Rolls-Royce

2017 Half Year Results

John Dawson

Director, Investor Relations

Agenda for today

Introductions	John Dawson
Highlights	Warren East
Financial review	Stephen Daintith
Reflections and outlook	Warren East

Notices

Safety

Safe Harbour

Mobile phones

Warren East

Chief Executive

Rolls-Royce

Results summary

Rolls-Royce

Underlying Revenue	Gross Margin	Underlying PBT
£6.9bn	£1,252m	£345m
↑ 6%*	↑ 13%*	↑ £187m or 98%*

Operating margin	Free cash flow	Payment per share
5.0%	£(339)m	4.6p
↑ 220 bps	2016: £(414)m	2016: 4.6p

* Percentage change at constant currency

First half overview

Rolls-Royce

Highlights

+ Large engine deliveries up by 27%; production up 37%
+ Good further progress with Trent XWB OE economics
+ Strong first half for Power Systems
+ Transformation programme continues ahead of plan
+ Successful technology and engineering organisational changes
+ UltraFan® power gear box testing and Advance3 engine build

Challenges

- Marine markets remain challenging : restructuring proceeding well
- In-service issues for Civil Aerospace

Civil Aerospace
2017 H1 scorecard

Rolls-Royce

Highlights

"Delivering on customer commitments…
strong aftermarket growth from growing installed base"

Results ahead of expectations

Revenue*	Profit	Op Margin
↑14%	£173m	4.7%
at £3.7bn	up from £31m	from 1.0%

* Underlying change at constant currency

Strong aftermarket & growing share

In-prod Trent engines	Out-of-prod engines	Overall growth
↑18%	↓3%	↑8%

% growth or reduction in number of large engines in operation

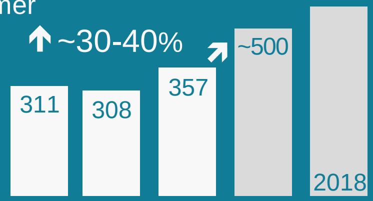
Good progress on large engine production ramp-up

H1 2017 invoiced deliveries to customer

↑27%

up 45 to 209

On track for around 500 in 2017



New product introductions reaching important milestones

- Technical progress on Trent XWB-97 & 1000 TEN
- Shipped Trent 7000 engines to power the first flight of the Airbus A330neo

Trent 1000 TEN on its flying test bed trials

Defence Aerospace
2017 H1 scorecard

Rolls-Royce

Highlights

“Outlook remains good; positive business developments for combat, new product and Transformation programmes going well”

In line with our expectations

Revenue*	Profit*	Op Margin
↓ 4%	↑ 16%	14.1%
at £1.0bn	to £148m	from 12.8%

* Underlying change at constant currency

New service delivery centres for UK and India

- RAF Lossiemouth, UK, to support Typhoon operations out of Scotland
- Bangalore, India, supporting over 750 engines in service with Indian armed forces

Improving on time delivery performance across OE

H1 2017 delivery performance

Delivery to purchase order

↑ to 95%

% of engines delivered to PO

Underpinned by strong performance from small engines

Aviall deal designed to leverage route to market for AE engine spares

A new parts sales and distribution agreement, initially worth $3 billion at list prices, to support the global fleet of AE defence engines

- Leverages strong sales and distribution infrastructure
- Improved customer service
- Benefits to inventory and capital employed

Power Systems
2017 H1 scorecard

Rolls-Royce

Highlights

"Good start to the year – new management revitalising the business – with positive order book growth the business is well positioned to make progress overall"

Strong start to the year

Revenue*	Profit	Op Margin
↑3%	£66m	5.4%
at £1.2bn	from £13m	from 1.2%

* Underlying change at constant currency

Positive order intake in key markets

Order intake

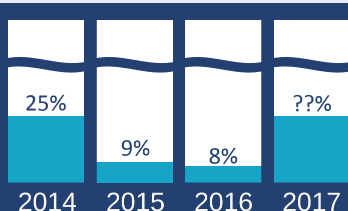
↑6%

to £1.4bn on constant currency basis

+ Recovery in industrial
+ Growth in agriculture
+ Gas systems for PowerGen
+ Defence applications
+ REMAN activities

Targeting a more balanced financial profile

- Rebalancing first and second half revenue and profit profile
- Benefits to cost planning and consistency



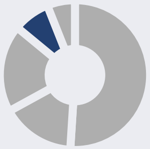
% FY profit reported in H1

Reducing costs and complexity

To date: >25% reduction in product variants

Marine
2017 H1 scorecard

Highlights



"Restructuring activities proceeding well … few signs of market improvement … order book yet to recover to satisfactory levels"

