Rolls-Royce

2015 Full Year Results

John Dawson

Director, Investor Relations

Rolls-Royce

Agenda for today

Introductions	John Dawson
2015 highlights	Warren East
Financial review	David Smith
Strategic priorities and conclusion	Warren East

Notices

Safety

Safe Harbour

Mobile phones

Warren East

Chief Executive

Rolls-Royce

Headline results

Rolls-Royce

Underlying Revenue

£13.4bn

↓ 1%

Gross Margin

£3,182m

↓ 10%

Underlying Profit

£1,432m

↓ 12%

Operating margin

11.2%

↓ 130 bps

Free cash flow

£179m

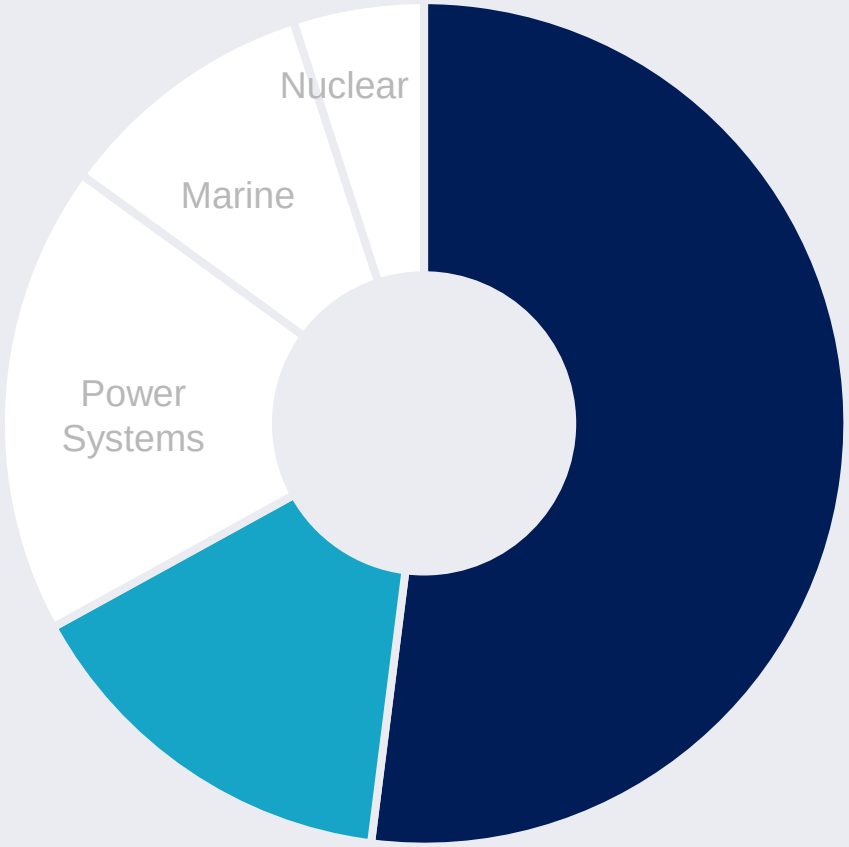
2014: £447m

'Dividend' per share

7.1p

2014: 14.1p

2015 highlights



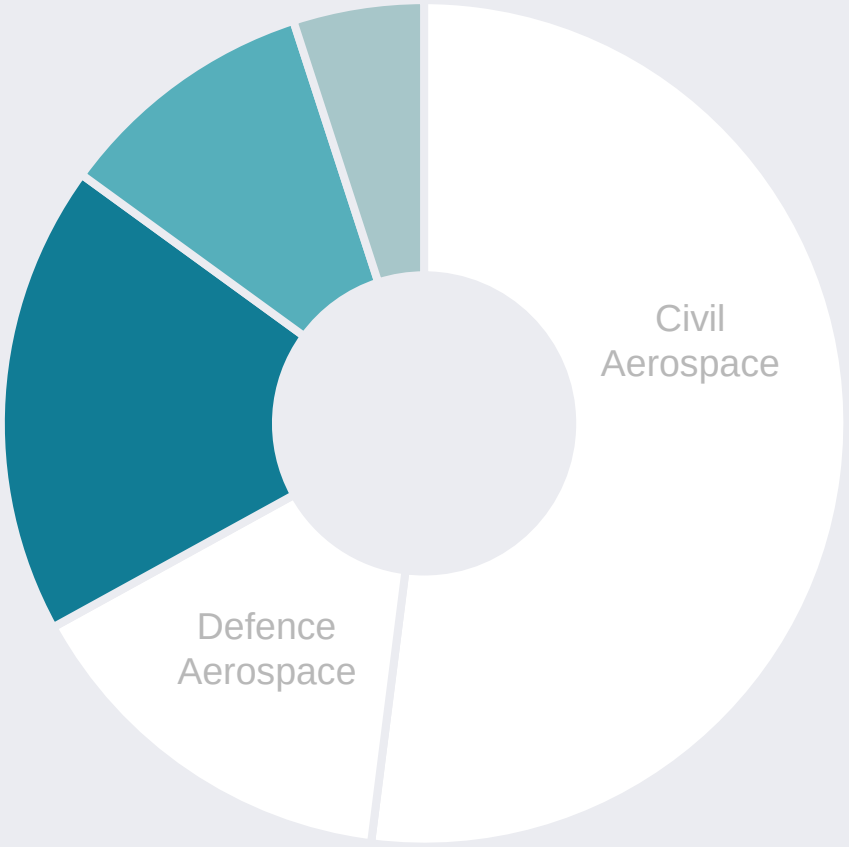
CIVIL AEROSPACE

- Production readiness for Trent XWB programme
- Trent 1000 TEN performance on test
- Strong order book growth
  - T900 for Emirates
  - HNA Group

DEFENCE AEROSPACE

- Good profit performance driven by long-term cost reductions

2015 highlights



POWER SYSTEMS

- Resilience despite challenging market conditions

MARINE

- Swift action on costs and restructuring for future competitiveness

NUCLEAR

- Steady performance despite delivery challenges

GROUP-WIDE

- Strength of contributions to the operating review
- Robust cash performance
- Refinancing initiatives

Reflections on issues emerging in 2015

Rolls-Royce

Consequences of Civil Aerospace market developments

Speed and complexity of decision making

Business integration

High fixed cost base and volume sensitivity

TotalCare accounting complexity

Personal goals for 2015

Rolls-Royce

Undertake thorough review of operations

Identify the clear areas for business improvement

Keep focus on delivering profitable growth

Improved disclosure and transparency

Set clear priorities for 2016 onwards

David Smith

Chief Financial Officer

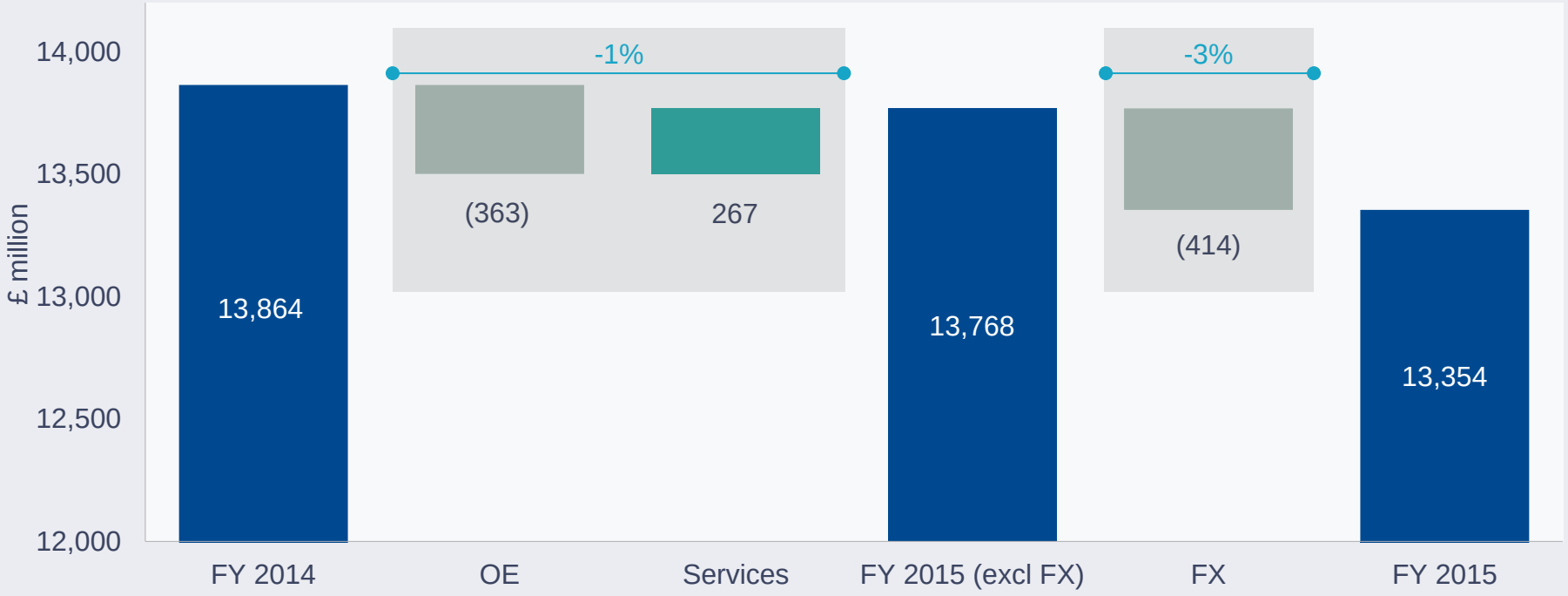
Rolls-Royce

Group highlights of 2015 performance

	2014	2015
Order book	£73.7bn	£76.4bn
Revenue	£13,864m	£13,354m
Profit before tax	£1,620m	£1,432m
Return on sales	12.1%	11.2%
Free cash flow	£447m	£179m
Earnings per share	65.4p	58.7p
Payment to Shareholders	23.1p	16.4p

