Elphinstone Capital Management

Equity Research Report

BAE Systems (BA.L)

August 2025

BAE SYSTEMS

Date: 6th August 2025

Ticker: BA.L

Exchange: LSE

Sector: Aerospace and Defence

Current Price

(As of 30th July 2025) : GBP 17.58

Target Price: **GBP 18.71**

Recommendation: **BUY**

Investment Summary

BAE Systems is one of the world's leading defence contractors, with a diversified operating footprint across the UK, US, Europe, and Asia-Pacific. The firm delivers critical capabilities across land, air, maritime, electronic systems, and cyber domains. Its long-term, government-backed contracts provide significant cash flow visibility, while a record £77.8bn order backlog reinforces revenue security into the next decade.

We are constructive on BAE Systems and maintain a BUY view, based on structural growth in global defence budgets, expanding geopolitical rearmament cycles, and BAE's strategic positioning across key Western defence programs (e.g. GCAP, AUKUS, Eurofighter). Fiscal commitments from NATO countries, increased US Indo-Pacific spending, and EU re-integration post-Brexit all support multi-theatre demand for BAE's portfolio.

With multi-decade procurement visibility, strong geopolitical positioning, and a record backlog, we view BAE Systems as a core long-term exposure to the global defence cycle. We recommend monitoring capital return announcements, acquisition integrations, and project execution pace over the next 6–12 months.

Top-Line Strength

Revenue grew 14% YoY to £26.3bn in FY24, with strong operating leverage and expanding EPS.

Secular Tailwinds

Global defence spending is shifting from cyclical to structural, driven by NATO rearmament, Indo-Pacific tensions, and EU industrial policy.

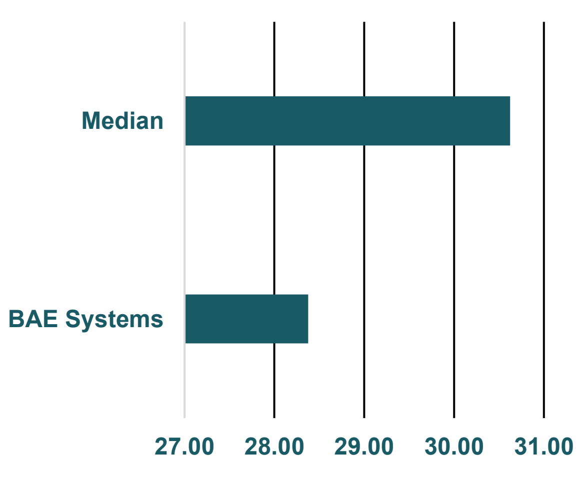
US & UK Keep Demand Strong

Dominant positions in US land and EW systems, UK submarines, and EU missile systems support durable growth.

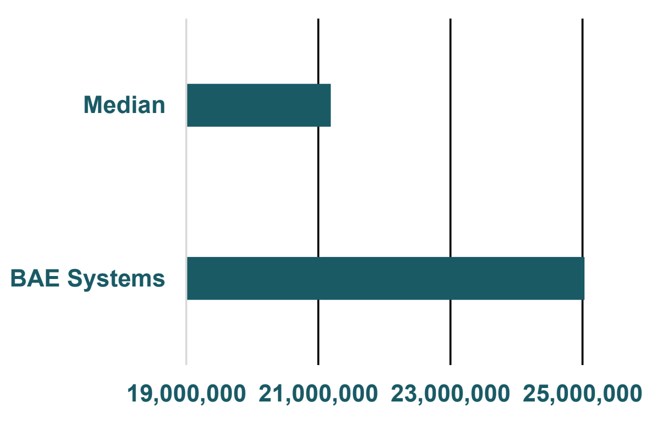
Capital Returns

Sustained FCF generation supports potential dividend increases and buybacks in upcoming quarters.

P/E



Revenues (£mln)



BAE Systems plc is a British multinational aerospace, military and information security company, based in London. It is the largest defence contractor in Europe and the seventh largest in the world based on applicable 2021 revenues. Its largest operations are in the United Kingdom and in the United States, where its BAE Systems Inc. subsidiary is one of the six largest suppliers to the US Department of Defence.

Business Model

BAE Systems' business model is built around the delivery of high-quality, technologically advanced solutions that meet the evolving needs of military and security customers. At its core, the model relies on long-term contracts with governments, generating stable and recurring revenue streams. The company's ability to operate across the full lifecycle of its products, from research and development to support and upgrades, positions it as a long-term strategic partner. Key aspects include Customer Focus, Innovation & Investment, Global Operations and Sustainability & Resilience.

Operating Segments

Electronic Systems: For both military and commercial applications, this segment provides a broad range of cutting-edge electronic products and subsystems. Engine controls, space electronics, electronic warfare capabilities, and flight control systems are among the company's core products.

Platforms & Services: Combat vehicles, munitions, naval ship repair, and sustainment services are all provided by this segment, which primarily operates in the US, UK, and other countries.

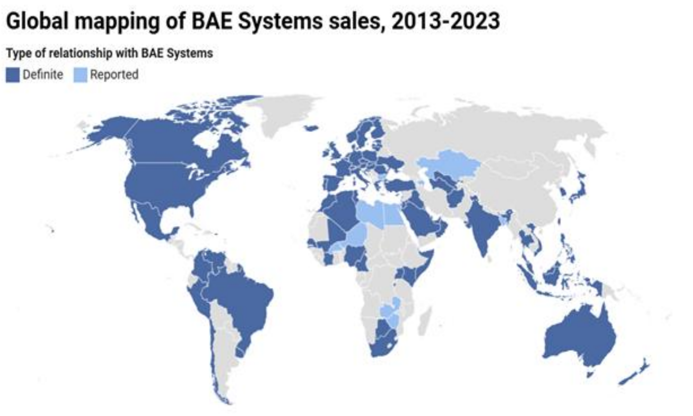
Air: Combat aircraft and training systems, such as the Eurofighter Typhoon, F-35, and Hawk advanced jet trainer, are the main focus of the Air segment.

