

Given the Structural Growth in Defence Procurement, The Market is Underestimating the Earnings Potential



Key takeaways from this report

- Sales growth for European defence companies is expected to outpace defence spending growth
- Volumes and operating leverage should allow earnings to grow faster than sales.
- Valuation multiples based on realised earnings number may underestimate stock price potentials
- Valuation reset creates a more attractive entry point into a structurally stronger defence cycle.

Key numbers for earnings growth in the European defence industry

Share of total defence spending to military equipment	Growth in spending on military equipment vs growth in total defence spending	Earnings growth (EBITA) vs sales growth 2025 to 2030
32% → 45%	16% vs 8%	16% vs 12%
NATO Europe: 2015-2025	NATO Europe: 2025-2030 CAGR	RBC 2026

SOURCES: NATO and RBC, European Defence Report (August 2026)

The European rearmament cycle is still at an early stage, with European NATO member states defence spending expected to rise from around 2.3% to 2.9% of GDP between 2025 and 2030 (RBC, European Defence Report, August 2026). We view this forecast as a reasonable assumption and an important anchor for the broader industry growth outlook.

It is important to note that an increase in the share of GDP is a blunt measure for the expected earnings growth for listed defence companies. There are three arguments for this conclusion:

1. Defence spending has three main components i) equipment and material, ii) personnel costs, and iii) spending on operations and maintenance. Spending on equipment and material, often termed *defence procurement*, is expected to grow much faster than the other two components in coming five years.
2. Most listed companies are exposed to the fast-growing market for military equipment and material.
3. Defence companies are now expanding production capacity. As sales grow over time, capacity utilization will increase. As production rises, increased productivity will cause earnings to growth significantly higher than sales growth. Margin improvement will motivate a valuation upgrade.



Gustaf Hagerud
Chief Investment Officer



Joakim Agerback
Lead Portfolio Manager



Fredrik Ljungdahl
Analyst

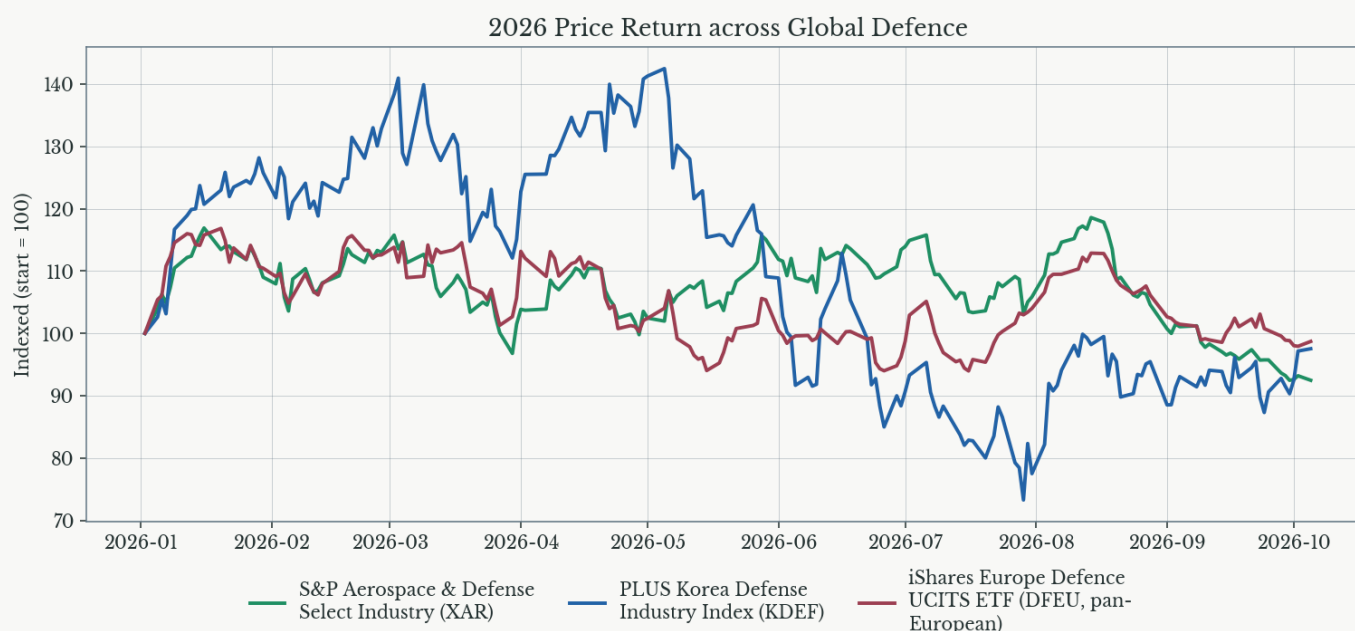
Finserve Nordic & Finserve Global Defence & Security Fund

This is a market report and should be regarded as marketing communication. Please read the fund company's prospectus and the Key Information Document before making any final investment decisions.

