BUY (Maintain)

CMP: INR 106 Target Price: INR 160 (INR 120) ▲ 51%

ICICI Securities

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11 October 2023

India | Equity Research | Company Update

Zomato

Internet

Decoding Zomato : Five key questions answered; Re-iterate BUY

Zomato is up >120% from the lows of Feb'23, which merits a debate on 'What now?'. In this note, we have tried to answer five key investor questions through a combination of fundamental analysis (annual report analysis, sensitivity analysis etc.) and primary research (a survey of 220 restaurants across 40 cities:(link). Our takeaways: 1) The company's medium term guidance of 4-5% adj. EBITDA as a proportion of GOV should be achieved as early as Q3FY24E (I-Sec est.: 4.0%); 2) Quick commerce adj. EBITDA profitability should be achieved by Q1FY25E and 3) Hyperpure adj. EBITDA losses should reduce from -5.7% in Q1FY24 to -3.2% in Q1FY25E. We raised our DCF based TP to INR160, which implies 1-year forward EV/EBITDA multiple of **42x** and P/E multiple of **63x**. **Re-iterate BUY**.

When will 4-5% adj. EBITDA (% of GOV) be achieved in food?

We estimate 4% adj. EBITDA (as % of GOV) to be achieved as early as Q3FY24E led by strong order volumes and AOVs during the festive season coupled with the ICC World Cup 2023. We estimate 4.6% adj. EBITDA (as % of GOV) to be achieved in food delivery by Q1FY25. This implies ~220bps profitability improvement over the next 4 quarters to be mostly driven by a combination of 1) increase in ad revenue (~60bps), 2) increase in gold revenue(~45bps) and 3) contribution from platform fees (~45bps). See below for details

When will quick commerce become operationally profitable?

We believe the quick commerce business could turn contribution positive (full quarter basis) by Q2FY24E and profitable at the adj. EBITDA level by Q1FY25. In our view, the quick commerce business could improve adj. EBITDA (as % of GOV) by 620bps over the next four quarters led primarily by: 1) scale benefits on corporate overheads (~210bps), 2) decrease in other fulfilment cost (~180bps), 3) mix improvement (~110bps) and 4) increase in ad revenues (~100bps). See below for details

Can 'Hyperpure' continue to scale without losing more money?

We estimate adj. EBITDA margin to improve from -5.7% in Q1FY24 to -3.2% in Q1FY25. This, in our view is likely to be driven primarily by 1) scale efficiencies on corporate overheads (~150bps), 2) gross margin improvement (~40bps) and 3) scale efficiencies on fulfilment costs (~25bps). See below

Financial Summary

Y/E March (INR mn)	FY22A	FY23A	FY24E	FY25E
Net Revenue	41,924	70,794	1,22,018	1,60,486
Adj. EBITDA	(9,729)	(7,045)	6,472	20,910
Adj. EBITDA Margin (%)	(23.2)	(10.0)	5.3	13.0
Net Profit	(12,087)	(9,713)	4,307	10,986
EPS (Rs)	(0.6)	(0.8)	0.7	1.9
EPS % Chg YoY	-	-	-	182.1
P/E (x)	(63.5)	(88.4)	160.7	57.0
EV/EBITDA (x)	(75.6)	(113.8)	120.8	36.2
RoCE (%)	(0.2)	(0.1)	0.0	0.0
RoE (%)	(9.8)	(5.4)	2.2	5.2

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Market Data

Market Cap (INR)	913bn
Market Cap (USD)	10,961mn
Bloomberg Code	ZOMATO IN
Reuters Code	ZOMT BO
52-week Range (INR)	108 /44
Free Float (%)	52.0
ADTV-3M (mn) (USD)	98.6

Price Performance (%)	3m	6m	12m
Absolute	41.8	96.6	54.4
Relative to Sensex	1.5	11.5	15.4

ESG Disclosure	2021	2022	Change
ESG score	-	41.4	-
Environment	-	26.2	-
Social	-	21.8	-
Governance	-	76.1	-

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

Earnings Revisions (%)	FY24E	FY25E
Revenue	7.2	6.8
Adj. EBITDA	-	11.38
EPS	131	18

Previous Reports

04-08-2023: Q1FY24 results review

22-05-2023: Q4FY23 results review

Is there enough room for food delivery to scale?

Our analysis suggests that the food aggregator space is still nascent (we estimate ~89% of revenues are coming from the top 18% of user base), which shows there is enough room for revenue growth in the medium term without expanding geographical footprint further. By our estimates, the gold users order from Zomato ~9 times a month; the next tranche of users, whom we classified as regular users (non-gold), order from Zomato ~2.7 times a month. Therefore, the ordering frequency increase potential for regular non gold users graduating to gold membership is very meaningful in our view. See below for details

Are the 'rich valuations' justified?

Given the outlook of sharp profitability improvement in all three businesses of Zomato, we believe valuations for the stock are now pretty sensible. We therefore think there is enough room for meaningful rerating of the stock. While our TP of INR160 is DCF based, we have tried to back calculate implied multiples for each of the business using an SOTP framework. Our SOTP implies a 1-year forward EV/EBITDA multiple of 40x for the food delivery, a 1-year forward EV/EBITDA multiple of 50x for quick commerce and a 2-year forward EV/EBITDA multiple of 50x and then discounted (discount rate 15%) to 1-year forward for 'Hyperpure'. In fact, at CMP, Zomato is looking attractively valued compared to many global and Indian peers on profit multiples. See below for details

Our numbers – Medium term outlook

We have priced in revenue growth of 25%/26%/20% in food delivery business and 43%/34%/25% overall over FY24E-26E. Also, we have priced in adj. EBITDA margins (as a % of reported revenue) of 14%/21%/23% in food delivery and 5%/12%/15% overall over FY24E-26E. See below for details

Risk Reward Skew (2.6:1) to the upside

We see the stock trading at INR200 per share in our bull case scenario and INR 70 in our bear case scenario implying a risk reward skew of 2.6:1 towards the upside. This re-inforces our view that Zomato remains a buy despite the 120% re-rating from all-time lows. See below for details

Valuation

We re-iterate our **BUY** rating on Zomato and increase our 3 stage DCF-based target price to INR 160 from INR 120 led by earnings upgrades, given improved visibility of profitability and sustained improvement in the underlying operating metrics. Zomato remains our top pick in the Indian internet space.

