"PDS Limited Q3 FY'24 Earnings Conference Call"

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MR. RAHUL AHUJA – GROUP CFO
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Moderator: Ladies and gentlemen, good day and welcome to the PDS Limited Q3 FY'24 PDS Limited Earning Conference Call.

As a reminder, all participants' lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touch-tone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Diwakar Pingle. Thank you and over to you, sir.

Diwakar Pingle: Good afternoon, good morning, everyone depending on the geography of this town, I welcome you all to the PDS Limited Q3 & Nine Months FY'24 Earnings Call.

Today from the Management we have with us Mr. Pallak Seth – Executive Vice Chairman; Mr. Sanjay Jain – Group CEO, Mr. Rahul Ahuja – the Group CFO, Ms. Reenah Joseph – Head of Corporate Finance, M&A, Chief Investor Relations Officer.

Please note that a copy of a disclosure is available on Investor Section of the Website as well as the Stock Exchanges.

Please do note that anything said on this call which reflects our outlook towards the future, or which can be construed as a forward-looking statement must be viewed in conjunction the risk the company faces.

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With that said, I'd like to hand over the call to Sanjay Jain – Group CEO for the "Opening Remarks".

Sanjay Jain: Thank you, Diwakar. Good morning, good afternoon and evening to everyone. A very warm welcome to our Q3 & Nine Months FY'24 Earnings Call.

Before we dive into the quarterly and nine months operating and financial performance, let's please take a few moments to discuss the current economic and industry landscape that has shaped our journey so far during the year and which we believe would also have an impact in the coming few quarters as well.

As we step into 2024, the global economic conditions stand at a crossroads, blending challenges with rays of optimism. While the World Bank projects a modest growth, there are very promising signs of improvement on the horizon. The ongoing geopolitical challenges, along with the recent Red Sea crisis are continuing to impact global trade. However, there is definitely room for cautious optimism. One beacon of hope is the resilience demonstrated by the US economy, which has proven to be a stabilizing force amid uncertainties around. Furthermore, the inflation rates are gradually aligning with the central bank's targets worldwide, instilling confidence in economic stability. The potential for interest rate reductions adds an extra layer of positivity, offering the prospect of stimulating economic activity.

With these encouraging factors at play, there is a chance that in the coming months could exceed expectations, bringing about a more optimistic economic outlook on a global scale. Overall, the industry will continue to see some demand headwinds, but our discussion with our clients is suggesting a revival in demand is definitely there in the coming few quarters. Somewhere we believe, while we also had the first two quarters of a decline in sales, in Q3 we are flat, which means we're nearly bottoming out and we're heading for growth in the current quarter and hopefully thereafter as well.

While the performance of this quarter has been below expectations, we are confident that this is nearly a temporary phase. At PDS, we had to take a call that should we wait for investing into a robust performance to follow in the coming few quarters or should we kind of defer the investment. We made a decision to invest into people. People who are definitely enabling us making inroads into the US market and now also enabling us make inroads into the Indian market as well.

The industry disruptions are presenting new opportunities for PDS to strategically partner with global brands and retailers. Our consistent efforts over the past two years are evident in our performance during these challenging times. The introduction of new service offerings, namely sourcing as a service and Ted-Baker Design Group, has effectively helped us mitigate the industry decline.

We are pleased to report significant progress in both our sourcing as a service and agency businesses in nine months of GMV for these business models, recording 260% and 90% growth respectively. In the sourcing as a service model, our GMV has surpassed $350 million for the first nine months of FY'24, which I just mentioned a 260% growth over the same period last year, and the agency business, clocking $118 million GMV in the first nine months, a growth of about 90% over last year, reflecting robust performance and market demand. And therefore, this performance was giving us assurance and confidence that we should continue to keep investing into our efforts into the US market and Indian markets and it's a matter of time that this will start giving us results. Unlike any normal company wherein the investments typically happen through balance sheet and then you reap the benefits until such time you get into commercial activity, it remains in your balance sheet, in PDS, it actually gets into the P&L. So, therefore, when we are bringing senior resources, it's actually happened in terms of Q3, wherein when you observe an employee cost increase, from our perspective that is an investment that we are making for winning business into US and Indian markets where the cost incurred is now, but we feel that in about four to six quarters, one should see a significant impact of this investment coming back. Of course, in the immediate next quarter and thereafter, one should see growth coming back in design-led sourcing but this investment that we chose to make in the third quarter is surely going to add to more benefits in the subsequent few quarters as well.

Aligned with our strategic objective to expand in the US market, we are very pleased and excited to announce that Target, a leading retailer in the US has been added on a platform as a new client and we are very confident and positive that we just onboarded them this quarter, we'll be gradually nurturing this relationship. Like some of the US-based clients that we've added in the last few quarters, there's Walmart, JCPenney and also Kohl's … in fact to talk about Kohl's, for example, the relationship started with doing fashion business and as the relationship is maturing besides fashion, we're also getting into doing core line activity with our customers. So, we believe this Target onboarding is a major win for us in the US market and therefore should lead to a scaling of the relationship in the upcoming few quarters.

India also, we have chosen to be a focused market for us. And as you know India is about $100 billion retail market, the fastest growing, but now India has prominent retailers who represent a size and scale wherein PDS is well poised to start positioning its service offering to them. And recently, we solidified our presence in the Indian market by sourcing as the service contract with Myntra. And this contract is actually to enable them to start outsourcing garments from outside India as well. So, therefore, PDS is now able to bring its experience of successfully practicing sourcing as the service for brands like Hanes, brands like retail format like Asda, at the same time having a global presence for example in Bangladesh and other countries. We're bringing these trends now to Indian retailers. And while I mentioned to you about a major win of target onboarding in US. Likewise, there is a signed customer contract with Myntra for enabling them to source from the markets outside India as well.