Maritime: The Maritime segment, which specialises in naval platforms, is in charge of designing, building, and maintaining cutting-edge warships and submarines.

Cyber & Intelligence: This section includes the US-based Intelligence & Security division as well as BAE Systems Digital Intelligence. It supports government agencies and defence clients with data analytics, cybersecurity, secure communications, and national intelligence

Geography, Products and Services

BAE's products and services are present in nearly half of the world's nations, across Africa, Asia, the Americas, Europe, and Oceania. The company's global reach includes controversial contracts with states that have faced significant human rights scrutiny, underlining BAE's strategic, albeit sometimes criticised, geopolitical links.



BAE's broad range of defence and aerospace capabilities includes small arms, artillery systems, bombs, and missiles. These products are commonly used in regional conflicts. Battle tanks and submarine systems produced by the company are supplied globally to both NATO and non-NATO nations. Fighter jets and trainer aircraft, along with airborne mission systems, are distributed worldwide.

Management Highlights

Dr. Charles Woodburn is Chief Executive Officer and has held this role since 2017. Woodburn's leadership was contributory in achieving the highest financial performance for past years and expanding BAE's global market presence. His strategic priorities included, maintaining operational and supply chain resilience despite global challenges, prioritising innovation in next-generation capabilities and reinforcing the Group's focus on sustainability and net-zero ambitions.

Cressida Hogg took over as Chair of BAE Systems in May 2023. She was the very first woman to hold the position in the company's history. Hogg's focus is on strengthening corporate governance, supporting the CEO and executive team and promoting diversity, equity, and inclusion at senior levels.

Historical Performance Snapshot

BAE Systems has demonstrated a solid upward trend in revenue. For example, reported revenue increased from £23,078 million in 2023 to £26,312 million in 2024. This growth is indicative of strong demand for their products and services. The company has also shown increased profitability over the past years. Operating profit rose from £2,573 million in 2023 to £2,685 million in 2024, with a net income of £1,956 million. This translates to a robust operating margin of 9.28%. Earnings Per Share (EPS) for BAE Systems has consistently grown, reaching 64.9p in 2024 compared to 61.3p in the previous year. A crucial indicator of future revenue, BAE Systems boasts a record order backlog of £77.8 billion. This substantial backlog provides strong visibility into future earnings and reflects sustained customer demand.

Market Trends and Total Addressable Market

Geopolitical Catalysts

Global defence spending is no longer cyclical - it is now structurally driven by intensifying geopolitical fragmentation, multipolar rivalry, and the re-emergence of great power competition. Europe has witnessed the most dramatic shift since the Cold War. Russia's invasion of Ukraine in 2022 shattered assumptions of continental peace, forcing NATO to operationalise its 2% of GDP defence target. Similarly, Middle East volatility has resurfaced, prompting Gulf states to bolster missile defence, counter-UAS, and cyber capabilities - all aligned with BAE's land and electronic systems portfolio. Chinese assertiveness in the Indo-Pacific - notably over Taiwan and the South China Sea - are reshaping defence priorities worldwide. Unprecedented fiscal commitments thus present powerful long-term headwinds for BAE.

Europe's Shift

In 2024, 23 of 32 NATO countries are meeting the 2% of GDP defence target (up from just 6 in 2021), with Germany committing €400 billion to rearmament and the UK pledging to reach 2.5% of GDP by 2027. Similarly, in early 2025, the UK and EU agreed on a formal Defence and Security Industrial Cooperation Framework, which grants UK-based firms, such as BAE Systems, re-entry into the European Defence Fund (EDF) and access to EU-wide procurement programmes**.** This development marks a structural shift for both BAE and the broader UK defence industrial base as UK firms, like BAE, can now lead or partner on EDF-funded R&D and procurement contracts. BAE is well-positioned through key roles in GCAP, MBDA, and munitions programs, giving it access to an estimated $300–400 billion of European defence spending by 2030.

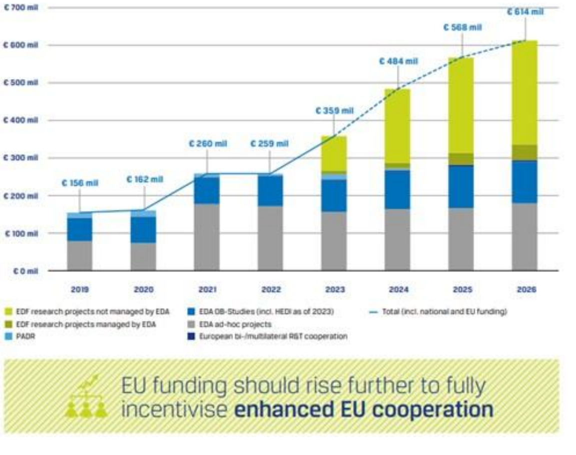


Figure 1: EU defence spending from 2019 to 2026, highlighting a drastic increase (European Defence Agency)

Asia-Pacific Build-Up

The Asia-Pacific region is undergoing a rapid militarization as states respond to China's assertiveness, rising maritime threats, and evolving U.S. alliances. This has transformed the region into a core driver of long-term defence expenditure growth - a trend from which BAE Systems is strategically positioned to benefit. As approved a record-breaking ¥43 trillion ($320 billion) 5-year defence budget through FY2027 - a 56% increase over the previous term - with a focus on acquiring long-range missiles, next-gen air systems, and naval deterrents. Australia is investing over A$300 billion (c. $200 billion USD) through 2034 in a complete reorientation of its defence posture, including AUKUS-related nuclear submarines, hypersonics, and airbase upgrades. BAE leads the design and delivery of the Hobart-class air warfare destroyers and plays a pivotal role in the AUKUS nuclear submarine design, alongside U.S. partners, opening $150-200 billion in addressable opportunities.

