Northern Arc Capital Ltd. – Investment BUY Call

Dear Bajaj Capital Investors,
New Stock Recommendations for BUY on 27 July 2026

CMP -> 306
Buying Range -> 306 to 312
Upside Potential-> 12%
Investment Horizon -> 6 Months
Target price -> 343

1. Business Overview – A Diversified Retail-Focused Credit Platform with Multiple Earnings Engines

Northern Arc Capital is a diversified NBFC that operates a unique hybrid business model by combining direct lending, credit solutions/platform services and fund management to improve credit access for India's underserved households and MSMEs. Over the last 15 years, the company has transformed from a wholesale-focused lender into a retail-centric financial platform supported by a proprietary database containing over 50 million loan records, 30+ machine-learning underwriting models and a dedicated 100-member risk management team. The company operates through three major businesses: (i) Direct-to-Customer (D2C) Lending, comprising consumer finance, MSME loans against property (LAP) and rural finance; (ii) Credit Solutions, which provides funding, securitisation, loan placements and technology solutions to 368 originator partners including NBFCs, MFIs and fintechs; and (iii) Fund Management, managing INR 3,092 crore of AUM across AIFs and PMS products. The company has a pan-India presence through 372 lending branches, 342 rural branches, 55 digital lending partners, operations across 28 states and 680 districts, serving industries including financial services, MSMEs, rural enterprises, consumer finance, vehicle finance and fintech. Key end-user sectors include small businesses, self-employed entrepreneurs, rural borrowers, microfinance customers and retail consumers, making Northern Arc a direct beneficiary of India's expanding formal credit penetration.

2. Q4FY26 & FY26 Financial Performance – Strong Earnings Growth Supported by Improving Asset Quality

Northern Arc delivered another strong financial performance during FY26 with growth across all key profitability parameters. Assets under Management (AUM) increased 22% YoY to INR 16,594 crore, while Direct-to-Customer lending contributed 59% of total AUM, compared with only 19% in FY21, demonstrating successful execution of its retail strategy. Net Interest Income increased 20% YoY to INR 1,377 crore, while Net Revenue (including fees) grew 19% YoY to INR 1,484 crore. FY26 Pre-Provision Operating Profit increased 21% YoY to INR 956 crore, while Profit After Tax rose 33% YoY to INR 406 crore. Q4FY26 was particularly strong, with PAT of INR 133 crore, representing the company's highest-ever quarterly profit, growing 251% YoY and 32% QoQ. FY26 Net Interest Margin improved to 9.4%, reflecting the benefits of the higher-yield retail portfolio. Cost efficiency also remained impressive, with the operating expense ratio maintained at 3.6%, despite significant branch expansion. Return ratios continued to improve with FY26 ROA at 2.8% and ROE at 11.1%, while Q4FY26 ROA improved further to 3.3% and ROE reached 14%, indicating improving operating leverage. Funding costs also declined by 48 bps YoY to 8.5%, while Debt-to-Equity improved from 3.9x to 3.1x, Capital Adequacy remained strong at 22.6% and tangible net worth increased 13% YoY to INR 3,896 crore, providing sufficient capital to support growth over the next 2–3 years.

3. Significant Improvement in Asset Quality, GNPA, NNPA & Credit Cost – Major Earnings Quality Driver

One of the strongest investment positives emerging from FY26 has been the company's significant improvement in credit quality. Gross NPA improved sequentially to 1.2%, while Net NPA declined to 0.6%, among the better asset quality metrics within diversified retail NBFCs. Stage-2 assets reduced consistently from 2.6% (Sept 2025) to 1.8% (Dec 2025) and further to only 1.5% (March 2026), indicating improving early-stage delinquency trends. Credit cost declined materially to 2.8% in FY26 from 3.2% in FY25, while Q4FY26 credit cost reduced sharply to 2.2% compared with 3.5% in Q3FY26, reflecting normalisation across retail portfolios. Rural finance credit cost also improved significantly from 6.7% in FY25 to 4.9% in FY26, while Q4 rural credit cost stood at only 1.3%. Collection efficiencies improved meaningfully across businesses, with MSME collection efficiency increasing from 97.8% to 99.4% and Rural collections improving to 99.6%, including recovery in Karnataka after regulatory disruptions. Management continues to maintain one of the industry's most conservative provisioning policies by providing 100% provisions on all unsecured loans crossing 90 DPD, while also maintaining an additional management overlay of INR 66 crore for macroeconomic uncertainties. Management highlighted that the RBI's February 2026 FLDG/ECL clarification has substantially reduced provisioning volatility and is expected to improve earnings stability going forward. Sustained reduction in GNPA, NNPA and credit cost is expected to remain one of the biggest profitability drivers over the coming quarters.