All figures exclude the Energy business sold to Siemens in 2014

Group revenue 2014 v 2015



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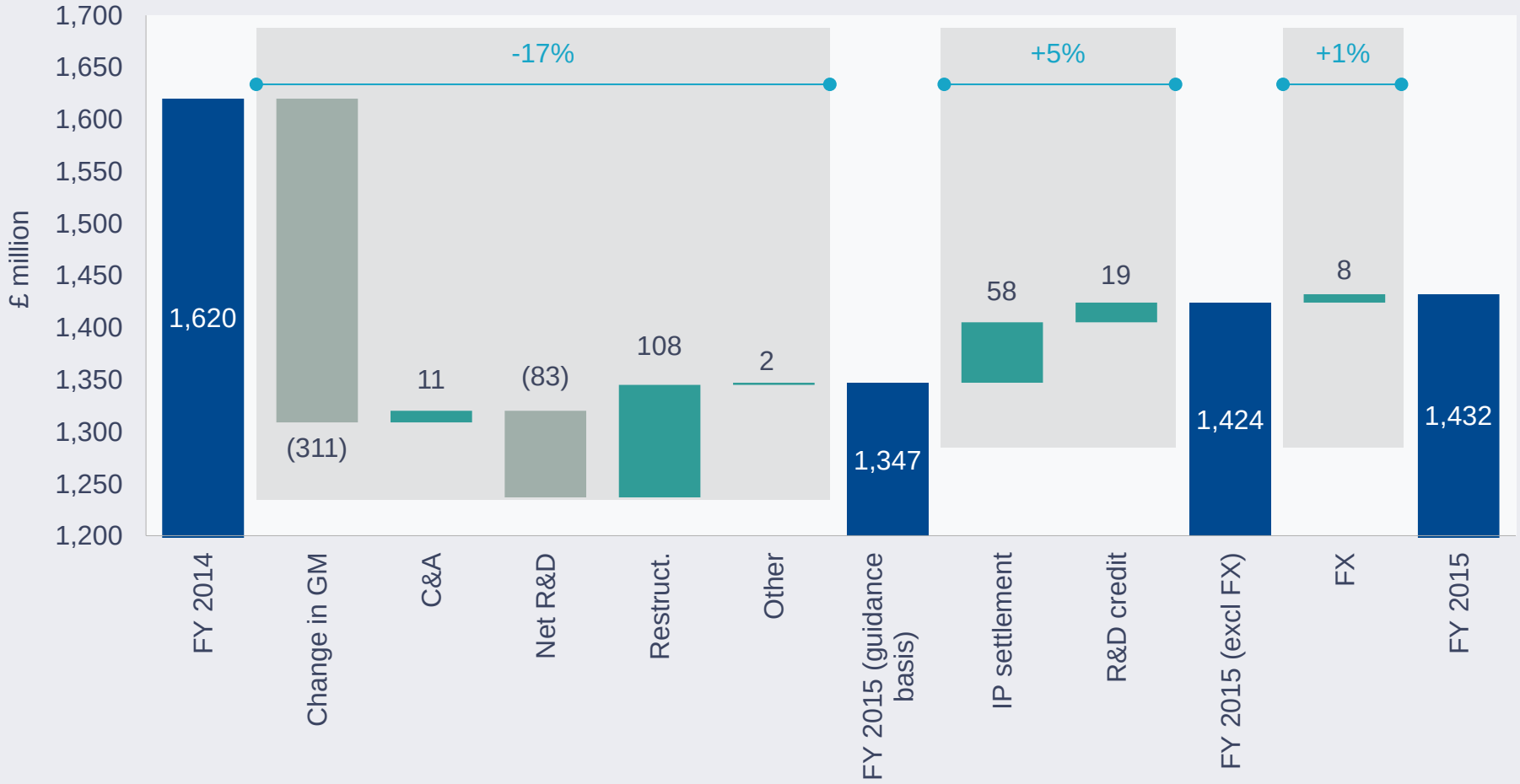
Group profit before tax 2014 v 2015



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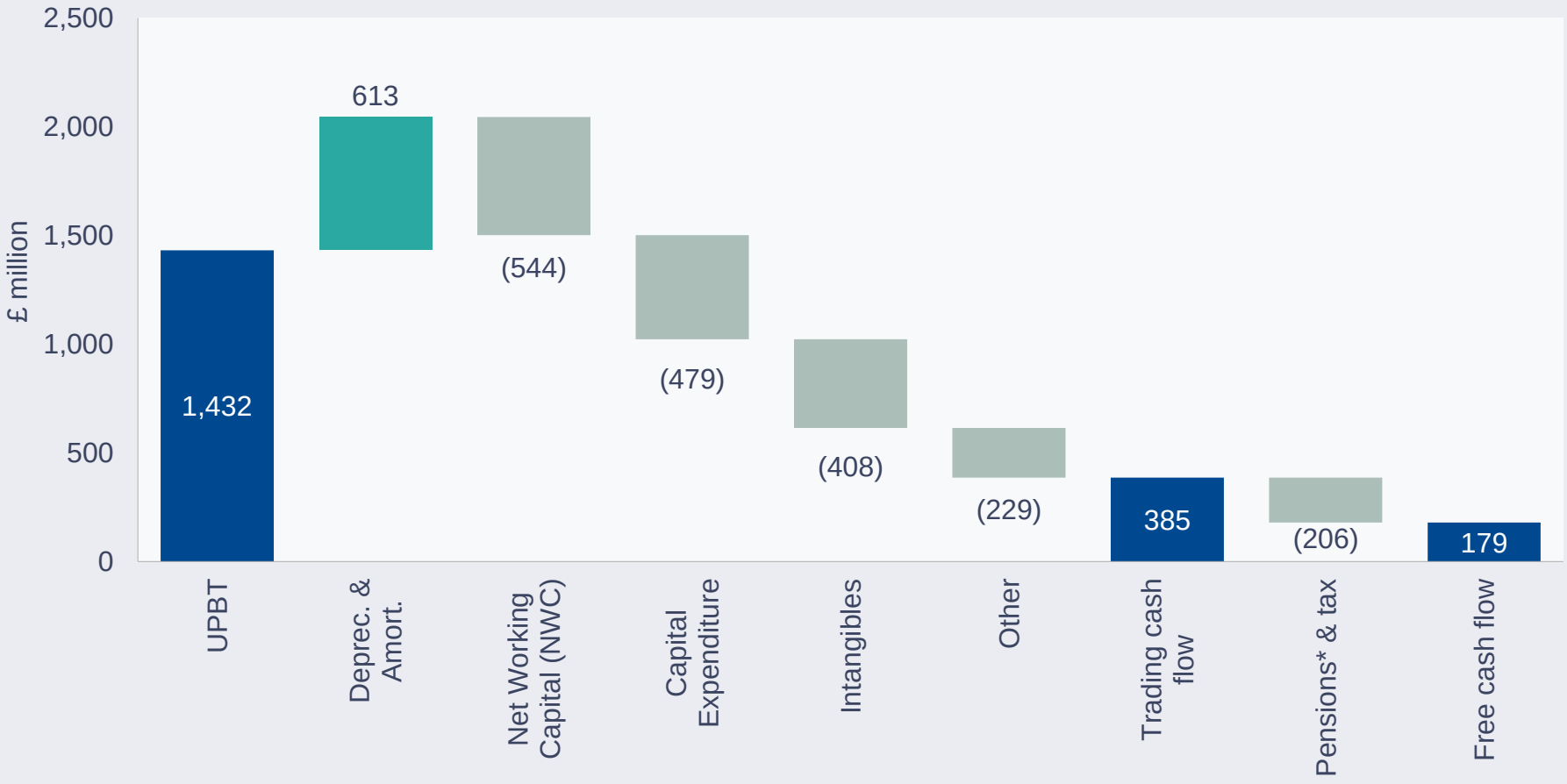
Group profit 2015 v free cash flow

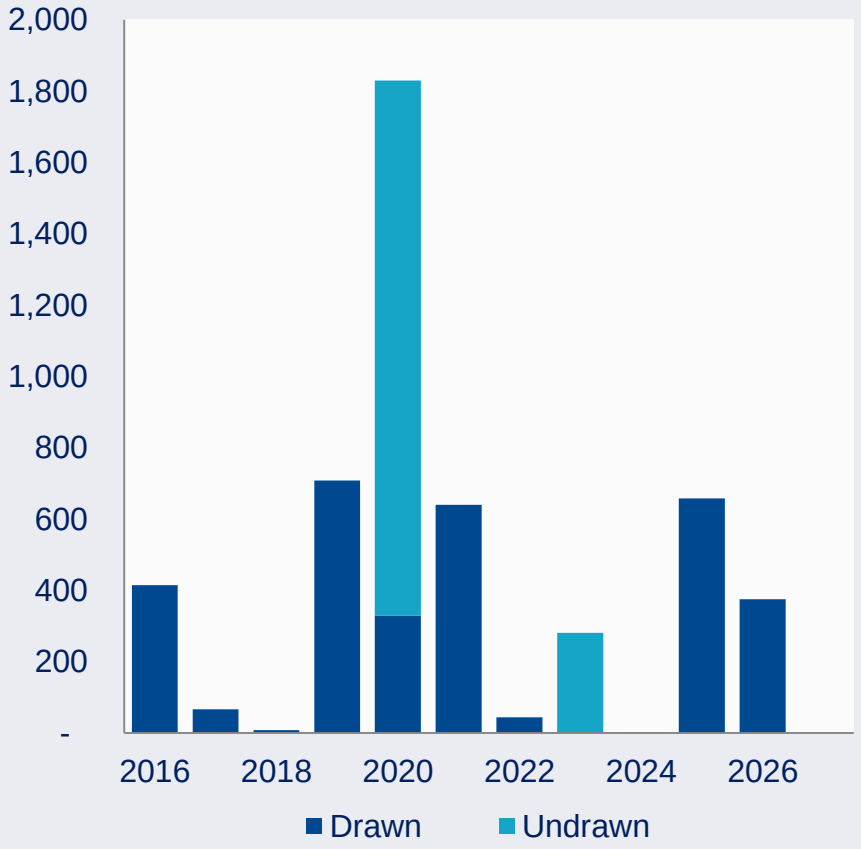


* Payments to defined benefit post-retirement schemes in excess of PBT charge

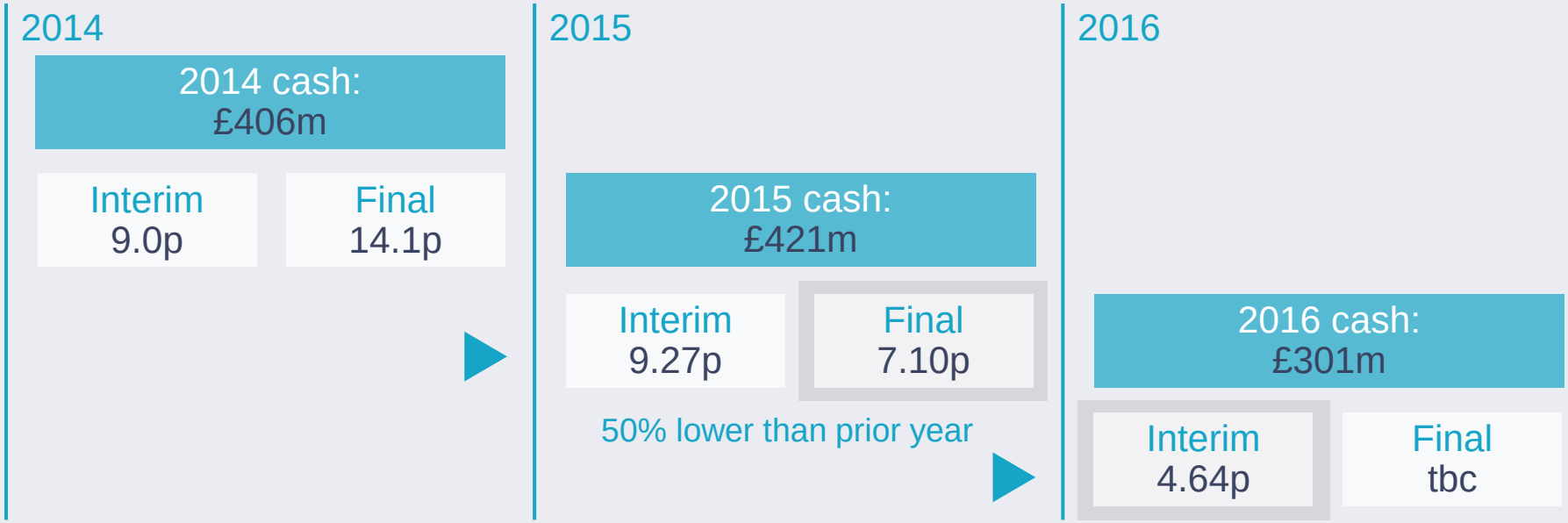
Group financial strength

Credit rating	S&P: A/Negative Moody's: A3/Stable Maintain investment-grade rating
Strong liquidity	Total liquidity £5 billion
Debt maturities	Spread to 2026 Maturities: • 2016 - £200m bond & €125m EIB loan • 2017 – €75m EIB loan
Risk management	Foreign exchange and commodity hedging

