June 06, 2024

Northern Arc Capital Limited: [ICRA]AA- (Stable) assigned to fresh NCDs; Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	325.00	325.00	[ICRA]AA- (Stable); reaffirmed
	0.00	625.00	[ICRA]AA- (Stable); assigned
Market linked debentures	150.00	150.00	PP-MLD[ICRA]AA- (Stable); reaffirmed
Long term – Fund-based limits	71.00	71.00	[ICRA]AA- (Stable); reaffirmed
Long term – Term loans	5,989.15	5,989.15	[ICRA]AA- (Stable); reaffirmed
Short-term bank facilities	645.00	645.00	[ICRA]A1+; reaffirmed
Long term – Non-fund based credit exposure limits	94.85	94.85	[ICRA]AA- (Stable); reaffirmed
Commercial paper	300.00	300.00	[ICRA]A1+; reaffirmed
Total	**7,575.00**	**8,200.00**	

**Instrument details are provided in Annexure I*

Rationale

The ratings factor in Northern Arc Capital Limited's (NACL) track record of operations in the non-banking financial company (NBFC) lending business and its adequate earnings profile. The company's profitability indicators improved in FY2024 with profit after tax (PAT)/average managed assets (AMA) of 2.8% vis-à-vis 2.7% in FY2023, supported by higher margins. The assets under management (AUM) grew by 30% on a year-on-year (YoY) basis to Rs. 11,775 crore as of March 2024 from Rs. 9,036 crore in March 2023 (Rs. 7,111 crore in March 2022). NACL's exposures remain largely towards financial institutions (FIs) with moderate risk profiles. Its underwriting, risk management and information technology (IT) systems are adequate, stemming from the experience in its key target asset segments, which shall support its AUM growth.

Over the years, the company has been gradually reducing its exposure towards NBFCs by diversifying into the retail segment, mostly via partnership arrangements with smaller NBFCs/digital platforms, and by engaging in direct lending to the retail segments. NACL scaled up this segment with a business correspondent (BC) arrangement through its subsidiary (Pragati Finserv Private Limited; Pragati). The company is also expected to focus on secured business loans, which it started providing in the recent past. NACL's overall non-FI (other corporate and retail loans) exposure continued to increase and stood at 43.5% of the AUM as of March 2024 compared to 41.6% as of December 2023 (34.8% as of March 2023). Within the non-FI segment, corporate loans accounted for 5.6% of the AUM as of March 2024.

NACL's capital profile was characterised by a consolidated managed gearing of 4.3 times as of March 2024 (3.8 times as of March 2023) and the capital-to-risk weighted assets ratio (CRAR) was adequate at 18.6%. ICRA notes that the company received equity funding of ~Rs. 382[1] crore in April 2024, which would have brought down the leverage to adequate levels. NACL has filed a draft red herring prospectus (DRHP) and is planning to launch an initial public offering (IPO) in H1 FY2025.

ICRA takes note of the concentration of NACL's exposures, with the top 20 exposures accounting for 20% of the AUM (103% of net worth) as of March 2024 compared to 30% as of March 2022. ICRA notes that the company has focussed on gradually reducing its top 20 exposures over the last few years (60% of the AUM as of March 2015). Going forward, a steady improvement

[1] *From International Financial Corporation (IFC) and others*

in the concentration profile and the ability to maintain healthy asset quality, especially in the newer retail asset segments, would be key monitorables.

The stable outlook reflects company's adequate capital profile and ICRA's expectation of a rangebound asset quality and profitability profile in the near term.

Key rating drivers and their description

Credit strengths

Adequate track record in key target asset segments – NACL has a track record of more than 15 years in the placement (arranging funding for its clients via loan syndication, securitisation and assignment among others) and lending businesses. It provides diverse financing solutions to NBFCs operating in different segments and small & mid-sized corporates. NACL has built relationships with more than 1,000 investor partners, including NBFCs, banks, mutual funds, insurance companies, development finance institutions, private wealth institutions and alternative investment funds (AIFs) among others, which participate in the loan syndication and securitisation transactions facilitated by the company. It also has partnerships with more than 300 originators.

