Management Discussion

Abhijit Tibrewal - Analyst, Motilal Oswal Financial Services
Yes, sir. Thank you, Muskan. Good evening, everyone. I am Abhijit Tibrewal from Motilal Oswal, and it is our pleasure to welcome you all to this earnings call. Thank you very much for joining us for the Northern Arc Capital call to discuss their Q2 FY27 earnings. To discuss the company's earnings, I am pleased to welcome Mr. Ashish Mehrotra, Managing Director and Chief Executive Officer; Mr. Atul Tibrewal, Chief Financial Officer; Mr. Pardhasaradhi Rallabandi, Group Risk Officer and Governance Head; and Mr. Chetan Parmar, Head of Investor Relations. On behalf of Motilal Oswal, we thank the Senior Management and the Investor Relations team of Northern Arc for giving us this opportunity to host you today.

I now invite Mr. Mehrotra for his opening remarks. With that, over to you, sir.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Hey, thank you, Abhijit. Thank you, everyone. Good evening and thanks for joining us today evening. It is my pleasure to welcome you to Northern Arc Capital's conference call to discuss the performance for the quarter ending 30th September 2026. I am joined by my colleagues Atul Tibrewal, our CFO; Pardhasaradhi, our Group Risk and Governance Head; Jigar, Head of our Strategy; and Chetan Parmar, Head of our Investor Relations. Let me begin with a few highlights for the quarter. I am very pleased to share that we continued on our growth journey, with an AUM increase by 34% on a year-on-year basis, taking to INR 19,003 crore and delivering a record profit for the quarter of INR129 crore .

Despite the challenging geopolitical environment. The performance reflects the resilience of our diversified business model, strength of our robust risk management framework, and our execution capabilities. The macro environment during the quarter Q2 FY27 remained challenging amidst persistent geopolitical uncertainty arising on account of West Asia conflict, heightened global inflationary pressure and impact of El Nino phenomenon, concerns overall potential supply disruption, volatility in the global crude oil prices, and continued to increase retail inflation in India from 4.38% in June 2026 to 5.54% during the quarter.

Further, the rainfall deficiency and drought-like condition in parts of India raised concern about agricultural throughput, rural income, and consumption demand. The evolving implication of AI technological challenges also remain an important consideration for the broader economic and the business environment. Despite these macroeconomic headwinds, India's credit environment remained supportive in Q2, underpinned by resilient domestic demand, sustained consumption, and healthy credit offtake across the key segments.

If you look at as of August 2026, the bank credit grew by about close to 19% on a y-o-y basis, and the retail lending remained the key growth driver, with the NBFC retail loan book growing at about 22% on year-on-year basis. The robust domestic consumption demand arising out of coming out of rising aspiration, expanding access to formal credit, and increase in digital adoption continues to drive growth in India's personal loan market. This momentum is reflected in 34% year-on-year increase in personal loan originations by value in Q1 FY27, as per TransUnion CIBIL data.

The rising disposable income and favorable financial conditions are also fueling spending, while government infrastructure push and continued policy support should sustain economic activity and further accelerate the credit growth. Deeper credit penetration among younger and creditworthy borrowers further supports the industry's growth outlook. Moving to India's MSME credit ecosystem,

continued to demonstrate strong momentum if you look at data as of June 2026, with small business credit portfolio, which means the loans to companies with overall revenue of less than INR5 crore, surpassed INR50 lakh crore revenue, registering about 15% year-on-year growth.

Growth was concentrated predominantly in loans above INR10 lakh, with stable delinquencies, and smaller enterprise borrowers witnessed higher delinquencies, underscores the need for prudent underwriting. With INR3.6 crore to INR8.8 crore registered MSMEs, a significant growth in the registered MSME entities in India, access to formal credit and significant headroom for further credit penetration remains a big opportunity for us. The microfinance industry continued its gradual recovery in Q2 FY27, supported by improving asset quality, stronger collection, and a revival in disbursement momentum .

Following a prolonged period of portfolio contraction, repayment behavior showing signs of improvement aided by tighter underwriting norms, borrower-level indebtedness guardrails put in by MFIN and implemented by most of the lenders, and greater lending discipline. Improving collection efficiency and a renewed focus on responsible lending are supporting a more stable operating environment for the sector. Having said so, we remain cautious in geographies affected by rainfall deficiency. Moving to geopolitical crisis, the ongoing geopolitical tension continues to create uncertainty around global trade and crude oil prices.

It is fair to highlight that less than 2% of our portfolio directly and indirectly exposed to segments which are directly impacted by high crude oil prices. Though we remain insulated in the first order of impact in this crisis, however, we continue to be vigilant and cautious, given that the headwinds of that translates into inflation and other sub-trends. Turning to drought situation, while the El Nino phenomenon has contributed to rainfall deficiencies in certain parts of India that raised concerns about drought-like conditions, our direct exposure to the most affected regions remain very, very limited.

