



THE ZOMATO IPO: A BET ON BIG MARKETS & PLATFORMS

Valuation First Principles

A much-watched IPO

- ❑ Zomato, an Indian online food-delivery company, started trading on the Sensex on July 14, 2021, and its market debut is being watched for clues by a number of other online ventures in India, waiting in the wings to go public.
 - ❑ The primary attraction, to investors, of the company comes not from its current standing (modest revenues and big losses), but from its capacity to take advantage of the potential growth in the Indian food delivery market.
 - ❑ In this post, I will value Zomato, and rather than just make a value judgment (which I will), I will also tie the value per share to macro expectations about the overall market.
- ❑ I will argue that a bet on Zomato is as much a bet on the company's business model, as it is a bet on Indian consumers not only acquiring more buying power and digital access, but also changing their eating behavior.

Setting the Stage: Zomato's history

- ❑ Zomato was founded in 2008 by Deepinder Goel and Pankaj Chaddah, as Foodiebay, in response to the difficulties that they noticed the difficulties that their office mates were having in downloading menus for restaurants, that they wanted to order food from.
- ❑ Their initial response was a simple one, where they uploaded soft copies of menus of local restaurants, in Delhi, on to their website, initially for people in their office, and then to everyone in the city.
- ❑ As the popularity grew, they expanded to other large Indian cities, and in 2010, they renamed the company "Zomato", with the tagline of "never have a bad meal".

And Business Model

- Transaction Fees: The bulk of Zomato's revenues come from the transactions on its platform, from food ordering and delivery, as the company keeps a percentage of the total order value for itself. While Zomato's revenue slice varies across restaurants, decreasing with restaurant profile and reach, it remains about 20-25% of gross order value.
- Advertising: Restaurants that list on Zomato have to pay a fixed fee to get listed, but they can also spend more on advertising, based upon customer visits and resetting revenues, to get additional visibility.
- Subscriptions to Zomato Gold (Pro): Zomato also offers a subscription service, and subscribers to Zomato Gold ([now Zomato Pro](#)) get discounts on food and faster deliveries. The service was initiated in 2017 and it had 1.5 million plus members in 2021, delivering subscription revenues of 600 million rupees (a little less than \$ 10 million, and less than 5% of overall revenues) in 2021.
- Restaurant Raw Material: In 2018, Zomato introduced HyperPure, a service directed at restaurants, offering groceries and meats that are source-checked for quality.

Cash Burn? VC Investors

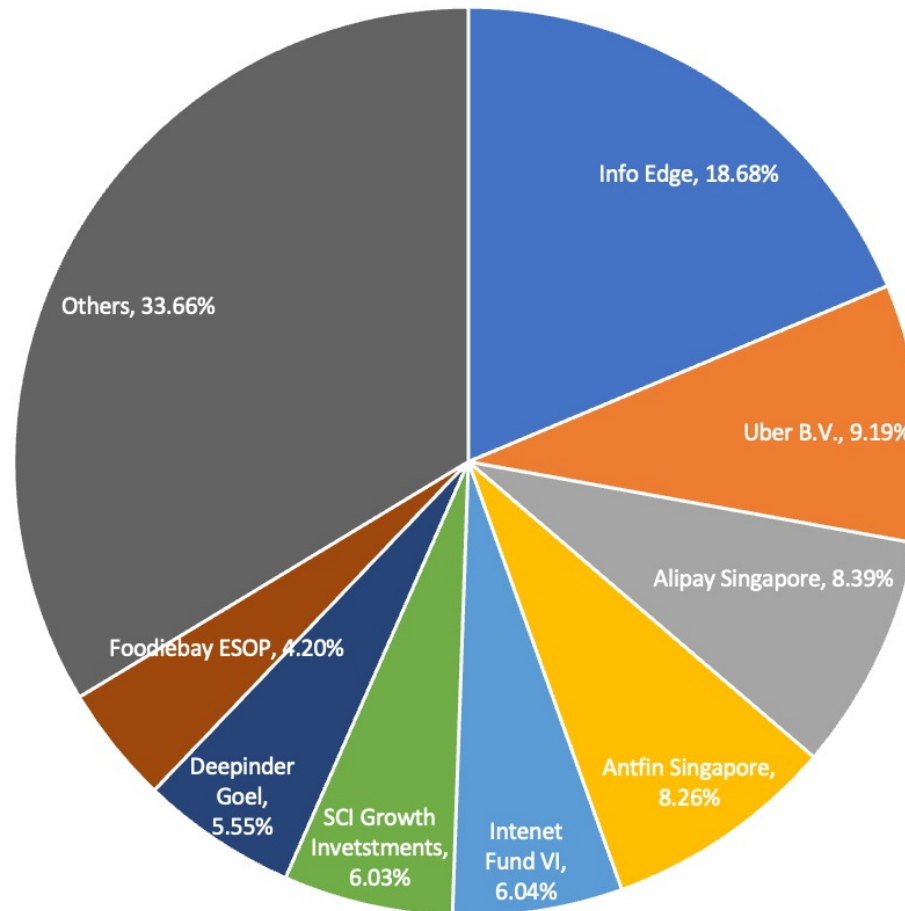
<i>Date</i>	<i>Stage</i>	<i>Investment (in millions of)</i>		<i>Investor</i>
		<i>In INR</i>	<i>In US \$</i>	
Sep-11	Series A	₹ 160	\$3.5	Info Edge
Sep-12	Series B	₹ 125	\$2.3	Info Edge
Feb-13	Series C	₹ 543	\$10.0	Info Edge
Nov-13	Series D	₹ 2,311	\$37.0	Info Edge, Sequoia Capital
Nov-14	Series E	₹ 3,703	\$60.0	Info Edge, Vy Capital
Apr-15	Series F	₹ 3,127	\$50.0	Info Edge, Vy Capital
Sep-15	Series G	₹ 3,970	\$60.0	Temasek Holdings, Vy Capital
Apr-17	Series H	₹ 1,293	\$20.0	Sequoia Capital India
Feb-18	Series I	₹ 12,826	\$200.0	Ant Financial
Oct-18	Series J	₹ 15,422	\$210.0	Ant Financial
Feb-19	Series J	₹ 2,501	\$35.0	Glade Brook Capital Partners
Mar-19	Corporate Round	₹ 3,850	\$55.0	Delivery Hero
Jan-20	Corporate Round	₹ 10,644	\$150.0	Ant Financial
Apr-20	Series J	₹ 381	\$5.0	Baillie Gifford
Sep-20	Series J	₹ 12,198	\$166.0	Tiger Global
Oct-20	Series J	₹ 3,839	\$52.0	Kora
Dec-20	Series J	₹ 48,708	\$660.0	Kora, Tiger Global Management
Feb-21	Venture Round	₹ 18,148	\$250.0	Kora, Tiger Global, Fidelity
Total funds raised		₹ 143,748	\$2,026	