Results reflect weak markets

Revenue*	Profit	Op Margin
↓15%	£(31)m	-5.9%
at £0.5bn	from £(13)m	from - 2.4%

* Underlying change at constant currency

Outlook remains challenging

- No change in off-shore market
- Merchant remains flat in our key niches
- Naval stronger, reflecting sustained investment in new capabilities

Rauma investment proceeding well

- £44m investment
- World-class thruster facility on significantly smaller footprint


New manufacturing hall under construction at Rauma, Finland

Marine 4.0

Rolls-Royce and Svitzer successfully demonstrated the world's first remotely operated commercial vessel in Copenhagen harbour, Denmark


Our 'remote bridge' in operation

Nuclear
2017 H1 scorecard

Highlights

“ Solid performances across submarines and civil nuclear activities with strong improvements to operational delivery ”

Six months in line with expectations

Revenue*	Profit	Op Margin
↑ 8% at £0.4bn	£14m from £18m	3.6% from 5.1%

* Underlying change at constant currency

Developing the submarines business

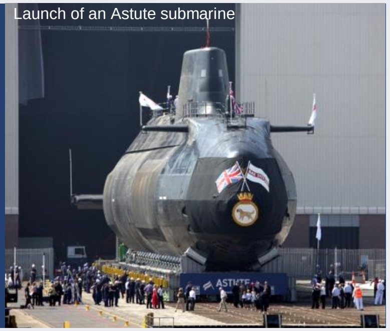
- Astute boat 6 contract signed
- Significant improvement in delivery performance
- Ongoing work with partners for new delivery model for Dreadnought class deterrent submarines

Strong delivery improvements

H1 2017 delivery performance

↑ >94%

Performance measured on time to customer PO / commitment



Launch of an Astute submarine

Positive civil nuclear growth opportunities

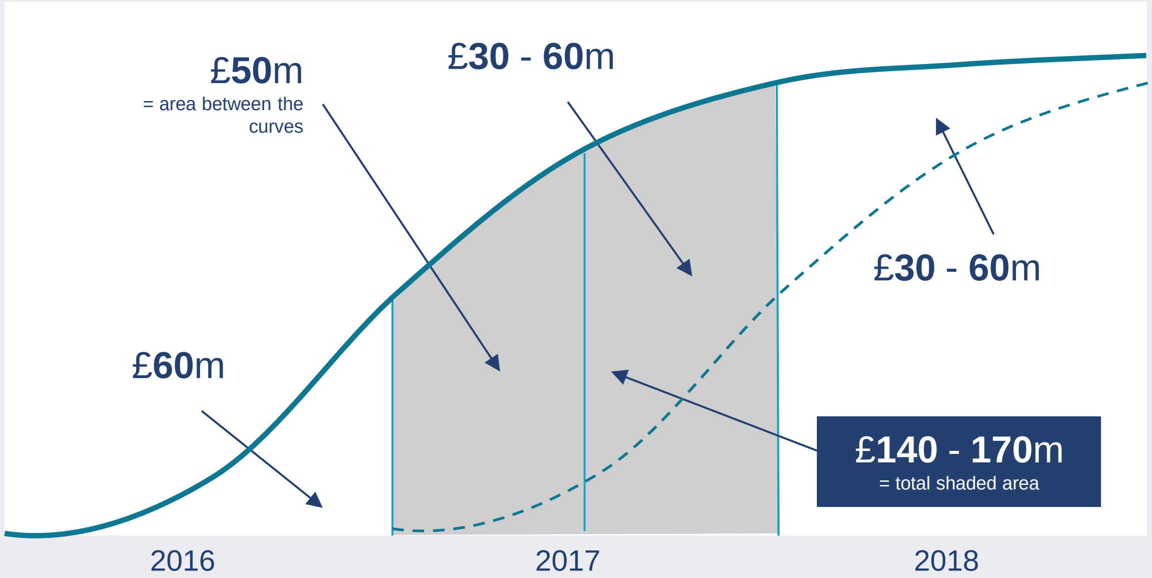
- UK – well positioned on new build projects including Hinkley Point C
- Strengthened role with key new designs and commercial arrangements in China

Nuclear I&C product

Transformation programme continues ahead of expectations

	2016	2017	2018
Delivered to date	£60m	£50m	-
To go		£30 – 60m	£30 – 60m
In year incremental benefit	£60m	£80 – 110m	£30 – 60m
Cumulative savings	**£60m**	**£140 – 170m**	**>£200m**

- On-track for savings of over £200m per annum from 2018 onwards
- Good in-year progress to date; target remains £140-170m delivered by end 2017 with run rate of over £200m
- Focus on process simplification, cost avoidance and functional streamlining