Maharashtra and Karnataka have been identified among the states facing significant rainfall-related challenges. I would like to highlight that in Maharashtra we have no exposure to MFI. In Karnataka, following the MFI indebtedness and issues and subsequent state ordinance, we had significantly strengthened our assessment and underwriting processes over a period of time, and all our loans in our rural finance business are underwritten using, whether they coming from JLG or non-JLG, are underwritten using our proprietary scorecard called NeoScore.

Further, the significant portion of our portfolio is supported through CGFMU, providing additional protection against potential credit losses. Having said so, we remain very cautious in Karnataka and prioritizing customers with stronger credit profiles and proven repayment track record with Northern Arc. The collection efficiency remained robust at 99.7% as of September 2026, with key states such as Tamil Nadu and Karnataka demonstrating very strong performance. With respect to intermediate retail lending business, we draw comfort from their strong capitalization and resilience with no partner default during the recent microfinance stress.

We continue to closely monitor the borrower-level cash flows, repayment behavior, and portfolio quality. Overall, our limited direct exposure to drought-affected areas, strengthen underwriting standard, diversified credit protection, and a strong financial position of our lending partners provides us with confidence in our ability to navigate the evolving situation. I think it is fair to spend a few sentences talking about the consultation paper issued by the IRDAI on insurance distribution and commission.

Our proposal aimed to enhance the prudence and ensure better pricing for policyholder and greater

participation and penetration of protection solution to country at large. From Northern Arc perspective, we continue to participate. However, fair to highlight, we do not expect any material impact from this proposal, as insurance commission income accounts for less than 1% of our net revenue in H1. The inflationary trend leading to higher interest rates, I think that is one of the interesting part of conversation in the recent days.

The persistent inflationary pressure driven by elevated energy prices, supply-side uncertainty have contributed to rising global bonds yields, tighter financial conditions. We have started witnessing marginal increase in yield on incremental borrowing; however, our diversified borrowing profile, our asset-liability structure provide a degree of resilience against rising interest rates. Approximately 37% of our borrowings are at fixed rate, which were locked in much earlier. Looking at the interest rate environment, we expect COF to increase marginally in H2.

On asset side, our intermediate retail business, which accounts to 25% of our loans asset, has a variable portfolio allowing us the yield to adjust the response to change the interest rate, subject to contractual reset mechanism. To this effect, we have already increased our FBLR by 30 basis points. Further, loans worth approximately INR8,500 crore are scheduled to mature over the next six months and expected to get repriced automatically. This provides a natural hedge against the rising cost of funds and help mitigate the potential impact on margin.

We further expect that our direct-to-customer mix to increase to about 70% from current 66%, which will partly compensate the increase in COF. We believe we should be able to maintain our NIM guidance for rest of the year and for the full year on a FY27 basis. Just now turning about our own performance, we continue to build a strong momentum where we saw a sequential growth across the sector. We reported the profit after tax of INR129 crore for the quarter, a strong 41% growth on a y-o-y basis, underscoring the resilience of our diversified business model and a very disciplined execution.

Our assets under management grew by 34% y-o-y basis to INR19,003 crore, outpacing the industry growth. This was driven by direct-to-customer segment, which now contributes 66% of our total assets under management. Direct-to-customer portfolio itself grew by 16% quarter-on-quarter, crossing INR12,502 crore. MSME financing continued to be an important growth driver, with portfolio expanding by 39% on an year-on-year basis to INR4,240 crore. The company expanded its geographical footprint by entering Uttar Pradesh with additional 11 branches.

Further, company remained focused on growing its book through higher ticket loan against property, between INR10 lakh to INR15 lakh and above segment. In parallel, the intensified our collection efforts led to an about 80 basis points quarter-on-quarter improvement in our expected collection efficiency to 98.3% in September 2026. Consumer finance, another key segment where we continued to see strong momentum in the business, with assets under management increasing by 19% quarter-on-quarter to INR6,912 crore. India's consumption demand remained very strong across both rural and urban markets, increasingly driven by access to credit.

The company continues to focus on building more resilient portfolio through higher ticket size loans and a longer-tenor loans. The share of loans with ticket sizes above 50,000 has increased from 37% to about 69% in 2026. Similarly, the share of disbursement with tenor more than six months have now gone to about 95% over the same period. This calibrated shift in portfolio mix reflects company focus on improving customer profiles and strengthening portfolio quality. In our rural finance business, we continue to build on momentum, with quarterly disbursement of INR399 crore and AUM grew by 12% quarter-on-quarter to about INR1,350 crore.

