A&O SHEARMAN

ARTICLE

Rising geopolitical tensions ignite European defense M&A

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As Europe scrambles to build its military-industrial capabilities, sector dealmaking is on the rise. Here we explore how foreign investors are shaping their strategies to navigate sweeping reforms of regulatory frameworks that are happening in parallel.

The defense sector has been one of the brightest spots for European dealmaking in the face of recent market headwinds. The war in Ukraine, escalating geopolitical tensions and the fraying of the U.S. security support that has protected Europe since the Second World War has exposed the fragility of EU military capabilities and galvanized political will to address capacity gaps.

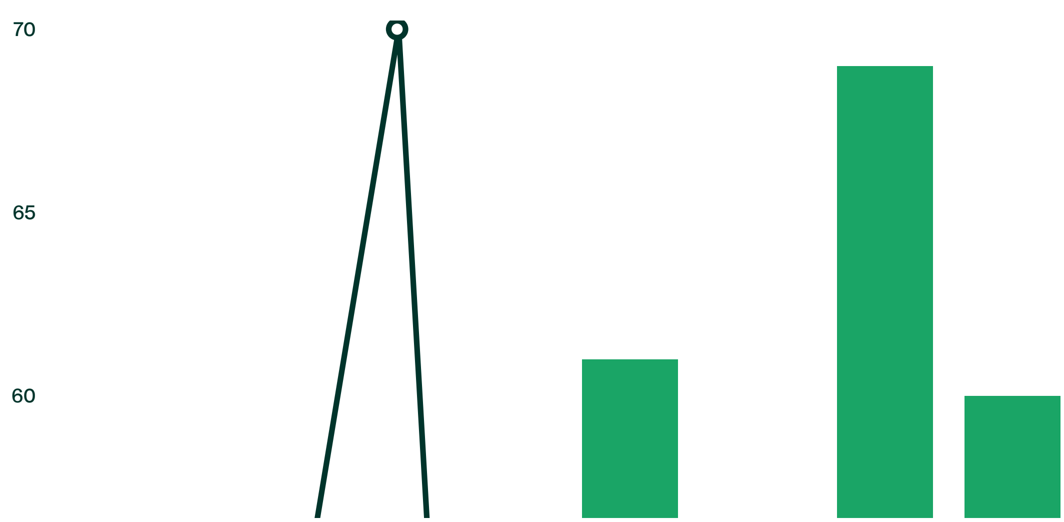
With defense spending by member states rising, the order books of Europe's prime contractors (Airbus, BAE Systems, Leonardo, Thales, Rheinmetall, Dassault Aviation, Saab and KNDS) grew by 15% in 2024. Their combined backlogs hit a record high of EUR291 billion over the same period, with the surge in demand generating strong cash flows and momentum for strategic investments.

