2023 Capital Markets Day

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Welcoming Remarks

Isabel Green

Head of Investor Relations, Rolls-Royce Holdings Plc

Hello and welcome everyone to our 2023 Capital Markets Day. I'm Isabel Green, Head of Investor Relations and I am delighted to welcome all of you to our event today.

Before we begin, I have a few notices to share. Firstly, Q&A. There's a lot of you here, so no more than two questions each. And please use your press to talk microphones which are in your seats so that everyone online can hear you. For those of you online, you can submit your questions on the Q&A box. My team and I are also available after the event if you want to email us.

Secondly, there are no practice fire alarms scheduled here today, so if you hear an alarm, leave the room by your nearest available emergency exit. And finally, please take note of our Safe Harbor Statement. The forward-looking statements we make today are subject to the usual risks and uncertainties. Further details can be found in the risk section of our latest annual report. Thank you. We will now begin.

CEO Presentation

Tufan Erginbilgic

Chief Executive Officer, Rolls-Royce Holdings Plc

Introduction

Okay, welcome everybody. Good afternoon, and if you are joining from the U.S., good morning as well. Thank you for taking the time to join us today, to those in the room and to those online. I hope you enjoy the video. Every time I watch it, I am impressed and energized.

Rolls-Royce is a great company with a rich heritage, a company with so much to be proud of, and so much potential. And it is that potential and how we will deliver it we will share with you today.

We have been making progress in creating a high-performing, competitive, resilient, growing company. We delivered strong first-half results, helped by transformation and performance management.

We are accelerating financial delivery and raised our full-year guidance earlier this year. This progress gives us confidence in the delivery of our strategic plan and the mid-term targets.

Meet the team

First, I would like to introduce my leadership team. They represent an outstanding mix of deep technical and commercial expertise and bring a fresh perspective. Presenting today, Helen McCabe, CFO; Adam Riddle, Defense; and two brothers there, Rob Watson, Civil Airspace; and Jorg Stratmann, Power Systems. And here, but not presenting, we have Chris Cholerton on the front row and Nikki Grady-Smith, blue-dress lady; and Simon Burr, just next to her, our technology guru; Sarah Armstrong, our HR Director; and Mike Gregory, our General Counsel. You will have the opportunity to meet them during the day.

As video suggested, Rolls-Royce is at a pivotal point in its history. This year, we developed a clear strategy that will see this great company perform to its full potential. We have made material progress, but there is more we want to do. That is what we are addressing today.

Agenda

Today, the team and I will take you through how we plan to do that. I will start with a strategic update and share our mid-term targets. Then I will set out our clear and granular strategy. Following that, Helen will take us through the financials, including our capital framework. We will then take the questions from the room, followed by an extended break, during which those in London can experience our on-site exhibition, and those online can explore case studies and exhibits virtually.

When we return, you will hear from the three divisional presidents about our detailed strategic initiatives which underpin our targets. We will conclude with a final Q&A and key takeaways.

I want you to leave today with a powerful sense that this strategy is clear and that it is different. It will take Rolls-Royce to a top-tier competitive performance. It will be rigorously delivered, and it is owned by the whole organization. Everyone is aligned and focused on its delivery.

I am proud of what our teams have achieved so far.

Rolls-Royce proposition

This is our proposition, which we shared with you before. Firstly, build a high-performing, competitive and resilient business with profitable growth. Second, grow sustainable free cash flow, generate cash from operations, and be disciplined with capital investment. Third, build a strong balance sheet and grow shareholder returns.

By doing this, we will become a stronger partner to our customers as they meet the challenges and opportunities that define the future. We will unlock the full potential as we translate engineering excellence into strong financial performance. We will have the financial strength to invest in growth and grow shareholder returns. And we will create more opportunities for our people so everyone can be a part of an energizing, rewarding, and world-leading team.

Differentiated group strengthened through transformation

Turning to our differentiated position, we have a strong portfolio of products and technologies in attractive markets. From these positions of strength, we are transforming to become a stronger business with a high-performance culture.

In civil aerospace, we are positioned to grow in the wide-body and business aviation markets with our market-leading, efficient and high-performing Trent and Pearl engine families. These products power the latest and most advanced aircraft types, such as the Airbus A350 and Gulfstream's G700 and 800.

In defense, we are a trusted long-term partner to the US Department of Defense and U.K. Ministry of Defense. We have an exceptional order pipeline in transport, combat, and submarine, helping to secure our long-term growth profile.

In power systems, we have a greater mix of revenue in high-power segments where the margins are stronger. This gives us a structural advantage compared to our peers. And in nuclear, our capability is unrivaled. We have the broadest capability in the industry and are leveraging it in the new markets, such as small modular reactors, SMRs, and microreactors.

All of this is underpinned by our strong brand, deep customer relationships, and partnerships. Our transformation is also making us stronger and more efficient and resilient. Transformation is driving high-quality earnings growth and more rateable and growing cash flows.

To achieve this, we need to work as One Rolls-Royce with different ways of working and a driven mindset to make a difference and achieve win-win solutions with our partners, a differentiated culture, performance culture, where performance is tightly monitored and actions are timely taken, a new organization to simplify, build capability, and become more efficient.

Strategic clarity that enables a more focused and aligned organization clear on accountabilities and sharing the same ambitions. A business which is externally focused and benchmarked. All of these will make us more differentiated. So you can see why I am feeling so confident about our future.

And of course, at all times, the safety of our customers and employees will remain of paramount importance.

Differentiated and advantaged technologies

Let me take a few moments to talk about our advantage technologies. We are experts in systems integrations. Our customers are not just buying an engine, they are buying a solution that integrates into a larger system, an aircraft, microgrid, or yacht, integrated seamlessly to create the power and propulsion they need.

Our advanced manufacturing techniques mean that we can consistently create complex and detailed parts to an exceptionally high specifications. Our expertise in controls and electrical systems underpins the high performance and reliability of our products.

Our next generation developments are also advantage. Today, I will just cover two, UltraFan and nuclear. UltraFan is distinctive, developed to be competitive in the wide body and narrow body segments. It has scalable thrust ranging from 25,000 pounds to 110,000 pounds, enabled by a gearbox that delivered 64 megawatt on test and aerospace power record. The suite of UltraFan technologies deliver a 10% efficiency improvements on the most efficient engine available today. By the way, just to remind you, probably you know, but most efficient engine is our XWB-84.

We can retrofit some of these technologies into today's engines, such as the Trent XWB, to increase time on wing and fuel burn efficiency.

Next, nuclear. Our distinctive nuclear capability means we are in the best position to play a leading role in the SMR and microreactor markets. Our SMRs are based on a modular construction that reduces cost, risk, and time to construct compared to large nuclear projects. Our microreactor technology is being designed for off-grid nuclear power applications, answering the demand for energy security and low carbon solutions.

Capturing performance improvement opportunities - Strategic framework

Moving to our strategy. In February, we launched our transformation and strategic review to clearly set out how we could unlock the potential of the business. Our strategic framework is clear. There are four pillars. First, portfolio choices and partnerships. The markets we have chosen to operate in, businesses we want to invest in, and the partnerships that will help create truly winning positions.

Second, our advantage businesses and strategic initiatives. How we will create competitive business, expand our earnings potential, and sustainably improve our performance.

Third, efficiency and simplification. The importance of a company-wide focus to drive synergies that will enable us to be more competitive and simplify the way we operate. And finally, fourth, our commitment to the energy transition and capturing the benefits of becoming digitally enabled.

This granular strategy will help deliver our proposition to be a high-performing company with quality profits, competitive margins, growing sustainable cash flows, and resilient returns.

Capturing performance improvement opportunities - Group mid-term targets

Before I take you through each part of the strategy, let me share our mid-term targets. We want to achieve these at pace. They are based on our expectations for the 2027 timeframe. But if we can get there in an accelerated way, we will. These are compelling targets and mean a step change in Rolls-Royce performance. They are underpinned by our strategy and demonstrate we are creating a new company, taking Rolls-Royce significantly beyond any previous financial performance.

The high and achievable bar that we have set is a reflective of our new winning mindset. We will quadruple operating profit from the 2022 baseline to achieve between $2.5 and $2.8 billion, and we will expand our operating margins to between 13 and 15 percent, equal or better competitive performance benchmarked against our peers.

We aim to grow sustainable cash flows to between $2.8 and $3.1 billion, more than 100 percent conversion of our improved profits. And finally, we are targeting 16 to 18 percent return on capital, improving by more than 10 percentage points compared to 2022, creating a compelling investment proposition.

Delivering these targets will mean we have created a financially and operationally strong business. They are a milestone on our journey, not our final destination.

I would like to emphasize this point, and we will continue to grow into the long term. As I mentioned in August, our progress in the coming years will be progressive, but not linear year on year. We will provide guidance for 2024 at our results in February.

This year, we are achieving good performance improvement. Our current trading is in line with guidance provided with our half-year results, and it is unchanged.

Capturing performance improvement opportunities - Divisional mid-term targets

Turning to the operating margin targets by division. The targets demonstrate that we are building a business which will perform competitively or better than our peers.

Civil aerospace has the biggest step change, moving from just 2.5% operating margin in 2022 to 15 to 17%. In defense, we started from a stronger place but can still do better. We plan to improve to 14 to 16%. In power systems, our most diverse business, we will deliver a step up from 8% in 2022 to between 12 to 13% in the midterm. These are also all best on record performances and represent a significant performance improvement to unlock the potential in every division. They are underpinned by divisional strategic initiatives and efficiencies across the group.

Portfolio choices and partnerships

Turning now to the first pillar of our strategic framework, portfolio choices and partnerships. Our strategy is granular. We are making choices and executing on them. This allows us to allocate resources more effectively and drive profitable growth. We have segmented our portfolio into three categories. Key investment areas for performance improvement and growth. Partnerships to create truly winning positions. Businesses and activities we will exit. Our strategic choices will drive value creation.

We will focus our investments on areas where the market is attractive and growing. Where we have or we could have a differentiated position with good market share, strong customer recognition, excellent products and technology that will generate midterm and long-term value so that we can win.

In civil aerospace, we will focus on widebody and business aviation, leveraging the value from our Trent and Pearl engine families and investing for the future with the UltraFan.

In defense, we have opportunities for greater performance in transport, combat and submarines. We can also use our expertise in adjacent fields such as nuclear micro-reactors. And in power systems, we will focus on governmental, marine and power generation and markets. Where we see the strongest demand and an opportunity for better returns from our power dense and reliable solutions.

In some cases, partnerships can help to strengthen our market positions, bring new skills, build capability and scale, as well as de-risk and reduce capital investment.