Our 30 plus days past due date, 30 plus DPD, continued to be one of the lowest in the industry at 0.4%. In our credit solution segment, we continue to benefit from strong and expanding network of our 382 plus originating partner. The quality of this network remains high, with around 93% of our partners rated BBB and above, and approximately 93% maintain capital adequacy upward of 20%. This provides a robust foundation for sustainable growth of our intermediate retail lending. As part of our credit solution platform, we recorded a healthy growth of 7% quarter-on-quarter in our volume, taking to the disbursement of INR6,501 crore.

This business is predominantly a fee-led business and we have seen big growth there, like we keep saying, continues to complement our lending operation. Our placement volume in Q2 grew by about 60% on year-on-year basis to INR4,088 crore. Our performing credit fund AUM stood at INR2,787 crore. We successfully closed our seventh fund, delivering the gross return of 14.5%. Further, we achieved the first close of our diversified debt fund with INR400 crore of committed investments. The fund is of INR2,000 crore in size, and we continue to raise money and deploy money for this fund.

The company has also launched our first-ever open-ended private credit fund called Savings plus Fund. This milestone reflect continued progress both in terms of delivering return in line with our guidelines to our investor, at the same time building high-quality scale with launch of new offering in our private credit landscape. This performance underscore our strategic focus in building a very comprehensive credit solution ecosystem, which is unique and powerful, and leveraging capital-light fee streams along with balance sheet-led lending model.

Our proprietary technology stack, a key role in enabling credit under the credit solution business called Nimbus, our B2B platform has enabled over one trillion of credit flow through this platform. And our nPOS, which is our partner origination system for retail loans, and our API-based on-lending and co-lending platform, we underwrite over 20,000 to 25,000 loans a day. Our proprietary machine learning-led underwriting scorecards, NeoScore, has essentially helped us to select the right set of customers, both in terms of ticket size, price, default, probability of default, and get right set of risk-adjusted return.

Further, we continue to see strong traction in our retail bonds platform, AltiFi, which has now registered users of over 1,10,000 and growing every hour. Volumes on the platform has more than doubled year-on-year, increased from INR164 crore in Q2 to about INR450 crore in Q2 FY27, reflecting a strong investor participation and engagement on the platform. Together, these businesses enhance capital efficiency, diversify revenue streams, and enable us to facilitate a large flow of credit beyond our balance sheet.

Risk management remain a core of our strategy and continue to be a key differentiator for Northern Arc. Our underwriting framework leverages over 52 million data points, more than 30 plus proprietary risk models, supported by dedicated team of over 100 plus professional on-ground presence, spanning 25% of India's districts. This combination enable us to identify emerging trends early and generate right set of risk indicators, maintaining strong portfolio quality across the business cycle. During the quarter, our asset quality remains stable, with net NPA of 0.5% as of 30, September 2026.

However, our provisioning coverage ratio on Stage three has improved by 10% to about 58.9%. Credit cost for the Q2 was flat on quarter-on-quarter to 2.6%, remaining within our guided range and reflecting the effectiveness of our risk management and collection framework. Overall, we delivered a strong quarter supported by healthy disbursement momentum, resilient portfolio

performance, and a steadily improving credit trends. While we remain watchful of external uncertainty, including geopolitical development, weather-related risk, we believe our diversified portfolio, disciplined underwriting approach, and a robust risk control positions us well to navigate through this challenging period.

With that, I would like to hand over and invite my colleague Atul to take you through the financial details. Atul, over to you.

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
Thank you, Ashish, and good evening, everyone. Let me walk you through the financial highlights for Q2 FY27. We achieved an important milestone during this quarter, with our direct-to-customer AUM crossing INR12,500 crore, underscoring the continued execution of our strategy to build a granular, diversified, and scalable retail franchise. Our total AUM stood at INR19,003 crore, reflecting a strong 34% y-o-y growth. The D2C segment contributed 66% of the AUM, with MSME finance at 22%, consumer finance at 36%, MFI at 7% of the portfolio.

Net interest income grew by 32% y-o-y and 8% quarter-on-quarter to INR425 crore. Our net interest margin for Q2 was 9.3%, reflecting the strength of our portfolio mix and disciplined pricing approach. Our cost of funds increased marginally by nine bps quarter-on-quarter to 8.55% for Q2, primarily reflecting the tighter liquidity and interest rate environment. Encouragingly, our incremental cost of fund remains stable at 8.8%, demonstrating our continued access to diversified funding source at competitive rates.

Total net revenue including fee income grew by 32% y-o-y and 9% q-o-q to INR453 crore. At the same time, the operating expense remained well controlled, with the expense ratio stable at 3.6%, reflecting ongoing operating leverage and disciplined cost management. Pre-provisioning operating profit grew by 32% y-o-y and 9% quarter-on-quarter to INR286 crore. Despite the broader macroeconomic uncertainties, the asset quality continue to be resilient. The credit cost remained stable at 2.6%, well within our guided range and reflective of the strength of our underwriting and collection capabilities.