The Investment Opportunity

Current share prices imply a pessimistic scenario for defence companies

Global defence stocks have underperformed broad equity indexes in 2026. This is partly explained by investors' strong preference for companies exposed to AI. This development has opened a possibility to reallocate capital to the sector and thereby improve the risk and return profile of the total equity exposure.



Source: FactSet, 2026-01-02 to 2026-10-05



In our view, the investment opportunity in European defence lies in the gap between how the defence sector is valued and how its earnings profile has evolved. Procurement on equipment and material is growing faster than aggregate defence budgets, while greater scale, higher utilisation and a favourable business mix are already translating into EBIT growth above sales growth for many companies. This is something we noted in our previous research report from August 2026.

The combination of durable demand, strong revenue growth and improving earnings economics creates an unusually supportive backdrop for the sector. Capacity investments can weigh on near-term cash flow, but as new capacity is commissioned and utilisation rises, they can also improve unit economics. At the same time, today's deliveries expand the installed base, supporting maintenance, upgrades and replenishment revenues well beyond the initial procurement cycle.

If these characteristics prove durable, the sector may warrant a different valuation framework from that implied by historical multiples. The opportunity is not uniform, however: capability exposure, execution, cash conversion and starting valuation differ materially across companies. We reflect those differences in how we weight individual holdings across the portfolio.

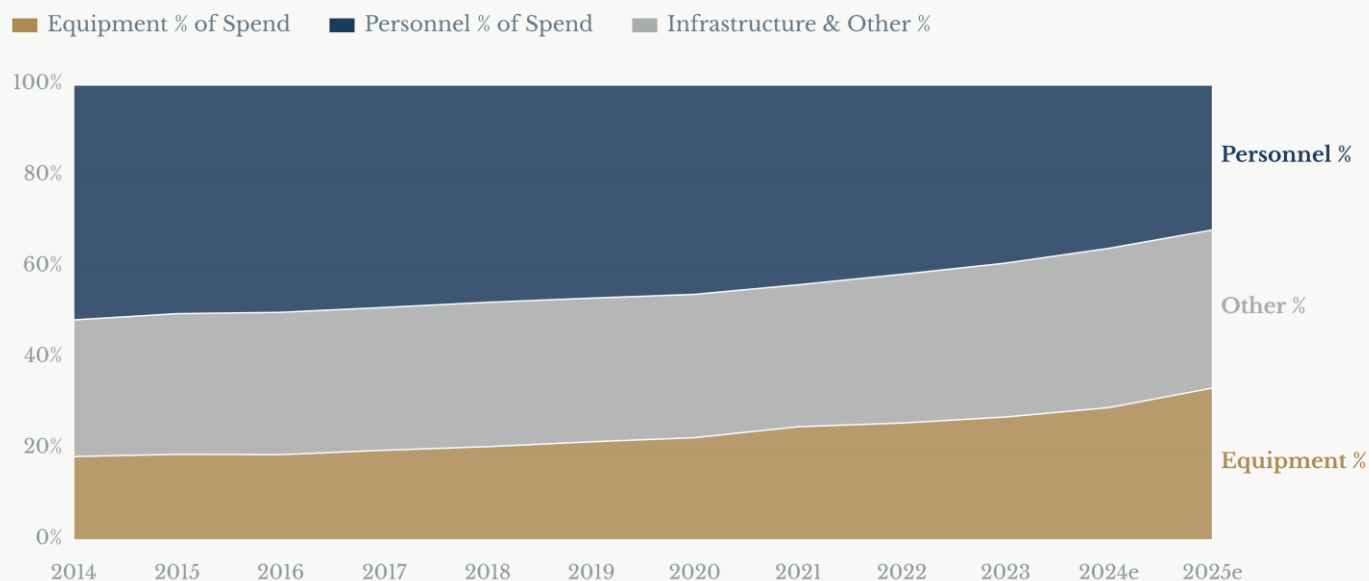
This is a market report and should be regarded as marketing communication. Please read the fund company's prospectus and the Key Information Document before making any final investment decisions.

Procurement, not the topline, is the addressable market

Europe is finally increasing equipment spending

After over 20 years of underspending in equipment and material, European NATO members are finally breaking the trend. Listed defence companies, will be big beneficiaries of this development.