In civil aerospace, we believe we are well positioned to re-enter the narrowbody market by choosing a partnership approach for the next program. Our UltraFan technology is a vital step towards this. At the right time, with the right partner, we will decide the next steps. For SMRs, a broad set of partners will strengthen our position to deliver the overall solution and reduce the future capital call. We have extensive nuclear expertise. Partnerships can bring funding and skills to complement this. In power systems, our focus strategy in PowerGen will make this business more efficient and competitive and drive faster profitable growth.

We are also considering potential partnerships to further grow our market position, broaden our power generation offering, and benefit from cross-business synergies. Battery storage systems are a logical complement to our stationary power generation business, as we have transferable capability. We are already developing a good position in Europe. A partnership with access to additional markets could strengthen our position.

But this strategy is also about making confident choices on where we will not invest. We are looking to exit non-core businesses that are not a strategic fit for us and we believe hold more value to others. In total, we expect to generate between GBP1 billion to GBP1.5 billion in gross divestment proceeds across all divisions during the next five years.

To be clear, we will only sell assets at the right time and at the right price. One point I would like to make is that this GBP1 billion and GBP1.5 billion is not included in our mid-term targets. Free cash flow does not include that.

For example, in Rolls-Royce Electrical, we are looking at options to exit in the short run or, alternatively, for the right value, reduce our position to a minority share with an intention to exit fully in the mid-term. We believe, given the world-class capability we have built in advanced air mobility, that this will represent good value to a third party and will allow us to focus on our core electrical engineering activities in civil aerospace, defense and power systems.

Advantaged businesses & strategic initiatives - Positioned in growing and attractive markets

Before talking about market growth, I want to talk about the current macro environment. Geopolitical outlook is uncertain. GDP growth in the next ten years is expected to be lower than in the past. Inflation and interest rates continue to be higher and this may continue for longer.

In the short run, we may see a recession and weakened demand in some parts of the world. Additionally, we expect industry-wide supply chain challenges in aerospace to continue for another 18 to 24 months. However, despite these challenges, our focus is ensuring we are building a truly resilient business that is better able to manage this volatility and continue to grow.

Our strategic initiatives will enable us to grow at a rate above the market in some spaces. In some areas, we are somewhat insulated from market volatility.

For example, there is a growing need for aircraft globally. Demand will continue to grow in data centers due to the increased demand for digitalization and AI. We expect defense budgets to continue to grow and these are partly insulated from GDP fluctuations.

Looking at market volume growth rates, I will take each of these in turn, starting with business aviation. Market growth is forecast to be 3% to 5% per annum to 2030, growing above GDP, driven by an increasing number of high-net-worth individuals and new aircraft programs. Rolls-Royce is an advantage in the large cabin market with a strong brand. Our position on the latest Gulfstream, Bombardier and Dassault platforms is driving higher than market growth.

By the mid-term, we will power three of the four fastest, largest, longest-range business aircraft and we plan to have a fleet of more than 9,000 business jet engines. In commercial aviation, in wide-body, market growth is forecast to be in the region of 5% to 7% per annum to 2030. This is driven by post-COVID recovery, fleet renewal and a growing middle class in markets such as India and China. We expect our wide-body business to grow faster than the market in the coming years, mainly due to the platforms we are on.

We also have a new opportunity to grow in the freighter market due to the launch of Airbus A350 freighter. In defense, the market in combat and transport is expected to be flat to 2% volume growth to 2030. We plan to grow slightly faster than the market as we deliver the newer aircraft programs we have won.

Submarines is also a growing market. Nuclear-powered submarines are critical in building strategic defense capability and our position as the provider of nuclear propulsion and power to the UK's Royal Navy is unique.

Australia will require nuclear propulsion capability under the AUKUS agreement, with new boats that will be powered by our reactors entering into service in the early 2040s. Over the long term in defense, our growth outlook remains really strong, with up to 5% average annual growth expected from 2022 to 2040. This is underpinned by our recent wins on FLORA in partnership with BELL, the B-52 re-engineering program, AUKUS and the Global Combat Air Program, known as GCAP.

In power systems, overall we expect the market for power generation solutions to continue to grow at an average rate of 5-7% per year. We have a strong market position in mission-critical applications such as data centers, where we have more than 20% market share that generate more than 70% of our OE revenues.

Data centers are growing rapidly, driven by global trends for data processing and AI. Our power system solutions currently back up every third email sent in the world. Battery storage solutions are another growth market, where we see growth of around 20% per year and an opportunity to benefit from the demand for low-carbon energy and expect to achieve profitable growth.

In mobile solutions such as yachts, tanks, navy and commercial marine, we expect average market growth of 4% to 6%, fueled by double-digit growth in governmental segments in the mid-term.

In summary, our portfolio is well positioned to capture growth in these markets and given our focus on performance improvement, we will also be a more resilient business, better able to manage and respond to external shocks.

Advantaged businesses & strategic initiatives - Sustainably expanding earnings potential

Now let me take you through the strategic initiatives which underpin our profitable growth.

On the left-hand side of the slide you can see the relative contribution of each division, with improved profitability in civil, defense and power systems. We also expect profits to benefit from portfolio choices, such as in new markets where we exit electrical. The other exits are expected to have some adverse impact on profitability.

On the right-hand side you can see the underlying drivers in each division, including the benefit of our group-wide efficiency and simplification program.

The business presidents will take you through this in much more detail, but I'll give you the key points. I will start with the initiatives in civil aerospace, where we expect the most material uplift.

In business aviation, the market success of the Pearl engine family has been outstanding, and we have a strong order book that is driving fleet growth. This positions us well to optimize commercial outcomes and grow our margin. In wide-body, there are six levers to improve LTSA margins that I have talked about before, three of which relate to costs and three to revenues.

These are extending time on wing with better product durability and greater use of digital tools, lowering shop visit costs with better working practices, reducing product costs with better buying and engineering, keeping engines earning for longer with contract extensions and conversions, implementing a new value-driven pricing strategy to our new and renewing contracts, as well as addressing onerous and low margin contracts, and finally, driving rigor on contractual terms and conditions.

We have already made good progress on these items. In this period, we continue to improve our LTSA margins due to our performance improvements on six levers. The same commercial and cost disciplines are being applied to other areas of our wide-body business too, with profitability improvements coming through in time and material, OE and spare engines.

We also see a favorable spare engine mix with more XWBs contributing to our improved performance.

Growth comes on top of this. Our in-service fleet is growing faster than the market. We power a third of the wide-body aircraft in service today, and in 2022, more than half of new deliveries in the industry were powered by Rolls-Royce engines. However, this growth alone at 2022 margins would only drive a small fraction of the improvements. We are guiding in the mid-term. We actually did this exercise. Our actions are expanding the margins this year and in the mid-term allow us to benefit from this growth.

Moving to defense. This business was already performing well, but there is still an opportunity to improve through strong performance management, commercial optimization initiatives, and efficiency.

We have common growth drivers across transport, combat and submarines. Firstly, growth from volume and mix as we move from legacy programs to new funded programs. Secondly, the same focus on commercial optimization and value pricing behaviors as we applied in civil. And finally, we are prioritizing investment as we focus our spend and benefit from an increase in customer funded programs.

In power systems, our profit growth is being delivered by strategic initiatives focused on power generation, governmental and marine end markets. In power generation, we are optimizing our cost structure and focusing on key markets to drive margin growth. We are also expanding our microgrid solutions and extending our services offering in battery storage systems, which is moving to be a profitable business in the short run.

In governmental, we are capturing near-term growth with scope expansion and investment. And in marine, we are developing alternative fuel solutions to strengthen our synthetic fuel ready portfolio.

As you can see in the graph, all our businesses see sustainable performance improvement from efficiency and simplification initiatives.

Efficiency & Simplification

This brings me onto the third strategic theme. We had a total cash cost to gross margin ratio of 0.8 in 2022 and before that 0.9 in 2019. I'm skipping for obvious reasons all the COVID years. You can calculate them, but they are not positive numbers.

This is around twice the best in class level for a business like ours. This will approximately halve by midterm, taking it to a market leading level. To achieve this, we are tackling costs from multiple angles. Firstly, we are right-sizing the organization and ensuring it is structured to support sustained efficiencies. We have already announced plans to reduce the number of roles across the company by between 2000 and 2500. We expect this to be largely completed by the end of 2025, with an annualized sustainable benefit of around GBP200 million.

We expect severance costs of between GBP200 million to GBP250 million, which will be taken as an exceptional charge. The new organization will be aligned to strategic delivery, removes duplication, enables simpler, more agile ways of working. It will be underpinned by upskilling more efficient processes, better use of technology and a common operating model.

Next, procurement excellence. We have plans to deliver around GBP1 billion of gross third-party cost savings over the next five years, which will help offset the impact of inflationary and product cost increases.

We announced last month a new enterprise-wide procurement and supplier management structure to further build capability and leverage scale. One recent example of procurement improvements was a review of our building services contracts, which cover around 70 sites worldwide and had not been reviewed for eight years.

We re-tendered this contract and achieved GBP38 million savings over five years.

And finally, zero-based budgeting. We have set a 10% to 15% reduction in targeted areas. Starting next year, we are taking a clean sheet approach to spend. Both Helen and I have experience in this area. I am confident this level of benefit can be delivered. We are also aligning R&D spend to our strategy, for example, through the exit of electrical. And we are benefiting from increased third-party funding.

TCCGM is an important metric. We track and pay attention to it because it is a measure of the operating leverage of our business and its resilience. Across the group, our efficiency initiatives and the choices we make will deliver sustainable - and sustainable is the key word here - sustainable annualized savings of GBP400 to GBP500 million in the mid-term, making us more competitively advantaged and fit for the future.

Lower carbon & digitally enabled businesses - Transition to lower carbon, supporting our customers on their journey to net zero

Turning to the first part of our fourth strategic pillar, lower carbon. We are committed to becoming a net zero company by 2050 and supporting our customers to do the same. We will play our role to reduce emissions within this strategy. This will also create new growth opportunities. Our foundations to do this are already in place. We are making good progress towards making our own operations net zero, with a 60% reduction in our Scope 1 and 2 emissions achieved since 2014. But there is more to do to fully decarbonize.

For aerospace and defense, the best solution to decarbonize is sustainable fuels, which can deliver an 80% reduction in life-cycle carbon emissions compared to fossil fuels. All the commercial aero-engines we produce and our most popular reciprocating engines are now all compatible with sustainable fuel.

We are excited to announce that today we are powering Virgin to make the world's first transatlantic 100% self-flight with a commercial airliner. I don't know if you have seen it outside. Unfortunately, it sort of had some delay, but it is now in the air, I'm told. So around 12 o'clock, it actually took off. And given that, we expect that to land in JFK around 3:30 local time.