Maturity profile (£ million)



Shareholder payment



"We recognise the importance of a healthy 'dividend' to our shareholders. Subject to short-term cash needs, we intend to review the payment so that it will be rebuilt over time to an appropriate level. This reflects the Board's long-standing confidence in the strong future cash generation of the business."

Foreign exchange: transactional

GBPUSD: $29 billion hedge book provides ~5 years' cover

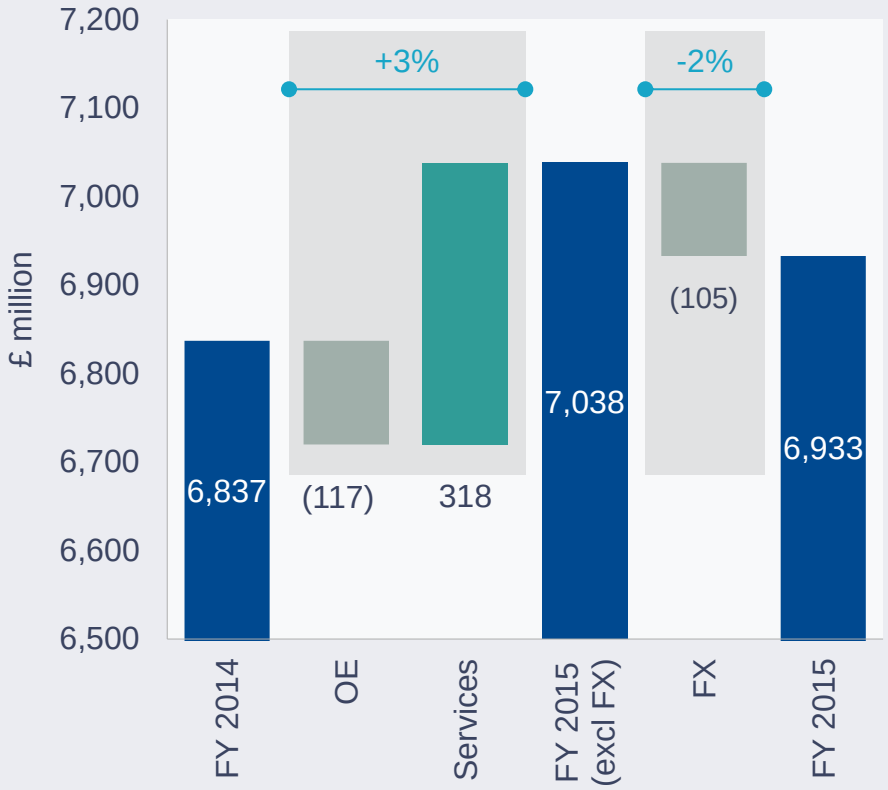
- Hedge book average rate is $/£1.59

EURUSD: $3 billion hedge book; €/$1.35 ~3 years' cover

Objectives of FX hedging policy

- Reduce volatility caused by FX movements
- Set maximum and minimum levels of FX cover
- Manage changes in forecast exposures

Civil Aerospace revenue



Drivers

- Growth in aftermarket revenues offset lower OE sales
- Maintained level of widebody deliveries
- Weaker corporate / V2500 volumes

Civil Aerospace
original equipment (OE) revenue mix

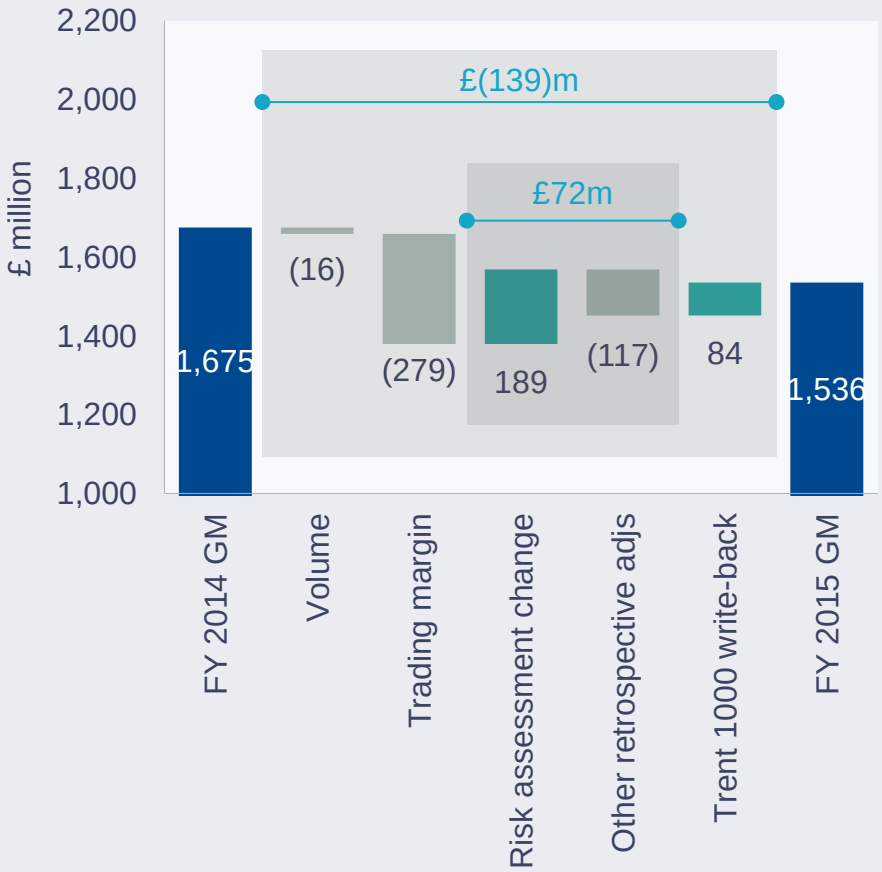
Rolls-Royce

	2014		Change at constant FX	yr-on-yr change	FX	2015	
	£m	of whole	£m		£m	£m	of whole
OE	**3,463**	**51%**	**(117)**	**(3)%**	**(88)**	**3,258**	**48%**
Large Engine: linked and other	1,766	26%	(191)	(11)%	(5)	1,570	23%
Large Engine: unlinked installed	392	6%	114	29%	(2)	504	7%
Corporate	974	14%	(9)	(1)%	(62)	903	14%
V2500	331	5%	(31)	(9)%	(19)	281	4%

Civil Aerospace aftermarket (AM) revenue mix

	2014		Change at constant FX		FX	2015	
	£m	of whole	£m	yr-on-yr change	£m	£m	of whole
AM	**3,374**	**49%**	**318**	**9%**	**(17)**	**3,675**	**52%**
Large Engine	2,029	30%	336	17%	6	2,371	34%
Corporate	383	6%	50	13%	(8)	425	6%
Regional	427	6%	(61)	(14)%	(6)	360	5%
V2500	535	7%	(7)	(1)%	(9)	519	7%

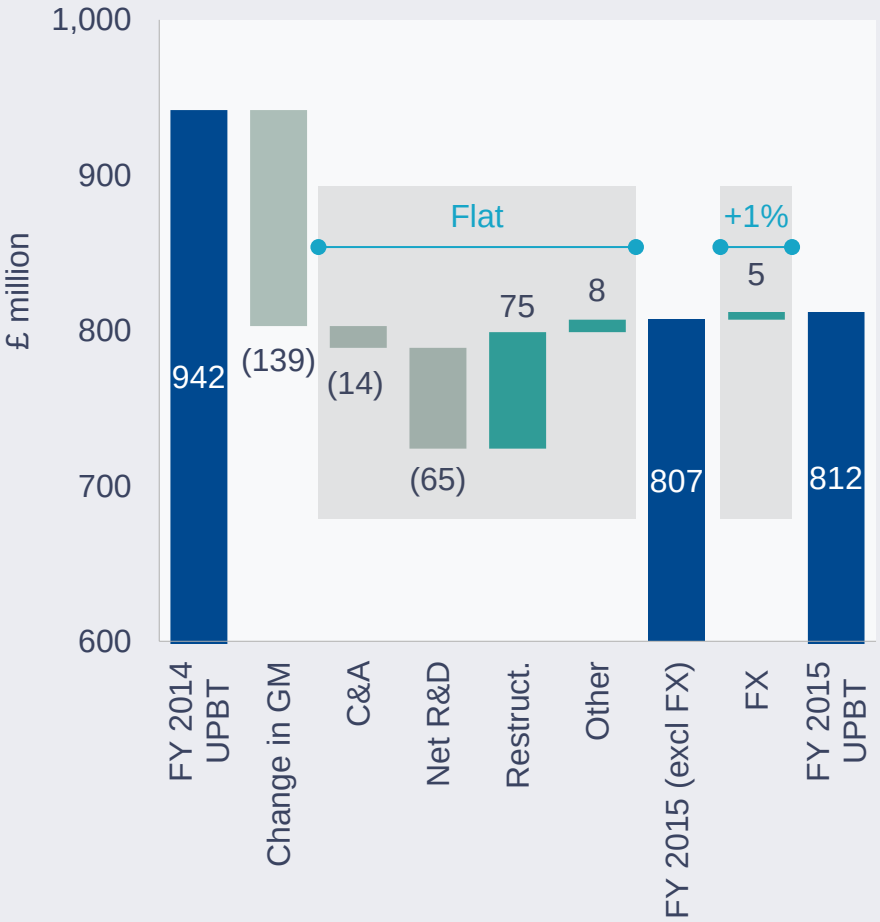
Civil Aerospace gross margin



Drivers

- Lower proportion of linked Trent 700 engines
- Contract risk assessment methodology refined, plus lifecycle cost improvements
- Trent 1000: reversal of CARs impairment and release of provision