Defence Spending of European NATO Members



SOURCES: NATO and RBC, European Defence Report (August 2026)

The war in Ukraine and the generally more tense situation between NATO and Russia have changed the distribution between the three main components of European countries' defense spending. The three components are i) equipment and materials, ii) personnel costs, and iii) expenses for operation and maintenance. Russia's increasing production of weapons, and elevated production capacity, has caused the European NATO countries to focus on equipment and material purchases. Stocks of weapons and ammunition must increase, and more production units must be established in Europe. In addition, NATO countries continuously send weapons and ammunition to Ukraine, which requires further increased production.

Costs for personnel, operation and maintenance will also increase in the coming years, but not quite as sharply as the cost for equipment and material. Personnel costs are dependent on active soldiers and wage increases, while the costs of operation and maintenance have historically increased in line with inflation. We subscribe to RBC's analysis (August 2026) estimates that over 80% of NATO's increase in defence spending will be driven by the purchase of equipment and material. If Europe is to address its equipment shortages, depleted stockpiles and readiness shortages, we expect to see above 15% annual growth in defence procurement.

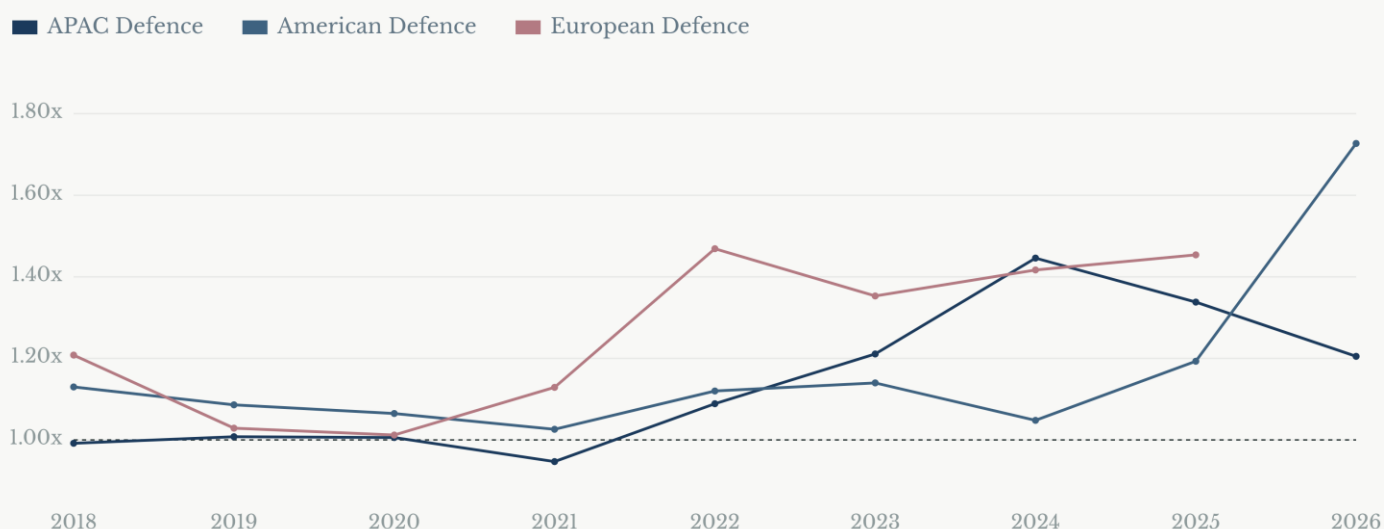
This is a market report and should be regarded as marketing communication. Please read the fund company's prospectus and the Key Information Document before making any final investment decisions.

From order growth to earnings visibility

Investors expected to focus on increased production capacity

Backlog is valuable only when orders are funded, binding, producible and scheduled. The quality and duration of the order book therefore matter as much as its headline size.

Book-to-bill ratios across Global Defence are showing an increased order intake



SOURCES: FactSet (2026-10-08)

Backlog has become one of the defining characteristics of the defence sector. But its analytical value comes from more than its size. A large order book provides visibility only to the extent that it is funded, binding and matched by deliverable production capacity. Framework agreements can signal substantial future demand without carrying the same revenue certainty as contracted orders. Book-to-bill numbers therefore remains important because it shows whether new orders continue to replenish revenues as deliveries accelerate.

For investors, the ideal pattern is not simply a rising backlog. Rather, the perfect match is a sustained book-to-bill above 1x, alongside accelerating revenue conversion and stable or improving margins.