US Stability

The United States, accounting for approximately 40% of global defence spending, remains BAE's most valuable export market outside the UK. With a FY2025 defence budget request of $895 billion - up from $858 billion in FY2023 the U.S. continues to prioritise nuclear modernisation, munitions stockpiling, and Indo-Pacific deterrence. BAE benefits from long-standing participation in major programs, including Bradley and AMPV vehicle upgrades, shipboard AEGIS and EW systems, advanced munitions, and ISR platforms. Its U.S. cyber and space segments are also gaining traction amid increasing electronic warfare and data-driven defence demand. With $2.7 billion in U.S. orders secured in Q1 2025 alone, BAE's U.S. total addressable market (TAM) through 2030 could conservatively exceed $250-300 billion, supported by rearmament cycles, shipbuilding initiatives, and joint interoperability investments under AUKUS and NATO-aligned frameworks.

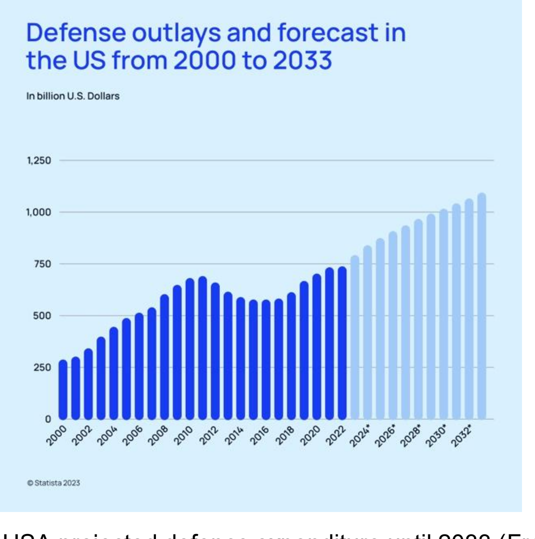


Figure 2: USA projected defence expenditure until 2033 (FranShares)

Market Headwinds

Fiscal Uncertainty and Budget Execution Risk

Announced increases in defence spending often overstate actual procurement activity. For example, while the UK government has pledged to raise defence spending to 2.5% of GDP by 2027, no legal framework or detailed funding plan has yet been legislated. In Germany, the much-publicized €100 billion Sondervermögen fund remains only partially disbursed, with major programs delayed by administrative bottlenecks. This mismatch between headline commitments and delivery timelines creates order visibility issues for contractors like BAE. Similar execution risk is seen in Canada and Japan, where strategic ambitions outpace procurement infrastructure. For BAE, this creates volatility in revenue recognition and program pacing, particularly in high-cost, multi-year projects such as submarines and air combat systems

Inflation and Supply Chain Volatility

Although inflation has cooled from 2022 peaks, key inputs for defence production remain elevated in cost and scarce in availability. BAE is especially exposed to rising prices in specialty steel, titanium, semiconductors, and rocket propellants. Fixed-price contract - common in defence - limit the ability to pass on input cost increases, risking margin compression. On the supply side, global shipping disruptions and strained semiconductor fabs continue to delay timelines for avionics, radar systems, and propulsion components. Additionally, BAE's advanced platforms - such as GCAP and SSN-AUKUS - rely on ultra-skilled labour. Shortages of engineers, welders, and AI/cybersecurity experts across the UK, Australia, and U.S. add further risk. Labour inflation and training lags increase program costs and delivery slippage, challenging BAE’s ability to meet aggressive multi-theatre project schedules and earnings forecasts.

Rising Competition and Fragmentation in Defence Markets

The geopolitical arms buildup has created fertile ground for new competitors and a resurgence of nationalist procurement strategies. German-based Rheinmetall has expanded aggressively, winning new NATO contracts and opening facilities in the UK and Hungary. France's Dassault and Italy's Leonardo are increasingly favoured in domestic projects due to sovereignty concerns. Meanwhile, Turkey, South Korea, and India are investing in domestic defence tech, reducing reliance on foreign primes like BAE. Simultaneously, trans-European coordination is weakening. Fragmentation between GCAP (UK-Japan-Italy) and FCAS (France-Germany-Spain) shows political divergence that risks duplication, inefficiencies, and lost scale. For BAE, which thrives on multilateral partnerships and export access, this fragmentation could limit its addressable market. Competitive encroachment may erode pricing power and reduce win rates for major tenders, particularly in land and air domains.