Consequently, PAT grew by 41% y-o-y to INR129 crore. Our profitability ratios also continue to improve, with ROA increasing to 2.8% and ROE improving to 12.4%. On the liability side, we continue to diversify our funding franchise with a sustained focus on securing long-term sources. Anticipating a tighter system liquidity and a reversal in the interest rate cycle following the geopolitical developments earlier in the year, we maintained higher liquidity levels on our balance sheet to support growth and preserve funding flexibility.

As a result, our liquidity position remains quite strong, with a surplus liquidity of approximately INR1,300 crore and a liquidity coverage ratio above 150%, providing a comfortable buffer to support the future growth. Total borrowings stood at INR14,107 crore as on September 2026. Around 63% of our borrowings are linked to variable interest rates, with nearly half of this benchmarked to MCLR, where the transmission of rate movements typically occurs with a lag. We continue to maintain our diversified funding mix, with 23% of the borrowings sourced from offshore and the DFI partners, and the remaining 77% from the other domestic institutions, underscoring the strength, depth, and diversification of the lending relationship.

Our balance sheet remains strong; tangible net worth increased by 15% y-o-y to INR4,221 crore, reflecting consistent earnings growth and capital accretion. Debt-equity ratio improved to 3.3 times, further strengthening our financial position while preserving ample capacity to support the future

growth. We continue to maintain a comfortable capital position, with CRAR at around 21%, well above the regulatory requirements, providing sufficient headroom to fund future growth opportunities while maintaining strong balance sheet resilience.

To conclude, the quarter reflects the strength of our franchise and the resilience of our business model. We delivered a healthy growth, improved profitability, maintained strong asset quality, and further strengthened our capital position. While we remain watchful of the external uncertainties, our diversified portfolio, prudent leverage, disciplined risk management, and a strong liability franchise provides us with a confidence in our ability to sustain profitable growth. Our focus will continue to be on balancing the growth with portfolio quality, maintain superior risk-adjusted returns, and creating long-term value for the shareholders.

With that, we open the floor for questions. Thank you.

Questions & Answers

Operator
Thank you very much. [Operator Instructions] The first question is from the line of Raghav Garg from Ambit Capital. Please go ahead.

Raghav Garg - Analyst, Ambit Capital
Hi. Good evening. I just have one question on your opex. When I look at the average cost per employee or even other opex per branch, that has risen by about 11% quarter-on-quarter and 17% respectively. What is the reason for that? And even when I look at the employee cost, when I look at the y-o-y trends over the last four, five quarters, they have been rising at 20%, 25%. I just wanted to understand what is going on there in the opex line item. Why are the unit costs rising so much? That is the only question that I have.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
I think, hi, this is Ashish here. Just want to say two big moving parts. One is we entered UP, so obviously there is an expansion in a branch footprint led to the cost. You get the cost early, and the productivity comes in over a period of time. The second, we have invested heavily in technology, and we continue to invest both in terms of building our own direct lending capabilities, and we have also launched the new variant of our AltiFi website, which is our bonds platform.

So I think larger allocation between expansion of physical footprint coupled with expansion and investment in the technology, both for direct lending and for the new refresh version of our bonds platform. And we will continue to invest in both of them, at least on...

Raghav Garg - Analyst, Ambit Capital
Okay. When I look at say the number of employees that has gone up by about 3.5%, 4% q-o-q, is that the only reason? You have hired higher cost employees? Is that the reason for the salary expense to go up by 11%?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Yeah, yeah. We have added the quality of senior talent also in the AltiFi and in the debt capital market business to build the fee piece. That is the another part which comes in, and obviously the tech expansion.

Raghav Garg - Analyst, Ambit Capital
Understood. That is all from my side. Thank you.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
No, thank you.

Operator
Thank you. The next question is from the line of Nischint Chawathe from Kotak Securities. Please go ahead.

Nischint Chawathe - Analyst, Kotak Securities
Hi. Just two questions. One was on AltiFi, if you could maybe call out some quantum of capital burn that it may entail. And the other one was actually on the insurance draft guidelines that I think you made a mention. You clarified that the insurance income is sort of less than 1% of earnings, but just curious how much is the credit loss reduction because of insurance policies? And do these policies continue in the future? Thank you.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
No, no, hang on. Hi, this is Ashish. Just want to clarify. Credit-linked protection insurance we continue to offer, both in our LAP businesses and for the rural business. I think it is important to provide right set of protection solution so that in case of mortality or higher incidence of morbidity, we do not put pressure on the families. I think it is important to do. I was referring more, and I am deeply committed to ensure as a responsible lender that we provide right set of protection solution to our people on the retail platform.

What I was referring to was the commission or the income we earn when we offer these product that constitute less than, significantly less than 1% of our fee of our overall revenue number. So I think that is where it is, and I said even if that moves whichever way the regulatory guidance come, we are perfectly fine with it. And obviously, as you see expansion in our retail growth like we have done, we are confident it will not have any meaningful impact as we look at forward-looking basis.

