

# Report of the directors

The directors present their report and the audited financial statements of Rolls-Royce Group plc (the Company) and its subsidiaries (together referred to as the Group) for the year ended December 31, 2006.

## Business review

A review of the business can be found on pages 12 to 40.

## Corporate governance

The directors' report on corporate governance and the Directors' remuneration report are on pages 44 to 47 and pages 48 to 57 respectively.

## B Shares

At the Annual General Meeting (AGM) on May 2, 2007, the directors will recommend an issue of 59.2 B Shares with a total nominal value of 5.92p for each ordinary share. Together with the interim issue on January 2, 2007 of 36.7 B Shares for each ordinary share with a total nominal value of 3.67p, this is the equivalent of a total annual payment to ordinary shareholders of 9.59p for each ordinary share.

Shareholders are given the opportunity to redeem their B Shares for cash or to convert them into additional ordinary shares in the Company. For those shareholders who have not elected to redeem or convert their B Shares, a B Share dividend at a rate of 75 per cent of the London Interbank Offered Rate (LIBOR) is payable half yearly in arrears.

The Board believes that there continues to be a significant benefit to be gained from the issue of B Shares. Payments to shareholders will, therefore, continue to be made through further issues of B Shares, generally in January and July each year.

## Going concern

After making enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

## Political donations

In line with its established policy, the Group made no political donations during 2006.

## Authority to purchase own shares

At the AGM in 2006 the Company was authorised by shareholders to purchase up to 176,956,928 of its own ordinary shares representing ten per cent of its issued ordinary share capital as at February 8, 2006. The Company did not make use of this authority during 2006.

The authority for the Company to purchase its own shares expires at the conclusion of the AGM in 2007 and a resolution to renew it will be proposed at that meeting.

## All Employee ShareSave Plans

Resolutions seeking approval from shareholders for the introduction of a new ShareSave plan for UK employees and an International ShareSave plan for overseas employees will be proposed at the AGM.

## Auditors

A resolution to reappoint the auditors, KPMG Audit Plc, and to authorise the directors to determine their remuneration, will also be proposed at the AGM.

## Directors

The directors' biographical details, including their other significant commitments, are set out on page 41. During the year there were a number of Board changes: Colin Green retired as an executive director on April 4, 2006; Hon Amy Bondurant and Carl-Peter Forster retired as non-executive directors on September 14, 2006.

Under the Company's Articles of Association, one third of the directors are subject to re-election every year, with each director also being subject to re-election at intervals of not more than three years. Any director appointed during the year is separately required to retire and seek election by the shareholders at the next AGM. The Board also requires any non-executive director who has served on the Board for more than nine years to be subject to annual re-election at the AGM. The directors retiring at this year's AGM are Peter Byrom, Iain Conn, James Guyette, Simon Robertson and Andrew Shilston. They all offer themselves for re-election.

The Company has entered into separate Deeds of Indemnity in favour of its directors. The deeds provide substantially the same protection as that already provided to directors under the indemnity in Article 170 of the Company's Articles of Association. The Company has also arranged appropriate insurance cover for any legal action taken against its directors.

## Share capital

At February 7, 2007, the following companies had disclosed an interest in the issued ordinary share capital of the Company in accordance with the requirements of Sections 198-208 of the Companies Act 1985:

	% of issued ordinary share capital
FMR Corp. and Fidelity International Limited	7.90
Franklin Resources Inc.	4.09
Barclays PLC	4.07
Legal & General Group Plc	3.14

By order of the Board



**Charles Blundell** Company Secretary

February 7, 2007