Key Competitors and Strategic Positioning

Company	Revenue (2024E)	Strategic Strengths	Key Risks	Position vs. BAE Systems
BAE Systems	£33bn (~$42bn)	Naval dominance, GCAP, munitions self-sufficiency, cyber contracts	UK budget ambiguity, EU reintegration still maturing	Strongest EU/NATO footprint; uniquely diversified geographically
Lockheed Martin	~$66bn	F-35 fighter jet, global export leadership, missiles and hypersonic development	High U.S. dependency, export licenses (ITAR)	Higher scale, but less EU exposure; reliant on flagship platforms
Northrop Grumman	~$36bn	B-21 Raider stealth bomber, space systems, hypersonics	Program execution risk, margin pressure	BAE has broader product spread; NG strong in aerospace R&D
RTX (Raytheon)	~$67bn	Patriot air defence, sensors, radar, command & control integration	Civil aerospace exposure, Boeing-linked volatility	BAE more defence-pure; RTX stronger in air defence technologies
Rheinmetall	$11bn	Leopard tank production, EU munitions expansion	Geopolitical exposure, narrow platform base	BAE has deeper global presence; Rheinmetall leading EU tank race
Thales / Leonardo	~€17–€20bn	Electronic warfare, avionics, cyber security, joint ventures (e.g. MBDA)	Fragmented portfolios, political complexity	Partners and rivals; BAE has stronger scale and integration role

Regulatory Outlook

BAE Systems operates at the intersection of three distinct but increasingly interconnected regulatory spheres: the United Kingdom's sovereign procurement strategy, the European Union's evolving defence industrial policy, and the United States' tightly regulated export and security environment. Each offers both opportunity and constraint.

Domestic Outlook

UK defence policy has shifted toward domestic capability, supply chain resilience, and industrial sovereignty. The Ministry of Defence's 2023 Defence Command Paper and Prime Minister Keir Starmer's continued remarks regarding remilitarisation up to 3% of GDP reaffirm commitment to sovereign defence manufacturing and multi-decade procurement visibility. Flagship sovereign programs - SSN - AUKUS submarines, the Global Combat Air Programme (GCAP), and long-range precision fires - are supported by preferential contracting, R&D investment, and cross-government coordination. The Defence and Security Industrial Strategy (DSIS) continues to prioritise domestic production and innovation, benefiting BAE's advanced munitions and shipbuilding operations.

European Union: Post-Brexit Reintegration

In a significant policy reversal, the new UK-EU Defence and Industrial Cooperation Framework (2025) permits UK firms, including BAE, to bid for contracts under the European Defence Fund (EDF) and the European Defence Industrial Development Programme (EDIDP). This effectively reopens a €150+ billion market by 2030, particularly in joint R&D, cyber, and missile systems. BAE's role in MBDA - a key pan-European missile JV - positions it advantageously under these multilateral schemes. Additionally, BAE's growing footprint in Sweden and other EU states allows for regulatory hedging via EU-based subsidiaries, smoothing access to EDF funding.

United States: ITAR, CFIUS, and Technology Controls

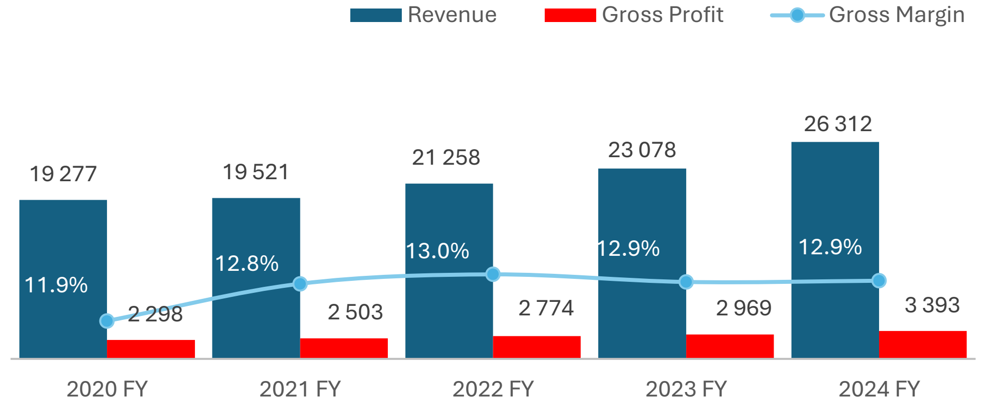
While BAE benefits from a substantial U.S. presence and defence orders (e.g., over $2.7bn in Q1 2025), its operations are subject to strict oversight under ITAR (International Traffic in Arms Regulations), CFIUS (Committee on Foreign Investment in the U.S.), and DFARS (Defence Federal Acquisition Regulation Supplement). In response, BAE has increased investment in "ITAR-free" subsystems-particularly for munitions, propulsion, and comms-to improve export agility. Its segmented U.S. governance structure (BAE Systems Inc.) ensures compliance while supporting autonomy in sensitive programs. Notably, AUKUS-related collaboration has triggered regulatory streamlining discussions to facilitate technology sharing across the UK, U.S., and Australia, potentially reducing future export control friction.

BAE is structurally advantaged by its alignment with UK sovereignty goals, renewed EU access, and compliant U.S. operating structures. Regulatory barriers are easing in Europe while remaining manageable in the U.S., enhancing BAE's strategic agility and market access at a critical time of global rearmament.