And AltiFi, we continue to invest both in terms of websites and solution, and it is an allocation of capital which we are doing. For the rest of the year, I think we will continue to, we will put in about INR10 crore to INR15 crore, but it is well within our budget and guidance what we have issued earlier, and we stand committed to the guidance we have issued earlier.

Nischint Chawathe - Analyst, Kotak Securities
Got it. Thank you very much.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Thank you.

Operator
Thank you. The next question is from the line of Sameer Bhise from Diamond Asia. Please go ahead.

Sameer Bhise - Analyst, Diamond Asia
Yeah. Hi. Thank you, and congrats on the quarter. Just had two questions. First is on the Stage three inch-up on a sequential basis. Can you just quantify where is it coming from? Is it only due to say share of D2C going up, so the book kind of gets seasoned, or how do we think about it?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Yeah, I am going to request Pardha, our Global Group Risk Head to answer.

Pardhasaradhi Rallabandi - Group Risk Officer and Governance Head, Northern ARC Capital Ltd
Yeah. The Stage three increment is partly on account of retail, the proportion of the retail book going up, less than 25% of that. The other increase is actually on account of classification of one set of exposures which we have taken in settlement of one trade exposure a couple of years back. But having said that, this is more a accounting classification issue, and it is fully provided for. What I can confirm is that the change in accounting that we are talking about is 100% provided for, and it doesn't have any net impact on the book.

Sameer Bhise - Analyst, Diamond Asia
So this was from the wholesale portfolio?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
It is a portfolio we purchased which we covered earlier.

Sameer Bhise - Analyst, Diamond Asia
Okay. So that also explains the PCR jump up sequentially?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Yes, yes. So we would have discounted it, 100 rupee of book we purchase at a fair value of 80. That is already adjusted for, so this is the accounting adjustment.

Sameer Bhise - Analyst, Diamond Asia
Okay. And ex of that, what are you seeing on ground with respect to asset quality, especially in some of the impacted states? Anything to read there?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Segment level, what we are seeing?

Pardhasaradhi Rallabandi - Group Risk Officer and Governance Head, Northern ARC Capital Ltd
Yeah. Ashish spoke about the Asia crisis, inflation, El Nino impact, this sort of things. What we see as of now is that there should be some stress that is building up, though not really in our areas. Part of Maharashtra, part of northern part of Karnataka is where we see, and we have very little portfolio there. So to that extent, we are cautiously optimistic in terms of numbers. But having said that, we are also conscious that the macro headwinds are pretty much there, and it should come and we will have some that on the portfolio.

Because of which, we are quite conscious, and this is a quarter where we have taken additional provisions, additional overlay, particularly in both MSME and in rural finance in anticipation of the stress that may come. This is more a conservative call and this is a quarter where we thought we should, though the numbers are yet to show anything on either of this portfolio.

Sameer Bhise - Analyst, Diamond Asia
Sure. And just finally on the asset side, any pricing actions we have taken in terms of incremental disbursements given the way the rate cycle is shaping up? Yeah, that is from my side.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Although it is safe to say that we hold our guidance on the credit cost. We have already increased

our FBLR by 30 basis points. Like I said, our portfolio, there is an ability to reprice our intermediate retail book. There is also a book which will, which is coming up for maturity, which obviously naturally, as we redo this new transaction, will get priced appropriately. Overall, given the change in the mix, we don't see any pressure in NIM. We should be able to hold to the guidance we have given. We may not see expansion, but we will be able to hold what we have said earlier.

Sameer Bhise - Analyst, Diamond Asia
Sure. Thank you and all the best. That is all from my side.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Thank you.

Operator
Thank you. The next question is from the line of Parth [Phonetic] from DAM Capital. Please go ahead.

Parth - Analyst, DAM Capital
Hi, team. Am I audible?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Yeah.

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
Yes, please.

Parth - Analyst, DAM Capital
Congrats on a great set of numbers. Just a couple of things here. With now a very good set of growth numbers in our second half, I mean in the second quarter, do we think the growth momentum could sustain better in generally a stronger set of second half, which is usually the case? And do we see we beating our guidance on growth this year of 20% to 23%? That was one. And secondly, on credit cost, you have been holding up till 2.6%. Can you give us some color on what is the exposure on Karnataka? And do we think, enough buffers with already built in, we could be closing the year at lower end of the guidance this year, or the second half credit cost could be better?

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
So, hi, Atul this side. As far as the guidance on the credit cost is concerned, as we have mentioned that we are holding on to 2.6% to 2.8%, I think we are within that range and we will continue to be in that range. That is the guidance we continue to hold. As far as the AUM growth is concerned, we are currently at around 34% Q2 versus Q2 last year. I think we will continue to be holding to the guidance of 23%. We should be in the range of 23% to 25% for the full year.