Acquisition-driven Growth

<i>Company Acquired</i>	<i>Date</i>	<i>Price (in millions INR)</i>	<i>In US \$ millions</i>
MenuMania	Jul-14	Undisclosed	Undisclosed
Obedovat	Aug-14	Undisclosed	Undisclosed
Lunchtime	Aug-14	Undisclosed	Undisclosed
gastronauti.pl	Sep-14	Undisclosed	Undisclosed
Cibando	Dec-14	Undisclosed	Undisclosed
Urbanspoon	Jan-15	₹ 3,500	\$52
Mekanist	Jan-15	Undisclosed	Undisclosed
MapleGraph Solutions	Apr-15	Undisclosed	Undisclosed
Nextable	Apr-15	Undisclosed	Undisclosed
Sparse Labs	Sep-16	Undisclosed	Undisclosed
Runnr	Sep-17	₹ 1,300	\$20
Tonguestun Food Network	Sep-18	₹ 1,230	\$18
TechEagle	Dec-18	Undisclosed	Undisclosed
Uber Eats India	Jan-20	₹ 15,250	\$206
FITSO	Jan-21	₹ 1,000	₹ 13

Zomato's Shareholder Base (Pre-IPO)

Zomato: Equity Ownership prior to IPO



The Food Delivery Market

	<i>India</i>	<i>China</i>	<i>United States</i>	<i>EU</i>
<i>General</i>				
GDP in 2020 (in trillions of US \$)	\$ 2.71	\$ 14.70	\$ 20.93	\$ 15.17
Population (millions)	1360	1430	330	445
Per Capital GDP	\$ 1,993	\$ 10,280	\$ 63,424	\$ 34,090
Number of restaurants (in 000s)	1000	9000	660	890
<i>Food Delivery</i>				
Online Access (percent)	43%	63%	88%	90%
Online Food Delivery Users (millions)	50.00	450.00	105.00	150.00
Online Food Delivery Market (\$ million) in 2019	\$ 4,200	\$ 90,000	\$ 21,000	\$ 15,000
Online Food Delivery Market (\$ million) in 2020	\$ 2,900	\$ 110,000	\$ 49,000	\$ 13,800

Difference Drivers

- Lower per-capita income: Eating out and prosperity don't always go hand in hand, but you are more likely to eat out, as your discretionary income rises. Thus, it should come as no surprise that the number of restaurants increases with per capita GDP, and that one reason for the paucity of restaurants (and food delivery) in India is its low GDP, less than a fifth of per capital GDP in China and a fraction of per capital GDP in the US & EU.
- Less digital reach: To use online restaurant services, you first need to be online, and digital reach in India, in spite of advances in recent years, lags digital reach in China, and is about half the reach in the US and the EU.
- Eating habits: Looking across the regions, it seems clear that there is a third factor at play, a pre-disposition to eat out in the populace. Looking at the number of restaurants in China and the size of its food delivery market, it is quite clear that Chinese consumers are far more willing to eat out (either in person at or with delivery from restaurants) than people living in the US and EU, especially if you control for per capita income differences.