Civil Aerospace profit



Drivers

- Lower overall gross margins
- Higher net R&D costs
- XWB 84k entering service impacts R&D capitalisation and amortisation
- Reduced restructuring costs

Civil Aerospace trading cash flow

£m	2014	2015	Variance
Underlying profit before financing	**942**	**812**	**(130)**
Depreciation, amortisation and impairment	381	410	29
Sub-total	**1,323**	**1,222**	**(101)**
CARs additions	(86)	(161)	(75)
Property, plant, equipment and other intangibles	(748)	(502)	246
Other timing differences*	(53)	(75)	(22)
Trading cash flow pre-working capital movements	**436**	**484**	**48**
Net long-term contract debtor movements	(463)	(406)	57
Other working capital movements	208	(78)	(286)
Trading cash flow**	**181**	**0**	**(181)**

* 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

Civil Aerospace revenue outlook

£m	2015	2016
Original Equipment	**3,258**	→
Large engine: linked and other	1,570	→
Large engine: unlinked installed	504	→
Corporate	903	→
V2500	281	→
Aftermarket*	**3,486**	→
Large engine*	2,182	→
Corporate	425	→
Regional	360	→
V2500	519	→
Total Revenue*	**6,744**	

* Adjusted for £189m methodology change

Civil Aerospace 2016 headwinds

- Trent 700 volume and price reductions
- Disappointing market outlook for corporate jets and regional aftermarket
- Rolls-Royce particularly impacted by specific exposures
  - 50-70 seat regional jets
  - Large corporate jets
  - Legacy RB211/Trent utilisation

	£m
Trent 700	~250
Large engine aftermarket	~50-80
Large engine other	~50-70
Corporate jets	~75
Regional jets	~75
Total headwinds	**~550**

Civil Aerospace trading cash flow outlook

Rolls-Royce

£m	2015	2016
Underlying profit before financing	**812**	→
Depreciation, amortisation and impairment	410	→
Sub-total	**1,222**	→
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Property, plant, equipment and other intangibles	(502)	→
Other timing differences*	(75)	→
Trading cash flow pre-working capital movements	**484**	→
Net long-term contract debtor movements	(406)	→
Other working capital movements	(78)	→ (i.e. favourable variance to PY)
Trading cash flow**	**0**	→

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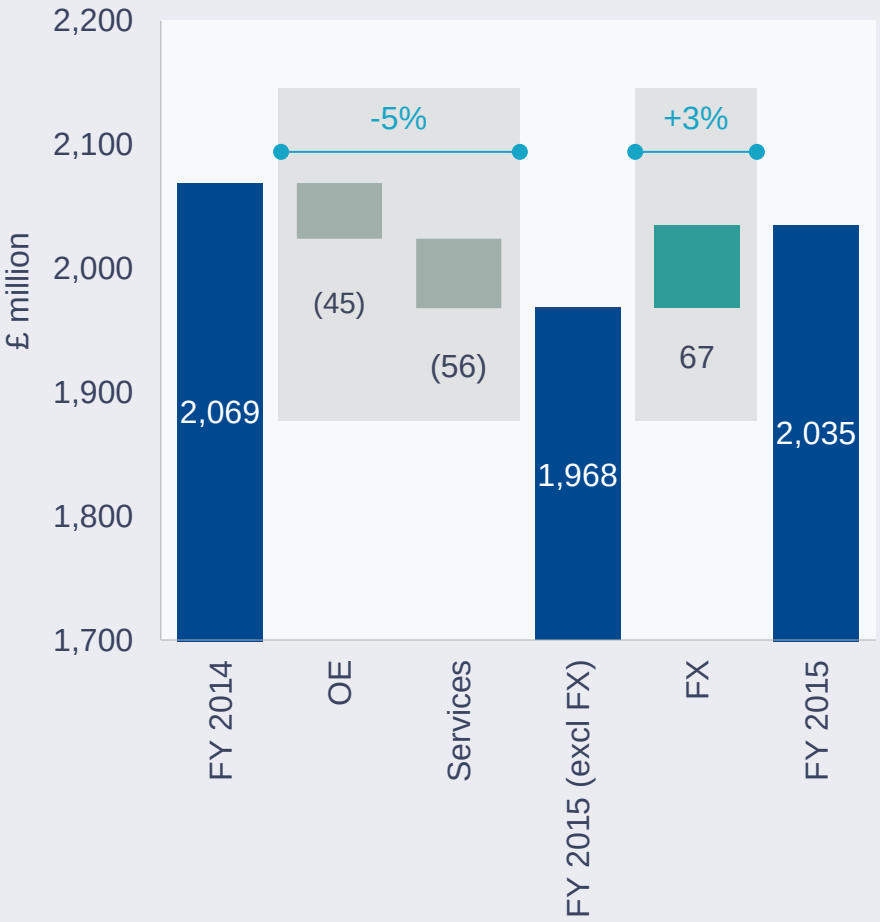
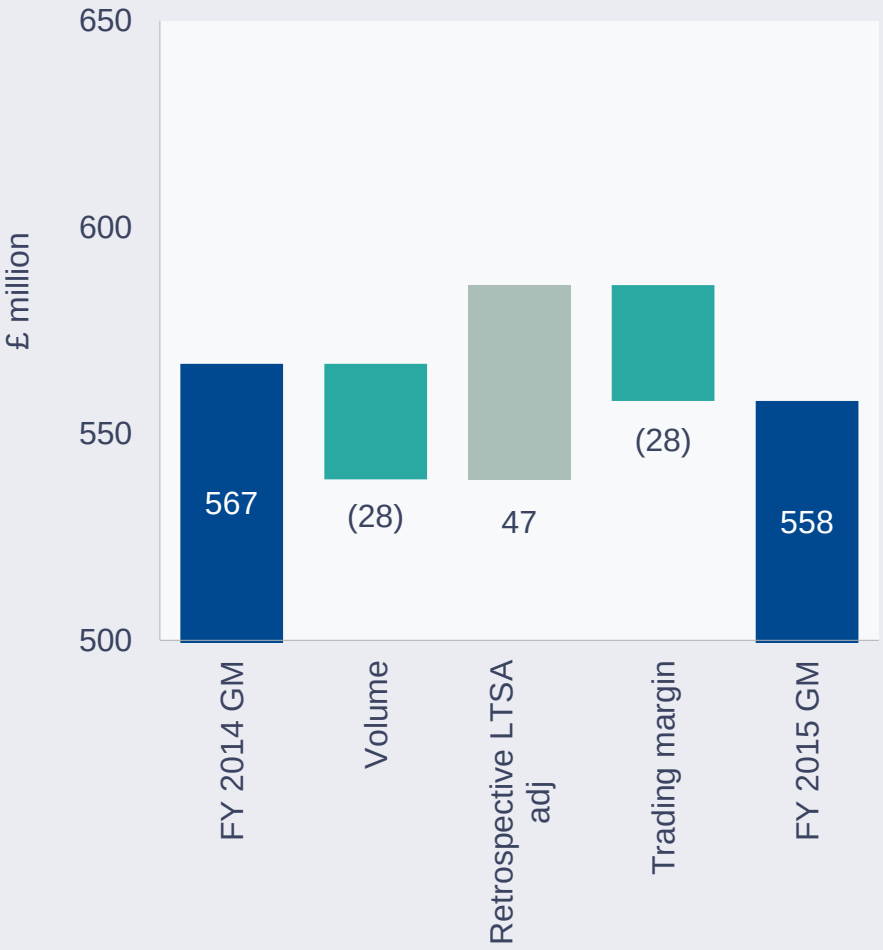
Defence Aerospace revenue



Drivers

- Lower original equipment volumes for helicopters and trainers
- Lower volumes on helicopter and spares
- Offset by higher revenues related to long term service agreements for combat aircraft

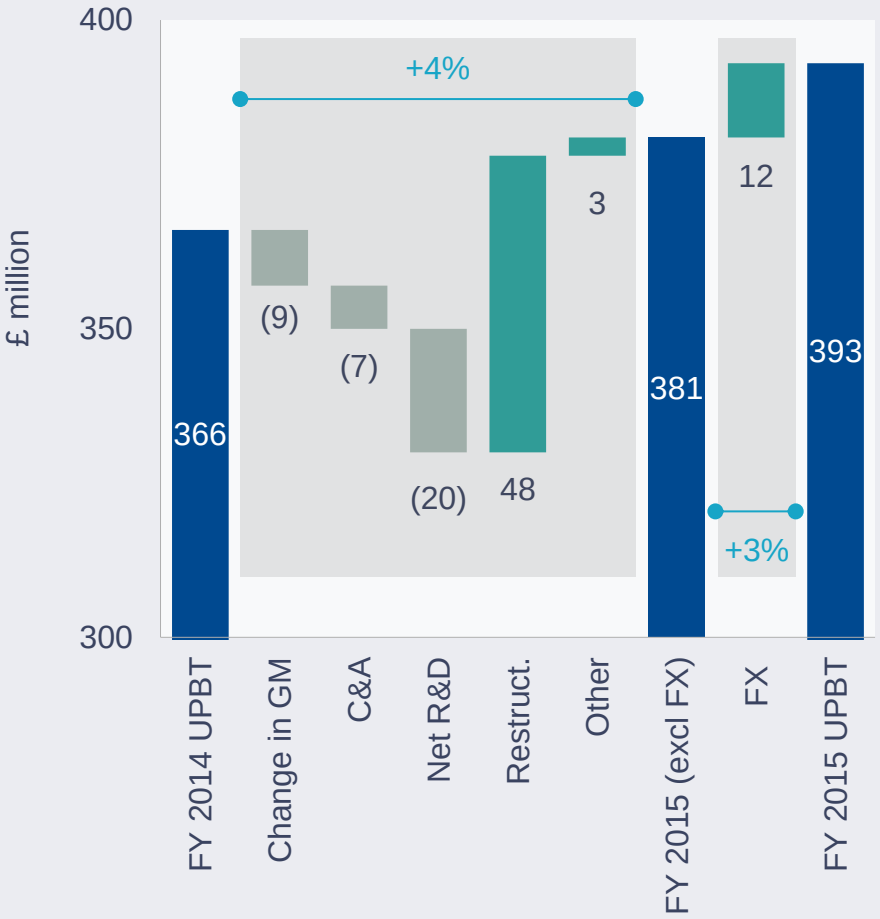
Defence Aerospace gross margin



Drivers

- Higher one-off margin improvements around existing long term service agreements (LTSA)
  - Changed flying patterns
  - Improved cost on combat platforms
- Adverse margin on transport contracts

