

Rolls-Royce Holdings plc AGM Q&A Summary

12 May 2022

1. Question from Mr Rodney Perry:

I'm very disappointed with the share price at the moment which keeps tumbling. And one of the problems that I foresee, or I anticipate in the future, is that very little was said today about the word reliability. I think reliability of your engines has really suffered in recent years and this causes a drag on the share price as well as profitability. I know you're very good at innovation, I myself am a Chartered Mechanical Engineer and have been an engineer with 40 odd years of business experience. So, I appreciate the problems. But trying to rush things into production maybe a bit in advance of having truly tested the things, has caused problems I think for you in the past. And I'm wondering what you're doing to ensure this doesn't affect our future products?

We have a lot of empathy on share price performance which over the years has been impacted by historic problems such as the SFO investigation, Trent 1000, the COVID-19 pandemic, the Ukraine War and further lockdowns in China. All which progressively had a downward pressure on share price. There is a continuing economic background against which we are all pushing, and many companies have experienced it, not just Rolls-Royce. We are doing what we can to manage the business in these difficult times and there are prospects in the future within the civil business which are encouraging. However, safety is paramount.

On the Trent 1000 engine powering the Dreamliner, we effectively identified nine issues that needed to be addressed with that engine. We have methodically gone through and addressed all those nine issues, and the final issue is actually yet to be certified by the FAA, but that is a delay which is possibly more associated with the backlog of activity that Boeing has to get through the FAA at the moment on a more general basis. We certainly had some very long hard looks at the causes of those nine issues and a lot of the causes of those nine issues had already been addressed by the time they actually emerged in the Trent 1000. That can be evidenced by the very strong record of reliability that we can see in the XWB engines which were designed after the Trent 1000. On the XWB, when you measure it in terms of despatch reliability, air turn-backs, in-flight shutdowns, we are absolutely top of the class with outstanding numbers in terms of reliability there.

But we are not resting on our laurels, and we track [our engines] very carefully. We have people looking for potential problems that haven't actually occurred but might occur. We track and monitor those on an internal basis, both within the Civil Aerospace business and at a Group level, through both regular monthly business reviews and monthly engineering reviews together with safety boards that we have across our business.

These matters are further reviewed by the Chair of the Safety, Ethics & Sustainability Committee. We encourage every Board member to attend that, so we do take a great interest in the oversight of safety at Board level. Earlier this week, the Committee reviewed all the red tops in our Civil Aerospace business and the rate of closure there.

2. Question from Mr Roy Turner:

I have complained previously about what Rolls-Royce was doing with its pension fund. The first thing I'd like to put up is why people aren't proud to work for Rolls-Royce anymore. Now this refers to the pension fund in particular and I appreciate you can say it's done by the trustees. But you appoint the trustees, and if the trustees were failing in their duty what's your responsibility? Should you just accept it and walk away.

The trustees in these repeated cases have salami-sliced the pensions so that they are now 33% below the pensions paid when they retired. Just bear that in mind - if you cut salaries by 33% how would you feel? But you've taken the oldest, least capable and vulnerable people and cut their pensions by 33%. Now again you can put up the defence, this is the trustees, but Rolls-Royce controls the trustees and every time I say 'why don't you do this?', the trustees say that it needs Rolls-Royce approval. It is a Rolls-Royce responsibility.

The funding for this was already there, with the previous trustees - my pension was built up over 30 years' service. Each year the directors place money in trust in a pension fund to pay for these future discretionary increases. And in 1997, discretionary increases ceased because it became mandatory. On that date, the pension fund trustees and the actuary said that they were 82% funded in advance.

The Company agreed it would pay a further £30m a year to make sure they were 100% funded in advance. This is money that was held in fund and yet Rolls-Royce turned round to say 'we're not approving an increase'.

On page 174 of the Annual Report, in a footnote to the table, it refers to the post-retirement benefits for UK defined benefits schemes - which this is. It says there are surplus assets of £1,118m, £1.1bn surplus and the Company is saying the surplus is recognised on the ultimate wind-up of the scheme when there are no remaining members. And it's claimed as a Company asset.

I believe the Pension Fund Trustee Board has been rigged. They are supposed to be trustees that are elected by the members. The rules for the pension fund say that a selection panel would carry out the selection of all the member trustees. Members do not have a vote in selecting trustees. And that is totally illegal. Any pension fund trustee, for the members, is supposed to be selected by the members, not by a selection panel consisting of the Chairman appointed by Rolls-Royce, the NCN Chair, the secretary to the trustees, who is a Rolls-Royce employee. There's nobody on there who represents the members.