Illustrative graphic : areas not precise

Goals for 2017

With a focus on pace and simplicity…

Strengthen our focus on engineering, operational and aftermarket excellence	Deliver good progress on transformation commitments	Rebuild trust and confidence in our long-term growth prospects	Complete strategic update; outline clear goals and priorities for Rolls-Royce

Stephen Daintith

Chief Financial Officer

Rolls-Royce

Agenda

Rolls-Royce

1 Priorities

2 H1 Results

3 Accounting Changes

Agenda

1 Priorities

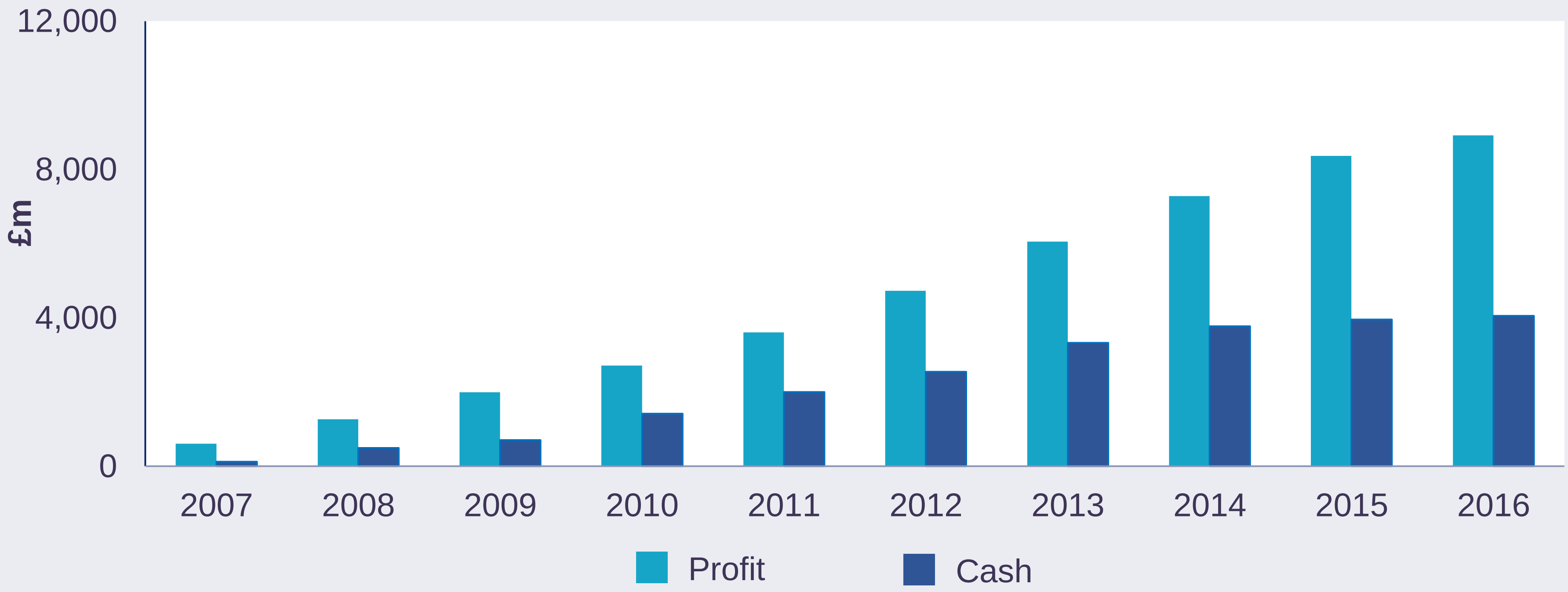
Priorities

Rolls-Royce

1. Cash
2. Costs
3. Balance sheet and capital allocation
4. ‘Clearing the fog’
5. Strong finance team

1. Cash

- Best indicator of economic performance
- Historic disconnect with profit, largely addressed by IFRS 15
- Understanding and managing the key drivers



Profit and cash calculated post-tax, shown on a cumulative basis

1. Cash

Rolls-Royce

The road map to a growing Civil FCF

1 OE economics	2 AM value	3 Cost management and capital allocation
Cash margin per engine sold	Growth in installed engine base	Focused improvement on operations and C&A costs
XWB progress	Growth in flying hours	Disciplined capital allocation on capex and R&D
	Shop visit efficiencies	Working capital management