But this is not all, because our defense team supported RFA's first 100% self-flight on a Voyager aircraft last year. In power systems, we are evolving our engines and developing alternative fuel solutions such as methanol, hydrogen, hybrid and battery storage solutions. In partnership with superyacht shipbuilder Larson, we are already working on offering methanol-powered engines for superyachts.

And in nuclear, I already talked about the potential opportunities with SMRs and micro-reactors, which will be needed to decarbonize the grid and can produce the power necessary to create synthetic fuels. In addition to the UK interest in SMRs, we are deeply engaged with governments, developers and potential industrial customers in Czech Republic, Finland, Sweden, USA, Poland and the Netherlands.

To summarize, we will transform our business to low-carbon without requiring high levels of investment today or in the mid-term, and the energy transition creates new opportunities.

Lower carbon & digitally enabled businesses - Differentiated customer experience and greater operational efficiency

The second element of our fourth pillar is digital enablement. We are focused on four areas of innovation - enhancing the customer experience, accelerating the product design, improving manufacturing and empowering our people. Let me give you some examples of where we are already in action and where we see further potential. Starting with customers, our intelligent engine platform provides two-way communication with our engines, delivering vital health and performance data to our secure cloud. With digital twin capabilities, we can predict the forecasted time and engine stays on-way. This is improving dispatch reliability and reducing disruptions for our customers and their passengers.

Our future vision is raising the bar to 100% availability, if you imagine that world, where everything is planned and predictable, improving the service we offer customers.

Secondly, digital tools impact how we design, build and transport our customers' fleets. Powerful virtual simulations can save up to 25% time in the rigorous development and certification testing of new engines. Taking this to the next level will accelerate product development of new technologies to market.

Using AI will create new versions of existing products 15% faster, reducing the cost and accelerating the time of bringing new engine programs to market in the future.

In manufacturing, we continue to improve by having more insight into operational performance. Our turbine manufacturing process leverages AI machine learning using data science to better understand the turbine cooling hole cutting process, predicting defects before human inspection.

If you want to know about more of this process, he is the man, Simon there for any questions, but in the future, we will enhance this technology with visual AI to inspect parts, giving real-time results and revolutionizing routine maintenance.

And finally, we are empowering our people to transform their working environment with the right digital tools and fostering a digital culture.

Looking ahead to the future, we aim to remove 20% of repetitive tasks using automation, generative AI and digital assistance, reducing costs and giving our people more time to focus on higher-value activities. We are already in action, but there is also a lot more to do and therefore more opportunity in this area.

Long-term growth momentum

Before I close, I want to share why I am excited about our long-term outlook, too. I have spent time on our strategy and shown the rigor underpinning our mid-term targets. Obviously, division presidents will give you a lot more than I did.

The same drivers underpin our long-term growth opportunities, too. In civil aerospace, the long-term growth is being driven by the strength of our Pearl and Trent engine families, which will power the in-service fleet well into the 2040s. In defense, we will see the benefits of recent wins such as B-52, FLORA, AUKUS and GCAP programs. These programs will ensure we continue to grow in these markets with engines that will remain in service for 30-40 years after they are delivered. We also see long-term potential for our competitive portfolio of power systems products. Development of more fuel-efficient platforms and adaptation to new fuel sources will drive demand.

SMRs have a compelling long-term growth story. We could have the first units producing power by early next decade if orders are placed soon. And there are also new business opportunities such as narrow-body aviation, where we are well positioned to partner on the next generation of aircraft with the UltraFan and in nuclear micro-reactors, too.

Key messages

In closing, I am confident and excited by the potential I see across Royce-Source. We have the expertise, the drive and the team to deliver this. We have a strategic plan to deliver our Royce-Royce proposition to become high-performing, competitive, resilient and growing profit and sustainable cash flows.

We will also have a strong balance sheet and growing shareholder returns. We have made good progress in 2023. We are accelerating financial delivery. Our progress so far and transformation actions give us high confidence in the delivery of our strategic plan and mid-term targets.

Our strategy is granular. We are clear on the choices we need to make to shape our portfolio and prioritize investment. We have strong foundations and advantage businesses in growing markets with performance improvement initiatives which are underpinned and owned.

The organization is aligned and mobilized to succeed with a more efficient and simpler structure. Our businesses are capable of delivering low-carbon solutions and digitally enhanced processes and services. All this is enabled by our new mindset, better ways of working and our performance culture.

These elements combined will create a distinctive capability in the industry. This is evident in the targets we have set. Targets which represent a step-change in performance to make Royce-Royce financially stronger than it has ever been. We are building One Royce-Royce, a company that will be able to deliver on the potential of our world-class technologies, invest to grow, lead the next generation thinking for our customers and play an important part in the energy transition.

Thank you.

Now I'm going to hand over to Helen.

CFO Presentation

Helen McCabe

Chief Financial Officer, Rolls-Royce Holdings Plc

Reflections and priorities

Thank you, Tufan. Good afternoon, everyone. It's great to have so many of you with us today in the room and watching online. Tufan has set out our strategic frame and mid-term targets. I will now take you through my key priorities as CFO, our free cash flow growth and our plans to strengthen the balance sheet and our capital framework. Before that, I'd like to share my initial reflections since I joined Rolls-Royce.

First, I'm delighted to be here. Everyone has been hugely welcoming. We are all focused on working together to deliver Rolls-Royce's full potential. Rolls-Royce is renowned for engineering excellence. In my first few weeks, I visited our sites across Europe, the US and the UK and saw this firsthand. It was great to walk the factory floors and see some of the world's most powerful, efficient engines being built. Our products power, protect and connect the modern world. That's quite a nice thing to be able to tell your kids when they see. So what is it you actually do at work all day?

I've also been struck by the passion, commitment and motivation of the people I've met. They are hugely proud to work at Rolls-Royce and rightly so. However, we need to capitalize on our advantage positions and be more deliberate in our strategic choices. We need to improve the quality and grow our earnings and cash flows to deliver the financial performance we are capable of and that investors deserve and expect from us. We have made substantial progress this year. That was evident in our first half results and our full year guidance, which we reconfirmed today.

We have started the journey, but there is much more to do. Before Rolls-Royce, I spent 30 years in large, complex global businesses with engineering and technology at their heart. I was a CFO of a global business with multiple divisions, which had a profit of more than $10 billion. A business where Tufan and I previously worked together, including on material transformation programs. In the last one, costs were reduced by $3 billion and the earnings potential of the business expanded by more than $5 billion. Transformation is not easy, but it can be done.

That's the opportunity that attracted me to this role and it shapes the four big priorities I have as CFO.

These are first, integrated performance management. One of the outcomes of the strategic review is the need for improved processes and a stronger culture of integrated performance management. In my previous business, my approach was that strategic plans were linked to annual budgets, which in turn were linked to in-year performance management. We actively tracked performance and made interventions proactively. Targets were underpinned and owned across the whole of the organization. That was not done well at Rolls-Royce. That's already changing in 2023 and we will strengthen it further.

Second, commercial and cost optimization. My focus is to develop sharper commercial acumen and a more cost-conscious culture. I support a philosophy where everyone acts like an owner. They treat every pound spent as their own and make it count. That's the mindset we're driving for. We're already upping our game with new frameworks and better training in place to build skills and capabilities. Again, still more to do.

Third, delivering a sustainable improvement in working capital.

And fourth, our capital framework. We need a strong balance sheet. I will come back to the last two as they are key priorities. Before that, I will turn to free cash flow.

Sustainable and growing free cash flow

We have a clear ambition for what Rolls-Royce can deliver. It is based on extensive benchmarking, the rigor of our strategic review and our transformation plan. In the mid-term, which we see as being around 2027, we are targeting between GBP2.8 billion and GBP3.1 billion of free cash flow. A growth of around GBP2.5 billion compared to 2022.

Let me walk you through the main elements of this growth. Operating profit growth between GBP1.8 billion and GBP2.1 billion over the period is key. We achieve that by sustainably expanding the earnings potential of the business, by being laser focused on our strategic choices, by having all divisions firing in all cylinders and by driving for an improved quality of earnings as demonstrated in the margin targets we have set.

We are making good progress. 2023 profits and margins are forecast to be materially above those of 2022. Our investment approach will be disciplined with spend targeting strategic growth, including the innovation and engineering excellence we are renowned for. We plan for CapEx and R&D to be above depreciation and amortization across the period. This compares to 2022, where it was approximately GBP300 million below. We expect the net civil LTSA balance to grow between GBP0.8 billion and GBP1.2 billion per annum. This compares to a net growth of around GBP800 million in 2022.

And on working capital, we are forecasting a release over the mid-term. Then, cash tax payments. These will naturally increase in line with our profit growth. And as we pay down debt and strengthen the balance sheet, our financing costs should reduce compared to the GBP350 million outflow in 2022.

Last, the cash costs of closing out historical over-hedged positions, which were a drag of GBP300 million in 2022, will be gone by the mid-term.

Our actions will make our cash flows more robust and rateable, with our free cash flow to operating profit ratio improving across the period. Whilst we expect cash flows to grow in all years between now and the mid-term, it is important to note it may not always be linear, due for example to the timing and mix of shop visits. I will now dive deeper into the civil LTSA balance.

Civil LTSA balance growth

A key driver of our civil aerospace business model is that we receive cash inflows from engine flying hour receipts ahead of shop visit costs being incurred. The best way to understand the true cash impact to Rolls-Royce is to look at the net movement of the LTSA creditor, the offsetting LTSA asset, and the prepayments we make to our risk and revenue sharing partners. This chart shows that. It shows the expected growth in the net LTSA balance. As I said, we expect this growth to be in the range of GBP0.8 billion to GBP1.2 billion per annum to the mid-term.

Why? First, we have strong positions in growing markets. We expect robust growth in our engine flying hour receipts as the market continues to recover and grow and as our fleet expands. We expect large engine flying hours to grow between 120% to 130% of 2019 levels by the mid-term.

Second, business aviation. Here, engine deliveries will grow to 250 to 300 per year, which compares to 165 in 2022. These engines are used less intensively than wide-body ones, so the time between shop visits is longer, driving the LTSA balance growth. Third, on a normalized basis, we're also achieving a higher average rate per engine flying hour from our contracts. On top of these initiatives, we are seeing the benefit of some of our other strategic initiatives, including time on wing. As you'll hear from Rob, and if you get the opportunity from our great teams who are managing the expos, we have a comprehensive plan to extend the time on wing of our modern engines.

However, we still expect large engine refurbs to grow to 700 to 750 in the mid-term.

And finally, currency. The consumption of our legacy hedge book, means our mid-term guidance, assumes a blended ForEx rate of around $1.36 to the pound, compared to $1.50 in 2022. This drives a higher sterling equivalent for our dollar-based inflows.