In 2025, European land-system backlogs stood at roughly five years of 2025 revenue on average. Long visibility reduces demand uncertainty, but it also raises the importance of execution and cash conversion. Therefore, it is essential to focus on execution when evaluating individual defence companies.

COMPANY AT A GLANCE

€63.8bn

Rheinmetall

- 2025 order backlog level reported at €63.8bn, +36% year on year in the company case study.
- The figure includes both binding order backlog and framework agreements — an important distinction for revenue certainty.

This is a market report and should be regarded as marketing communication. Please read the fund company's prospectus and the Key Information Document before making any final investment decisions.

Earnings will grow faster than revenues in 2026-2030

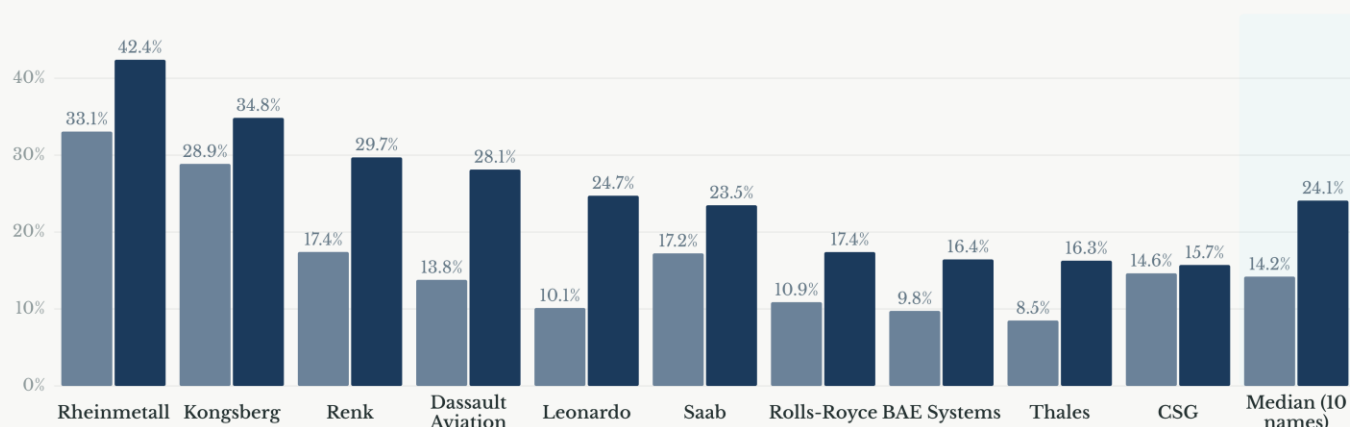
Higher volumes and utilisation can create operating leverage and drive earnings growth

Higher production volumes, capacity utilisation, productivity and business mix can improve fixed-cost absorption, allowing earnings to grow faster than revenues.

An industry growing sales at low double digits with earnings growing several percentage points faster has a very different economic profile than the low-growth defence industry seen after the end of the cold war. Financial analysts estimate a sector level sales growth of close to 12% between 2025 and 2023. In the same period, EBITA is expected to increase by approximately 16% per year. The dispersion between companies is substantial, which is equally important. Operating leverage is not a sector entitlement; it depends on program mix, contract structure, execution and the maturity of capacity investments.