So we hold to both the guidance on the credit cost as well as on the AUM. As far as Karnataka is concerned, as we mentioned, we have a very small exposure in Karnataka.

Pardhasaradhi Rallabandi - Group Risk Officer and Governance Head, Northern ARC Capital Ltd
The rural finance exposure we have in Karnataka is 2% of the overall AUM that we have, and part of, quite a bit of that is actually covered through CGFMU cover as well. So to that extent, we are reasonably protected on that portfolio. While there is concern on where the drought situation is or how much it is likely to impact on the portfolio, we are reasonably protected and it is a small part of

the portfolio.

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
And in Maharashtra, we do not have any exposure on the microfinance portfolio.

Parth - Analyst, DAM Capital
Got it. That is really helpful. Thank you.

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
Thank you.

Operator
Thank you. The next question is from the line of Kaushik Agarwal from Haitong. Please go ahead.

Kaushik Agarwal - Analyst, Haitong
Yeah. Hi. Thank you for the opportunity. I hope I am audible.

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
Yes, please.

Kaushik Agarwal - Analyst, Haitong
Sir, just on your guidance on the growth piece, you hold your guidance for 20% to 25%, but seeing the trend of 34% growth in this quarter, even if we grow by 5% sequentially for the next two quarters, we will easily exceed the guidance which the management has given. So are you seeing some sort of a slowdown at least in the month of October or November, due to which you are not upgrading the guidance on the AUM front?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
No, we should do upward of 25%, but that is the position we like to hold. Obviously, we continue to remain cautious. We are going through a very different environment. The current demand on account of festival season between the consumer finance and MSME is very, very good and robust, but we need to look at it how the rest of the year plays out. From where we are today, you are rightfully saying we should do upward of 25%, and that is our endeavor will be. We will try and do better, but we want to ensure what we tell you, we do better than that. That is the core of it.

Kaushik Agarwal - Analyst, Haitong
Okay.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Simple math tells you that we will do.

Kaushik Agarwal - Analyst, Haitong
Okay. Sir, next question is on the margin. Sir, our D2C mix has increased sequentially each quarter, but still our yields have remained broadly steady. In fact, there has been some pressure being noted in this quarter. So if we are guiding for 70% mix on the D2C front, don't you think that yields should inch up from here on and thereby margins should expand in the second half?

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
Yeah, you are right. The yield should definitely go up going forward, but at the same time, as you can see, the cost of funds will also go up. In fact, in Q2, the cost has already gone up by nine basis

points, and we are already seeing an increase in the repo rates by RBI. The market benchmark yields have also spiked up significantly. In fact, ICRA in one of their reports have mentioned that the NBFC cost of fund will go up by close to 30 basis points in H2. So I think in line with that, our cost of fund will also go up.

And so to that extent, that cost will be made good by the incremental yields. So that is the reason Ashish also mentioned in his opening remarks that we will be holding on to the NIM projections or NIM guidance for the current financial year.

Kaushik Agarwal - Analyst, Haitong
Okay. So, sir, a part of this question, like how much are you building in in terms of repo rate hike in your assumption on the cost of fund side?

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
If you look at our existing cost of fund, it is at 8.55% for the book, already gone up by nine bps. So in line with what we are seeing from the market trends, this should be closer to 8.65% in Q3 and 8.85% in Q4, which would mean that we will end the year at close to 8.75%. On the incremental side, I think the cost of fund should be nearer to 9% in Q3 and 9.25% in Q4, which would mean for the full year the incremental cost of fund will be closer to 9%. So this is against 8.65% full year last year, and the exit COF will be closer to 8.75%.

Kaushik Agarwal - Analyst, Haitong
Got it. And, sir, just last question on your ROA for the full year FY27 and FY28, what is the guidance for FY28? And for FY27, should we expect the ROA should improve from these levels?

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
Yeah. So if you look at our ROA tree, the ROA has been consistently improving quarter-on-quarter. In fact, same period last year we were at 2.4%, last quarter we were at 2.7%, and this quarter we are already at 2.8%. So our guidance remains the same that we will be around 3% by the end of this financial year, and next year we should be in the range of 3.4% to 3.5%.

Kaushik Agarwal - Analyst, Haitong
Okay. Got it. Thank you so much, sir. That is all from my side.

Operator
Thank you. The next question is from the line of Pawan Kumar from Edelweiss. Please go ahead.

Pawan Kumar - Analyst, Edelweiss
Hi, sir. Am I audible?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Yes, please.

Pawan Kumar - Analyst, Edelweiss
Just one clarification before I move to the questions. The ROA when you said 3.4% to 3.5% in FY28, is that the FY28 exit ROA, right?

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
That is right. Of course.