Friends, these developments underscore our commitment to expansion, innovation, and strategic partnerships. We remain focused on delivering value to our clients and leveraging growth opportunities in key markets to sustain our upward trajectory. Therefore, as demand rebounds back across various geographies, our existing businesses will recover. We believe this quarter we should see growth bouncing back and we stand to benefit not only from the growth of our current ventures, but also from the disproportionate profitable growth of our new ventures.

Our confidence in the aforesaid mentioned outlook is evident in the investments we have made in enhancing capabilities, recruiting talent and somewhere as I mentioned this Q3 as compared to the previous Q2, we made a decision to invest into senior talent to enable us get business in India and US markets. We also chose to invest into Sri Lanka. And we believe in the current market conditions, given the global footprint, given our strong financial position, there is an opportunity to get partner factories onboard. PDS will continue to be asset-light, but we spotted an opportunity to get about a 25% stake in a facility in Sri Lanka. And with an option with us that at the same very, very low valuation that we got, we can at least step up our stake to nearly half in due course of time.

Notably, industry veterans such as Mark Green and Harold Tillman have recently joined PDS, bringing with them their extensive networks. We will leverage their connections to promote the narrative of customized solutions that PDS can provide to global brands and retailers.

We also recently acquired a new office in Watford, UK which will house PDS operation close to key customers while showcasing our presence in UK. PDS actually has got now a PDS Towers in Gurgaon which is primarily catering to our design capabilities to support the global operations, it is supporting to commercial activities for the global operations. While we are using few floors for our own consumption, few we are letting it out to reputed companies. So, therefore PDS Towers in Gurgaon we are running it as an independent P&L. We have an investment in real estate in our office infrastructure in Hong Kong which is actually housing key of our businesses and global treasury activities.

And now we believe this presence in UK which is primarily housed our Poeticgem operations and internally this Poeticgem vertical, which is somewhere closer to $350 million in top line has itself got a trajectory to be a billion dollar in about three to four years. We believe this office infrastructure that we have invested into UK will reflect, a) the need of the vertical to grow and also the stature of the organization in positioning its services to reputed clients.

In conclusion, drawing from 25 years of experience in the industry, we have consistently observed disruptions that often serve as catalyst for new collaboration opportunities. Therefore, we strongly believe that the resilient business model we have cultivated has weathered these challenging times and position us for recovery. In fact, our history tell us that whenever there are tough time PDS tends to gain manifold in terms of size and a foothold in terms of relationship with the customers.

With that said, we will now pass on the call to our Group CFO – Rahul Ahuja, who will provide an Overview of the Financial Performance for the Quarter.

Rahul Ahuja: Good day to all on this call, and thanks, Sanjay for setting the context by outlining the macro challenges and opportunities in today's world.

Now, let's delve into the Financial Performance for the Quarter and Nine Months ended December 31st, 2023:

In the first nine months of this Financial Year, we reported a top line of Rs.7,157 crores with the gross margin of 20.6%. Despite the 9% decline in top line, the value of gross merchandise we handled, increased by 19% from Rs.8,978 crores to Rs.10,724 crores. This growth demonstrates our resilience and ability to thrive amidst market disruptions.

Our gross margin improved from 16.8% last year to 20.6% in nine months of FY'24, driven by higher margin ventures like sourcing as a service and Ted Baker. Additionally, negotiations within our core design-led sourcing business contributed to expansion of the gross margin.

The employee and other costs have shown a year-over-year increase of 22% and 18% respectively. Like Sanjay mentioned, this has been largely on account of the new businesses we have added on to our platform, which is Ted Baker and Gerry Weber. And these obviously didn't exist same time last year. Despite demand pressures in the core business, we have refrained from any drastic cost containment measures as we believe the recovery is around the corner and we need to retain our talent and capabilities to capitalize on this opportunity.

It's important to note that other income in nine months of the previous financial year included a one-time gain on the sale of real estate which effects the comparability of EBIT and PAT year-over-year. Interest costs also rose due to an increase in the average base rate, which is SOFR from 2.62% to almost double at 5.23% this year. While taxation is higher, it's largely attributed to the Ted Baker operations, which have been profitable from day one, and those profits accrue in a high tax jurisdiction.

Coming to the performance during the quarter, we clocked GMV of Rs.3,868 crores versus Rs.2,950 crores last year, translating into a growth of 31%. We arrested the decline we witnessed over the last two quarters of this fiscal, that is in Q1, revenues declined by 10% and in Q2 they declined by about 16%. In Q3, the reported top line of Rs.2,580 crores is flat as compared to the same period last year.

Gross margins in Q3 FY'24 increased by 333 basis points to 20.8%, echoing the trends observed in the nine months. Similarly, increases in employees and other expenses are consistent with year-to-date figures. This translated into an EBIT of Rs.67 crores versus Rs.120 crores reported during the same period last year.

During the quarter, the base interest rate, which is SOFR, increased from 3.82% last year to 5.32% in the current year, translating into higher interest costs. The increase in taxation, as I said, is largely linked to the Ted Baker business, which is in a high-tax jurisdiction.