Civil Aerospace

Trading cash flow – as previously presented

£m	2015	2016	Variance
Underlying profit before financing	812	**367**	(445)
Depreciation, amortisation and impairment	410	491	81
Sub-total	1,222	**858**	(364)
CARs additions	(161)	(208)	(47)
Property, plant, equipment and other intangibles	(502)	(739)	(237)
Other timing differences*	(75)	111	186
Trading cash flow pre-working capital movements	484	**22**	(462)
Net long-term contract debtor movements	(406)	(246)	160
Other working capital movements	(78)	267	345
Trading cash flow**	0	**43**	43

* Includes timing differences between underlying profit before financing and cash associated with: joint venture profits less dividends received; provision charges higher /(lower) than cash payments; non-underlying cash and profit timing differences (including restructuring); and, financial assets and liabilities movements ** Trading cash flow is cash flow before: deficit contributions to the pension fund; taxes; payments to shareholders; foreign exchange on cash balances; and, acquisitions and disposals

1. Cash

Civil: a simpler view of 2016

OE economics

AM value

Cost management & capital allocation

£bn			2016
Original Equipment	320 @ £1.6m		(0.5)
Aftermarket	11m engine flying hours		1.0
Spare engines			0.2
Widebody Cash Margin			**0.7**
Business & Regional			0.6
V2500			0.3
Gross Cash Margin			**1.6**
Operations		(0.5)	
Engineering		(0.2)	
Commercial & administration		(0.3)	
			(1.0)
Operating Cash Margin			**0.6**
R&D			(0.6)
Capital expenditure			(0.3)
Working capital and other			0.3
Trading Cash Flow			**0.0**

2. Costs

Rolls-Royce

Relentless focus on costs

20% reduction in footprint by 2020

Simplification = productivity

Engine economics/ ESV cost reductions

Footprint & factory utilisation

Lifecycle cost reductions

Process efficiency

C&A management

XWB-84 breakeven by 2020

Factory utilisation of at least 80% by 2020

Targeted reengineering to reduce costs

Tight headcount control

Ongoing transformation across the business – a way of life

3. Balance sheet and capital allocation

Rolls-Royce

Deliver
a strong FCF

+

Disciplined
capital
allocation

=

Flexibility
for investment

Secure as investment grade,
delivering pathway to a sustainable A rating

Return on capital targets, long-term perspective

4. 'Clearing the fog'

Internal and external focus

Understanding & explaining the performance	Clear metrics & accountability (including Group KPIs)	Greater clarity on cash flow	IFRS 15 helps enormously

All giving greater transparency

4. ‘Clearing the fog’

Rolls-Royce

Developing Group KPIs, possibles……

Return on capital employed	FCF per share
Cash conversion	Cash margin

4. 'Clearing the fog'

Rolls-Royce

USD:GBP hedging policy

Policy objective

- **Reduce FX volatility on cash & profit**

Policy parameters

- Forecast of net USD income
- Hedged up to 10 years forward
- Maximum and minimum hedge positions

