The UK remains indispensable to Europe's defence rebuild

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Key Takeaways

- UK is industrially embedded in Europe's defence ecosystem
- The UK remains a key military and technological partner
- Europe defence valuations reflect future growth, not hype

As Europe accelerates its rearmament agenda, the United Kingdom (UK) remains a vital player in the continent's defence value chain, even though it is no longer part of the European Union (EU). Despite being excluded from the EU's €150 billion defence rearmament fund[1], the UK's deep industrial integration, historical cooperation, and forward-looking strategies place it at the heart of Europe's defence resurgence.

Britain's defence industry and military continue to act as a critical force multiplier for European security, even outside the EU framework. This has significant implications for investors and stakeholders in the defence sector, underscoring that Europe's quest for strategic autonomy still heavily involves British know-how, technology, and leadership.

Industrial and technological integration in European projects

One of the strongest ties binding the UK into Europe's defence resurgence is industrial integration. Major British defence companies are tightly interwoven into multinational European weapons programs. For example, the Eurofighter Typhoon – Europe's flagship multirole fighter jet – is developed and produced by a consortium of firms from four countries. Britain's BAE Systems builds large portions of the Typhoon alongside Airbus (Germany/Spain) and Leonardo (Italy), under a joint venture (Eurofighter GmbH) managed via a NATO[2] agency representing all partner nations. Likewise, the Typhoon's engines (the EJ200 turbofan) are built by an alliance of Britain's Rolls-Royce with Germany's MTU Aero Engines, Italy's Avio and Spain's ITP, a pan-European engine consortium (EuroJet Turbo GmbH) formed specifically for this project.

These arrangements mean that as continental Europe upgrades its fighter fleets, British industry automatically shares in the work and revenue. Another prime example is MBDA, Europe's integrated missile manufacturer. Formed by merging the missile divisions of UK, French, and Italian companies, MBDA is co-owned by BAE Systems (UK), Airbus (Pan-European), and Leonardo (Italy)[3].

It employs over 13,000 staff (4,000+ in the UK alone) and supplies many of the cutting-edge munitions being procured by European militaries. When EU nations invest in missiles like the Meteor air-to-air or Storm Shadow/SCALP cruise missile, they are effectively investing in a British-inclusive supply chain. In fact, MBDA's ownership structure (37.5% BAE, 37.5% Airbus, 25% Leonardo) exemplifies how deeply British technology is embedded in Europe's defence industrial base[2].

Precision and power projections

Additionally, British firms contribute niche technologies and R&D that bolster European projects. QinetiQ, a UK-based defence technology company collaborates on various European defence research initiatives – from robotics and artificial intelligence to test & evaluation of new systems. British aerospace engineering (for example, Rolls-Royce's jet engines or reaction wheels for satellites) and electronics expertise (radar, sensors, cyber security) are frequently part of joint developments with European partners. The UK brings advanced strike capabilities that strengthen Europe's offensive and deterrent options. The Royal Navy's submarines armed with Tomahawk cruise missiles can strike targets at long range, and the Royal Air Force's strike fighters (Typhoons and F-35B Lightning stealth jets) carry Storm Shadow cruise missiles and other precision munitions.

Britain's investment in two new Queen Elizabeth-class aircraft carriers gives Europe its only true carrier strike groups aside from France, capable of deploying fifth-generation F-35 jets globally. This expeditionary air-maritime power provided by the UK significantly enhances NATO's collective reach, from the North Atlantic to the Mediterranean. European allies, while increasing their arsenals, continue to depend on British long-range strike assets and naval air power for high-end operations.

This industrial interdependence means that Europe's rearmament boom directly benefits UK companies and, conversely, European armed forces gain from British innovation. Evidently, Britain's defence sector is still tapped into the surge of European military investment through joint ventures, licensing, and cross-border supply chains established over decades.

Capturing the WisdomTree European Defence opportunity

This reality is reflected in the construction of the WisdomTree Europe Defence UCITS ETF (WDEF), where the UK represents the second-largest country allocation at 26%[4] in the portfolio. The exchange-traded fund (ETF) invests in the UK's world-class defence companies including BAE Systems, Rolls-Royce, Babcock International Group, QinetiQ, Chemring and Cohort indispensable to Europe's multi-decade rearmament cycle. The WisdomTree Europe Defence UCITS Index prioritises companies with a higher exposure to the defence industry by assigning an exposure score:

- **Exposure Score 3:** companies with > 50% exposure to defence activities
- **Exposure Score 2:** companies with 25% to 50% exposure to defence activities
- **Exposure Score 1:** companies with 10% to 25% exposure to defence activities

Companies will then be weighted by free-float market capitalisation adjusted by the Exposure Score. In doing so, the WisdomTree Europe Defence UCITS ETF (WDEF) provides an exclusive focus on European defence companies, providing an undiluted exposure to the sector's growth potential.

Valuations remain reasonable

Despite strong stock performance, European defence stocks are not overpriced relative to their earnings growth potential amid heightened military spending and growing global tensions. Compared to US aerospace and defence stocks, which trade at higher historical P/E[5] ratios, European aerospace and defence stocks still trade at lower price-to-earnings multiples and offer comparatively higher quality metrics such as Return on Equity and Return on Assets as illustrated below.

Figure 1: Comparison of fundamentals

Figure 1a.



Source: Bloomberg, WisdomTree as of 31 March 2025. **Historical performance is not an indication of future performance and any investments may go down in value.**

Figure 1b.