Pawan Kumar - Analyst, Edelweiss
Okay. On the, thank you, on the capital adequacy, can you please let me know what is our Tier one right now, and when do you think we will have to go for the fundraise? That is one question. Second question, in the investment management side, the fund management side, is the fundraise INR400 crore only, or has there been the overall amount is much higher? Because we have seen like INR9.8 crore of losses in the investment management segment, right? So, yeah, I just want to understand that. Those are my two questions.

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
Yeah. On the capital adequacy, the Tier one capital is closer to 20.5%, and the covenants which the banks have, generally the lenders have is 16% to 17%. So for us there is enough headroom for the next one, one and a half years before we need to hit the road. Debt-equity is also very low at 3.3, and generally the rating agencies and the regulators and the lenders are all comfortable till around four to 4.5. So I think we will not need to raise equity for the next one and a half years. And plus we are highly profitable, we add profits every quarter .

So that also helps. So we are home as far as capital adequacy is concerned for the next one and a half years. Sorry, what was your next question?

Pawan Kumar - Analyst, Edelweiss
Thanks for that. On the fund management side, we have seen a loss of INR9.8 crore, right? So what resulted in that? What is the overall fundraise that we have done?

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
So there was one account where we had to take a fair value loss, since we had an investment in that fund from the manager itself. And that fund has come up for maturity, so we have taken that hit in the fair value.

Pawan Kumar - Analyst, Edelweiss
Fair enough, sir. Yeah, that is from mine. I will come back in the queue. Thank you.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
I think the last question was on how much fundraise we have done. The fundraise is significantly higher. The fundraise of INR400 crore refers to the first close of a new fund we launched this quarter called Diversified Debt Fund, which is a fund is of 1,500 plus INR500 crore of greenshoe, taking the total fund to INR2,000 crore. We launched this fund in this quarter, and we first closed with INR400 crore of commitment and deployment.

Pawan Kumar - Analyst, Edelweiss
Thank you, Ashish.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Thanks.

Operator
Thank you. The next question is from the line of Prit [Phonetic] from Wealth Financial. Please go ahead.

Prit Nagarsheth - Analyst, Wealth Financial
Yeah. I just wanted to understand regarding the credit guarantee fund. Two things here. One is that how is this shaping up in terms of is this being continuously rolled out and accepted by the government, or are there any changes to it that are coming out in the near future? And the second part is that how do we navigate it if there was a reduction in the overall amount for this fund?

Pardhasaradhi Rallabandi - Group Risk Officer and Governance Head, Northern ARC Capital Ltd
As it stands, the NCGTC has opened the CGFMU scheme. The scheme is open for the origination that has happened before March 2026. That portfolio continues to be secured and insured, and we have paid the premium for that portfolio. The new bookings from 1st April 2026 onwards, they are yet to open the window. As and when it is opened, we will be able to lodge that portfolio also and pay the premium. But having said that, our underwriting continues to be the way it is based on NeoScore, and we underwrite the borrowers.

The underwriters or people at the ground level would not know whether there is an insurance available or not available. The underwriting is purely based on NeoScore and purely based on our comfort on what the portfolio should look like. The CGFMU cover is more for volatility being controlled, and if there are any very high risk events, we should not have significant impact on the portfolio. But having said that, at a ground level, it is the borrower underwriting, it is not insurance which covers the portfolio.

Prit Nagarsheth - Analyst, Wealth Financial
So what percentage of your book is covered via this part?

Pardhasaradhi Rallabandi - Group Risk Officer and Governance Head, Northern ARC Capital Ltd
As far as our rural finance book is concerned, around 50%, 55% plus is what is covered.

Prit Nagarsheth - Analyst, Wealth Financial
I see. Okay. Understood. Okay, great. Thank you.

Operator
Thank you.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Hey, we need to, fair to highlight this one thing, Ashish here, that this constitute less than 7% of our overall balance sheet. Our current performance, 30 plus is significantly lower, that means we are perfectly fine. We like to continue to keep this additional guarantee cover possible, and we continue to, like me and my colleague said earlier, create overlay around it. However, the government right now I think looking for revalidation of the scheme, and we are waiting for it and we will apply for it.

So if it comes through, we are fine with it. Irrespective whether it is there, not there, from the last two years, all our loans are individually underwritten, whether group or non-group. We think of this as a joint co-origination and joint servicing program for us to collectively reach out to customers, provide them with credit solutions and service them, and each loan is underwritten using our proprietary scorecard on the ground. So we are perfectly fine. We risk tested it, and we are fine with what we are doing, and it is a pretty small part of our portfolio.

Prit Nagarsheth - Analyst, Wealth Financial
Thank you.

Operator
Thank you. The next question is from the line of Aravind Ravichandran from Sundaram Alternates. Please go ahead.

Aravind Ravichandran - Analyst, Sundaram Alternates
Hi. I hope I am audible.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Yes, please go ahead.