Turning to our balance sheet, the net debt has increased from Rs.27 crores to Rs.253 crores year-over-year, whereas in the previous quarter, which is September, this debt was at Rs.178 crores. This increase is mainly on account of the Ted Baker acquisition, which was financed through internal accruals and was partly replaced with an overdraft facility. We have now got a non-recourse factoring limit from our prime bank, which is HSBC which would help reduce the debt further. Further, we also invested in the UK property like Sanjay mentioned in his conversation.

While working capital days increased to nine days this year, excluding the Ted Baker component, our net working capital days stand at two days, aligning with our historical performance. The implementation of the non-recourse factoring lines that we have recently got sanctioned for is expected to reduce receivable days, particularly for Ted Baker.

Despite these dynamics, our balance sheet continues to remain robust with strong leverage ratios of net debt-to-EBIDTA at about 0.61 and net debt-to-equity at 0.22.

In conclusion, the resurgence of demand and the promising performance of our new ventures bolsters our confidence in achieving growth in the upcoming quarters and driving steady progress in quarters to come.

With this, I request the moderator to open the floor to questions and we will reply to those amongst us.

Moderator: We will now begin the question-and-answer session. The first question is from the line of Akshay from Sam Capital. Please go ahead.

Akshay: I just wanted to hear from the management because last quarter on the call, Mr. Jain sounded very confident that growth will pick up quite a lot in the second half of the year. So, I just wanted to know the details of what's happening at the customer end as most of the destocking over, just wanted to delve into a little bit more details, because Mr. Jain was really confident that we will end the year with say single to double digit growth rate?

Sanjay Jain: Allow us to answer this in two parts. While I will reflect on the discussion we had in the past, we also have the benefit of our Vice Chairman, Pallak Seth who has dialed in. So, I'll be requesting him soon to share his perspective on interface with the customers. But yes, we did anticipate that the growth would be bouncing back in the second half of the year and somewhere we are witnessing that traction. As I mentioned in my opening remarks, from a decline of sales of 14% to 15% in the first six months, it is flat now in the Q3 and we are confident that there would be a growth in Q4. So, therefore, yes, there is a lack of growth returning back by a quarter or so, but we believe the growth is now there, but amidst cautions, I think I'll continue to be cautious, but this quarter we're witnessing growth traction and let me request, Pallak, do you want to add in

Pallak Seth: Hi, good afternoon, everyone. So, I think the customers' inventory issues which were there post COVID in the last year have more or less been taken care of and this Christmas has been positive for most of the retailers we're working with. So, we are definitely seeing an uptick on consumption in these markets we're operating, but more importantly, the customer base we are working with. There's been a lot of cleanup, lot of the small, medium sized retailers in the last 12 - 18 months have gone out of business. So, whichever retailers are remaining, which is predominantly the customer that PDS works with is beginning to see growth as well. So, combination of growth coming from consolidation industry, existing retailers we're working with, getting a higher share of the market along with cleaner inventory, which I think definitely is going to drive our growth coming to next year and in Q4 we are seeing that impact in our order books.

Akshay: My second question is more related to the American market. As you mentioned, you had quite a few hirings in that market, but still, I mean, despite being the biggest market, it only contributes about say 12% of our business and also we had our plans to acquire a factory in and around Egypt to service the American market. I mean also, do we have any acquisitions planned in the United States market or we'll just hire from the ground up and like build business from the ground up or is there any acquisition in the United States market in specific?

Pallak Seth: So, next year's budget, already we are seeing US market share percentage of turnover going up to almost 20%. Sanjay just mentioned Target USA, which is the second or third biggest retailer in the US, which is hundreds of billions of dollars. They're evaluating close to 150 vendors in the last 18 months to bring onboard. I'm very proud to say out of the 150 vendors they had evaluated only one was bought in which was PDS. Right. So, PDS being asset-light business model, where all the other groups that put forward were large asset heavy businesses. The reason PDS is bought in because Target, US has the whole aim for moving to sustainability, innovation and they saw PDS as a perfect partner to provide not only design, development, FOB, LDP option but also partnering with them in the journey of sustainability and innovation. So, that account alone could be in hundreds of millions because they don't add a vendor for $1-$2 million business, if they add a vendor it has to be scaled. Similarly, Walmart is also one of the largest retailers as we know in the world. So, deeply looking at PDS and various options. So, we feel very confident that the way we are positioned in the US market right now and the restructuring happening in the US market where there's a lot of cost cutting happening at the retailers level, so service providers required to fulfill those requirements because if the retailer doesn't have that cost, they need someone else to take on the cost and service them. So, the combination of having these large US accounts, which typically in 25 years we've been trying, we were not able to get, in the last six months we had this win, is definitely going to help drive our US business. So, our current approach is more organic because there's a lot of good talent available. We will bring them onboard and organically grow with them. It's cheaper that way for us because then we don't have to take on debt and have pressure on our balance sheet. But saying that, if we find some small, medium-sized companies which we can get at a net asset value or almost to acquihire teams and plug-and-play them on the platform, we'll continue consuming those as well. So, just last week, I spent the time in the US and had meetings with several large retailers. So, PDS is the only company which in the vendor base gets appointment straight at the C-Suite level. We're meeting the CEOs of large S&P 500 and Fortune 500 companies, which keep talking to PDS about various opportunities. No other vendor globally has this option that we are getting to engage at the senior leadership level of these retailers and not only talking about was supplying products but providing services that we offer as a company. Either being a vendor with design or becoming a sourcing as a service partner or help launch brand for them. So, Sanjay mentioned about Kohl's as well. So, we are a vendor to Kohl's right now, but now our recent discussion with the management of Kohl's has been, can you guys take one of their existing brand which is a $40 million brand right now to the end-to-end design development and sourcing which has the potential to become a $200 million brand in next three to five years. They want PDS hire design team and do the whole brand from end-to-end. So, we're very liked that from the retailer side. So, I feel very confident that the US business could probably become 50% of our turnover, at a very high base in Europe and UK going as well in the next three to four years.

