



Capital Mix Analysis

zomato

Company Overview

Zomato Limited operates as an online food delivery company in India and internationally. The company operates through India Food Ordering and Delivery; Hyperpure Supplies; Quick Commerce Business; and other segments. Its technology platform connects customers, restaurant partners, and delivery partners. In June 2022, Zomato announced the acquisition of quick-commerce company Blinkit for US\$568 million. Zomato IPO bidding started on July 14, 2021 and ended on July 16, 2021. The allotment for Zomato IPO was finalized on Thursday, July 22, 2021. The shares were listed on BSE, and NSE on July 23, 2021. Zomato is currently (as of Nov 2023) unprofitable.

Reasons for Unprofitability:

- **Growth and Expansion Strategy:** Zomato's losses could be attributed to its aggressive growth and expansion strategies. The company might be investing heavily in acquiring new market segments, technology, or even other companies, like Blinkit, which can lead to short-term losses.
- **Market Penetration and Customer Acquisition:** Startups like Zomato often prioritize market penetration and customer acquisition over immediate profitability. This approach involves spending significantly on marketing, discounts, and technology development.
- **When COVID-19 just ended, people were still in their homes (Work from Home).** There was a peak in online food orders. But now people started to step out and eat outside again, the dine-in business has seen an increase. This suggests that the slowdown in the food delivery business may be partially due to changes in consumer behaviour and increased demand for dine-in options.

Data Collection

We are analyzing the data for the fiscal year 2022-2023, as per the [Annual Report](#) published on Zomato's [website](#). The Balance Sheet, Income Statement and Cash Flow Statement are attached with the pdf separately.

Capital Mix Analysis

Important Numbers (FY 22-23) (in million INR)

(Data from pages 139, 140, 141, 147 & 148)

Total Liabilities	21455		Total Assets	215987	
Shareholder Equity	8364		Intangible Assets	9905	
Loss before Tax (EBIT)	10146		Earning per share	1.2	
Market value of Share	121.85 INR (as of 16th Nov) (not in million)		Net Cash Generated from Operating Activities	8440	
Current Liabilities	14410		Current Assets	108310	
Debt	Current Borrowings	58	Net Loss (FY 22-23)	9710	
	Current Lease Liabilities	3508	Net loss (FY 21-22)	12225	
	Non-Current Borrowings	346	Interest Expense	Operating Activities	50
	Non-Current Lease Liabilities	1154		Financing Activities	93

Ratios

Debt to Equity Ratio	Considering only Debt	$5066/8364 = 0.605$	$\text{Debt to Equity Ratio (D/E)} = \frac{\text{Total Debt}}{\text{Total Shareholders Equity}}$
	Considering all Liabilities	$21455/8364 = 2.565$	
Debt Ratio	Considering only Debt	$5066/215987 = 0.023$	$\text{Debt Ratio}_{\text{Debt-to-Asset}} = \frac{\text{Total Debt}}{\text{Total Assets}}$
	Considering all Liabilities	$21455/8364 = 0.099$	
Equity Ratio	Considering all Assets	$8364/(215987 - 9905) = 0.041$	$\text{Equity Ratio} = \frac{\text{Shareholders' Equity}}{\text{Total Assets} - \text{Intangible Assets}}$
	Excluding Intangible Assets	$8364/215987 = 0.039$	
Interest Coverage Ratio	$-10146/(50 + 93) = -70.951$ (-ve because of loss)		$\text{Interest Coverage Ratio} = \frac{\text{EBIT}}{\text{Interest Expense}}$
Price to Earnings Ratio	$121.85/1.2 = 101.542$		$\text{P/E Ratio} = \frac{\text{Market Share Price}}{\text{Earnings Per Share (EPS)}}$
Cash Flow to Debt Ratio	Considering only Debt	$8440/5066 = 1.666$	$\text{Cash Flow to Debt} = \frac{\text{Cash Flow from Operations}}{\text{Total Debt}}$
	Considering all Liabilities	$8440/21455 = 0.393$	
Current Ratio	$108310/14410 = 7.516$		$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$

