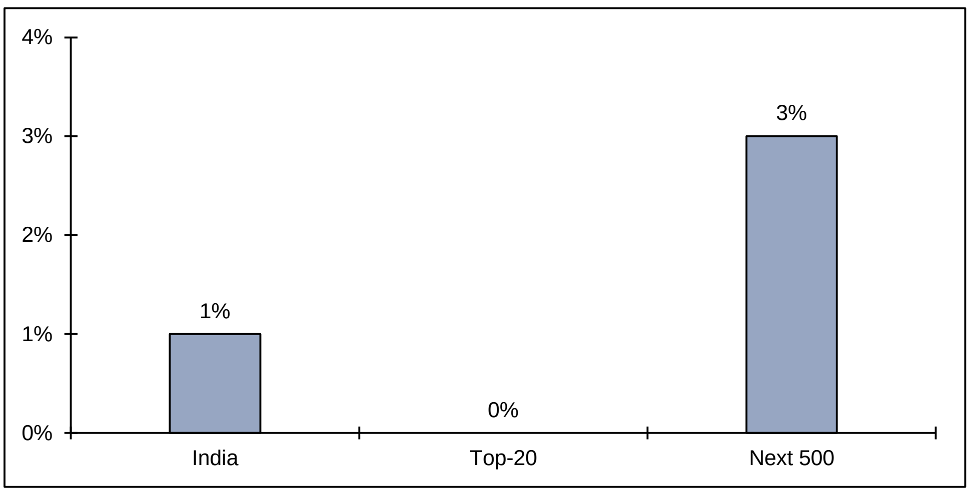
Key takeaways from our channel checks

We conducted in-depth channel checks and analysed menu price at 150+ restaurants across 16 cities in India. The Top-20 cities included in our analysis are Mumbai, Delhi, Bengaluru, Chennai, Hyderabad, Kolkata and Pune. The Next-500 towns included in our analysis are Nashik, Meerut, Thrissur, Coimbatore, Jabalpore, Raipur, Bhubaneswar, Bikaner and Vijayawada. We picked some of the best-selling items in each of these ~150 restaurants to compare the menu prices (before - discounts, delivery fee and taxes) across channels. Zomato currently has ~150k restaurants signed up on its delivery platform. Given the sample size, our analysis has a margin of error of 8% at 95% confidence level. Key findings are as follows.

Zomato v/s Swiggy – Congruent menu prices

On an average, menu prices on Zomato and Swiggy (pre – discounts, delivery fee and taxes) are found to be largely equal across restaurants and items. Barring a few items (e.g. Pizza etc.) standardisation (on grammage) is absent in the industry. Leveraging on that, we noticed innovations by many food outlets on Zomato / Swiggy - like new SKUs / price points with quantity change within customer's 'just noticeable' range. Such innovations are win-win situations for restaurants, aggregators and customers. They can also play a key role in driving up consumption / ordering frequency.

Chart 29: Menu price differential - Zomato v/s Swiggy



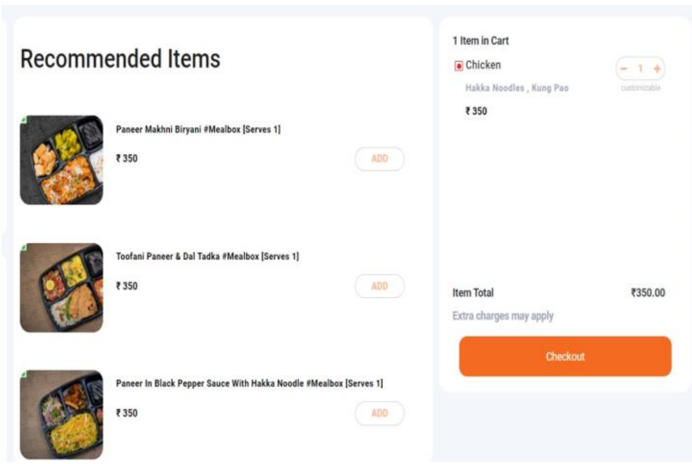
Source: I-Sec research, Primary data from 7 Tier I and 9 Tier II cities in India.

Direct ordering – Inferior user experience at the same price

Around 94% of restaurants in India are standalone in nature and do not have the resources (financial and / or manpower) to manage a dedicated delivery fleet. Our channel checks suggested that even those restaurants / chains with financial wherewithal find it difficult to manage the fleet given the high attrition and the cost of labour law compliance. Most food outlets limit the delivery (if any) to ~3-4 km radius around the store (vs ~12 km radius covered by Zomato). And even for delivering in the limited radius, many insist on minimum order value > Rs 500 (25% higher than AOV).

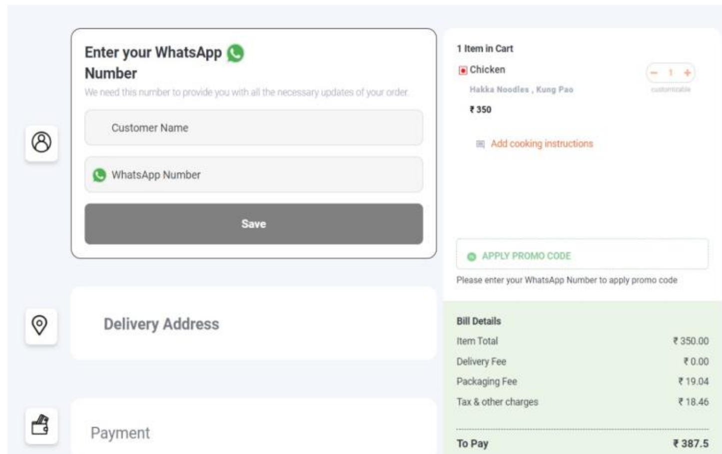
Even for those restaurants with self-managed delivery fleets (e.g. Dominos) or the ones that partner with third parties (e.g. DotPe + Dunzo), menu prices across different online channels (including Zomato / Swiggy) are similar. For instance, on a like to like basis, an item on Dominos delivery app will have a similar price as on Zomato / Swiggy. This menu price parity should naturally drive customers to order on aggregator apps like Zomato / Swiggy which provide bundled offerings. Besides, the poor user experience and quality control on direct ordering apps (e.g. DotPe) further add to our conviction that food-tech industry will continue to be a duopoly.

Chart 30: Inferior user experience on browser



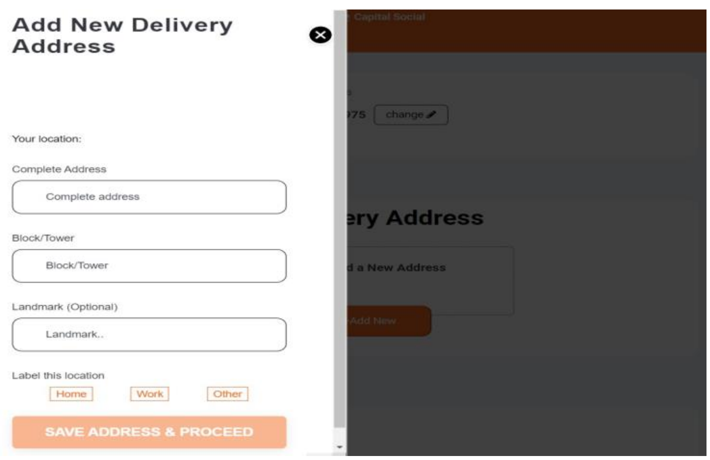
Source: I-Sec research, Company

Chart 31: …based store fronts on DotPe



Source: I-Sec research, Company

Chart 32: Inferior user experience on browser…



Source: I-Sec research, Company

Chart 33: …based store fronts on DotPe

Source: I-Sec research, Company

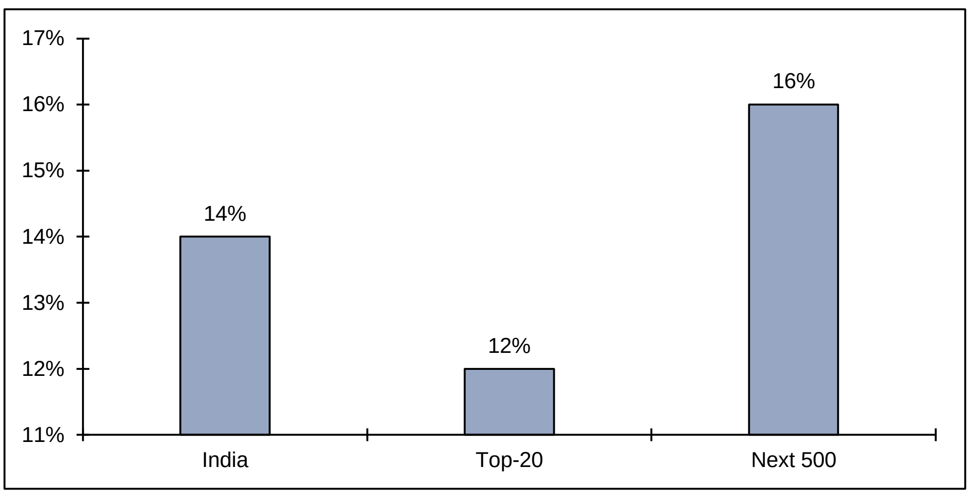
Customers don't mind paying for convenience!

When compared with the in-store menu prices (before discounts and taxes), the quotes on Zomato / Swiggy are 14% higher, on average. The differential is close to 20% in case of restaurants that enjoy loyal customer base and pull demand (e.g. Persian Darbar, Arya Bhavan in Mumbai & A2B – Anand Bhavan in Bengaluru).

Interestingly, even QSR chains (e.g. Dominos, KFC, McDonalds etc.) currently have marked up prices (12-20%) on Zomato / Swiggy compared to dine-in menu rates. Notably, this mark-up does not include delivery fee charged separately by Zomato / Swiggy. Inclusion of delivery fee (Rs 33 per order) will translate into ~21% differential between dine-in and delivery prices, on an average. The differential can be substantially higher (~30%-40%) in some cases.

For most restaurants, this mark-up is a way of partially subsidizing (1) aggregator commissions, (2) their share of discounts (mark down post mark up) and (3) packaging costs. Our conversations with restaurateurs suggest this differential has not been discouraging customers from ordering online (even when in the dine in options were open before onset of Covid). Clearly, it appears that customers see two different value propositions in delivery and dine-in - habit vs experience. And do not mind paying an extra penny for convenience.

Chart 34: Average menu price on Zomato is 14% higher /s dine in



Source: I-Sec research, Primary data from 7 Tier I and 9 Tier II cities in India.

Rationality in discounts

Analysis of discounting trends at these 150+ restaurants and our recent conversation with the management of Swiggy (link) hint at 'some level' of a discount discipline given the duopoly structure. Both the firms are now running similar discount / marketing campaigns akin to the big billion day and prime day of Flipkart and Amazon.

Chart 35: Both Swiggy and Zomato now run…

Source: I-Sec research, Company

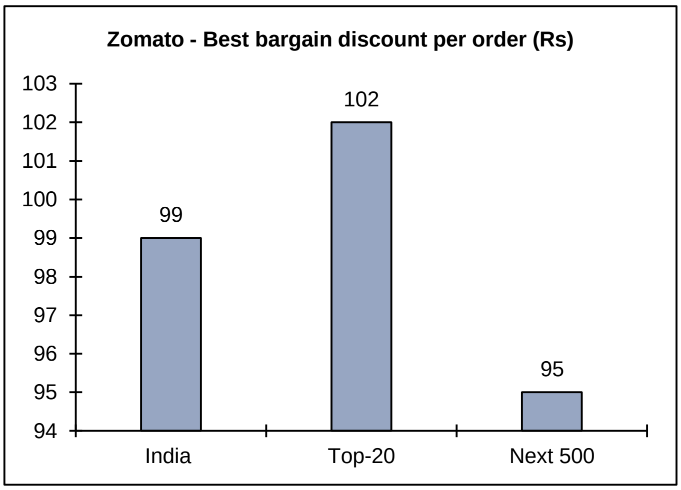
Chart 36: …very similar discount programmes

Source: I-Sec research, Company

During the ongoing 60% off sale, 'best' bargain discount is noticed to be Rs 100 (~25% of AOV) on average with the burden shared between the restaurant, Zomato and payment providers. Given the prior mark up of menu prices by restaurants, the true discount here comes down to ~Rs 40-45 to be shared by the three parties. Assuming such big discounts continue round the year, Zomato's discount share will likely be Rs 15 / order – base case scenario for our estimates. However, restriction of such sales to one month a quarter can translate into surprisingly lower discount share for the platform - Rs 8 / order (= FY21). This poses significant upside risk to our contribution and EBITDA margin estimates elaborated in the subsequent sections.

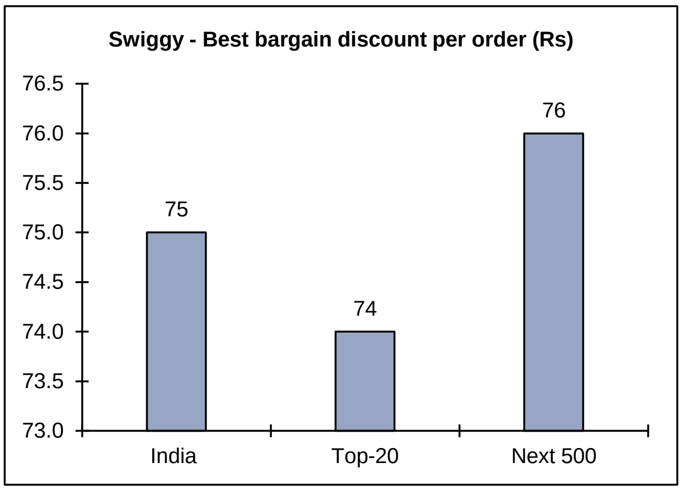
While the average best bargain discount on Swiggy is observed to be lower, it does not necessarily point to higher discounting aggression from the P&L of Zomato. We noticed the differential is largely being driven by one credit card provider (American Express) running a flash sale in association with Zomato.

Chart 37: Currently, best bargain discount on …



Source: I-Sec research, Primary data from 7 Tier I and 9 Tier II cities in India.

Chart 38: …Zomato is higher than that of Swiggy



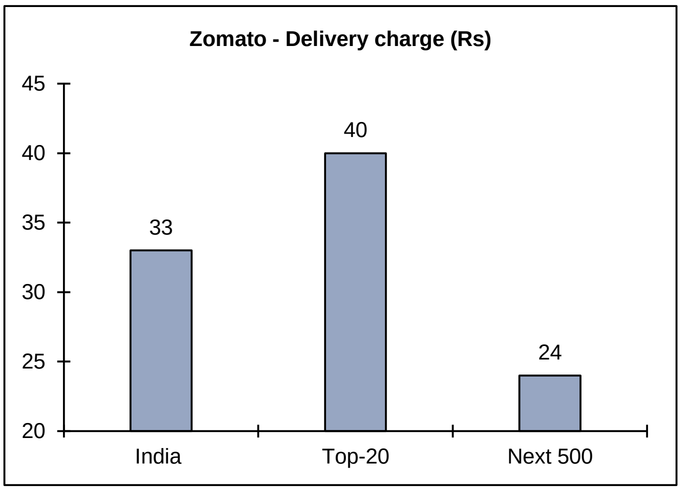
Source: I-Sec research, Primary data from 7 Tier I and 9 Tier II cities in India.

Sharp increase in delivery fee

Over the previous 12-18 months, Zomato and Swiggy started charging delivery fee more religiously. Where the servicing radius is > 5km, they are now charging an additional long distance fee. Our analysis of the final pricing of the 150+ restaurants indicated average delivery fee charged by Zomato currently amounts to Rs 33 (8% of AOV, vs ~9% in case of Swiggy). This is 22% higher vs the delivery fee reported by Zomato in its FY21 unit economics.