You have quoted a number of statistics about the funding position of the pension fund from many years ago. As we know, surpluses can go up or down depending on changes in market conditions and how the actuaries view longevity. We paid £415m into the UK scheme during the three years from 2018 to 2020. However, we cannot sensibly address the points you have raised about the period from 2006 to 2010 and who had the discretion to do what at that time. Although, we would note that 50% of the current Trustees are either union-nominated or member-nominated. We do not have the facts regarding the situation in 2006 to 2010 here today.

We understand that you have raised these complaints in the past. They have also been reviewed by the Pensions Ombudsman and the Regulator, and so some of these are not open matters. We understand you are very passionate about them, but we have tried to respond, in previous meetings, on them. Mark Gregory, General Counsel, will speak with you following the meeting. However, to make clear, from our perspective there is absolutely no illegality going on. We are acting in accordance with the rules and overriding legislation.

3. Question from an unidentified shareholder:

I am a long-term shareholder in the company and am pleased to tell you with reference to the first question that I have just completed a very punctual and trouble-free return trip to Singapore on the Trent 1000 Dreamliner. I am also well aware of the peaks and troughs of the world in which the Company operates, but I was, with many others I suspect, always rather unhappy with the decision to abdicate from the short-haul market, which many might regard as entry level. Your statement, therefore, in the Annual Report that we now have, or will have, an opportunity to re-enter this apparently thriving arena is very welcome. After an arid few years, are you prepared to give an indication of when this might occur, or is it always to be jam tomorrow?

We have a lot of respect for people who made decisions prior to our appointments, such as the decision to leave the narrow-body market. The single-aisle market is an attractive market. Volumes are significantly greater than the long-haul market and therefore there are economies of scale. Although we would be delighted to enter the short-haul market, we don't have the industrial capacity, and so that probably would be done in partnership with another entity.

The challenge we have is that there are no opportunities at the moment to enter. We have some great technology; our new UltraFan technology we know will scale and we know we can do a better job than the incumbents, from a technical and performance point of view. However, unless one of the two key airframers is up for re-engineering one of their platforms, there is simply no opportunity for a new engine to be introduced. What we do not want to do is waste everybody's money creating some sort of wonderful engine that sits on the ground with no airframe to attach it to.

Both airframers are well aware of our technology, but the decision that they have to make, to re-engine or not, is a decision for them to make. We make them fully aware of the economic benefits that could be passed on to their airline customers through use of our technology, but they have to make the decisions around their business case. As soon as they're ready to go, we are ready to go. Therefore, we are looking for other growth opportunities, perhaps in slightly smaller sectors, where there are more current opportunities in order to grow our business.

4. Question from Climate Action 100+:

What specific objectives does the Company seek, and what principal actions will it take to reduce actual emissions from product use beyond the capability of products with net zero goals, in particular, from the Civil Aerospace business?

Will the Company set interim medium-term objectives related to Material Scope 3 emissions?

How will product-related capital allocation be aligned with the goals of net zero and low carbon solutions whilst balancing risk and reward across the portfolio?

Thank you to Climate Action 100+ for your questions and to Mr Andy Jones who has submitted these relevant questions on their behalf+. We really appreciate our engagement with you. We have put being a net zero carbon company at the heart of our strategy. So, our aim is to be net zero across the value chain by 2050 and to set targets to ensure that all our new products will be compatible with net zero by 2030 and that our operations will be compatible with those targets by 2030.

In response to the first question, to decarbonise our product range and the fleet, we have to really take action across three main areas; the first one is pioneering new, low and zero carbon technologies and the sustainable solutions around those. The second area is accelerating the availability and the affordability of sustainable aviation fuels, commonly known as SAFs. The third area is continuing to improve the efficiency of our engines, particularly those under development.

For Civil Aerospace, we operate in a very highly regulated environment, and that, in some ways, does restrict our influence over how some of our products are used, for example, whether traditional aviation fuel is used or whether sustainable aviation fuels are used in our products. However, we are taking a large number of actions, actually, to reduce our emissions from product use in the future such as:

Product development - a very exciting new development called the UltraFan engine. This is a new architecture that delivers a real step change in engine fuel efficiency. That demonstrator will be tested here, in Derby, later this year. Its first test run will be on 100% sustainable aviation fuels, SAF. Designing and developing new electric prototypes for commuter aircraft and for regional flights. We have recently successfully tested two 500Kw prototypes to serve this emerging commuter market in electrification of flight.

