

<b>Retail Research</b>	<b>IPO Note</b>
<b>Sector: NBFC</b>	<b>Price Band (Rs): 249 - 263</b>
<b>13<sup>th</sup> September 2024</b>	<b>Recommendation: Subscribe for Long Term Investment Horizon</b>

## Northern Arc Capital Ltd.

### Company Overview:

**Northern Arc Capital Ltd (NACL)** is a non-deposit taking diversified NBFC with an Asset Under Management (AUM) of Rs 11,710 cr as of Mar'24. The company focuses on sectors such as MSME finance (40%), microfinance (23%), consumer finance (27%), vehicle finance (6%), affordable housing finance (3%) and agriculture finance (1%). It operates through a network of 328 Originator Partners, 50 Retail Lending Partners and 1,158 Investor Partners providing multi-channel services including Lending, Placements and Fund Management. Northern Arc offers financing to Originator Partners for on-lending and directly to customers. Its presence spans 671 districts across 28 states and seven union territories. The Placements channel helps raise funds through various financing products recording Rs 1,01,903 cr in aggregate placements by Mar'24. The Fund Management division manages over Rs 12,078 cr across alternate investment and portfolio management funds. Northern Arc's proprietary technology stack, including Nimbus, nPOS, Nu Score and AltiFi, enhances efficiency & ensures the ability to serve diverse sectors effectively.

### Key Highlights:

**1. Robust ecosystem creating strong network effect:** The company has created a robust ecosystem of 328 originator partners, 50 retail lending Partners and 1,158 investor partners as of FY24. The seamless integration of multi-channel offerings has expanded its opportunities for debt raising and investments.

**2. Technology product suite drives efficiency:** The company is a technology-driven financial services platform supported by in-house technology solutions that enable it to expand and drive revenue growth. NACL's in-house technology stack consists of **(i) Nimbus**, a curated debt platform that enables end-to-end processing of debt transactions; **(ii) nPOS**, a co-lending and co-origination technology solution based on application programming interfaces ("API"); **(iii) Nu Score**, a customized machine learning based analytical module designed to assist originator partners in the loan underwriting process; and **(iv) AltiFi**, an alternative retail debt investment platform.

**3. Robust risk management processes:** The company considers risk monitoring as a central aspect of its operations across all sectors, channels and borrowers' capacities. NACL's risk management approach has enabled it to actively identify, monitor & manage risks towards creating strong and sustainable business operations. As a result of this approach to risk management, it has one of the lowest GNPA of 0.45% and NNPA of 0.08% as of FY24.

**4. Diversified sources of funding:** The company maintains a well-diversified funding profile that is underpinned by established relationships with lenders & investors, a proactive liquidity management system and a strong credit rating. It reduces the interest rate mismatch while maintaining sufficient liquidity to comply with the LCR norms by investing in low-risk & liquid investments such as short-term treasury bills.

**Valuation:** The company is valued at a P/E & P/BV multiple of 13.4x & 1.5x respectively based on the upper price band on the post-issue capital. The company is one of India's leading diversified non-banking financial companies (NBFCs) in terms of Assets under Management (AUM). It has honed its expertise in facilitating credit across targeted sectors in India. It has a robust ecosystem of 328 originator partners, 50 retail lending Partners and 1,158 investor partners. The issue appears to be fairly valued when compared with close peers on most valuation and financial matrices. We recommend subscribing to the issue for a long-term investment horizon

Issue Details	
Date of Opening	16 <sup>th</sup> September 2024
Date of Closing	19 <sup>th</sup> September 2024
Price Band (Rs)	249 – 263
Offer for sale (Rs cr)	262 – 277
Fresh Issue (Rs cr)	500
Issue Size (Rs cr)	762 – 777
No. of shares	3,06,12,641 – 2,95,43,727
Face Value (Rs)	10
Employee Reservation	5,90,874 shares
Employee Discount (Rs)	24 per share
Post Issue Market Cap (Rs cr)	4,044 – 4,243
BRLMs	ICICI Securities, Axis Capital, Citi Global Markets India
Registrar	KFin Technologies Ltd
Bid Lot	57 shares and in multiple thereof
QIB shares	50%
Retail shares	35%
NIB shares	15%