Indian Market Size, adjusted for income and digital reach...

	<i>Indian Per Capita GDP as % of China Per Capita GDP</i>			
	25%	50%	75%	100%
Current Internet access	\$5,417	\$10,834	\$16,250	\$21,667
China-level Internet access	\$7,936	\$15,872	\$23,809	\$31,745
US-level Internet access	\$11,085	\$22,171	\$33,256	\$44,342

Zomato: The Prospectus

- Definitions and abbreviations: The prospectus starts, and I wonder whether this is by design, with 17 pages of abbreviations of terms, some of which are obvious and need no definition (board of directors, shareholders), some of which are meaningless even when expanded (19 classes of preferred shares, all of which will be replaced with common shares after the IP) and some of which are just corporate names.
- Risk Profile: If you did not believe my assertions about the pointlessness of risk sections in IPOs, please do read all 30 pages of Zomato's risk profile (pages 39-68 of the prospectus). The company lists 69 different risks investors may face from investing in the company, and after you have read them all, I dare you to list three on that list that you would remember.
- Subsidiary/Holdings Mess: I find it mind boggling that a company that is only thirteen years old has managed to accumulate as many subsidiaries, both in India and overseas, as Zomato has done. Since Zomato owns 100% of most of these subsidiaries, there may be legal or tax reasons for this structure, but there is no denying that it adds complexity (and pages) to the prospectus, with no real information benefits.

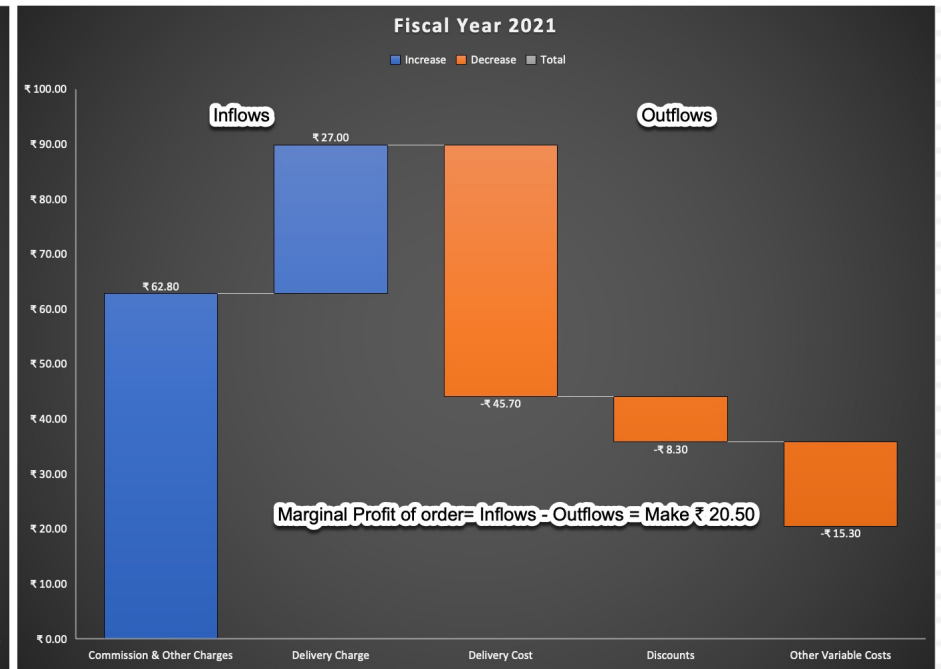
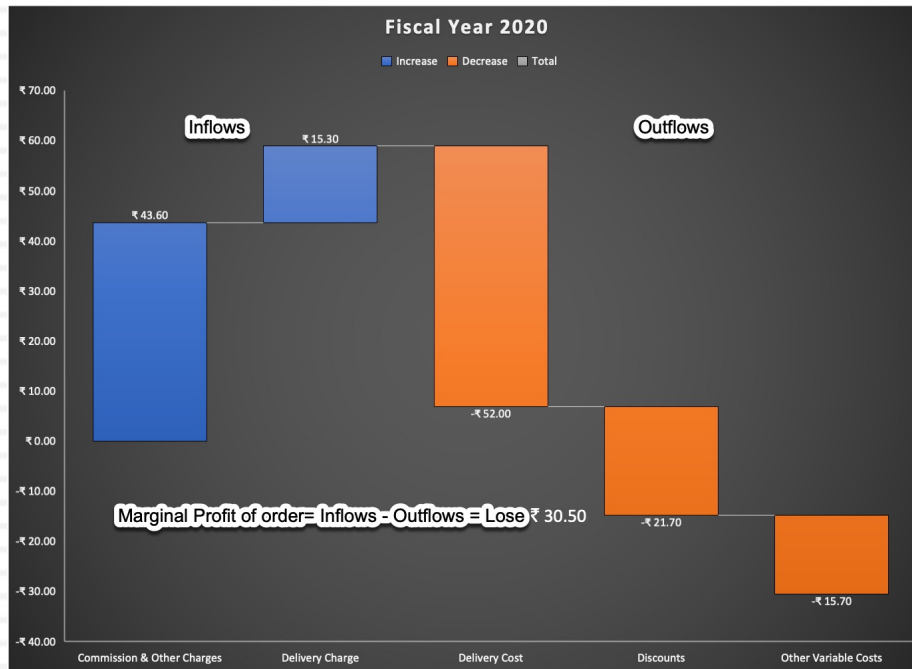
Growth & Profitability Trends