Akshay: So, just wanted your industrywide view on the threat from a lot of the ultra-fast fashion guys such as Shein and Tamo on some of our incumbent customers and our industry as a whole?

Pallak Seth: Yes, it's a very good question, very valid question also. Just for your information, Shein is very closely associated with PDS at this stage in terms of the senior leadership is talking to us about doing some brands business and other things because they see PDS is also a global partner for their needs especially in the West because they're a China-based company and they need to launch brands. And so they're talking to us, can PDS help them in either develop brands or launch brands. So, that's just so association, not PDS as a competitor or basing PDS as a competitor, but as you know potential collaborator for future opportunity. But I think the business model they have developed is very fascinating because they're almost a zero inventory model, they're putting small quantities on website, seeing the customer reaction and then going to bulk production within two to three weeks. So, Shein is definitely impacting other online retailers globally. We see in UK alone and Europe alone companies like Boohoo, Misguided, ASOS which were large online, few of the online retailers are getting really impacted. We had also seen companies which are in fast fashion like New Look and few others which was catering to the young customer segment also getting impacted. But PDS does not play in that segment. So, our customer base are not these young fashion retailers or these online retailers. So, we are not directly seeing the impact of any reduction in demand where these retailers in the West are seeing. Our customer base are predominantly the large volume retailers, who also supply value like supermarkets in Europe or the large, big box seaters in the US or also these kind of specialty retailer like Primark. So, at that level, we have not seen too much market share being taken by people like Shein and team, but there's definitely something to watch and also to keep a careful eye on. Another point, I want to mention, the Shein supply chain today in China has almost become a commodity. I think there are 10,000 factories in China which are now actually supplying Shein, but they have excess capacity to offer that to other retailers. So, PDS China operations has also launched a product for ultra-fast fashion delivery to its customers where we are able to create a software program which will plug into many of these, out of 10,000 vendors we feel around 500 or 800 vendors or factories are compliant to PDS standard. So, that software platform taking 500 or 800 factories are still evaluating the final number that fulfills the compliance requirements can be onboarded on PDS platform to provide the same sourcing that Shein gets for its direct-to-consumer business for PDS to offer to its retail partners as well. So, we are piloting that with one Indian retailer to begin with, but also some of the European and US retailers, we started showcasing this as a product. So, yes, there is some disruption, but Shein reached out to PDS to collaborate. So, that gives you just some perspective as well.

Moderator: The next question is from the line of Pritesh Chheda from Lucky Investment. Please go ahead.

Pritesh Chheda: From your initial slides of the presentation where we have given the GMV, so is it fair to assume that these new models of Sourcing-as-a service and agency business, is where there is this whole interplay between revenue and GMV? So, had you not done, let's say the SaaS or the same clientele, if you had not done the SaaS or the agency business, then the GMV would be a part of your revenue being a better sourcing or design sourcing, that's how we should interpret this?

Sanjay Jain: If I understand your question rightly, we have reported for nine months ended December '23 Rs.10,724 crores of GMV and the revenue from sale of goods is about Rs.6,829 crores and there's other operating income of Rs.327 crores, for revenue Rs.7,517 crores. Now specifically to answer your point, the agency sales have been Rs.982 crores for the nine months which we said is about 90% growth over the same period last year. The sourcing as a service, the sales are at Rs.2,912 crores which is a GMV that we handle, a growth of 262%. So, on the $981mn of agency on the sourcing as a service of $2,912mn, it is an average 4% to 5% if that gets booked into our revenue. So, therefore, to answer the question, this is the difference of Rs.38 crores in the GMV and in the revenue for the nine-month period.

Pritesh Chheda: And the same way when we look at the GP number, so you have a gross profit, though your revenue decline of 9% percent is there, but your GP has grown in nine months and GP has grown in the Q3. So, now that's a function of the fact that the SaaS and the agency business has grown, which wouldn't have the revenue but only would have the GP or the profitability element to it. Is that interpretation correct, sir?

Sanjay Jain: Yes, partly right. There is Ted Baker that got added in the current full quarter of Ted Baker business and that is relatively speaking high gross margin business. That is one factor to gross margin enhancement. And yes, secondly for me both the sourcing as a service and agency business are much, much higher gross margin business, and whatever pretty much is the revenue actually gets pulled into gross margin. Yes, partly what you said is the reason, partly Ted Baker is the reason.

Pritesh Chheda: My second question is, sir, with respect to your operating profitability, a lot of the GP has got consumed in two heads, the other expenses and the employee. I heard your comments about your people increase in US and Indian market, but if you could just give a little bit more elaboration in terms of what kind of teams you have increased because the increase as a percentage of sales in both these heads is fairly high. So, we need to understand that part. And second, you were running your business earlier at about, let's say between 3% and 4% EBITDA margin and at that time the cost of borrowing in the system was less than 1% or 1 - 1.5%, whereas the margin is still the same but the cost of borrowings has gone up, for the same business, the ROE has become different. So, how should we now interpret your business considering the cost of financing?

