

transcription



Rolls-Royce

Half-Yearly Results 2010 – Questions

- Andrew Gollan, Investec: Yes, just trying to drill down a bit more into some of the - more detail on the Civil aftermarket side, which I guess you're not surprised I'm asking a question on that. If we assume that, in the first-half, the total care side of the equation grew reasonably well, given the fleet growth and flying hours, etc. In the light of what some of your competitors have said in terms of demand trends, can you give a bit more colour on what's going on with the time and materials side and spare parts, and whether the order trends are picking up? Or what your customers are indicating to you going into the second-half?
- Andrew Shilston: Yes, I think we indicated back in February that we hadn't seen much upturn in demand on the Time and Materials side and that continues to be the case. Typically we get two to three months of visibility of demand through the repair and overhaul network and we're still not seeing much change to that fairly flat pattern. Obviously in the end I think as there is more flying activity one would expect some recovery. But there's not much evidence of it yet.
- Andrew Gollan, Investec: And on Civil margins then, if we stick with that profile of recovery and what you said about production, do we see Civil margins trending back higher from where we are this year, giving there's a few negatives hitting the division?
- Sir John Rose: Well I think we'll have to wait 'til early next year before we start to give some guidance for 2011, but for this year I think the comments I've made - hold good, that we'll see the number of engines on early programmes having some negative effect and obviously over time those will tend to work out of the system.
- Andrew Gollan, Investec: Thanks. And just one last question on Marine, a very strong performance. Is that, on the aftermarket side, a result of the market share gains? Is the proportion of aftermarket going up

as a result of your investments? And similarly on the margin side, going forward, you've had a very big jump in returns. Is that sustainable, or will the mix continue to go up?

Sir John Rose:

Well I think on the aftermarket it's a function of two things, firstly we've spent quite a lot of money improving our dockside presence around the world which captures more of the aftermarket and the fact that we've delivered so much original equipment has contributed to that growth. So we see that the strong performance in the first-half continuing for the second-half of the year.

Andrew Gollan, Investec:

And beyond?

Sir John Rose:

Well I think we'll give you that guidance when we get there, but you know the margins this year will clearly show the benefit from growth in aftermarket.

Antoine Boivin-Champeaux,
Credit Agricole Cheuvreux:

You showed us plus 7% in Civil Aero aftermarket in the first-half, could you give us the underlying figure in the in dollar terms and excluding the Aviall distribution agreement for the first-half? And give us your expectation for the full-year as well? Thank you.

Andrew Shilston:

Well I think we guided back in February that the full-year aftermarket growth would be about one third to do with foreign exchange, one third to do with the Aviall agreement and one third to do with the growth in underlying aftermarket. And for the full-year we see that to be very much what is likely to happen.

I think what's happened in the first-half, we've seen a bit less from perhaps Time and Materials than we expected, although we never had great hopes for recovery. But I think the full-year

composition of the aftermarket to be much as we expected back in February.

Sir John Rose:

And indeed the scale of the growth, so we were guiding to 12% I think in the prelims and we're staying with that guidance. So mathematically the second-half will be a bit better.

Zafar Kahn, Soc Gen:

I have two questions, please. The first one is on the Marine; you mentioned the encouraging pickup in the orders there. I was just wondering if you could give us a bit more detail of where that's coming from, is it a specific, or across the board? That's the first question.

The second is just on your balance sheet, which is almost one billion of net cash on an average basis. And I know Andrew, you mentioned that gives you flexibility; I just wonder how you're hoping to deploy that, going forward?

Andrew Shilston:

Well I think on the balance sheet, you know, we've always made a feature of financial strength and you know that continues to the case. We have appetite to grow, in particular our Energy and Marine businesses, and time will see what opportunities we identify. Whether those are inorganic or organic and we have nothing particular in mind at the minute. But we have a lot of capability and we'd like to find ways of capitalising on that.

Andrew Shilston:

On Marine, I wouldn't overstate how quickly it's coming back, but I think the nature of our products are that we have a lot of capability where increasingly the market is interested in high efficiency products, low emissions products. I think for the first time, perhaps in the last year people are talking about emissions in the merchant fleets around the world, which is not something that people have really talked much about before. So there's going to be more demand for the sorts of things that we do, which is - not that we're concentrated in the heavy end of the

merchant fleet world, but for example coastal ferries which originally started in Norway using gas engines we've detected demand elsewhere in the world as people get worried about emissions close to coastlines.

So I think it's not only going to be from our traditional markets that in the future we see demand picking up. It's also going to be demand that's spawn by appetite for cleaner more efficient equipment.