Defence Aerospace profit



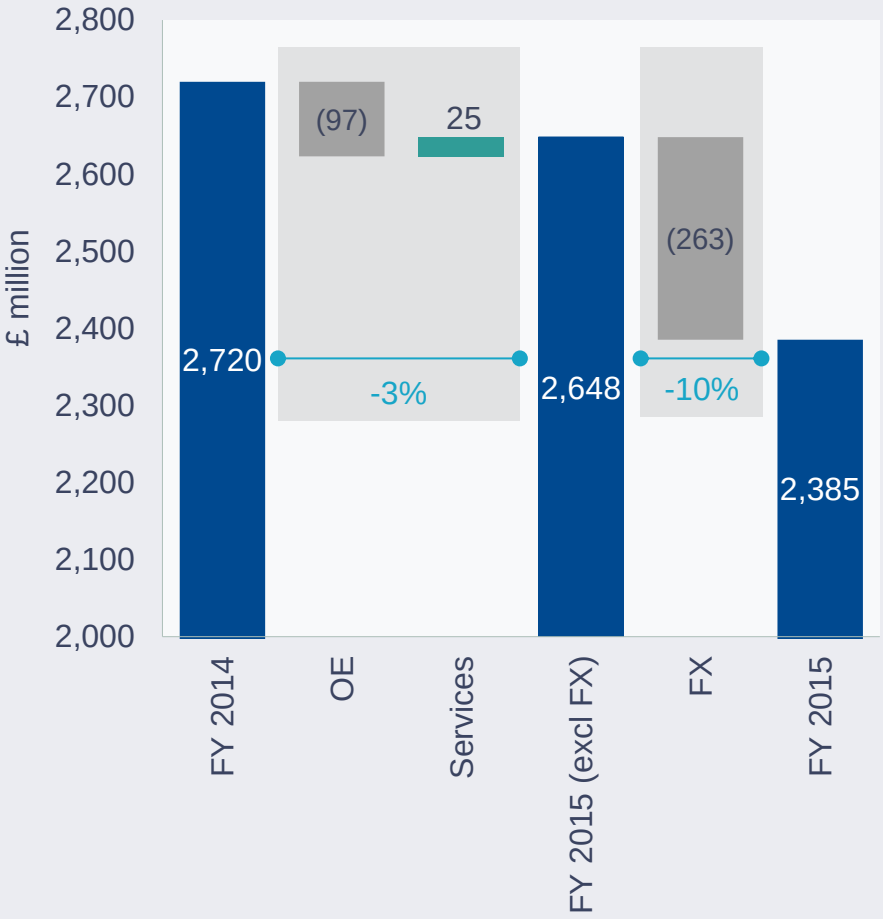
Drivers

- Increased R&D on next-gen technology
- Lower restructuring costs after major 2014 downsizing

Defence Aerospace outlook

- Positive long term outlook
  - Strong incumbent position
  - Growth in development for availability based contracts
  - Increase in R&D
  - Operational restructuring
- Continued pricing pressure on extended service contracts
- Lower near-term free cash flow but strong long-term outlook

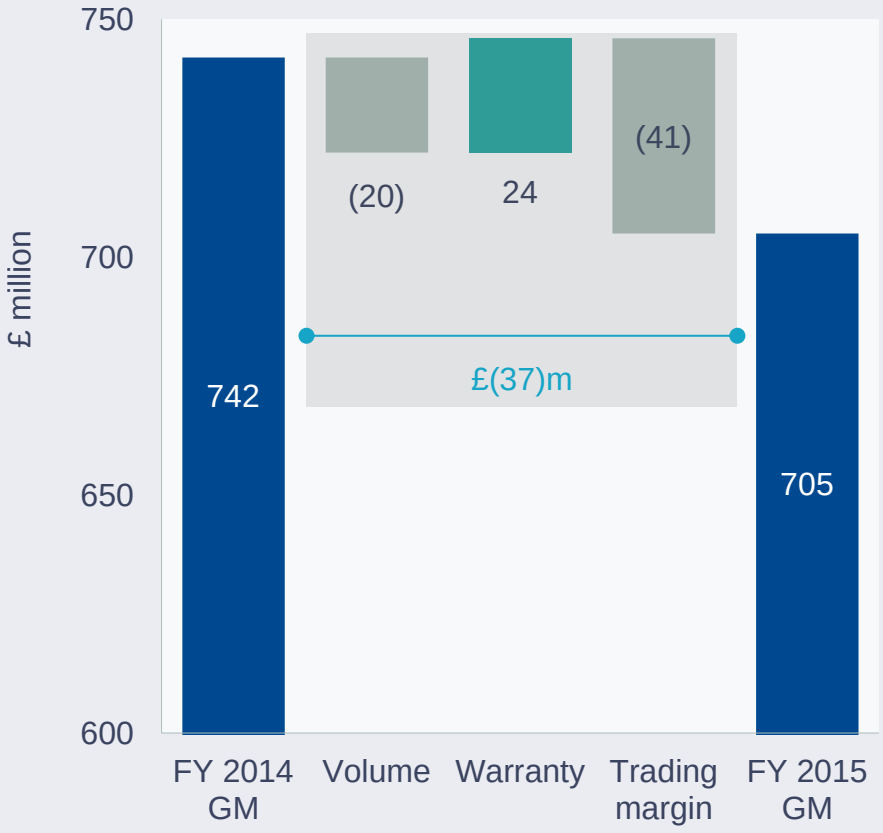
Power Systems revenue



Drivers

- Non-repeat of significant 2014 government projects
- Weaker oil & gas markets
- Agricultural OEM / luxury yacht stronger
- Significant -10% FX impact due to £/€
- Order book broadly unchanged at £1.9bn

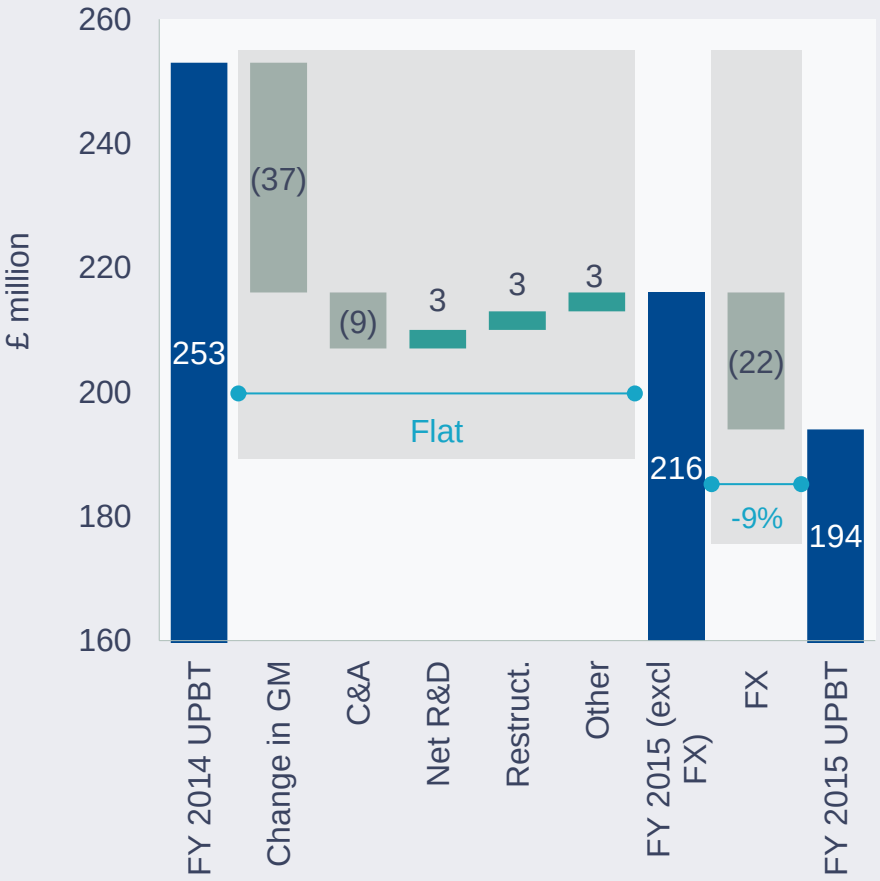
Power Systems gross margin



Drivers

- Volume impact
- 2014 specific warranty issue
- Margin mix: naval vs. agricultural