Return on Equity	$-9710/8364 = -1.16$ (-ve because of loss)		$\text{Return on Equity (ROE)} = \frac{\text{Net Income}}{\text{Average Total Equity}}$
Return on Assets	Considering all Assets	$-9710/215987 = -0.0449$	$\text{Return on Assets (ROA)} = \frac{\text{Net Income}}{\text{Average Total Assets}}$
	Excluding Intangible Assets	$-9710/(215987 - 9905) = -0.0471$	

Significance & Inference

1. **Debt-to-Equity Ratio** [1] [2]

- Significance
 - The higher the debt-to-equity ratio, the riskier the business.
 - Anything above 2 is considered very unstable and risky which means more than $\frac{2}{3}$ of the money used in the operations comes from debt. If a debt-to-equity ratio is negative, it means that the company has more liabilities than assets—this company would be considered extremely risky. A negative ratio is generally an indicator of bankruptcy.
 - A high debt-equity ratio can be good because it shows that a firm can easily service its debt obligations (through cash flow) and is using the leverage to increase equity returns.
 - The benchmarks for debt-to-equity ratios are different depending on the industry. The reason for this is that some industries generally use more debt to finance the company than others.
- **Zomato's POV**
 - A debt-to-equity ratio of 2.5 for Zomato suggests that the company has a relatively lower level of debt compared to its equity. In contrast, competitors with ratios of 8 and 9 indicate higher levels of debt in their capital structure.
 - For a startup like Zomato, a lower ratio can be justified as it indicates a conservative approach to financing, minimizing financial risk. This approach enhances investor confidence and allows greater flexibility without the constraints of heavy debt obligations.

2. **Debt Ratio** [12]

- Significance
 - If the ratio is more than 1 then the company has more debt than assets. Ratios of 0.6 are considered high while ratios of 0.4 or less are considered low.
 - It doesn't take profitability into account and doesn't discriminate around different types of debts.
- **Zomato's POV**
 - A low debt ratio suggests that Zomato relies less on debt financing and has a more conservative capital structure. This can contribute to financial stability, as the company is not heavily burdened by interest payments and principal repayments.
 - With a low debt ratio, Zomato is likely to incur minimal interest expenses. This can positively impact the company's profitability and cash flow, as less

income is directed towards servicing debt.

3. **Equity Ratio** [3] [4]

- Significance
 - It determines what percentage of a company's assets are owned by investors and not leveraged and therefore could come under the control of debtholders (such as banks) in the event of bankruptcy.
 - Equity ratios that are .50 or below are considered leveraged companies; those with ratios of .50 and above are considered conservative, as they own more funding from equity than debt, and hence are stronger financially.
- **Zomato's POV**
 - Zomato's equity ratio has changed from 0.044 to 0.039 in FY22-23
 - Zomato's increased total assets, from the acquisition of Blinkit, suggest a strategic expansion of its business operations should have led to this decrease.
 - Asset Increase: The increase in total assets due to the acquisition would lead to a decrease in the equity ratio if the equity doesn't increase proportionately.
 - Financing the Acquisition: If the Blinkit acquisition was financed primarily through debt or if it involved issuing fewer shares relative to the increase in assets, this would explain the decrease in the equity ratio.

4. **Interest Coverage Ratio** [5]

- Significance
 - Companies with high ratios are more financially stable and may have more cash available for growth, as they spend less on interest payments.
 - The lower the ratio, the more the company is burdened by debt expenses and the less capital it has to use in other ways. When a company's interest coverage ratio is only 1.5 or lower, its ability to meet interest expenses may be questionable.
 - If a company is in a loss (negative EBIT), it means that the earnings are not sufficient to cover the interest expenses. A negative interest coverage ratio is a sign of financial distress and may indicate that the company is having difficulty servicing its debt.
- **Zomato's POV**
 - An interest coverage ratio of -70.951 implies that Zomato is not just making a loss, but its earnings before interest and taxes (EBIT) are negative. This means the company's operational revenues are insufficient to cover its

operating expenses, let alone its interest expenses.