Sir John Rose:

And I think just as an addendum to that, our Marine business is slightly different from the other Marine businesses that you would typically compare us with; in that most of them are diesels led, whereas we're systems led. And diesels is just one of the prime drivers that we can use. And Andrew's point is that, you know, the environmental agenda is clearly more important, but also just the capability agenda and we do clever ships; they go fast, they are very manoeuvrable, you know, they can hold position on the seabed, they can tow arrays, etc, so we have a lot of systems capability. So as you've seen pictures before of the sorts of vessels we provide systems for we'll be providing something like 60% of the content of a vessel and doing the integration task.

Harry Nourse, HSBC:

I was just wondering, could you possibly give us some kind of geographical breakdown on your Defence revenues exposure to different parts of the world and perhaps some thoughts on how potential cuts might affect you? Thanks.

Sir John Rose:

Well I think probably Mark can give you a detailed breakdown, but just you know simply our biggest customer is the DoD and our second biggest is the UK and Europe and then it grades through the world. As Andrew said, we have more than a hundred countries which we sell to. I think the points that he

made remain valid, that we have about 50% of our revenue coming from services. Then there's about 20% that comes from development programmes, which are typically in Europe and the US and then the balance is original equipment which is pretty broadly spread across a large number of programmes.

So no individual programme is a disproportionate part of our revenue in that sector. And we're highly focused on areas such as transport, sort of utility areas of demand as opposed to the more exotic programmes; although we are involved in the odd exotic programme.

So I think it's important we have a very widespread list of customers, a large spread of programmes, we have a good split between services and OE and no single programme is disproportionately important to us.

Harry Breach,
Barclays Capital:

Following on my colleague Harry's question on Defence, can I ask two things? First, could I just resolve a small question, the F136 development expenditure to go to completion, to move it into production; at Farnborough I think we heard a number of \$1 billion. Your friends on that programme have given a number of \$1.8 billion, which is correct?

Andrew Shilston:

We'll come back to you and correct the data point but I think the point is that we're not incurring costs on our own dollar. This is still a funded programme and it looks as if funding will be in place through the balance of this year.

Sir John Rose:

And the other thing that's just worth remembering on that programme is that we're involved in two components of the F35 one is Lift Fan where we're 100% of it and then the other one of

course is, I think, the one you were asking about, which is the engine which is where we're 60/40 with GE.

Harry Breach,
Barclays Capital:

The other question was, we've seen a number of companies comment on delays in contract placements by various ministries of defence. Have you seen any of that at Defence Aerospace?

Mike Terrett:

Nothing material.

Andrew Shilston:

No I don't think so, not discernibly. I mean there are some places in the world where contract negotiations take a long time, but that's always been the case.

Harry Breach,
Barclays Capital:

When we saw the slides earlier in Mike's presentation of Singapore, it reminded me of a nearby customer. And I'm wondering, have we seen a Boeing 787 engine selection by Singapore Airlines?

Sir John Rose:

No we haven't.

Avi Hoddes, UBS:

Three questions. First, could you pass a comment on unit costs, pressures and the various pieces within that give some colour on where that's going? Second question on working capital, if you could just, again, give some colour as to where you think those three pieces are going. I guess in particular I'm interested in inventory. But also, given the order flow that we've seen, what's going to happen on the payables line or in the advances line? And then finally on ODIM, I don't feel like I've ever really heard from you the rationale behind ODIM, publicly. And really how that fits with - I see you guys as a company that delivers power, delivers energy, and how really ODIM fit into that strategy? Thanks.

Sir John Rose:

Why don't we start with ODIM first. We did explain the rationale and it is consistent with the overall systems strategy in our Marine business, which as you know already goes beyond just power. We go from the bridge, through propulsion and we have some of the ancillary capabilities that are associated with the function that those ships deliver. We're primarily power, but we have a broader systems offering, as we do - for instance in oil and gas where we have a broader systems offering with compression.

So it is analogous to the sorts of activities that we already perform in the oil and gas industry particularly, but we've just broadened into a slightly wider area of activity. It's a business we know extremely well, it's co-located more or less with our businesses in Ulsteinvik and we're very comfortable with the acquisition and we think it will add a lot of value to the company.

Andrew Shilston:

Well I'll take working capital and the Mike you might want to touch on unit costs.