The consolidated AUM grew by 30% YoY to Rs. 11,775 crore as of March 2024 (compound annual growth rate (CAGR) of around 29% from March 2020). As of March 2024, the AUM comprised advances to NBFCs and corporates (40.9%), investment in debt instruments (13.1%; directly and via AIFs), advances to retail via partners (25.7%), direct retail loans (11.7%), managed direct assignment (DA) book (6.7%), subordinated tranches of retail loan pools and DA (1.4%) and guarantees (0.5%). On an asset class basis, NACL's exposure to the microfinance segment was 17% as of March 2024, including the direct retail book (26% in March 2023 and 24% in March 2022). Other key asset classes, namely small business loans, vehicle finance and consumer finance (including direct exposures on loans originated by partners), stood at 26%, 7% and 26%, respectively, as of March 2024.

NACL, via its subsidiary (Northern Arc Investment Managers Private Limited; NAIM), manages five AIFs with a total fund AUM of about Rs. 2,668 crore as of March 2024. Its exposure to these funds was minimal (0.1% of the fund AUM) as of March 2024, following the regulatory directive on investments in AIFs for regulated entities (REs).

The company has a nine-member board comprising four independent directors, including the Chairman, and three nominee members from the private equity (PE) investors/shareholders. NACL benefits from the experience of its senior management team across key business functions.

Nimbus, the proprietary technology system, provides a common system to NACL's originator and investor partners to access fundraising and investment opportunities and execute the entire debt transactions online. N-POS, an extension of Nimbus, is designed to support retail co-lending transactions with originator partners, including underwriting capabilities (Nu Score), as a platform service to FIs. Altifi, a bond trading platform, allows individual and small corporate investors to invest directly in fixed income instruments. Overall, NACL's technology systems are expected to provide value-added services to both investors and partners, which can support fee-based income going forward.

Share of retail segment expected to increase – NACL's retail exposures, direct and via partners, stood at 37% of the AUM as of March 2024 vis-à-vis 16% in March 2022 (10% in March 2021). It increased its retail segment exposures, namely consumer loans, small business loans and microfinance, via partnership arrangements with other NBFCs/digital platforms. These exposures are generally covered by a first loss default guarantee (FLDG) from REs, which currently limit their credit risk to an extent. The share of these loans stood at 25.7% of the AUM as of March 2024 vis-à-vis 24.2% as of December 2023 (15.4% in March 2022).

Following the acquisition of the microfinance business of SMILE on a slump sale basis in April 2022, SMILE's loan portfolio was taken over by NACL and it commenced direct retail lending in the microfinance asset segment with Pragati acting as its BC. As of March 2024, direct lending in the microfinance asset segment stood at 6.4% of the AUM (7.2% as of December 2022). NACL also started providing secured business loans in FY2023, which stood at 5.2% of the AUM as of March 2024 (3.9% as of December 2023), spread across four states at present. This book is expected to remain regionally focussed on South India over the near-to-medium term to maintain tight control on the asset quality. While the diversification in the retail segments, at present, is largely in the unsecured asset segments, the existence of FLDGs and NACL's internal sectoral exposure cap of 30% of the AUM provide support to its risk profile.

Improvement in profitability indicators – NACL's consolidated revenue includes income from the lending portfolio, fee income from syndication services, and investment and management income from the AIFs. Its income growth accrued predominantly from balance sheet expansion with its AUM increasing at a CAGR of about 29% from March 2020. On the other hand, the contribution of placement fee income remained modest as a proportion of net interest income (5% in FY2024, 8% in FY2023 and 14% in FY2022). The yield on loans improved to 17.7% in FY2024 from 15.1% in FY2023 (13.4% in FY2022), partly supported by the increase in the proportion of the high-yielding retail segment in the AUM, thus resulting in a higher margin in FY2024 and FY2023. Correspondingly, the operating expense ratio (as a proportion of average managed assets) increased to 5.7% in FY2024 and 4.4% in FY2023 from 3.1% in FY2022 (2.3% in FY2021). NACL maintained its overall expected credit loss (ECL) provision at 1.4% and 1.3% of AUM as of March 2023 and March 2024, respectively. Accordingly, its net profitability improved further to 2.8% in FY2024 from 2.7% in FY2023 (2.6% in FY2022).