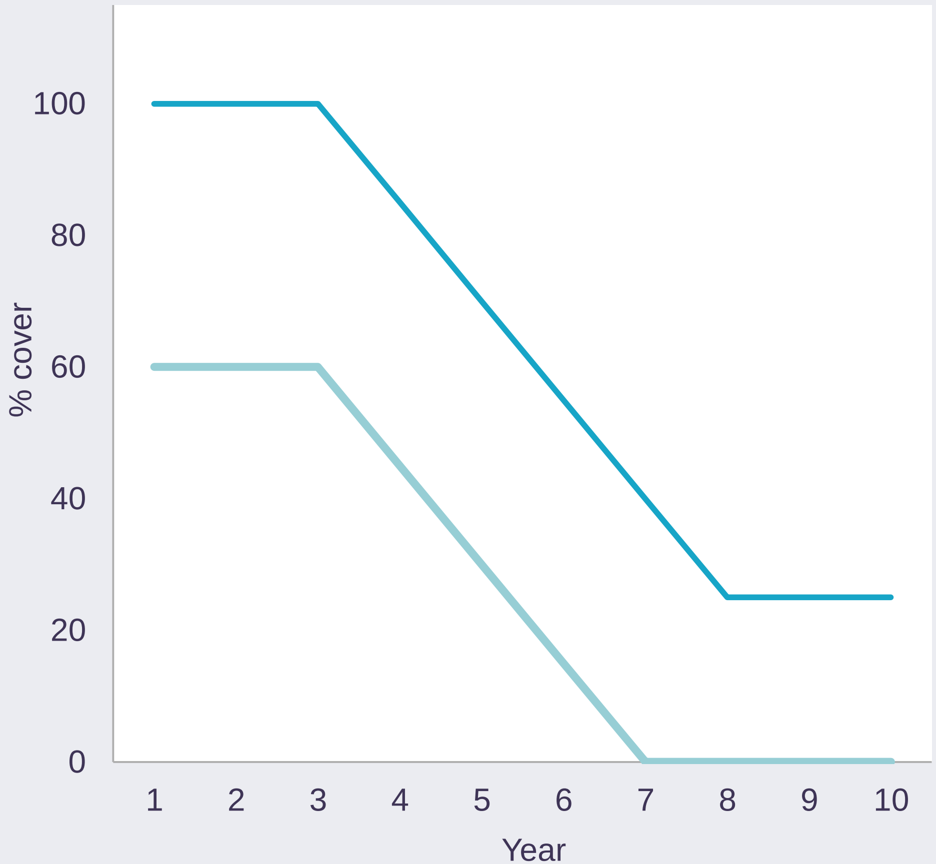
Main hedging instruments

- FX forwards and cross-currency swaps
- No collateralisation or margin requirements

Main long-term exposures led by Civil Aerospace

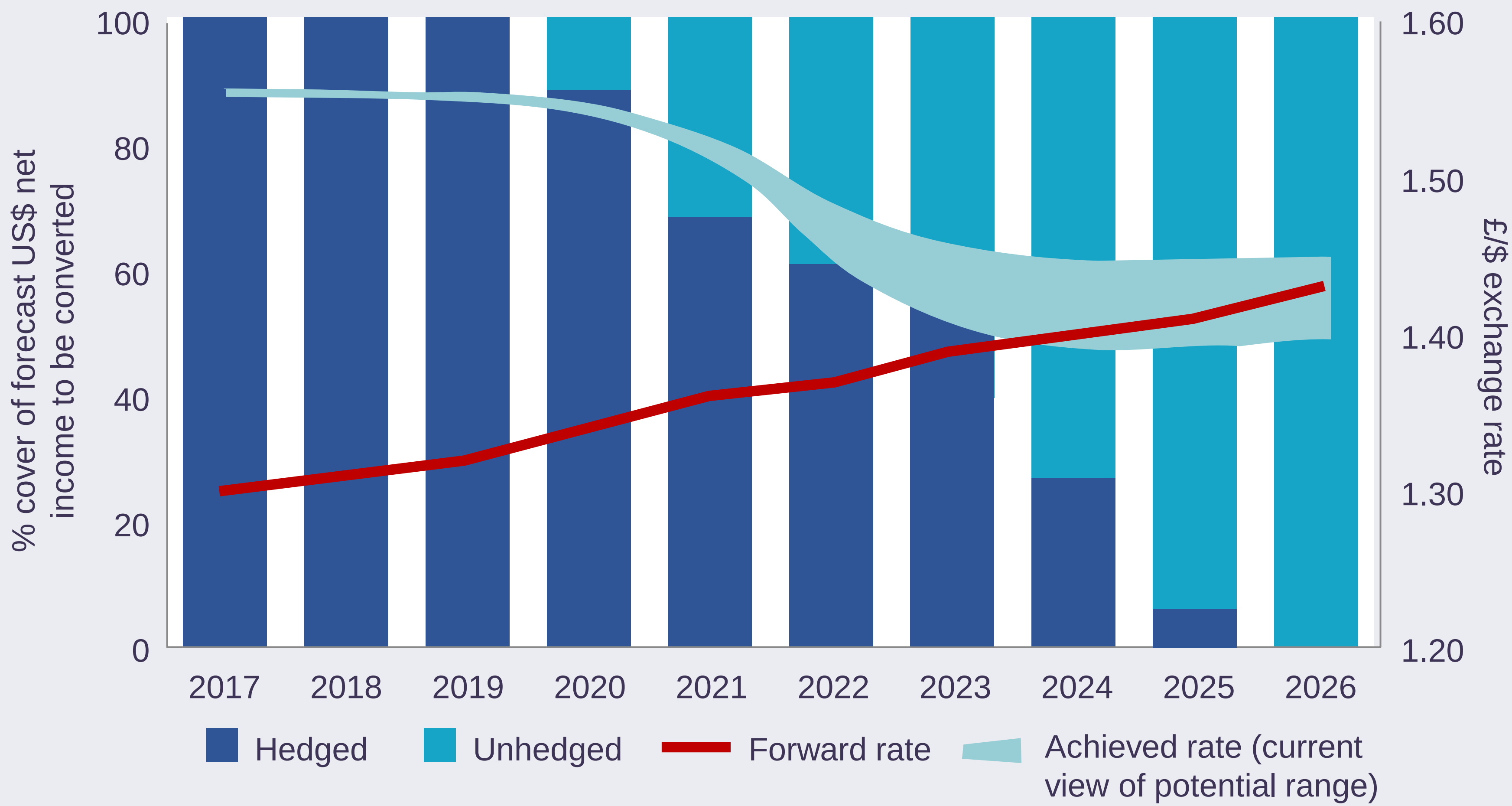
- Net USD income : GBP (c. $5bn in 2017)
- Net USD income : EUR (c. $1bn in 2017)