So, as you can see, there are several factors that influence the net LTSA balance growth. As the gross numbers, such as invoiced flying hour receipts, are large, there can be a degree of volatility in any given year. To recap on LTSA, the growth in engine flying hours, the shape and expansion of our engine portfolio, and our strategic initiatives will drive growth in our net LTSA balance each year.

Working capital optimisation

Working capital. It is a key focus for me, for us, as we look to strengthen our balance sheet and improve our return on invested capital. We have a detailed plan to drive a material and sustainable improvement across the period. However, some of this benefit will be offset as we address legacy headwinds and support the business as it grows.

Overall, as the chart shows, we expect a net release of working capital over the mid-term, which will further increase our net liability position. Let me unpack that for you. We have completed a detailed analysis of each business, including industry benchmarking. We have detailed insights from this work, if I share just two. First, we found that supply chain management and production plans were not as tightly linked as they should have been.

And second, that supplier and customer terms were not always clear, consistent or adhered to. It was clear that we were and are leaving value on the table. Insights like these have helped us design programs that will support the sustainable release of around GBP2 billion of working capital benefit.

The largest opportunity relates to inventories. We are targeting a meaningful reduction in inventory days. Some of the steps we are taking across the group include improved demand planning, ensuring we order parts and materials only when they are needed, reducing holding times in our warehousing and optimizing buffer stocks.

In power systems, for example, we found we were holding several years' worth of stock when it was not needed. The team are now on that. In civil, we are reducing unnecessary buffer stocks by almost GBP100 million this year. Across all our businesses, we are improving how sales and operation planning links to inventory planning. Mindful of current industry challenges, we are also improving our supply chain management. We are working closely with our suppliers and we are driving tighter management of lead times, ensuring we have inventory when and where we need it.

We are making progress. We expect to release inventory in the second half of this year. We also see an opportunity to improve receivables. Squads are in place to drive down unbilled debt and ensure it does not build again. For example, in civil aerospace, we have sped up by more than 25% the invoice review process when engines are overhauled. And there is more Rob's team tell me they want to get after.
These improvements mean we have a clearer, quicker and consistent view of what should be built and when. Better for us, more predictable for our customers. We are also reviewing customer payment terms and sticking to them more consistently. We have implemented a

new tool across the group that gives us a more granular real-time view of customer debt than we ever had before.

It allows us to be more proactive and follow up on accounts before they become overdue. And we're also improving our payables performance through being more disciplined and consistent on supplier payment terms. So lots to get after and lots still to do. The team are owning and driving these changes.

But there are a few headwinds. The largest being an outflow associated with concessions, totaling around GBP800 million across the period. There are two roughly equal parts to this. First, deferred Boeing concession payments, GBP200 million of which impact 2023, which we have already guided. Second, an impact from historical agreements with customers to delay concession payments owed to them. These deals date back several years, in some cases more than a decade.

Our focus is now sustainable and quality cash growth.

Next, as group revenues grow between 2022 and the midterm, this will naturally result in a relatively small increase in working capital. But the big picture is we expect to release working capital over the midterm.

We are managing working capital differently. We are managing cash differently. We are focused on sustainable improvements, delivering a higher quality of cash flow. With that, let me move to our capital frame.

Capital framework

Our capital frame is focused on three clear priorities. A strong balance sheet with an investment grade profile. A commitment to growing shareholder returns. And a disciplined approach to investments.

Strengthening the balance sheet is a clear priority. We are positioning Rolls-Royce to better withstand volatility and external shocks and give us financial flexibility for the future. Better for us, better for our shareholders.

Our cash flow growth will enable us to reduce our gross debt by paying down our near-term debt maturities as they fall due. Namely, the EUR550 million bond in 2024 and the $1 billion bond in 2025.

The increasing strength of our liquidity position means we may also look to close some of our more expensive undrawn facilities early. The resultant improvement in our net debt to

EBITDA ratio will make our balance sheet much more resilient and should position us comfortably with an investment grade profile which we intend to maintain.

When we are confident that the strength of the balance sheet is assured, we are committed to reinstating and growing shareholder distributions. Whilst we are not at this point today, we expect to be there in the near term. And our current thinking is, our policy going forward will be based on an earning payout ratio.

This should result in growing shareholder distributions consistent with our expectations of profit and cash performance. Once the criteria for a return to distributions are met, I will come back and share more. The final area of our capital framework is our approach to investments. We will prioritize the most profitable growth opportunities across all of our businesses and allocate the appropriate level of funding to them to drive increased shareholder value. These investment decisions are ranked based on strategic fit, where we can and want to win. We have strict investment hurdle rates in the mid to high teens for our three established divisions.

We also have a group-wide investment committee process where Tufan and I review and sign off on all investment cases above GBP25 million.

To summarize, we are building a strong balance sheet which will underpin an investment grade profile in the near term. When we have strengthened the balance sheet, we plan to resume shareholder distributions.

Thereafter, we will optimize between shareholder distributions and further investment in the business. And our investment decisions are focused on driving greater value creation.

Key messages

To close, we are driving for a sustainable and higher quality growth in earnings and cash with an improved return on capital. This is underpinned by better operating leverage. We have a clear capital frame centered around creating and maintaining a strong balance sheet with an investment grade profile. We are committed to resuming shareholder distributions in the near term. Our investments and allocation of cash will always be returns and risk focused and anchored in strategy.

We are ambitious for the business. These are big steps we are taking. There is more we need and want to do. And we have the detailed plans to deliver our targets. And I am confident that we are building the financial strength to shape and own our future.

With that, let's move to Q&A. Thank you.

Q&A

Tufan Erginbilgic: Thanks, Helen. Okay, now we are going to open up for questions. David? Hi, David. David, I think you have sort of somewhere. Yeah, that should work, hopefully.

David Perry: Okay, thank you, David Perry from JP Morgan. I've got two on, and maybe the only time allowed today on civil aero. The first is, I'm a bit surprised by your view of engine deliveries, I think it's 300 to 350, which looks quite light compared to what Airbus and Boeing are guiding to. So you just talk to that. Have you taken a haircut or have you assumed a very low market share on the 787?

The second one is more philosophical, but based on the plan outlined today, you're going to be very profitable and very cash generative in the next few years. Are you still wedded to the LTSA business model? We know other companies are trying to encourage some of their customers to go towards more time and material. Did you consider that in your strategy review?

Tufan Erginbilgic: Okay, thanks, David. I think, first of all, on your second point, sort of LTSA business model. I mean, I said it all along that that business model actually works well if you price the risks well.

So, because who is complaining in a high interest rate environment, getting the cash in advance, but it comes with a risk profile that you need to price well. Second thing I'm going to say on that, our strategy is not unbundling time and material. So by doing that, we are actually creating flexibility for ourselves because your EFH rate effectively doesn't include time and material, and that gives us flexibility. And that is a change in strategy without any doubt because that change we actually made this year, effectively.

So, and I know you are keen sort of do we have a margin on it? We definitely have good margin on LTSA, and I can categorically tell you, given the program, six levers I talk about, and frankly, Helen touched on time on wing as well, those levers will actually improve not only contract profitability, but also our LTSA margin in this period.

So, I think your first question was, I think our plans, I'm going to make it very simple, our plans are totally in line with Boeing and Airbus plans. They are totally aligned.

There was one question sort of two row behind David. I don't know if still exists, but okay, over to you.

Rob Stallard: Yes, hi there. Rob Stallard from Vertical Research. A couple of questions, I'm only allowed two. First of all, on the disposals, 1 to 2 billion of gross proceeds, I was wondering if you could elaborate on what sort of assets you're looking to get rid of. You mentioned electrical, but and also what revenues those businesses might be generating at the moment.

And then with regard to the LTSA balance, the other part of that equation, of course, is the trajectory of shop visits. I just wanted you to give us some idea of how that's going to pan out over the medium term. Thank you.

Tufan Erginbilgic: So, I think I'm going to pass to Helen in a minute for shop visits. On divestments, I actually said 1 to 1.5 billion. You inflated that to 2 billion, but if we can achieve that, we will. But I think it is 1.5 billion. And I said it in my conversation, effectively, it is a -- when you have granular strategy, day one, some of you, I don't know how you helped, but I said, we need a granular strategy. It does many things for you. It becomes performance management and engagement tool. I won't talk about it in divestment context.

But what it does is it gives you line of sight, not only at divisional level, really subdivision, subsegment level. Then you decide with that kind of granularity, do you want to invest in that business or not? You can make decisions at that level. And that's what we are talking about here. Therefore, we set it across the group. That means all the divisions by definition. And it is true. And obviously, we specifically-- why did we talk about electrical specifically today? Because it is, in a way, one division that I needed to sort of highlight.

But others are actually subsegment, subdivision level.

Helen McCabe: I'll take the question in shop visits. So thank you, Rob. So as I said, so LTSA balance growth, we expect that to be in the region of 0.8 to 1.2 billion per year. As I said, there's a number of factors which does influence that, which is why we've given you a range. Shop visits and the mix of shop visits being one of those.

If I look out towards the mid-term year, I think it's probably holding your mind when it comes to shop visits in total, around 1,400 to 1,500. That compares approximately to be about 1,000 or 1,100. And Rob, I think, will give you more detail. He's given me the thumbs up. He'll give you more detail specifically on the large engine shop visits when he talks. I don't want to steal his thunder, but I've given you the total. Thank you.

Tufan Erginbilgic: Thanks, Helen. Oh, there are multiple. But you were the first one. Then I'll come to you guys. Yeah, go for it. Do you mind using microphone? Because nobody online, they cannot hear you.

Unidentified Participant: Yeah, can you hear me?

Tufan Erginbilgic: Yeah.

Unidentified Participant: [Nicola Ducat] from Spancap. So just a question on tax. You mentioned tax is naturally supposed to increase going forward. I think there's a big element regarding tax, which is the amount of net operating losses that Rolls-Royce accumulated over the year. That's a giant amount. Some is disclosed and recognized in the statements. Some is not. And it's, at least for me, it's a bit complicated to understand to which extent you will be able to use those losses and offset them against profit.

And it's not very detailed in the materials you provide. So do you plan to have a workshop on this? Because this could be quite a lot of value, to be honest.

Helen McCabe: So great question. So and I'm happy so we can take offline with the IR team and take you through more detail. So a couple of things I would say on tax. So you're absolutely right. I did say that we expect our tax charge to increase, as you would expect, in line with profit. I think from a modeling perspective, if you hold a cash tax rate of mid-20s, that reflects your geographical spread. Some of the shield that we hold in relation to tax in the UK.

If you go back and you look at our half-year accounts, we do have a deferred tax on the balance sheet of about 2.8 billion. There's some of that which is not recognized on the balance sheet. That becomes complicated. But looking as we've put the plan together, I do expect that deferred tax asset on the balance sheet to come down over the period. But it is rather complicated about how you bring on some of the new elements that haven't been recognized. So but we have looked at that and modeled it. But that is not driving any of our obviously profit and cash flow growth going forward.