Sales and Earnings Growth for European Defence Companies

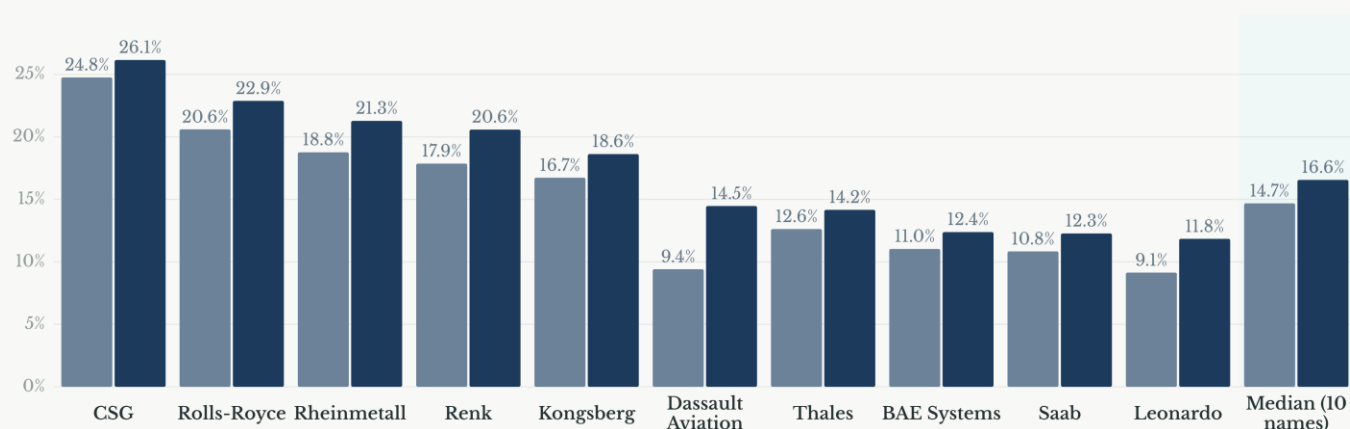
■ Sales CAGR ■ EBIT CAGR



SOURCE: FactSet (2026-10-08)

Margin Expansion for European Defence Companies

■ EBIT margin 2026E ■ EBIT margin 2030E



SOURCE: FactSet (2026-10-08)

This is a market report and should be regarded as marketing communication. Please read the fund company's prospectus and the Key Information Document before making any final investment decisions.

Industrial capacity

Scaling capacity and converting growth into cash

Higher demand requires substantially greater production capacity, particularly in munitions and other high-volume capabilities. Scale, automation, higher utilisation and more resilient supply chains can improve throughput and unit economics, while governments' need for assured production capacity can support longer procurement frameworks and greater contract visibility.

The near-term trade-off for production capacity is cash flow. Capacity expansion and inventory build require capital ahead of deliveries, but as new capacity is commissioned and utilisation rises, working-capital intensity should moderate, and stronger earnings should increasingly convert into free cash flow.

The economics of industrial capacity

Scale production – Higher-volume demand requires industrial capacity above recent peacetime levels.

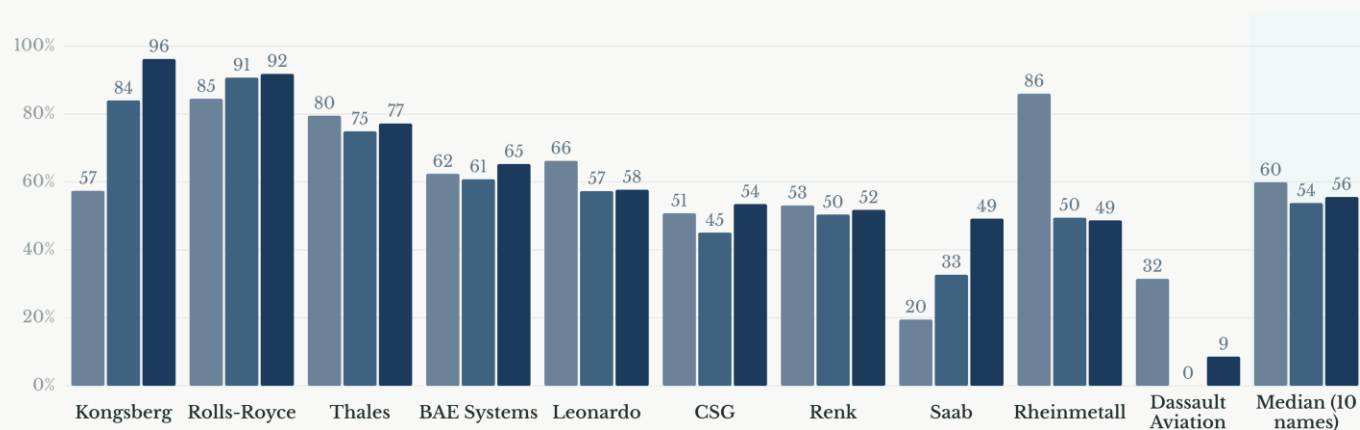
- Secure supply – Resilient supply chains and critical-input access improve delivery certainty.
- Improve economics – Automation, larger production runs and utilisation support fixed-cost absorption.
- Extend visibility – Strategic-capacity agreements can align government supply needs with suppliers' investment requirements.

Capacity expansion and inventory build require capital ahead of deliveries, but as utilisation rises, stronger earnings should increasingly convert into free cash flow.

Cash Conversion

Cash conversion remains more uneven than margin progression, reflecting differences in capex, working capital and customer funding.

● FCF conversion 2026E ● FCF conversion 2027E ● FCF conversion 2028E



SOURCES: FactSet (2026-10-08)

The investment case therefore depends not only on higher margins, but on whether the production ramp ultimately converts those earnings into stronger free cash flow.

