Management Discussion

Chintan Shah - Analyst, ICICI Securities Ltd
Yeah. Thank you, Rio. So good evening, everyone, and welcome to the Q1 FY27 results conference call of Northern Arc Capital Limited. First of all, I would like to thank the Northern Arc Capital management for giving us the opportunity to host their call and also congratulate them for a very strong set of numbers. Yeah, from management now, we have 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 lastly, Mr. Chetan Parmar, Head, Investor Relations.

So now, without further ado, I would like to hand over the call to Mr. Ashish. Thank you and over to you, sir.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Hey. Thank you very much. Thanks, Chintan, for hosting this for us. Good evening, everyone. Thank you for joining us today. It's my pleasure to welcome you to Northern Arc Capital conference call to discuss our performance for the quarter June 30, 2026 first quarter of the new fiscal year. As Chintan said, I'm joined by Atul, our CFO, Pardha, my colleague in Risk and Jigar and Chetan for the conversation today.

Let me begin with few key highlights and few observations of what we've seen in the quarter. I think it's fair to say in the world where the uncertainty has become the norm shaped by the geopolitical development, evolving liquidity conditions, rapid technological changes, it is reassuring that some fundamentals remain intact. Indian economy continues to demonstrate strong resilience. Household and entrepreneur continues to require access to capital to fuel their aspirations and investors continue to seek high-quality, well-structured assets. Northern Arc remains firmly positioned at the intersection of this demand and supply of credit.

Our strategic focus on building a granular, diversified retail lending franchise continues to deliver very strong outcomes. I'm pleased to share that our direct lending portfolio has now crossed over INR10,000 crores, a significant milestone that reflects the strength of our customer-centric approach and our disciplined execution. We are also proud to have assigned an outstanding ESG rating by ICRA. This was our first ESG rating with a score of 81 making us one of the highest rated financial institution and placing us among the select group of few high rating in the band of outstanding. This recognition reinforces our commitment to responsible and sustainable growth supported by strong ESG practices.

Let me briefly touch upon the macroeconomic environment. The global economy continues to navigate heightened uncertainty, particularly in light of the ongoing West Asia crisis. This has led to volatility in energy prices, supply chain disruptions, increased risk awareness across financial markets. These dynamics coupled with evolving trade relationships have created near-term headwinds for the global growth and added complexity to the inflation and interest rate outlook here in India. Despite these external challenges, Indian economy remained resilient supported by strong domestic fundamentals. GDP growth stood at about 7.8% for Q4 '26 reflecting sustained economic momentum. Robust domestic demand continues to act as a buffer against the global volatility.

The consumption trend remains healthy across both rural and urban markets supported by improved disposable income and favorable financial condition. Government focus on infrastructure and continued policy support are expected to further sustain the economic activity and drive credit

growth. The microfinance sector is showing early signs of recovery after a prolonged period of stress. The collection efficiencies have improved. The lenders are cautiously resuming disbursement and following a phase of consolidation. We are also beginning to see early signs of recovery in micro LAP and some of the unsecured business loan segments. While there are concerns around El Nino, its potential impact on monsoon, the rural economic activity remains stable supported by healthy reservoir level, government spending on infrastructures and other investments.

Talking of Northern Arc, particularly for the quarter, the quarter was characterized by external uncertainties. We spoke about warranting calibrated and prudent approach. Despite this, we continue to build a very strong momentum. We report a profit after tax of INR114 crores for the quarter, a strong 41% growth on a Y-o-Y basis underscoring the resilience of our diversified business model and a disciplined execution of our strategy. Our assets under management grew by about 26% on a Y-o-Y basis to about INR16,855 outpacing industry growth. This was driven by the significant growth coming in our direct lending business, which now contributes 64% of our overall AUM in line with the strategy what I have been reiterating since the beginning -- since we started this conversation many quarters back,

Our direct-to-customer portfolio itself grew by more than 50% on a Y-o-Y basis. The MSME finance continued to be another important engine of growth secured LAP business predominantly. That portfolio expanded by about 40% Y-o-Y to about INR3,761 crores. In rural finance, we achieved highest ever quarterly disbursement of INR328 crores reflecting steady momentum. AUM in this segment grew after many quarters for the first time by about 26% Y-o-Y taking to about INR1,200 crores. Collection efficiencies remained robust at about 99.6% in June '26, the key states such as Tamil Nadu and Karnataka demonstrating strong continued momentum both in terms of the disbursals and in terms of collection efficiency.