But happy to take you through that in more detail offline.

Unidentified Participant: Great, thank you.

Tufan Erginbilgic: On the third row, there is a lady and man, unless ladies first, then we go from there.

Charlotte Keyworth: Thank you. Charlotte Keyworth from Barclays. I just had one question actually on pricing. You mentioned about the one of the factors in the LTSO balance growth was actually your engine flight hour for wide-body increases. I know it's a commercially sensitive topic, obviously, but you've seen some benefit from that already in the first half of the year.

How much how should we think about that from a sort of tracking perspective to the medium term? Obviously, you've been having discussions, I should imagine some engines are easier to discuss than others in terms of potential uplift. But I'm just really...

Tufan Erginbilgic: Short answer is obviously, we want, I mean, as I said, sort of, we always want win-win solutions with our customers. And that goes into also contract question. But contract improvements, the way you need to think about how do you improve profitability of contracts, we actually have six levers. Pricing is only one, right? So I'll come back to your question. I'm not sort of deflecting on it, but it is important that we have other levers.

When it comes to pricing. Yes, we take commercial actions, because we need to reflect the risks. My answer to David's question, because new engines have more shop visits and so on. This is an industry issue, industry, more fuel efficiency, that means engines come to shop visits more often. So we need to price it in the right way. Yes, Helen said it already, per rate, you should expect that to go going forward every year. And that is effectively what we have here.

Helen, do you want to add anything to that?

Helen McCabe: I think you've covered it too far. And I think, you know, I don't know if this is behind your question, but maybe just an additional piece. I think we're saying that by the midterm, when we get to that year, then substantively we have unwound the majority of the onerous contract provision. So I think it's most definitely not back ended by 2027. And we do expect to have worked most of that through.

Charlotte Keyworth: Yeah. Thank you.

Tufan Erginbilgic: Thanks, Helen. We'll go. Okay. There are three. I didn't realize it is three. Okay. I thought it was two.

Unidentified Participant: (Inaudible) so I guess I have a question from my side. (Inaudible) head of the report. Okay. (Inaudible) So you said CapEx and R&D are going to increase going forward in the new box of situations. Can you give any estimates for the quality of the market, going forward?

And second question on XWV97. (Inaudible) There has been some press articles about and there is some writing about the durability of those engines. (Inaudible). Do you want me to repeat the question?

Tufan Erginbilgic: No, that's fine. We will repeat. Helen, do you want to pick up the first one? I'll take the second one.

Helen McCabe: Fantastic. Thank you. So two parts to your question. So CapEx and R&D. So we're not going to give year on year guidance, but I think easy way to hold the CapEx is our net investments are increasing each year. And if you use 2022 as a base, actually over the midterm, they're going up by more than 300 million. Yeah.

Versus 2022. R&D, the simplest way to hold that is we expect our gross R&D spend to be broadly flat over the period. Now, the important thing to remember there when I speak to R&D and CapEx is because of the actions that we're taking as part of our strategic review, our portfolio will be smaller and more focused. So actually, that is in a light for light portfolio basis spend. But I think those two data points will help you with that triangulation.

Tufan Erginbilgic: Okay, I want to be done with that row and we'll go somewhere else. XWB, I'm sorry, 97. Let me tell you this, first of all, the best engine in the industry is XWB84. Right. So let's not be sort of it is the most efficient durability and reliability perspective. Best engine. If you come to XWB97, higher thrust engine, the same sort of family, I should say. And it is actually very good engine. It has been out there almost five years. If you look, we sell it really well and Airbus sells it really well. Therefore, in benign environments, it is very good engines only in very harsh environment like sand, etc. Then obviously some Middle East sort of Middle Eastern countries sort of tend to be in that category.

What we are looking to do in this period are time on wing improvement for all the engines that also include 97. And it will actually improve in that period significantly. And it will be like our 84, if you like, because it will further improve benign environment time on wing, but also it will significantly improve non-benign environment.

So I'm going to move that way because otherwise, let's go there.

Charles Armitage: Good afternoon, Charles Armitage. A couple of questions.

First of all, resilient. It's on either side of you. You are the least resilient or Rolls-Royce, you were you were during COVID. You know, five, four billion outflow, a billion of that was factoring, but so three billion underlying MTU had zero, Safran had cash inflow. How are you changing the way you do business to make that more resilient?

Tufan Erginbilgic: Very good. Great question. The heart of what we are doing. So let's talk about that. Right. Your cash goes to gross margin ratio is point nine in 2019. So going into COVID, Rolls-Royce at point nine. I run lots of businesses in my career. I never seen point nine. Frankly, it is a revolution for me. Right. So there is always learning opportunity in life. But so when you are point nine, what is it telling you? You don't need COVID. You need a good recession. You are going to be in negative territory. Right.

That is a mindset. You may look at it. You may say, too funny to scale this, that today's targets telling you that is a mindset and the performance improvement and how you actually run the business. Right. If you allow that to happen, you will never be resilient. Now you come to point four, which is I talk about if you remember that business in enormously resilient. But I'll give you another lens on resilience. Right.

What this plan is saying, because we are now creating value not only in civil airspace, but actually two more rateable businesses, power systems and defense, their cash generation will be a lot more than in the past. What does it do? Rateable break. So you not only sort of TCCGM resilience, you also create cash generation perspective to breaks that actually not volatile as much as civil airspace. And then you think you do third thing in civil airspace. You create that TCCGM lots of room to play with when the volatility comes.

That is what we are doing with this program. So this is not a bunch of numbers. They look cash is good to profit, whatever, however you hold it. It changes the shape of the business. Therefore, I say it transforms the business. Right. Those words there actually mean something for us, every one of them. And that's what we are doing. That is mindset. If actually Roche-Roche did that in 2019, they would have dealt with COVID a lot better. I can tell you a lot better.

Charles Armitage: Excellent. Sorry, my second question, if I may.

Tufan Erginbilgic: Oh, Okay.

Charles Armitage: You mentioned about LTSAs and pricing the risk correctly. Presumably you have, I'm sure you have plans on how time on wing, how the costs of the overhaul, the cost per hour will be coming down. How can we get comfortable as external people? How can we get comfortable that those are priced appropriately and that you haven't made on the downside huge assumptions that time on wing is going to get up, you priced it accordingly. And if it doesn't come in like that, there's downside risk. How can we get comfortable with that?

Tufan Erginbilgic: So I think Rob will talk this afternoon sort of time on wing improvements. We are planning next three, four years, 40 percent improvement. Right. All the engines will improve sort of at varying degrees, not all the same. Obviously, most improvement will come from 97 and Trent 1000, as you may expect, frankly.

So I think that's there in contract accounting, frankly, when we deliver that time on wing, I think there is an upside, I would say. But we put normally contingency in case it is not delivered. What it does tells you is actually when we deliver, there is going to be upside because of the contingency. Right.

So and I think Simon is here at break. He can explain to you how we are going to do that. But I'll tell you, Trent 1000, we doubled the cycle time already. Once it is certified next year in Boeing, it is actually with Boeing. There is nothing we can do or should do. It is technically right. They know it is technically right. We need Boeing FAA certification effectively. And that's going to more than double Trent 1000 cycle time already.

This is not a sort of new work. Let's see what the engineers do. It is done. We know it works because we did the same in Trent 7000. It works. They are sort of brother engines, if you like.

Helen McCabe: So we've also got the Expo outside actually with the teams. You'll hear the passion from them about what they're doing on time and wing. So that may be a nice one to visit. But you'll hear the motivation and the detail from that as well.

Tufan Erginbilgic: Very good, Helen. Good reminder. I'll go there. Sorry. I need to go to you. Otherwise we will have a problem. Sort of a revolution.

Nick Cunningham: Thank you. Nick Cunningham from agency partners. I hope you don't regret allowing me to ask my question. It is a technical modeling type question really which is you're giving absolute numbers for 2027, some numbers. Is there an inflation assumption built into that? And if so, what is it? Or is that all on 2023 prices? And then if you like, the sort of second but very related question is that the cost reductions, for example, the GBP400 million to GBP500 million pound total cost reduction you've talked about, is that an absolutely lower cost relative to 2022 base or is that relative to where you would be in 2027 based on the volume expansion you expect?

Tufan Erginbilgic: Okay, we don't do smoke and mirrors. I'll tell you that. I think a second part of your question is very clear. It is lower cost 400 to 500. Okay, there is no it could have been this. It would have been this because this is not a financial modeling. Right. We spend good time on strategy review.

Then to me, financial plans are strategic plans. You just financialize the strategy you work. By the way, when you are working this strategy, you are already financializing. Right. So what is the growth potential of this market? Are we differentiated? How much we can grow? That's in a way financialization already. Right. Then we translate all those into five year plan. Therefore, this is not a sort of less model things. So it is pretty much grounded in our strategic review and the financials. Yes, it has inflation assumptions, ForEx assumptions and so on and so forth. We won't share it with you, but sort of you can see where the world is going. Obviously, front end higher inflation, lower end sort of less so. And then that applies to cost, et cetera, and so on, as well as obviously top line.

Yes, we do apply. I'll go here.

Julian Cook: Thank you, Julian Cook from Atka Capital. It seems that on the narrow body, you've already made a decision to partner as opposed to maybe going on your own. I mean, we saw you used to be with Pratt and obviously decided not to go ahead with the geared turbofan, which with hindsight is probably a good decision. Why so early a decision not to perhaps go on your own?

Tufan Erginbilgic: So I think what we are saying is given the great work Simon and the team did on UltraFan, frankly, for some years, that and the IPs we have on UltraFan. I think we are well positioned for wide body as well as narrow body. Yes, we are saying financially, I think, sort of to de-risk things a little bit, partnership approach will be a good approach for the next generation.

Obviously, partnership needs to work. If it doesn't work, we can consider alternatives because we are actually bringing a technology into this. So that's how we see it.

Julian Cook: Yeah, following up on narrow body, does it really make sense to enter in that space through a partnership? It's a very competitive playing field and is it worth the investment?

Tufan Erginbilgic: Okay, I will disagree with you. I never called duopoly a very competitive place, but economics books will disagree with you, I think. But duopoly it is. And with high barriers to entry. We can go in because of our technology and engineering and so on. But we are the probably only one who can go in.

So therefore, for the, we will, I said it day one, we will not do anything which is not going to bring profitable growth. We are, we don't, one thing I want you to take away from this, to deliver these numbers and grow beyond that, we don't need to enter narrow body. It is an opportunity. And given there are only few companies, I'm not going to name others, in the world who can actually do that with partnership approach, I believe it can be a profitable place. And if it is not profitable, we won't do it because we don't need to do it.