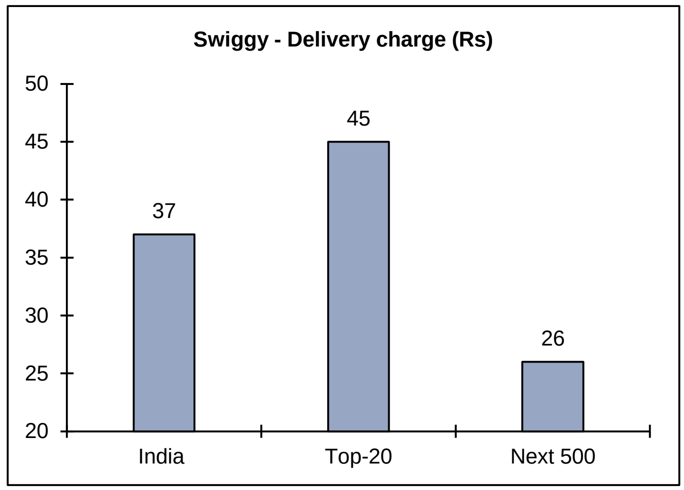
Given the (1) not so price elastic customer segment, (2) duopoly nature of industry and (3) convenience addiction, we expect stickiness and upward bias in delivery fee. Currently, lower delivery fee in Next 500 (Rs 24 / order v/s Rs 40 in Top-20 cities) leaves scope for further increase. Conservatively, we factor in delivery charges of Rs 33-35 / order in our contribution estimates.

Chart 39: Average delivery fee charged by both



Source: I-Sec research, Primary data from 7 Tier I and 9 Tier II cities in India.

Chart 40: …players increased in FY22 (v/s FY21)



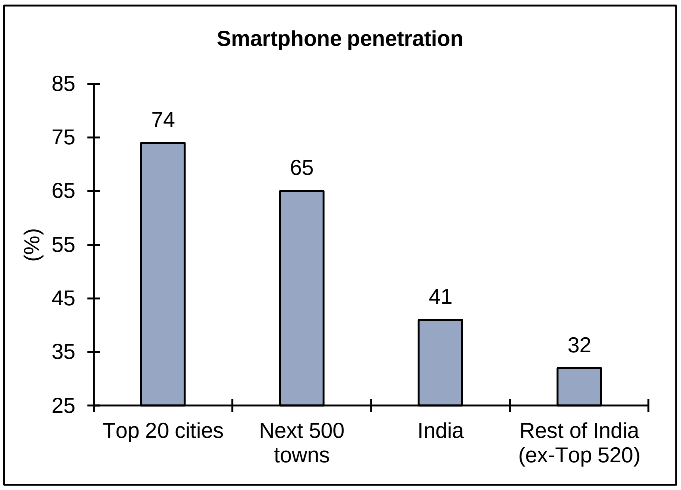
Source: I-Sec research, Primary data from 7 Tier I and 9 Tier II cities in India.

How do we think about long-term growth drivers?

For Zomato, we reckon a viable market to have 100k+ population and 50+ restaurants. Accordingly, the 65% of the rural population will not even be in the addressable market given the bottlenecks on the supply side. That leaves the company with two key markets with different dynamics – (1) Urban core (Top-20 cities) and (2) Next 500 towns. Both Zomato and Swiggy currently operate out of all these ~520+ markets. We understand while Swiggy has stronger market share in the Top-20, Zomato is better penetrated into Next-500, partly because of its relationships in the discovery platform.

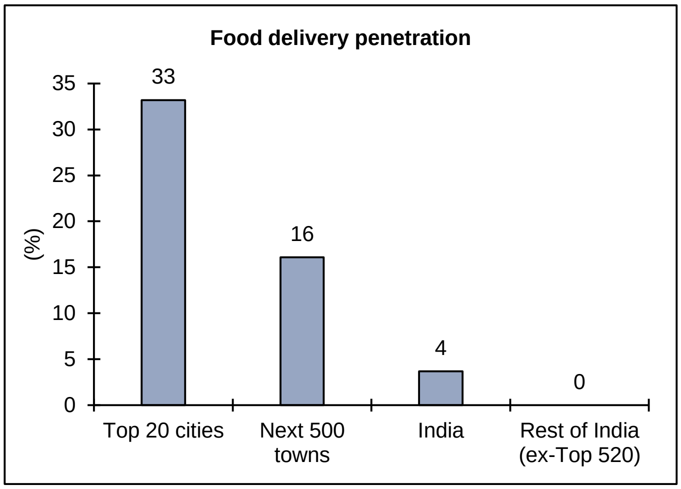
Despite limited operational history and network effect, food-tech adoption outside the urban core at 16% (I-Sec est.) is encouraging. As supply is augmented and network effect strengthens, we see a strong scope for further increase in adoption. The lower restaurant density and poorer ambience quality in the Next 500 give us this confidence. That said, we will also watch out for any change in the dynamics of these markets as office work resumes and corporate employees return to Top-20 cities from their hometowns. Given multiple macro and industry level tailwinds, we expect robust 33% revenue CAGR over FY21-31.

Chart 41: Current adoption in Next 500 is great...



Source: I-Sec research, Company

Chart 42: ...despite limited network effect so far

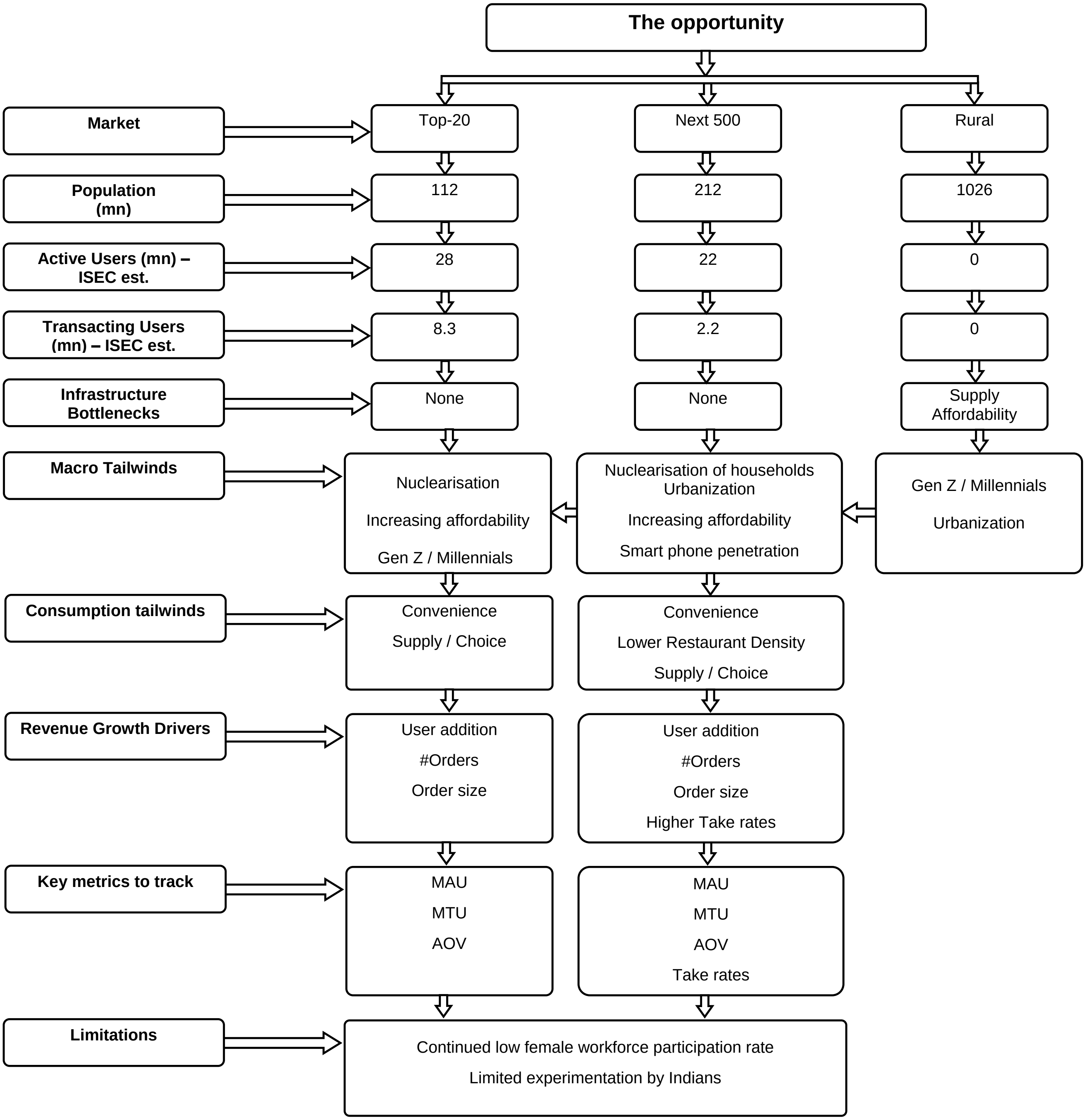


Source: I-Sec research, Company

Supply-side interventions should offer medium-term tailwinds

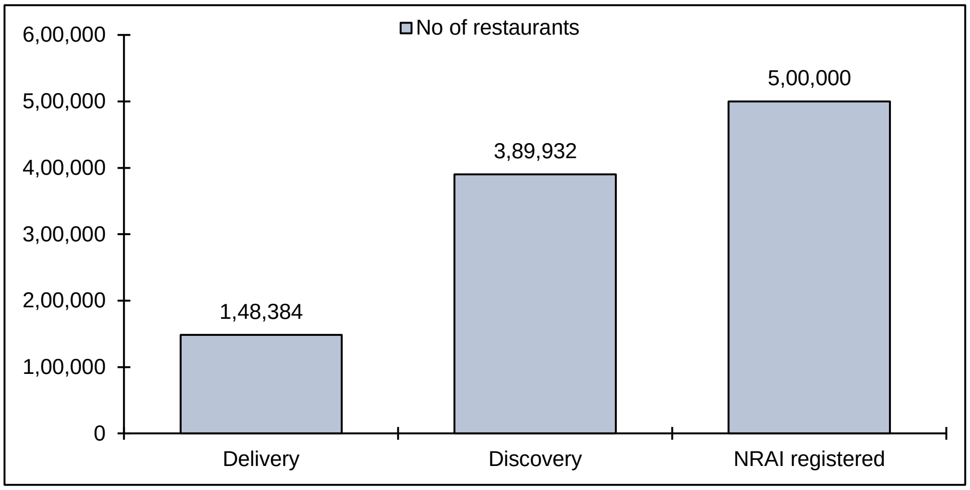
We have elaborated the demand side tailwinds / drivers in our food-tech thematic (link). However, our conversations with industry experts hint at supply-side challenges given the high (1) share of unorganised presence among restaurants (two thirds of 3.6mn food outlets in India and (2) attrition. The structural innovation underway on the supply side (e.g. delivery only, virtual and cloud kitchens) is expected to address some of the challenges and give medium-term growth tailwinds to the industry. In addition, as supply is augmented in Next-500 towns, we see scope for further strengthening of customer engagement and network effect on the platform.

Chart 43: Multiple macro and industry tailwinds



Source: I-Sec research, Company

Chart 44: Good headroom on supply front, especially with interventions



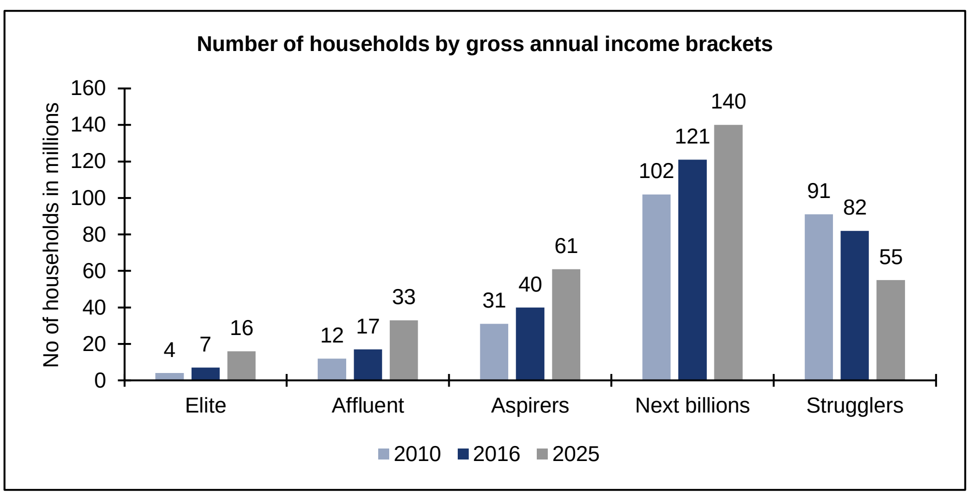
Source: I-Sec research, Company, NRAI. Note: Data as of FY21

Affordability is not a limiting factor

Pessimists on the food-tech business model often cite limited affordability in India (vs the US or China) as a key bottleneck hindering the scalability of this business model. We disagree! In FY21, nearly 90mn families in India were estimated to be classified as elite, affluent and aspirer categories, which form the right target market. Of them, there are close to ~30-35mn credit card users who can potentially be the super users.

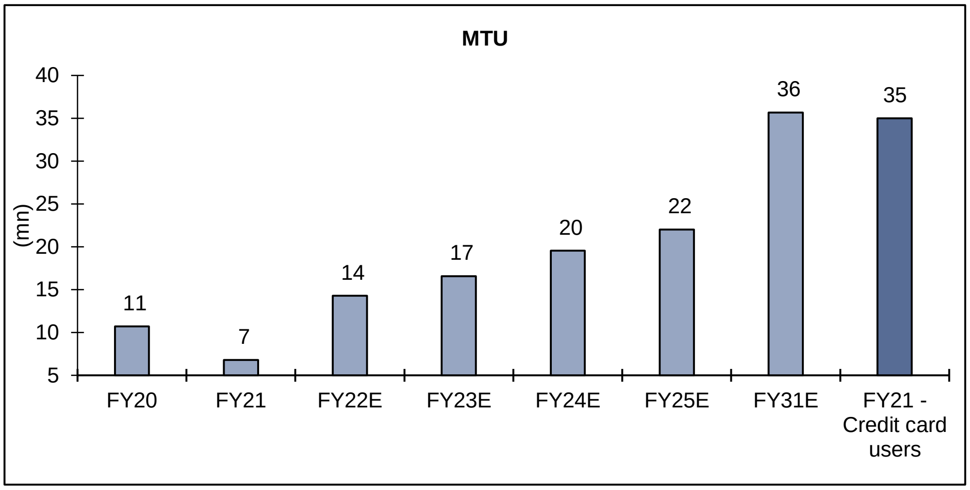
In comparison, Zomato had a transacting user base of ~11mn in FY20. Conservatively, even assuming one user / decision maker per family (in reality this may be higher), the transacting users of the industry can grow multi-fold before affordability becomes a bottleneck, in our view. Even after a decade, the transacting user base (36mn, I-Sec est.) will still be a fraction of today's target segment.