Aravind Ravichandran - Analyst, Sundaram Alternates
Thank you so much for the opportunity, and congratulations on the resilient set of numbers despite a tough environment. A few questions here. You talked about 3.4% to 3.5% ROA by exit quarter of FY28. How do you visualize this? Where the major contribution has to come from? Is it opex optimization, or NII expanding, net interest margin expanding? Is that going to be the major driver, or credit cost also will be a major driver?

How do we envisage that? That is my first question. And you talked about Stage three increase. Most of it is related to reclassification of one account, but Stage two also increased. Is that also related to the same wholesale business, or something else going on there? And you talked about additional overlay. Can you quantify that overlay?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
I think, like we said earlier, on the forward-looking part, if you look at it, as we bring our strategy into execution, we are aiming to end our retail book at about close to 70% by end of this fiscal year, and that will continue to expand as we get into the next year. The focus is on, so you will see growth coming in both from NIM, NIM expansion, operating leverage coming on account of productivity as we continue to expand our footprint and invest in technology.

So those two will be the big drivers for where you see that the revenue expansion will happen without corresponding increase in cost. And obviously, we continue to hold the guidance on the credit cost. Pardha, do you want to ask on detailing on the Stage one and Stage two and Stage three?

Pardhasaradhi Rallabandi - Group Risk Officer and Governance Head, Northern ARC Capital Ltd
Stage three, as I explained earlier, it was on account of reclassification of one asset, underlying related portfolio. The Stage two, actually the increase is basically from 1.6% to 1.7%. It is not really too much of volatility there. And this is part of pretty much the way the portfolio is. Again, there is one MSME asset which is part of that. But having said that, you would have seen that the provision coverage for the Stage two also significantly increased from around 10.9% to 17.3% in terms of Stage two asset coverage, and Stage two increase is marginal and the coverage is significantly better.

Overall, in fact, the approach this quarter has been that while the current numbers do not show too much of stress, we do see that the macro environment is not that great, and we would want to keep provisions and keep overlays as much as we can. And that is how the approach has been. So Stage two increase is marginal and the coverage is improved.

Aravind Ravichandran - Analyst, Sundaram Alternates
Okay. If we can quantify that overlay, otherwise fine. Just one more question. A significant part of

the growth in retail, especially the mix change out of the intermediate into direct business, it has come from consumer business. Obviously, I understand that MFI has gone through a tough cycle, so we can't expect a lot of meaningful growth there. Maybe going forward we can expect that. But MSME growth has been, mix has been pretty broadly stable over last four, five quarters. Can we expect that to change in the coming year?

Pardhasaradhi Rallabandi - Group Risk Officer and Governance Head, Northern ARC Capital Ltd
Yeah. On the consumer portfolio growth, as we explained in multiple calls earlier, the way we see it, this is where we have a lot of estimation and the coverage. This is one good profitable portfolio which is growing for us. We don't really have too much of a concern on that. As far as the MSME book is concerned, the MSME book, the CAGR is around 45% over last four years, five years, and even between September 2025 and September 2026 in the last one year, the book growth is around 38%.

The way we look at it, this is a pretty stable and in the long term, good to have portfolio. We are pretty confident on that.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Yeah, and since we are essentially building a long-term annuity business, which is predominantly loan against property at the higher end, obviously over the course of year, last year or two, we would have course corrected, tightened to ensure that we get the right set of risk-adjusted returns. So I think we continue on it. Now it takes time to build brick by brick, and we are focused on building this long-term annuity book.

Aravind Ravichandran - Analyst, Sundaram Alternates
Understood, sir. One last question if I can have. The fund management AUM is declining for last two, three quarters. When can we expect any turnaround there?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Yes, we have two maturities. Our funds have matured. That is why we have launched two large funds. One is a 1,500 plus 500 greenshoe, INR2,000 crore fund on which in this quarter when we launched the fund, we have already raised INR400 crore. So I think by end of the year we should be close to INR1,000 crore there on it. And then we have launched I think very unique, powerful Savings plus which is an open-ended, call it a perpetual, but let us call it an open-ended fund, unique in its own way with two years plus six months of lock-in and providing liquidity after that.

Very unique, powerful for us, and we are very confident of raising money on it. So I think by end of the year we should be upward of INR4,000 crore. It is about these are funds launch takes time. These are amortizing structures. Unlike some of the others, we are fairly prudent on a risk piece. We like to do amortizing structures when we invest through this funds and we do quarterly payouts. So I think that is where it is.

Aravind Ravichandran - Analyst, Sundaram Alternates
Sure, sir. Thank you so much.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Thank you, all.

Operator
Thank you. As that was the last question for today, I would now hand the conference over to the management for closing comments. Over to you, sir.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
No, thank you very much. Thank you for joining us today, and I take this opportunity to wish you and your families festival seasons and happy and prosperous Diwali to all of you. Thank you all, and look forward to engaging with you in next week.

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
Thank you so much.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Thank you. Thank you.

Operator
[Operator Closing Remarks]