Key risks: Slowdown in discretionary spending, negative externalities disrupting business operations.

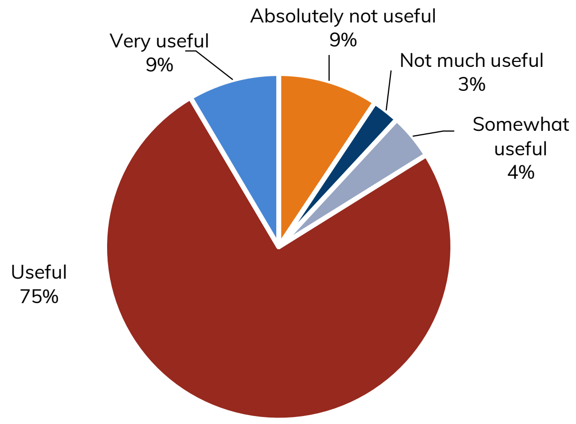
When will 4-5% adj. EBITDA (% of GOV) be achieved in food?

We believe food delivery profit improvement over the last 3-4 quarters was driven by strong growth in ad-revenues. This, in our view is not well understood by investors. We realised this when we saw that ~53% of respondents in our recent survey of restaurants indicated that they were actually advertising on aggregator platforms. Also, 88% of those who did advertise on the platforms, had a positive experience.

Exhibit 1: 53.0% of respondents are advertising on food aggregator platforms

Source: I-Sec research

Exhibit 2: 88.1% of respondents who are advertising, have a positive experience



Source: I-Sec research

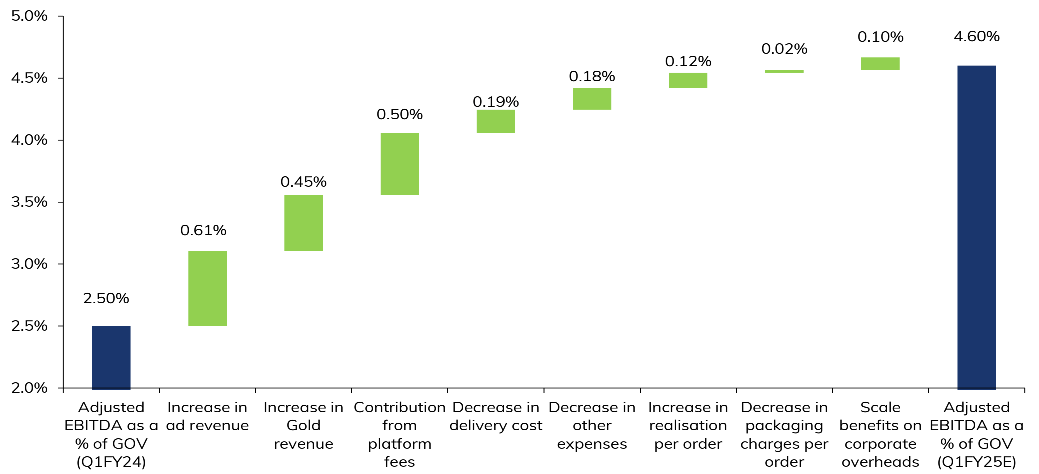
This, in our view, is indicative of the fact that ad-revenues are likely to continue to grow over the medium term.

In their FY23 annual report, Zomato disclosed that they had 1.8mn Zomato gold users as of March end FY23. We estimate this is likely to grow to 2.25mn by Q1FY25E.

Zomato has also started to charge customers 'platform fees' for food delivery. This is likely to further aid profitability improvement.

We est. 4% adj. EBITDA (as % of GOV) to be achieved as early as Q3FY24E led by strong order volumes and AOVs during the festive season coupled with the ICC World Cup 2023. We estimate 4.6% adj. EBITDA (as % of GOV) should be achieved in food delivery by Q1FY25E. This implies ~220bps profitability improvement over the next 4 quarters to be mostly driven by a combination of 1) increase in ad revenue (~60bps), 2) increase in gold revenue(~45bps) and 3) contribution from platform fees (~45bps).

Exhibit 3: Adjusted EBITDA as a % of GOV - Food Delivery



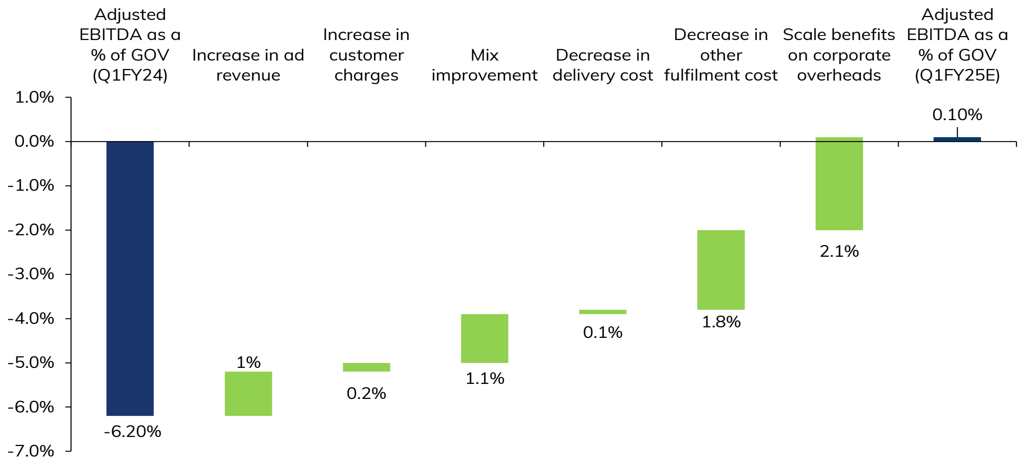
Source: I-Sec research

When will quick commerce become operationally profitable?

The viability of quick commerce as a business has been questioned by investors on multiple occasions. While these questions generally arise from the belief that quick commerce has limited room for gross margin improvement, we think what is not understood is the ability of these platforms to monetise ad-revenues and charging customers for convenience. Also, all the quick commerce players have recently been focussing on increasing density of service polygons which should aid in reducing delivery costs (which is proportional to distance travelled) and increase productivity of delivery personnel. What is also not understood is the ability of the quick commerce players to improve gross margin using assortment as they figure out ways to do better demand planning.