Policy maximum & minimum hedge positions



4. ‘Clearing the fog’

USD hedge book: looking forward



5. Finance team

Helping drive the change

- Strong commercial understanding
- Leveraging different industry experience
- Providing insight & analysis
- Informing and driving decision-making

Both supporting and challenging our business

Recent hires

Sarah Kuijlaars

Ben Fidler

Agenda

Rolls-Royce

2 HY Results

Revenue by business

Underlying £m	2016 H1	2017 H1	% change	Underlying change at constant rates
Civil Aerospace	3,171	3,676	+16%	+14%
Defence Aerospace	1,002	1,048	+5%	-4%
Power Systems	1,084	1,233	+14%	+3%
Marine	548	524	-4%	-15%
Nuclear	356	391	+10%	+8%
Other*	(18)	(7)		
Group	**6,143**	**6,865**	**+12%**	**+6%**

Solid start to the year

Note: 'Other' includes eliminations, corporate and other

Profit

Rolls-Royce

Underlying £m	H1 2016	H1 2017	Underlying change at constant rates
Group revenue	**6,143**	**6,865**	**+385**
Gross margin	**1,033**	**1,252**	**+133**
Gross margin %	*16.8%*	*18.2%*	*+100bps*
Commercial and administrative costs	(538)	(531)	+38
Restructuring	(6)	(8)	(1)
Research and development costs	(378)	(411)	(6)
Joint ventures and associates	47	43	(9)
Operating profit	**158**	**345**	**+155**
Operating margin	*2.6%*	*5.0%*	*+220bps*

Improving margin, but still much to do

Profit by business

Underlying £m	2016 H1	2017 H1	Underlying change at constant rates
Civil Aerospace	31	173	+125
Defence Aerospace	128	148	+7
Power Systems	13	66	+48
Marine	(13)	(31)	-17
Nuclear	18	14	-4
Other*	(19)	(25)	-4
Group	**158**	**345**	**+155**

Civil Aerospace & Power Systems strong contribution, Marine operating in tough markets

Note: 'Other' includes eliminations, corporate and other

Free cash flow

£m	H1 2016	H1 2017	Change
Operating profit	**158**	**345**	**+187**
Net financing	(54)	(58)	-4
Profit before tax	**104**	**287**	**+183**
Depreciation & amortisation	335	372	+37
Movement in net working capital	(255)	(110)	+145
PPE, intangibles	(539)	(753)	-214
Other	13	(52)	-65
Trading cash flow	**(342)**	**(256)**	**+86**
Pension and tax	(72)	(83)	-11
Free cash flow*	**(414)**	**(339)**	**+75**

Steady operating performance, effective working capital management

Note: Free cash outflow comparator for H1 2016 of £399m was restated to include £15m of exceptional restructuring which had been excluded when reported in June 2016

Cash analysis

Rolls-Royce

Operating cash margin

- Cash outflows from higher installed engine production
- Offset by increased cash revenues from aftermarket growth

Free cash flow

- Increased capital investment
- Higher level of working capital management (up ~£180m) principally in receivables
- Other than this, cash flow performance largely as expected

Overall better than expected

Note: Free cash outflow comparator for H1 2016 of £399m was restated to include £15m of exceptional restructuring which had been excluded when reported in June 2016

Civil Aerospace: H1 overview

£m	2016 H1	2017 H1	Underlying change % Actual rates	Constant rates	
OE	1,461	1,666	+14%	+12%	
AM - LTSA	1,379	1,552	+13%	+10%	
AM - T&M	331	458	+38%	+37%	+15%
Underlying revenue	**3,171**	**3,676**	**+16%**	**+14%**	
Gross margin	399	543	+36%	+30%	
Gross margin %	12.6%	14.8%	+220bps	+180bps	
Operating profit	**31**	**173**			
Operating margin %	1.0%	4.7%			

Solid growth in revenue and margin, a busy second half ahead

Civil Aerospace: H1 drivers & outlook

Rolls-Royce

Underlying revenue

- OE growth underpinned by ramp up in large engine deliveries, particularly the Trent XWB to support the A350 production ramp (85 engines in first half vs 41 in prior year)
- AM growth led by flying hours (+15%) from growing in-production Trent engine fleet
- Strong business aviation aftermarket (+21%) reflecting the success of CorporateCare®