Service offers, and this is introducing and scaling new options that prioritise emission reductions for our customers and helping them reduce their emissions. We are working in partnership with the industry to advocate the increased use of sustainable fuels and we have recently launched the Global SAF Declaration at the Singapore Air Show. We have not done this by ourselves, we have done this with other key influencers in the sectors, partners, such as Airbus, Safran and Singapore Airlines. We are hoping that will grow to increase the influence of sustainable fuels across the sector.

Increasing our R&D investment in low and net zero carbon technologies, such as electrification of flight. We are pivoting the level of spend of our R&D budget - which is about c.£1.2bn to £1.4bn every year and we are pivoting from about 50% spend on zero and low carbon technologies to 75% of our spend on those technologies.

In response to the second question, we are in the process of setting science-based targets for the Group to reduce Scope 1 and 2 emissions and also our Material Scope 3 emissions, and this will include emissions associated with the use of our products in the marketplace and our purchased goods and services. Under the science-based targets, we will be looking to set both long-term measures out to 2050, and medium interim measures out to 2030. Our Power Systems business is already established interim targets out to 2030 because their product development cycle is a shorter wavelength than for Civil Aviation, for example. Their target, by 2030, is to reduce emissions by 35% by 2030.

In response to the third question, during 2021 we completely updated our approach to analysing investment cases in the Company so that we could place a much greater focus on sustainability, particularly carbon emissions. When we look at investment cases, we look at four primary factors; the first one, you would expect, is returns. The second one, you would also expect, and that's risk. The third one is carbon, carbon emissions. The final one is impact on our transition to net zero and the transition to net zero in the world. We also look at wider sustainability factors, such as impact on the community, safety, which is critical, and employee considerations. All the projects that we invest in must demonstrate alignment with all these criteria.

5. Question from Mr Charles Cuddington:

One of the things which I would like to raise again is the focus on the difference between technology and engineering. I was pleased to hear in your speech, Chair, that you refer to the engineering excellence of the Company. This is true. And I was also pleased that Warren East referred to the fact, on the new electrical equipment, that one of the issues that Rolls-Royce can bring to the table is the integration and certification of it. These are key aspects.

And, when it comes to the Civil Aerospace products, and I'm afraid I'm a civil aerospace man - and it's relevant to the point the gentleman made earlier - the technology, yes, is important, well, essential one might say, but it is not the only necessary thing. The thing that puts Rolls-Royce and GE and Pratt & Whitney apart from many other companies in the world that have good aerospace technology is the ability to engineer that technology into a competitive, certifiable, reliable product.

And, over recent years, I have been concerned that the focus on the engineering function within Rolls-Royce has diminished. And you do that at your peril, I think. And, not that I'm trying to produce a parallel here, but one of the actions that Boeing have taken as a result of the disaster that they had with the 737 MAX, and there were several issues in there, not just this, but one of the issues they've taken is to strengthen the focus of the engineering function to give much more leadership from an engineering point of view as opposed to a technology point of view. And that distinction is important, and I hope that the Company will take that on board for the future. Thank you.

Engineering is still very much at the heart of Rolls-Royce and not just within Civil Aerospace. We view the technology piece as, sort of, additive to the engineering. One of the ways that we make money out of good technology is by sound engineering that turns that into a reliable product and delivers value.

We understand that we no longer have a Group Chief Engineer on our Executive Team nor a Group Chief Engineer on the Board. However, we have strengthened the Board in terms of engineering with the appointment of people such as Paul Adams.

Chris Young, as Group Chief Engineer, reporting into Grazia Vittadini, our Chief Technology Officer, has all the assets he would be expected to have, including a direct reporting line to the Chief Executive, if he is concerned in any way about safety or reliability or anything associated.

Chris has been strengthening the profile of engineering within the Company under his tenure. It is more to do with individuals in the role rather than where the role happens to sit in an organisation chart. We would encourage you to use your connections and speak with Chris directly.

Turning back to Paul Adams, Paul has spent many years in the aerospace industry and, at the conclusion of this meeting, Paul will chair the Science & Technology Committee. During 2021, there have been several deep dives on the quality of engineering, engineering spend or resource at the Science & Technology Committee, which is a committee of the Board. Therefore, the Science & Technology Committee is taking a serious look at both engineering capability and science and technology. In addition, we are looking at the technology portfolio which could be improved and is a key focus of the Committee

We have great people and we have great engineers and it is upon us to help develop the next generation of engineers who can build the next generation of great products. That starts with getting people who have the right combination of domain expertise and then cross-functional

excellence and developing the people who would understand how the products work and know how to architect the next generation of engines. We are putting a lot of emphasis on that with the Committee, and we are working with the organisation to do that. As we go forward on the actual technologies, we need to focus on getting them over the line where they are no longer just a lab technology but something that is a robust commercial product that gives us differentiated products in the marketplace.