We believe the quick commerce business can turn contribution positive (full quarter basis) by Q2FY24E and profitable at the adj. EBITDA level by Q1FY25E. In our view, the quick commerce business can improve adj. EBITDA (as % of GOV) by 620bps over the next 4 quarters led primarily by: 1) Scale benefits on corporate overheads (~210bps), 2) Decrease in other fulfilment cost (~180bps), 3) Mix improvement (~110bps) and 4) Increase in ad revenues (~100bps).

Exhibit 4: Adjusted EBITDA as a % of GOV – Blinkit



Source: I-Sec research

We have identified 'adj. revenue per order' and 'orders per day per dark store' as two key metrics which impact profitability for the quick commerce business. Below is a scenario analysis for adjusted EBITDA margin in quick commerce by varying these two metrics.

Exhibit 5: Quick commerce breakeven scenario analysis

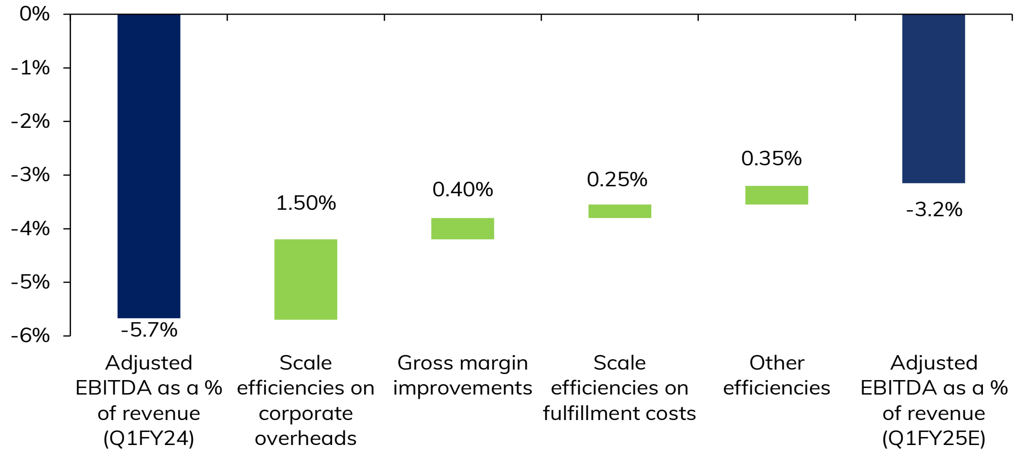
Orders per day per dark store ↓ / Adj. rev. per order →	115	118	125
1,090	-1.7%	-1.2%	**0%**
1,390	-0.7%	**0%**	1.2%
1,630	**0%**	0.7%	1.9%

Source: I-Sec research

Can 'Hyperpure' continue to scale without losing more money?

We estimate "Hyperpure' losses should start reducing significantly as it scales up. We estimate adj. EBITDA margin improving from -5.7% in Q1FY24 to -3.2% in Q1FY25E. This, in our view is likely to be driven primarily by 1) scale efficiencies on corporate overheads (~150bps), 2) gross margin improvement (~40bps) and 3) scale efficiencies on fulfilment costs (~25bps).

Exhibit 6: Adjusted EBITDA as a % of revenue - Hyperpure



Source: I-Sec research

Is there enough room for food delivery to scale?

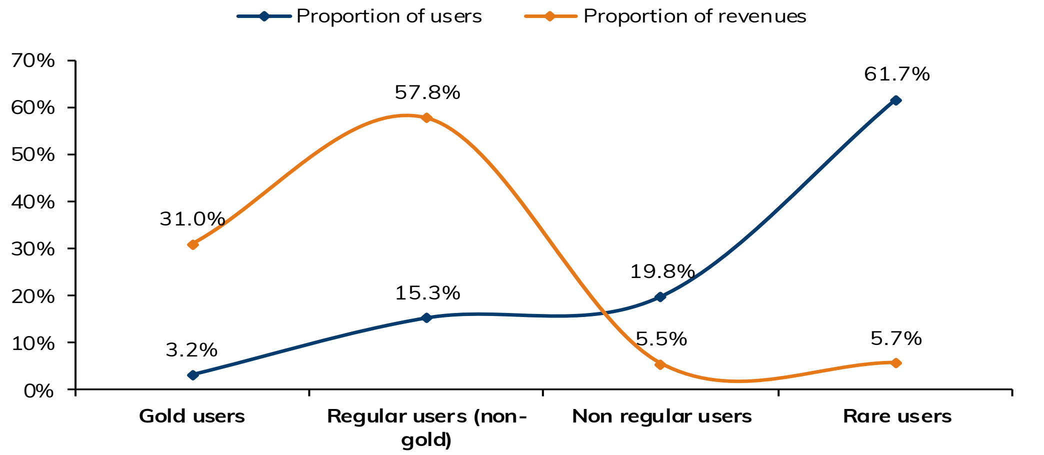
We have tried to calculate the consumption patterns of Zomato's consumer base using various data points given by them such as the number (1.8mn at the end of FY23), GOV contribution of gold users in Q1FY24 (31%) and the total number of users who used Zomato in FY23 (58mn). The table below shows our calculations.

Exhibit 7: Zomato Gold analysis

Zomato gold analysis	Mar-23	Q1FY24
Number of users (in mn)	1.80	1.85
Proportion of GOV from Gold		31%
GOV per gold user per quarter		**12,236**
GOV per gold user per month		**4,079**
Ordering frequency per gold customer per month		**9.06**
GOV per non gold user per month		**1,076**
Calculated AOV for non gold users (est)		**402**
Ordering frequency per non gold user per month		**2.7**
Non-gold tail analysis analysis		
Total transacting users per annum (in mn)		**58**
Gold customers		**1.85**
Regular non gold users (who order every month)		8.85
Non regular non gold users (who order once a quarter)		11.5
Rare non gold users (who order once a year)		35.5
MTU		17.5
Regular non gold user analysis (who order every month)		
Ordering frequency per non regular non gold customer per month		**0.33**
Ordering frequency per non gold regular customer per month		3.96

Source: I-Sec research

Exhibit 8: Proportion of users and their revenue contribution



Source: I-Sec research, Company data

Our analysis suggests that the food aggregator space is still nascent (we estimate ~89% of revenues are coming from the top 18% of user base), which shows there is enough room for revenue growth in the medium term without expanding geographical footprint further. By our estimates, the gold users order from Zomato ~9 times a month, the next tranche of users, whom we classified as regular users (non-gold) order from Zomato ~2.7 times a month. Therefore, the ordering frequency increase potential for regular non gold users graduating to gold membership is very meaningful in our view.