Power Systems profit



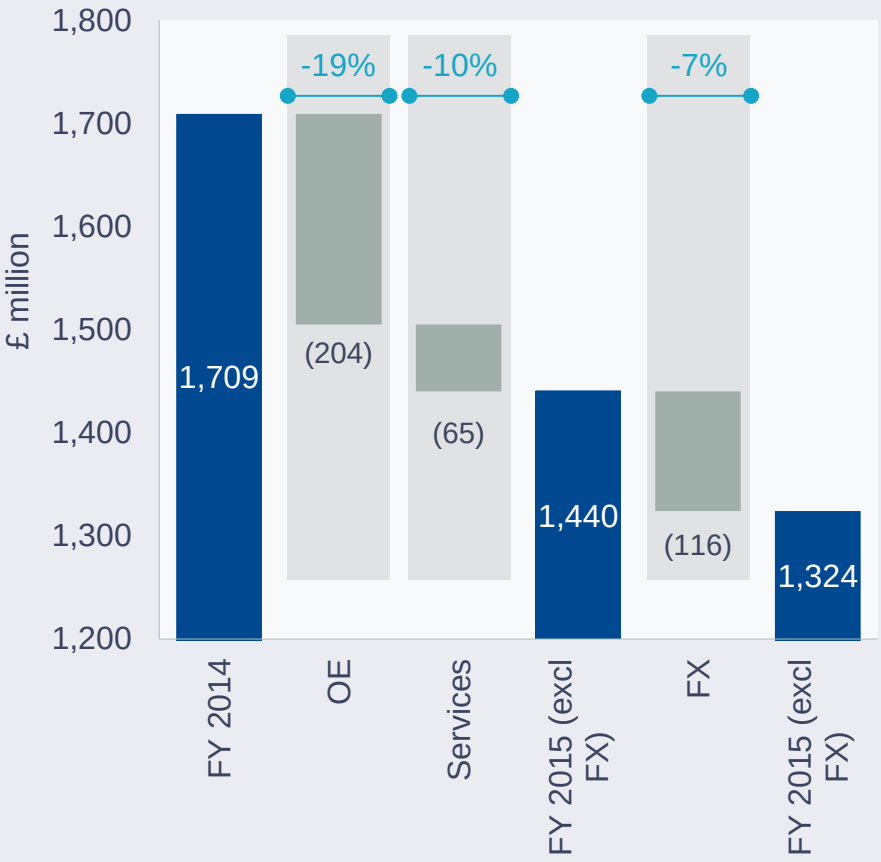
Drivers

- Gross margin main impact
- FX impact: -9%

Power Systems outlook

- Outlook steady
- Key markets: healthy order book

Marine revenue



Drivers

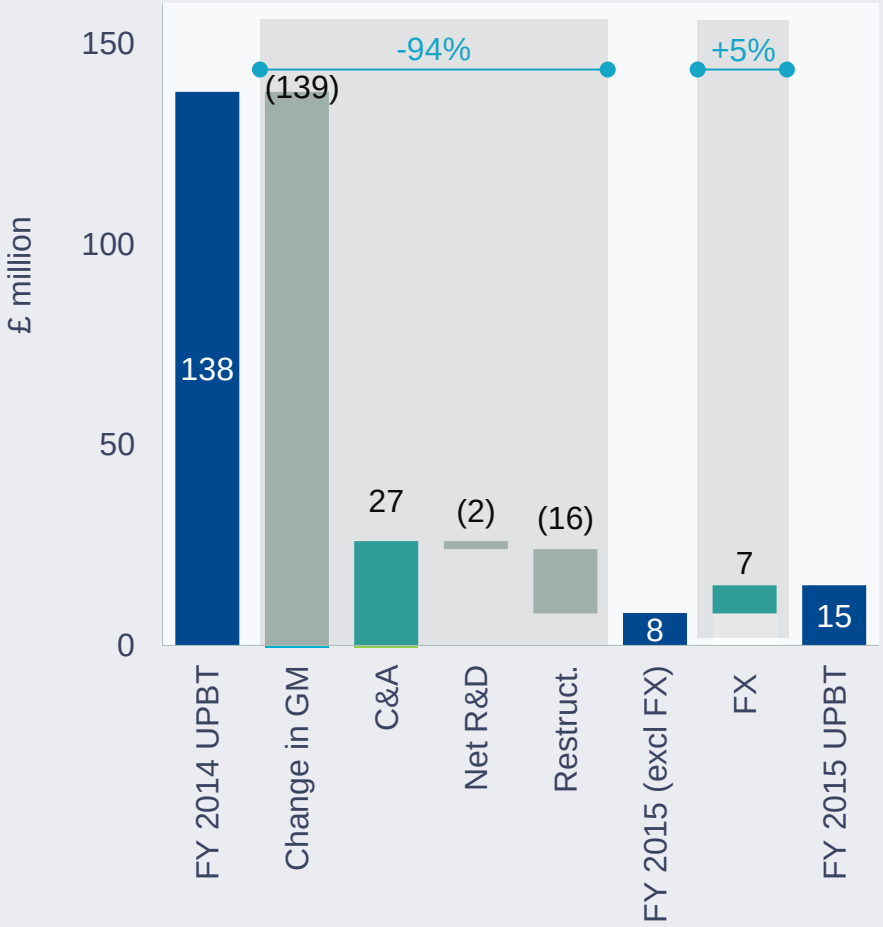
- Order book declined to below £1.1bn
- Challenging offshore market
- Minimal order intake/ deferred contracts / servicing
- Naval / merchant progress
- Material -7% FX impact: NOK

Marine gross margin

Drivers

- Market-driven pricing pressure
- Financial charges:
  - Offshore customer contract/other provision
  - Non-repeat of 2014 product quality

Marine profit



Drivers

- Significant reduction in gross margin
- Indirect headcount benefit to C&A
- Higher restructuring costs

Marine outlook

- Continuing uncertainty in offshore markets
- Focus on repositioning & cost base
- Increase targeted R&D
- Focus on Asia region
- £75-100 million lower profit (before restructuring benefits)

Nuclear*

Underlying revenues +9%

- OE revenues +12%
- Services +7%

Underlying profit slightly up

- Benefitted from £19m tax credit from joining R&D Credits scheme

Gross margin lower

- Submarine servicing
- £10m nil-margin submarine project

Outlook

- Remains steady

* Revenue, gross margin and profit charts for Nuclear are included in the appendices

Technical factors for 2016

Guidance at constant 2015 foreign exchange

	2015	2016 Guidance
Finance Charges	£94m*	£90m-£110m
Tax rate	24.5%	c.26%
Capital expenditure (Property, plant, and equipment)	£494m 4% of revenue	£500m-£550m
Net R&D spend	£831m 6% of revenue	>£800m
Free cash flow	£179m	£(100)m-£(300)m

* 2015 excludes an underlying gain of £34m taken in 2015, on realised foreign exchange contracts settled to convert significant overseas dividends from group companies and is not expected to recur

Conclusions

Rolls-Royce

Full year results in line with our expectations

Strong balance sheet provides financial flexibility

Transformation plans in place to deliver sustainable savings

Outlook unchanged

Warren East

Chief Executive

Rolls-Royce

Strategic clarity

We are a Power Systems business…

VISION

"… to be the market leader in high performance power systems where our engineering expertise, global reach and deep industry knowledge deliver outstanding customer relationships and solutions"

STRATEGIC FOCUS

"… focus on differentiated, mission critical power systems markets with high barriers to entry where we can leverage our leading engineering skills and manufacturing excellence to drive growing market shares"

Personal goals for 2016

With a focus on pace and simplicity…

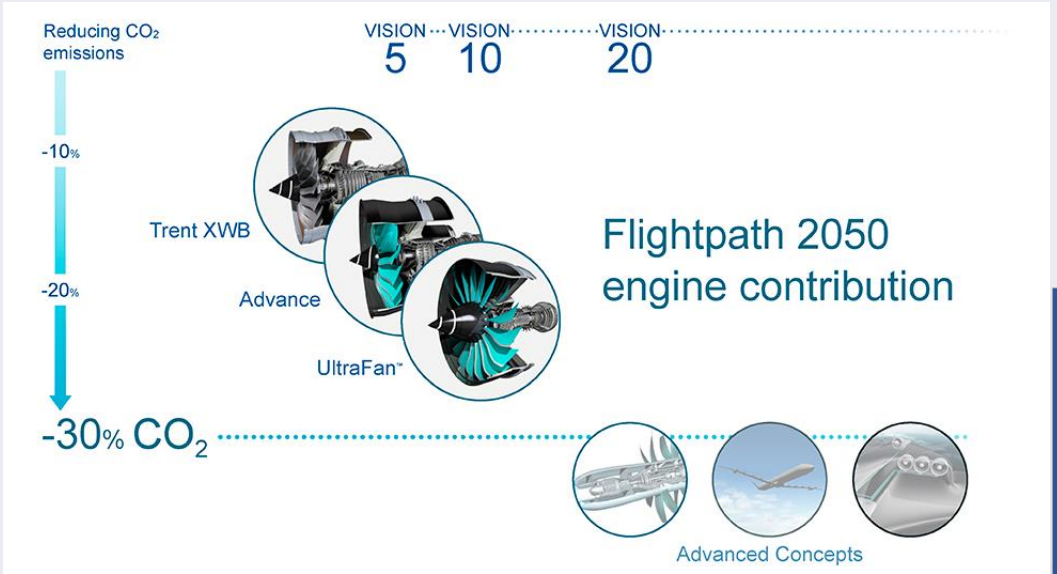
Strengthen our focus on engineering and operational excellence and leveraging our installed base

Deliver a strong start to our transformation programme

Start rebuilding trust and confidence in our long-term growth prospects

Engineering excellence

Pace, simplicity and flexibility



Advanced Manufacturing Research Centres

- Developed with other companies and key universities

Advanced Blade Casting Facility in Rotherham

- Opened at the beginning of 2015
- This new facility is co-located with the AMR centre set up with the University of Sheffield

Operational excellence

Focus drives meaningful reductions in unit engine costs

Rolls-Royce

Supply Chain Product Cost Index

↓ 1.8%

- External product cost index **↓ 3%**
- Internal costs **↑ 1%**
  - Improved scrap and production processes offset by inflation and lower utilisation

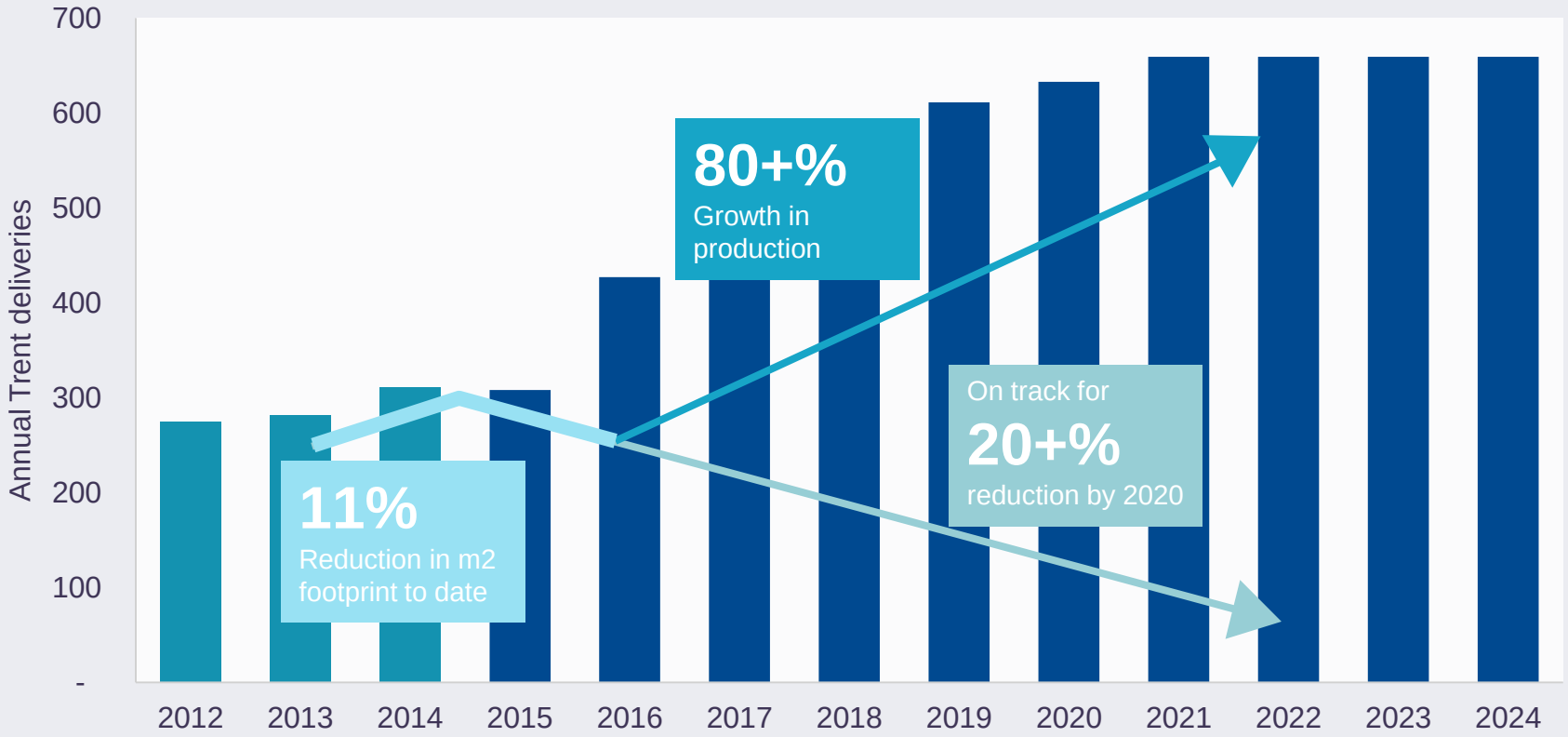
e.g. Wide chord fan blade

↓ 6% reduction in unit costs

- Significant increase in automation
  - Reduced dependency on limited number of highly skilled resources
  - Major reduction in scrap rates
  - Reduced processing time
- Good example of the many continuous improvement projects needed to achieve our goals

