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BBGI GROUP Global Investments

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Investments - Flash

A PARADIGM SHIFT FOR EUROPEAN DEFENSE

A decoupled sector offering high visibility over the next 10–15 years

European defense budgets are experiencing unprecedented growth (driven by NATO objectives and EU initiatives, such as the Readiness 2030 plan). Following a period of rapid growth in valuation multiples, the sector has entered a phase of execution and delivery of financial results. The outlook for defense companies now extends beyond 2030. Production bottlenecks and the ability to scale up remain the primary operational challenge. However, the positive outlook varies among pure-play equipment manufacturers, digital sovereignty players, and software subcontractors. The average order backlog of major European manufacturers now represents nearly four years of guaranteed revenue. The European Union is seeking to address its sovereignty deficit, and approximately 50% of major equipment contracts are awarded to European suppliers, leaving a massive growth potential for regional players. The sector's projected average earnings per share (EPS) growth is expected to remain at a rate of 20% to 30% per year through 2028. In terms of stock market performance, the sector is primarily composed of a few major players in France and Germany. Rheinmetall is a quintessential heavy weapons manufacturer and the primary beneficiary of the Bundeswehr's rearmament and European joint procurement initiatives. Thales is considered a more balanced investment thanks to its diversification. It will capture a significant share of the budgets allocated to command and control systems, electronic warfare, and air defense. Dassault Systèmes is more of a tech player essential to the sovereign ecosystem and benefits from software investments by other players, such as Dassault Aviation. The latter is also a "pure-play" aerospace company, positioned directly at the heart of the build-up of European air combat capabilities. Its order backlog has reached an all-time high of 45 billion (5 years' revenue). It holds a 26% stake in Thales, benefiting from strategic and financial synergies. After a very positive initial phase on the stock market, the sector has seen profit-taking and consolidation. Entry points are now more attractive and more solid. The 10- to 15-year budget outlook, the NATO agreement aiming for defense spending of 3.5% to 5% of GDP by 2035, and the German budget plan create a guaranteed cash flow floor for manufacturers. The unique situation created by the war in Ukraine and the new perception of future military risks have helped reshape the sector's fundamentals and its correlation with the global equity market. In our view, the sector is now less correlated and contributes to optimal diversification of opportunities and risks.