Gross margin

- Growth in AM from in-production large engines, plus T&M from older engines
- Positive (+£33m) contract accounting adjustments; including £77m credit risk benefit and £(59)m technical costs
- Impact of reductions of BR710 engines

Operating margin

- Improvement largely from trading performance
- Slightly higher R&D spend as new programme development activity intensifies
- Increased R&D capitalisation on Trent XWB-97

Outlook

- Unchanged, growth supported by large engine aftermarket growth, further life-cycle cost reductions and a higher level of R&D capitalisation
- Further improvements on XWB-84 OE margin
- Higher costs related to increased maintenance activity in respect of the Trent 1000
- Trading cash flow broadly unchanged year-on-year; OE volume costs offset aftermarket cash inflows

Defence Aerospace: H1 overview

£m	2016 H1	2017 H1	Underlying change % Actual rates	Underlying change % Constant rates
OE	412	431	+5%	-4%
AM - LTSA	206	199	-3%	-10%
AM - T&M	384	418	+9%	-
Underlying revenue	**1,002**	**1,048**	**+5%**	**-4%**
Gross margin	211	230	+9%	-
Gross margin %	21.1%	21.9%	+90bps	+80bps
Operating profit	**128**	**148**		
Operating margin %	12.8%	14.1%		

-4%

Performance as expected, second half production growth

Defence Aerospace: H1 drivers & outlook

Rolls-Royce

Underlying revenue
- Lower EJ200 OE sales following completion of Saudi Typhoon contract in 2016
- Growing overhaul activity for LiftSystem and EJ200 (Saudi)
- Lower legacy spares and contract lifecycle improvements

Gross margin
- Adverse margin mix on lower legacy spares volumes
- Key drivers:
  - Lower one-off LTSA releases
  - Net benefit of non-repeat of TP400 charges (2016: £31m)

Operating margin
- R&D costs (£30m) for future programme development similar to prior year
- Lower C&A – key driver of £7m improvement in operating profit

Outlook
- Outlook remains solid, with full year expectations unchanged
- H2 growth in AE engine production, but margins and profits expected to soften from the recent levels
- Reflecting infrastructure and R&D investments to support long-term growth, and non-repeat of 2016 benefits

Power Systems: H1 overview

Rolls-Royce

£m	2016 H1	2017 H1	Underlying change % Actual rates	Constant rates
OE	711	820	+15%	+5%
Services	373	413	+11%	+1%
Underlying revenue	**1,084**	**1,233**	**+14%**	**+3%**
Gross margin	254	319	+26%	+14%
Gross margin %	23.4%	25.9%	+240bps	+250bps
Operating profit	**13**	**66**		
Operating margin %	1.2%	5.4%		

Encouraging start to year, slowly improving market

Power Systems: H1 drivers & outlook

Rolls-Royce

Underlying revenue

- Good OE growth (+5%): growing PowerGen demand for Chinese rapidly expanding telecoms market
- Signs of recovery in several industrial markets including construction and rail; lower half-on-half government and marine activity
- Proactive push on remanufacturing (REMAN) service activity

Gross margin

- Margin improvement from better customer and product mix
- Improved factory utilisation and better overhead recovery from higher sales volumes

Operating margin

- Majority of margin increase from improved trading performance
- Some early signs of transformation savings:
  - streamlined product development lowering R&D by £7m; plus £6m lower C&A costs
- Strong working capital management

Outlook

- Outlook remains cautiously positive
- Solid order book and good order coverage in several key longer cycle markets
- Markets continue to be mixed, with some industrial markets remaining soft
- Mitigated by diverse end market mix
- Q4 key for service revenue growth, as in 2016

Marine: H1 overview

£m	2016 H1	2017 H1	Underlying change % Actual rates	Underlying change % Constant rates
OE	303	268	-12%	-22%
Services	245	256	+4%	-6%
Underlying revenue	**548**	**524**	**-4%**	**-15%**
Gross margin	108	94	-13%	-23%
Gross margin %	19.7%	17.9%	-180bps	-190bps
Operating profit	**(13)**	**(31)**		
Operating margin %	-2.4%	-5.9%		

Tough offshore market, restructuring continuing

Marine: H1 drivers & outlook

Rolls-Royce

Underlying revenue

- Revenue decline reflects lower 2016 OE order intake and ongoing tough offshore market
- Services revenues more stable, but at historic low levels
- Merchant market softer but naval and ship design enjoyed good H1 activity

Gross margin

- Adverse volume, foreign exchange and product mix
- Impact partly offset by cost reduction programmes, particularly for OE

Operating margin

- R&D investment up £6m largely for ship intelligence
- C&A costs £12m lower
- Headcount reductions benefitting both trading margin and overheads