Importantly, approximately 94% of our MFI book is now covered under CGFMU providing strong credit protection. Combined with a branch network and improving collection, this gives us confidence to scale the business prudently. Like I've said earlier, let me reiterate, all our loans are individually underwritten, whether sourced through group or through directly using our own proprietary scorecard called Nu Score and that gives us a lot more comfort than anything else and that's the approach we continue to follow. Our credit solutions segment, we continue to benefit from a strong and expanding network of over 373 originating partners. The quality of this network remains high. Around 90% of our partners are rated BBB and above. Approximately 95% maintain capital adequacy upward of 20%. This provides robust foundation for sustainable growth.

Our fee-based business which includes placements, fund management and our retail bonds platform Altifi remains a key differentiator and giving us unique power to our credit solution business. While placement volumes were subdued during the quarter due to the border credit moderation, we are beginning to see improving traction across the key segments such as MFI, MSME and consumer finance. Our performing credit fund continues to scale. We received the approval to launch two new funds. One is a diversified debt fund and the second is the Northern Arc Saving Plus Fund providing strong visibility for growth. In June, AUM stood at about INR3,000 crores.

Further, we continue to see strong traction on our retail platform. Altifi has registered crossing over 1 lakh subscriber. The volume on the platform has more than doubled on a Y-o-Y basis increasing from INR146 crores to over INR315 crores or so reflecting growing investor participation and engagement on the retail bonds platform. Together, these developments enhance capital efficiency,

diversify revenue streams and enable us to facilitate a large flow of credit beyond our balance sheet.

Risk management remains central to our strategy. Our underwriting framework that leverages over 50 million data points and more than 30 plus proprietary models supported by a dedicated team of 100 plus professional risk specialists on ground and presence in 25% of the districts. This enables us to generate early risk indicators and maintain portfolio quality. We continue to follow a conservative provisioning approach writing off unsecured loan on 90 days past due date. While this may lead to higher near-term credit costs, it significantly strengthened the balance sheet over time. As a result, our GMP improved by about 1% as of June '26 and credit cost moderated to 2.6% in Q1 '27 within our guided range, which we've given earlier.

Company is increasingly embedding AI capability across the function. Over the past years, we have developed a suit of in-house AI-enabled tools across lending, risk operation and markets using AI natives and agentic approach. The key initiative includes end-to-end (ph) AI-enabled lab journey for our retail branches solution across bureau reporting to ensure a seamless onboarding and fulfillment of retail lab customers. These capabilities and many others are enhancing operational efficiency and developing agility while augmenting our credit underwriting and collection capabilities with all material credit decision continue to remain within our credit offices.

Overall, we started '27 on a strong footing supported by healthy disbursement momentum, improving credit trends. While we remain vigilant to external risk, including geopolitical development, weather-related uncertainties, we are confident in our ability to navigate these challenges. Our diversified business model, disciplined risk approach and strong execution capability position us well to sustain growth while maintaining profitability and asset quality.

With that, I'd like to hand over to Atul to take you through our financial results in greater details. Atul, over to you.

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
Yeah. Thank you, Ashish, and good evening, everyone. Let me walk you through the financial highlights of Q1 FY27. We achieved an important milestone this quarter with our direct-to-customer AUM crossing INR10,000 crores reinforcing our strategy of building a granular and diversified retail portfolio. Our total AUM stood at INR16,855 crore reflecting a Y-o-Y growth of 26%. The D2C segment contributed 64% of the total AUM with MSME finance at 23%, consumer at 34% and MFI at 7%. The net interest income grew by 32% Y-o-Y to INR394 crores. The NIMs improved by 44 basis points Y-o-Y to 9.3%.

Despite a challenging liquidity environment, our cost of fund remained stable at 8.46% for Q1, lower than 8.5% in FY26 and 50 bps lower than Q1 FY26. Incremental cost of fund also remained stable at 8.69%. The total revenue including fee income grew by 28% Y-o-Y to INR416 crores. Operating expense remained well controlled with the expense ratio stable at 3.6%. Pre-provisioning operating profit grew by 27% Y-o-Y to INR263 crore. Asset quality continued to improve with GNPA at 1%, NNPA at 0.5% as on June 2026. Credit cost reduced to 2.6% in line with our guidance. Profit after tax increased by 41% Y-o-Y to INR114 crore. ROA improved to 2.7%, while ROE increased to 11.5%.

On the liability side, we continue to diversify our funding base with a focus on long-term sources. Liquidity remains strong with surplus liquidity of approximately INR1,300 crores and a liquidity coverage ratio well above 150%. Total borrowing stood at INR12,440 crore with 62% linked with variable interest rate positioning us well in a declining interest rate environment. Our funding mix

remains diversified with 27% from offshore and DFI partners and 73% from the domestic sources. Tangible net worth increased by 15% Y-o-Y to INR4,063 crores. Our debt equity ratio improved to 3.1x reflecting our strengthened balance sheet. Capital adequacy remains comfortable and well above the regulatory requirement providing sufficient headroom for future growth.

Thank you so much. And we would like to open the floor for Q&A.

Questions & Answers

Operator
Thank you very much. We will now begin the question-and-answer session. [Operator Instructions] The first question is from Digant Haria with GreenEdge Wealth. Please go ahead.

Digant Haria - Analyst, GreenEdge Wealth Services
Yeah, hi. Congrats on a good set of numbers and thank you for taking my question. My first question is for Atul. Basically, see, I can see that provisions this quarter were around INR110 crores and in your notes to accounts, you have written that the ECL estimates have been revised taking into account the macro events and there is provision of INR66 crore. So did we make any prudential provision in this quarter? Like does this INR110 crore number include any prudential provisions also? Hello.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Yeah. We had a overlay of around INR66 crores in -- as of March '26. The number -- I mean there is a small -- very small difference, but the number remains around INR66 crores as of June as well. So this INR110 crores doesn't include any overlay per se. However, in certain segments, we have been a little more prudent and conservative and taken some good book provisions that we will come to. When you look at the individual segment-level provisions, you will realize that.

Digant Haria - Analyst, GreenEdge Wealth Services
Yeah. So the next question is on this only that, see, our credit solutions, it has degrown quite a bit this quarter and we would have expected that because personal loans and MFI, the outlook for both is actually improving. But I see that provisions in this segment has spiked. It's almost 1.5%. So what happened here or if you could just explain this part?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Yeah. There is no incremental Stage 3 asset that has moved in this quarter in IR business, trade solutions business. What we have --and volatility and AUM that you see is normal in every year Q1. We will have lower AUM on in trade solutions business which is normally how it operates. So obviously, there is a denominator degrowth. And we have been -- we had the flexibility and we have been conservative and we were able to provide a bit more on the good book than what we normally would.

Digant Haria - Analyst, GreenEdge Wealth Services
Okay. But you're saying there is no deterioration that you see and this is...

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
No. Not a single account. I think that's the...

Digant Haria - Analyst, GreenEdge Wealth Services
Okay. Perfect. And Ashish, one question is on this. Yeah, sorry, go ahead, please.

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

Digant Haria - Analyst, GreenEdge Wealth Services
Yeah. So I'm saying that in MSME, if I look at all other lenders, a lot of them have reported slight increase in Stage 3 or Stage 1, Stage 2. Whereas we have actually shown a remarkable improvement in MSME. So this is a welcome step. But just wanted to know like how much of this is the small LAP portfolio and how much of this is the merchant -- the digital merchant where improvement has happened?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
So in both the portfolios, we LAP -- our average ticket size is about 12 to 15. In there we've seen a significant improvement in the overall collection efficiency while the X bucket will move here and there, but the overall portfolio quality looks much better like I said also in the opening comments. So about 50% of that is actually LAP business and balance part is about INR1,000 crores is merchant. Both the credit performance and indicators, both leading, lagging are looking reasonably strong and we'll continue to build that business month on month. Focus is to get a high-quality balance sheet growth there.

Digant Haria - Analyst, GreenEdge Wealth Services
Yeah. And like the next question is on -- this -- our branch or brick-and-mortar business which is the MFI and small LAP, like where do you see this scaling up this year and are we planning to add any new products in this, the physical world kind of lending business?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Yeah. I think in both sides as we see the stabilization of MFI and the improvement in the LAP, we don't do the small ticket less than INR5 lakh LAP is not a target. So our average customer like I said is about INR12 lakh to INR14 lakh segment, which is better quality customer. So we will add to my mind like we said we are at 430 branch network. We will add about another 50 to 60 branch this year. We've added some branches, about 20 branches in Q1 itself and we'll continue to add more branches to the network.

We've added actually 230 people in the sales in the quarter one itself. So idea is to get more sales per store per branch. We've also like I spoke about building the AI in a journey to automate trying to do 90% of turnaround within three days. So all that is being done to get better productivity per store and also get better collection as a consequence to see a better quality balance sheet growth on both these lines. We begin to grow MFI also as I said earlier. So both of them should see a healthy growth in the coming quarters.

Digant Haria - Analyst, GreenEdge Wealth Services
Okay. And then given that this year credit cost in small LAP and micro finance will be lower, would you want to give a guidance on loan growth and ROA for the FY27?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Yeah. So we've already given and we will hold to our estimate to what we've given. Our guidance on the blended credit cost is about 2.6% to 2.7% range and we are holding to that. Our target ROA is to

get to closer to 3% in this year. So we are pretty focused on the numbers and you should see a quarter-on-quarter improvement to the guidance to the position we've said earlier. We'll continue to work towards it. Because our focus is to just to have a disciplined execution of our strategy of what we've been saying for last six or eight calls. And as we continue to execute strategy, continue to build the fee franchise, we will get there. You will have a movement within quarter like on the fee and other lines. But we know where we want to get to and how do we get there by quarter-on-quarter basis. So we're pretty sharply focused on it. Thanks.

Digant Haria - Analyst, GreenEdge Wealth Services
Okay. Thank you. Thank you. I'm done.

Operator
Thank you. Next question is from Kaushik Agarwal from Haitong. Please go ahead.

Kaushik Agarwal - Analyst, Haitong Securities India Pvt Ltd
Yeah, hi, sir. Thank you for the opportunity and congratulations for the quarter. Sir, I have couple of questions. So just continuing to the last response that you gave that you are targeting close to 3% ROA for this year. So I can see that for this year, we have delivered around 2.7%. So what will drive this 3% ROA that you are targeting? That is one. Secondly, on the margin piece, I wanted to understand what has happened during the quarter. There is a 50 bps sequential decline in NIMs. This is as per the reported numbers that you have given. So what led to this dip in the margins during the quarter?

And on the lending side strategy, so what I picked up is that on the intermediate retail, you would be broadly degrowing this book. So large part of the growth will be coming in from your D2C segment. And within that, I can see that consumer finance is growing out quite robustly. So what gives you the confidence in terms of growing so aggressively over there? And broadly, if you can share some data points in terms of this book is divided among how many DSAs like digital DSA and is there any concentration risk over here? So these were the two questions.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Let me try and answer them in serenitum (ph), but however, I'd like to call out one thing. It's not that we are de-growing the credit solution business. That business will continue to grow at about 8% to 10% year-on-year. We will be expanding funds. Our objective is to provide credit solution when we work with our obligors. The solution can come from funds or it can come from balance sheet depending on funds finding the right set of thematic opportunity to invest in. We have a full credit solution franchise, which is the most powerful institutional placement business with 17 -- 16 years of track record with funds nine years of performing credit track records and Altifi, which is a retail bonds platform and has a four years of high quality track record.

So I think we've got the full composition right when we talk to our obligors on the other side. Our objective is to grow the business in a calibrated manner with a very sharp focus on the growth. I think the movement on the yield because some part of the growth happened towards the end of the Q4 in June and hence you did not see the full realization of yield. So I think that I will not be very worried because we will hold to the stuff we've given to you to our NIMs number. There could be movement within the quarter, but the overall numbers will continue to come in line or better than what we have said and I think that's our endeavor.

So if you -- now coming to the question of how do you plan to get there, as we continue to expand

the direct-to-customer business, you should see improvement in the NIMS on a Q-on-Q basis. There could be movement on a specific quarter, but that's where you will see. Over the last five years, our NIMs has expanded from 5.5% to about 9.5% -- 9.4%, 9.5% and I think that's where -- that's the number is and you should see that improvement coming in. The second part of the improvement will come in on two big lines, which is essentially on a loaded NIM basis, which is coming on the fee line. One is a funds management business. We've now launched two funds. One is INR2,000 crores diversified debt, INR1.500 crores plus green shoe of INR500 crores.

Another is a savings plus fund. Both of them will provide high-quality growth on the income. We make about 110 basis points. So as the funds AUM grow, you should see expansion in the fee income. The placement business given the pipeline we are sitting on both with regards to securitization and assignments and other, so I think you should see a strong Q2 and a Q3 on that. And the overall fee composition will continue to expand. We are holding on to the guidance we've given earlier that the fee will constitute about 75, 80 bps to about 100 bps on our overall revenue line. So that's where you will see expansion in the loaded NIM. As the NIM expands and we see the fee expansion, you will see the loaded NIM expansion. Our OpEx like we said will remain at about 3.6%. We are holding to that number quarter-on-quarter while investing at the early stage in building more capacity, pushing for more sales per store and so on so forth.

Like I said, we were almost added 250 people on the production line in between a branch network. We've added digital partners, more digital partners being added. So that continue to see a rapid expansion and we want to ensure that it is pretty well balanced between the MSME and the consumer and direct-to-customer business. In the MFI, it's a very calibrated growth. It's starting from a small book, but you should continue to see that growth if we continue to see the better set of performance there. So I think we are pretty confident to what we've said and we should be able to hold and maybe deliver better than that. That's my response. I hope I've covered all the four or five areas you wanted to question.

Kaushik Agarwal - Analyst, Haitong Securities India Pvt Ltd
Yes, sir. Sir, thank you. Sir, just on the consumer finance piece, I think -- wanted to check like what gives you the confidence in terms of growing like aggressively over there. I understand this is mostly -- you have this DLG cover over here, but also wanted to understand is there any concentration risk over here in terms of the channel through which you're sourcing? Is there any specific partner on which your book is highly concentrated?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
We work with almost 30 plus partners. We worked also with about 50 plus on a direct site basis. So it is pretty well diversified. Diversification is key to our risk both at a sector level and let's call consumer as a sector, MFI as a sector, then at the product level, then at a geography level, then sector, product, geography at a district level, then concentration and an obligation partner level. So it's pretty well diversified. These are the to my mind are the core guardrails with which we adhere to. And that's the only thing which is non-negotiable and not the -- the guardrails we set for the diversification and the quality of book. And that enables us and gives us an agility to dial up, dial down as we see opportunities in the market.

Our growth on consumer is actually good because we worked across the segment with multiple players and the cohort level performance is fairly strong. We're happy to have a detailed conversation on it, but at a cohort level which we track on loan by loan, partner by partner, we're

tracking better than what we anticipated it to be and I think we should continue to hold that.

Operator
Thank you. [Operator Instructions] The next question is from Abhijit Tibrewal from Motilal Oswal. Please go ahead.

Abhijit Tibrewal - Analyst, Motilal Oswal Financial Services
Yeah. Good evening, sir, and thank you for taking my question. Just an extension of what you just answered. Sir, if you look at the growth this quarter and I'm sorry I joined in a little bit, so some of my questions could be repetitive. Please let me mark. I'll look at the transcript. So this D2C growth that we are seeing 10% kind of a Q-o-Q growth. Within that, bulk of it driven from consumer where we have called out we have 19 life partners backed by FLDG.

So can you just help us understand are all these 19 life partnerships that we have all of them provide 5% FLDG? And the other thing is, I mean, doesn't this worry you a little bit that at a time like this when I would say we're in the middle of the war, despite that nothing kind of seems to show anything negative on the asset quality front and across lenders. Don't you think some of that stress, whatever that could be could be moving into some of these segments like, let's say, consumer loans, gold financing. So your thoughts on that, please.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
No, actually you're right if you -- and it's something we debated today earlier. If you actually look at the entire retail pool growth in the industry given we work with all of them with about 370 plus partners and you look at the overall credit growth, the 70% of the growth is coming from gold and that's because the gold prices have appreciated over three years by about 3x from INR60,000 to INR150,000. So leave that aside. I think if you look at it, our MFI business because we also have a small base arbitrage, so percentage may not be the great way to look at it. Our MFI business after we've been dialing down and moderating for now about six quarters to seven quarters for the first time grew by about 19% on a quarter-on-quarter basis.

Our consumer grew by about 15% quarter-on-quarter. Our MSME retail grew by about 8%. So I think the overall growth is pretty well moderated across the three sectors. The consumer looks bigger because it's -- as a whole it's bigger and it's easier to execute. Rest of the stuff, there is a brick-and-mortar and there is a lot of hard work before it start culminating into growth. We've added 232 people between the LAP and the MFI to push towards greater productivity and push toward expansion in it. So I think all that gives us -- Abhijit, puts us in a pretty strong position to continue to build on this momentum we have. The advantage we have is that we're starting from a small base. INR10,000 crores is a small base on a direct business. I think we continue to do so. The idea is how do we grow our credit solution business, how do we grow our funds and how do we build a stronger fee franchise. And that's also the focus area. I think both of them will continue to stay very sharply focused and I think this growth is sustainable quarter-on-quarter basis.

Abhijit Tibrewal - Analyst, Motilal Oswal Financial Services
Got it, sir. And before I ask my second question, just a small follow-up. Have you already commented on what led to this Q2 decline in this intermediate retail credit solutions business?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Yeah. We've commented. The growth in the Q1 tends to be slower because you had higher volumes volume disbursal overall growth across the sector. It tends to be between Q3 and Q4. So Q1 tends to

be slower both in terms of people borrowing because people borrow heavily for Q3, Q4 festival season onwards and subsequent to which start tapering off. And I think the current pipe looks very good. So it will continue to grow 8%,9% on a year-on-year basis and the funds will then provide the incremental impetus. The idea is how do we build more on the bonds and on the placement business. So that I would look at it at a credit solution level total volume and then look at it at that volume moving between placement funds, bonds and then balance sheet to ensure better economics on a return on capital basis.

Abhijit Tibrewal - Analyst, Motilal Oswal Financial Services
Got it. Thanks for that. And then the last question that I had was on the D2C portfolio. This book has now crossed INR10,000 crores for us, contribute 64% of the AUM. As this mix continues to increase, how should we think about the trade-off between growth, margins and operating expenses? So what I'm just trying to understand is this D2C, do you see it structurally becoming more profitable over the next two, three years?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Of course, that's the underlying thesis. If you look at it today, some of those mature businesses make 4% plus ROA, yeah. So my big piece of the flow will also be as we get larger per store sales in LAP in our branches and as the Pragati productivity goes up because of the sharper, better underwriting and fulfillment that will ensure that you will get to see better output per employee. That's where it is. Because you were very conservative, you tighten policy, you wanted to have tighter selection of risk on the segment that you wanted to play. As the things stabilize and you test your scores, you have an ability to see how do I look at better throughput at a customer level and at a salesperson level. So there is also a productivity gain net-net, which I'm hoping we will get as we go through the rest of the three quarters. So the jaws should continue to open if that's the sharper answer.

Operator
Thank you. Next question is from Raghav Garg from Ambit Capital. Please go ahead.

Raghav Garg - Analyst, Ambit Capital
Hi, [Indecipherable] good evening. I just have two very small questions. One, I look at your incremental cost of funds at 8.7% and then on the book it's 8.5%. So do you expect that this cost of funds will converge to about 8.7% by end of this year? I'm just asking from a modeling point of view. That's my first question. And the should I ask my second question also?

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Yeah, yeah, please. We can take about cost first and then we come to the next.

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
So Raghav, we have seen a spike in the benchmark rates in the background of the prevailing geopolitical conditions. We have seen a 50 bps increase in last six months as far as the benchmark rates are concerned. We have also seen the movement in the hedge cost. It has gone up by 75 bps in the last six months and obviously, the banks have also been increasing their MCLR, though by just small margins. But it has gone up by close to 10 to 15 basis points. So overall, there has been a trend of increasing borrowing rates. But if you have looked at our numbers, we have been able to maintain our cost at around 8.5% consistently now for the last three quarters.

Our incremental cost of fund, it ranges between 8.6% to 8.7%. We have not seen too much of an increase on that front as well. But there will be some debt which will come up for repricing in the next couple of quarters. There we might see increase of close to 5 to 10 basis points. So overall, Raghav, I don't see any major changes in the cost of fund. It should remain rangebound at around 8.5% to 8.6% level. We do not see that changing much in spite of the conditions. Liquidity though has become quite tight. We are seeing challenges on that front, but as far as Northern Arc is concerned, we are very well capitalized. We have good amount of undrawn sanctions of close to INR1,300 odd crores. So interest rate and liquidity both are comfortable for Northern Arc.

Raghav Garg - Analyst, Ambit Capital
But see, I understand that if you look at actually look at last few quarters, the NIMs have come down and the cost of funds have been stable. Now with cost of funds going up there could be further decline in spread. Is that the way to think about this?`

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
No. No, Raghav, the yields have actually gone up except for quarter one. This yields for us has been going up consistently over the past few quarters. It is only in Q1 where we have seen a slight decline in the yield, which Ashish mentioned.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Most of the credit solution disbursement was towards the back end.

Raghav Garg - Analyst, Ambit Capital
Correct. Understood.

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
So the cost of fund is consistent. The yields have been going up. So we are in line to reach a 9% -- 9.5% NIM in the next quarter and close to 10% by the end of this year. So we are pretty confident about it. If you look at our NIMs, it has been only increasing quarter-on-quarter and we are very hopeful of reaching the 10% by the end of this year.

Raghav Garg - Analyst, Ambit Capital
Understood. And my second question is that I think your Tier 1 is about 21% as of March '26. At what point do you come to the market for raising capital? Is there a thought process right now behind this or...

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
I think capital adequacy as I mentioned is very comfortable at 22.7%. We have enough headroom for growth. Debt equity is just 3.1%. The comfort level for the rating agencies, for the regulator, for the lenders is 4%, 4.5%. So I don't see ourselves hitting the equity market in the next two years. I think we will be -- we are highly profitable. We add good amount of profit to the net worth every quarter. I don't see the need of any equity raise for the next two quarters to take care of our 22%, 23% growth target that we have.

Abhijit Tibrewal - Analyst, Motilal Oswal Financial Services
Understood. The only reason I ask is that if I look at since FY22, I think the Tier 1 has not gone down below 20% and hence, I was just trying to take some views on that.

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
I think it should remain in that range, Raghav.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
No. No. Other way to look at it also if you are able to fund close to what we are planning to grow, while you see the overall throughput going up without requiring so much of incremental capital.

Atul Tibrewal - Chief Financial Officer, Northern ARC Capital Ltd
Good. Anything else?

Raghav Garg - Analyst, Ambit Capital
Understood. That's all from my side.

Operator
Thank you. The next question is from Chintan Shah from ICICI Securities. Please go ahead.

Chintan Shah - Analyst, ICICI Securities Ltd
Yeah, thank you for the opportunity. So just on the fintech lending, fintech partnerships, I think this is a business probably which we have been doing pretty well in terms of yields, ROA, et cetera. And probably other peers, NBFC peers, most of them have not been able to scale this business successfully without taking any hit on the credit cost run. So how are we looking at this business? Could it reach to a certain scale and then probably plateau or is there scope for expansion. So some thoughts on that, yeah.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
I think this business should continue to grow. We work with multiple partners without any concentration risks at a partner level or concentration of higher volume on a single partner. Our commitment on this actually goes to the genesis of Northern Arc. And our genesis to Northern Arc is a comprehensive credit solutions business. We work with people at a very early stage. We take small exposure by dipping our fees (ph). We test that performance. We get to know them better. We get to know their proposition. Then we take -- we work with them more closely by supporting them in their liability need. Then we try and bring other lenders to participate to provide them to grow.

If we continue to see good performance, we also offer our funds team to look at it if that marries with their investment opportunities depending on funds, investment thesis and funds, I see approval. We like them more, we continue to offer them tech, data, securitization and other services. We continue to work with them. And when we find there is an opportunity of our target client model versus their target client model at the price band we like to play, then we also participate in enabling them to fulfill more people who are coming through their door, coming through them and providing them a comprehensive convenient financing solution.