5. **Price to Earnings Ratio (P/E)** [6]

- Significance
 - A high P/E ratio could mean that a company's stock is overvalued, or that investors are expecting high growth rates in the future.
 - It signifies the amount of money an investor is willing to invest in a single share of a company for Re. 1 of its earnings.
 - A low PE ratio may signal that the stock price doesn't accurately reflect the true value of the company based on its earnings.
- **Zomato's POV**
 - Growth Expectations: Zomato's slightly lower P/E ratio compared to its competitors might suggest that the market has somewhat lower growth expectations for Zomato, or it perceives a higher risk associated with the company.
 - Profitability and Revenue Streams: Zomato's earnings are more volatile than its competitors, which could contribute to a lower P/E ratio.

6. **Cash Flow to Debt Ratio** [7]

- Significance
 - A higher Cash Flow to Debt Ratio indicates that a company is better positioned to service its debt using its internally generated cash flow.
 - Generally, a ratio of 1 or greater is considered favorable, as it means the company generates enough cash flow to cover its total debt within a year.
 - A ratio less than 1 indicates that the company's cash flow is insufficient to repay its debt within a year, which may signal a higher risk of financial distress or the need for additional financing.
- **Zomato's POV**
 - A ratio of 1.66 suggests that Zomato's operating cash flow is sufficient to cover its debt 1.66 times. This is typically viewed positively, indicating the company can comfortably manage and pay down its debt.
 - When expanding the scope to include all liabilities (not just debt), the ratio drops to 0.393. This lower ratio indicates that Zomato's operating cash flow covers less than 40% of its total liabilities. Such a ratio can signal potential short-term solvency issues, suggesting that the company may struggle to meet all its liabilities, not just debt, from its operating cash flow.

7. **Current Ratio** [8]

- Significance

- A ratio under 1.00 indicates that the company's debts due in a year or less are greater than its assets—cash or other short-term assets expected to be converted to cash within a year or less.
- A current ratio of less than 1.00 may seem alarming, although different situations can negatively affect the current ratio in a solid company.
- The interpretation is not straightforward, if a company's ratio is greater than 3, it means it has enough cash to meet its liabilities three times over. However, it also means it isn't managing its assets as efficiently as it may be. It is not adequately ensuring its finances by maximizing the profitability of its working capital.
- **Zomato's POV**
 - Strong Liquidity: This high ratio indicates strong liquidity, meaning Zomato has a substantial amount of current assets relative to its current liabilities. This position is generally positive, signifying that the company can easily meet its short-term obligations.
 - Short-term Solvency: It also suggests that Zomato is in a good position to handle any unforeseen expenses or downturns in the short term.
 - While a high current ratio is generally positive, it can sometimes suggest overly conservative management, where too many resources are tied up in current assets and not being effectively used for growth or investments.

8. **Return on Equity** [\[9\]](#)

- Significance
 - With ROE, investors can see if they're getting a good return on their money, while a company can evaluate how efficiently they're utilizing the firm's equity.
 - A high ROE could mean a company is more successful in generating profit internally. However, it doesn't fully show the risk associated with that return. A company may rely heavily on debt to generate a higher net profit, thereby boosting the ROE higher.
- **Zomato's POV**
 - ROE increased from -1.597 in FY 21-22 to -1.16 in FY 22-23 indicating an improvement in Zomato's profitability.
 - Zomato has made significant investments or acquisitions (Blinkit) that haven't generated sufficient returns yet, which can contribute to negative ROE. The initial costs and time needed for these investments to translate into profits can impact the overall equity return.
 - Challenges in the core business operations, such as increased competition

(Swiggy for eg.), changes in consumer preferences, or supply chain disruptions, may lead to lower profitability and contribute to negative ROE.

9. *Return on Assets*

- Significance
 - A higher ROA means a company is more efficient and productive at managing its balance sheet to generate profits while a lower ROA indicates there is room for improvement.
 - A falling ROA could suggest that a company has made poor capital investment decisions. Moreover, it isn't making enough revenue to cover the cost of those assets.
- **Zomato's POV**
 - Zomato's ROA improved from -0.07 to -0.04, likely due to enhanced operational efficiency, strategic initiatives, and potential growth in revenue, reflecting a more effective use of assets.
 - The decrease in ROA when excluding intangible assets suggests that these assets may not be contributing positively to overall returns. Excluding intangible assets from the ROA calculation could reveal a more accurate representation of Zomato's operational performance. If the company is heavily relying on intangible assets that are not contributing positively to profits, it can result in a lower ROA.
 - To increase Zomato's Return on Assets (ROA), the company should focus on improving operational efficiency, enhancing revenue generation, optimizing asset management, and evaluating the performance of intangible assets.

