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THE DEFENCE SYSTEM:
WITH DEMAND FOR SECURITY AND TECHNOLOGICAL INNOVATION ON THE RISE, THE DEFENCE INDUSTRY IS GROWING

Defence industry multinationals: total sales expected to increase by 9% in 2024 and by 12% in 2025

US players three times the size of their European counterparts

Outstanding stock market performance: shares have risen by 72.2% in 3Y, with the European groups (up 128.1%) outperforming their US counterparts (up 59.1%)

Leading Italian defence industry companies: 59.3% of aggregate total revenues attributable to the Italian state, 25.1% to non-Italian-owned companies, and 15.6% to Italian family-owned companies

Milan, 25 November 2024

The **Mediobanca Research Area** has published a report on the defence system to coincide with the event "The Defence era: capital and innovation in the current geopolitical cycle". The report, presented exclusively by the Director of the Mediobanca Research Area Gabriele Barbaresco and by leading analyst Nadia Portioli, analyses the financial data of **40 multinationals** and **100 Italian firms** operating in the security industry, with a focus on the most recent trends in the sector and its prospects.
The Chief Executive Officer of Mediobanca, Alberto Nagel, commented on the main findings of the research in his introductory speech. Also taking part in the event were Matteo Perego di Cremnago, Under-Secretary of the Italian Ministry of Defence, and Glenn McCartan, representative of the Defence Innovation Unit at the US European Command. The data illustrated in the report will form the basis for the discussions as part of a roundtable featuring leading sector operators: Domitilla Benigni, CEO of Elt Group, Pierroberto Folgiero, CEO of Fincantieri, Emanuele Serafini, Vice President of Western Europe Lockheed Martin, and Guido Lami, Executive Group Director of MBDA Italy.

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Defence sector: political and economic dimension

In the current scenario, in which the threats to global security are escalating, the defence sector requires large-scale investment to be able to ensure that the nations' stability continues to be protected. Such investments are required to increase both the level of protection and to develop technological innovation.

Financing defence is a challenge for governments required to balance resources between investing in national security and other forms of spending geared more closely to the population's economic and social prosperity, such as welfare. Furthermore, public ownership of so many defence sector companies places governments in the dual role of owners and clients, further complicating the spending decisions to be taken.

The perception of external threats and the demand for security thus play a crucial role in determining the level of spending to be incurred in the area of defence, influencing governments' political and strategic decisions.

The global defence industry: above and below the surface

The escalation of the geopolitical tensions triggered by the conflicts in Ukraine and the Middle East, as well as those in Sudan and Myanmar, has led to growing attention being focused on security issues and an increase in defence spending, which in 2023 reached **a record high of $2,443bn at global level** (up 6.8% on 2022),the equivalent of $306 per person. This has had a direct impact on the results of the leading industry players, and on their stock market returns, demonstrating their dynamism, financial and industrial health, and excellent prospects. The upshot of this has been a particularly buoyant consolidation process.

Considering all companies at a global level with individual revenues deriving from security in excess of €0.5bn, the **aggregate global turnover generated by the defence industry reached nearly €615bn** in 2023 (up 9.8% on 2022). Excluding the players for which insufficient earnings or financial visibility is available (primarily the large Asian companies) and the smaller operators, the analysis of the global defence industry in this report is concentrated on the **leading 40 multinationals (the "Top 40")** that are responsible for almost

60% of the aggregate turnover in the sector, **generating revenues of €355bn from their core defence business** in 2023 (up 6.9% on 2022 and up 18.6% on 2019).

Top 40 defence industry multinationals

Of the 40 defence sector multinationals with individual turnover in 2023 of above €1bn, 17 of which are located in Europe (four in the United Kingdom, four in France, two each in Germany, Italy and the Netherlands, one each in Poland, Spain and Sweden), 16 in the United States and seven in the Middle East and Asia (two in South Korea and India, one each in Israel, Turkey and Taiwan).