<i>Fiscal Year ended</i>	<i>3/31/18</i>	<i>3/31/19</i>	<i>3/31/20</i>	<i>3/31/21</i>
Gross Order Value	₹ 19,154.25	₹ 53,870.10	₹ 112,209.00	₹ 94,828.70
Total Revenue	₹ 4,660.23	₹ 13,125.86	₹ 26,047.37	₹ 19,937.89
Cost Of Goods Sold	₹ 2,963.53	₹ 6,269.94	₹ 9,229.39	₹ 9,455.04
Gross Profit	₹ 1,696.70	₹ 6,855.92	₹ 16,817.98	₹ 10,482.85
Selling General & Admin Exp.	₹ 944.06	₹ 12,629.44	₹ 13,771.49	₹ 5,823.91
Provision for Bad Debts	₹ 18.31	₹ 29.47	₹ 124.95	₹ 88.42
R & D Exp.	-	-	-	-
Depreciation & Amort.	₹ 291.47	₹ 431.15	₹ 842.36	₹ 431.99
Other Operating Expense/(Income)	₹ 1,641.21	₹ 16,630.87	₹ 25,966.51	₹ 8,941.29
Operating Income	-₹ 1,198.40	-₹ 22,865.00	-₹ 23,887.30	-₹ 4,802.76
Interest Expense	-₹ 52.80	-₹ 70.60	-₹ 110.20	-₹ 63.95
Interest and Invest. Income	₹ 73.10	₹ 133.46	₹ 264.90	₹ 223.75
Net Interest Exp.	₹ 20.32	₹ 62.84	₹ 154.66	-₹ 287.70
Currency Exchange Gains (Loss)	-₹ 16.90	-₹ 0.30	-₹ 0.90	₹ 24.83
Other Non-Operating Inc. (Exp.)	₹ 8.72	-₹ 10.70	₹ 266.44	₹ 289.94
EBT Excl. Unusual Items	-₹ 1,186.30	-₹ 22,813.20	-₹ 23,467.10	-₹ 4,328.19
Impairment of Goodwill	-	-	-₹ 962.70	₹ 0.00
Gain (Loss) On Sale Of Invest.	₹ 94.85	₹ 600.82	₹ 513.91	₹ 612.30
Gain (Loss) On Sale Of Assets	₹ 2.96	₹ 0.31	₹ 0.86	₹ 0.00
Asset Writedown	-₹ 0.10	-₹ 0.10	-₹ 155.20	₹ 0.00
Other Unusual Items	₹ 19.39	₹ 12,109.81	₹ 214.27	₹ 0.00
EBT Incl. Unusual Items	-₹ 1,069.20	-₹ 10,102.30	-₹ 23,856.00	-₹ 8,164.28
Income Tax Expense	-	-	-	-
Earnings from Cont. Ops.	-₹ 1,069.20	-₹ 10,102.30	-₹ 23,856.00	-₹ 8,164.28
Minority Int. in Earnings	₹ 32.39	₹ 452.86	₹ 184.43	₹ 36.12
Net Income	-₹ 1,036.80	-₹ 9,649.50	-₹ 23,671.60	-₹ 8,128.16

Quarterly Come back?