Sanjay Jain: I think on the first one, both Pallak and I would reply. Because besides giving the names, I want to make the use of benefit of Pallak being there in terms of the utility and the value that people are adding. But on the number bit on the first part, I think if I have to attempt for example there is approximately between the Q2 of this financial year and the Q3 of this financial year, there is approximately about 60 to 70 crores element of cost increase that has happened and nearly about 12 crores to 15 crores is in the other expenses and the remaining 45 crores is in the employee cost. So, that's the increase that has sequentially happened. I think in the other expenses, there is a bit of travel that has gone up because we are increasing our engagement with the customer that you should see as a part of investment that is what I mentioned. And other expenses of 77 crores in Q2 versus 191 crores in Q3, I think somewhere a midpoint is a sustainable level as we go ahead. I'm giving you answers more on Q2 versus Q3 because this is more like-to-like as compared to same period last year. Because same period last year, Ted Baker was not there, same period last year Gerry Weber was not there, but Q2, Q3 are comparable. So, therefore in the other expenses, from 176 crores to 191 crores somewhere closer to that is a sustainable level. Employee cost increased from Q2 to Q3 of about 45 crores. I would tend to break it up in three parts. There is an element of about 3, 4 crores, which is the wage increase that nearly happened for a month in Q3 in both our factories in Green and Progress and it takes a while for us to pass it on or engage with the customer. When you engage with the UK and European customers, which is predominantly the ones that are occupying the two factories. One, see a decent possibility of passing it on, but a bit of lag in the month of December, I had a 4 crores to 5 crores of element of that. Then there is an element of about 8 crores to 10 crores. Typically, whatever is the performance of last year, we make our best estimation wherever feasible, and we'll try and book for the incentives of people. But you always have some lag in terms of what you accrued and what you actually pay. There's an element of about Rs.10 crores of incentive in that, which is a one-time that happened because of the high profitability. As I said, we make our best estimation to accrue, but then there is a large element of about 25 crores to 30 crores which is pertaining to the new people that we have actually got onboard. Before we go to the second question on finance costs, so this 25 crores to 30 crores that has happened because of the new people coming onboard, I'm requesting Pallak to give you an insight into who these people are and what are the potential benefits.

Pallak Seth: We've got a few very senior industry veterans who have joined PDS, you can see a gentleman called Mark Green. He was the Director of Sourcing for Walmart, for Victoria's Secret and most recently for PVH and Tommy, Calvin Klein. So, he's been the industry for 25 years. He just left PVH, and he joined PDS to help look at US strategy and help increase our network in the US. A new board member, a lady called Sandra Campos, again based in New York. She was the President of Centric Brands and for global brands and with some other large U.S. companies and have extremely strong network in the US at the C-Suite with all retailers. So, we also benefit from her joining us. Another very strong industry veteran called Krishantha. He was the CEO of Epic. Epic is one of the large manufacturing groups in Hong Kong, doing $700 million. He was there for the last four years. Before that he was in Walmart for the last 15 years. He's also joined our company to help expand the U.S. business and network. So, PDS is finding opportunity with some of the most well regarded, respected senior industry leaders who have multiple offer letters on the table from various companies globally, choosing PDS as the right company because of our culture, because of our products that we offer, because of the infrastructure ecosystem we have created to come and join our business and help expand our services to US retailers and customers. We also are planning, I think, Sanjay, on the board meeting we discussed about bringing one large American brand into India on a wholesale basis. So, we have another industry veteran, a gentleman called Vedji who is also joining us to take that large US underwear brand opportunity on a wholesale basis into the Indian market. So, we are very proud. PDS has become a platform not only for the best retailers and brands in the world, also for some of the banks who want to reduce the exposure of small, medium sized companies wanting to give us additional limits as a platform company to provide working capital financing to factories and customers but also some of the leading talent in our industry globally wanting to join us and offer services to the network being part of PDS platform.

Pritesh Chheda: Sir, which means these costs are ongoing costs, right?

Pallak Seth: But they are ongoing cost without any revenue. So, once these people join, each of them, they're talking about billion-dollar revenue like Mark Green who is got a Target as the US business of PDS should become a billion dollar in the next three to four years, obviously in the building blocks towards that.

Pritesh Chheda: As a percent, so the operating leverage will then flow in? Right now you've got hit by the operating deleverage, which is of the cost. That's how we have to interpret these costs, right?

Pallak Seth: Exactly. Because the talent gets available, this is once in a kind of 10-year industry shift happening because there's a lot of restructuring happening at the US retailer level. So, the top talent is getting available, there's lot of cost cutting at the US retailers that they are doing. They require a company to provide services. For example, I was in New York, had a meeting with Tommy Hilfiger himself, the guy who basically is one of the most successful and obviously well known retailers globally and his exact comments were, Pallak, he has not seen a company like PDS in his career. He's one of the most formidable retailers around the world. He said the services and the kind of product offers you are giving, he's never seen it and we see there's a huge potential for PDS to do many things, and even he's like, let's talk, he gets these opportunities coming on a regular basis. He said PDS is the first company he will get in touch to take care of those opportunities. So, I think our U.S. business has not happened in the last many years, but with the structural changes happening, with the investment, with the quality of people we are making, it could overtake our European and UK market in next three to five years that we have to be cautious, but, yes, the building blocks are there now finally.

Sanjay Jain: Sorry, just one point to add. I think pertaining to your previous question around the difference in GMV and our own revenue from design-led sourcing, I don't think we're cannibalizing our own business. For example, Asda as a client, what we have been hitherto doing with them is design-led sourcing and which is continuing healthy. Of course the market conditions have impact quarter-to-quarter, but the relationship is well intact. And it is the tech pack business.