Are the 'rich valuations' justified?

While our PT of INR160 is DCF based, we have tried to back calculate implied multiples for each of the business using an SOTP framework. Our SOTP implies a 1-year forward EV/EBITDA multiple of 40x for the food delivery, a 1-year forward EV/EBITDA multiple of 50x for quick commerce and a 2-year forward EV/EBITDA multiple of 50x and then discounted (discount rate 15%) to 1-year forward for 'Hyperpure'.

Exhibit 9: Zomato SOTP

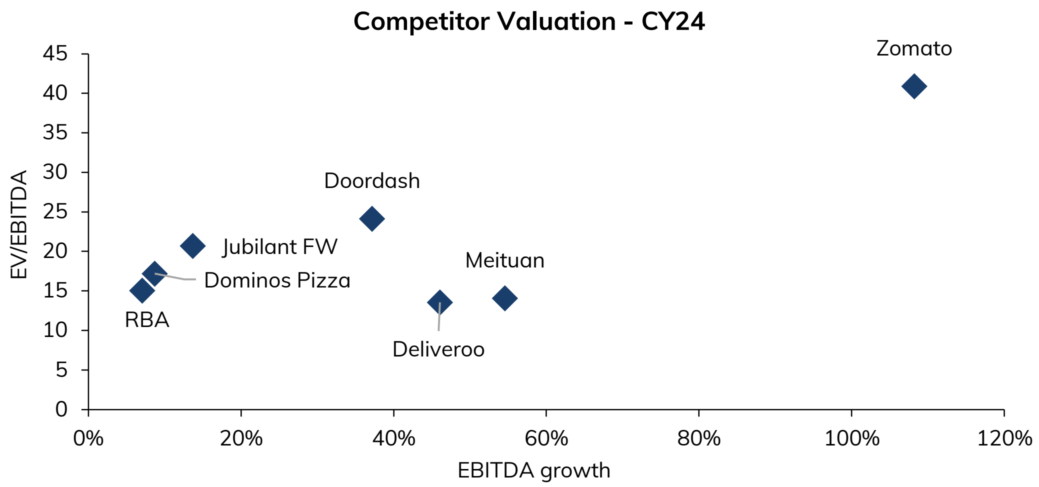
SOTP	EV (INR bn)	EV (USD bn)	EV/EBITDA	Proportion	INR per share
Food delivery	931	11.2	40	72.0%	115
Blinkit	157	1.9	50	12.2%	19
Hyperpure	19	0.2	50	1.5%	2
Others	20	0.2		1.5%	2
Cash	165	2.0		12.8%	20
Overall	1,292	15.5	42	100.0%	160

Source: I-Sec research

Peer comparison

In fact, at CMP, Zomato is looking attractively valued compared to many global and Indian peers on profit multiples.

Exhibit 10: Zomato peer valuation

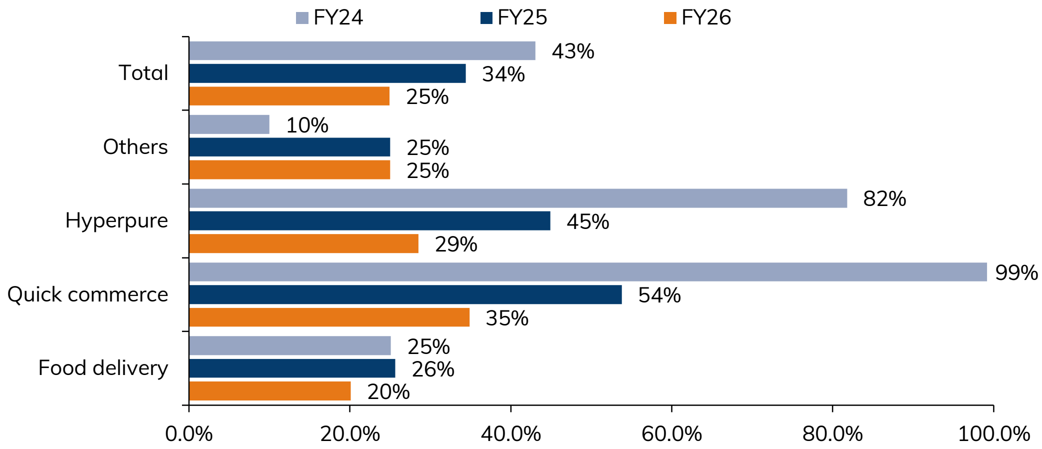


Source: I-Sec research, Bloomberg

Our numbers - Medium term outlook

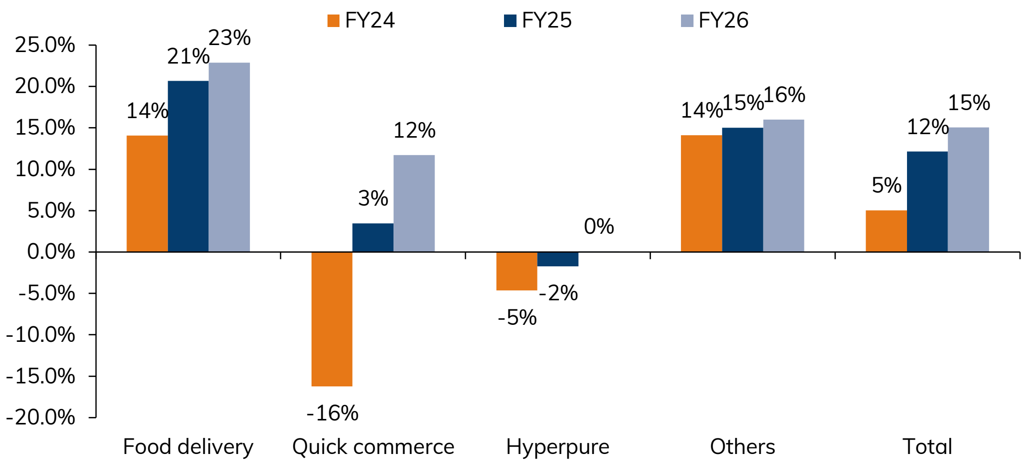
We have priced in revenue growth of 25%/26%/20% in food delivery business and 43%/34%/25% overall over FY24E-26E. Also, we have priced in adj. EBITDA margins (as a % of reported revenue) of 14%/21%/23% in food delivery and 5%/12%/15% overall over FY24E-26E.