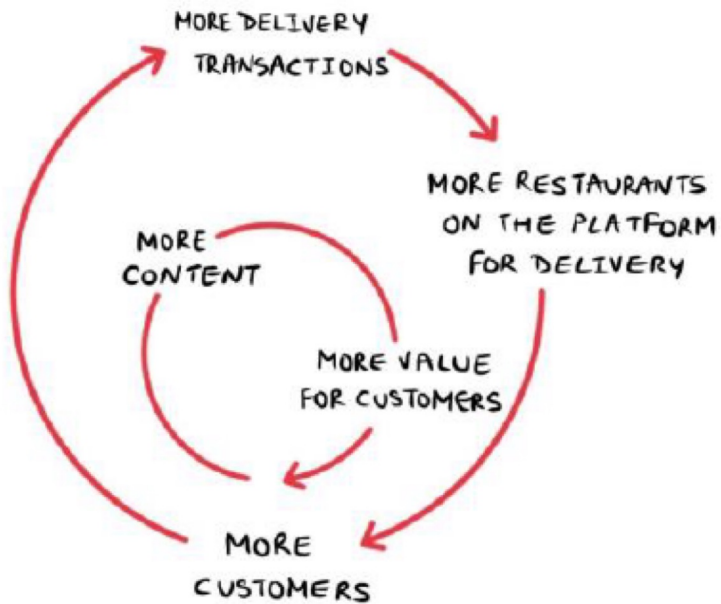
	<i>2020</i>	<i>2021</i>	<i>% Change</i>
Q1	₹ 25,333.00	₹ 10,936.00	-56.83%
Q2	₹ 32,174.00	₹ 20,952.00	-34.88%
Q3	₹ 27,853.00	₹ 29,810.00	7.03%
Q4	₹ 26,849.00	₹ 33,130.00	23.39%

Unit Economics

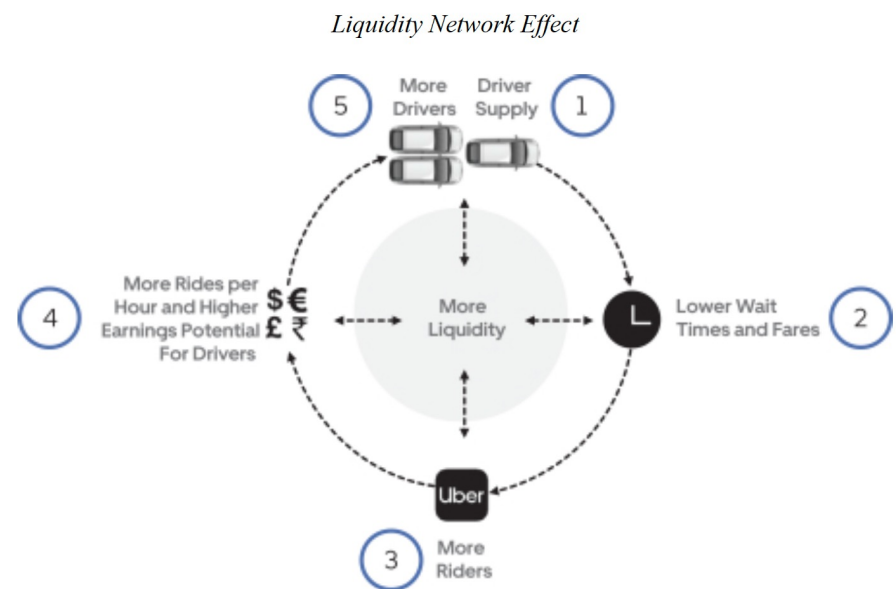


Competitive Advantages

The Zomato Network Effect (Zomato Prospectus 2021)







The Uber Network Effect (Uber Prospectus 2019)