The panorama has for a long time now been **dominated by the US groups,** with a share of 68% of the aggregate global revenues posted in 2023, followed by the European players with 27% and the Asian operators with 5%. Italy, represented by **Leonardo** and **Fincantieri**, is responsible for 14% of the European turnover and for 4% of the global revenues. The market is concentrated, with the top ten multinationals accounting for more than two-thirds of the aggregate turnover**.** The degree of concentration is highest in the US panel of companies (the top ten operators represent 92% of the total), ahead of the European panel (86%). The top five positions are held exclusively by US groups which alone generate more than half of the **total revenues originated from the core defence business**: **Lockheed Martin** (€55.0bn in 2023), **RTX** (€36.8bn), **Boeing** (€31.0bn), **Northrop Grumman** (€30.6bn), and **General Dynamics** (€26.8bn). **Leonardo** (€11.5bn) and **Fincantieri** (€2.0bn), rank in ninth and 31st positions respectively. The European players are large, but still a long way off the size of the US operators: the average size is just over one-third of the US groups. The **European** rankings are headed up by UK firm **BAE Systems** (€25.8bn), followed by **Airbus** (€11.8bn), **Leonardo** (€11.5bn), **Thales** (€10.1bn) and **Rheinmetall** (€5.1bn); **Fincantieri** (€2.0bn) ranks in thirteenth position. To make the European companies more competitive, a round of industrial consolidation is required, along with a supranational vision of Europe as a "whole", which is especially important for the security ecosystem. The European defence industry as a whole is suffering from a **double structural deficit**: **reduced focus on innovation**, with lower investments compared to the United States (by approx. one-third), and **high levels of fragmentation**, which limit its range and efficiency, increases costs, and hampers its operations on the ground, as the decision-making centres continue to be located at the individual Member State level. To address the issue of global competition and to guarantee security at European level, increased integration between the sector's different industries is indispensable, as is the establishment of poles for major supranational programmes.

The defence sector is a highly technological industry, featuring dynamic innovation, which means that huge **investment in R&D** is required. The European Union spends less than one-tenth of what the United States does on R&D for defence: €10.7bn, vs €130bn.

In **the 2019-23 five-year period,** the growth in total revenues generated by the European groups from defence business (average rate 3.3%) was below that reported by the US groups (4.3%) and the Asian groups (12.2%). In response to the current challenges facing the industry, for the Top 40 companies a **9% increase in aggregate revenues is forecast for 2024**, more than twice the rate at which global GDP is expected to grow (3.2%), driven by the **European groups which are expected to outperform their US counterparts**: in 2024 it is estimated that the European players will report an 11% increase in turnover versus 2023, compared with 8% by the US giants. For **2025,** in a disinflationary scenario and with interest rates falling, with the world fragmenting increasingly into different blocs that are talking less and less to each other, aggregate total revenues are set to rise by **12%**, still outperforming the growth in global GDP estimated (up 3.2%). This estimate is based on a relatively stable geopolitical environment which continues to support defence spending budgets, without considering risks related to new conflicts or protectionist tendencies that could drive a further increase, but does factor in the potential effects that the newly elected Trump administration might have on the security industry, which translate to additional orders of a certain size being acquired.

The aggregate profitability of the Top 40 companies is decreasing: the Ebit margin has gradually declined from 7.7% in 2021 to 7.5% in 2022, to 7.2% in 2023 and to 7.1% in 1H 2024 (the same as in 2019). Here the top three performers were all Asian: Indian companies **Bharat Electronics** (Ebit margin 26.5%) and **Hindustan**

Aeronautics (25.9%) and Turkish group **Aselsan** (17.2%), all of which are state-owned. The European companies are reporting improving margins compared to their US counterparts (Ebit margin of 7.7% for the former and of 6.7% for the latter in 2023), with the German firms the outstanding performers here (12.5%), almost 2x the panel's average. The top three European companies in this respect were **Rheinmetall** with an Ebit margin al 13.5% in 2023, ahead of French-German JV **KNDS** (12.6%) and UK group **QinetiQ** (12.6%); next, but still with margins in double digits, came Polish group **PGZ** (11.8%) and **MBDA** (11,1%), a joint venture between Airbus (37.5%), BAE Systems (37.5%) and Leonardo (25%).