Exhibit 11: Estimated adj. EBITDA margins



Source: I-Sec research

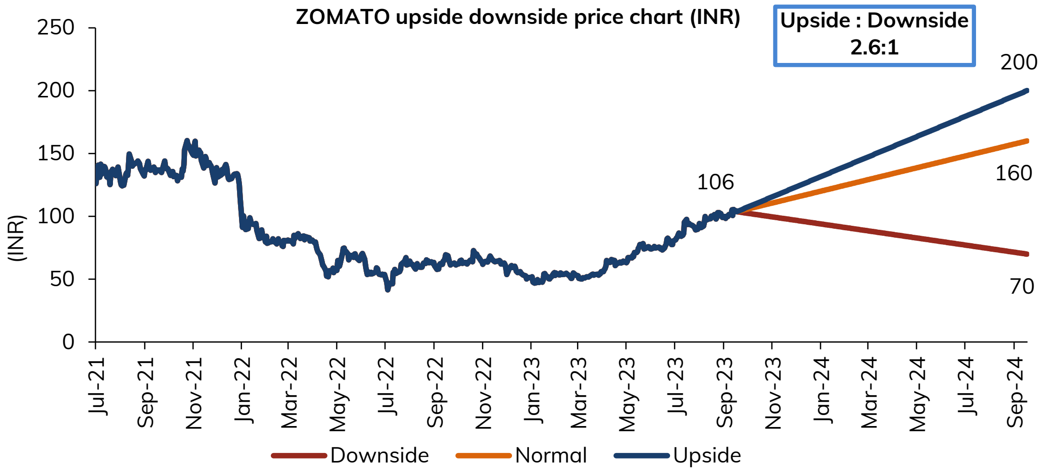
Exhibit 12: Estimated adj. EBITDA margins



Source: I-Sec research

Risk Reward Skew (2.6:1) to the upside

Exhibit 13: Zomato: Risk reward skew



Source: I-Sec research

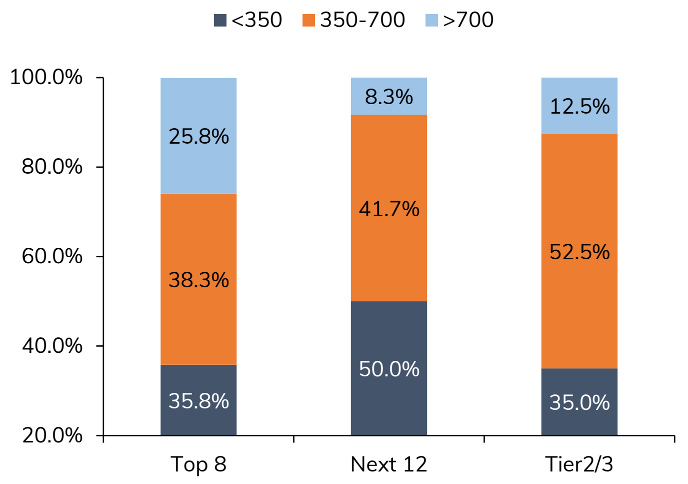
Bull case (INR200): The bull case prices in 30% YoY GOV growth in FY24E and adj. EBITDA (% of GOV) improvement of 350bps in FY24E over FY23. This case also prices in adj. EBITDA profitability in quick commerce achievement in Q4FY24E. Resultant overall revenue growth of 48% YoY in FY24E with an adj. EBITDA margin (% of reported revenue) of 5.5% in FY24E. In this case we think the stock could trade at INR200, implying a 1 year forward EV/EBITDA multiple of **46x** and P/E multiple of **70x**.

Base case (INR160): The base case prices in 19.3% YoY GOV growth in FY24E and adj. EBITDA (% of GOV) improvement of 290bps in FY24E over FY23. This case also prices in adj. EBITDA profitability in quick commerce achievement in Q1FY25E. Resultant overall revenue growth of 43% YoY in FY24E with an adj. EBITDA margin (% of reported revenue) of 5% in FY24E. In this case we value the stock at a PT of INR160, implying a 1 year forward EV/EBITDA multiple of **42x** and P/E multiple of **63x**.

Bear case (INR70): The bear case prices in 10% YoY GOV growth in FY24E and adj. EBITDA (% of GOV) improvement of 130bps in FY24E over FY23. This case also prices in adj. EBITDA profitability in quick commerce achievement beyond Q2FY24E. Resultant overall revenue growth of 35% YoY in FY24E with an adj. EBITDA margin (% of reported revenue) of 0.5% in FY24E. In this case we think the stock could trade at INR70.

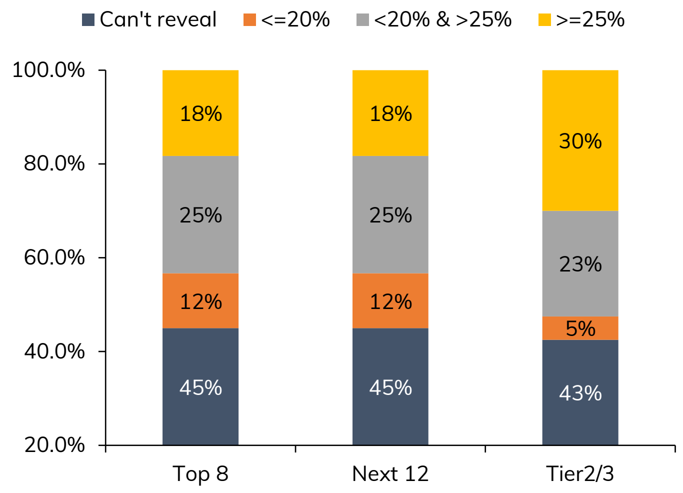
Appendix: Key charts from our survey (link)