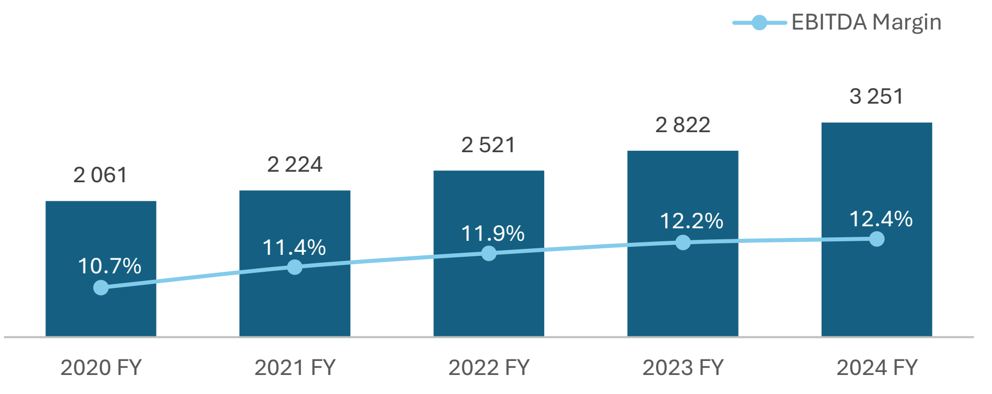
Financial Overview: Revenue, EBITDA & Net Income

BAE Systems has shown strong revenue, EBITDA and net income growth while maintaining profit margins in line with industry averages.

Revenue & Gross Profit (£m)

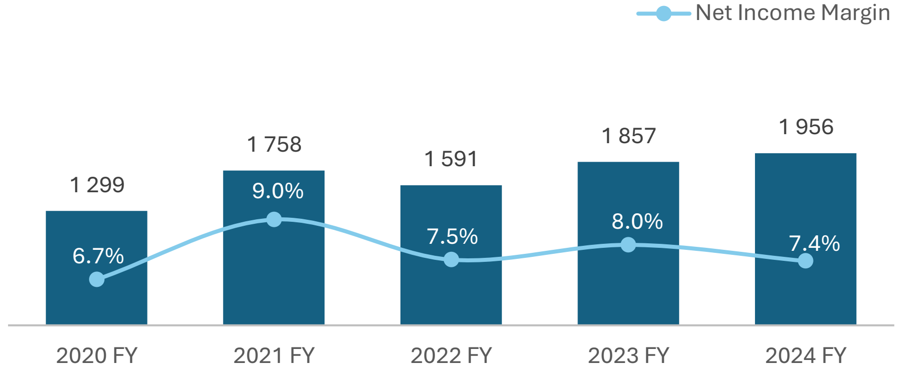


EBITDA (£m)



Source: S&P Global Capial IQ

Net Income (£m)



Key Profitability Metrics

	BAE Systems	Market Average
Gross Profit Margin	12.9%	22.5%
EBITDA Margin	12.4%	12.5%
Net Income Margin	7.4%	6.7%

Source: S&P Global Capial IQ

Financial Overview: Balance Sheet & Cashflow metrics

BAE Systems shows strong balance sheet health while maintaining above industry standard leverage.

Balance Sheet Health – Key Metrics

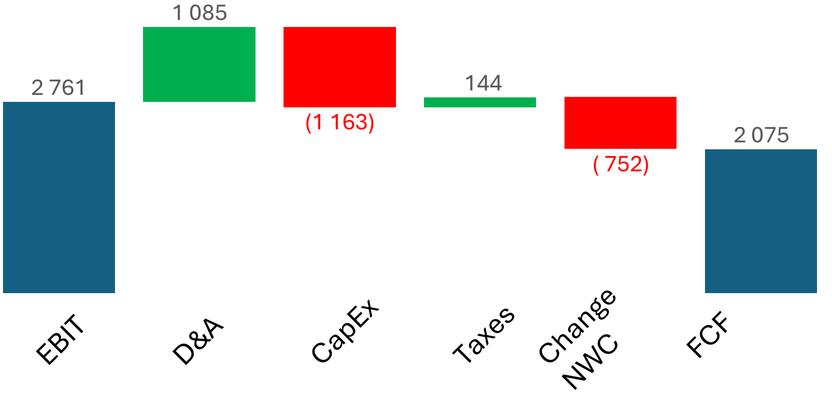
	BAE Systems	Market Median
Debt to Equity	0.75x	0.51x
Net Debt to EBITDA	2.12x	1.29x
EBITDA / Interest Expense	6.25x	12.52x

	Moody's	S&P Global	Fitch
Current Rating	Baa1	A-	A-
Outlook	Positive	Stable	Stable

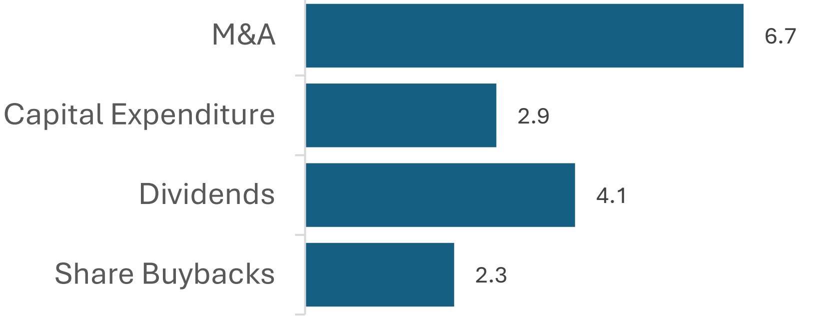
	BAE Systems	Market Median
Current Ratio	0.95x	1.18x
Quick Ratio	0.75x	0.67x
Avg. Cash Conversion Cycle	44.7	171.6

Source: S&P Global Capial IQ

Cash Conversion Bridge (£m FY24)



Capital Allocation (£b Last 5yr Cumulative)



ROIC: 7.82% (FY24)

Overview - Underlying Assumptions

The recent high growth rate of 14% is unlikely to hold and is far higher than previous years due to geopolitical changes. The British and European increase in defence spending has meant that BAE has received higher contracts and supply demand than in previous years, due to one of the most peaceful times in history and a lowering in defence spending as a proportion of GDP. However, with the current American administration, other NATO members have had to pledge to increase their defence budgets, and so growth is expected to remain high for at least the next 3 years. The current conflicts in Ukraine and the Middle East have also helped to boost the industry; however, as these conflicts enter a slow-burn phase (Ukraine), and de-escalation (Middle East), it is unlikely there will be such significant jumps in revenue as we have seen recently.