6. Question from Mr Paul D'Amico:

Why did you, Rolls-Royce, on 15 March 2022, authorise Rolls-Royce Canada Management to lock out its 530 technicians and then withhold their annual bonus?

In doing so, you stopped the production of the Montreal plant and angered its employees. Aren't you putting at risk the three pillars at the base of all viable companies: workers, customers and shareholders? Are you putting at risk a high capital cost plant, a 75-year-old relationship and jeopardise our Montreal team quoted to be the best in the network in 2016? A lock out affects customers and profitability. It could damage the Group's reputation, employee relations and ability to attract future personnel, any of which could have a material adverse effect on the Group's business, financial condition, results of operations and prospects. Don't you believe that you have to provide the conditions to attract and retain the best workforce?

Could you tell us what you did to avoid this conflict and what you will do to fix it?

We have to consider a sustainable business in all senses of the word, and that includes sustainable from a business point of view. Therefore, things which are uncompetitive need to be addressed. That is really the root of the removal of the defined benefit pension scheme, which was the catalyst for the dispute which we currently have. It has been a regrettable action, regrettable dispute. The Union has been a little bit aggressive such as showing up with six buses full of people to the home of our local manager which is not acceptable.

We know that, together, we need to move on and find a solution to this, and so we are pleased that we are now in the process of mediation, and we expect to find a solution in the next several weeks.

7. Question from Mr Donald Whittaker:

I just want to ask the Board, are they aware that this new method of holding shares makes it much more difficult for the Company to communicate with shareholders? They want you to hold them electronically via the stockbrokers and you don't have a say then. They receive all the reports. And I couldn't have attended this meeting if I'd have gone ahead with that and reversed my decision. Thank you.

The intent is not to make it more difficult for our shareholders. There are ways in which we can help and we will talk to you after the meeting to ensure you have the right level of support.

8. Question from Mrs Caroline Roberts-Hemmings:

Can you please provide an update on the financial impact of Brexit on the Company's results?

Brexit affects the economy in so many different ways, and it is very difficult to disaggregate that from what is happening in other aspects of the world. During Brexit, people expected that the value of the pound would fall and that they expected that this might slow down GDP. We have probably had both but whether it is due to Brexit or whether it is the effects of the pandemic is very, very difficult to tell.

We are now in an environment of inflation and we would conclude that that is not just down to Brexit, that it is actually due to global events, and so we think most of the economic issues and the economic environment that the Company is facing is due to the effects of the pandemic, to effects like the shock of the Ukraine War, the effect on the oil price, and inflationary pressures around the world.

It is very difficult to disentangle and some of the other challenges that we face make some of the issues that we anticipated with Brexit a little bit insignificant, for instance the amount of buffer inventory that we propose to hold to deal with moving goods across the border. We are holding inventory now for other reasons and at much higher levels.

We are pleased with how, at a practical level, some of the fears we voiced in 2016 have been dealt with such as engine certification and transferring certain job functions into an EU country to enable us to deal with that. It has actually worked very smoothly, and so we can be pleased with that.

A couple of weeks ago, Warren East attended a meeting of the ASD, where the European aerospace and defence industry get together with leaders from the major companies. The sentiment was entirely different from the political sentiment in Brussels around, sort of, 'UK out, we now want to be EU'. The ASD is talking about European companies rather than EU companies.

Therefore, all the benefits that we have in terms of collaborating on R&D programmes with our peers in Europe, we can continue to do, both from a practical level, by moving goods into an EU jurisdiction and working together because, simply, that's what the European rather than the EU aerospace sector wants to do.

9. Question from Mr Brian Coleman:

I have two very short questions. What you will enjoy is that I know the answer to them. It's relevant to an earlier question. I joined the company in the early '70s, I was an employee for 30 years, I've been a pensioner for nearly 20 years, and I asked myself the question – Am I satisfied with the pension scheme, the way it was handled and the way in which Legal & General deal with it? – and I'll answer that for you in a minute.

The second part of the question is, having been with Rolls-Royce for all that time, am I proud to have been part of Rolls-Royce and am I still proud to be part of Rolls-Royce even though I'm a pensioner? The answer to both of those is yes.

I'm also in touch with over 100 pensioners from the area in which I live, and I can't really answer for them, but I suspect they would share that view.

Thank you, Mr Coleman.