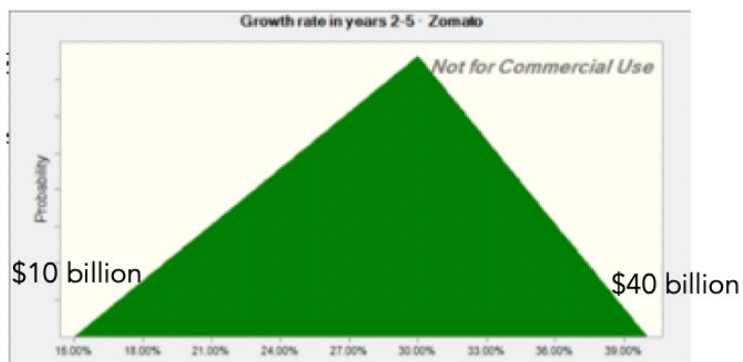


Zomato: Story Pieces

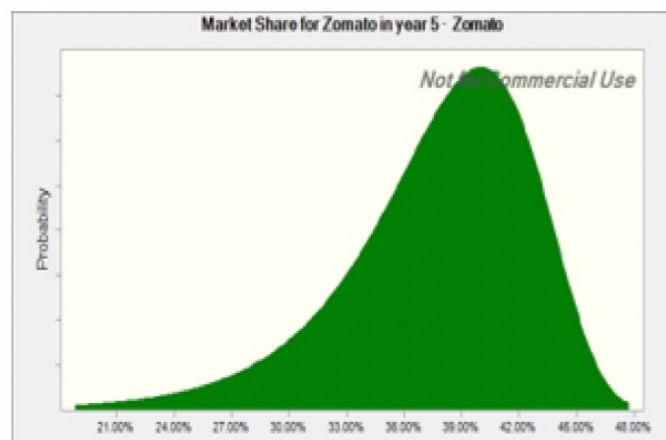
- Total Market: I find it hard to see the *total market exceeding \$40 billion, with US \$20-\$30 billion, in ten years*, being a more likely outcome. (In rupee terms, this will translate into a market that is roughly 1800-2000 billion INR.)
- Market Share: Expecting any company to have a *market share that exceeds 40%* of this market is a reach, and I will assume that Zomato will be one of the winners/survivors
- Revenue Share: That number was 23.13% in FY 2020, but dropped to 21.03% in FY 2021, as shut downs put a crimp on business. I will assume a *partial bounce back to 22% of GOV*, starting in 2022, but the presence of Amazon Food will prevent a return to higher values in the future.
- Profitability: I will assume that *pre-tax operating margins will trend towards 30%*, largely because I believe that the market will be dominated by a few big players, but with the very real possibility that one rogue player that is unwilling to play the game can upend profitability.
- Reinvestment: One of the advantages of being an intermediary business is that you can grow with relatively little capital investment, defined in conventional form (as plant, equipment or manufacturing facilities). That said, reinvestment takes a different form for online intermediaries, like Zomato, with investments in technology and in acquisitions, driving future growth.
- Risk: In terms of operating risk, the company, in spite of its global ambitions, is still primarily an Indian company, dependent on Indian macroeconomic growth to succeed, and my rupee cost of capital will incorporate the country risk. Zomato is a money losing company, but it is no start-up, facing imminent failure. On the plus side, its size and access to capital, as well as its post-IPO augmented cash balance, push down the risk of failure. Overall, I will attach a likelihood of failure of 10%, reflecting this balance.

Zomato					Jul-21	
The Story						
Zomato will benefit as the Indian food delivery market grows, driven by overall economic growth and more digital access, and it will be one of a few (two or three) players who will dominate the market; there will be a near term COVID bounceback effect. While Amazon Food remains the wild card, economies of scales will allow the company to generate high operating margins, and the company will continue to reinvest (acquisitions and technology) as it grows. The risk of failure is low, given the company's post-IPO cash balance and access to capital and its operating risk reflects its exposure to Indian country risk.						
The Assumptions						
	Base year	Next year	Years 2-5	Years 6-10	After year 10	Link to story
Indian Food Delivery	₹ 225,000	₹ 337,500	30.00%	15.27%	₹ 1,961,979	Indian food market rebounds in 2021 and growsto about \$25 billion in year 10
Market Share	42.15%	41.72%			40.00%	Zomato is one of two or three lead players in Indian food delivery market
Revenues as % of GOV	21.03%	22.00%			22.00%	
Revenues (a)	₹ 19,937.89	₹ 30,975	Total Market * Market Share* Revenue as % of GOV		₹ 172,654	COVID rebound in 2021 + Growth in food delivery market in India long term
Operating margin (b)	-24.10%	-10.0%	-10.00%	 35.00%	35.00%	Margins improve as growth wanes
Tax rate	30.00%		30.00%	 30.00%	30.00%	Indian corporate tax rate over time
Reinvestment (c)		5.00	2.50	3.00	35.42%	Acquisitions & technology investments needed to sustain growth
Return on capital	-7.15%	Marginal ROIC =	127.01%		12.00%	Newworking benefits allow for high ROIC, near and long term.
Cost of capital (d)			10.25%	 8.97%	8.97%	Cost of capital reflects Indian country risk
The Cash Flows						
	Total Market	Market Share	Revenues	EBIT (1-t)	Reinvestment	FCFF
1	₹ 337,500	41.72%	₹ 30,974.78	-₹ 3,097.48	₹ 2,207.38	-₹ 5,304.86
2	₹ 438,750	41.29%	₹ 39,852.91	₹ 498.16	₹ 3,551.25	-₹ 3,053.09
3	₹ 570,375	40.86%	₹ 51,270.19	₹ 3,247.17	₹ 4,566.91	-₹ 1,319.74
4	₹ 741,488	40.43%	₹ 65,951.07	₹ 5,770.72	₹ 5,872.35	-₹ 101.64
5	₹ 963,934	40.00%	₹ 84,826.17	₹ 10,762.32	₹ 6,291.70	₹ 4,470.62
6	₹ 1,203,471	40.00%	₹ 105,905.47	₹ 14,994.01	₹ 7,026.43	₹ 7,967.57
7	₹ 1,440,555	40.00%	₹ 126,768.85	₹ 24,503.10	₹ 6,954.46	₹ 17,548.64
8	₹ 1,650,156	40.00%	₹ 145,213.72	₹ 35,577.36	₹ 6,148.29	₹ 29,429.07
9	₹ 1,805,271	40.00%	₹ 158,863.81	₹ 38,921.63	₹ 4,550.03	₹ 34,371.60
10	₹ 1,881,995	40.00%	₹ 165,615.52	₹ 40,575.80	₹ 2,250.57	₹ 38,325.23
Terminal year	₹ 1,961,979	40.00%	₹ 172,654.18	₹ 42,300.27	₹ 14,981.35	₹ 27,318.93
The Value						
Terminal value	₹ 578,790.83					
PV(Terminal value)	₹ 225,869.40					
PV (CF over next 10 years)	₹ 50,979.90					
Value of operating assets =	₹ 276,849.30					
Adjustment for distress	₹ 13,842.46		Probability of failure =		10.00%	
- Debt & Minority Interests	₹ 1,591.72					
+ Cash & Other Non-operating assets	₹ 135,959.70		Includes cash proceeds from IPO of		₹ 90,000	
Value of equity	₹ 397,374.81					
- Value of equity options	₹ 73,244.53					
Number of shares	7,946.68					
Value per share	₹ 40.79		Stock was offered at = ₹ 70.00			