Objects of Issue	
Sector wise deployment of net proceeds towards onward lending	Estimated amount (Rs cr)
MSME	150.0
MFI	150.0
Consumer finance	150.0
Vehicle finance	25.0
Affordable housing finance	5.0
Agriculture finance	20.0
<b>Net Proceeds</b>	<b>500.0</b>

Shareholding Pattern		
Pre-Issue	No. of Shares	%
Promoter & Promoter Group	-	-
Public & Others	14,23,14,010	100.0
<b>Total</b>	<b>14,23,14,010</b>	<b>100.0</b>

Post Issue @Lower Price Band	No. of Shares	%
Promoter & Promoter Group	-	-
Public & Others	16,23,94,331	100.0
<b>Total</b>	<b>16,23,94,331</b>	<b>100.0</b>

Post Issue @Upper Price Band	No. of Shares	%
Promoter & Promoter Group	-	-
Public & Others	16,13,25,417	100.0
<b>Total</b>	<b>16,13,25,417</b>	<b>100.0</b>

Source: RHP, SSL Research

## Key Financials

Particulars (Rs cr)	FY22	FY23	FY24
Interest Income	780.8	1,148.4	1,712.1
Total Income	135.7	162.7	193.8
PAT	181.9	242.2	317.7
EPS (Rs)	20.5	27.2	35.5
Diluted EPS (Rs)*	14.0	18.6	24.3
P/E (x)	18.8	14.2	10.8
P/BV (x)	2.0	1.8	1.5
RoA (%)	2.3	2.8	3.0
RoE (%)	10.5	13.1	14.9

Source: RHP, SSL Research

\*Diluted EPS includes Compulsorily Convertible Preference Shares (CCPS)

## Risk Factors

- **Credit risk:** The company through lending channels extends loans directly to customers or extends loans to & invests in the debt of Originator Partners for on-lending by them. Any increase in defaults by borrowers may increase Stage 3 assets & write-offs could adversely affect the business, cash flows, financial condition and operations.
- **Investment risk:** A significant portion of the company's investments are in credit facilities & debt instruments which are unsecured and/or subordinated to other creditors. Any inability to recover such investments may result in increased levels of NPAs which could adversely affect the business, prospects, results of operations, cash flows and financial condition.
- **Regulatory risk:** The company is subject to certain conditions & restrictions for financing arrangements and has not been compliant with certain of these covenants in the past. Any inability to comply with repayment and other covenants in the financing agreements could adversely affect business, financial condition, cash flows and results of operations.
- **Liquidity risk:** As is typical for NBFCs, part of the funding requirement is met through short-term borrowing sources such as revolving loans and cash credit facilities. Any asset-liability mismatches would expose them to interest rate and liquidity risks that could have a material & adverse effect on business, results of operations, cash flows and financial condition.
- **Industry risk:** The company operates in a highly competitive industry, any inability to compete effectively may adversely affect business, reputation, results of operations, cash flows and financial condition.

## Growth Strategy

- Enhance the ecosystem by growing and deepening relationships with partners while leveraging and scaling up technology & products.
- Expand to adjacent sectors such as climate lending (electric mobility, solar energy harvesting and distribution), gold loans and enhance ESG risk management systems.
- Expand the Fund Management channel.
- Continue to scale Direct to Customer Lending channel to enhance risk-adjusted returns.
- Focus on credit quality to manage credit costs efficiently
- Continue to diversify sources of funds and widen the lender base to scale borrowing requirements while lowering costs.
- Expand through inorganic growth.

## Assets Under Management (AUM)

Assets Under Management (AUM)	FY22		FY23		FY24	
	Rs cr	% of AUM	Rs cr	% of AUM	Rs cr	% of AUM
MSME	2,836.4	39.9	3,361.6	37.3	4,660.1	39.8
MFI	1,918.3	27.0	2,459.1	27.3	2,712.3	23.2
Consumer Finance	1,096.1	15.4	1,892.9	21.0	3,112.0	26.6
Vehicle Finance	829.5	11.7	865.9	9.6	725.5	6.2
Affordable Housing Finance	234.5	3.3	247.2	2.7	336.9	2.9
Agriculture Finance	193.6	2.7	182.0	2.0	163.1	1.4
<b>Total</b>	<b>7,108.3</b>	<b>100.0</b>	<b>9,008.7</b>	<b>100.0</b>	<b>11,710.0</b>	<b>100.0</b>