Comparison with Industry Benchmarks [\[13\]](#)[\[14\]](#)[\[15\]](#)

<i>Return vs Industry</i>	ZOMATO exceeded the Indian Hospitality industry which returned 28% over the past year.
<i>Return vs Market</i>	ZOMATO exceeded the Indian Market which returned 10.9% over the past year
<i>Stable Share Price</i>	ZOMATO is not significantly more volatile than the rest of Indian stocks over the past 3 months, typically moving +/- 5% a week.
<i>Volatility Over Time</i>	ZOMATO's weekly volatility (5%) has been stable over the past year.
<i>Price-To-Sales vs Peers</i>	ZOMATO is expensive based on its Price-To-Sales Ratio (11.1x) compared to the peer average (5.6x).

Earnings vs Savings Rate	ZOMATO is forecast to become profitable over the next 3 years, which is considered faster growth than the savings rate (6.7%).
Earnings vs Market	ZOMATO is forecast to become profitable over the next 3 years, which is considered above average market growth.
Revenue vs Market	ZOMATO's revenue (23.3% per year) is forecast to grow faster than the Indian market (8.9% per year).

Risk Analysis

Financial Risk:

Zomato's activities expose it to a variety of financial risks, namely market risk, credit risk, and liquidity risk.

- **Credit Risk:**

The company's credit risk at the reporting date is mainly from trade receivables amounting to 622 million INR. A provision matrix is used to compute expected credit loss, incorporating both external and internal credit risk factors and historical data. Receivables are monitored, with allowances made for impairment beyond 180 days.

Recommendations:

1. Continue rigorous credit monitoring and updating the provision matrix regularly.
2. Enhance credit approval processes and limit settings.
3. Consider credit insurance for high-risk accounts.
4. Regularly review and adjust the credit risk model for changing economic conditions.

Conclusion: Effective credit risk management is crucial, necessitating the maintenance of a robust provision matrix and the continual assessment of the receivables portfolio to mitigate potential financial losses.

- **Liquidity Risk:**

Liquidity risk is currently not perceived as an issue for the company, thanks to adequate cash reserves and a liquidity management framework. The contractual maturities of financial liabilities as of March 31, 2023, show trade payables due within a year totalling 3,660 million INR, with lease liabilities and other financial liabilities spread over the next five years.

Recommendations:

1. Maintain or increase cash reserves to cover upcoming liabilities.
2. Monitor cash flow forecasts against actuals to anticipate funding needs.
3. Consider refinancing or negotiating payment terms for larger or longer-term

liabilities.

4. Ensure a balance between short-term and long-term liabilities to avoid future liquidity crunches.

Conclusion: Despite no current liquidity risk, continuous monitoring and proactive management of cash flows and liability maturities are advised to sustain this status.

- **Market Risk:**

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, foreign currency risk, and other price risk, such as equity price risk and commodity risk.

Zomato ensures the optimization of cash through fund planning and robust cash management practices.

- **Interest Rate:**

A 1% interest rate fluctuation impacts the fair value of our debenture or bond investments by 12 million INR (FY ending March 31, 2023).

Recommendations:

1. Diversify investments to mitigate risk
2. Employ derivatives for hedging.
3. Align asset-liability durations.
4. Adjust debt-to-equity ratio.
5. Enhance interest rate monitoring.

Conclusion: Proactive adjustments to our investment strategy and capital structure are essential to manage the high sensitivity to interest rate changes.

- **Foreign Currency Risk:**

Sensitivity analysis reveals that a 1% increase in the AED exchange rate results in a 9 million INR change in value for the year ended March 31, 2023. For the previous year, a 1.21% increase corresponds to a 15 million INR change.