Chart 45: Elite, affluent and aspirer segments are expected to outgrow



Source: I-Sec research, Statista

Chart 46: MTUs we are projecting in FY31 is close to number of credit card users in India in FY21

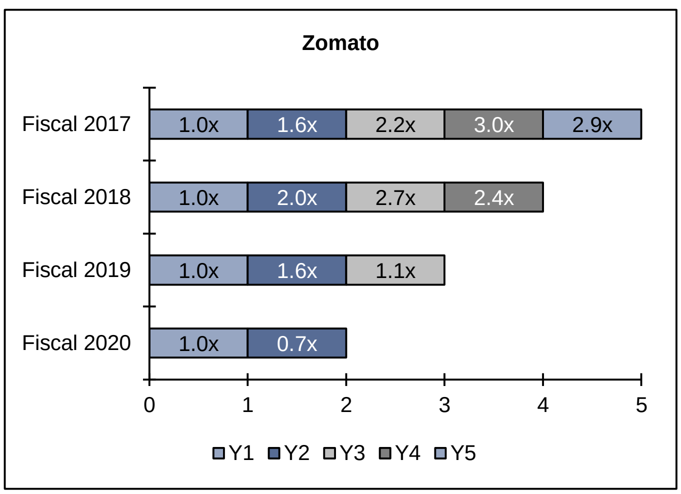


Source: I-Sec research, Company

Consumer cohorts in India are showing stronger retention

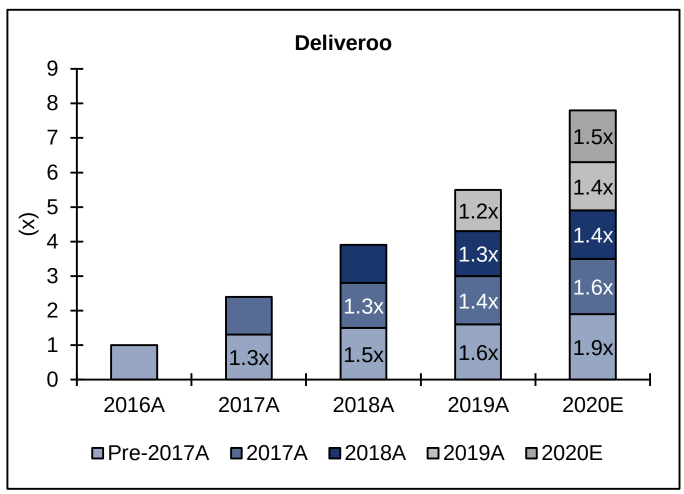
A significant section of the street (mistakenly) presumes affordability (lower per-capita vs developed economies) and natural aversion of Indians to eat outside food to be key limitations on the food-tech opportunity. However, cohort retention data of Zomato, DoorDash and Deliveroo actually suggests otherwise. We noticed stronger cohort retention in case of Zomato vs its developed market peers.

Chart 47: Stronger cohort retention of Zomato…



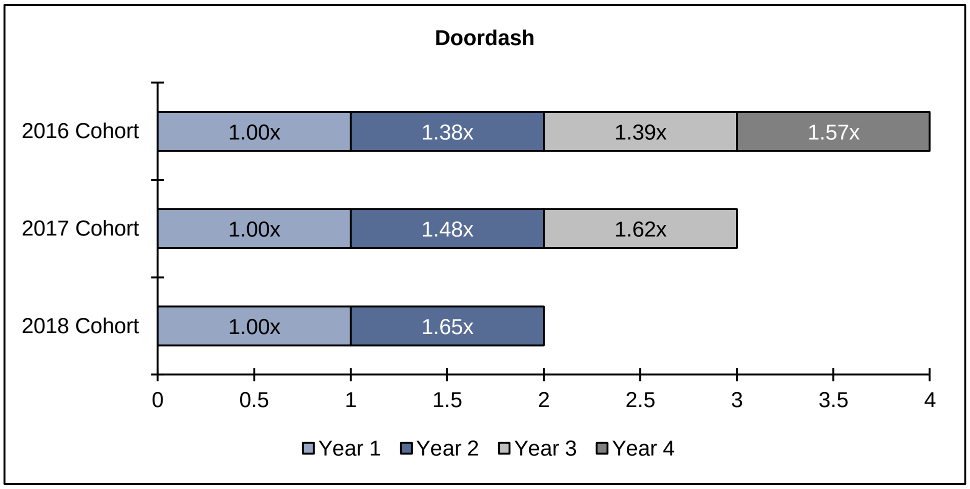
Source: I-Sec research, Company

Chart 48: …indicates neither lower per-capita nor…



Source: I-Sec research, Company

Chart 49: …reluctance of Indians to eat outside food are limitations

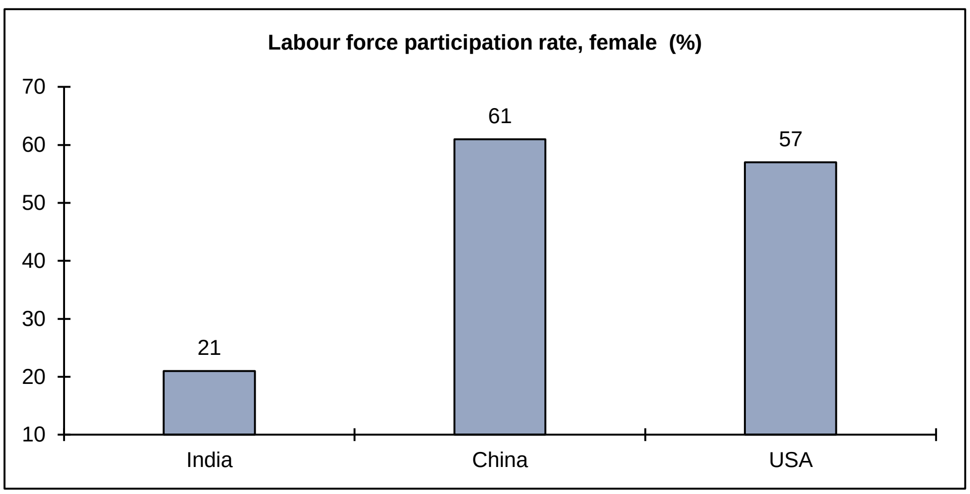


Source: I-Sec research, Company

Declining female workforce participation can be a limitation

More pronounced than in Western markets or even China, cooking / consumption of food in India is also a function of certain societal stereotypes. For instance, cooking in a household is often stereotyped to be a woman's primary responsibility. Low female workforce participation in India may be interpreted as an outcome of this mindset.

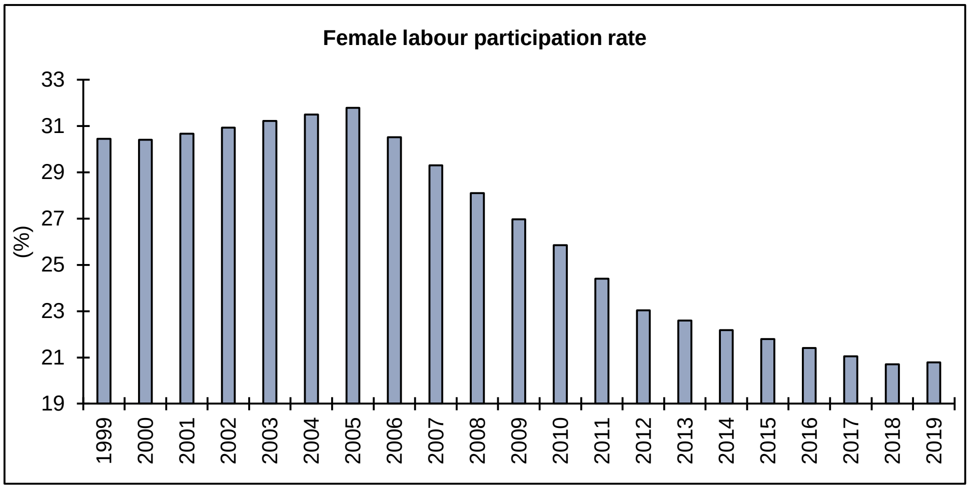
Chart 50: Female labour force participation in India is significantly lower



*as % of female population ages 15+ Source: World Bank, I-Sec research

It is important to note that despite improvement in female education, their workforce participation over the previous decade has deteriorated (more surprisingly in urban India). This trend was largely driven by the educated women in the (1) elite and affluent sections voluntarily leaving the workforce and (2) aspirers and next billion (likely) pushed out of employment to take care of household responsibilities. We believe this can be a key bottleneck constraining user addition / ordering activity.

Chart 51: Female workforce participation has been declining steadily



as % of female population ages 15+
Source: World Bank, I-Sec research.

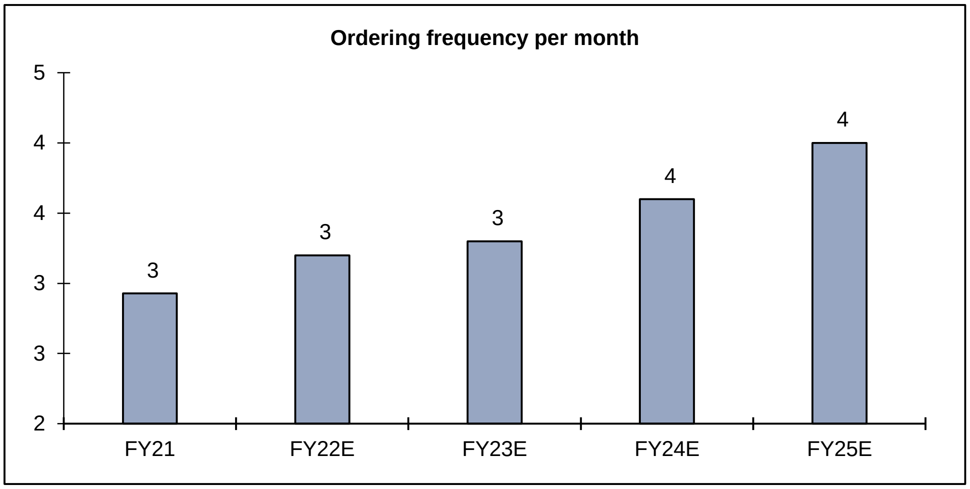
Limited experimentation by Indians is a variable to watch out for

In a way, Zomato and Swiggy brought the restaurants closer to customers, given their higher serviceable radius. However, > 80% of consumers visit / order from a maximum of 5 restaurants currently (Source: Uber Eats – Food moods of India report). This is despite the availability of a large variety of cuisines / choices to order from. It is noticed that customers repeat ordering from the same restaurants irrespective of the need or occasion. The impact of this limited experimentation on ordering activity over the long term needs to be seen.

Chart 52: Indians are low on food experimentation

Source: I-sec research, Uber Eats – Food Moods of India report

Chart 53: We expect ordering frequency to increase slightly over FY21-25



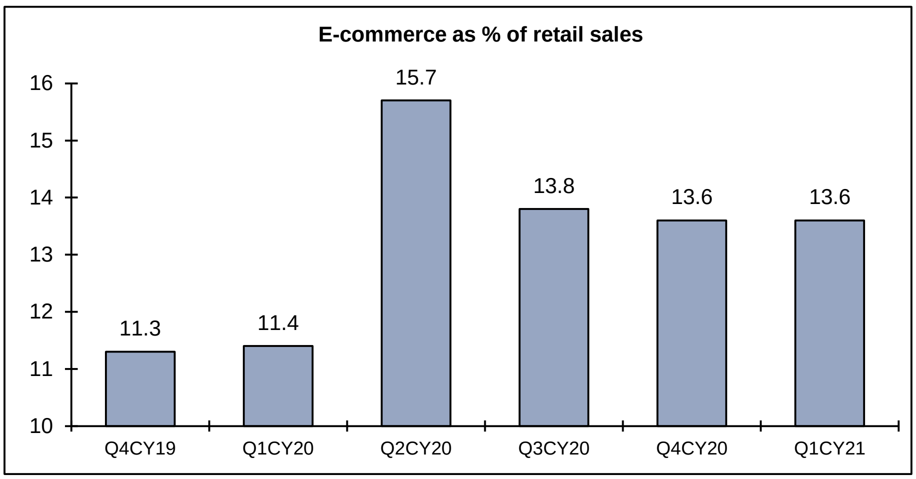
Source: I-Sec research, Company

How can the unlock impact the business?

Covid-19 pandemic (and the lockdowns) impacted the demand and supply dynamics of businesses in different ways. A bird's eye view suggests high touch businesses relying on physical channels suffered while virtual businesses relying on digital channels thrived at the former's expense. Many geographies and business models witnessed a significant migration of the traffic from physical to digital channels (e.g. Amazon, Zoom, Teams, Netflix etc.) during the course of the pandemic.

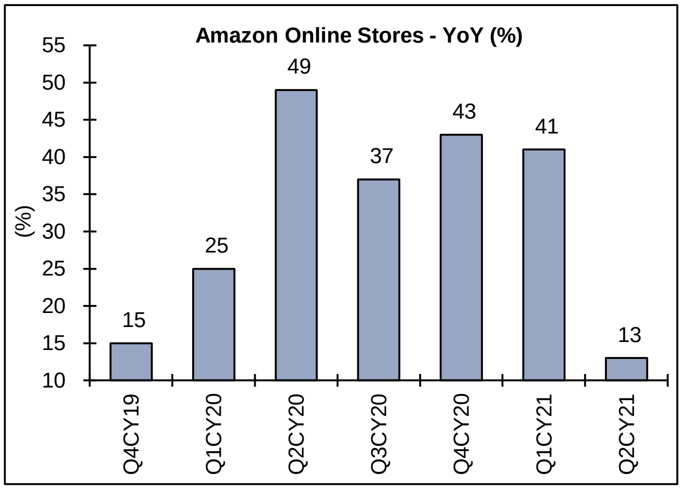
Of late, as economies unlock, vaccination picks up pace and public mobility improves, we are noticing a trend reversal and traffic reversion from digital to physical channels. e-commerce which accounted for 16.1% of overall retail sales in US at its peak (Jun-20) is now down to ~13.6%. (1) Jun-21 earnings / commentary of digital companies like Amazon, Facebook, Netflix etc. and (2) Google mobility trends especially in retail & recreation segment corroborate this. In this backdrop, can Zomato face headwinds going forward? What will be the impact on metrics like growth and AOV?