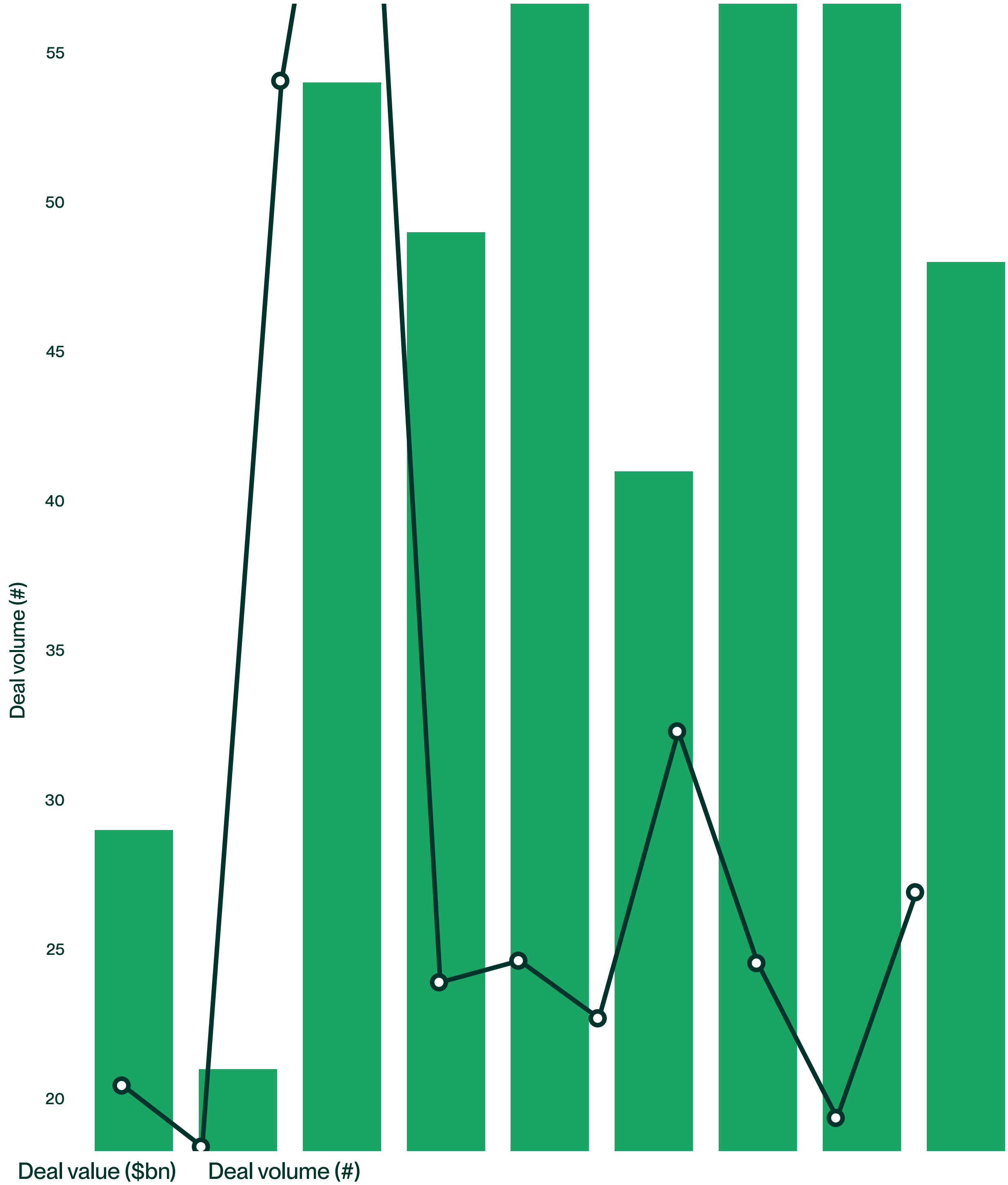
European defense M&A up 35% year-on-year

In the first six months of 2025, European defense M&A by value hit USD2.3bn, 35% up on the same period last year and indeed higher than 2024's annual total. Globally, the combined value of aerospace and defense transactions in H1 2025 stood at USD21.7bn, more than double that of H1 2024 and the highest figure since the same period in 2021.

Geopolitical shifts ignite European defense M&A

Deal value for H1 2025 up 35% year-on-year; near fivefold increase on H2 2024





Source: Refinitiv • Data correct to June 30

As governments search for ways to boost the volume of private capital flowing into the sector, so interest in defense assets among private equity funds is growing. PE dealmaking in the defense sector globally more than doubled last year to USD13.8bn, with M&A volume up 30% year-on-year. Figures from S&P show that the U.S. and Canada have attracted 83% of global PE and venture capital investment in aerospace and defense since 2020.

LPs push private equity funds for exposure

In the past, the PE universe has been split on defense investment. While some funds have excluded the sector altogether others have been involved for many years, albeit not investing directly in front-line munitions manufacturers but preferring instead to back suppliers and developers of dual-use technologies. However, under pressure from their LPs to gain exposure to fast-growing industry, both stances are changing. As they consider their strategies to capitalize on current tailwinds, a number of the biggest players are looking at consolidation deals with investment horizons much shorter than the typical five-year hold period.

Focus on advanced manufacturing targets and tech providers

The biggest defense deals in Europe last year—Rheinmetall's USD950 million deal for Loc Performance Products, a U.S.-based manufacturer of machined components for military vehicles, and U.S. defense components manufacturer Loar Holdings' acquisition of France-based LMB, which develops customized high-performance fans and motors, for USD382m—involved conventional weaponry and advanced manufacturing. More recently, Tikehau Capital entered into an agreement to acquire a majority stake in Belgian defense company ScioTeq BV—which develops visualization and computing solutions—from OpenGate Capital, LLC.

But a closer analysis of recent M&A transactions reveals how battlefield dynamics are reshaping the sector. A growing number of investors are targeting technology startups rather than industrial companies, reflecting that 21st century warfare is fought as much with drones and artificial intelligence as it is with warplanes and tanks. Here, Europe's technology deficit in comparison to China and the U.S. is likely to require collaboration with foreign innovators.