Andrew Shilston:

Well looking at working capital if we look at inventory first of all, we know that there is scope to bring inventory levels down. But I think this is not a simple process, because we have about two thirds of what we put into an engine comes from the external supply chain. So we're also having to manage risk in the external supply chain. And then we have the phenomenon we've experienced over the last two years of programme delays, which just makes smooth flow of material through the factories more difficult. So over time I think there are opportunities in inventory, but they may not be that significant in a very short-term.

With regard to deposits, I think that is always difficult to predict and we are forecasting some negative turnaround in deposits in the second-half, i.e. that the order intake, particularly in the Marine business will not be at levels that we've seen in previous years but we could be wrong. So I think the deposit areas are notoriously difficult to forecast and it's one of the reasons why working capital is quite volatile. Mike do you want to comment on unit costs?

Mike Terrett:

On unit costs, generally we give guidance at the full-year on unit costs and give you a sort of sense of what's going on. In February we guided that we'd be stable this year and I don't see anything to change that guidance.

Avi Hoddes, UBS:

Can you talk about raw materials? I appreciate you've got long-term contracts on that, but just the various pieces within that?

Mike Terrett:

Well you know I think we gave you some data back in February and nothing really changed. We're hedged out well into the next decade on titanium, we're hedged on the other materials that's all - we haven't seen volatility in the ups, we haven't seen - you know we'll see volatility when it does go, it's the hedging process. So nothing's - you know operations doesn't really move around very rapidly on a day to day basis. We'll give more guidance again at the full-year.

Gordon Hunting, Fiske:

Will your Marine business be badly affected by what's happened in Deep Sea Gulf?

Sir John Rose:

Well interestingly since then Petrobras particularly has reaffirmed its capital programmes for their activities. And it's not only deepwater, but some of the other areas in the world where exploration is taking place; you know the colder waters that are driving the demand for vessels. So that plus the renewal cycle,

if you go and look at the bigger fleets - some of them have a lot of assets that are no longer really useful for some of these more complicated environment.

So I think on the whole we think that demand will remain consistent with our earlier view, I don't think the deepwater has changed that.

I mean just as a sort of sideline, if as the government says we really are going to have 15% of our renewables, our electricity generated by renewables, largely offshore wind by 2020 that will require an unprecedented number of ships.

Now I don't personally think it's an easy target to meet. But offshore wind requires exactly the same sorts of capability as placing a rig. And so you need a lot of ships for that globally and any other form; if you saw our tidal generator - a sort of artist's impression of it on one of the slides, we're deploying that up in the Orkneys for testing. That needs the sort of vessel that we're talking about; you can't do it without that sort of vessel.

Andrew Gollan, Investec:

Just a quick follow-up. Mike, you touched on materials hedging. Could you just come back to foreign exchange hedging at the period end, what the hedge book - what the size of the hedge book and what the average rate was, please?

Andrew Shilston:

Yes, there's some more detail in the appendixes but just to summaries the hedge book is about \$20 billion in size and the average rate embedded is \$1.60.

Rupinder Vig, Morgan Stanley:

Just two questions. I remember back at the full-year results you talked a lot about Energy prospects for Civil Nuclear. Could you just give us a bit of an update as to what's happened since? How positive you're feeling about that area in the future? And

then just back to the Civil business, if we think about the IAE consortium, what's the future for that going to be in terms of new programs? And from your own perspective, how big or small is the impact for you if you don't participate in future programmes with the IAE? Thank you.

Sir John Rose:

Nuclear first, well it's moving along the trajectory that we thought. You know, everybody is learning about nuclear, frankly what we assumed were the incumbent companies learnt something when Korea won the bid in UAE. So there are - a wide number of potential and actual competitors now in the market.

We continue to pursue our strategy really on two fronts, one is as being subsystem suppliers to the primes where we can do specialist design and manufacturing of large components that will give us a meaningful part of the core and the aftermarket. And secondly the instrumentation and control opportunities that comes from our base where we provide instrumentation and control on - I think nearly all of the French power stations, half the US and a bunch of others around the world. So there are really two strands to it and perhaps a third which is around the sort of services and advisory capability.

It's going to be as I've said right from the outset a relatively slow burn. You know, decisions are inevitably taking longer than people originally expected; but we're still comfortable that it is a sensible extension of our capabilities in our nuclear businesses. And you've seen some announcements around MoU with Larsen & Toubro for instance, which are - possible ways of extending our manufacturing capability. And as Mike showed you we're investing in a facility that is largely for submarine capability, but is sized so that we can respond to the Civil demand.