Roger?

Unidentified Participant: Can you hear me?

Tufan Erginbilgic: Yeah, yeah, Roger, go, go for it.

Unidentified Participant^ So if you're, thanks for the presentation, if your financial targets are met, you know, ballpark, not exact numbers, but something like over the next four years, you could generate, call it 10 billion of free cash flow. There are not that many high quality growing companies in the world with high barriers to entry that could convert half of their market cap to cash over four years.

So my question is, why isn't, you talk about getting a good return on investment, why isn't buying back your stock one of the better returns on investment?

Tufan Erginbilgic: Sorry, why buying Microsoft?

So, so let's go, Roger, thanks for the, yes, your, your math, your math is not too bad. So I think we will generate cash, definitely. One thing I will disagree with you, the half of sort of market cap, because I'm hoping market cap will be a lot more than that at that time. But sort of, but I take your point. So I think, frankly, when we create strong balance sheet, which is, which is our intent, and we will reestablish, Helen talked about, shareholder returns, and then we are already investing quite a bit in this.

Frankly, one thing you should take away, our investments here, therefore, I said, midterm targets is a milestone, will actually deliver more in the future. Like take time on wing, you can actually interrogate my friend Rob in an hour time or so, you will see his time on wing and Simon's improvements will actually deliver in this period, but deliver more in the next period, I can tell you, genuinely tell you.

So therefore, this is a milestone, we will keep going, that will then I, we would like to be in a position to say, okay, depending on how we see the world, depending on share price, we can decide to give more to shareholders, it can be buyback, it can be whatever, or further investment into the business.

Frankly, when I came day one, I mean, I -- I didn't have that luxury. So to one, where do you want to invest? So it was an academic question.

So right now it is becoming with the delivery of this plan, it is becoming a reality, but we will be very responsible. We are not after market share. I said it many times, we are after good, high quality profit and cash generation, but sustainable cash and profit generation of this company.

So sorry, is there one more question or not?

Isabel Green: I was going to let the one last question come from our audience online, but if you would like to keep it in the room, that's okay.

Tufan Erginbilgic: Let's get one last and then we'll go to Isabel. Apologies. We couldn't answer all the questions, but…

Ian Douglas-Pennant: I appreciate you taking me. It's Ian Douglas-Pennant. I even moved seats in order to catch your eye line. So I appreciate you.

Tufan Erginbilgic: You did well, by the way.

Ian Douglas-Pennant: Sitting in the corner, by the way, for those who want to ask a question. Terrible idea. So two questions, please. Firstly, for Helen, you said that the improvements is going to be progressive, but not linear. How not linear should we assume it is? I mean, given the performance that you had in H1, is it like 80% in the first half of the planning period? Can you help us think through that?

And secondly, if I think about the cash flow targets that you've given, at least versus my numbers, the big difference is the time on wing or the shop visit assumptions. Could you help us break down to find just like philosophically, the magnitude of the different interventions that you're making and how important they are in driving the difference, just holistically speaking?

Tufan Erginbilgic: So I'm going to ask Helen to cover the first question, but let me pick up your second question. I think this is important, okay? Because I realize, frankly, before we announce, I realized sort of, you may not get to the free cash flow that we are getting to. But there are good reasons. This is really high quality and sustainable cash flow. So what is in it? It is driven by operating profit. And in 2027, we have more cash based operating profit in 2027, rather than provisions, et cetera, et cetera.

Therefore, more of the profit converts to cash. That is very important. Second important thing is LTSA growth. And Helen talked about the drivers of LTSA growth. I'm not going to repeat those drivers. But if you take those drivers, let's break that apart. It is effectively your installed engine base is growing and with an extended time on wing and your commercial practices increasing your unit rate.

That is sustainable as long as you continue to increase your installed base. And if you look at our forecast, therefore I'm saying LTSA growth will be sustainable. Because if you look at for a while, probably maybe 10 years, you should expect those drivers in force and with growing installed engine base. If you actually combine the two high quality cash based operating profit with sustainable growth in LTSA and the margin profile on that LTSA balance, is improving every year. That's going to be the case.

Suddenly you have a pretty sustainable model for a long time. That's how philosophically you should actually think about this. Helen, over to you.

Helen McCabe: So thank you. So to your question on progressive and not linear. So the way to hold that is we do expect year on year profit and cash growth. But you can't necessarily take a straight line and draw from 22 to 27. I don't think that's our experience of how transformations have gone in the past. And indeed, there's too many variables in there.

But a couple of things that I would just reinforce year on year profit and cash flow growth we expect. And in case there's any concerns, it's most absolutely not back end loaded. I think I already shared two data points on that. Working capital, we expect a release over the period. That is not a big release by the midterm. And we already spoke around onerous contracts and catch ups.

Yeah, that is not coming towards the back end as well. So hopefully that helps.

Tufan Erginbilgic: So thanks, Helen.

Isabel, over to you.

Isabel Green: Thank you, Tufan. And we have got a very large audience online. So I'm going to quickly squeeze in a question from George at Deutsche Bank, who mentioned, would we consider retendering for debt to accelerate RD leveraging?

And also asked, now we're mentioning investment grade profile as opposed to investment grade rating. Could we confirm that the latter is still the priority before resuming shareholder payments?

Tufan Erginbilgic: So I'll let Helen to answer the first one. Investment grade, we talk about profile because that is in our hands. We can create that profile. We are not a rating agency. Therefore, we cannot rate ourselves. That's why we talk about profile. And Helen talk about it in near term. We expect to get there. And frankly, you can you have nice models. You can model it. You will see that in near term we will get there. And therefore, we talk about investment grade profile.

Over to you, Helen.

Helen McCabe: Fantastic. Thank you. So to the question on debt, as I shared, we actually have plans to reduce our gross debt from our cash. So we have maturities that fall due in twenty four and twenty five. We're very clear that we will close those down through cash and we have no intent of strengthening the balance sheet and getting back to that investment grade profile by raising cash. So that's not our intent.

Isabel Green: Thank you both. And we are just very slightly behind schedule. So we're taking a break now. The schedule does say we'll return at ten past three. I think we'll make that nearer twenty past three to make sure everybody has got enough time to get through the expo.

So if you're watching online, please take this opportunity to enjoy the videos that we shared on our website. For those in the room, you've got a map in your bag showing the layout of the exhibits. You will see we have a dedicated exhibit area on the outside of the auditorium near where you came in this morning.

We are restricted on the number of people we can have in the area. So we'll be operating that on a first come first serve basis.

Presentations and Q&A in that area will take about 15 minutes for each stand. And there are other exhibits outside the doors. If you could leave, please, through the doors down here on the right. That will help with your flow into the expo area.

We're going to be using this auditorium for two of the exhibits. These two are not repeating at the end of the day, but the presentations will be around still later if you want to ask them. So please do some of you stay here or come back to hear that team.

Our executive team will also still be on hand in the coffee area if you want to ask them questions. So enjoy your break and see you back here in just under an hour.

Thank you very much.

Welcoming Remarks

Isabel Green

Head of Investor Relations, Rolls-Royce Holdings Plc

We are I think live again online so welcome back everyone in the room and online. We will now continue with the formal part of the afternoon with presentations from each of our business presidents.

There's more time for Q&A with all of the presenters at the end.

So now it gives me great pleasure to welcome my colleague Rob Watson, President of Civil Aerospace to the stage.

Civil Aerospace

Rob Watson

President, Civil Aerospace, Rolls-Royce Holdings Plc

Introduction

So good afternoon, welcome back. I hope you had a great break and took the opportunity to explore the Expo either in person or online and for those in the room I also hope you had the chance to talk to some of our inspiring colleagues to learn more about the actions we're taking to turn Rolls-Royce into a high-performing, competitive, resilient and growing business.

I'm Rob Watson, President of Civil Aerospace and I've been at Rolls-Royce for 13 years and have worked across all the divisions in defense, with power systems and in global and operational roles across the group. I'm going to build on Tufan and Helen's presentations and take you a little deeper into the civil business. Our view of the market opportunity and the strategic levers we're focusing on to drive the margin improvement Tufan mentioned, taking us from just 2.5% to 15% to 17% in the mid-term.

Civil Aerospace – Advantaged products and services in growing markets

Firstly, most of you know our business. Put simply, we make and service gas turbine engines for aeroplanes. You'll see in the civil fact sheets that we power more than 35 types of commercial aircraft and today we have more than 12,000 engines flying around the world. On this slide you can see how we think about the core product portfolio for the business.

In business aviation we have roughly 70% market share of all aircraft in service in the large cabin business aviation market in 2022. We actually have closer to 85% share of the very long range and ultra long range aircraft which is the most valuable segment of the business aviation market.

This position is important because while the very long range and ultra long range segments is forecast to grow between 3% and 5% by 2030, our growth will be between 8% and 9% per year as we bring new engines into the market.

In the mid-term we expect to see engine flying hours for Rolls-Royce powered business aviation aircraft increasing to between 120% to 130% measured against levels from 2019. In widebody we had a 55% OE delivery share in 2022 and 36% market share of installed engines. We power four out of five new generation widebody aircraft and we're sole source on three of those. It's a great position to be in.

While the total widebody market is forecast to grow between 5% and 7% per annum to 2030, we expect to grow above the market rate due predominantly to the growing installed base of Trent XWB engines and the related growth in engine flying hours that drives our revenue.

In the medium term we expect to see engine flying hours for Rolls-Royce powered widebody aircraft recovering to between 120% to 130% of 2019 levels. Our competitiveness has been proven this year as we've won major orders for example from Air India and Air France, more recently with EVA, Egypt Air and Ethiopian Airlines and we also see further upside potential from freighter orders too. I'll talk more about that later.

As I mentioned we also have a strong presence in the regional market and with the V2500 with 2,000 regional aircraft in active service and more than 35 to 40 million engine flying hours still ahead of us and we also see an opportunity to continue to support the V2500 into the 2030s.

So to recap we're in valuable market segments, we're building on a strong industrial base and our installed base strength and forecast for new deliveries means we expect to grow materially above the market rate for both business aviation and the widebody market.

Capturing performance improvement opportunities

Let's talk a little about how we see our growth in the medium term.

Our operating margin target range is 15 to 17 percent and judging by the reaction on people's faces when Tufan shared this, you appreciate it's a big improvement. So how will we get from two and a half to 15 to 17 percent? We'll achieve this by executing granular focused plans that will underpin profitability in our business aviation and widebody businesses as well as the enterprise level focus on transforming our business into a simpler and more efficient operation.

I'll explain each of these initiatives over the next few minutes but in essence the market success of the Pearl engine family in the business aviation market has been outstanding and as a result aircraft deliveries will grow 9% per year over the mid-term and we'll see aftermarket growth and we'll focus on commercial optimization.