4. Growth Catalysts – Retail Mix Shift, Consumer Finance, MSME Expansion & Digital Ecosystem

Northern Arc possesses multiple high-quality growth drivers that are expected to sustain 22–25% AUM growth, in line with management guidance. The biggest structural catalyst remains the continued shift toward higher-yield Direct-to-Customer lending. D2C AUM has increased from 19% of total AUM in FY21 to 59% in FY26, while management targets 65% over the medium term. This transition has already resulted in approximately 380 bps expansion in Net Interest Margin from 5.6% to 9.4% and further mix improvement should continue enhancing profitability. Consumer Finance has emerged as the largest growth engine, with AUM crossing INR 5,000 crore, growing 50% YoY, while the company now underwrites approximately 25,000–26,000 loans every day. Management continues targeting 15–16% risk-adjusted yields and ROA exceeding 4% in this business while maintaining prudent underwriting standards. Importantly, nearly 70% of customers are repeat borrowers, highlighting customer stickiness and underwriting quality. Simultaneously, MSME LAP grew 43% YoY to INR 3,691 crore, supported by the addition of 17 new branches during FY26, conservative average LTV of 48%, yields of 17–18% and a large addressable MSME credit gap estimated by management at approximately INR 30 lakh crore. These businesses collectively provide significant operating leverage due to their higher-margin nature.

5. Strategic Initiatives, Operating Leverage & New Growth Opportunities

The company continues executing several strategic initiatives that should further enhance profitability over the next few quarters. During June 2026, Northern Arc signed a strategic Memorandum of Understanding with YES BANK, integrating its proprietary NuScore, NIMBUS and nPOS platforms into the bank's lending ecosystem. This partnership is expected to create significant opportunities across co-lending, loan placement, securitisation, wealth distribution and digital credit origination while expanding the distribution of Altifi bonds and fund management products. The recently approved RBI factoring licence also expands the company's addressable opportunity in receivable financing and supply-chain finance. Meanwhile, the company continues to monetise its technology assets, with NuScore now commercially processing over 2.5 lakh loan assessments, while Altifi has crossed 94,000 registered users, creating capital-light fee income opportunities. Credit Solutions remains another important earnings contributor, with placement volumes reaching INR 11,834 crore during FY26, while placement fee income increased 22% YoY to INR 31 crore. Fund Management also continues to scale, generating INR 38 crore of fee income while maintaining INR 3,092 crore of AUM, with an additional INR 520 crore GIFT City Blue Horizon Fund pipeline expected to expand fee income. Management has consistently demonstrated a strong execution track record by successfully implementing previously announced retail expansion, branch additions, digital underwriting, securitisation capabilities and technology monetisation initiatives while maintaining underwriting discipline and asset quality.

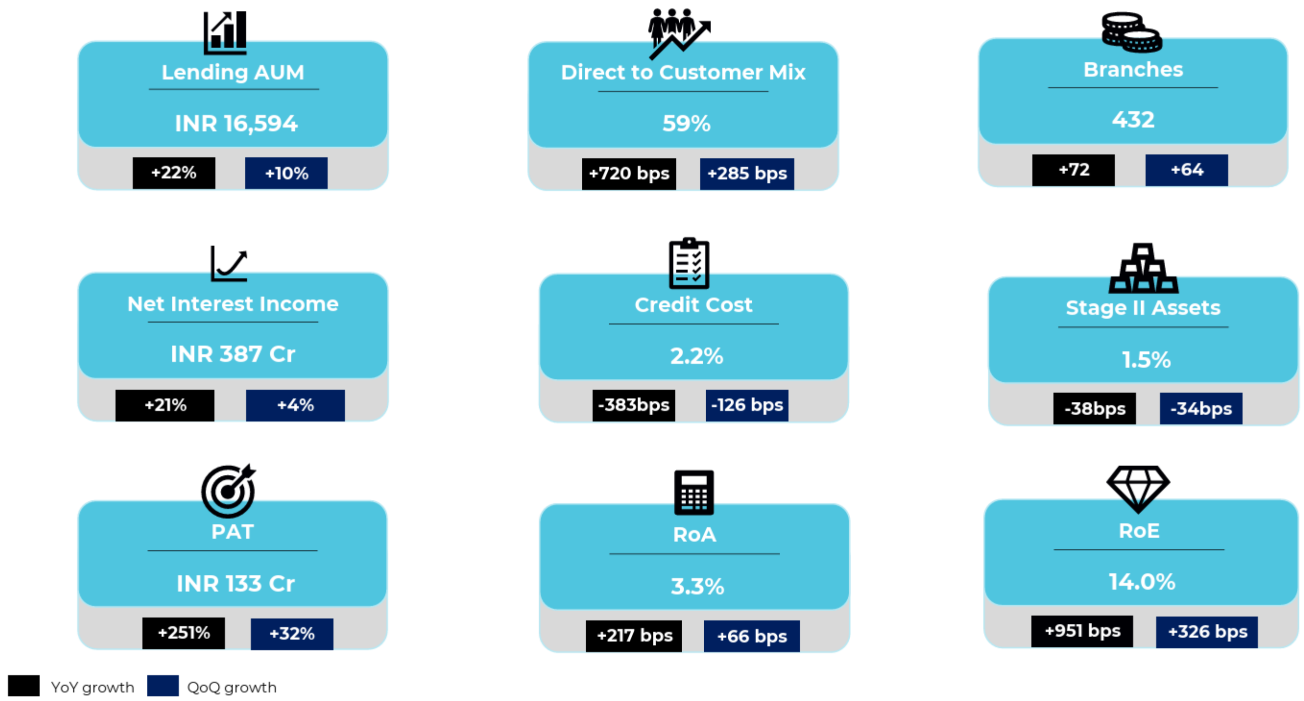
6. Industry Tailwinds, Management Outlook & Medium-Term Growth Visibility