Source: RHP, SSL Research

## Assets Under Management (AUM) by Lending Channel

Lending Channels	FY22		FY23		FY24	
	Rs cr	% of AUM	Rs cr	% of AUM	Rs cr	% of AUM
Intermediate Retail Lending AUM	5,449.3	76.7	5,623.2	62.4	5,876.7	50.2
Direct to Consumer Lending AUM	1,659.0	23.3	3,385.5	37.6	5,833.3	49.8
<b>Total</b>	<b>7,108.3</b>	<b>100.0</b>	<b>9,008.7</b>	<b>100.0</b>	<b>11,710.0</b>	<b>100.0</b>

Source: RHP, SSL Research

## Borrowings Mix

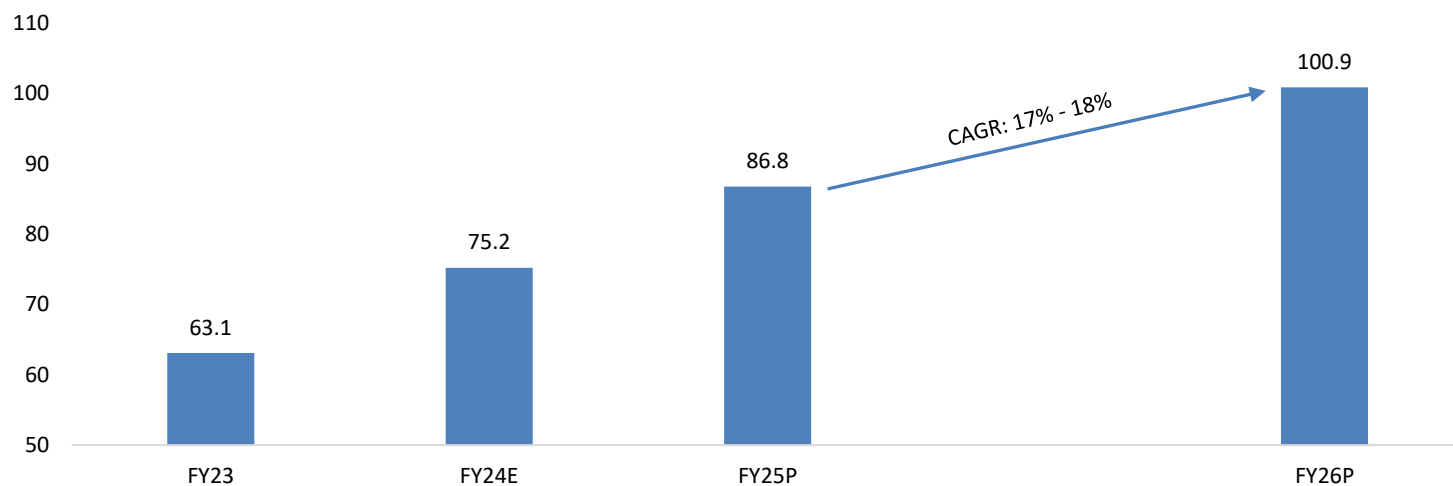
Particulars	FY22	FY23	FY24
Average Tenure of Borrowings (years)	3.03	3.38	3.07
Incremental Cost of Borrowings (%)	8.45	9.48	9.48
Average Cost of Borrowings (%)	8.55	8.84	9.23

Source: RHP, SSL Research

## Industry Overview

**Retail Credit in India** which includes housing finance, vehicle financing, gold loans, education loans, consumer durables, personal loans, credit cards and microfinance stood at Rs 75.2 trillion in FY24. The Indian retail credit market is expected to grow at a CAGR of 17-18% between FY24-FY26E to reach Rs. 100.9 trillion by FY26E. The moderation of growth of retail credit is on account of normalization in the unsecured segment which had witnessed exuberant growth in the past and the impact of RBI's risk weight circular. Moreover, the increasing demand & positive sentiments in the Indian retail credit market present an opportunity for both banks & NBFCs to broaden their investor base