2025 Growth Rate

The initial range for the 2025 growth rate was set at between 7% - 11%, based on Bloomberg data and previous general assumptions outlined above. However, this range was narrowed following the release of a BAE Systems company report, which stated that 2025 revenues are expected to grow at 7% - 9%. The higher end of 9% was assumed in line with Bloomberg data, and the current increase in spending, especially by the United Kingdom, in the past few months alone. However, even more success in the US will heavily contribute to an increase in revenues, with new contracts being awarded, such as the $1.2Billion space force missile warning systems.

Coming Years and Looking Ahead

The underlying assumption is that the Western world will continue to re-arm and increase defence spending over the next 5 years, in line with pledges made. BAE Systems, as one of the largest in the region, will likely benefit from this; however, growth is likely to drop as the initial boost subsides. The war in Ukraine and increasing worries around China will likely keep revenues growing at a high single-digit figure. BAE has a high backlog, which will also keep revenues growing in the next 3-5 years, as the AUKUS submarine program and the Tempest fighter jet development, etc, will sustain growth. The previous period yielded a CAGR of 6.42%, so a future period with a CAGR ranging between 5% - 7% is reasonable and expected. The expectation may fall in the lower end due to the maturity of the industry and the time taken to carry out current projects. A more conservative future CAGR is also reasonable due to the highly competitive field in an increasingly dangerous world. The implied perpetuity growth rate of 4.20% is again conservative and falls below the expected 5.44% CAGR; however, this assumption aligns with a long-term focused business. Other financial outputs are realistic with the growth rates assumed. To gain an actual % growth rate for the years 2026-2029, Bloomberg analyst data for competitors was compiled, and a midpoint was taken. BAE would be expected to fall within the higher end of the industry, and so the midpoint percentage was increased slightly to better reflect BAE. These assumptions were then checked against analyst recommendations, with any slight adjustments to the underlying assumptions listed above. It could be argued that growth in the later years, 2028-2029, may be lower, and some analysts point to data that shows this; however, the majority have a more optimistic view with NATO increasing spending over this period.

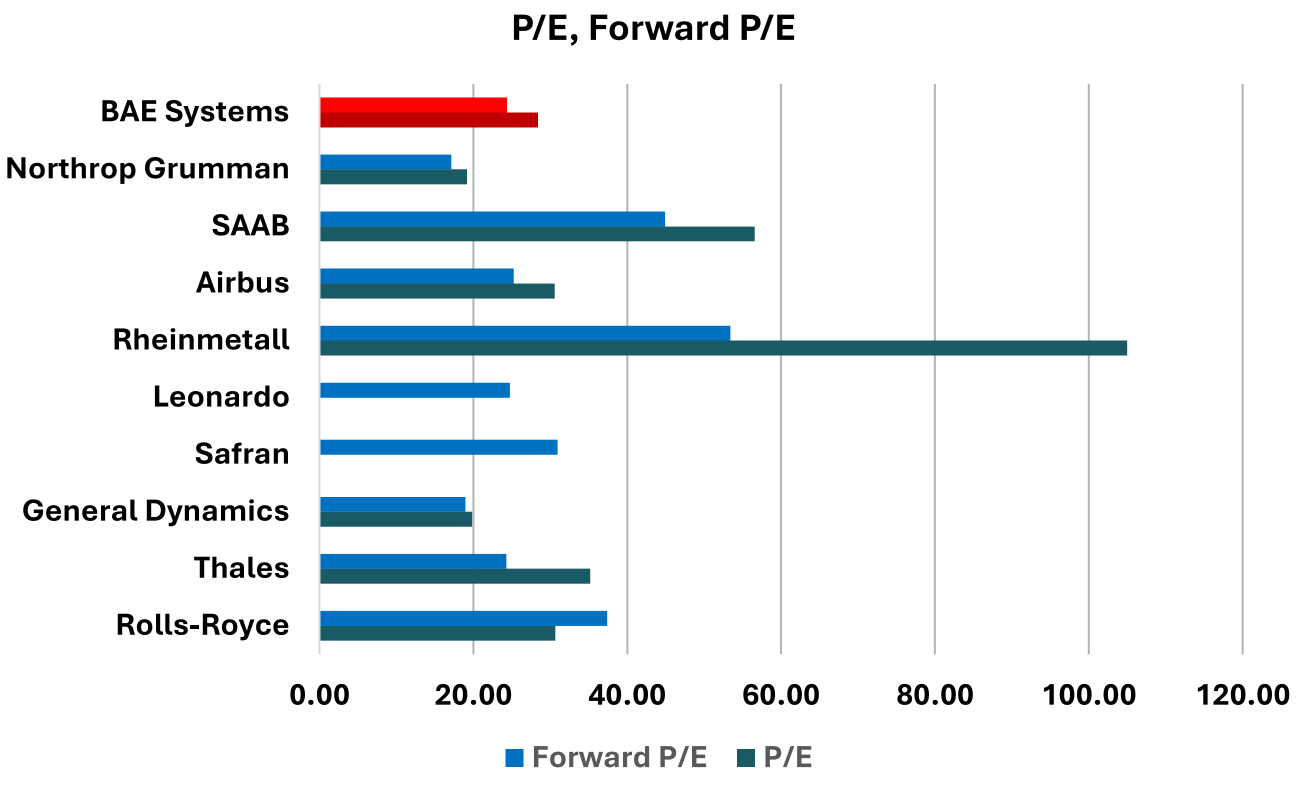
Projection Period					
	2025	2026	2027	2028	2029
Operating DATA					
Revenues	**28,680.08**	**31,031.85**	**33,204.08**	**35,262.73**	**37,378.49**
%Growth	*9.00%*	*8.20%*	*7.00%*	*6.20%*	*6.00%*
COGS	**24,981.71**	**27,030.21**	**28,922.32**	**30,715.51**	**32,558.44**
%Revenues	*87.10%*	*87.10%*	*87.10%*	*87.10%*	*87.10%*
Gross Profit	**3,698.37**	**4,001.64**	**4,281.75**	**4,547.22**	**4,820.05**
%Margin	*12.90%*	*12.90%*	*12.90%*	*12.90%*	*12.90%*
SG&A	**(19.62)**	**(21.23)**	**(22.71)**	**(24.12)**	**(25.57)**
%Sales	*-0.068%*	*-0.068%*	*-0.068%*	*-0.068%*	*-0.068%*
EBITDA	**3,776.85**	**4,086.55**	**4,372.61**	**4,643.71**	**4,922.33**
%Margin	*13.17%*	*13.17%*	*13.17%*	*13.17%*	*13.17%*
Depreciation&Amort	**722.67**	**781.93**	**836.66**	**888.54**	**941.85**
%Sales	*2.52%*	*2.52%*	*2.52%*	*2.52%*	*2.52%*
EBIT	**3,054.18**	**3,304.62**	**3,535.95**	**3,755.18**	**3,980.49**
%Margin	*10.65%*	*10.65%*	*10.65%*	*10.65%*	*10.65%*
Taxes at 21%	**641.38**	**693.97**	**742.55**	**788.59**	**835.90**
EBIAT	*2,412.80*	*2,610.65*	*2,793.40*	*2,966.59*	*3,144.58*
CapEX	**-1079.10**	**-1167.59**	**-1249.32**	**-1326.77**	**-1406.38**
%Sales	*-3.76%*	*-3.76%*	*-3.76%*	*-3.76%*	*-3.76%*