Chart 54: Post the sharp spike in Jun-20, e-commerce share has been consolidating



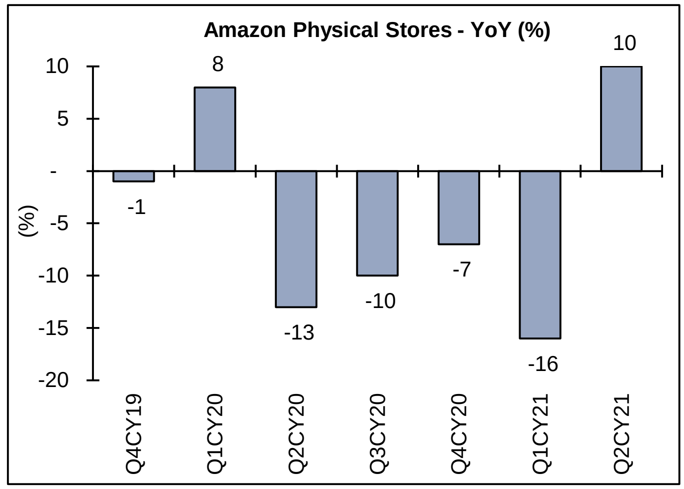
Source: I-Sec research, US Census

Chart 55: Traffic shift from digital to physical channels…



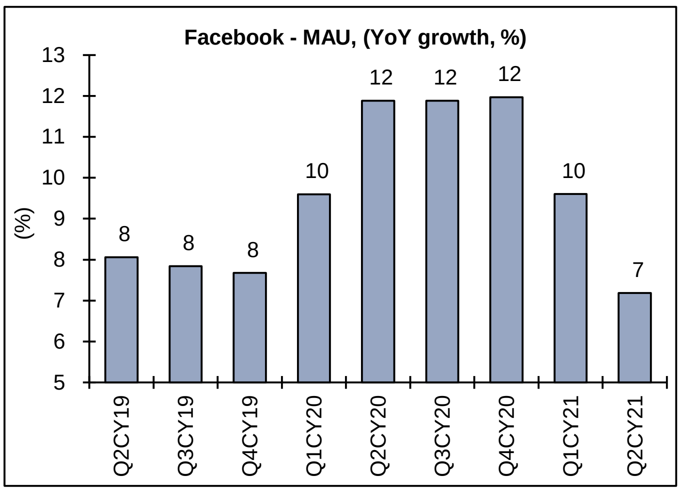
Source: I-Sec research, Company

Chart 56: …is driving growth deceleration at some digital firms like Amazon



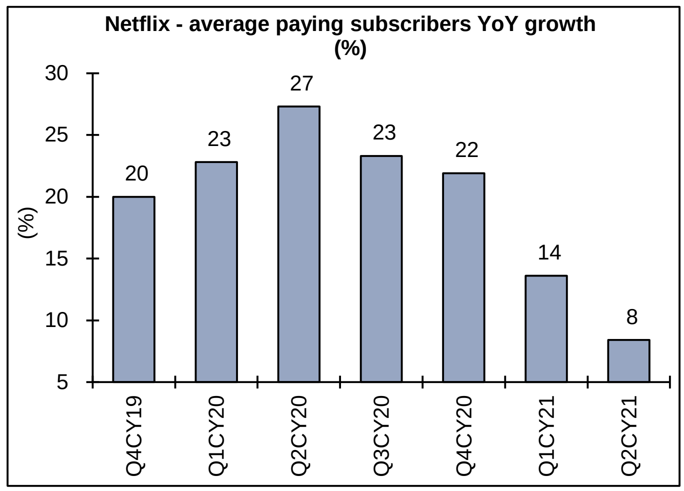
Source: I-Sec research, Company

Chart 57: With the unlock, user engagement in …



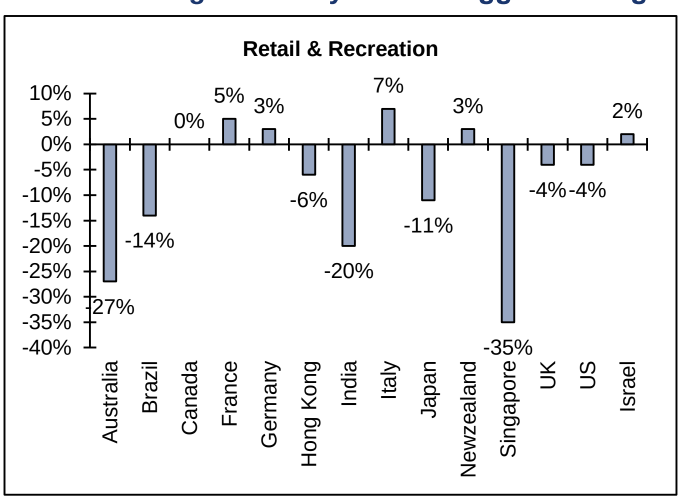
Source: I-Sec research, Company

Chart 58: …digital channels is coming off too



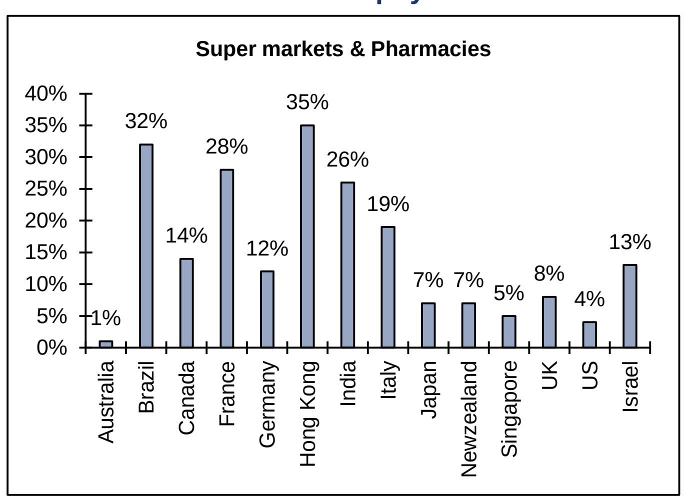
Source: I-Sec research, Company

Chart 59: Google mobility trends suggest strong…



Source: I-Sec research, Company. Note: Above data indicates change v/s pre Covid baseline levels

Chart 60: …bounce back in physical channel traffic

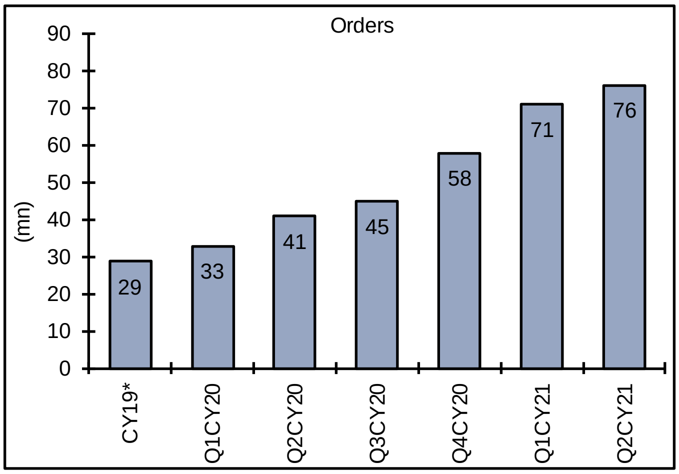


Source: I-Sec research, Company. Note: Above data indicates change v/s pre Covid baseline levels

Zomato witnessed a contrasting trend (v/s global internet) in FY21

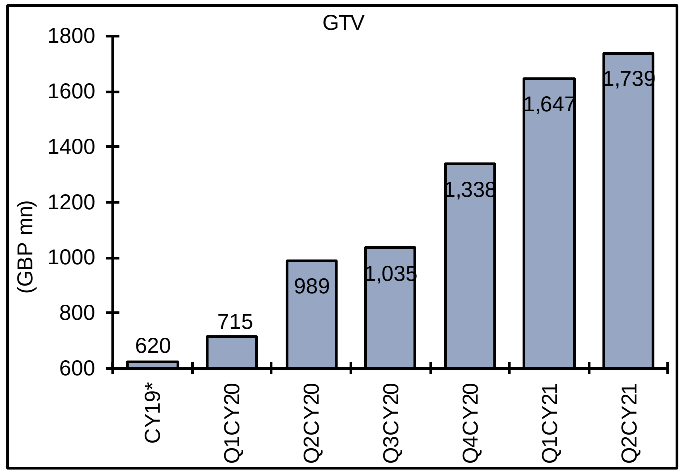
Contrary to its global peers like Deliveroo and DoorDash, Zomato witnessed a sharp fall in key metrics like GOV / revenue in the first few months of the lockdown. This was led by multiple factors, most important of which are: (1) more stringent lockdowns vs other countries, (2) higher job uncertainty, absent state funded furlough schemes like in developed countries, (3) migration of white collar employees to tier 2 / tier 3 towns and (4) unsubstantiated concerns about food being a vector for Covid transmission.

Chart 61: Overseas food delivery had seen…



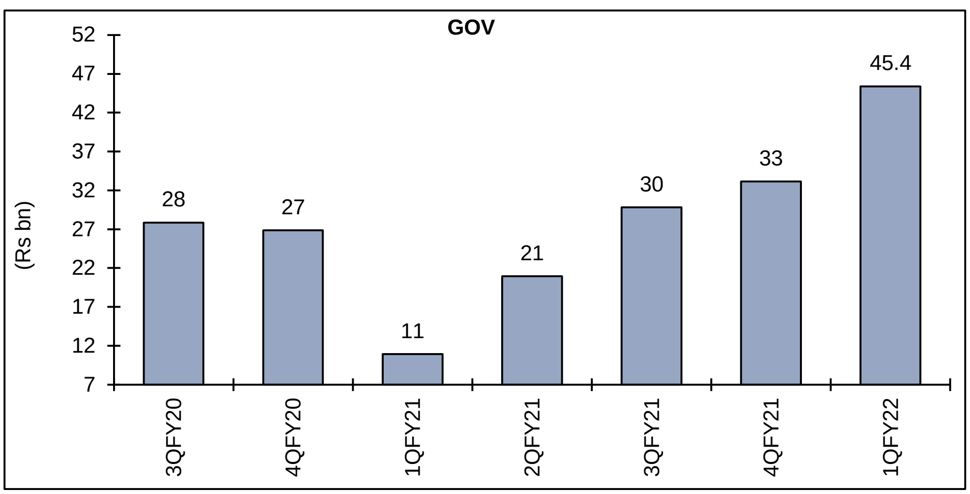
*Quarterly run rate for CY19
Source: I-Sec research, Company (Deliveroo)

Chart 62: … a strong increase in ordering activity



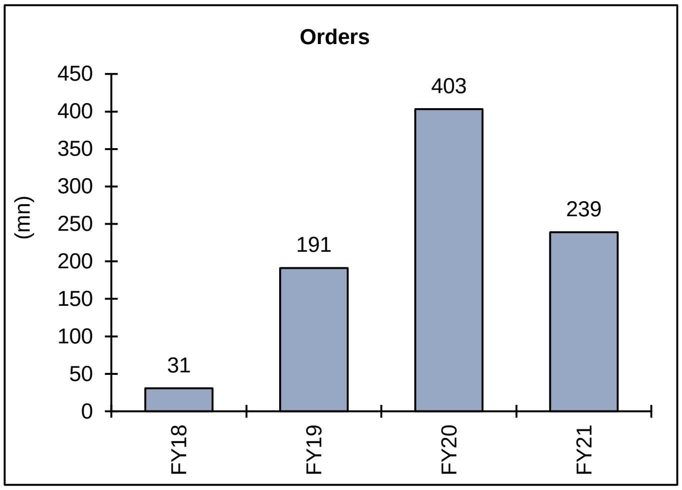
*Quarterly run rate for CY19
Source: I-Sec research, Company (Deliveroo)

Chart 63: However, Zomato witnessed a sharp drop in key metrics



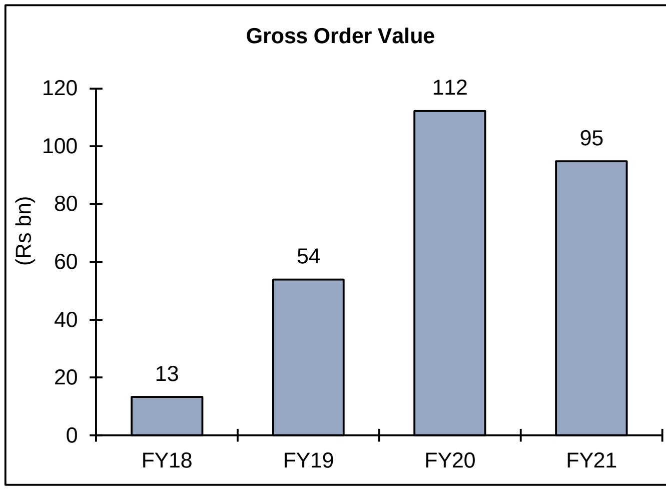
Source: I-Sec research, Company

Chart 64: This contrasting trend at Zomato was…



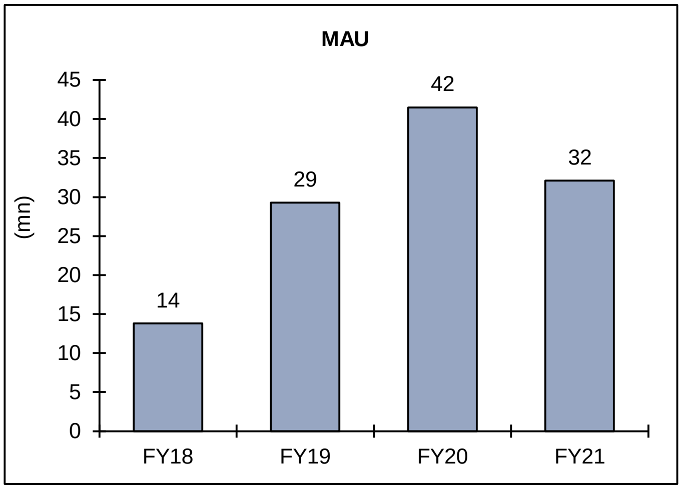
Source: I-Sec research, Company

Chart 65: ...led by multiple supply bottlenecks



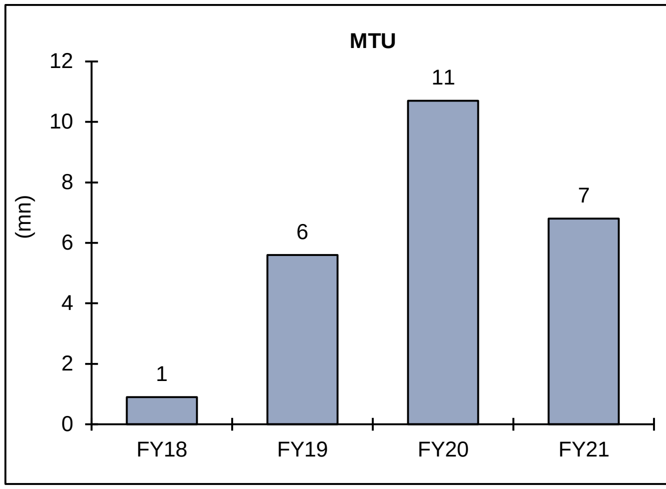
Source: I-Sec research, Company

Chart 66: This contrasting trend at Zomato was…



Source: I-Sec research, Company

Chart 67: …led by multiple supply bottlenecks



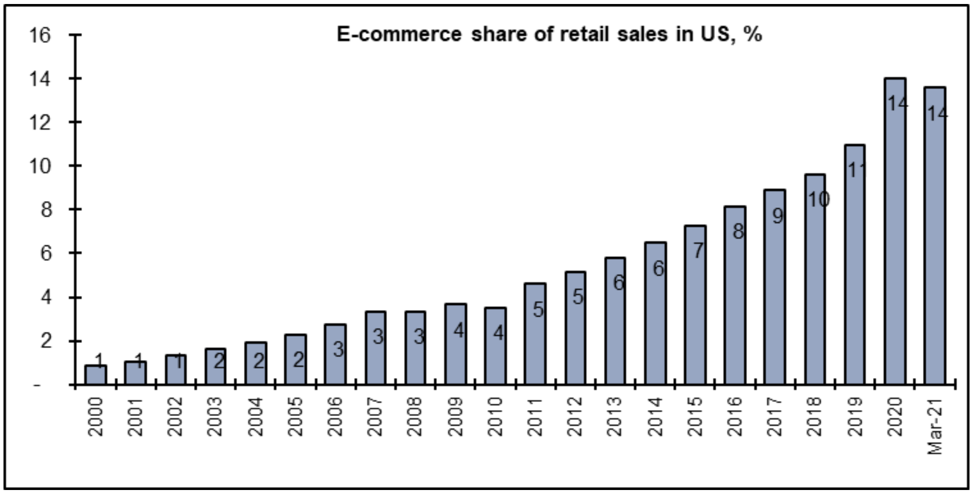
Source: I-Sec research, Company

Despite the unlock, secular tailwinds should continue

Covid is an 'event'; unlikely to impact secular trends either ways

Online businesses around the world have been witnessing secular growth for nearly two decades now. For instance, e-commerce which contributed to <1% of retail sales in US during 2000, now accounts for ~13-14% (~19% CAGR over last two decades). This secular growth is being led by customers seeking convenience and embracing digital channels as a credible complement to physical channels.

Chart 68: e-commerce adoption has been a secular trend for 2 decades



Source: I-Sec research, US Census

Covid and associated lockdowns are force majeure events, very much like the Spanish Flu (1918-20) or regulatory disruption like demonetisation (2016). As we detailed in our Oct-20 Technology Sector thematic (link), such black swan events are unlikely to impact the underlying secular trends in consumer behaviour or technology.

At best, we are seeing a near term and heterogeneous base shift across businesses – pull forward or push backward of demand. This can translate into sharp growth acceleration followed by deceleration for some businesses (e.g. Amazon, facebook) or vice-versa (e.g. Google, Zomato). However, over two years (FY20-22), we expect these distortions to normalise in most cases when looked at on CAGR basis.