Tech pack means the customer is actually giving designs to factories. And there is the tech pack business that actually typically we are taking over under sourcing as a service contract wherein we are supporting the retailer reduce their cost structures of running your own offices or having people onboard in management of the factories. So, tech pack, I am taking over gradually from retailers under my offering sourcing as a service. My design-led sourcing business is very much in track and is going to grow as well in line with the market. Just to clarify that particular point. I think on the on the finance cost if I got… and I'll also request Rahul to chime in, our debt utilization levels typically haven't gone up on an average basis as compared to the same period last year. It is increase in the finance cost of SOFR the base rate that has actually gone up. And in my opening remarks I mentioned that one is probably also observing that the interest rate should witness a decline. So, therefore we should start benefiting in a quarter to two from the declining trends in the finance cost as well.

Rahul Ahuja: So, I guess Sanjay you covered it. Absolutely right, the base rate has almost doubled from the same period last year to where we are today. And even if you were to see during the year, there's a difference of almost 170 to 180 basis points of increased rate that we are witnessing. But as we do the journey during the next year, it's anybody's guess, sooner than later this trend should reverse in the global markets, and we will then stand to benefit from that as well.

Pritesh Chheda: I understand the rate has gone up and the cost increase, but actually for the same business that you do and for a cost that increases because of the financing, the ROE comes down. So, is there a way to mitigate this, for the same business our profitability becomes lower, right, your PAT margins becomes lower because cost goes up?

Sanjay Jain: I think as Rahul was mentioning that we wrote a check of about 150- 160 crores business in terms of working capital that we got into our fold when we got Ted Baker design group into our fold, that's an upfront investment we made. And now few months into getting this into our hold, we have got a non-recourse factoring line up and running soon in a month's time. But we got the line sanctioned from one of our leading banks. That would actually reduce the capital that we deployed by half. And therefore from a return on capital employed, which eventually translates to return on equity, we believe whatever we invested, the numerator has started to happen in terms of EBIT, the denominator, the capital employed we clearly see now an opportunity in the next 30 to 60 days to try and squeeze it down by utilizing the non-recourse factoring facility.

Pritesh Chheda: I'll take this offline.

Moderator: The next question is from the line of Rishi Modi from Marcellus Investment. Please go ahead.

Rishi Modi: Sanjay, just a couple of questions. Firstly on the Ted Baker piece, right, so if you could just give us the economics of how it's going in this quarter, how do you envision it going, how much is the GMV, how much revenue, gross profit, what are the fixed cost sitting in there, how much is our capital blocked out there, and how will this flow over let's say next one year or so?

Rahul Ahuja: As far as Ted Baker business is concerned, like we have said earlier as well, it's been profitable from day one. The business largely has two components, which is the wholesale and agency piece and it's been ramping up well since we got it on our platform around mid of June. We have in the nine months period ended December done about 345 crores of top line in Ted Baker with a bottom line PAT margin of about 7.1%. As far as the split of the business is concerned, it's largely between wholesale and agency, largely 50:50, in agency we get a fee of 10% of the business that goes through us. So, we feel that as the market rebounds, it should have a rebound effect on this business as well going forward and it should perform consistently for us both as far as top line and bottom line is concerned. And as far as capital employed is concerned, I think Sanjay mentioned that actually capital employed it's kind of a misnomer because basically what we did was, pay for the working capital which is inventory and receivables which was around $18 million from our internal accruals, and as our factoring lines get into place about half of that will be replaced by the factoring lines. So, effectively the net capital employed in this business from our side, which is working capital should be about $9 million to $10 million.

Rishi Modi: I recently read an article that the retail chain which operates the stores for Forever 21 in I think UK and Europe, right, they have gone under, or some issue has happened between ABG and that retailer. So, just if you could give an understanding of what's happening out there for Forever 21 or Ted Baker, these guys the retailer has gone into some trouble or some disagreement with the ABG Group, so if you can just shed some color out there?

Pallak Seth: Ted Baker case study, we should present to the investor community. In Ted Baker case study on what was paid for the asset by the New York IP Company, what PDS finally paid for it after without recourse factoring, what is the bottom line we're expecting and return on capital employed we're expecting on this business. So, as Rahul just mentioned from $18 million are working capital because of without recourse factoring which could take some time to bring onboard and net working capital would be down to $8 million, $9 million. And the profit of the business is close to like $6 million in year one. So, the $9 million capital employed between $5 million to $6 million is finalizing a figure for the year with the profitability of this kind of business model. So, it's a highly profit business model that can be multiplied into various brand management opportunities around the world, because New York IP companies are continuing to acquire various brands and they need operators like PDS to come and run them.

Rishi Modi: I am talking about this issue between Authentic Brands and AARC?

