



## Top Canadian Defence Stocks of 2023

### Description

Are you considering investing in defence stocks? Here's everything you need to know before you dip your toe in the defence industry.

### What are defence stocks?

Defence stocks are companies involved in the production and sale of aircraft, ships, spacecraft, weapon systems, and equipment for military purposes. An adjacent sector is the aerospace industry, which conducts many of the same activities but for civilian purposes.

Defence stocks fall under the umbrella of the industrial sector, comprised of companies involved in manufacturing, resource extraction, and construction. Thus, defence companies that manufacture and sell equipment/crafts are covered by this sector.

The defence industry primarily operates under long-term, exclusive contracts with government and military entities, both domestically and globally. Defence companies produce weaponry, but may also offer information technology (IT), [cybersecurity](#), intelligence, data analytics, and robotic services.

This cyclical sector often experiences strong tailwinds during times of geopolitical instability and conflict due to increased demand and government budgets for their products and services. Recent examples include the Russian invasion of Ukraine, which sent defence stocks in the United States skyrocketing.

### Investing in Canadian military stocks

Canadians looking to buy domestic defence stocks should begin their search in the industrials sector of the [Toronto Stock Exchange](#). From there, it is important to determine if the company under consideration is a pure-play defence stock or hybrid.

A pure-play defence stock refers to a company that derives a substantial portion of its revenue from military-related contracts. A hybrid refers to a company that derives a smaller, non-core portion of its revenue from military-related contracts. This is important because many aerospace companies dabble in defence, but do not make it a core component of their business model, electing to focus more on

civilian applications.

When considering Canadian defence stocks, many of the same [fundamental analysis](#) and valuations that apply to the industrials sector should be considered:

1. Is the company's balance sheet healthy? What is the current and long-term debt-to-equity ratio? Is shareholder equity negative?
2. Has the company consistently grown quarterly revenues and earnings year over year? If so, at what rate?.
3. Are the company's gross and operating margins positive and ample?
4. How does the company's enterprise value-to-EBIDTA ratio compare to peers in its sector?
5. What are the company's price-to-book, price-to-sales, price-to-free-cash-flow, and price-to-earnings ratios, and how do these compare to peers in its sector?
6. What do the company's return on assets, return on equity, and return on invested capital ratios look like?
7. Does the company's revenues depend on a single large customer?
8. How long-term and secure are the contracts that the company signs?

## Top Canadian defence stocks

Here are some of the top military stocks in Canada based on [market cap](#):

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Defence Company	Description
<a href="#">CAE (TSX:CAE)</a>	CAE designs, manufactures, and supplies simulation equipment and training solutions to defence and security markets, commercial airlines, business aircraft operators, helicopter operators, aircraft manufacturers, and health care education and service providers worldwide.
<a href="#">Bombardier (TSX:BBD.B)</a>	Bombardier engages in the manufacture and sale of business aircraft in Europe, North America, the Asia Pacific, and internationally, providing new aircraft, specialized aircraft solutions, pre-owned aircraft, and aftermarket services.
<a href="#">MDA (TSX:MDA)</a>	MDA designs, manufactures, and services space robotics, satellite systems and components, and geointelligence surveillance systems in Canada, the United States, Europe, Asia, the Middle East, and internationally.

## CAE

CAE is one of Canada's largest defence contractors, having been in operation since 1947 and currently employs 13,000 employees.

The company designs, manufactures, and supplies simulation equipment and training solutions to defence and security markets worldwide, with a focus on the aircraft industry. CAE is separated into three segments targeting different markets:

- Civil aviation training solutions offer products and services like flight simulation devices, pilot and crew training, and optimization software.
- Defence & security offers mission support services for military forces and public safety organizations.
- Health care offers surgical and imaging simulations, patient simulators, and training curriculum.

## Bombardier Inc.

Bombardier, incorporated in 1902, is a Canadian manufacturer of business and military aircraft currently employing around 13,400 employees.

The company supplies customers, government and private, across Europe, North America, Asia Pacific, and internationally, with new aircraft, specialized aircraft solutions, and used aircraft. Bombardier also operates a sizeable aftermarket services division, which focuses on parts, maintenance, training, and technical publications.

Recently, the company underwent a 25-1 [reverse split](#) (consolidation) of its common stock. The company also recently announced its new Global 8000 aircraft, which they say is the world's fastest (Mach 0.94) and longest-range business jet (8000 nautical miles). The new plane has a list price of \$78 million and is anticipated to enter service in 2025.

## MDA

MDA designs, manufacturers, and services a variety of robotics, space, and intelligence systems for customers worldwide. The company was founded in 1969 and currently employs 2,400 employees.

MDA primarily offers geointelligence solutions via satellite generated imagery and analytical services for customers involved in national security, climate change, and maritime/aerospace surveillance. Another segment of the company provides autonomous robots and sensors that are capable of operating in space, whether in orbit or on other planets.

MDA is also involved in telecommunications services for government agencies, prime contractors, and space companies via its space-based broadband from a low-orbit network of satellites. Recently, the company was awarded a contract from Lockheed Martin to build antennas and electronics for 42 low earth orbit satellites.

## Are Canadian defence stocks right for you?

Investing in the defence sector is a high-risk, high-reward endeavour. Most Canadian defence stocks do not have the best balance sheets, often exhibiting high amounts of debt, operating losses, high capital expenditures (CAPEX), and low or negative earnings. This can lead to high volatility in their share prices.

Furthermore, much like the broader industrial sector, defence stocks are considered [cyclical stocks](#), outperforming in some economic conditions and underperforming in others. During periods of economic growth and falling interest rates, defence stocks often benefit from higher spending. When inflation and rising interest rates strike, their margins and valuation can drop sharply as end users cut spending.

Declines in government budgets for defence will also significantly affect their earnings, as government contracts can comprise a large portion of their revenues. Some defence companies can be dependent on a single or few critical contracts. The loss of one of these at the end of a period to a successful competitor bid can be devastating.

However, with high volatility and risk comes strong growth and potential for high returns. Investors who buy into a defence stock with solid fundamentals during a period of under-valuation could reap significant returns once the industry takes off.

And for investors who want downside price protection against geopolitical tensions or war, they can use defence stocks as a hedge due to their tendency to outperform when conflicts arise.

#### **TICKERS GLOBAL**

1. TSX:BBD.B (Bombardier)
2. TSX:CAE (CAE Inc.)
3. TSX:MDA (MDA Ltd.)

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