Then in widebody we focus on six levers which underpin delivery of the margin growth, keeping our engines flying for longer, value-driven pricing, contractual rigor and then staying focused on controlling shop visits and product cost and extending time on wing.

These commercial and cost disciplines will drive our aftermarket margin improvement and finally we're leveraging the power of One Rolls-Royce to simplify our organization and drive efficiencies. We're already seeing tangible benefits in areas such as third party spend and disciplined capital allocation. All of this activity is underpinned by our culture, it's our people who will deliver this improvement and we'll retain our focus on product and people safety that you would expect from a world-class engineering organization and the great news, we're already seeing tangible results. Our margin in the first half of this year is already double digit and we have clear plans to continue to build on that progress for the mid-term.

Business Aviation – Strategic initiatives driving margin improvement

So business aviation, let's talk a little more about how we're on track to deliver returns that are materially above industry average and basically there are three drivers.

First we're increasing our market share with our new Pearl engine family which is seen as today's engine family of choice in this growing market segment. We've won the last three major campaigns due to the engine's superior performance and if you've not already Dirk and Helen are available to talk at the expo about this fantastic engine family. By 2030 the main platforms in this market will be Rolls-Royce powered, Bombardier's aircraft with the Pearl 15, Gulfstream with the Pearl 700 and Dassault with the Pearl 10x.

And why are these wins important? Well we're playing in the biggest business jet segment which accounts for more than half of the total value of the business jet market. Second there's a similar growth story in the aftermarket, our installed base is growing, we delivered 165 engines in 2022 and we see that growing to 250 to 300 engines in the medium term, that's growth of 80%.

We're seeing continued growth in flying hours, business aviation bounced back strongly, we're currently at 110% of 2019 levels and we also have a very popular and differentiated services model, corporate care, which provides comprehensive support and maintenance for our customers and here we're seeing two to three percent annual growth on top of an already large installed base of BR710 and 725 engines.

Finally to maximize this market growth, what really matters is our commercial and cost discipline.

Over the mid-term we'll deliver 100% operating profit growth by reducing our unit cost, improving our commercial terms, and implementing value-based pricing.

Widebody – Strategic initiatives driving margin improvement

Okay, for widebody as I referenced we have six levers to improve our margin performance, let's talk about the first three. Firstly we have a significant installed base which is incredibly important to us, we're absolutely focused on keeping our engines flying and earning for as long as possible.

For example with the Trent 700, our most profitable widebody engine today, we're focused on contract extensions and transitions, basically the transfer of ownership from one operator to another, and in addition the A330 passenger to freighter conversion market, a rapidly growing market, is a really good opportunity for us. Our Trent 700 has 80% market share of all committed freighter conversions on the A330. This is important as the engines are likely to fly much longer as freighters than as passenger aircraft.

Commercial optimization is also critical, as you would expect we're also reviewing our contracts and working hard to get better value propositions for ourselves and our customers, and we're doing this by creating win-win opportunities, identifying areas where we can provide additional value to our customers, such as additional service coverage or enhanced engine availability, while securing better terms for Rolls-Royce.

By doing this, we aim to increase our operating margin and in some contracts release some of our onerous contract provisions. We're also adopting a value-driven pricing strategy for new contracts, spare engine sales and our time and material business. This ensures we capture the maximum value from our engine and the aftermarket services that we sell.

Our strategy takes into account market trends, customer needs and competitive dynamics. It also sets the right price for our aftermarket service contract based on the risk and service we offer over the contract duration. This is hard work for the team but we're already having an impact and importantly our teams are confident they have my and the wider management team support in driving these negotiations to successful outcomes.

Finally engine volumes and mix drive a lot of opportunity. We plan to grow ahead of the total wide-body market growth through to the end of the decade. There are some significant metrics behind this growth. Over the medium term OE deliveries will increase from 190 to between 300 and 350 a year. Major refurbishments grow from nearly 250 to between 700 and 750. Annual total shop visits grow from just over a thousand to between 1100 and 1200 and our LTSA engine flying hours grow from 10 million to over 18 million over the same period, growing to between 120 to 130 percent of pre-COVID levels by the mid-term.

Widebody – Strategic initiatives driving margin improvement

The next three strategic levers really focus on how we underpin profitable growth. First let's start with time on wing. Put simply this is extending how long our engines stay on wing and therefore lowering the number of shop visits. The real determinants of time on wing are the operational profile of the engine, where it flies, at what rate, for how long and the consequence durability of the engine's parts. To keep engines on wing, we're continually investing in product developments to drive durability across the fleet and we continue to forecast at least a 40 percent improvement in time on wing in the medium term. For example we've been improving the design of HP turbine blades in our Trent 1000 and Trent 7000 engines to give them a longer operating life. And where we have life limited parts we're focused on extending that lifing as it's often the expiry of these parts that drives a shop visit.

Secondly when we do get to a shop visit we are focused on reducing the cost of each shop visit across all engine types. By mid-term we'll have halved the cost of a Trent XWB shop visit. In fact at that point the XWB will be at a cost of a half of the cost of a Trent XWB shop visit. The XWB will be the cheapest of the Trent overhauls, a major opportunity for us given its position in the product portfolio towards the end of the decade. And we're achieving these cost savings through multiple initiatives including using AI tools to manage the work scope of a shop visit, optimizing how we strip and build the engine to keep time in the shop to a minimum, investing in technology to improve our repair capabilities rather than replacing parts and where possible making better use of service use material.

Finally we're continually focused on product cost reduction. Here's two examples that bring that to life. Firstly focusing on our high performing suppliers. We're transferring work to them from under underperforming parts of the supply chain. Of our total two and a half billion spend in the external supply chain this year, GBP685 million is spent with this group and since 2020 we've awarded GBP3 billion worth of work to our high performing suppliers.

Secondly we've roughly 200 engineers focused on driving technical cost out, identifying how we can reduce costs through better parts design, manufacturing methods and reducing scrap and waste. And we continue to wrap a digital thread around our operations whether this is using our intelligent engine to support in-service engine performance or our smart factory which connects supply chain data to create a manufacturing digital twin.

This enables data driven decision making to minimize capital expenditure, working capital and waste.

In summary this laser focus on our six strategic levers will improve margin performance and profitability and if you've not already I encourage you to speak with some of our brilliant team in the expo or watch the videos if you're joining us virtually to learn more about some of these exciting initiatives.

Transition to lower carbon

As well as focusing on operating margin improvement we also remain focused on our future, critically the energy transition and the drive to reduce emissions in our sector. Our starting point is to maximize the efficiency of our current fleet as many of these engines will remain in service for the next two decades and beyond.

The Trent XWB84 really sets the benchmark here with 15% better fuel burn than the original Trent engine and great reliability to match. I think as Tufan mentioned earlier it's delivering 99.94% on-time reliability for departures for our operators today.

The Trent 7000 powering the A330neo is the latest addition to the Rolls-Royce widebody family and has a similar step up in efficiency and we've demonstrated that all our production engines are 100% SAF compatible and excitingly today as Tufan mentioned, and hopefully, you saw out in the expo we're powering the world's first commercial transatlantic flight fueled by 100% SAF and my customer director Ewan is on board. I spoke to him before the flight took off and he said the buzz was electric and this is a big step forward not just for Rolls-Royce but the whole of the aviation industry and for Ewan's selfie collection with Richard Branson I imagine.

Part of the SAF story is around achieving scale in production volumes which is not within our control. What we can do though is continue to focus on ever more efficient gas turbines because whatever the fuel source, it will be a gas turbine powering large aircraft for decades to come, and here our UltraFan technologies play a critical role. Earlier this year we started testing our UltraFan technology demonstrator engine in Derby and we've now run the engine at full power. It's another major milestone. And as the engine architecture is scalable it can be considered for both wide body and narrow body applications on future platforms. And while we expect this geared architecture will be 25% more efficient than the first trans engines and therefore a critical step in our sustainability roadmap some of the technologies can be used in today's engines to play an important role in driving time on wing for our current fleet.

So as well as continuing to invest in technology we're embracing earlier opportunities to exploit this technology in our current fleet.

Key messages

So to recap we're in valuable market segments, we have a strong installed base and we expect to grow materially above the market rate for both business aviation and the wide body market. We're focused on commercial and operational discipline and the levers outlined today will ensure we deliver 15 to 17 sustainable operating margin growth over the mid-term.

We've already made good and tangible progress as you saw in our half-year results and fundamentally enabling the energy transition remains a priority for our future.

If you were to ask me what's different and why I'm confident our plans to deliver this level of performance improvement will deliver my simple answer would be we're clearly aligned as One Rolls-Royce. We've got detailed granular plans and we're rigorously performance managing our operational execution. We know what we need to do and how we're going to do it and as you've seen in 2023 we've already made a great start.

I hope you found this session informative and insightful. I'll be happy to answer any questions in the Q&A, but now, I've got great pleasure in handing over to my esteemed colleague President of Power Systems Jorg Stratmann.

Power Systems

Jorg Stratmann
President, Power Systems, Rolls-Royce Holdings Plc

Introduction

Yeah, thank you Rob for handing over and congrats on the flight today. I think this is some kind of historic. So also a very warm welcome from my side or guten tag as I would say at home. It's really a great pleasure for me to introduce Power Systems which is a substantial pillar of the Rolls-Royce Group.

But before I start I'd like to say a few words about myself and also my passion.

I joined Rolls-Royce about one year ago coming from the automotive supplier industry which is known for its emphasis on continuous improvement, process optimization and also rigorous cost management. And my goal when I joined Power Systems was to transfer this knowledge and experience. And I'm happy of all the improvements we have already today implemented and the momentum we have generated for the changes to come. And this is exactly why I wanted to be part of Rolls-Royce.

I'm often asked if my expectations have been met and I can tell you they have been exceeded and this for many reasons. Our great markets with diverse applications and our extensive customer base. But also I'm impressed by our outstanding technology and by the continuous efforts of our highly engaged employees who enable us to achieve successful and sustained business performance.

So today I want to set out our strong positioning in highly attractive growth markets, our strategic initiatives to capture market performance improvements, and how we are already transitioning to lower carbon solutions. So let's talk about how we will explore the full potential of Power Systems.

Power Systems – Resilient business model in attractive growth markets

Power Systems operates in highly attractive growth markets. And based on our strong product portfolio and our unique sales and service network, we are a leading player with double digit shares across our markets.

So in power generation, we are a leading supplier for a variety of applications such as the rapidly growing data center market. In governmental, our propulsion systems are well placed for the current investment cycle into military vehicles and naval vessels with a strong market share of above 30 percent. In marine, we have a market leading position in the highly profitable yacht market and also a strong position in commercial marine. And in industrial, we are a key supplier to service intensive applications with high running hours like rail and mining.