Despite the unlock, secular tailwinds should continue for Zomato

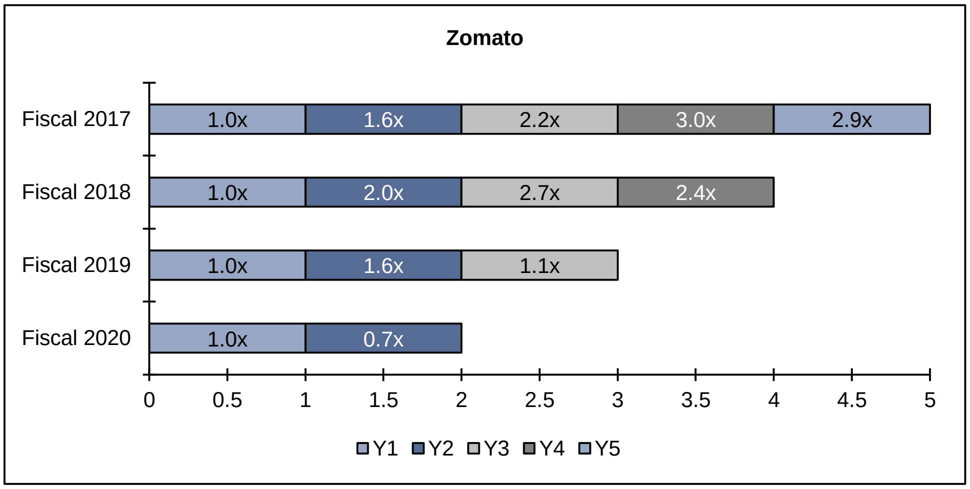
Over FY18-20, Zomato witnessed robust CAGR of 73% / 190% / 136% in MAU / GOV / sales. Had FY21 been a normal year, we believe the company would have continued its growth momentum – albeit with some deceleration on an increasing base. For reasons elaborated in the previous sections, Zomato witnessed a sharp reduction in MAU / GOV / sales (15%-23%, YoY) – contrary to its counterparts in developed countries.

In other words, operational and other bottlenecks imposed upon by lockdowns in FY21 had optically masked the true demand potential in the system for food delivery. This translated into an artificially depressed base which we believe should see a sharp bounce back as operational bottlenecks ease. We are confident this bounce back will more than offset the unlock-led uptick in dine-ins in the near term.

AOVs may see some normalisation going ahead…

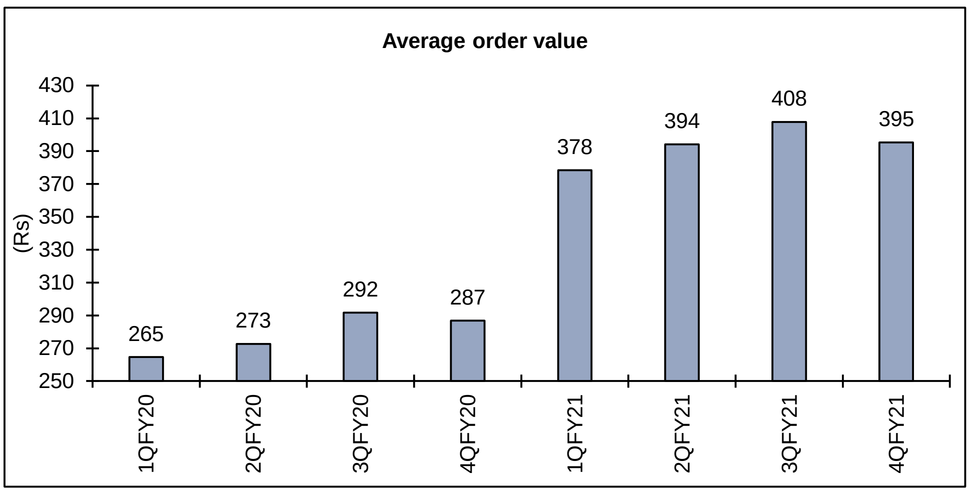
In FY21, GOV retention in older cohorts (FY17 & FY18) was reasonably strong despite Covid-19 impact. Expectedly, the retention in newer cohorts (FY19 & FY20) saw a bigger drop. In our view, these cohorts are largely outside the urban core where food services (both restaurants and aggregators) faced more serious logistical constraints (vs Top-20) due to lockdowns. This shift in mix within MTUs towards older cohorts coupled with the trend of WFH (bunching up of orders) was a key driver of increase in average order value (AOV) in FY21.

Chart 69: Drop in newer cohorts led to mix shift towards older cohorts



Source: I-Sec research, Company

Chart 70: Shift in MTU mix was a key driver of the sharp rise in AOV



Source: I-Sec research, Company

As the economy unlocks, the reversal of the above mentioned trends may translate into some normalisation in AOVs, in our view. We build in AOV of Rs 371 (-6% YoY) for FY22.

…and some shift of bargaining power to restaurants

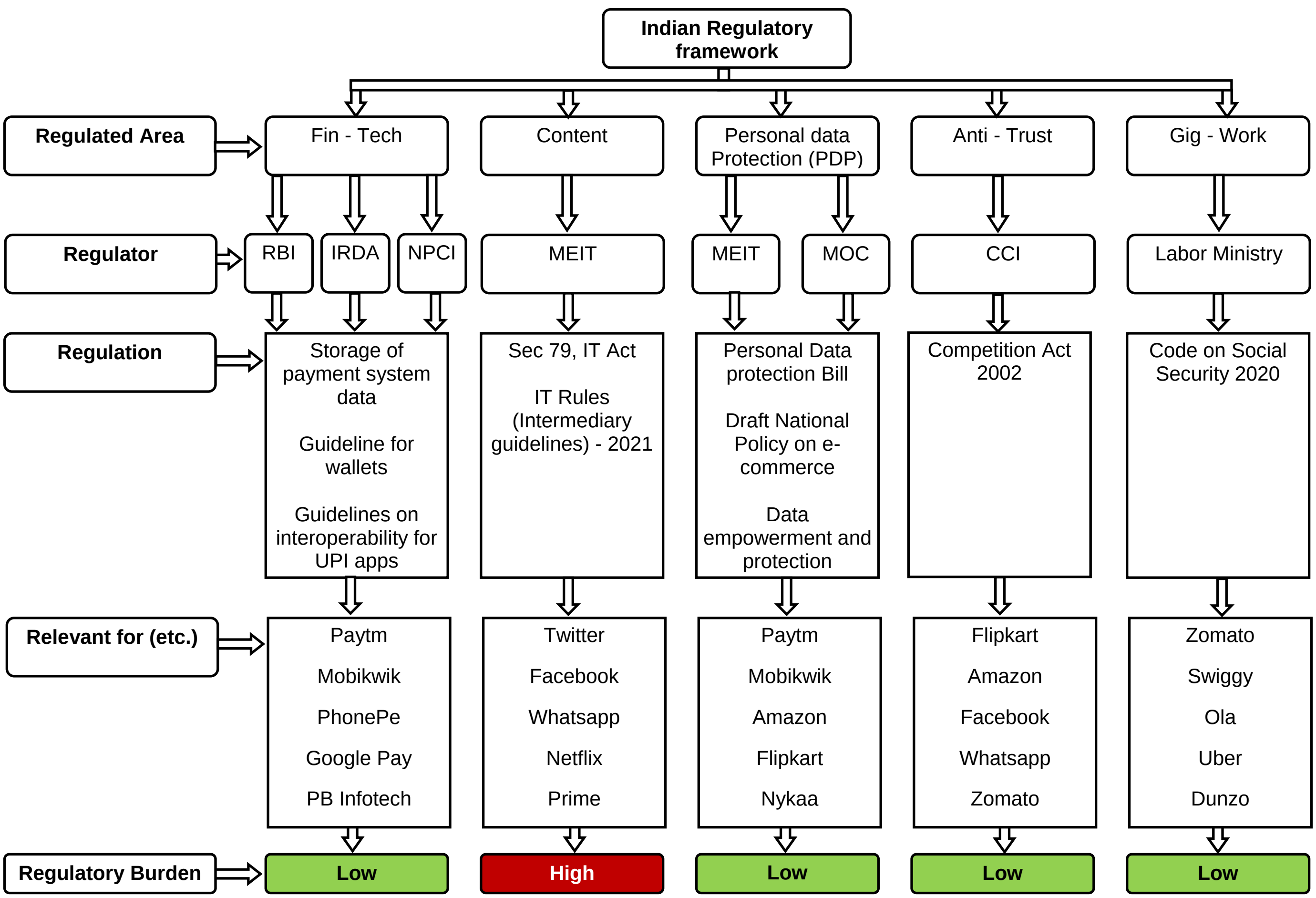
During lockdowns, delivery was the predominant channel of sales for many restaurants. With unlock, the sales mix of most restaurants may shift back with a skew towards dine-ins. Accordingly, in the near term, we expect shift of some bargaining power to restaurants and pressure on take rates. However, over the medium term, we see scope for increase in take rates as elaborated in our food-tech thematic (link).

Is a regulatory tech-lash possible like in China?

Crackdown on internet companies by China made investors jittery on the potential regulatory risks in other countries. China may be an extreme example of regulatory authoritarianism coupled with geopolitical motives. Nevertheless, internet companies (e.g. Deliveroo, Uber) in developed countries too often found themselves at odds with local governments / judiciaries (e.g. AB5 in California). Notably, Biden's administration in the US is seeking to strengthen oversight of big tech by beefing up anti-trust. Back in India, we believe the recent spat between GoI and Twitter brings to the fore the regulatory risks inherent in some of these business models.

Our analysis of the regulatory framework for internet businesses in India hints at potentially five broad areas of regulatory controls– (1) fin-tech, (2) content (e.g. Twitter, Facebook etc.), (3) personal data protection, (4) anti-trust and (5) gig work. Despite their applicability, we believe Zomato should be largely unaffected by the former four. But, we see a likelihood of minor impact due to the gig work issue (e.g. mandatory contribution to social security fund). Across the high growth internet companies in the world, we would rate Zomato as one of the least vulnerable to a regulatory tech-lash. The regulatory actions elsewhere can actually be a blessing in disguise as investors scout for regulatory paradigms accommodating free markets.

Chart 71: India's regulatory framework around internet companies is more conducive vs the world



Source: Company, I-Sec research

Partner structure of Zomato riders and the legal nuances

Riders of Zomato / Swiggy are largely structured as partners and are paid on per delivery basis (plus a rider availability fee). This is due to two reasons which are critical to the survival of the business model: (1) to bring in flexibility in fixed costs and more importantly (2) to incentivise the riders for more deliveries. World over, most new age business models (e.g. Uber, Deliveroo, DoorDash, Zomato etc.) follow the same path. However, in both US and UK, this partner model witnessed backlash both from legislative and judiciary bodies.

In Sep-19, California state government brought about a legislation – California Assembly Bill 5 (AB5) / gig worker bill. This requires companies like Uber that onboard independent partners to reclassify them as employees, with some exceptions. Recently (in Feb-21), the UK Supreme Court upheld a prior employment tribunal ruling that Uber drivers should be classified as workers rather than independent partners. This judgment also played a spoiler in Deliveroo's IPO especially as investors focused on sustainable investing shunned the issue.

In India gig employment – wage dynamic is different

The legal activism in US and UK led to concerns around similar legal risks in India. Nevertheless, it should be noted employment / wage / poverty dynamics in India are different from those in developed economies. Fundamentally, gig work in the West (formalised economies) is competing with and benchmarked against formal work.

In India, with ~88% of workforce being informal, gig work is still an upgrade for people who would otherwise be left with informal or no work. Unlike AB5, Social Security Code 2020 passed by the Indian Parliament shows no intent to establish employer – employee relationship between gig workers and platform operators.

Secondly, unlike in the West with lower order volumes, we estimate Zomato / Swiggy riders to be earning (ex-tip / service charge) higher than minimum wages (on per hour basis) in the respective micro-markets. For instance, media articles (link) hint at multiple instances of protests by Deliveroo riders over making less than the national legal minimum wage (currently, GBP 8.9 / hour).

In India, assuming an average of ~16-17 fulfilments per day and 26-day work month, riders are likely to take home an average of ~Rs20-23k, which is more than the highest minimum wage in the country (Rs16-18k / month, in Mumbai & Delhi). In its recent earnings release, Zomato indicated that 20% delivery partners who put in > 40 hours / week of delivery effort received pay out of more than Rs27k per month.

Expect a 'worst case' mandatory contribution to social security

It should be noted that Provident Fund (PF) / ESIC contribution is mandatory only for those employees whose monthly salary < Rs15k / Rs21k, respectively. Given the income levels, minimum wage / PF compliance is not relevant for Zomato / Swiggy riders. In worst case scenario, we expect some mandatory contribution (e.g. ~1-2% of net revenue, in the form of additional tax or cess) for the social security fund being envisaged for gig workers by the government.

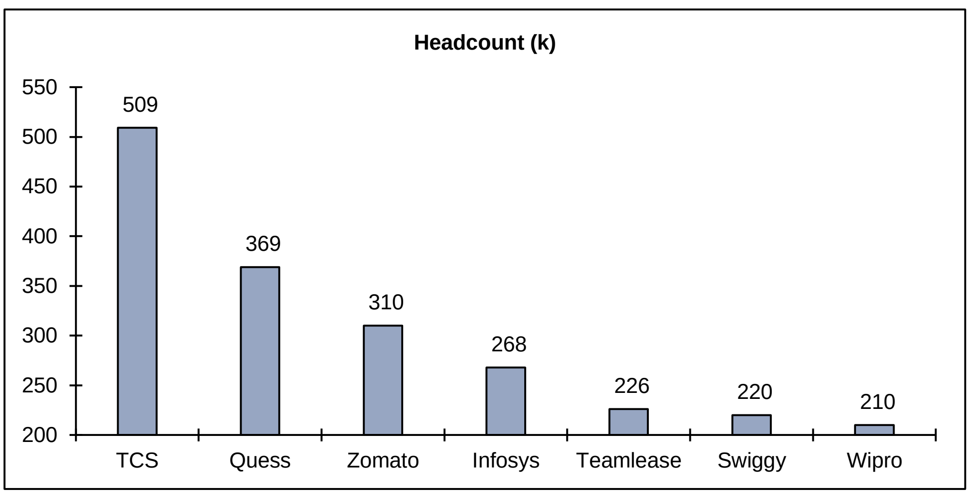
So far, the labour ministry has not notified the source of funding for this scheme. However, labour law experts expect this scheme to be funded either solely or jointly by central government, state governments, CSR spend pools of companies or collected in the form of additional tax / cess from gig platforms like Zomato.

India’s regulatory paradigm will continue to be conducive

In case of China or even in developed economies like US, alarming concentration of economic and / or political power usually preceded a regulatory tech-lash. A case in point being the unusual concentration of power between Tencent and Alibaba groups in China or Big-5 tech companies in US (Apple, Alphabet, Amazon, Facebook and Microsoft). Further, some of these companies have also been accused of acquiring start-ups, to limit the systemic innovation.

On the contrary, India has a thriving, fragmented and innovating internet ecosystem – which also happens to be a key generator of blue collar employment. For instance, we reckon Zomato to be among the Top-3 private employers in the country. Concentration of power (economic or political) is not a concern and a long time away. None of the Indian internet companies has a history of killing competition through M&A.

Chart 72: Zomato is among the Top-3 employers in India currently



Source: I-Sec research, Company

Accordingly, we expect India’s regulatory paradigm to remain conducive. In our view, content broadcasting / transmitting platforms (e.g. Twitter, WhatsApp, Facebook, Netflix etc.) will likely be an exception given legal sensitivities in some cases. Across high growth internet companies in the world, we would rate Zomato as one of the least vulnerable to a regulatory tech-lash. We believe the regulatory actions elsewhere (e.g. China) will likely be a blessing in disguise as investors scout for regulatory paradigms accommodating free markets.