Since October 2024 there have been six acquisitions of European drone and counter-drone start-ups, with buyers including Rheinmetall and German defense tech player Quantum Systems. In September last year Safran acquired French defense AI developer Preligens for USD243m, while in June, Rheinmetall announced a partnership with U.S. defense tech business Anduril to develop drones for Europe and explore opportunities to build solid motors for missiles and rockets. Acknowledging the sensitivity of cross-border collaborations, the companies said their alliance was built on "mutual respect for sovereignty" and would "prioritize local control, transparency and adaptability".

Venture funding on the rise

VC funding of European defense tech developers reached USD5.2bn in 2024, up 24% year-on-year. The sector is also attracting interest from some of the Continent's most prominent investors; in June, Spotify founder Daniel Ek's fund Prima Materia led a EUR600m investment round in German drone maker Helsing that valued the company at EUR12bn.

Looking ahead, a key focus of transaction strategies—particularly among investors from outside the EU—will be how to structure deals to benefit from the huge volumes of public money flowing into the sector.

Foreign investors focus on deal structuring to access opportunities in Europe

The ReArm Europe Plan, launched in March 2025, is designed to facilitate and incentivize investment and collaboration in the European defense sector. It includes a EUR150bn EU loan facility (the Security Action for Europe (SAFE) financial instrument) to support the joint procurement of military systems.

ReArm Europe also activates the Stability and Growth Pact's escape clause, which would allow member states to exceed current treaty-imposed debt and deficit limits by up to EUR650bn over the next four years. In response, Germany has lifted its constitutional "debt brake" and will increase defense spending to 3.5% of GDP by 2029, with Nato members pushing to invest 5% of GDP on military capacity, resilience and security over the longer term.

For overseas dealmakers looking to benefit from this flood of investment, substance is critical. Not only do they have to navigate EU and member state FDI screening rules, which closely scrutinize inbound investments in military and dual-use technologies, but they also need to consider the intent of SAFE.

Its funds are intended for distribution to member states as well as countries in the European Economic Area (EEA), European Free Trade Area (EFTA), prospective EU member states, Ukraine, and nations that have signed security and defense partnerships with the EU. The funding is designed to facilitate joint procurement involving at least two countries from these areas.

For relatively basic products such as small drones or ammunition, 65% of the costs have to originate from companies that are established and managed in those territories, as long as those companies are not controlled by another country. Where the product is more complex, it must also be possible to substitute components that could be restricted by other nations.

Against this backdrop, foreign investors must carefully consider their deal strategies, corporate structuring and governance processes to navigate potential hurdles.

Sponsors consider bespoke fund structures and governance processes

For financial sponsors this could involve establishing EU-domiciled fund structures and management teams, as well as developing separate strategies for dual-use technologies and pure defense assets. In the case of foreign defense suppliers, it may mean participating in defense projects as a secondary, rather than a prime, contractor.

The impetus for European defense acquisitions grew stronger in June when the European Commission finalized its Defence Readiness Omnibus package.

SAFE, introduced as an early initiative under this broader program, has already begun shaping procurement dynamics. The Defence Omnibus operationalizes and expands upon its financial and policy framework, ensuring that regulatory and administrative processes do not impede access to funding or the scaling of Europe's defense capabilities.

It also clarifies the application of sustainability and ESG requirements to ensure legal certainty for investors and operators, and simplifies the regulatory environment for defense-specific and dual-use technologies.

Regulatory reforms provide pathway to faster profitability

The Omnibus package proposes implementing a directive that would raise the value threshold at which EU procurement rules are triggered, taking many smaller contracts out of scope. It also introduces the possibility of accelerating joint procurement contracts concluded by at least three member states under certain conditions. These include that contractors must be established and have their executive management structures in the EU or an associated territory, and that they cannot be controlled by countries or entities from outside these areas.

The Omnibus proposals would streamline access to EU-level investment, fast-track permits for defense readiness projects and smooth the transfer of defense products across borders.

It also clarifies that the defense industry is more likely than other sectors to make use of provisions permitting the omission of sensitive or classified information from ESG disclosures in recognition of its importance to the resilience and security of the Union, and thereby to peace and social sustainability.

Antitrust enforcement and state aid in the spotlight

At the same time, the Commission is likely to take a more flexible approach to merger reviews, antitrust enforcement and state aid analysis in relation to defense activities.

Importantly, the Omnibus package also addresses the challenge around whether defense-related investments can be considered sustainable under the EU Sustainable Finance Framework. While the EU Taxonomy Regulation currently excludes weapons outlawed by international arms conventions, further guidance is expected under Paris-Aligned and climate transition benchmarks later in 2025.

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