Operational excellence

Significant productivity improvements



Strengthen our focus on engineering and operational excellence and leveraging our installed base

Deliver a strong start to our transformation programme

Start rebuilding trust and confidence in our long-term growth prospects

Leveraging our installed base

Aerospace initiatives to extend our offering

Rolls-Royce

Changing dynamics as we mature …

Significant growth in installed base…

2005	2015	2025
Installed engine count	Installed engine count	Installed engine count (estimated as at Dec 15)
3354	4600	7450

… creates a capacity limit within existing network

Maturing installed base…

2005	2015	2025
Number of Trent engines >10 years old	Number of Trent engines >10 years old	Approx number of Trent engines >10 years old
0032	0978	2600

… changes service demands as fleets age

Response… reorganising

New structure focused on flexibility and competition…

- Investing ~$200m to rebalance MRO network – HAESL, SAESL & N3
- Closing TAESL
- New facility at Delta TechOps

Response … new TotalCare offerings… designed around the customer

TotalCare

TotalCare Flex

- Pay-as-you-go
- Guaranteed power
- RR choice to own engines
- Owner receives asset value

CATHAY PACIFIC

SelectCare

- Service choice
- Event based pricing
- Fixed price overhauls
- Engine exchanges
- Customisable

American Airlines

Strengthen our focus on engineering and operational excellence and leveraging our installed base | Deliver a strong start to our transformation programme | Start rebuilding trust and confidence in our long-term growth prospects

Transformation

Strong project management and governance

Rolls-Royce

Transformation team…

- Strong governance over all programmes – old and new
- Enduring process simplification and cost reductions
- Updating and strengthening key performance indicators

Transformation

Legacy programmes proceeding well

Rolls-Royce

Incremental changes (as announced)

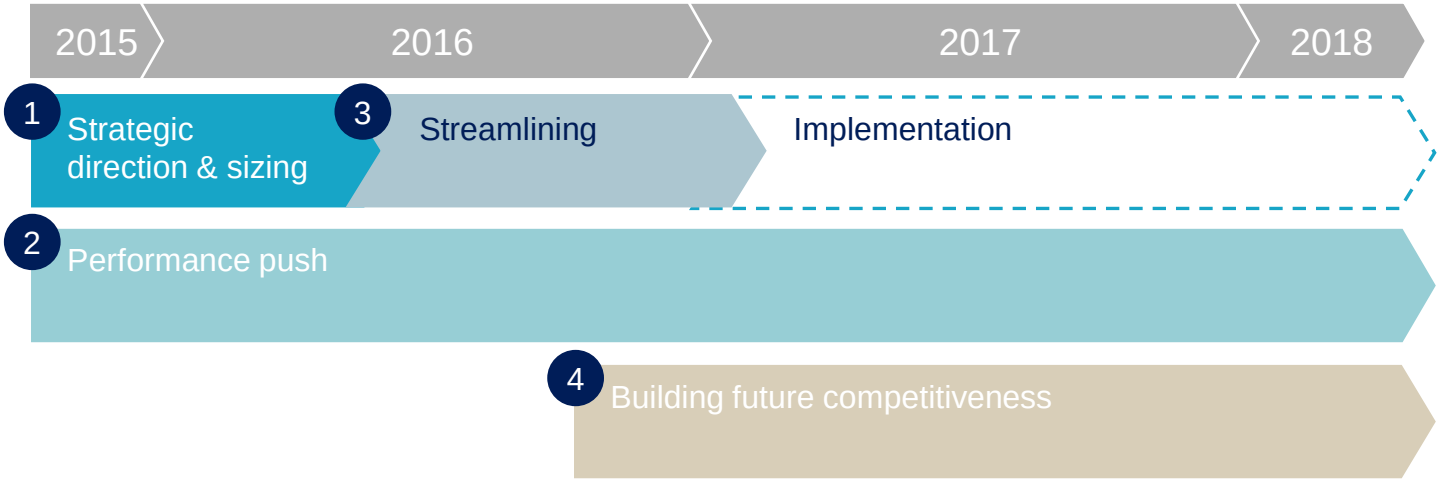
Aerospace	2015	2016	2017
Net improvement	£0m	£80m	£0m
Headcount reduction	2,200*	400	–

Marine	2015	2016	2017
Net improvement	£(10)m	£35m	£40m
Headcount reduction	600	400	–

* includes 545 who left the business in 2014

Transformation

Power Systems' major improvement programme



- Started in Q4 2015
- 15 individual workstreams phased over two years
- 7 workstreams up and running

- Initial focus on…
  - Direction and sizing/resources
  - Performance push
  - Change management

Transformation

£150-200m cost saving programme

Senior management headcount reduction 20% of top two layers

Further management headcount reductions to be announced in H1

Initial benefits identified

- Identified cost savings of £75-100m
  - ~£35-50m benefit in 2016
  - full run rate by end 2017
- 2016 exceptional restructuring charge of £75-100m

Additional benefits

- Further cost savings targeted for 2017
  - £75-100m driven by a focus on 'organisational software'

Update at end Q2 on progress

Strengthen our focus on engineering and operational excellence and leveraging our installed base | Deliver a strong start to our transformation programme | Start rebuilding trust and confidence in our long-term growth prospects

Rebuilding trust

Enhancing disclosure and transparency

Civil Aerospace revenue outlook

Rolls-Royce

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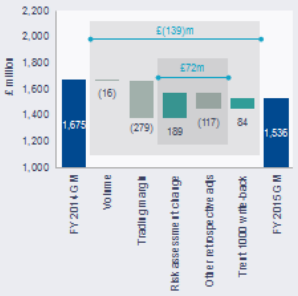
Civil Aerospace gross margin

Rolls-Royce



Drivers

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22

Civil Aerospace trading cash flow outlook

Rolls-Royce

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

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Strengthen our focus on engineering and operational excellence and leveraging our installed base | Deliver a strong start to our transformation programme | Start rebuilding trust and confidence in our long-term growth prospects

Rebuilding trust

Rolls-Royce

Clear programme of milestones for 2016

Investigate & Scope

Now

- Analyse
- Prioritise
- Engage Team

Detail & Implement

FY & Q2

- Plans & Priorities
- Costings/Timescales
- KPIs/Measures of Success

Review & Refine

Q4

- Implementation update
- Progress on Financials
- Progress vs plans: More? Faster? Deeper?

Strategy & Portfolio →

Fuelling long-term growth critical to our success

Rolls-Royce

Successful product innovation

- Address emerging customer needs
- Drive growth in installed base which in turn drives profitability and cash
- Scale efficiencies in the aftermarket help drive higher achieved returns on sales

Order book reflects significant future value

- Widebody order book is strong
- Pricing robust
  - future performance is about driving cost savings on new engine programmes as we have on older ones – continuous improvement
- But visibility strong for only certain elements of the business
  - limited foresight on balance in volatile market conditions – e.g. oil prices, Asia growth and short-term changes in aircraft utilisation

Growth opportunities exist across the portfolio

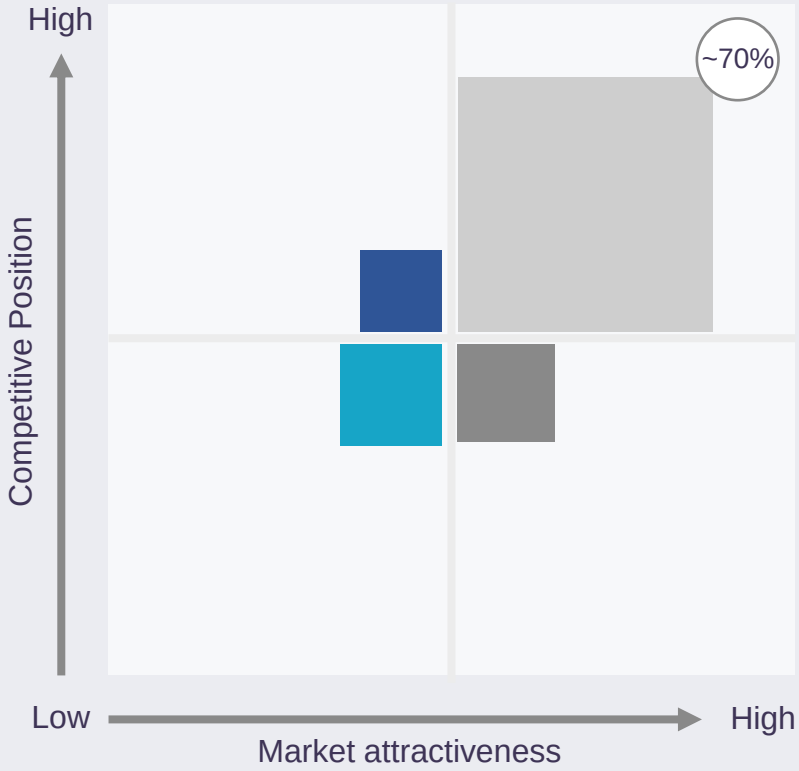
Strong mix of business

- Over 80% in attractive growth markets
- Over 75% in with strong competitive advantages