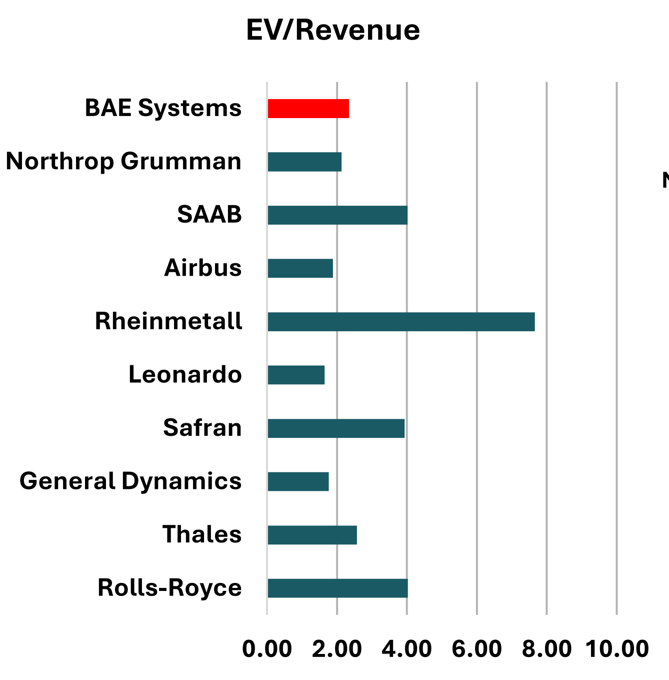
NWC		627.19	678.62	726.12	771.14	817.41
△NWC		(77.81)	51.43	47.50	45.02	46.27
Free Cash Flow		**2,134.18**	**2,173.57**	**2,333.24**	**2,483.33**	**2,633.78**

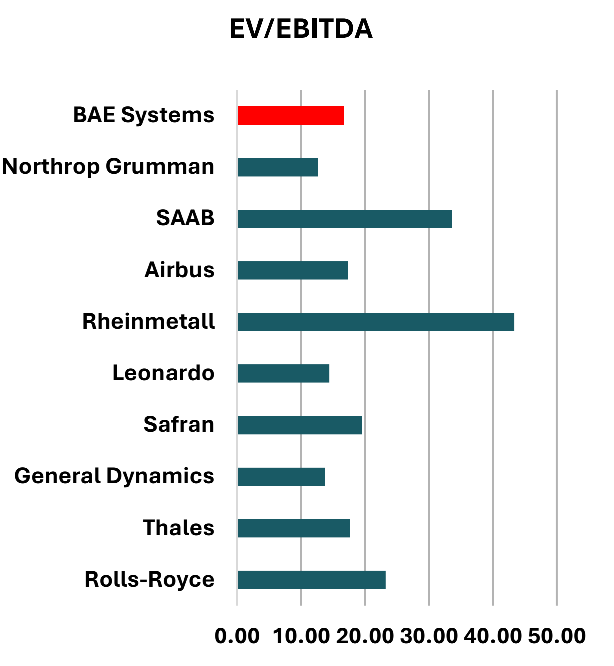
Terminal Value	
EBITDA (2029)	4,922.33
Exit Multiple	15x
Terminal Value	**78,757.36**
Present Value of TV	**63,325.90**