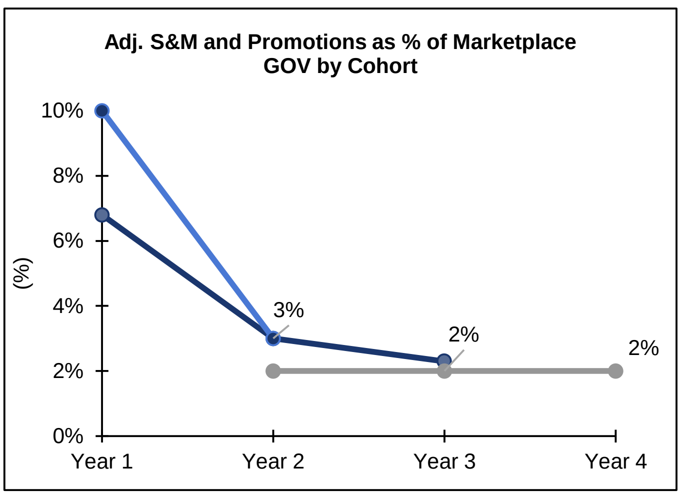
Expect 8% pre-ESOP EBITDA margin by FY23

Learning from global peers (e.g. Door Dash) suggests maturing customer cohorts and restaurants leave headroom to sharply lower CAC and increase the take rates / delivery fee. As discussed in the previous sections, our channel checks too corroborate discount rationality and an increase in the delivery fee. With rising order volumes, we see scope for further delivery cost rationalisation. V/s FY21, we expect 'J' shaped improvement in contribution. In FY22, higher bargaining power of restaurants, lower AOV and rising fuel prices are key headwinds. Beyond that, better delivery dynamics and improvement in take rates should drive a sharp rise in contribution even as discount intensity remains high in our base case (Rs 15 / order v/s Rs 8 in FY21).

This should translate into pre-ESOP EBITDA margin of 8% by FY23, a big surprise v/s street's expectation of EBITDA profitability by FY25. Outside food delivery, while recovery in dine out (43% EBITDA margin in FY20) and pick up in advertising (20% EBITDA margin in steady state) are key margin tailwinds, increasing share of Hyper pure (low margin) in the mix is a key risk to watch out for. Potentially lower discounts (< Rs 15 / order) pose key upside risk to our estimates. We do not factor in (1) incremental investments in any new business or (2) further lockdown-related risks.

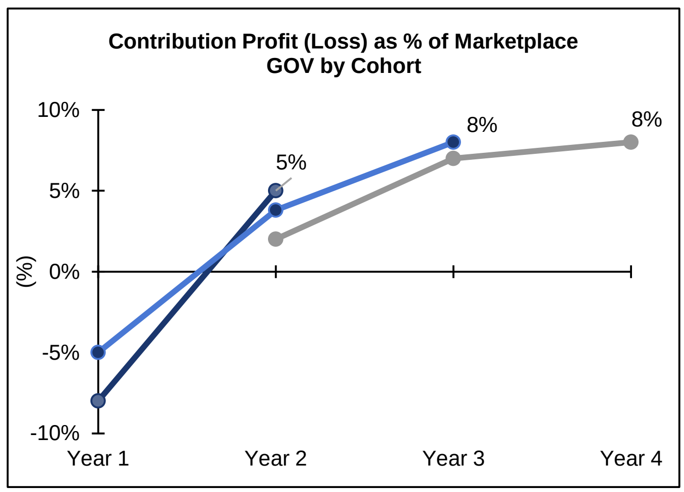
Maturity in customer cohorts => CAC rationalisation

Chart 73: As cohorts mature, CAC is expected to…



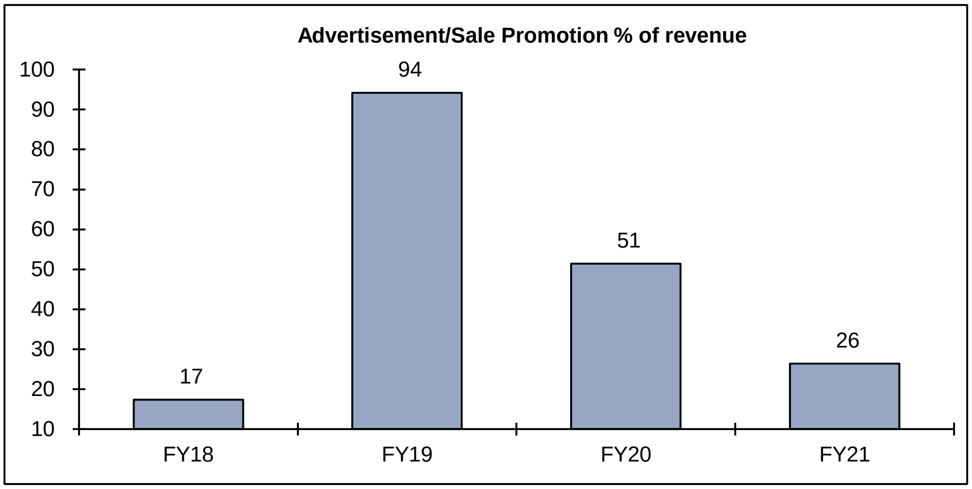
Source: I-Sec research, Company (Doordash)

Chart 74: …fall driving a sharp rise in contribution



Source: I-Sec research, Company (Doordash)

Chart 75: Zomato rationalised its advertising / sales promotion expenses



Source: I-Sec research, Company

Take rates – See headroom for increase

Currently, we understand take rates (ex-delivery fee, on net basis) for Zomato range between 13-28% with pan-Indian average at 18%.

Table 3: In FY21, take rates averaged to 18% for Zomato on net basis

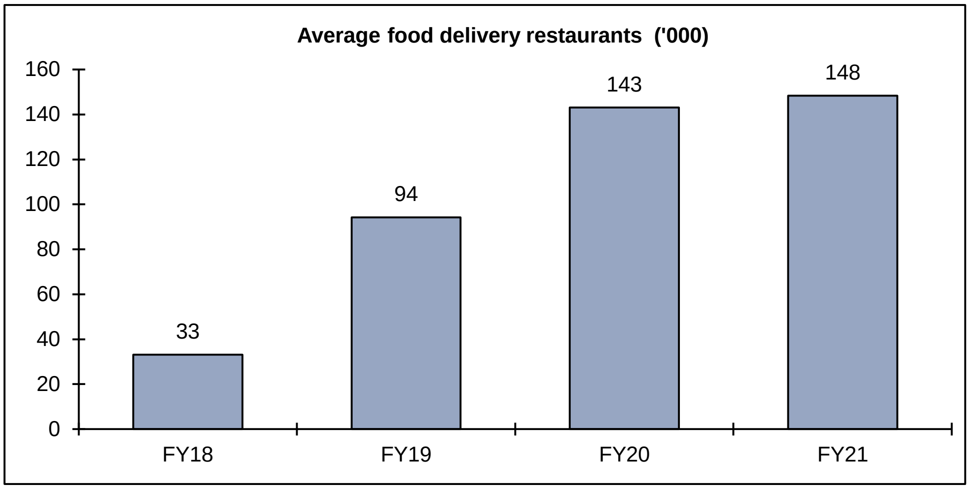
Rs	FY20	FY21
AOV (incl GST, delivery fee, gross of discounts)	278	395
Restaurant GST (5%)	10	15
Delivery charge (incl GST)	15	27
Restaurant invoice ex GST & gross of discounts	**253**	**353**
Discounts	22	8
Restaurant invoice ex GST & net of discounts	**231**	**345**
Commission	**44**	**63**
Aggregator Take Rate as % of Gross invoice	**17%**	**18%**
Aggregator Take Rate as % of Net invoice	**19%**	**18%**

Source: I-Sec Research, Company

Robust restaurant sign ups => 'J' shaped impact on take rates

Our in-depth analysis into the take rate trajectory (link) hints at scope for further increase as restaurants mature. Our interactions with industry experts suggest when restaurants are initially on boarded onto aggregator platforms, the sign up is incentivised through a low take rate. Over a period of time, as these restaurants mature, aggregators likely push up the take rates. It should be noted both Zomato and Swiggy witnessed significant restaurants sign ups over FY20 and FY21, especially in the Next 500 towns. As network effect in these micro markets strengthens and order volumes increase, blended take rates at national level should increase, in our view.

Chart 76: Robust restaurant sign ups lead to a 'J' shaped impact on take rates



Source: I-Sec research, Company

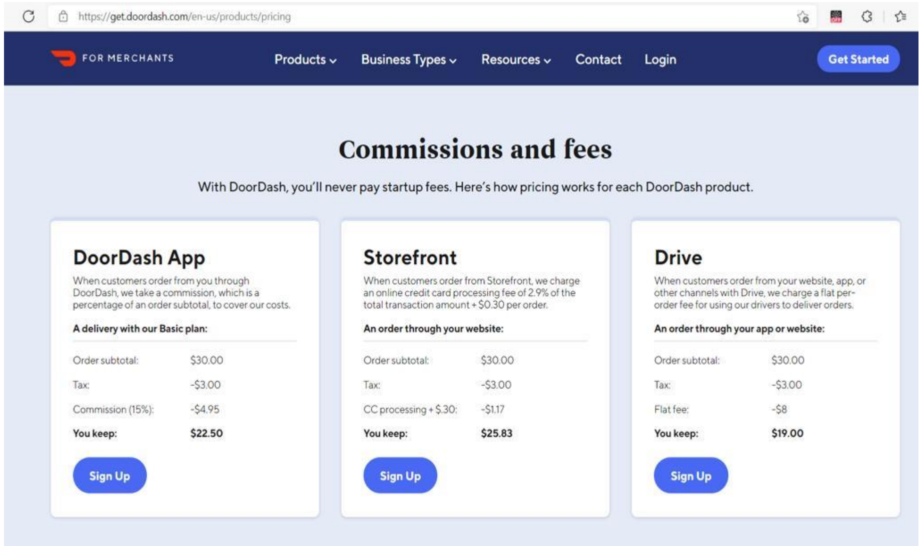
Global comparison of take rates is misleading and backward looking

A significant section of the street (wrongly) presumes Indian take rates have already peaked out vs peers in China / developed markets and can only trend down going ahead. However, it should be noted such comparisons are often misleading given the differential supply dynamics and portfolio mix (e.g. discovery only, delivery, store front only, advertising) across countries.

It should also be noted that food delivery as a business model is fast evolving even in developed economies. Several variables (e.g. take rates, delivery fee, discounts) change on a dynamic basis and benchmarking to previously reported financials is backward looking in many cases. We believe developed economies are unlikely to present static goal posts / benchmarks for Zomato, as it is usually the case in most other businesses.

A deeper examination into the current pricing structure of DoorDash for its merchants reveals it has take rates in the range of 4-30% depending on whether the service offered to the merchant is just that of store front (like DotPe) or discovery (like Zomato or JustDial discovery) or delivery (like Zomato or Swiggy). In the 'drive' use case (more comparable to Zomato and Swiggy), where DoorDash uses its drivers to deliver orders, take rates are close to 30% (net basis).

Chart 77: On a like to like basis, Zomato's take rates are lower than its developed market peers



Source: I-Sec research, Company (Doordash)

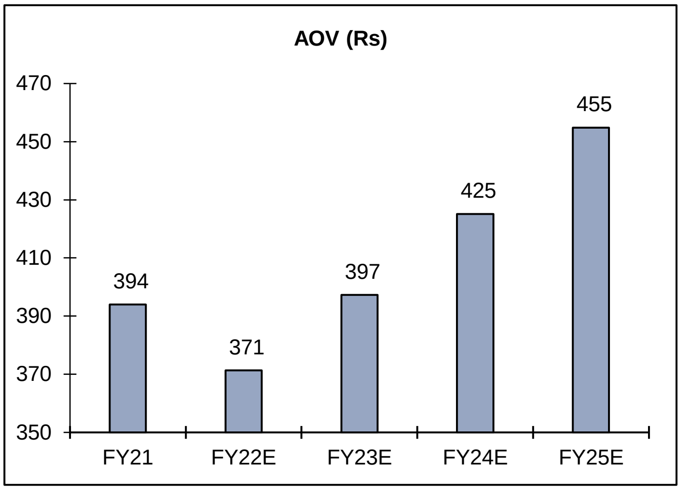
Scale / data led cost optimisation

With scale (order density) and data / insight into food consumption / spending patterns of customers, we see scope for further optimisation of certain variables. For instance, as the number of trips and data / insight related to these trips increase, scope for optimisation of delivery routing / delivery cost per order cannot be ruled out.

"*As the number of transactions on our platform increased, order density also increased, and so the probability of grouping more orders together in one trip improved, which allowed us to further reduce our average delivery cost per order. Meituan's AI powered intelligence order dispatching system was able to collect more data to optimize our advanced routing algorithms and improve delivery efficiency*."

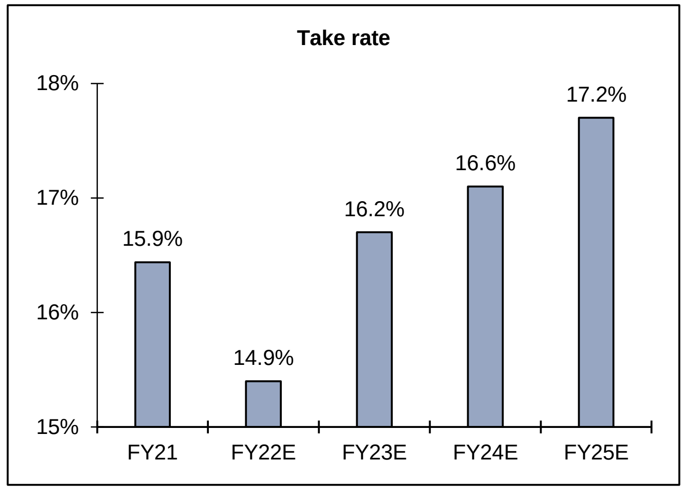
- Meituan's quarterly filings

Chart 78: We expect 'J' shaped improvement in..



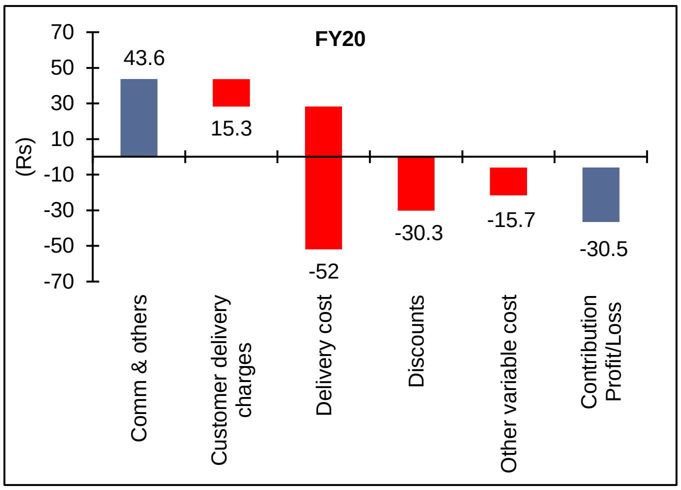
Source: Company data, I-Sec research.