I'm absolutely sure that for many countries that the energy mix is going to be clean coal, gas and nuclear. You know, countries will vary because they'll have different regulatory environments and different resource strengths. You know, clearly France is hydro and nuclear and as such is the only country sensibly in Europe that can use electric cars. And energy strategy is going to be very important going - you know as we look forward and I'm convinced nuclear is going to be a big part of it and probably a bigger part of it than we expect today. It is clean and we know how to do it.

On IAE, you know clearly it's essentially a one product company at the moment and the next decision will have some impact on what the future is of IAE. But we said I think two or three years ago when this debate started that we were always happy that we had the options to go alone or through IAE, although we had the preferences to use the brand value and partnership relationship that we'd build up over 20 odd years with IAE in addressing that particularly sector. But we have the option to address it on a standalone basis today in a way that we didn't in the 1980s.

Sandy, RBS:

Coming to this exciting life Mike leads, I mean this is just something I've been mulling over. Unlike some of your peers, we've always had this variety of products. With the Trent XWB, a bit like the Trent 700 today, we have a real opportunity to settle down and make one thing. Now, I know you want flexibility, but you might have thought that in terms of your operations that that was actually, in some respects, going to make your life easier and might allow you to more closely rival the shelling peas.

I think we're hooked on this execution thing. You've got a lot of flexible facilities that make a lot of different parts for different products, even across the divisions. But for once in our lives we're going to get a real crack at something. How do you sort of view that as an opportunity?

Mike Terrett:

Well just to put some fact and figures, the Trent XWB thrust we talked about, I mean that is about the same as a thousand CFM56's because of the scale and size of it. So yes, it's clearly helpful to have a big stable run of products going through your facilities.

But actually a lot of the tooling we use for the various different components on the Trent, the tooling is very similar and quite flexible between Trent families. And if you go and walk through our turbine facilities, you know you do see a huge amount of commonality to be able to produce a turbine blade for various different products; sometimes the exact same one, often very similar. And when I take some of you around the turbine facilities, I do have - you know I have to ask the operator which blade he's producing because I can't tell from a distance.

So we are set up to actually make our facilities, our domestic facilities work flexibility, because they're on components where they differentiate the product. So there's a high degree of precision technology in the making as well as the design. And that's where we make our components.

And our supply chain, our supply chain is much more - the word commoditised doesn't really do it justice because they are advanced products. But they tend to have facilities that are more the way you've described them. So when we set up our supply chain for the Trent XWB we've got less than a hundred first tier suppliers and they're tiered to be more specialised. But

that less than a hundred suppliers some of them - you know particularly our revenue sharing partners exist on other Trents, some are dedicated to one particular programme. So it's a more complex answer than it first appears, because of the way in which we do our make buy. I don't know if that helps you Sandy.

Andrew Shilston:

It's clearly helpful to have a big run of a big engine.

Sandy, UBS:

Yes, and you know - the closest we've come to that is the Trent 700. And I don't know whether you look at that one and say, yeah, that ticks my operation box in terms of, you know?

Mike Terrett:

Actually it's not our biggest volume, our biggest volume of wholly made Rolls-Royce is the BR 710 or the AE programme which is across Civil and Defence and the AE programme runs across the V-22, the C130-J, the Embraer, you know the Cessna, it's in a lot. The core of that engine in Indianapolis is very, very similar, high volume. The BR700 which has two Civil application and a Military that engine is higher volume than the Trent 700, albeit it's a bit smaller. The V2500 is high volume but we've only got 32.5% of it.

So those supply chains have high volume repetitive product, the Trent 700 is another one, you know only two or three a day and the Trent XWB will be another one. But our domestic make facility are set up to get the best out of the special products that we make ourselves, our supply chains are then designed around the volumes we expect for the different products.

Sir John Rose:

Your answer reminded me that I forget to answer part of an earlier question, which was how important is IAE in terms of market share and so on? And it's just worth remembering Airbus A320 and Boeing 737, CFM has 75% of the market, IAE

has 25% of the market, we have 30% of that 25%. So it's a relatively small percentage of our market.

Mike Terrett:

Just one last point for you Sandy on this. The facilities you saw there of the wide-chord fan blade are a good example, they do Trent fan blades, they'll be in Singapore and Barnoldswick in the UK. We'll have the capability to do multiple Trents in both facilities which is very helpful from a business continuity perspective.

But we may load those facilities to optimise the repetitive nature of certain products. That give us - we have the choice to do similarly with the assembly and test we'll have the choice to - do what you described which is to shell pees, albeit it quite bit and quite expensive peas.

Sir John Rose:

Okay if there are no more questions thank you very much, I know you've got a busy day so thank you for joining us.

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