Exhibit 14: Spread of ticket size across tier



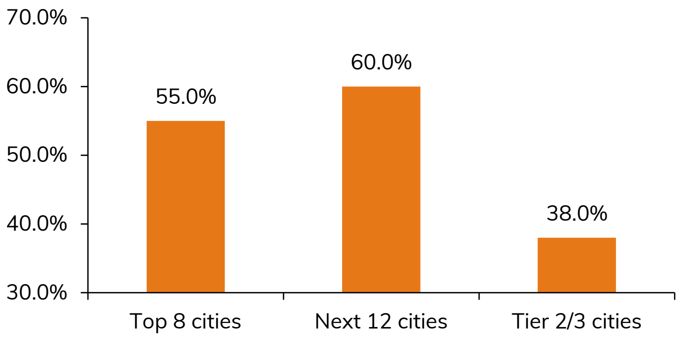
Source: I-Sec research, Ticket size is in INR and applicable for 2

Exhibit 15: Spread of take rates across tier



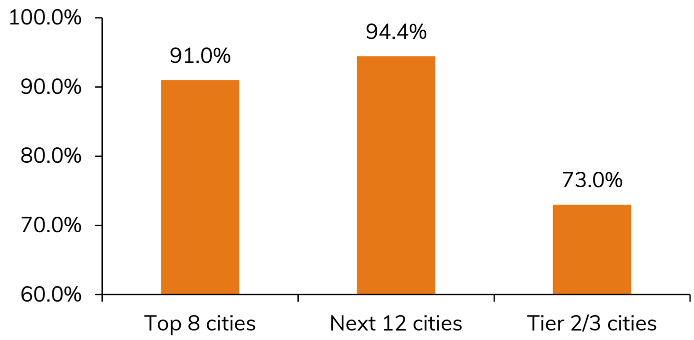
Source: I-Sec research

Exhibit 16: 'Next 12' cities have the highest proportion of advertisers, followed by 'Top 8' cities



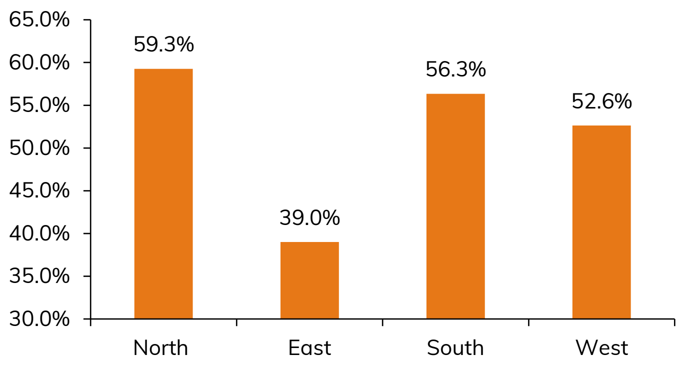
Source: I-Sec research

Exhibit 17: Advertiser satisfaction is highest in 'Next 12' cities, followed by 'Top 8' cities



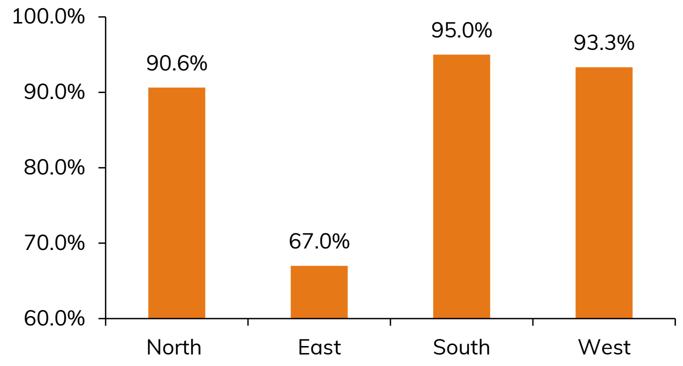
Source: I-Sec research

Exhibit 18: Northern region has the highest proportion of advertisers, East lags



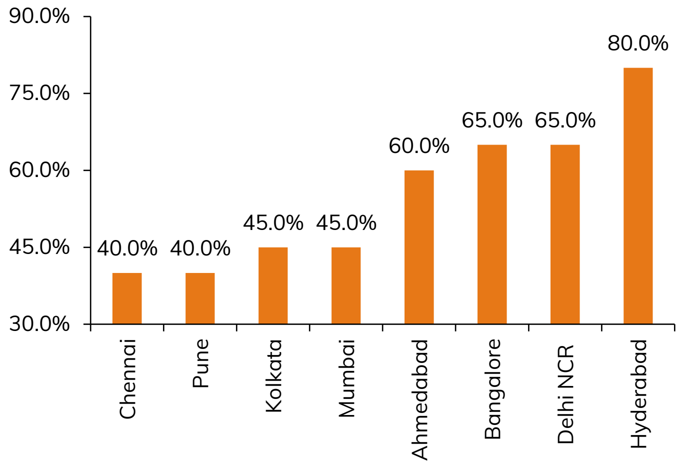
Source: I-Sec research

Exhibit 19: Advertiser satisfaction is highest in South, followed closely by West and North



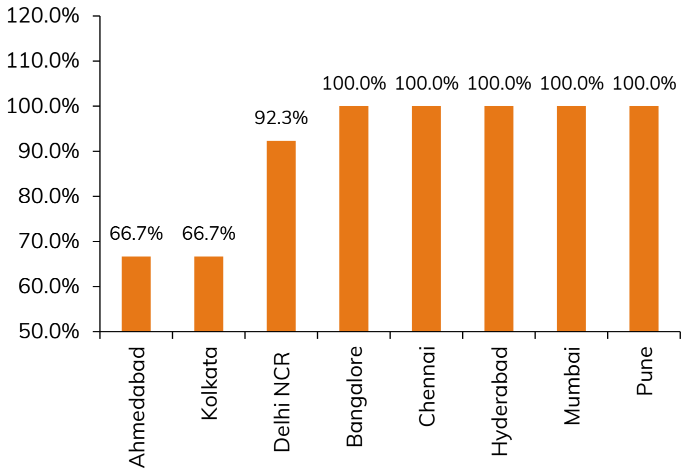
Source: I-Sec research

Exhibit 20: Hyderabad has healthy lead in proportion of advertisers, followed by Delhi-NCR and Bangalore