Chart 79: …AOV and take rates going forward



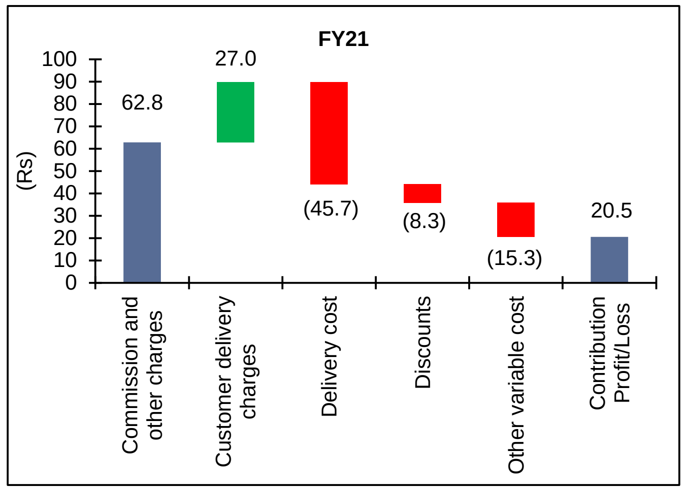
Source: Company data, I-Sec research.

Chart 80: Even assuming higher discount v/s FY21



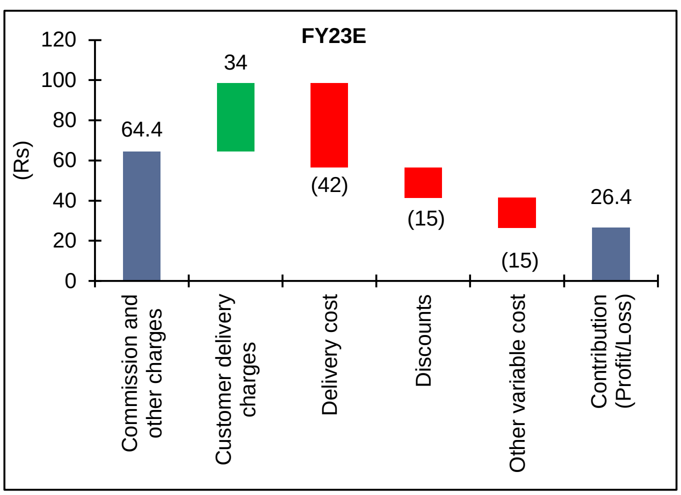
Source: Company data, I-Sec research.

Chart 81: contribution will see a sharp rise led by..



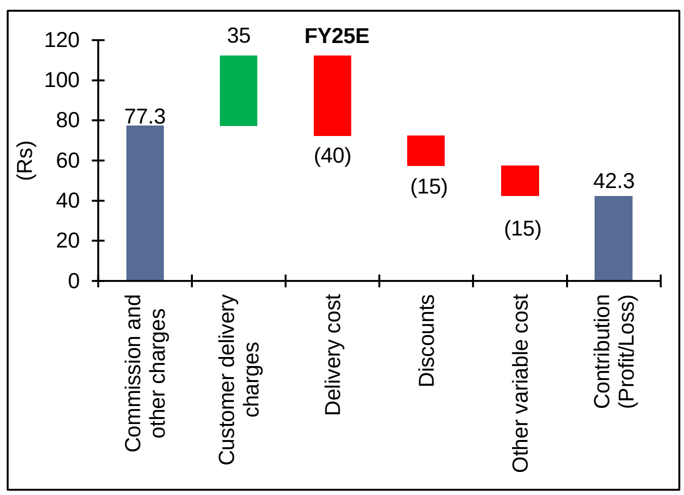
Source: Company data, I-Sec research.

Chart 82: increase in delivery fee and scale driven



Source: Company data, I-Sec research.

Chart 83: …reduction in delivery costs



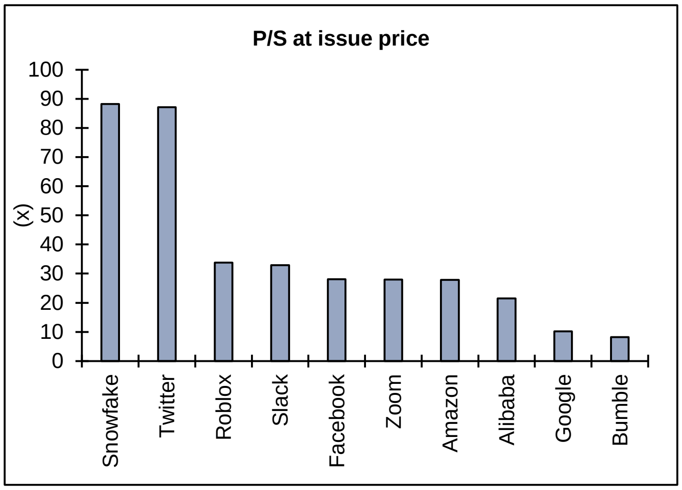
Source: Company data, I-Sec research.

Great value stock unlike what street believes it to be

Given the fact growth rates and PAT margins are yet to reach the steady state, PEG ratio is a better metric v/s P/E ratio for relative comparisons, in our view. At 0.5x FY24E PEG, Zomato is significantly cheaper v/s median food services (1.9x), technology (1.8x) or consumer (2.9x) stocks. We value the stock at 55x 2-year forward P/E, in-line with median consumer discretionary multiple. Initiate coverage with Zomato as TOP BUY in our coverage.

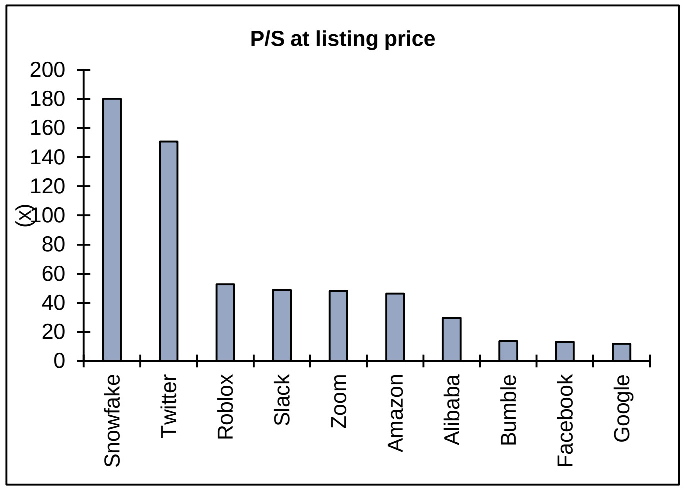
Our TP (Rs 220) bets on ~22mn Indians ordering ~4 times / month in FY25E! This is a low bar given that India 'today' has ~35mn / 114mn credit card / Paytm transacting users who likely fall in the super user category / user funnel. Likely lower discounts than our base case (< Rs 15 / order) and scaling up in attractive adjacencies pose key upside risk to our estimates and target multiples.

Chart 84: Near-term valuations at IPOs are...



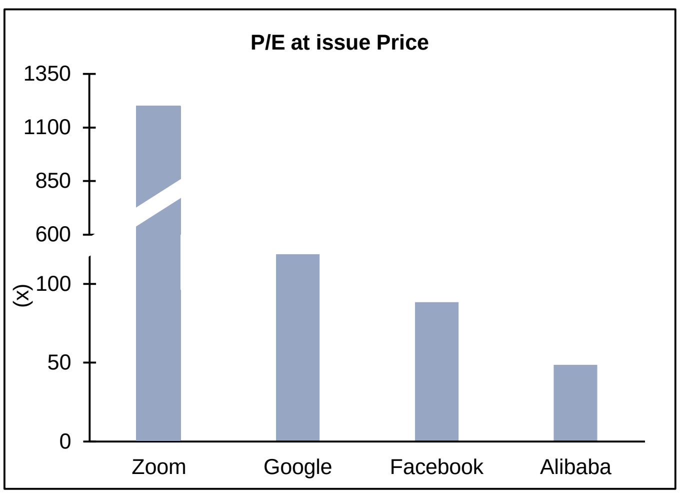
Source: Company Data, I-Sec Research

Chart 85: …optically high and misleading



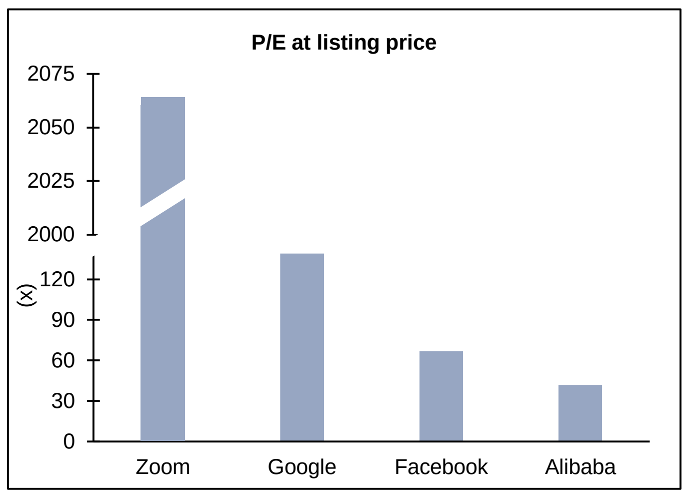
Source: Company Data, I-Sec Research

Chart 86: Near-term valuations at IPOs are...



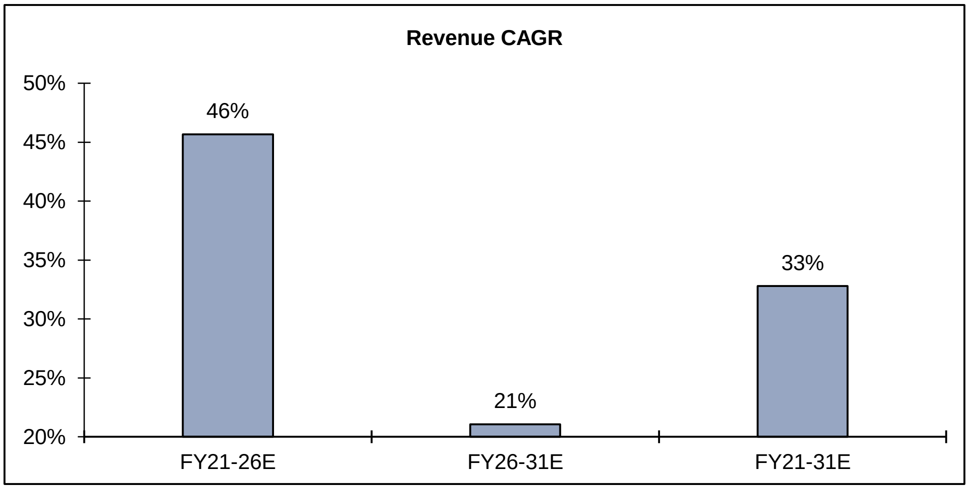
Source: Company Data, I-Sec Research, Bloomberg

Chart 87: …optically high and misleading



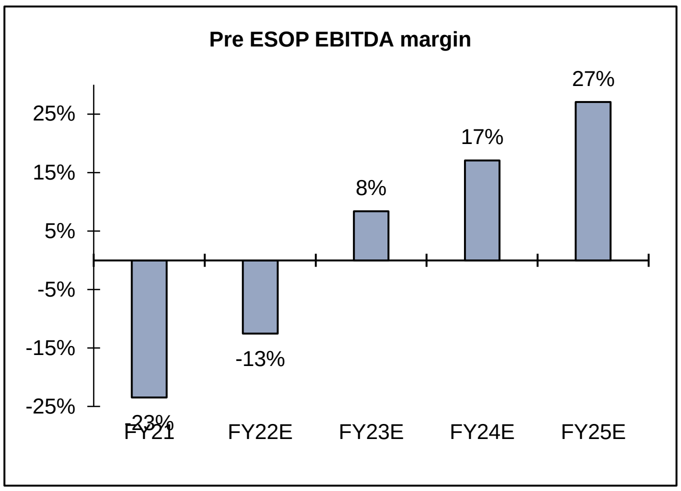
Source: Company Data, I-Sec Research, Bloomberg

Chart 88: We expect robust 33% revenue CAGR over the next decade



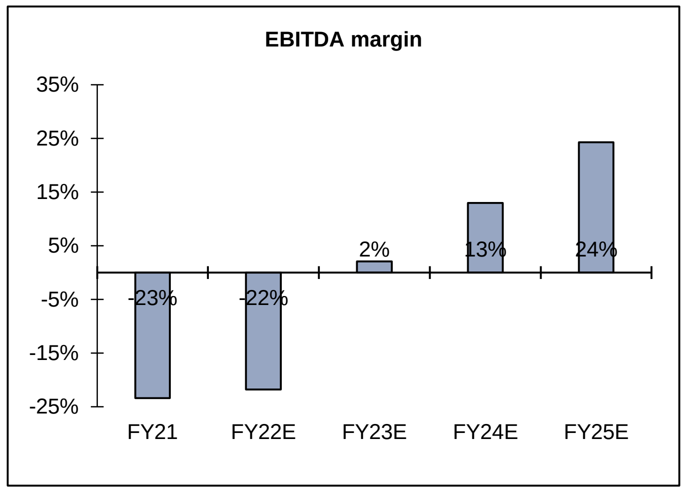
Source: I-Sec research, Company

Chart 89: EBITDA margin will likely turn positive



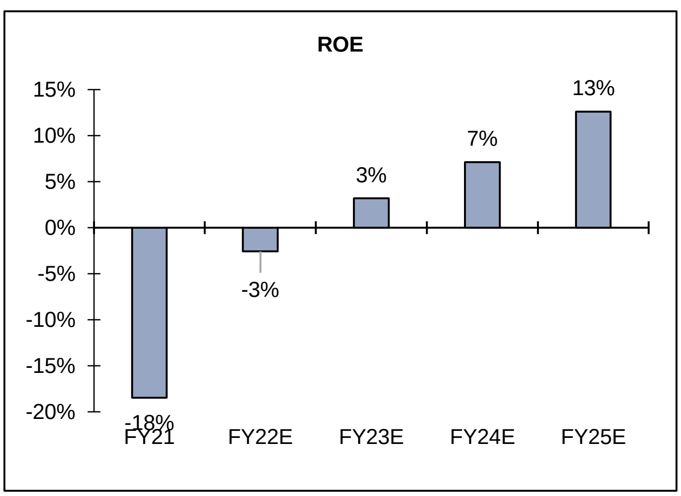
Source: Company data, I-Sec research.

Chart 90: earlier than street expectations



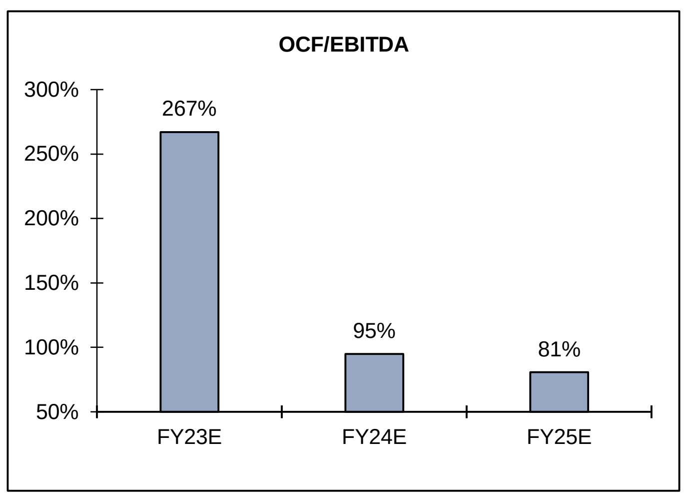
Source: Company data, I-Sec research.

Chart 91: In the steady state, we expect high ROE



Source: Company data, I-Sec research.

Chart 92: …and robust cash conversion



Source: Company data, I-Sec research.

Table 4: We are ahead of consensus on both revenue and margin

		I-sec estimates	Consensus estimates	Difference (%)
Revenue (Rs mn)	**FY22E**	40,047	35,792	11.9
	FY23E	55,858	51,595	8.3
	FY24E	77,959	72,960	6.9
EBITDA (Rs mn)	**FY22E**	-8,722	-8,175	n.a.
	FY23E	1,167	-8,284	n.a.
	FY24E	10,123	-298	n.a.
PAT (Rs mn)	**FY22E**	-3,229	-7,486	n.a.
	FY23E	5,553	-4,386	n.a.
	FY24E	13,095	1,195	995.8
EPS (Rs)	**FY22E**	-0.50	-0.89	n.a.
	FY23E	0.86	-0.55	n.a.
	FY24E	2.03	0.21	882.2

Source: Bloomberg, I-Sec research.