ICRA takes note of the expected increase in the share of retail loans, including the direct retail lending business. The company's ability to keep the operating and credits cost under control, in view of the above, while maintaining the margins given the increasing interest rate scenario, would be key from an incremental profitability perspective.

Credit challenges

Concentrated exposure to entities with moderate risk profiles; controlling asset quality in newer segments would be key monitorable – NACL remains exposed to moderate borrower profiles as it predominantly lends to small and mid-sized NBFCs and corporates. Its exposures are concentrated, with the top 20 entities accounting for about 20% of the AUM (103% of net worth) in March 2024 (28% in December 2022) because of the institutional nature of its exposure to NBFCs and corporates. NACL's unrated exposures stood at 21.5% (excluding co-lending, retail book, AIF, guarantees & DA) of the AUM as of March 2024. Its exposure to the microfinance segment was 17% as of March 2024, including the direct retail book (26% in March 2023 and 24% in March 2022). The company commenced direct lending in the secured business loan segment in Q4 FY2022, which had grown to 5.2% of the AUM from 2.2% as of June 2023.

ICRA notes that the company kept the asset quality under control in FY2024, with minimal incremental slippages in its wholesale book. The overall 90+ days past due (dpd) stood at 0.3% of the AUM (excluding guarantees and DA) as of March 2024 vis-à-vis 0.4% as of December 2023. The retail book originated via partnerships (25.7% of the AUM as of March 2024) has some FLDG coverage, which is typically invoked once the assets become 90+ dpd. With the 90+ dpd in this book at 0.1%, NACL is expected to be made good through the existing FLDG. Thus, the credit losses are expected to be minimal. ICRA notes that the share of pass-through certificates (PTCs; largely subordinated investments) has reduced steadily over the past few years and stood at 0.5% of the AUM in March 2024 vis-à-vis 1.4% in December 2022. It is noted that NACL has a relatively lower track record and portfolio seasoning in the retail segment, which remains a monitorable, given the average risk profile of these borrower segments.

Capital infusion critical for medium-term growth plans – With the sizeable expansion in its AUM in recent years, NACL's managed gearing (consolidated) increased to 4.3 times (3.8 times as of March 2023 and 3.6 times as of March 2022) while net worth/AUM (standalone) declined to 19.3% as of March 2024 from 20.6% as of December 2023 (24.2% as of March 2022). The capital adequacy ratio stood at 18.6% as of March 2024 compared to 19.3% in December 2023, partly impacted by the higher risk weight on consumer credit (~19% of the overall AUM).

NACL raised capital of ~Rs. 382 crore in April 2024 from a new investor. Further, it has filed a DRHP, planning to launch an IPO in H1 FY2025. This is expected to support it in maintaining its managed gearing under 4 times over the medium term. ICRA notes that NACL raised sizeable equity in the past (Rs. 960 crore from FY2014, including Rs. 648 crore in FY2019 and FY2020) from investors such as Leapfrog Financial Inclusion India, IIFL Special Opportunities Fund, Affirma Capital, SMBC Bank, Eight Roads, etc.

Liquidity position: Adequate

As of March 31, 2024, NACL had positive mismatches across all the buckets of the structural liquidity statement. The average tenor of the loan/investment portfolio is 1-2 years. On the other hand, NACL has secured a sizeable portion of its borrowings from longer-tenor loans (average tenor of ~3 years) while only 13% of the total borrowings was from short-term sources including commercial paper, cash credit and working capital demand loans as of March 2024. As of March 2024, term loans, working capital facilities from banks and FIs, NCDs (including sub-debt), external commercial borrowings, commercial paper and PTCs accounted for 66%, 7%, 11%, 8%, 5% and 3%, respectively, of the total borrowings.

NACL had cash and liquid investments of Rs. 1,042.0 crore and undrawn bank lines of Rs. 1,405.0 crore as on April 30, 2024, against repayment obligations of Rs. 3,099.0 crore during May 2024 to October 2024. The monthly collection efficiency remained robust throughout FY2024.

Rating sensitivities

Positive factors – A significant increase in the scale and diversification to retail asset classes, while keeping tight control over delinquencies, could lead to a positive impact on the ratings. A sustained reduction in the exposure concentration could also positively impact the ratings.