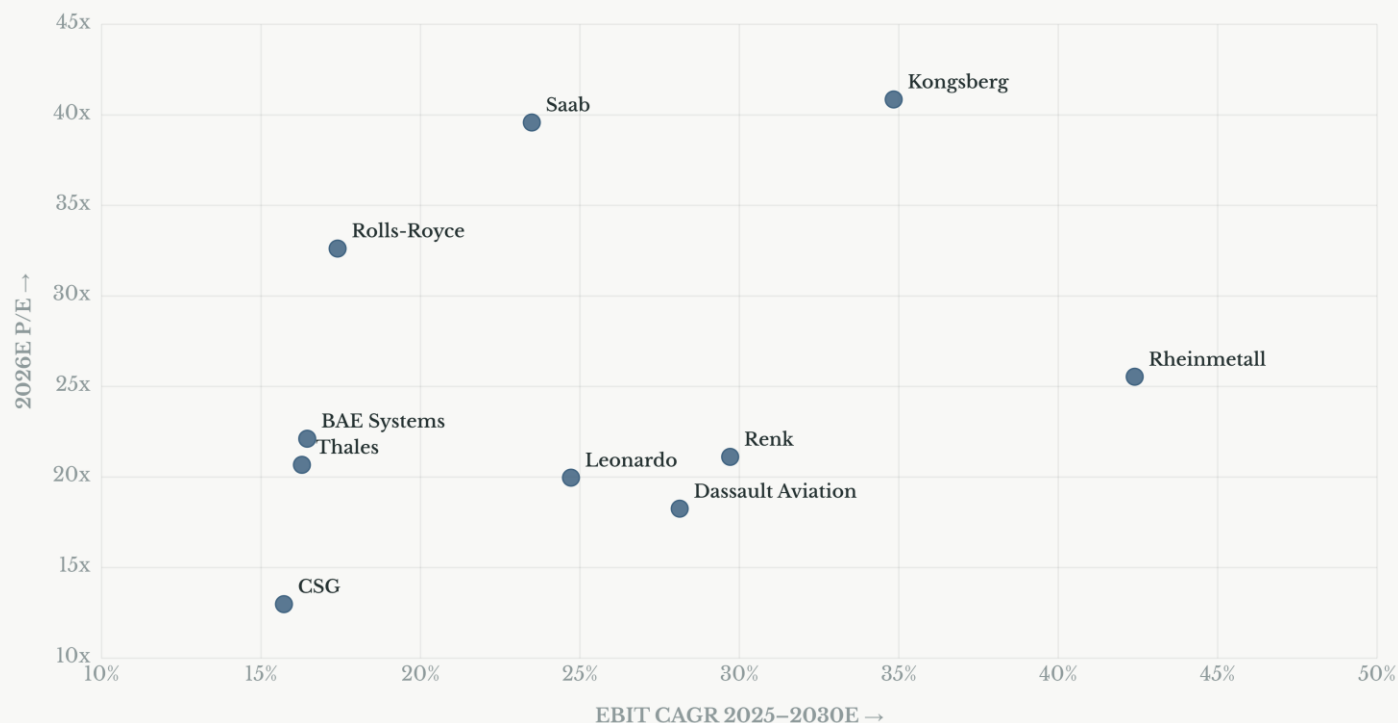
This is a market report and should be regarded as marketing communication. Please read the fund company's prospectus and the Key Information Document before making any final investment decisions.

Long-duration growth and valuation

Upside in forward valuation metrics for the sector

Historical defence multiples are less relevant if growth, order visibility and earnings duration have changed structurally. Investors should focus on valuation relative to forward growth and expected execution quality.

P/E-ratios and Earnings Growth for European Defence Companies



SOURCE: Factset (2026-10-07)

The picture above shows a wide dispersion in both growth and forward P/E. The chart does not imply that higher growth automatically deserves a higher multiple; it shows why sector-level historical averages can obscure company-specific economics.

Historical multiples for European defence companies reflect a historical earnings regime characterised by low growth, short visibility, smaller order books and limited capacity expansion. If those variables have structurally changed, comparing today's P/E with a ten-year average, risks comparing two different economic regimes.