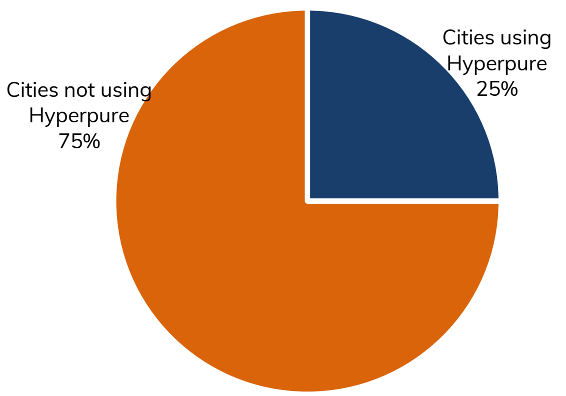
Source: I-Sec research

Exhibit 21: Advertiser satisfaction is at 100% in 5 top cities



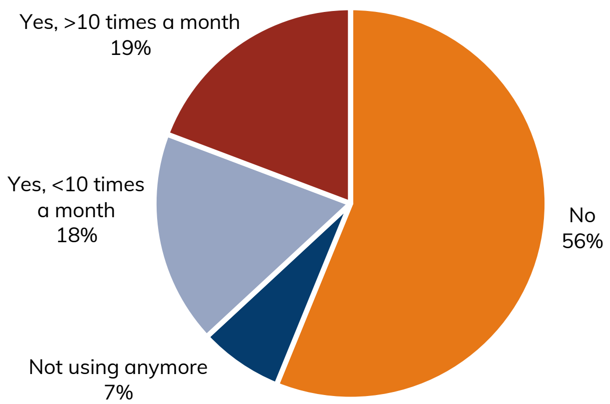
Source: I-Sec research

Exhibit 22: 25% of cities surveyed use Hyperpure



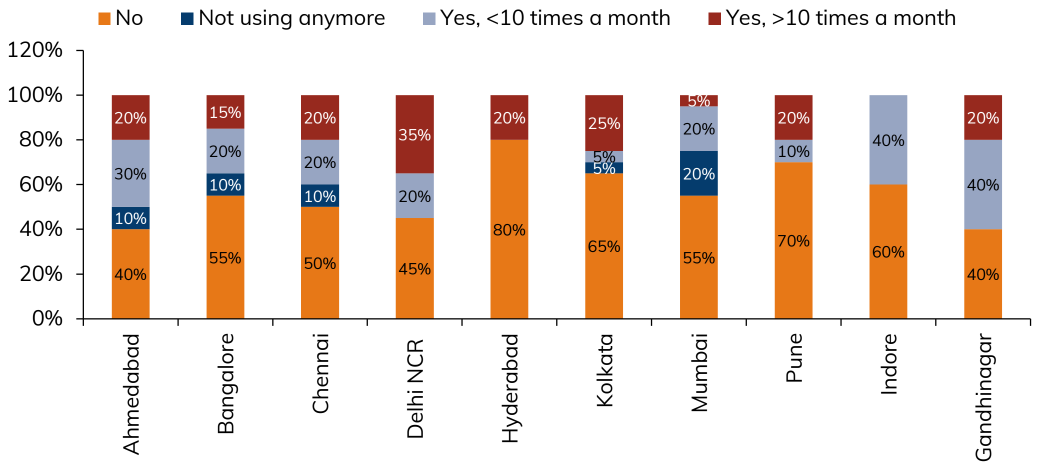
Source: I-Sec research

Exhibit 23: 37% of respondents in relevant cities are using Hyperpure and 7% claimed to have stopped using



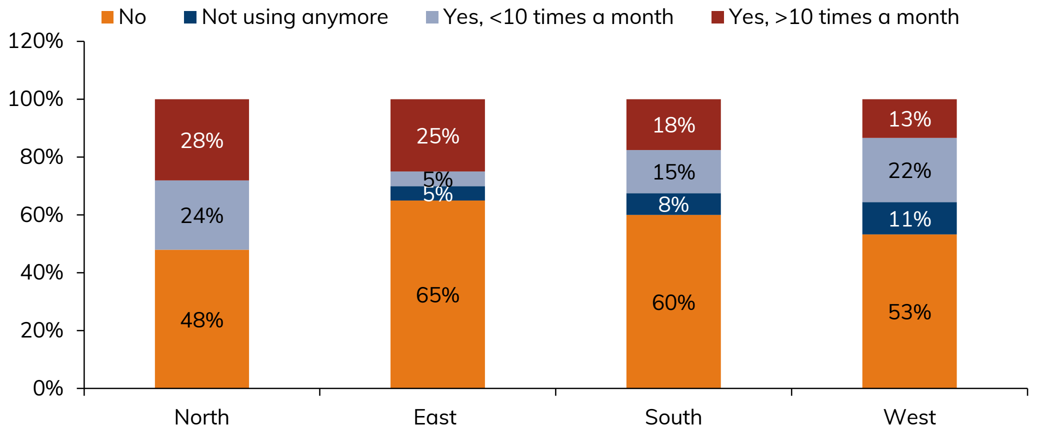
Source: I-Sec research

Exhibit 24: Delhi-NCR ,Gandhinagar and Ahmedabad are amongst heaviest users of Hyperpure



Source: I-Sec research

Exhibit 25: 28% of restaurants in relevant cities in North and 25% in East are using Hyperpure more than 10 times a month



Source: I-Sec research

Exhibit 26: Shareholding pattern

%	Dec'22	Mar'23	Jun'23
Promoters	0.0	0.0	0.0
Institutional investors	63.5	62.7	64.4
MFs and others	5.6	6.4	8.3
FIs/Banks	0.1	0.1	0.1
Insurance	1.1	0.8	0.8
FIIs	31.7	31.6	34.1
FDI	25.0	23.0	21.1
Others	36.5	37.3	35.6