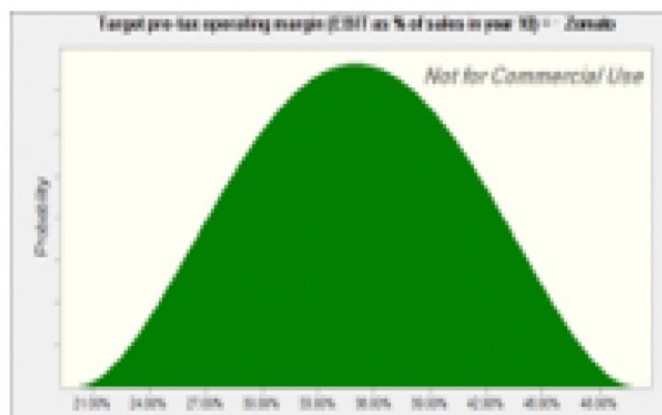
Growth in Indian Food Delivery Market



Zomato's Market Share

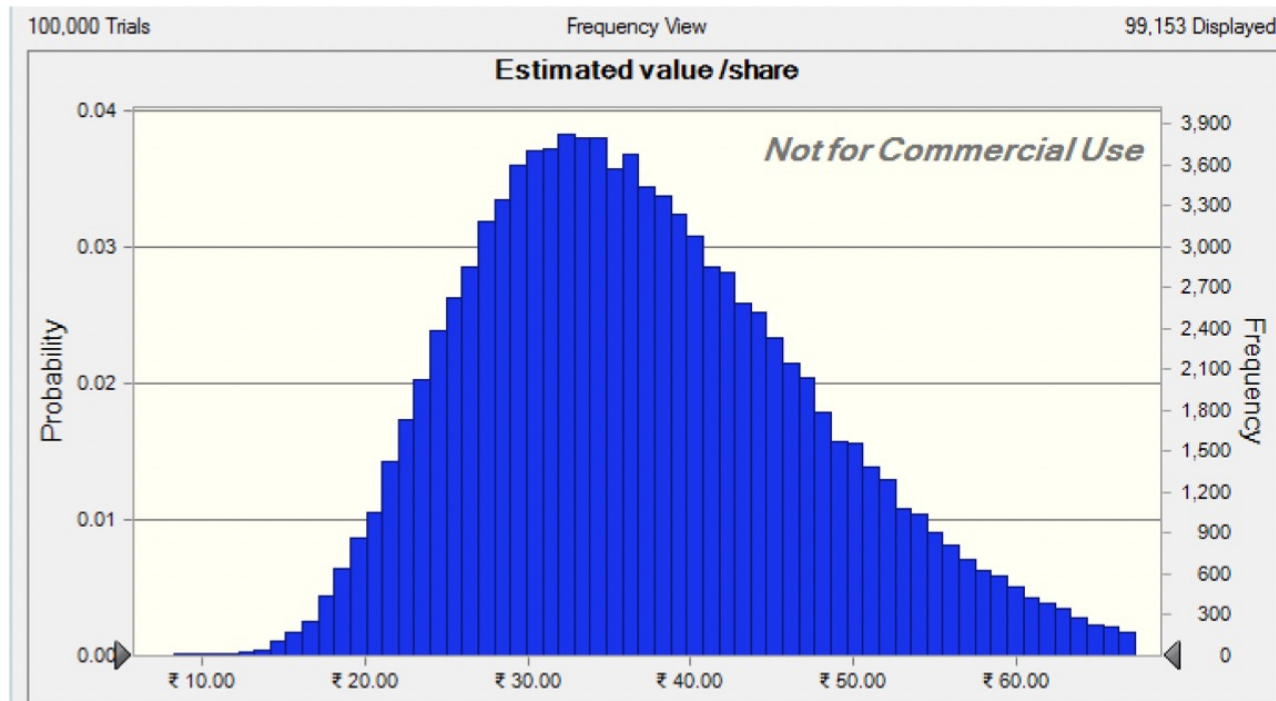


Zomato's Operating Margin (Pre-tax)