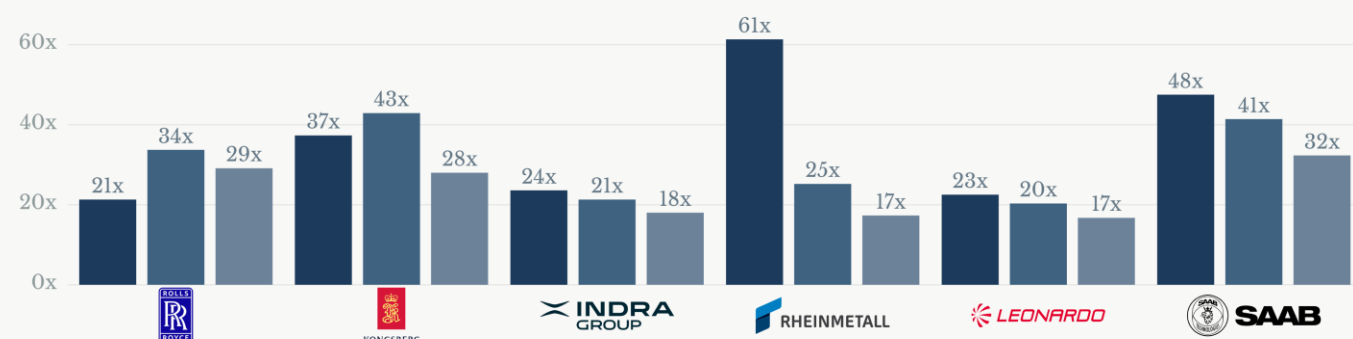
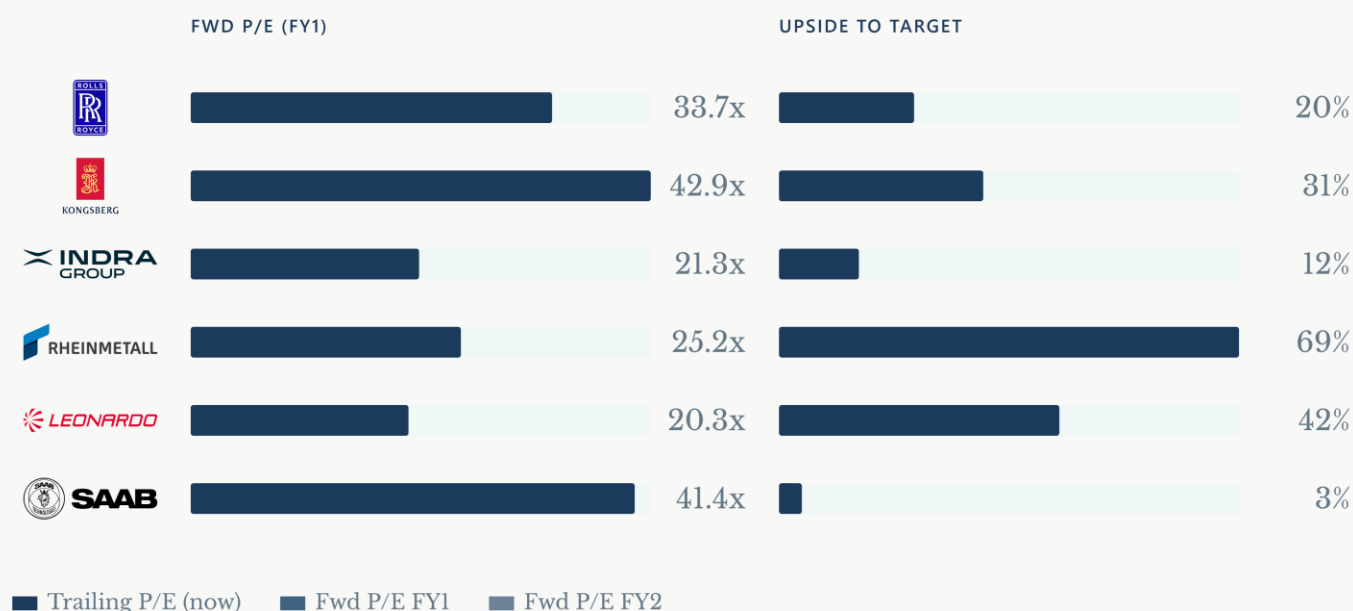
A more relevant framework is to compare forward valuation with forward sales growth, EPS/EBITA growth, free-cash-flow conversion and earnings duration. This is also why comparisons with broad equity markets are useful. If a defence company offers comparable or superior earnings growth to other structural-growth sectors, with multi-year state-backed order visibility, the appropriate valuation question is not whether it trades at a premium to its own history. Rather, it is whether the premium or discount is consistent with its prospective growth and risk profile.

This is a market report and should be regarded as marketing communication. Please read the fund company's prospectus and the Key Information Document before making any final investment decisions.

Current Valuation of European Defence

In 2026, earnings growth is strengthening faster than current valuations imply

Earnings expectations remain strong while sector valuations have reset from their recent highs. If current estimates are broadly delivered, today's forward multiples offer a materially more attractive entry point into the European defence cycle.



This is a market report and should be regarded as marketing communication. Please read the fund company's prospectus and the Key Information Document before making any final investment decisions.