Negative factors – A sustained deterioration in the asset quality (90+ dpd/AUM beyond 3.0%), impacting the earnings performance, could lead to a negative impact on the ratings. An increase in the managed gearing beyond 4.0 times on a sustained basis would also negatively impact the ratings.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's credit rating methodology for non-banking finance companies
Parent/Group support	Not applicable
Consolidation/Standalone	Consolidated

About the company

Northern Arc Capital is a systemically important NBFC. It acts as a platform in the financial services sector with the objective of catering to the diverse credit requirements of underserved households and businesses by providing access to debt finance. This is done either through direct lending and investments or by providing syndication and structuring services. The company commenced its business by targeting microfinance institutions (MFIs) and has diversified into other sectors including micro, small, and medium enterprise (MSME) finance, vehicle finance (includes commercial vehicle and two-wheeler finance), consumer finance, affordable housing finance and agricultural supply chain finance. Further, over the years, NACL has steadily diversified across products, geographies, and borrower segments. Nimbus, NACL's proprietary technology system, forms the backbone of its growth as a platform and enables the scaling up of business operations with execution and functional efficiency and data analytics.

As of December 2023, on a fully-diluted basis, IIFL Special Opportunities Fund was the largest shareholder with a stake of 25.6% in NACL, followed by Leapfrog Financial Inclusion India II Limited (22.5%), Augusta Investments II Pte Ltd (19.5%), Eight Roads Investments (Mauritius) (II) Limited (10.2%), Dvara Trust (7.5%), Accion (5.8%), SMBC (5.3%) and others (3.6%).

Northern Arc Investment Managers Private Limited

Incorporated in February 2014, Northern Arc Investment Managers Private Limited (NAIM) is a wholly-owned subsidiary of NACL, which provides investment management services to several AIFs. The company manages five AIFs, at present, while it has already provided full exit from four other AIFs. It also manages two portfolio management services (PMS) strategies.

Northern Arc Investment Adviser Services Private Limited

Incorporated in September 2012, Northern Arc Investment Adviser Services Private Limited (NAIAPL) is a wholly-owned subsidiary, which provides investment advisory services.

Northern Arc Foundation

It was constituted as a Section 8 company (not for profit) in FY2019. NACL holds a 100% stake in the company. Northern Arc Foundation is primarily engaged in the business of, inter alia, providing vocational training and skill training for the development of members of marginalised communities, conducting workshops, seminars and symposiums, carrying out educational programmes for social upliftment, and undertaking research to identify areas for improving the standard of living.

Pragati Finserv Private Limited

Pragati is a recently incorporated subsidiary of NACL (90% stake). In April 2022, NACL had acquired the microfinance business of SMILE. Pragati is operating as a BC for the direct MFI lending of NACL.

Northern Arc Securities Private Limited

It was established to run the bond platform – Altifi, an alternative retail debt investment platform, which facilitates fixed income investments for individuals and small corporates. The company has applied for stockbroker registration in the debt segment with the NSE and BSE.

Key financial indicators (IndAS) – Consolidated

	FY2022	FY2023	FY2024
Total income	917	1,311	1,906
Profit after tax	182	242	318
Total managed assets	8,211	9,841	12,557
Return on managed assets	2.6%	2.7%	2.8%
Managed gearing (times)	3.6	3.8	4.3
Gross stage 3#	0.5%	0.8%	0.5%
CRAR#	22.8%	20.8%	18.6%