Correlation = 0.50

Zomato: Monte Carlo Simulation of Value/Share



Percentile	Value per share
0%	-₹ 0.22
10%	₹ 24.49
20%	₹ 27.96
30%	₹ 30.74
40%	₹ 33.35
50%	₹ 36.02
60%	₹ 28.86
70%	₹ 42.11
80%	₹ 46.07
90%	₹ 51.92
100%	₹ 91.69

Add-ons and Distractions: Platform Optionality

- As a company with millions of users on its platform, if Zomato can deliver other products and services to the users of the platform, it can augment its earnings and value.
 - First, not all platforms are created equal, in terms of being adding value, with platforms with more intense users and proprietary data having more value than platforms where users are transitory and there is little exclusive data being collected.
 - Second, even if you believe that there is optionality, attach a numerical value to that option is one of the most difficult tasks in investment. While there are option pricing models that can be adapted to do the valuation, getting the inputs for these models, especially before the optionality takes form, is difficult to do.

A Big Market Premium?

- Indian and Chinese companies, especially in young and nascent businesses, have an advantage that they often play to, which is immense local markets. It is not surprising that companies play up this advantage, when marketing themselves to investors, with some analysts attaching premiums to value, just because of market size.
 - Double counting: I believe that this is a distraction, because that market size should already be incorporated into the intrinsic value, through growth and margin expectations. In my base case valuation of Zomato, I assume that revenues will increase more than twenty-fold over the next 10 years, because the Indian market is expected to grow so strongly.
 - The Big Market Delusion: In fact, the danger to investors, when faced with Indian and Chinese companies, is not that they will under value these companies, but that they will over value them, precisely because the markets are so big.

A Pricing Story?

	<i>Doordash (2020)</i>	<i>Doordash (2030 Forecast)</i>	<i>Zomato (2020)</i>	<i>Zomato (2030 Forecast)</i>
Market Capitalization	\$57,860		\$8,600	
Enterprise Value	\$53,640		\$7,500	
Gross Bookings	\$18,897	\$72,072	\$1,264	\$10,038
Revenues	\$3,601	\$9,009	\$266	\$2,208
Gross Income	\$1,864	\$4,955	\$140	\$1,325
EBIT	-\$412	\$1,802	-\$64	\$773
Platform Users	20	50	40	200
	<i>Current</i>	<i>Forward</i>	<i>Current</i>	<i>Forward</i>
<i>EV/GOV</i>	2.84	0.74	5.93	0.75
<i>EV/Revenues</i>	14.90	5.95	28.20	3.40
<i>EV/ Gross Income</i>	28.78	10.83	53.57	5.66
<i>EV/ User</i>	2682.00	1072.80	187.50	37.50

It's a money loser!

- There are good arguments to be made against investing in Zomato at its proposed offering price, but one of the emptiest, and laziest, is that it is losing money.
 - I know that for some value investors, trained to believe that anything that trades at more than 10 or 15 times earnings or at well above book value, this argument suffices, but given how badly this argument has served them over the last two decades, they should revisit the argument.
 - The biggest reason that Zomato is losing money is because it is a young company that is trying to take advantage of a market with immense growth potential, not because it cannot make money.
- In fact, if Zomato cut back on customer acquisitions and platform investments, my guess is that it could show an accounting profit, but if it did so, it would be worth a fraction of what it is today.

Conclusion

- I believe that the first principles of valuation are the same in all markets, and I hope that I have stayed true to that belief in this post.
 - I valued Zomato, using the same process that I used to value Doordash, with the country-specific effects being incorporated into my growth and risk projections.
 - While I did take issue with some of the holes and over reach in Zomato's disclosures, I ran into the same challenges, when I valued Doordash.
- I believe that while Zomato is a money-losing, cash burning enterprise now, it has promise and is on track to delivering a viable business model. It will face plenty of challenges on that path, both at the micro level (management, competition) and at the macro level (economic and political developments in India).
- I believe that the company is overpriced, given its potential, but I would have no qualms about investing in the stock, if the price drops in the near future, with the full understanding that this is a joint wager on a company, a sector and a country.