Risks and what can challenge the thesis

The principal risk is not necessarily that defence spending reverses, but that procurement conversion, capacity scaling or cash generation develop more slowly than current expectations imply. In that scenario, valuations could remain somewhat lower despite a strong structural demand backdrop.

1. **Procurement conversion** – Budgets may translate into funded orders more slowly than expected.
2. **Capacity and execution** – Supply-chain constraints or delays could limit output and margins.
3. **Cash conversion** – While production capacity is valuable, the impact on capex and working capital may delay free-cash-flow improvement.
4. **Valuation** – Slower earnings or negative revisions could pressure multiples. revisions could leave current valuations exposed.

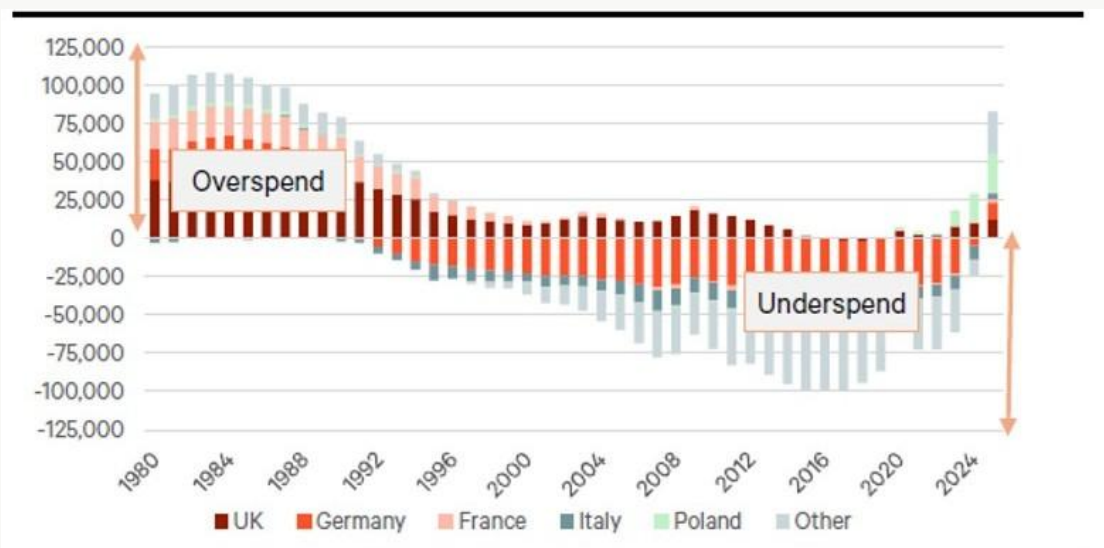
While these risks can constrain valuations, we argue the same factors mainly create opportunities in current state, where structural growth, execution and cash conversion are stronger than current market expectations imply.

This is a market report and should be regarded as marketing communication. Please read the fund company's prospectus and the Key Information Document before making any final investment decisions.

Summary and Conclusion

European Defence Spending in the last 45 Years

European defence is entering a multi-year investment cycle as governments rebuild inventories, expand production capacity and strengthen readiness. Equipment and material procurement—not aggregate budgets—is the principal earnings driver and is expected to represent more than 80% of the increase in European NATO spending, supporting annual procurement growth above 15%.



SOURCE: NATO and SIPRI, collected by Berenberg

Large order books and book-to-bill ratios above 1x provide multi-year visibility, but funded contracts, capacity, supply-chain resilience and execution determine conversion into revenue and cash. Higher utilisation should create operating leverage: sector estimates indicate approximately 12% annual sales growth and 16% EBITA growth through 2030, with material dispersion between companies.

Investment conclusion. The outlook remains constructive but selective, motivating active management. Historical multiples are an incomplete benchmark for a higher-growth, longer-duration earnings regime. Investors should prioritise funded demand, scalable production, forward EBITA growth and free-cash-flow conversion. Execution delays and supply constraints remain the principal risks.

References

1. Finserve Global Defence and Security Funds update H1 2026 "Strong Quarterly Reports Set the Stage for a Favourable Second Half of 2026"
2. RBC Capital Markets, European Defence – Initiation, Aug. 2026
3. Deutsche Bank Research 21 September 2026
4. [SIPRI Military Expenditure Database](#), Apr. 2026
5. Berenberg, More Rounds to Fire, Jan. 2026
6. NATO "Defence Expenditure of NATO Countries (2014-2025)"

This is a market report and should be regarded as marketing communication. Please read the fund company's prospectus and the Key Information Document before making any final investment decisions.