Source: WisdomTree, MSCI, FactSet, Bloomberg, as of 28 February 2025. Holdings of the peers were sourced from Bloomberg. Fundamentals were sourced from FactSet. PEG rations are based on forward P/E ratios and est. long term growth. Please note: MSCI World A&D Index denotes MSCI World Aerospace & Defence Index. MSCI Europe A&D Index denotes MSCI Europe Aerospace & Defence Index. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

In comparison to peers, the WisdomTree Europe Defence UCITS Index offers the highest long-term estimated growth rate estimate at 24%[6]. When viewed in isolation the price to earnings ratio appears high at 27.3x, however on comparing the price-to-earnings to the annual earnings per share growth estimate we arrive at a price-to-earnings growth (PEG) ratio of 1.1x which is lower than the competitive landscape.

What's not in the price?

The WisdomTree Europe Defence UCITS Index is positioned for strong earnings growth, with earnings per share expected to rise by 20% in 2026 and 17% in 2027[7]. This reflects expanding market share, multi-year procurement cycles, and increasing defence budgets across Europe. While cash flow per share may dip temporarily as companies scale operations, debt levels are projected to decline, ensuring financial stability.

Figure 2: Earnings per share forecasts

	2024	2025		2026		2027	
Measure	Actual	F12 Est	Growth	Y+1 Est	Growth	Y+2 Est	Growth
Earnings Per Share	10.18	12.11	18.96%	14.56	20.19%	17.07	17.28%
Cash Flow Per Share	16.46	16.15	-1.89%	19.64	21.61%	56.27	186.43%
Dividends Per Share	3.22	4.52	40.10%	5.34	18.29%	6.23	16.59%
Book Value Per Share	57.47	63.6	10.66%	72.13	13.42%	83.02	15.09%
Sales Per Share	147.6	163.47	10.75%	180.11	10.18%	198.46	10.19%
EBITDA Per Share	17.97	23.46	30.56%	26.91	14.74%	30.74	14.24%
Net Debt Per Share	10.71	6.76	-36.90%	0.83	-87.74%	-6.34	
Enterprise Value Per Sha	321.24	317.25	-1.24%	311.33	-1.87%	304.16	-2.30%

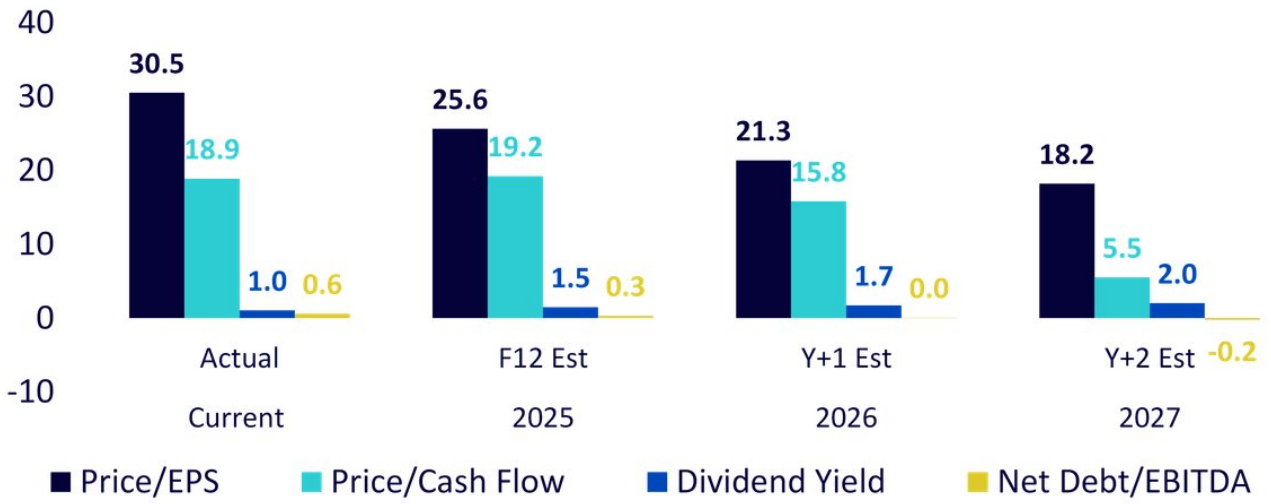
Source: Bloomberg, WisdomTree as of 9 April 2025. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

A higher P/E ratio doesn't mean it's expensive

At first glance, the current price-to-earnings (P/E) ratio for the European defence sector at 30x may appear elevated. However, this is a reflection of current earnings levels, not future profitability. The defence sector operates on long-term contracts, meaning that earnings expansion takes time to materialise.

As order backlogs convert into revenue and profitability scales up over the next few years, earnings growth will drive the P/E ratio down naturally. By 2026 and 2027, with higher earnings expectations already forecasted, valuation multiples will become more attractive.

Figure 3: Fundamental ratios—WisdomTree Europe Defence UCITS Index



Source: Bloomberg, WisdomTree as of 9 April 2025. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

Investors looking at short-term valuation metrics may overlook the long-term earnings trajectory of the sector. The forward-looking nature of the defence industry, driven by sustained government contracts and multi-year procurement cycles, makes this a strategic, long-term opportunity rather than an overvalued trade.

[1] European Parliamentary Research Services as of 28 February 2025.
[2] NATO = The North Atlantic Treaty Organization, also called the North Atlantic Alliance, is an intergovernmental transnational military alliance of 32 member states.
[3] Mbda-systems.com
[4] FactSet, WisdomTree as of 21 March 2025.
[5] P/E = price-to-earnings.
[6] WisdomTree, FactSet as of 14 March 2025.
[7] Bloomberg, WisdomTree as of 18 March 2025.

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