India's structural credit under-penetration across MSMEs, retail borrowers and rural households continues to provide a favourable long-term opportunity for diversified retail NBFCs. Northern Arc is well positioned to benefit from increasing financial inclusion, formalisation of MSME credit, digital lending adoption, securitisation growth and rising institutional participation in private credit markets. Management remains optimistic and has guided for 22–25% AUM growth in FY27, approximately three times India's expected GDP growth, while targeting sustainable ROA above 3% and ROE of 15–17% over the next 8–10 quarters. Credit costs are expected to remain stable at approximately 2.7–2.8%, while funding costs are expected to remain around 8.5–8.6%. The continued increase in D2C contribution toward 65%, combined with higher-margin consumer finance, secured MSME lending, monetisation of NuScore, growth in Altifi, expansion of credit funds and increasing fee-based income should collectively support operating leverage and margin expansion. Flat operating expenses despite aggressive branch expansion during FY26 clearly demonstrate management's ability to scale efficiently, creating significant earnings leverage as loan growth accelerates.

7. Investment Conclusion – BUY for Medium-Term Horizon (6 Months) | Key Risks

Northern Arc Capital presents a compelling medium-term investment opportunity supported by strong earnings momentum, improving asset quality, expanding retail mix and multiple high-margin growth drivers. The company trades at an attractive Price-to-Book valuation of approximately 1.3x TTM, which appears reasonable considering its improving profitability profile, strengthening balance sheet and visible growth outlook. Significant reductions in GNPA (1.2%), NNPA (0.6%), Stage-2 assets and credit costs (2.8%), together with expanding NIMs, disciplined underwriting, stable funding costs and growing fee-based businesses, substantially improve earnings quality and reduce downside risks. Management has consistently executed on previously announced strategic initiatives, including retail expansion, branch growth, technology monetisation and capital-light businesses, providing confidence in future execution. However, investors should monitor short-term risks including geopolitical uncertainty, adverse monsoon conditions affecting rural borrowers, competitive intensity in MSME lending, regulatory changes impacting retail finance and any deterioration in borrower repayment behaviour. Nevertheless, given the company's improving credit metrics, strong capital adequacy, diversified business model, robust technology platform, visible operating leverage and multiple near-term growth catalysts, Northern Arc Capital remains well positioned to deliver healthy earnings growth over the next 2–4 quarters, supporting a BUY recommendation for a 6-month medium-term investment horizon.

<u>Q4FY26 Financial Performance:</u>



Q4FY26 & FY26 Operational Highlights:

INR crore	Q4FY25	Q3FY26	Q4FY26	YoY %	QoQ %	FY25	FY26	YoY %
Interest income[1]	519	602	632	22%	5%	1,969	2,279	16%
Interest expense	198	231	245	24%	6%	823	902	10%
Net Interest Income	**320**	**370**	**387**	**21%**	**4%**	**1,147**	**1,377**	**20%**
Fee & Other Income	30	31	27	-9%	-14%	102	108	6%
Net Revenue	**350**	**402**	**414**	**18%**	**3%**	**1,248**	**1,484**	**19%**
Employee Costs	68	85	85	25%	0%	285	331	16%
Operating Costs	52	53	59	13%	13%	171	198	16%
Total Operating Costs	**121**	**138**	**145**	**20%**	**5%**	**455**	**529**	**16%**
Pre-Provision Operating Profit (PPoP)	**229**	**264**	**269**	**17%**	**2%**	**793**	**956**	**21%**
Credit Costs	194	130	87	-55%	-33%	405	412	2%
Profit / (Loss) on Associates	0	1	(6)	-	-	(2)	(8)	-
Profit before tax	**35**	**135**	**176**	**402%**	**30%**	**386**	**536**	**39%**
Tax expense	-3	33	43	-	30%	85	132	56%
Profit after tax	38	102	133	246%	30%	301	404	34%
Profit after tax (excluding NCI)	**38**	**101**	**133**	**251%**	**32%**	**305**	**406**	**33%**

Recommendation Timeline & Performance Summary: -

1. 10 May 2026 – Initial BUY Recommendation: The BUY call was initiated at a price of 287 with a target price of 330, implying an upside potential of 15% over a 6-months investment horizon.

2. 13 July 2026 – Target Achieved: The stock achieved our target price of 330 on 13 July 2026 and delivered a return of 16% (CMP is 333 on 13 July 2026) in 2 months from our recommendation, significantly ahead of our envisaged 6-months investment horizon.

3. **27 July 2026 – Re-Initiation of BUY Call:** We have re-initiate the BUY call at the CMP of 306 with a target price of 343, indicating an envisaged upside potential of 12% over the next 6 months.

Happy Investing!

Thank you and best regards,

On behalf of Bajaj Capital's Research Team