

RHEINMETALL: LOCKED AND LOADED

- The company is seen as one of the key beneficiaries of EU's push towards greater defence spending with its stock up 120% YTD.

The Trump effect

- President Trump's active anti-EU stance and the temporary suspension of military aid to Ukraine has heightened the need for Europe to rebuild its military power.
- The US' formidable nuclear weapons arsenal, second only to Russia, has historically provided a powerful deterrent to any potential attack on a NATO state. The current stance of the US administration raises questions about whether it can be relied upon to support EU allies or whether the US is planning to leave NATO.
- The US wants NATO's EU members to foot their defence budget and increase military spending beyond 2% of GDP, potentially to 5%.

EU's Response

- On March 6th 2025, EU leaders endorsed the European Commission's "ReArm Europe Plan", with the aim to mobilise €800Bn over the next 4 years for defence. The plan includes provisions to allow countries to increase defence budgets by up to 1.5% of GDP, which could potentially unlock €650Bn if EU's average defence spending reaches 3.5% of GDP.
- Germany has voted to exempt spending on defence and security from its strict deficit caps. Models state that should Germany spend 3.5% of GDP, it could amount to €600Bn over 10 years.
- UK's Prime Minister announced that it will raise defence spending to 2.5% of GDP by 2027.
- Denmark also announced a \$7.2Bn defence acceleration fund to increase defense spending above 3% of GDP.
- At least 65% of spending would be channelled mostly to European suppliers as per proposals.

Rheinmetall

- Rheinmetall is a leading German group specialized in defence (87% of adj. EBIT) and automotive (13% of adj. EBIT). The defence solutions include mid and large calibre ammunition as well as tactical and logistic vehicles.
- The company benefits from 3 main tailwinds: increase in EU budget spending; increase in allocation to equipment

spending within defence budgets; and increased market share due to the "Buy European narrative" and limited capacity among US peers.

- Rheinmetall anticipates significant growth in NATO defence spending, potentially reaching €700Bn - €1Tn by 2030. The company foresees equipment spending to account for a greater share of the overall defence budget due to underinvestment in recent years prompting the need for building up of inventories. Equipment spending is predicted to account for 50% of defence budget for 2025 & 2026 - up from 31% in 2024 - before declining to 40%.
- As it expects to capture 20-25% of the spending on equipment, Rheinmetall sees a potential cumulative revenue opportunity of €300 – 400Bn up to 2030. With its margins around 20%, this represents the potential for a cumulated €60 – 80Bn of operating income until 2030 for a company with a market cap of €57Bn, indicating a payback of less than 6 years or an ROI of 16+%.
- The upside scenario, despite the 120% increase YTD, is that the market has not factored in the increase allocation to equipment spending. Incorporating these in their forecasts, Morgan Stanley increased their target to €2,000 from €1,300, which could be adjusted to €3,000 should the company gain market share further.

Outlook

- Given the commitment of EU nations to gearing up their defences, the probability of the investment thesis playing out is skewed to the upside. Morgan Stanley expects a wave of earnings upgrades from the 2025 summer as investors get more clarity on the direction of European defence budgets. As EPS forecasts are revised upward, we are likely to see the stock rally even further given the significant potential it currently provides.

26th Mar 2025

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