Outlook

- With prevailing markets remaining weak our expectations for the H2 are more cautious
- Transformation and restructuring savings should partially offset market challenges
- Expect the H2 reported loss to be similar to the second half of 2016
- Well-placed when offshore markets eventually start to recover

Nuclear: H1 overview

Rolls-Royce

£m	2016 H1	2017 H1	Underlying change % Actual rates	Underlying change % Constant rates
OE	141	170	+21%	+18%
Services	215	221	+3%	+1%
Underlying revenue	**356**	**391**	**+10%**	**+8%**
Gross margin	51	56	+10%	+6%
Gross margin %	14.3%	14.3%	-	-20bps
Operating profit	**18**	**14**		
Operating margin %	5.1%	3.6%		

Solid performance across both submarine and civil nuclear activities

Nuclear: H1 drivers & outlook

Rolls-Royce

Underlying revenue
- Solid performances across both submarine and civil nuclear activities
- Reflects phasing of activities on long term contracts
- Improved trading across all civil nuclear activities; early work on Hinkley Point projects
- I&C: good progress in France, Finland, China and Canada

Gross margin
- Gross margin unchanged
- Higher volume of submarine activity, focus on operational performance

Operating margin
- No R&D credit in H1
- Investment in small modular reactors (£10m)
- Transformation programmes driving improvements – C&A savings of £3m

Outlook
- Revenues and gross margins expected to be largely unchanged year on year
- Full year profit is expected to be roughly half that of 2016, largely reflecting increase in R&D spend
- Market interest remains positive on our small modular reactor programme
- Long-term outlook unchanged

Agenda

3 Accounting changes

Accounting changes: no effect on cash

Rolls-Royce

IFRS 15 (from 1 Jan 2018)

Civil Aerospace adjustments £m	2015	2016
OE underlying revenue	(888)	(816)
Aftermarket underlying revenue	(208)	(474)
Total underlying revenue	**(1,096)**	**(1,290)**
Underlying operating profit	**(933)**	**(823)**
Transition adjustment: Post-tax balance sheet reserves (£bn)	**(3.2)**	**(3.9)**

2016: rest of group impact <£25m for revenue/operating profit

IFRS 16 (from 1 Jan 2019)

- Operating leases will be brought onto the balance sheet (2016: c. £1bn)
- Similar principles already used by rating agencies

Summary

1 **Clear priorities**

2 **Solid first half**

3 **Much to do in H2**

4 **Outlook unchanged**

Warren East

Chief Executive

Rolls-Royce

Reflections on two years as CEO

Rolls-Royce

Team

‘Operational hardware’

- New, balanced senior leadership team in place
- New structure accentuates Technology alongside Engineering
- 1st round de-layered management and increased accountability
- Direct line of sight of senior team to the businesses

Resilience

- Transformation programme delivering ahead of early ambitions
- Improved transparency and reporting internal & external business drivers
- Major cultural changes following SFO investigation
- Creating more balanced technology portfolio

Pace & Simplicity

‘Operational software’

- Work in progress, still much to do
- Speeding up decision making, removing signatures & meetings
- Changing anecdotes into best practice; islands of excellence emerging

Sustainability

- Sustained investment in future growth
  - Capital investment, R&D and installed base growth
- Rebased dividend for future growth
- Technology : preparing for the future

Priorities for next six months

Rolls-Royce

1	**Financial**	Deliver to expectations
2	**Engineering**	Progress new product introductions
3	**Operational**	On time delivery across all businesses
4	**Aftermarket**	Focus on in-fleet customer support
5	**Vision and technology**	Review by year end

Rolls-Royce

Strengthen our focus on engineering, operational and aftermarket excellence

Deliver good progress on transformation commitments

Rebuild trust and confidence in our long-term growth prospects

Complete strategic update; outline clear goals and priorities for Rolls-Royce

Q&A

Warren East, Chief Executive
Stephen Daintith, Chief Financial Officer

Investor Relations

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For more information: www.rolls-royce.com/investors

Safe harbour statement

This announcement contains certain forward-looking statements. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. In particular, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of interest or exchange rates, the availability of financing to the Company, anticipated cost savings or synergies and the completion of the Company's strategic transactions, are forward-looking statements. By their nature, these statements and forecasts involve risk and uncertainty because they relate to events and depend on circumstances that may or may not occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements and forecasts. The forward-looking statements reflect the knowledge and information available at the date of preparation of this announcement, and will not be updated during the year. Nothing in this announcement should be construed as a profit forecast. All figures are on an underlying basis unless otherwise stated. See note 2 of the Financial Review for definition.