Pallak Seth: I'm coming to that. I'm just first clarifying the business model and the multiple options that can come on a similar basis. So, AARC was basically, when PDS got the opportunity, we basically as a B2B business decided that we're not going to retail, e-commerce or concession. We will just take care of running the head office against which we get a commission of anything these retail operators buy from the factory as a fixed commission of 10% on the FOB value and we run the wholesale, which is predominately pre-sold, so there's no inventory risk. So, ABG broke this business down into various maybe 10 global franchisees, the retail operators in India with Aditya

Birla and China and there is someone in US. So, in UK, Europe there's an operator called AARC. AARC was unable to get the financing in place to operate the retail stores in e-commerce and the concession that they were supposed to. So, ABG basically has replaced them and come in themselves as the operator of the business. So, which is good news for PDS because instead of having a counterparty like AARC, which is not a properly funded business, ABG has decided to run the business themselves for the time being. So, they're now capitalizing the business further, putting in close to £18 million into the retail operation to capitalize it correctly and then make it more stable and invest in the brand to grow. So, ABG is a $40 billion today retail IP brand owner. So, for them, in any brand they acquire, the stability of the operation is key, they cannot have any issues in any of the operations. So, ABG took the right decision that the counterparty in UK and Europe was not able to operate the stores correctly with the financing required. So, they replaced them and took over their equity and running it themselves. So, we are in a more stable position now than we were before with AARC as a counterparty.

Rishi Modi: Second question I had was on the deal wins that we've done, Myntra, Target and the Indian retailer whom we have tied up with. So, how big an opportunity is each one of these?

Pallak Seth: They all take time, but I think Myntra probably for year one is around $15 million to begin with, the baseline of the business obviously can double, or triple in the next 2-3 years depending on how the business goes. Target US obviously has onboarded PDS as a vendor. So, we're expecting by Q4 FY'24-25 we will start shipping the orders. We are in the process of onboarding some factories right now. Target US is not going to onboard a company to do $1, $2, $5, $10 million, they onboard a vendor to do $50, $100 million. That can ramp up pretty quickly. The discussions are happening, multiple engagements are happening with them at various levels. So, as I said, out of 180 vendors they had evaluated in the last 18 months, only one was added which is PDS. So, we feel it could become one of our top ten accounts in the next two to three years.

Rishi Modi: And this Indian retailer that you all have tied up with, who is that and how big is an opportunity there?

Pallak Seth: That is still under discussion in India. So, once finalized and signed, then we can say.

Rishi Modi: Thirdly, the Nobleswear acquisition that we've done, right. What's the FY'24 revenue run rate EBIDTA, PAT? I can understand it looks cheap on FY'23 but things are not the same since last year. So, just trying to get a hold of how things have moved out there.

Pallak Seth: While Sanjay can tell the figures, I will just mention from my perspective Nobleswear is being seen as a top maybe five- seven manufacturer in Sri Lanka right now with a very good customer base and a very high reputation. So, the halo impact on Norlanka operation by taking a strategic stake in a company like Nobleswear is already added more accounts to our design led sourcing business. For example, Sainsbury, a big UK retailer supermarket was not currently engaging with PDS. After that acquisition, they've now onboarded us as a vendor. Seeing the opportunity of PDS also having some strategic manufacturing asset. Similarly, Primark, which is obviously one of the largest volume retailers in the world is under discussion with PDS to basically become the exclusive vendor out of Sri Lanka with a potential volume of $100 million in the next two to three years. So, all these building blocks we do as a company, taking small strategic stake in the businesses at a very low value compared to even book value has a very big impact on our overall operation. So, coming to the specific on Nobleswear, Sanjay can please mention now.

Sanjay Jain: Pallak, you were also touching the point that the ROI for us from such an investment is not just into the factory wherein we're acquiring a stake but also the rub-off effect. But to answer specifically, we believe the current year profitability of the factory would be under pressure. I think it did EBITDA of about 15 crores in FY'23 and about 11 crores PAT in FY'23. And from the current quarter onwards if I have to paint a picture of the next four quarters, we believe we should be running the factory almost at the same level. The last three quarters have been a bit troublesome because of the factories running at low capacity, because of the global conditions, but we are positive that from the current quarter onwards to the next forth, we should be running the factory at the same level at which we acquired the profitability of growth.

Rishi Modi: Just to clarify, you said 30 crores you have spent in bringing in I think three people, one, Mark Green, second, Sandra Campos and one other guy from Hong Kong. So, these guys are getting paid like USD4 million per year or how is working out there like this USD4 million sounds a bit too huge for an annual compensation?

Sanjay Jain: There is an element of a joining bonus or onboarding bonus which get expensed off. And then what we have shared with you are the people who are the leaders, they typically bring their own team of two, three people or we give them two, three people. So, therefore 30 crores is not just the impact of these people but it's a team that one has taken onboard.

Moderator: The next question is from the line of Varun Gajaria from Omkara Capital. Please go ahead.

Varun Gajaria: So, I just had a question on Ted Baker and Gerry Weber integration. In this quarter our cost went up substantially because of the integration in these businesses. So, how are the costs expected to look in the coming quarters like are we done with full integration, how is it faring and how will the margins look now?

Sanjay Jain: I think as Rahul gave you an insight into overall Ted Baker financials and he also mentioned that we expect the traction to continue. In Q3 that we reported I think it would be fair to say that both Gerry Weber getting into a fold and Ted Baker, the cost structures have now actually been captured into the P&L. So, it is now normalized in terms of Q3, Q4 onwards. We don't anticipate any incremental cost getting added up. For example, if I have to speak, the Gerry Weber revenue like nine months is close to about $22 million. But now on a quarterly run rate to stay close to the question you ask, the costs are fully factored. We should see the benefits now flowing in on top of it.

Moderator: The next question is from the line of Chirag from RatnaTraya Capital. Please go ahead.

Chirag: Just one clarification question. The new senior members who have been brought out, they have basically been brought on onto roles, is that how we should understand this or is there a different sort of a commercial understanding there?