Source: Company, ICRA Research; # Standalone; Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Current Rating (FY2025)	Chronology of Rating History for the Past 3 Years							
					Date & Rating in FY2025	Date & Rating in FY2024			Date & Rating in FY2023			Date & Rating in FY2022	
					Jun 06, 2024	Mar 27, 2024	Jul 25, 2023, Aug 07, 2023, Sep 27, 2023, Jan 08, 2024	Jun 23, 2023	Mar 30, 2023	Jul 21, 2022 Aug 29, 2022	Jun 17, 2022	Mar 18, 2022	Mar 02, 2022 Sep 15, 2021
1	NCD	Long term	325.00	325.00	[ICRA]AA- (Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
			625.00	625.00	[ICRA]AA- (Stable)	-	-	-	-	-	-	-	-
2	MLD	Long term	150.00	150.00	PP-MLD [ICRA]AA-(Stable)	PP-MLD [ICRA]AA-(Stable)	PP-MLD [ICRA]AA-(Stable)	PP-MLD [ICRA]AA-(Stable)	PP-MLD [ICRA]AA-(Stable)	PP-MLD [ICRA]A+ (Positive)	PP-MLD [ICRA]A+ (Stable)	PP-MLD [ICRA]A+ (Stable)	PP-MLD [ICRA]A+ (Stable)
3	Long term – Fund-based limits	Long term	71.00	71.00	[ICRA]AA- (Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
4	Long term – Term loan	Long term	5,989.15	5,989.15	[ICRA]AA- (Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
5	Long term – Non-fund based limits	Long term	94.85	94.85	[ICRA]AA- (Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	-	-	-	-	-	-
6	Long term – Unallocated	Long term	0.00	0.00	-	-	-	-	-	-	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
7	Short-term bank facilities	Short term	645.00	645.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-	-
8	Subordinated debt	Long term	0.00	0.00	-	[ICRA]AA-(Stable); withdrawn	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
9	Commercial paper	Short term	300.00	300.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instrument

Instrument	Complexity Indicator
NCD	Simple
MLD	Moderately Complex
Long term – Fund-based limits	Simple
Long term – Term loan	Simple
Long term – Non-fund based limits	Very Simple
Short-term bank facilities	Simple
Commercial paper	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument	Date of Issuance/ Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE850M14BS8	Commercial paper	Jun-27-2023	9.10%	Jun-25-2024	100.00	[ICRA]A1+
INE850M14BQ2	Commercial paper	Jun-19-2023	9.25%	Jun-17-2024	100.00	[ICRA]A1+
Not placed	Commercial paper	NA	NA	NA	100.00	[ICRA]A1+
INE850M07442	Non-convertible debentures	Sep-29- 2022	8.95%	Jun-30-2024	20.00	[ICRA]AA- (Stable)
INE850M07459	Non-convertible debentures	Jun-12-2023	9.00%	Jul-12-2024	57.10	[ICRA]AA- (Stable)
Not placed	Non-convertible debentures	NA	NA	NA	872.90	[ICRA]AA- (Stable)
INE850M07426	Market linked debentures	Jul-27- 2022	Linked to IGB 5.85%	Jan 27-2025	114.10	PP-MLD[ICRA]AA- (Stable)
Not placed	Market linked debentures	NA	NA	NA	35.90	PP-MLD[ICRA]AA- (Stable)
NA	Long term- term loans	Jan-29-2021 to Mar-12-2024	NA	Mar-05-2024 to Dec-29-2027	5,763.14	[ICRA]AA- (Stable)
NA	Term loan – Proposed	NA	NA	NA	226.01	[ICRA]AA- (Stable)
NA	Non-fund based – Credit exposure limits	NA	NA	NA	94.85	[ICRA]AA- (Stable)
NA	Cash credit	Dec-31-2021 to Jan-31-2024	NA	NA	71.00	[ICRA]AA- (Stable)
NA	Short-term bank facilities	Mar-25-2022 to Feb-28-2024	NA	NA	605.00	[ICRA]A1+
NA	Short-term bank facilities – Unallocated	NA	NA	NA	40.00	[ICRA]A1+

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis

Name of the Entity	Ownership	Consolidation Approach
Northern Arc Investment Managers Private Limited	100.00%	Full consolidation
Northern Arc Investment Adviser Services Private Limited	100.00%	Full consolidation
Pragati Finserv Private Limited	90.10%	Full consolidation
Northern Arc Securities Private Limited	100.00%	Full consolidation
Northern Arc Foundation	100.00%	Full consolidation
Northern Arc Employee Welfare Trust	Not applicable*	Full consolidation
Finreach Solutions Private Limited		Equity method
IFMR FImpact Long Term Credit Fund#		Full consolidation
Northern Arc Emerging Corporates Bond Fund#		Equity method

#Based on an evaluation of the existence of control on these AIFs, in accordance with IndAS 110 (Consolidated Financial Statements), these funds have been included as a part of the consolidated financial statements of NACL; ceased to be subsidiaries as of March 2024
** NACL consolidated this entity based on de facto control with effect from April 1, 2021*

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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