Table 5: On PEG, Zomato is significantly cheaper than global food services, tech and consumer stocks

	Sales Growth (%)			EBITDA Margins (%)			EPS Growth (%)			P/E (x)			P/S (x)			PEG		PSG	
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Zomato	**101**	**39**	**40**	**-22**	**2**	**13**	**n.a.**	**n.a.**	**136**	**n.a.**	**157**	**67**	**22**	**16**	**11**	**n.a.**	**0.5**	**0.4**	**0.3**
Global Food Services																			
Restaurant Brands	16	8	5	39	41	42	73	14	13	23	20	18	5	5	5	1.4	1.4	0.6	1.0
Doordash	58	20	27	6	8	13	n.a.	n.a.	297	n.a.	513	129	14	12	9	n.a.	0.4	0.6	0.4
Dominos Pizza	8	8	8	20	21	21	8	15	13	38	33	29	4	4	4	2.2	2.3	0.5	0.5
Jubilant	37	22	16	26	26	26	105	38	23	104	75	61	11	9	8	1.9	2.6	0.4	0.5
Deliveroo	56	27	20	-10	-6	-2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	4	3	2	n.a.	n.a.	0	0.1
Median	**37**	**20**	**16**	**20**	**21**	**21**	**73**	**15**	**18**	**38**	**54**	**45**	**5**	**5**	**5**	**1.9**	**1.9**	**0.5**	**0.5**
Big Tech																			
Apple	33	3	5	33	31	31	68	1	6	27	27	25	7	7	6	35.2	4.5	1.9	1.2
Microsoft	16	15	13	48	49	50	34	12	15	38	33	29	13	12	10	2.7	1.9	0.8	0.8
Google	13	17	16	48	47	46	n.a.	9	18	26	24	20	9	8	7	2.8	1.1	0.5	0.4
Netflix	19	15	15	23	24	27	75	19	27	47	40	31	8	7	6	2.1	1.2	0.5	0.4
Facebook	38	20	18	55	54	54	58	15	14	23	20	17	9	7	6	1.3	1.2	0.4	0.3
Amazon	24	19	17	15	16	17	61	21	38	48	40	29	3	3	3	1.8	0.7	0.2	0.1
Median	**21**	**16**	**15**	**40**	**39**	**39**	**61**	**14**	**17**	**32**	**30**	**27**	**8**	**7**	**6**	**2.4**	**1.2**	**0.5**	**0.4**
Consumer Discretionary																			
Kansai	19	14	-3	16	18	17	11	28	-1	58	45	45	6	5	6	1.6	-79.1	0.4	-2.1
Asian Paints	22	14	12	21	22	23	17	23	14	77	63	55	11	10	9	2.7	3.8	0.7	0.7
Berger	25	15	12	18	19	19	26	23	17	87	71	61	10	8	8	3.0	3.7	0.6	0.6
Jubilant	37	22	16	26	26	26	105	38	23	104	75	61	11	9	8	1.9	2.6	0.4	0.5
Page	20	22	14	20	21	22	34	32	15	74	56	49	10	8	7	1.7	3.3	0.4	0.5
Titan	29	23	16	11	13	13	108	38	20	89	65	54	7	5	5	1.7	2.8	0.2	0.3
Bata	43	39	13	22	27	26	n.a.	143	20	117	48	40	9	6	6	0.3	2.0	0.2	0.4
Avenue	29	40	24	8	9	9	42	53	26	142	93	74	8	6	4	1.8	2.9	0.1	0.2
Median	**27**	**22**	**13**	**19**	**20**	**20**	**34**	**35**	**18**	**88**	**64**	**55**	**9**	**7**	**6**	**1.7**	**2.8**	**0.4**	**0.5**
Consumer Staples																			
Nestle	12	11	12	24	25	25	15	16	14	74	63	56	12	11	10	3.9	4.1	0.9	0.8
Colgate	9	9	9	31	31	31	5	10	10	42	38	35	9	8	7	3.9	3.5	0.9	0.8
HUL	13	11	11	25	26	27	15	18	13	62	53	47	11	10	9	2.9	3.5	0.9	0.8
Dabur	14	12	11	21	22	22	11	16	13	55	48	42	10	9	8	3.0	3.3	0.7	0.7
Emami	12	10	9	30	30	31	56	16	11	36	31	28	8	7	7	2.0	2.5	0.7	0.7
GCPL	12	11	11	22	23	23	14	16	13	52	45	40	8	7	7	2.8	3.1	0.7	0.6
Marico	18	11	11	19	20	21	13	17	13	50	43	38	7	6	6	2.5	2.8	0.6	0.5
Britannia	9	11	10	17	18	18	-4	15	13	49	42	37	6	6	5	2.8	2.8	0.5	0.5
ITC	16	10	9	36	37	37	18	12	8	17	15	14	5	5	4	1.3	1.7	0.5	0.5
Median	**12**	**11**	**11**	**24**	**25**	**25**	**14**	**16**	**13**	**50**	**43**	**38**	**8**	**7**	**7**	**2.8**	**3.1**	**0.7**	**0.7**
IT Services																			
TCS	16	12	10	28	28	28	22	12	9	33	29	27	7	6	5	2.5	2.9	0.5	0.5
Infosys	17	13	12	27	27	27	15	14	13	33	29	25	6	5	5	2.0	2.0	0.4	0.4
Accenture	14	10	8	19	19	19	10	11	10	37	33	30	4	4	3	2.9	3.1	0.4	0.5
Wipro	24	11	10	22	22	22	15	11	12	28	25	22	4	4	4	2.3	1.8	0.4	0.3
HCLT	12	12	6	25	25	25	9	14	10	22	20	18	4	3	3	1.4	1.8	0.3	0.5
TechM	13	12	11	19	19	19	22	10	10	22	20	18	3	3	3	1.9	1.7	0.2	0.2
Median	**15**	**12**	**10**	**23**	**23**	**24**	**15**	**12**	**10**	**30**	**27**	**24**	**4**	**4**	**4**	**2.1**	**1.9**	**0.4**	**0.4**

Financial summary (consolidated)

Table 6: Profit and loss statement

(Rs mn, year ending Mar 31)

	FY21	FY22E	FY23E	FY24E
Operating Revenues (Sales)	**19,938**	**40,047**	**55,858**	**77,959**
Operating Expenses	24,610	48,769	54,691	67,836
EBITDA pre ESOP cost	**(4,672)**	**(5,022)**	**4,667**	**13,323**
% margins	*(23.4)*	*(12.5)*	*8.4*	*17.1*
ESOP costs	-	3,700	3,500	3,200
EBITDA	**(4,672)**	**(8,722)**	**1,167**	**10,123**
% margins	*(23.4)*	*(21.8)*	*2.1*	*13.0*
Depreciation & Amortisation	1,377	413	442	494
EBIT	**(6,049)**	**(9,135)**	**725**	**9,629**
% margins	*(30.3)*	*(22.8)*	*1.3*	*12.4*
Other Income	1,246	6,184	6,827	8,009
Interest & Finance Chgs	101	118	147	178
Profit / (Loss) before Taxation	**(4,904)**	**(3,070)**	**7,404**	**17,460**
Less: Taxes	13	-	1,851	4,365
Profit / (Loss) before MI	**(4,917)**	**(3,070)**	**5,553**	**13,095**
Minority interest	(36)	-	-	-
Recurring Profit / (Loss)	**(4,881)**	**(3,070)**	**5,553**	**13,095**
Exceptional items	(3,248)	(159)	-	-
Reported Net Profit/(Loss)	**(8,128)**	**(3,229)**	**5,553**	**13,095**

Source: Company data, I-Sec research

Table 7: Balance sheet

(Rs mn, year ending March)	FY21	FY22E	FY23E	FY24E
Assets				
Total Current Assets	41,505	1,31,701	1,43,874	1,64,412
Total Current Liabilities & Provisions	5,176	7,744	10,430	14,184
Net Current Assets	**36,329**	**1,23,957**	**1,33,444**	**1,50,228**
Net Fixed Assets	15,392	15,274	15,274	15,390
Long-term loans and advances	-	-	-	-
Other Long Term Assets	30,085	37,495	37,495	37,495
Deferred tax assets (net)	53	53	53	53
Total Assets	**81,858**	**1,76,778**	**1,86,265**	**2,03,166**
Liabilities				
Long term provisions	259	549	765	1,068
Other Long Term Liabilities	669	4,778	8,495	11,998
Equity Share Capital	0	6,441	6,441	6,441
Reserves & Surplus	80,930	1,65,010	1,70,564	1,83,659
Net Worth	**80,930**	**1,71,451**	**1,77,005**	**1,90,100**
Total Liabilities	**81,858**	**1,76,778**	**1,86,265**	**2,03,166**

Source: Company data, I-Sec research

Table 8: Cashflow statement

(Rs mn, year ending Mar 31)

	FY21	FY22E	FY23E	FY24E
Operating Cash flow before W Cap changes	**(2,798)**	**(5,181)**	**4,667**	**13,323**
Working Capital Inflow / (Outflow)	(7,381)	(188)	(1,548)	(3,728)
Capex	(48)	(295)	(442)	(610)
Free Cash flow	**(10,228)**	**(5,665)**	**2,677**	**8,985**
Cash Flow from other Invst Act (Ex Capex)	(52,388)	(1,227)	6,827	8,009
Proceeds from Issue of Share Capital	66,083	93,750	-	-
Inc/(Dec) in Borrowings / Deferred Liabilities	(2,014)	-	-	-
Interest & Dividend paid	(50)	(118)	(147)	(178)
Increase/(Decrease) in Cash	**1,403**	**86,740**	**9,357**	**16,816**

Source: Company data, I-Sec research

Table 9: Key ratios

(Year ending Mar 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Earnings per share (Diluted Reported)	(1.5)	(0.5)	0.9	2.0
Earnings per share (Basic Reported)	(1.5)	(0.5)	0.9	2.0
Cash earnings per share	(1.3)	(0.4)	0.9	2.1
Dividend per share	-	-	-	-
Book Value per share	15.0	26.6	27.5	29.5
Growth Ratios (%)				
Operating Income (Sales)	(23.5)	100.9	39.5	39.6
EBITDA	n.a.	n.a.	n.a.	767.1
Recurring Net Income	n.a.	n.a.	n.a.	135.8
Diluted EPS	n.a.	n.a.	n.a.	135.8
Diluted CEPS	n.a.	n.a.	n.a.	126.6
Valuation Ratios (x)				
P/E	n.a.	n.a.	157.1	66.6
P/CEPS	n.a.	n.a.	145.5	64.2
P/BV	9.0	5.1	4.9	4.6
EV / EBITDA	n.a.	n.a.	637.2	71.8
EV / Sales	35.3	18.8	13.3	9.3
EV / FCF	n.a.	n.a.	277.8	80.9
Operating Ratio				
Other Income / PBT (%)	(25.4)	(201.4)	92.2	45.9
Effective Tax Rate (%)	(0.3)	-	25.0	25.0
Fixed Asset Turnover (x) on average	0.7	0.5	0.3	0.2
Receivables (days)	23.8	20.0	20.0	20.0
Payables (days)	54.4	38.0	38.0	38.0
D/E Ratio (x)	0.0	0.0	0.0	0.0
Return/Profitability Ratio (%)				
Recurring Net Income Margins	(24.5)	(7.7)	9.9	16.8
RoCE (Based on Avg)	(11.7)	(7.1)	0.3	3.7
RoNW (Based on Avg)	(18.5)	(2.6)	3.2	7.1
Dividend Payout Ratio	-	-	-	-
Dividend Yield	-	-	-	-
EBITDA Margin	(23.4)	(21.8)	2.1	13.0

Source: Company data, I-Sec research

Index of Tables and Charts

Tables

Charts

This report may be distributed in Singapore by ICICI Securities, Inc. (Singapore branch). Any recipients of this report in Singapore should contact ICICI Securities, Inc. (Singapore branch) in respect of any matters arising from, or in connection with, this report. The contact details of ICICI Securities, Inc. (Singapore branch) are as follows: Address: 10 Collyer Quay, #40-92 Ocean Financial Tower, Singapore - 049315, Tel: +65 6232 2451 and email: navneet_babbar@icicisecuritiesinc.com, Rishi_agrawal@icicisecuritiesinc.com.

"In case of eligible investors based in Japan, charges for brokerage services on execution of transactions do not in substance constitute charge for research reports and no charges are levied for providing research reports to such investors."

New I-Sec investment ratings (all ratings based on absolute return; All ratings and target price refers to 12-month performance horizon, unless mentioned otherwise)
BUY: >15% return; ADD: 5% to 15% return; HOLD: Negative 5% to Positive 5% return; REDUCE: Negative 5% to Negative 15% return; SELL: < negative 15% return

ANALYST CERTIFICATION
I/We, *Sudheer Guntupalli, PGDM; Manoj Menon, MBA, CMA;* authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of the ICICI Securities Inc. It is also confirmed that above mentioned Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months and do not serve as an officer, director or employee of the companies mentioned in the report.

Terms & conditions and other disclosures:
ICICI Securities Limited (ICICI Securities) is a full-service, integrated investment banking and is, inter alia, engaged in the business of stock brokering and distribution of financial products.
ICICI Securities is Sebi registered stock broker, merchant banker, investment adviser, portfolio manager and Research Analyst. ICICI Securities is registered with Insurance Regulatory Development Authority of India Limited (IRDAI) as a composite corporate agent and with PFRDA as a Point of Presence. ICICI Securities Limited Research Analyst SEBI Registration Number – INH000000990. ICICI Securities Limited SEBI Registration is INZ000183631 for stock broker. ICICI Securities is a subsidiary of ICICI Bank which is India's largest private sector bank and has its various subsidiaries engaged in businesses of housing finance, asset management, life insurance, general insurance, venture capital fund management, etc. ("associates"), the details in respect of which are available on www.icicibank.com.
ICICI Securities is one of the leading merchant bankers/ underwriters of securities and participate in virtually all securities trading markets in India. We and our associates might have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. ICICI Securities and its analysts, persons reporting to analysts and their relatives are generally prohibited from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.
Recommendation in reports based on technical and derivative analysis centre on studying charts of a stock's price movement, outstanding positions, trading volume etc as opposed to focusing on a company's fundamentals and, as such, may not match with the recommendation in fundamental reports. Investors may visit icicidirect.com to view the Fundamental and Technical Research Reports.
Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.
ICICI Securities Limited has two independent equity research groups: Institutional Research and Retail Research. This report has been prepared by the Institutional Research. The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating, and target price of the Retail Research.
The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on a reasonable basis, ICICI Securities is under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities might be acting in an advisory capacity to this company, or in certain other circumstances.
This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and shall not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities accepts no liabilities whatsoever for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.
ICICI Securities or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.
ICICI Securities or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction.
ICICI Securities or its associates might have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the companies mentioned in the report in the past twelve months.
ICICI Securities encourages independence in research report preparation and strives to minimize conflict in preparation of research report. ICICI Securities or its associates or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither ICICI Securities nor Research Analysts and their relatives have any material conflict of interest at the time of publication of this report.
Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.
ICICI Securities or its subsidiaries collectively or Research Analysts or their relatives do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.
Since associates of ICICI Securities and ICICI Securities as a entity are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report.
ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.
Neither the Research Analysts nor ICICI Securities have been engaged in market making activity for the companies mentioned in the report.
We submit that no material disciplinary action has been taken on ICICI Securities by any Regulatory Authority impacting Equity Research Analysis activities.
This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.
This report has not been prepared by ICICI Securities, Inc. However, ICICI Securities, Inc. has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed.