ICRA

PRESS RELEASE
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ICRA assigns a positive outlook to Defence sector

- *Entities in the Indian Defence sector to sustain double digit growth rate, benefitting from robust order book*
- *Indian defence entities benefitting from GoI's policy push; exports up by more than 11x in last decade*

According to rating agency ICRA's analysis[1], entities operating in the Defence sector are expected to sustain robust growth momentum, with likely revenue expansion of 15%-17% in FY2026. The healthy revenue growth is primarily driven by strong execution progress on the back of a robust order book position, with order book/operating income (OB/OI) ratio at 4.4 times as of FY2025 end. Driven by the Government's sustained budgetary outlay and policy support for Defence, ICRA has assigned a positive outlook to the sector.

Over the years, the Government of India (GoI) has implemented numerous policy initiatives, with Atmanirbhar Bharat at its core, to enhance domestic Defence production capabilities, encourage investments and expand exports. These include the liberalisation of FDI policies in the Defence sector, continuation of the Defence offset policy, establishment of two Defence Industrial Corridors and a sustained push towards indigenisation through the notification of five 'Positive Indigenisation Lists' and the online indigenisation portal 'SRIJAN'.

These apart, the Government has also increased the budgetary outlay for the sector with a thrust towards capital outlay, which has grown at a CAGR of 8.29% over the previous five years to Rs. 1.92 lakh crore in FY2026 BE. Through these initiatives, the expenditure on Defence procurement from domestic vendors has increased from 61% in FY2017 to about 75% in FY2025e, while exports have grown by more than 15 times and at a healthy CAGR of 41% to Rs. 23,622 crore during FY2017-FY2025e period.

Commenting further on the subject **Suprio Banerjee, Vice President and Co-Group Head, Corporate Ratings, ICRA Ltd.,** said**:** "*As per ICRA's analysis, entities across the entire spectrum of Defence production – land, naval, aeronautical, armaments & ammunition and ICT*[2] *– will benefit from the sustained expansion in budgetary outlay since 2015, which is expected to translate into healthy order inflows as the Government continues to increase domestic procurement. The weighted average operating margins are expected to remain healthy at 25%-27% for FY2026, supported by economies of scale, rising localisation, with entities beginning to undertake the production of more value-accretive system-level products, compared to the earlier sub-component/assemblies manufacturing."*

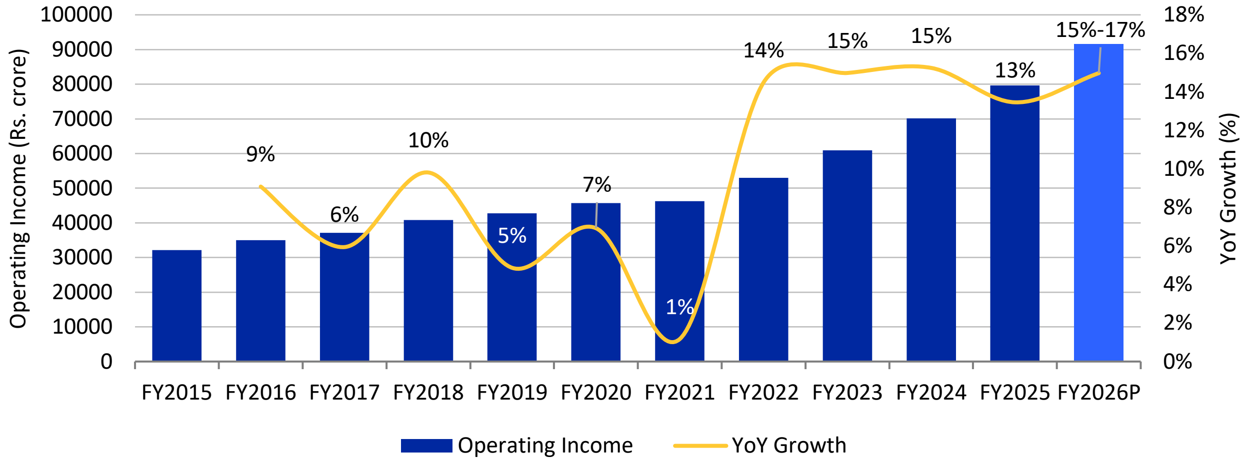
While the land and ICT-based segments are expected to see increased private sector participation, the Defence Public Sector Undertakings (DPSUs) continue their dominance in the naval, aerospace and armaments segments. Due to the difference in the means of financing available to the DPSUs and private entities for their working capital requirements, working capital intensity can vary significantly across segments. However, the gross operating cycle[3] remains elevated at over 400 days in FY2025 for ICRA's sample and is expected to remain a strain on cash flows, given the need to maintain adequate inventory levels to ensure an uninterrupted manufacturing process. Nevertheless, the sector remains well-positioned with respect to the financing of its working capital requirements

[1] 6 Defence Public Sector Undertakings (DPSUs) and 6 private entities accounting for ~50% of the industry's expected revenues for FY2025
[2] ICT – Information and Communication Technology
[3] Gross operating cycle is defined as the sum of debtor and inventory days

with the DPSUs resorting to sizeable mobilisation advances and the private sector resorting to raising equity through QIP /preferential allotment routes to support its working capital financing needs.

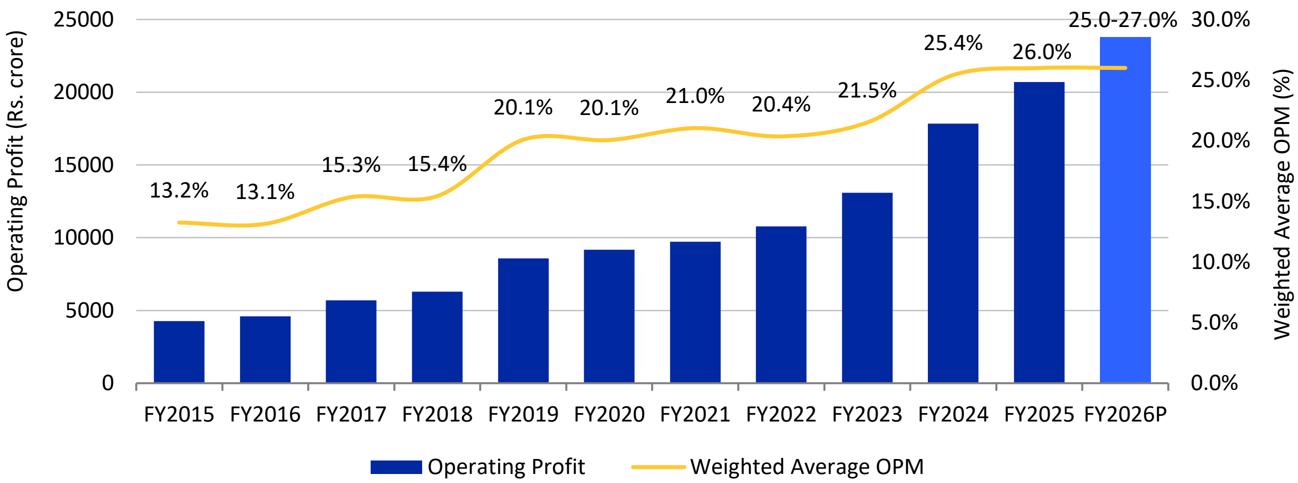
"*While revenues and profitability have grown on a sustained basis during FY2015-25, working capital management has remained a challenge for the private players in this segment. Even though the gross operating cycle has gradually improved over this period, efficient working capital management will remain imperative to sustain the growth momentum. Notwithstanding these concerns, in FY2026, the metrics for revenue and operating margin for ICRA's sample set amid a likely expectation of a stable gross operating cycle, meets ICRA's benchmark for positive outlook for the sector.*" **Banerjee** added.

Exhibit 1: Trend in Operating Income for ICRA's sample set



Source: ICRA Research

Exhibit 2: Trend in Operating Margin for ICRA's sample set



Source: ICRA Research

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About ICRA Limited:

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