Competitive advantage strengthened by investments

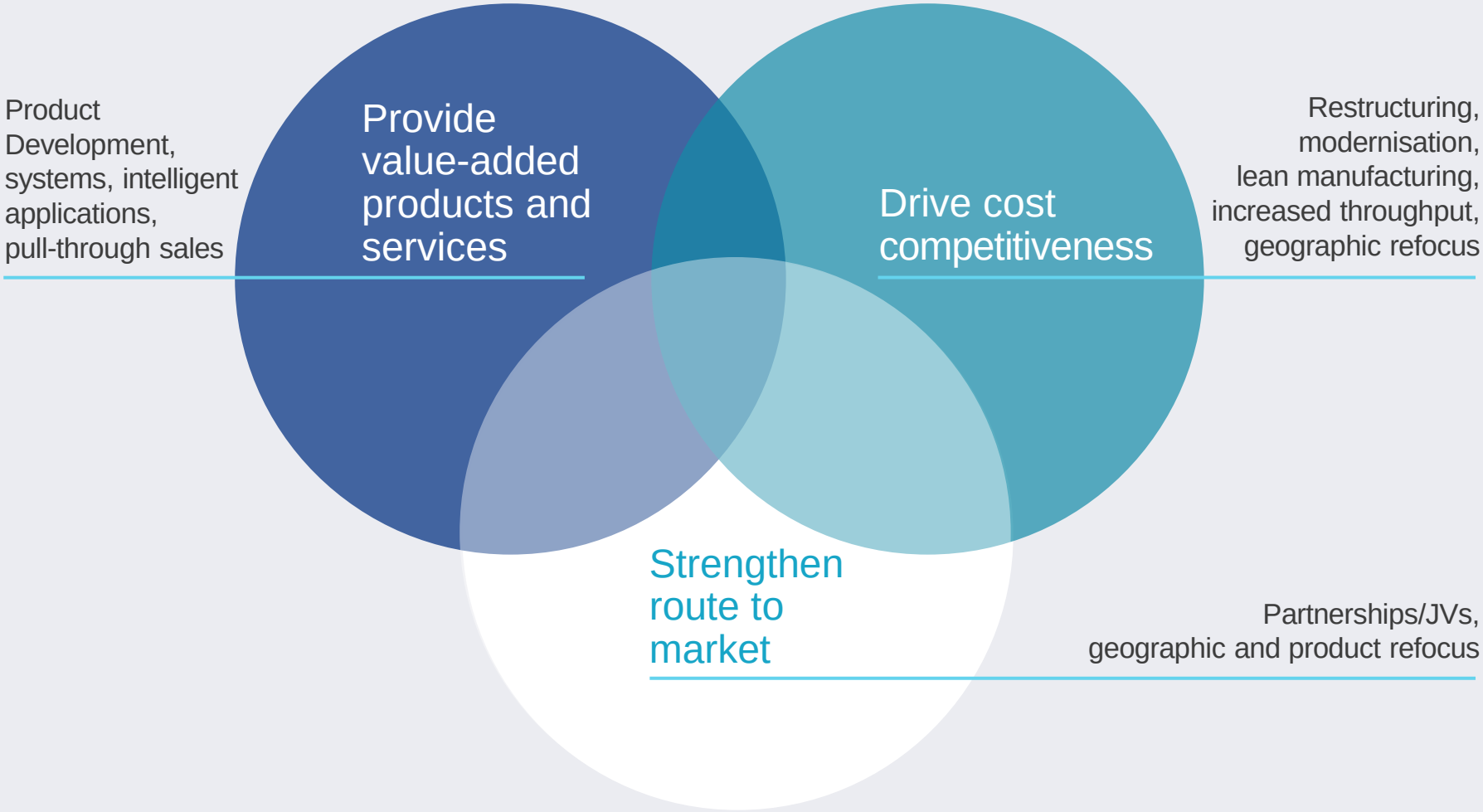
- 2/3rds of group will benefit from transformation programme

2020



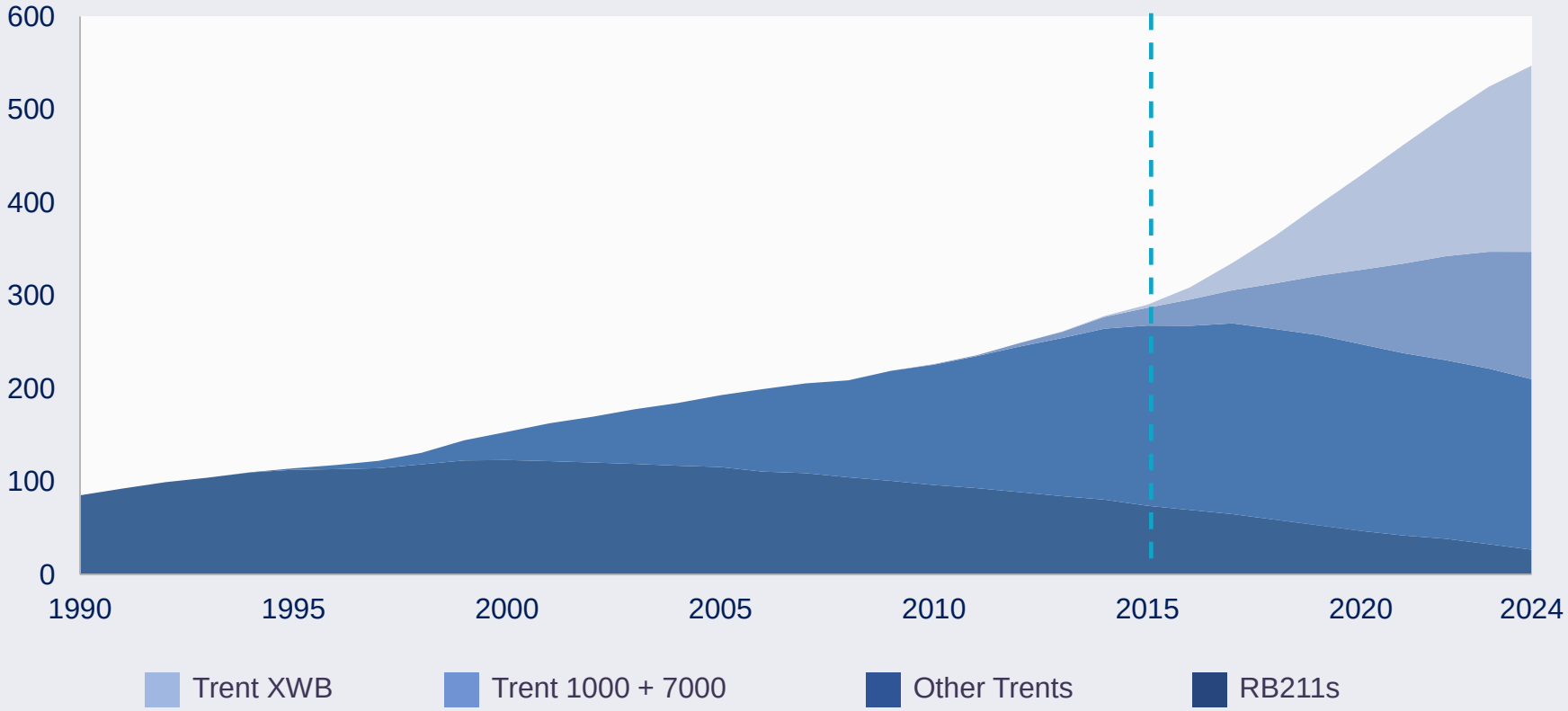
Power Systems and Marine focused on driving profitable growth…

Rolls-Royce



Civil Aerospace: widebody installed thrust growth

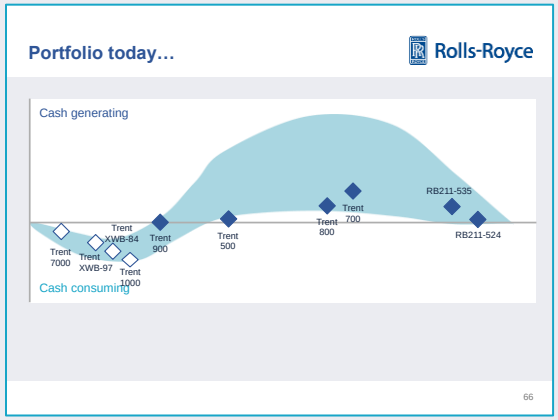
Installed thrust drives aftermarket revenue growth

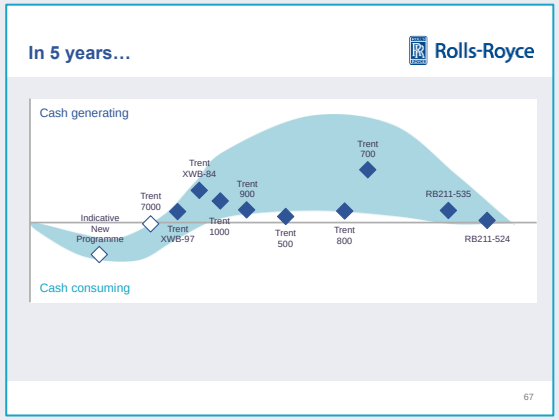


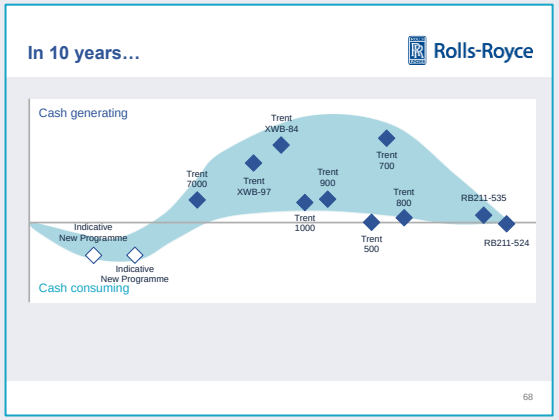
* Installed thrust is shown net of retirements - includes parked and stored engines

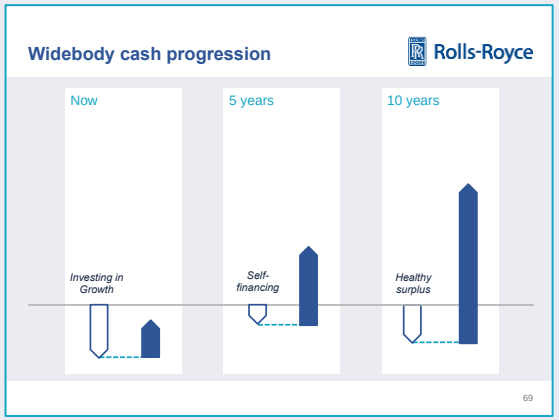
Aerospace cash flows will come from scale in the aftermarket

Rolls-Royce









Legacy Issues

Co-operating with authorities including UK & US

Significant actions to improve ethics/ABC culture & processes

Zero tolerance to misconduct

Summary

2015

- Met most expectations for revenue and profit
- No major trading issues arising during second half of the year

Challenging 2016

- Transition effects in Civil Aerospace and Marine
- Steady cash flow outlook

Clear Strategic priorities to focus activities in 2016 and onwards

- Three focus areas
- Transformation underway
- Committed to rebuilding trust in the long-term prospects of the business

Growth expectations remain positive

- Long-term market demand in Aerospace, Defence and Power Systems remain positive
- Civil Aerospace order book reinforces strong market share gains

Strengthen our focus on engineering and operational excellence and leveraging our installed base

Deliver a strong start to our transformation programme

Start rebuilding trust and confidence in our long-term growth prospects

Q&A

Warren East, Chief Executive
David Smith, Chief Financial Officer

…with a focus on pace and simplicity

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