Recommendations:

1. Diversify currency exposure.
2. Utilize currency hedging strategies.
3. Regularly review and adjust currency positions.
4. Consider natural hedging via matching currency for costs and revenues.

Conclusion: The company must actively manage foreign currency exposure to mitigate risks from exchange rate fluctuations, given the impact on financials.

Operational Risk:

Zomato's operational risks include intense competition from other food delivery services, necessitating continuous innovation to maintain market share. Regulatory challenges require vigilance and investment in compliance to adapt to changing food safety and labor laws. Geopolitical risks in multiple countries necessitate a strategic approach to international operations and supply chain resilience. Cybersecurity threats require robust defences to protect customer data and maintain trust.

Investment Attractiveness

1. Stability:

- *Leverage on Conservative Debt Structure:* Zomato's conservative debt-to-equity ratio of 2.6% is indicative of a stable financial foundation. Investors seeking stability should appreciate the company's lower reliance on debt for its operations, reducing the risk of financial distress. This conservative approach enhances Zomato's stability, making it an appealing choice for investors who prioritize steady, low-risk returns.
- *Monitor Interest Coverage and Cash Flow:* Given the negative interest coverage ratio, Zomato must address profitability to cover interest expenses adequately.

2. Profitability:

- *Strategies to Improve Profit Margins:* Zomato's long-term success depends on investors focusing on profitability initiatives. Cost control, operational efficiency, and revenue diversification are crucial. Positive net profit margins and lower losses would imply effective strategy implementation, making the company more attractive to profitability-seeking investors.
- *Evaluate Return on Equity (ROE):* Its negative ROE shows Zomato's unprofitability. Investors should actively watch the company's attempts to attain a positive ROE, showing efficient equity use for returns. Positive ROE would indicate increased profitability and may attract investors seeking companies with positive shareholder returns.

3. Growth Potential:

- *Market Trends and Industry Benchmarks:* Investors seeking growth should track Zomato's performance against market and industry benchmarks. Zomato's capacity to outgrow the sector, increase market share, and adapt to consumer preferences is vital. Comparing the company to competitors reveals its competitive position and growth trajectory.

- *Long-Term Vision and Innovation:* Innovation and trend adaptation are key to Zomato's long-term growth. Growth investors should evaluate the company's long-term strategy, innovation pipeline, and strategic ambitions. Technology, worldwide expansion, and collaborations may indicate a strong growth strategy, making Zomato an attractive investment for long-term value seekers.

Recommendations for Zomato! [\[16\]](#)

The customer base of Zomato has significantly reduced post-pandemic, it introduced schemes like Zomato Gold to attract more customers, but it led to losses. Zomato could consider opting for the following strategies to increase its customer base.

1. **Tiered Rewards System:** Implement a tiered system where customers earn different levels of rewards based on their spending. Higher tiers could offer increased benefits, such as priority customer service, exclusive access to new features or menu items, and invitations to special events. These tiers can be established based on the amount spent or the number of orders placed within a certain timeframe. Customers start at the Bronze level and progress to higher levels as they meet set criteria. The rewards and benefits increase in value as customers move up the tiers. To maintain their tier status, customers must meet minimum spending or ordering requirements within a set renewal period, such as every quarter or year.
2. **Gamification Elements:** Create monthly challenges that encourage users to try new things, like ordering from a new restaurant, sharing a meal photo on social media, or trying a featured dish. Points can be earned for completing various activities. Badges can be awarded for milestones, like trying all the cuisine types available on the app. Encourage users to share their achievements or rewards on social media for bonus points or rewards, which also serves as organic marketing for Zomato. Offer small point bonuses for providing feedback on orders, which can help improve the service while engaging customers.

In both the tiered system and gamification, the key is to balance customer engagement with business profitability. The rewards should be enticing enough to motivate customers but sustainable for the business.

To mitigate its operational risks, Zomato should focus on proactive brand reputation management, including quick response mechanisms to negative feedback and intellectual property compliance. Effective stakeholder management can be achieved through transparent communication and data analytics to understand and meet stakeholder needs.