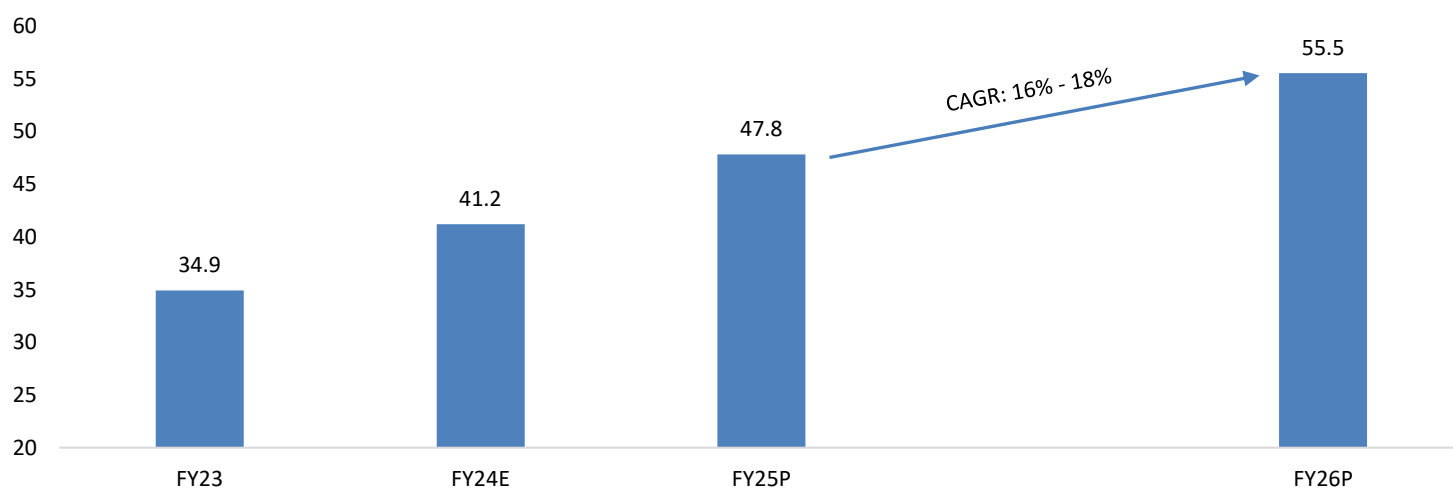
**Retail Credit in India (Rs trillion)**



Source: RHP, SSL Research

**NBFC Credit in India** stood at Rs 48.8 trillion in FY24 and is expected to grow at a CAGR of 16%-18% between FY24-FY26E to reach Rs 55.5 trillion by FY28E. The credit growth will be driven by retail verticals; housing, auto and microfinance segments. Rapid revival of the economy is expected to drive consumer demand in FY25E leading to healthy growth of NBFCs. Moreover, organic consolidation is underway with larger NBFCs gaining share. Further, the growth in the NBFC industry will be driven mainly by large & medium size players with strong parentage who have funding advantages & capability to invest and expand into newer geographies.

**NBFC Credit in India (Rs trillion)**



Source: RHP, SSL Research

## Financial Snapshot

INCOME STATEMENT			
(Rs cr)	FY22	FY23	FY24
Interest Income	780.8	1,148.4	1,712.1
Interest Expense	410.7	557.4	726.4
<b>Net Interest Income</b>	<b>370.2</b>	<b>590.9</b>	<b>985.7</b>
Other Income	136	162.7	193.8
<b>Total Income</b>	<b>505.9</b>	<b>753.6</b>	<b>1,179.6</b>
<b>Operating Expenditures</b>	<b>221.0</b>	<b>391.4</b>	<b>635.9</b>
Employee Expense	97.9	148.9	241.6
Other Expense	123.0	242.5	394.3
<b>Operation Profit before Provision</b>	<b>284.9</b>	<b>362.2</b>	<b>543.7</b>
Provisions	36.5	39.2	122.4
<b>Operating Profit After Provision</b>	<b>248.4</b>	<b>323.0</b>	<b>421.2</b>
Exceptional Items	-	-	-
Share of loss from Associates	-	1.9	1.0
<b>Profit Before Tax</b>	<b>248.4</b>	<b>321.2</b>	<b>420.3</b>
<b>Provision for Tax</b>	<b>66.5</b>	<b>79.0</b>	<b>102.5</b>
Current Tax	50.5	97.0	108.8
Provision related to earlier year	-	-	0.5
Deferred Tax	15.9	(18.0)	(6.7)
<b>Profit After Tax</b>	<b>181.9</b>	<b>242.2</b>	<b>317.7</b>