The customer goes to many platforms, about 30 such people whom we work with. It pushes the application to Northern Arc. Northern Arc underwrites that application. Northern Arc engages with that customer. Northern Arc takes the repayment instruction from that customer, sanctions them the loan, communicates their disbursals and present for correction. So it is a fully well embedded, completely processed. If somebody is looking at it as a short-term growth may not work. Ours is deep commitment with our partners, which goes for five, 10, 12, 15 years. In most of the cases, we were the first lenders to them. Some of them now hit capital markets or in the process of hitting capital markets.

They all know the Northern Arc's value and Northern Arc commitment in the partnership in their success. And their success lies Northern Arc. So it's a fully embedded model. We've been doing this now for seven or eight years if I am right and I think we continue to grow. We continue to -- we manage it very sharply. And today, we had the Board meeting and I did show to them saying how quick we are to react to dial down when we have to dial down.

And the word I use in the Board is that we do not shy away by demonstrating the strength of character to say no when we think it is not right when we see that the cohort is not performing as per our expectation. We work with partner very seamlessly. I think that's the nature that we are good at it in what we do. We should continue to hold and stay very sharply focused in ensuring that the end customer has a very seamless experience and our service principles and the partner service principles remains the same. I think that's the core of it and that's why you see a sustainable growth in it (ph).

Chintan Shah - Analyst, ICICI Securities Ltd
Sure. Thank you for the detailed answer and I think this is very comforting. So just one more thing on the margin. So as we mentioned margins are likely to scale to 10%. So one thing phenomenal is that we -- our cost of funds has been quite stable like 8.5% since the past four quarters despite the liquidity, West Asia crisis, et cetera. So now the 10% delta margin from currently 9.3%, is it going to come from the yield? So what is exactly -- how are we expecting the yields to pan out? And just one last question on the provision thing. So are we expecting any provision reversal from AVM Housing or Kinara Capital or any other provision reversal expected for this year? Yeah.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Let me take both. I think the yield should continue, should see some bit of an expansion as we continue to grow our business on a moderated in a calibrated manner and that should continue to happen. If you could see a change in quarter depending on when did you disburse the loan, if the larger part of disbursal on the credit solutions side happened towards the mid of June, while you would see the reserving cost, you will not see the full earnings rectifying and reflecting in the yield. So I think that's the one part of it. The second part to your question is so as that expands, so the NIM should continue, should see a bit of an expansion and I'm holding onto the number Atul has said.

So if you look at it, you will see some bit of movement on quarter-on-quarter basis. But towards the end, we should get to 9.7%, 9.8% which is -- and getting too close. The big part is how do you increase that loaded NIM from 10.10% that means the fee has to grow from 50 basis point to about 70, 80 basis point. That's a big play we are working towards very sharply and I think that's the sense we have. So I'm not going to be too much current. It's calibrated growth across these three sectors, both between the credit solutions business and direct-to-customer business, with growth coming across the three sectors of MSMR, consumer and MFI will provide additional.

We hold more. We hold as you would have heard some of my earlier colleagues, we actually also hold an overlay of sizable amount of provision, which we did not release on DLG changes because I thought given the uncertainty and that we should hold that additional provision. We continue to hold it. AVM is in a sense more than adequately provided. We hold almost 75% because there are two pronged approach to it which we said in the first call when that incident happened, which is between what the value we have assigned as part of the direct assignment. The retail book of that continues to be provided pretty aggressively following our approach.

The other part of the book is fully provided. We don't have anything on Kinara. And also I think that's

all done. That's all securitized, taken over, fully done and dusted. That's where it is. So I think we should see some bit of upside as settlement happens. But right now, I don't want to comment on it. It'll be unfair for me to comment an individual account level.

Chintan Shah - Analyst, ICICI Securities Ltd
Sure. Thank you for the detailed answer. Thank you and all the very best for the coming quarters.

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

Operator
Thank you very much. We'll take that as the last question. I would now like to hand the conference over to the management team for closing comments.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
We just wanted to thank you for joining us today evening, on Monday evening. Thank you all and we will see you next quarter. Thank you.

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

Operator
Thank you very much.

Ashish Mehrotra - Managing Director and Chief Executive Officer, Northern ARC Capital Ltd
Thank you. Thank you all for being a great moderator, Chintan. Thanks for supporting us.

Operator
[Operator Closing Remarks]