Implied Perpetuity Growth Rate	
FCF Terminal	2,633.78
WACC	7.85%
Terminal Value	78,757.36
Implied Growth Rate	4.20%

Implied Share Price	
Present Value of Cash flows	59,952.30
Cash (£m)	3,378
Debt (£m)	10,316
Shares Outstanding	3,013
Implied Share Price (£)	**18.71**
Current Share Price	**18.01**
Upside/Downside	6.42%


P/E, Forward P/E
BAE Systems
Northrop Grumman
SAAB
Airbus
Rheinmetall
Leonardo
Safran
General Dynamics
Thales
Rolls-Royce
0.00
20.00
40.00
60.00
80.00
100.00
120.00
Forward P/E
P/E


EV/Revenue
BAE Systems
Northrop Grumman
SAAB
Airbus
Rheinmetall
Leonardo
Safran
General Dynamics
Thales
Rolls-Royce
0.00
2.00
4.00
6.00
8.00
10.00


EV/EBITDA
BAE Systems
Northrop Grumman
SAAB
Airbus
Rheinmetall
Leonardo
Safran
General Dynamics
Thales
Rolls-Royce
0.00
10.00
20.00
30.00
40.00
50.00

Catalysts & Risks

Key Catalysts

Sustained Defence Spending Growth

The business operations of BAE Systems align well with defence spending trends that are expected to increase in UK, US and European markets. Defence budget increases are happening because of new tensions between Eastern Europe and Asia-Pacific nations which are directing money toward modern defensive equipment, alongside cyber systems and naval warfare capabilities. Stock price appreciation could occur because of positive budget updates and contract wins in these budget areas. The UK government pledged to increase defence spending to 2.5% of GDP (from ~2.0%), driven by tensions with Russia and China (UK Defence Command Paper 2023). Following this, the FY2024 US defence budget request was $842 billion, with focus on naval and cyber capabilities (US DoD FY2024 Budget).

Contract Pipeline Conversion

The defence company maintains a strong collection of potential contract awards that includes major Eurofighter Typhoon upgrades and Type 26 Frigate support and classified US Electronic Systems programs. BAE secured a £4.2bn contract for Royal Navy frigates (UK MoD, 2022). BAE Systems will gain improved revenue transparency when their pipeline opportunities transform into active contracts.

Integration and Delivery of Acquisitions

The integration process for both the Collins Aerospace Military GPS business acquisition and the Airborne Tactical Radios business acquisition proceeds according to schedule. The achievement of synergy integration combined with announced revenue growth would help investors adjust their earnings projections upward.

Global Aircraft Program Progress

The development of Tempest sixth-generation fighter program and Typhoon export opportunities indicates long-term growth potential for global combat aircraft projects. New partner additions and faster development timelines will act as positive forces for the company.

Capital Return Policy Updates

The strong cash generation and robust order backlog of BAE Systems allows for potential shareholder distribution increases which could boost near-term stock value.

Currency Tailwinds

The UK defence company benefits from the ongoing GBP to USD exchange rate decline because its business operates under significant US revenue streams. Improved foreign exchange rates would serve as a catalyst for increased earnings predictions.

Key Risks

Programme Execution Risks

BAE Systems operates as a prime contractor on defence programs that last multiple years which creates execution challenges as a standard part of their business operations. The combination of Type 26 Frigate, F-35 components and next-generation munitions programs risks cost increases and production delays which would trigger both revenue reductions and contractual penalties.

Geopolitical and Regulatory Risk

The rising geopolitical tensions create market demand yet introduce export control and regulatory approval challenges. The rise of export control regulations for Middle Eastern countries creates market restrictions that affect available customer bases. Changes to ITAR (International Traffic in Arms Regulations) policies from the US will impact the revenue performance of the US segment.

Budget Constraints and Political Cycles

Although defence spending is trending upwards, fiscal pressures in major customer countries pose a risk to long-term procurement pipelines. The defence sector faces budgetary changes due to political shifts which occur in the United States and United Kingdom.

Competitive Pressure

Defence sector competitors such as Lockheed Martin, Northrop Grumman and Raytheon Technologies maintain extensive investments to develop next-generation technologies while competing with each other in the market. Key bid losses by BAE would cut into their market position while damaging their future growth potential.

Currency Volatility

The currency risk exposure of BAE Systems is substantial because it reports in GBP although most revenues and costs are in USD. Negative currency movements produce detrimental effects on reported earnings and cash flow generation.

ESG and Reputational Risks

ESG concerns about defence contractors from investors will affect their market value and institutional stockholder base. The reputation of the company faces risks when arms exports reach conflict zones and human rights concerns surface since these elements affect stakeholder attitudes and regulatory approval requirements.

Macroeconomic Risk

The combination of rising input costs due to inflation alongside supply chain issues and labour shortages creates a risk to both operational efficiency and cost structures of the company.

Drawn Conclusion for Catalyst & Risk Considerations

The investment case for BAE Systems is supported by strong sector tailwinds, a robust order backlog, and structural demand for advanced defence systems. The investment thesis requires investors to keep a close eye on execution challenges alongside political budget changes, regulatory obstacles, and competitive competition because these factors may limit the potential gains.