BALANCE SHEET			
(Rs cr)	FY22	FY23	FY24
<b>Shareholders Fund</b>	<b>1,739.1</b>	<b>1,955.4</b>	<b>2,314.4</b>
Share capital	88.9	89.0	89.4
Instruments entirely equity in nature	82.6	82.6	82.6
Reserves and Surplus	1,567.5	1,783.7	2,142.4
Non-controlling interest (NCI)	93.0	112.3	6.0
<b>Non-Current Liabilities</b>	<b>6,142.0</b>	<b>7,303.8</b>	<b>9,387.2</b>
Debt Securities	1,343.6	1,224.3	1,413.7
Borrowings	4,599.4	5,770.3	7,634.0
Subordinate Liabilities	39.9	40.0	
Other Liability and Provision	159.0	269.3	339.5
<b>Total Equity and Liabilities</b>	<b>7,974.1</b>	<b>9,371.6</b>	<b>11,707.6</b>
<b>Assets</b>			
<b>Non-Current Assets</b>			
Cash and Balances	715.2	232.3	179.4
Balances with Banks	87.3	190.3	228.3
<b>Investments</b>	<b>1,765.7</b>	<b>1,762.7</b>	<b>1,780.7</b>
<b>Advances</b>	<b>5,208.8</b>	<b>6,888.6</b>	<b>9,209.6</b>
Fixed Assets	2.0	3.8	6.7
Other Assets	195.2	293.8	302.9
<b>Total Assets</b>	<b>7,974.1</b>	<b>9,371.6</b>	<b>11,707.6</b>

RATIOS			
Particulars	FY22	FY23	FY24
Yield on Assets (%)	11.1	14.4	17.1
Cost of fund (%)	6.9	8.6	9.0
Spread (%)	4.2	5.9	8.0
NIM (%)	5.2	7.4	9.8
Cost to Income Ratio (%)	43.7	51.9	53.9
Credit Cost (%)	0.7	0.6	1.5
Tax (%)	26.8	24.6	24.4
GNPA (%)	0.5	0.8	0.5
NNPA (%)	0.2	0.4	0.1
PCR (%)	57.3	47.8	82.7
BVPS (Rs)	133.5	150.0	177.1
PE(x)	18.8	14.2	10.8
P/BV (x)	2.0	1.8	1.5
ROA (%)	2.3	2.8	3.0
RoE (%)	10.5	13.1	14.9

Source: RHP, SSL Research

## Peer Comparison

Particulars	Northern Arc Capital Ltd	Five Star Business Finance Ltd	Credit Access Grameen Ltd	Bajaj Finance Ltd	Cholamandalam Investment & Finance Co Ltd	Aadhar Housing Finance Ltd
CMP (Rs)	263.0	741.0	1,255.0	7,425.0	1,576.0	458.0
NII (Rs cr)	985.7	1,729.8	3,290.2	29,582.0	8,543.6	1,161.4
PAT (Rs cr)	317.7	835.9	1,446.0	14,451.0	3,423.0	748.5
M.Cap (Rs cr)	4,242.9	21,683.0	20,011.0	4,59,623.0	1,32,410.0	19,671.0
AUM (Rs cr)	11,710.0	9,640.6	26,714.0	2,44,826.0	1,45,572.0	21,121.0
ROA (%)	3.0	8.4	5.6	5.1	2.6	4.9
ROE (%)	14.9	17.6	24.9	22.1	20.6	18.4
GNPA (%)	0.5	1.4	1.2	1.1	3.5	1.1
NNPA (%)	0.1	0.6	0.4	0.5	2.3	0.7
CRAR (%)	18.3	50.5	23.1	25.0	18.6	38.5
P/BV (x)	1.5	4.3	3.0	6.0	6.8	4.4
P/E (x)	13.4	25.9	13.8	31.3	38.3	24.1

*The data is based on FY24 financial data.*

*For Northern Arc Capital Limited, the Market cap, P/E (x) and P/BV (x) are calculated on post-issue equity share capital based on the upper price band.*

*CMP as on 12<sup>th</sup> September, 2024.*

*Source: RHP, SSL Research*

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