Investments reported double-digit growth in 1H 2024 (up 11.3% on 1H 2023), and versus the previous year too (up 14.9% on 2022 and up 26.7% on 2019). In 2023, as with profitability, the German operators were the stand-out performers, with the highest average investment rate (5.7%), almost double the sector average. The figure for the European groups (4.2% in 2023) is higher than that for the US firms (2.5%).

In 2023, the amount of **dividends** distributed by the defence industry multinationals reached the highest levels seen in the last five years (up 6.5% on 2022 and up 19.8% on 2019), despite remaining below 2019 levels in terms of payout ratio (52.1% in 2023 vs 52.7% in 2019). The US companies again proved to be willing to implement stronger risk capital remuneration policies: their payout ratios are consistently higher than those of their European counterparts, at 62.1%, compared with 40.8% for the latter in 2023. The Asian groups were at the opposite end of the spectrum here, paying dividends which did not go beyond 25.6% of net profits.

The top 40 defence industry multinationals **employed almost 1.7 billion people in 2023** (up 8.4% on 2019, which translates to more than 120,000 more employees). Further growth in employment levels of 7% is expected for 2024, driven by the European groups (up 10%), twice the rate of increase expected by the US groups (5%). The European multinationals recruit worldwide, despite the fact that more than one-third of their workforce continues to be employed within the continent's own borders: on average 71% of the workforce is employed in Europe, 17% in North America, and the other 11% in Asia and other geographies.

On the **balance-sheet side**, financial stability has improved in the last five years: shareholders' equity was 41.0% higher than in 2019, and minority interests 32.9% higher. At end-June 2024, the Asian players were the most solid financially, followed by the European groups, whose net equity is 1.3x their net debt; the US multinationals were the least capitalized, with a ratio below par (0.7x). Liquidity levels are also growing, with cash and liquid assets representing 39.9% of borrowings at end-2023, compared to 37.6% at end-2019.

The aggregate **market capitalization** of the defence industry multinationals totalled **€1.000.9bn** at end-October 2024, equal to **0.9%** of the aggregate value of global stock markets. The top-ranking positions are held by four players with market values of over €100bn: **RTX** (€148.3bn), **Lockheed Martin** (€119.2bn), **Airbus** (€111.0bn), and **Boeing** (€102.8bn). The stock market and investors have demonstrated their appreciation for the value of the security industry: **since the start of 2022 and end-October 2024**, years in which global geopolitical tensions have been escalating, the defence industry has **reported a return of 72.2%**, more than 3x the 20.1% performance delivered by the global stock market as a whole, with the **European players outperforming their US counterparts**: up 128.1%, vs 59.1%. In the **first ten months of 2024**, the top three European operators by stock market performance were **Rheinmetall**, whose share price rose by 66.2%, followed by UK group **QinetiQ** (up 55.6%) and **Leonardo** (up 49.0%), with **Fincantieri** in eighth position (up 18,3%).

As of November 2024, 88.8% of the Top 40 multinationals' **ownership structure** was free floating (66.4% attributable to institutional investors and 22.4% widely held), with the remainder split between public shareholders (6.9%) and private shareholders (4.3%). There are, however, major **differences on both sides of the Atlantic.** Of the US companies' ownership, all of which are listed, 99.2% floats freely (with 79.8% attributable to institutional investors and 19.4% widely held), in line with the public company model which is prevalent in the United States and United Kingdom especially, with the other 0.8% privately-owned. In Europe, by contrast, 70.1% of the ownership is free float (39.8% attributable to institutional investors and 30.3% widely held), 17.3% is state-owned (2.8 p.p. fewer than in 2019), and 12.6% owned by private shareholders (up 3.5 p.p. In the same period).