Sanjay Jain: So, one of them is on a board wherein the payment is through a sitting fee. They're playing a role on the listed company board as well on the subsidiary boards, for example, the new board member is also on the board of the US subsidiary to support the US business. So, that's on the board part. But beyond that, the others are actually in the capacity of employees or consultants, mostly employees that have in lieu of employment they're onboard.

Chirag: A couple of clarification questions. One, on the factoring side, is it probably correct to understand that once the factoring comes in, that would have a commensurate impact on the gross margins, your realization should go down a little bit there given that you would get that money earlier and get it factored, is that right or am I missing something there?

Sanjay Jain: In fact, it's an interesting point. There are two facets to actually. The factoring cost actually gets into my finance cost. So, to that extent it does not impact the gross margin negatively at all. And when I said two facets, in fact, there's a potential upside to gross margin because I am able to get factoring money much sooner and then I'm able to sit across the table with my vendors and pitching for early payment discounts. And to the extent that I'm actually able to get EPDs, which are actually much higher than my financing cost. The EPD I get a benefit in the cost of goods sold. We can adjust it from there. So, therefore increased factoring gives me a leverage to actually negotiate better and therefore improve my gross margins.

Chirag: If I just summarize that, essentially the gross debt would go down, finance cost also would come down by a little bit, not by a large amount, but you'll also get maybe some benefit on the gross profit. Is that the three effects of the factoring?

Sanjay Jain: The finance cost may partially go up because when I'm availing the non-recourse factoring then I'm actually raising money which has a cost. So, therefore finance cost could go up, the capital employed would come down, the debt would come down. And now that I have more money into my account, my flexibility to sit across the table and get an EPD goes up. So, gross margin accretive, yes, capital employed reduction, yes, finance cost goes up because I'm availing more factoring.

Chirag: Finance cost in comparison to the base quarter right now where instead of factoring, we were actually drawing down an overdraft. So, in that comparison -

Rahul Ahuja: So, you're right, if you compare it with the overdraft getting replaced by factoring, then the impact is not there on the finance cost. However, if you were to compare it with internal accruals deal getting replaced by factoring, then my interest cost will go up.

Chirag: Incentive that you pointed out that we might have a sort of proportioned a smaller amount, is the right understanding then this Rs.10 crores should have been around 2.5 crores each quarter for the last 3-4 quarters, that's what should have been instead of the 10 crores this quarter, maybe 7.5 crores should have come in the last three quarters, is that the way we should get that?

Sanjay Jain: Yes, you can at least say that one could have, as I said, we try and use the best efforts to factor it in, but to the extent there is any gap and it got paid off as a lump sum in this quarter and therefore it correctly should typically get amortized over the entire year.

Chirag: Last question is on Gerry Weber business. Can you elaborate a little bit more about how should we look at that business? Does that fall into wholesale agency services? Can you just talk a little bit more about that business and going forward, how that would look like?

Sanjay Jain: There is one like a design-led sourcing wherein I take my design, get the orders, then sourcing as the services, I get the designs and I'm actually running an office on behalf of the retailer and charging my fee for handling volume for them. And now there is a third category which is Gerry Weber business is a complete sourcing solution. The retailer is saying, I've got nothing to do with designing or sourcing anything. You please 100% take it over and that's how we actually got this contract from Gerry Weber in Germany. When we have taken this contract, from a credit assessment perspective, we've done management of risk by way of an escrow account with the customer of keeping some deposit which reflects typically the inventory that we may have in transit or on our books before it is passed on to the customers. We've also kept a right with us that I can use this inventory for others as well. So, we've mitigated our risk when we have ventured into doing complete outsourcing for retailer.

Chirag: Just some clarification. How would this be different from normal brand management that we would do say in other scenarios like Ted Baker, what would be the difference between this contract and a brand management contract?

Sanjay Jain: As Rahul was answering that, 50% of revenue stream of Ted Baker is for example the agency business wherein while there are agents appointed or franchisee appointed by ABG for Ted Baker business for example, a name that resonates everybody in India is Aditya Birla Fashion, who is running Forever 21, and Ted Baker as a franchisee. So, now to answer the question, Ted Baker group is facilitating the designs for the garments that they are getting sold in the stores. Ted Baker group, that PDS is running is also facilitating the management of the factories. Facilitating. The factories are billing directly to the retailers here. So, for performing this service of designing, for performing the service of managing the factories or managing their traffic, I'm actually getting a 10% agency fee. So, that's the difference. So, I am not buying and selling inventory, it is being directly billed, I'm just getting paid for my service. That's the difference between part of the Ted Baker business, which is the agency business versus a complete sourcing solution. On the Ted Baker other bit, the wholesaling, wherein I am actually buying goods on my books and I'm like selling it. While there is on the face of an inventory risk, but again in line with PDS philosophy, it's a pre-sold kind of situation. A) it is a wholesale business; it is not a B2C business. I'm not running retail stores here. I take it to the leading retailers who actually allocate space for Ted Baker brands to be laid out. And then typically we tend to engage into pre-sold order so that I know that there is visibility and that is where I'm getting into an inventory that I'm buying on my books and then selling it to the retailer.

Moderator: Ladies and gentlemen, due to the time constant, we will take this as a last question. I would now like to hand the conference over to Mr. Sanjay Jain for closing comments.

Sanjay Jain: Thank you, EY team for supporting us and the logistics of the call. Thank you so much, ladies and gentlemen, for joining our Investor Call and we look forward to once again engage with you at the end of Q4 Earnings Call and have a good afternoon and evening, all of you, and stay safe.

Moderator: On behalf of PDS Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.