Source: Bloomberg

Exhibit 27: Price chart

Source: Bloomberg

Financial Summary

Exhibit 28: Profit & Loss

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Net Sales	**41,924**	**70,794**	**1,22,018**	**1,60,486**
Operating Expenses	55,186	68,945	94,048	1,07,331
EBITDA	**(9,729)**	**(7,045)**	**6,472**	**20,910**
EBITDA Margin (%)	(23.2)	(10.0)	5.3	13.0
Depreciation & Amortization	1,503	4,369	4,637	4,815
EBIT	(20,011)	(16,472)	(2,523)	8,690
Interest expenditure	120	487	610	802
Other Non-operating Income	4,949	6,815	7,440	8,121
Recurring PBT	**(15,182)**	**(10,144)**	**4,307**	**16,008**
Profit / (Loss) from Associates	-	-	-	-
Less: Taxes	20	(436)	-	5,023
PAT	(15,202)	(9,708)	4,307	10,986
Less: Minority Interest	141	(6)	-	-
Extraordinaries (Net)	-	-	-	-
Net Income (Reported)	**(12,228)**	**(9,707)**	**4,307**	**10,986**
Net Income (Adjusted)	**(12,087)**	**(9,713)**	**4,307**	**10,986**

Source Company data, I-Sec research

Exhibit 29: Balance sheet

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Total Current Assets	18,312	18,452	37,017	62,330
of which cash & cash eqv.	15,755	10,168	26,988	49,139
Total Current Liabilities & Provisions	6,922	12,910	22,819	29,038
Net Current Assets	**11,390**	**5,542**	**14,197**	**33,292**
Investments	16,764	46,952	49,802	52,720
Net Fixed Assets	-	-	-	-
ROU Assets	-	-	-	-
Capital Work-in-Progress	-	-	-	-
Total Intangible Assets	-	-	-	-
Other assets	1,38,194	1,50,583	1,47,655	1,45,087
Deferred Tax assests	-	-	-	-
Total Assets	**1,66,348**	**2,03,077**	**2,11,654**	**2,31,099**
Liabilities				
Borrowings	**-**	**404**	**404**	**404**
Deferred Tax Liability	**-**	**-**	**-**	**-**
provisions	653	936	1,671	2,198
other Liabilities	3	2,543	1,719	2,246
Equity Share Capital	1,65,055	1,94,598	1,99,939	2,15,007
Reserves & Surplus	-	-	-	-
Total Net Worth	**1,65,055**	**1,94,598**	**1,99,939**	**2,15,007**
Minority Interest	(66)	(66)	3,258	6,582
Total Liabilities	**1,66,348**	**2,03,077**	**2,11,654**	**2,31,099**

Source Company data, I-Sec research

Exhibit 30: Quarterly trend

(INR mn, year ending March)

	Sep-22	Dec-22	Mar-23	Jun-23
Net Sales	16.613	19.482	20,560	24,160
% growth (YOY)	62.2	75.2	69.7	70.9
EBITDA	(3,114)	(3,662)	(2,254)	(480)
Margin %	(18.7)	(18.8)	(11.0)	(2.0)
Other Income	1,695	1,734	1,705	1,810
Net Profit	(2,508)	(3,466)	(2,044)	20

Source Company data, I-Sec research

Exhibit 31: Cashflow statement

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Operating Cashflow	**(6,930)**	**(8,440)**	**11,698**	**17,080**
Working Capital Changes	2,483	(1,759)	5,226	1,192
Capital Commitments	(572)	(1,014)	(1,708)	(2,247)
Free Cashflow	**(7,502)**	**(9,454)**	**9,990**	**14,833**
Other investing cashflow	**(78,806)**	**6,694**	**7,440**	**8,121**
Cashflow from Investing Activities	(79,378)	5,680	5,732	5,874
Issue of Share Capital	90,000	40	0	-
Interest Cost	-	-	-	-
Inc (Dec) in Borrowings	-	-	-	-
Dividend paid	-	-	-	-
Others	(2,502)	(1,314)	(610)	(802)
Cash flow from Financing Activities	87,498	(1,274)	(610)	(802)
Chg. in Cash & Bank balance	**1,190**	**(4,034)**	**16,820**	**22,152**
Closing cash & balance	3,923	3,288	19,001	41,153

Source Company data, I-Sec research

Exhibit 32: Key ratios

(Year ending March)

	FY22A	FY23A	FY24E	FY25E
Per Share Data (INR)				
Reported EPS	(1.7)	(1.2)	0.7	1.9
Adjusted EPS (Diluted)	(0.6)	(0.8)	1.9	0.7
Cash EPS	(1.5)	(0.7)	1.1	2.0
Dividend per share (DPS)	-	-	-	-
Book Value per share (BV)	22.8	24.0	24.7	26.6
Dividend Payout (%)	-	-	-	-
Growth (%)				
Net Sales	110.3	68.9	72.4	31.5
EBITDA	199.3	(27.6)	(191.9)	223.1
EPS (INR)	-	-	-	182.1
Valuation Ratios (x)				
P/E	(63.5)	(88.4)	160.7	57.0
P/CEPS	(72.5)	(160.6)	96.0	54.3
P/BV	4.7	4.4	4.3	4.0
EV / EBITDA	(75.6)	(113.8)	120.8	36.2
P / Sales	18.3	12.1	7.0	5.3
Dividend Yield (%)	-	-	-	-
Operating Ratios				
Gross Profit Margins (%)	87.5	80.3	79.7	77.8
EBITDA Margins (%)	(23.2)	(10.0)	5.3	13.0
Effective Tax Rate (%)	(0.1)	4.3	-	31.4
Net Profit Margins (%)	(36.3)	(13.7)	3.5	6.8
NWC / Total Assets (%)	-	-	-	-
Net Debt / Equity (x)	1.0	1.0	1.0	1.0
Net Debt / EBITDA (x)	3.3	8.1	(11.8)	(4.9)
Profitability Ratios				
RoCE (%)	(0.2)	(0.1)	0.0	0.0
RoE (%)	(9.8)	(5.4)	2.2	5.2
RoIC (%)	(12.3)	(5.1)	2.5	5.4
Fixed Asset Turnover (x)	0.5	1.1	0.6	0.4
Inventory Turnover Days	3	4	11	15
Receivables Days	14	24	20	20
Payables Days	37	35	38	38

Source Company data, I-Sec research

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