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The Top 100 Italian defence industry companies

Italy is one of the pillars of the European defence sector's industrial base, and excels in certain critical sectors such as helicopters, electronics and shipbuilding. The Italian defence industry is highly developed and diversified, and may perhaps best be represented in the form of a **pyramid**, with the two largest players, **Leonardo** and **Fincantieri** (which are also active in other sectors), both state-owned, at the top, acting as prime contractors in the most important market segments in terms of business volumes and technology contents. The second tier consists of smaller companies often specializing in specific types of equipment or sub-systems. The third tier, meanwhile, comprises a whole host of small and medium-sized enterprises, many of which outstanding companies that require to be nurtured and encouraged to grow.

The **Top 100 Italian defence industry companies** (the **"Top 100"**), with turnover of above €19m and which employed more than 50 people in 2023, are typically **dual use** companies, that is, they sell products and services to both the civil and security markets. For this reason, their **aggregate revenues**, equal to €40.7bn in 2023, are not entirely attributable to defence, but only a portion of it that may be estimated at 49% of the total, approx. **€20bn (up 6.6% on 2022 and up 14.7% on 2021).** With reference to the workforce, too, which amounts to over 181,000 employees in 2023, the share attributable to defence alone and based in Italy is estimated to be **over 54,000 employees.** The **value added** attributable to the **defence** industry is equal to approximately **0.3% of Italian GDP in 2023.**

Aggregate total revenues amounted to €40.7bn, with the **aerospace/automotive** sector responsible for 49.0% of the total, and **shipbuilding** for 23.3%. Alongside Leonardo and Fincantieri, only another eight companies reported turnover of above €1bn, which with them represent three-quarters of the aggregate turnover.

The contribution from the **Italian state-owned companies** was the largest, accounting for **59.3%** of the aggregate total revenues. **Non-Italian groups** have an important footprint in the Italian defence industry: 36 of the Top 100 companies have non-Italian ownership which controls **25.1%** of the **aggregate turnover** (12.2% of which European and 10.1% US-owned). The Italian, family-owned companies contribute just **15.6%** of the total revenues, even though they are more numerous (56) than the internationally owned firms, and so are smaller.

The defence value chain boasts an impressive share of **exports**, equal to 68.2% in 2023, which, however, without the two major operators, both of which are highly international in their operations, decreases to 49.4%, The top 100 companies' main end-markets were Europe, which accounts for more than half total sales (61%), the Americas, driven primarily by the United States (29%), and other continents (10%).

In 2023, **spending on R&D** was on average equal to **6% of total revenues.**

Profitability reflects an **increasing trend**, with the Ebit margin rising from 5.7% in 2021 to **6.2% in 2023.** The Italian family-owned medium-sized enterprises outperformed all the other categories, on the back of their leaner and more flexible operating structures (Ebit margin 12.2%).

The aggregate **net profits** earned by the Top 100 countries in the 2021-23 three-year period totalled €4.5bn; **record aggregate net profits** were reported **in 2023**, of €1.6bn (up 11.2% on 2021), with **average net earnings per company** amounting to **€43,000 per day**.

The top 100 companies have implemented healthy **investment** campaigns, which in 2023 were 46.5% higher than in 2021, and have increased in intensity, too, rising from 3.1% of total sales in 2021 to 3.9% in 2023. As with profitability, the Italian family-owned medium-sized companies reported the highest growth in investments, both in absolute terms (up 71.9% in 2021-23) and in terms of intensity (5.2% in 2023).

On the balance-sheet side, the Top 100 have strengthened their **financial structure** (net debt was equal to 61.3% of net equity in 2023, compared with 70.2% in 2021), with the increase in net equity (up 20.2%) more than 4x the size of the growth in borrowings (which were up 4.9%). **Cash and liquid assets** at the aggregate level fell from 47.2% of borrowings in 2021 to 42.7% in 2023.

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