All our markets show an excellent outlook with an annual growth rate of two to seven percent and often, and this is important, often decoupled from GDP development.

So for example, our power generation business benefits from the global digitalization growth leading to significant investments into new data centers and resulting in an average growth of 5% to 7% per year. And in governmental, the current investment cycle leads to a market growth of above 10% per year in the next three to four years.

Our broad positioning in different industries further makes us resilient to market volatility in individual sectors. And across our markets, we can leverage an installed base of more than 160,000 units. And this installed base is the basis for our service revenue, which represents about one third of our total business. Compared with our peers, we have structural advantages. And these include a higher share in the more attractive high power segment, a unique and great mix of products, systems and solutions, and a very good market understanding through direct customer access.

So building on these advantages, we have defined clear strategic initiatives to outgrow the markets and significantly increase our returns. So now let me set out our plan to build on these advantages.

So again, I would like to set out our plan, how we build on these advantages, and how we will significantly improve our performance.

Capturing performance improvement opportunities

So we will deliver our strong profit growth through four key strategic initiatives and additional efficiency and simplification measures across our business.

So first, in power generation, we are focusing on optimizing our cost structure and further scaling the business, benefiting from our strong position with key data center customers. And these scale effects will also create additional benefits as the engine platforms are the same across our different markets.

Second, in governmental, in our governmental business, we are aiming to capture strong growth through our leading market position and also expanding our product scope.

Third, in marine, we will strengthen our market position and realize further growth through our system strategy. And fourth, our battery energy storage system business complements the power generation business, which is strong data center segment, and it expands our markets towards new applications such as utility scale storage.

We expect that the demand for battery storage will grow at around 20% per year, and we will continue to leverage our existing system capabilities and market access to even outgrow this market.

And finally, we will increase efficiency and drive simplification in our business. So to give you some specific examples, we will streamline our organization, we will reduce third-party spend by an optimized supplier portfolio, and we will create additional synergies with Rolls-Royce.

And we believe these strategic initiatives will unlock our potential and bring us to an operating margin of 12% to 14% midterm. And yes, there's a lot to do, but our teams are unified behind this. So next, I will give you further details on the first three initiatives, starting with power generation.

Power generation performance improvement

So power generation is a highly attractive growing segment with a huge profit pool and also significant margin improvement potential. With a 9% revenue growth per year, it's also one of our biggest growth drivers. And this growth comes particularly from more than 20% increasing annual spend into AI-ready data centers.

So and thanks to our strong position in this market today, we will capture this significant growth.

We also see great potential in service through additional offerings such as upgrade and retrofit kits or also digital services. So we are planning to double our service business midterm.

Significant potential also comes from an increased focus on commercial optimization. So first, we are optimizing our internal cost structure and investments. Second, we will benefit from volume effects. And third, we will leverage our global production footprint.

So for example, we will benefit from an increased localization of our engines by 40 percentage points in China.

On top of these measures, we are investigating to further broaden our offering and improve our cost structure through strategic partnerships. This will help us to share investments, capture market share, and also lower our cost base.

So just -- on a side note, it might be interesting. So do not worry about any blackouts today, as this building and also this room are backed up by our power systems engines. So there are eight of them on the roof of this building.

Profitable governmental growth

So let's talk about our governmental business. The governmental market is highly attractive for us with strong growth, good margins, and a leading market position. And here we are a key supplier for tank programs of the NATO partners, and we also see increasing demands of the NATO allies. So in fact, we serve major tank platforms around the globe, such as the Leopard, the Puma, the Boxer, or the MT Booker. And current geopolitical tensions have resulted in increasing security needs globally. And therefore, we see more than 10% annual market growth in the coming next three to four years.

And we are in a strong position to capture that growth and even outgrow the market from both the sale of new equipment and also higher service revenue. In addition, we see opportunities to provide our customers not only with a perfect propulsion system, but also with more integrated solutions, such as ship automation products. And we are well positioned to triple our revenue in this area.

We also focus on disciplined investments in technologies to strengthen our longer-term opportunities and to underpin our leading position. So now, let's come to our marine initiative.

Profitable marine growth

Marine is a key profit contributor for us with even further potential for profitable growth. Here we plan to strengthen our number one position in yachts and improve our position in commercial marine through the following key levels. So first, we will create profitable upsell potential and differentiation by providing our customers with fully integrated solutions from bridge automation to propulsion systems. And as part of this bridge to propeller approach, we acquired the company Team Italia this year, a high value player with strong automation capabilities enabling us to offer integrated bridges for luxury yachts.

And let me tell you when you are on a ship or even better on a yacht and you look into this engine room and hear the engines running, power systems engines, this is spectacular. It's really spectacular. It's fantastic. Whenever you have the opportunity, please do so.

Second, we will secure our leading portfolio position by offering alternative fuel-ready engines to support our customers transition towards sustainability. And alternative fuels will play a key role, especially in short and midterm transition. And our key engine platforms are already being released step by step to run on these.

In the long term, we see methanol as the prime decarbonization path and therefore also developing methanol-based solutions for our engines.

And finally, our high margin service business provides us with great growth opportunities with a revenue share of more than 40%. It is a substantial profit contributor. And to capture additional potential, we are developing new digital solutions such as equipment health monitoring, which provides our customers with higher availability of their equipment.

Transition to lower carbon

One further topic that we are currently driving is energy transition. And here we have made already significant progress towards offering lower carbon solutions, enabling our customers journey to net zero. The speed of transition and customer demand strongly varies between our market segments. Many of our customers, such as data center and governmental clients, will continue to use combustion engines well into the future.

Combustion engines will remain highly relevant for many years, but increasingly powered by sustainable fuels.

So by the end of 2023, I am really pleased to say that all our major engine platforms will be released to run on these fuels. And we already see first customers such as the mining corporation Rio Tinto using our engines with the sustainable diesel substitute HVO.

In marine, we are developing methanol-based solutions and for power generation, we see hydrogen-based engines as a future solution. These developments are based on existing engines and given the progress already made, we are well prepared to deliver this transition.

Hybrid solutions will be key in various segments. So we are already developing them in the yacht or the rail business. So in the UK, for example, you can enjoy our hybrid rail system by taking the Chiltern Railways line from London Marylebone to Aylesbury. In our important power generation business, engine-based systems will continue to dominate the market. Yet, we are also very well prepared to deliver hybrid solutions in the future. We are also very well prepared for the gradual transition towards battery-based solutions as we have the required capabilities and products already today.

And finally, digital solutions will contribute to the decarbonization by increasing efficiency of our products. Digital products like asset and fleet management and equipment health monitoring will enable us to generate additional value streams.

Key messages

So let me conclude. In summary, power systems will contribute significantly to the success of Rolls-Royce. We have a resilient business model with strong market positions and opportunities ahead in growing markets to unlock the full potential of our business. And we have a clear strategy to deliver this. It's built on a resilient business model and the combination of cost efficiency and substantial growth in attractive markets.

This will significantly contribute to the profit and cash improvement of Rolls-Royce.

In addition, we are well prepared for the energy transition to secure future business opportunities. So all power systems employees, including the management team and of course myself, are aligned and mobilized to deliver on this strategy and to succeed with the One Rolls-Royce mindset.

So together with Tufan's leadership and the entire company worldwide, we are really looking very positively forward into our future.

And now with all these great opportunities in front of us, I think you can understand why my expectations about Rolls-Royce and power systems have been exceeded.

So we have achieved a lot, but we are just getting started. There's much to do, but we are all really excited to continue our journey.

And with this, I will now hand over to my dear colleague and friend, Adam, for defense.

Thank you.

Defence

Adam Riddle

President, Defence, Rolls-Royce Holdings Plc

Introduction

Thank you, Jorg.

Jorg and I have now worked together for a year and I have great admiration for him. His passion and dedication to power systems is always on display, is highlighted in his remarks. I also want to acknowledge Rob. He was one of the first people I met in defense when I joined Rolls-Royce 10 years ago, and it is a real pleasure to be here with him today.

Good afternoon and thank you for attending. Today, I'm going to discuss how defense is playing its part in creating a One Rolls-Royce that, as Tufan outlined, delivers on its potential. For me, it also marks the culmination of the strategy review that I worked on in my previous role. So it's a big day.

I plan to take you through a quick overview of our business today, show how transformation is improving our midterm performance, and highlight how our recent program wins can unlock the door to long-term growth.

Before I start, I would like to acknowledge my 11,000 defense teammates. As a former US Army officer and longtime member of the defense industry, it is a real honor to represent them. All of them are dedicated to our customers and to ensuring they can accomplish their missions, providing assistance when natural disasters strike, providing deterrence in the air and sea, or medevac-ing those in need of medical care.

All those customers depend on us every day, and we take our role in delivering for them very seriously. We also take our role in delivering to our shareholders very seriously, which I will address shortly.

Defence – Advantaged and resilient business operating in attractive markets

As you'll see in the fact sheets, the defense business largely includes aero and naval gas turbines and nuclear submarine propulsion. Indianapolis is the mainstay of our transport engines. Bristol is a center for combat. Raynesway in Derby is home to our nuclear submarine business. And our sites in Mississippi, Massachusetts, and in Canada focus on our naval capability. In all, we have over 16,000 engines in service with around 160 customers globally, and we work in close partnership with the UKMOD and the USDOD.

I've spent most of my career in strategy here at Boeing and Anheuser-Busch, so I concur with Tufan's analysis of how we make decisions about our portfolio. Is the market attractive? Are we differentiated? Can we generate competitive financial returns? And when I look at our defense business, I believe there's strong evidence that we tick all three boxes and therefore enjoy advantaged market positions.

Our financials have demonstrated that the defense market is resilient. We maintained our customer and shareholder commitments throughout the COVID pandemic. And the global security situation that has developed since has led to governments increasing their commitment to defense. Our half-year results showed strong revenue growth and order pipeline. Our customers continue to invest in capability in our core markets, and we have demonstrated that we are differentiated. The versatile AE engine family has enabled us to win positions on the C-130J, V-22, and the MQ-25 in transport, and 13 others if you're counting.

Our full-engine combat capability enables us to power today's aircraft and position us as an international partner for the development of future platforms. Our capability in nuclear submarine propulsion is unique. We are the only company that can design, manufacture, and support naval reactors.

The high power density of our naval gas turbines brings real advantage as mission systems require more space on modern warships. And in helicopters, we've accumulated huge experience in military and civil programs. We also believe our business model is differentiated. Defense programs typically generate positive financial returns throughout the life cycle to include design, development, production, and service.

And the life cycle lasts 40, 50, perhaps even 80-plus years. In transport, we are still making T-56 engines for the Hawkeye over 60 years since they first rolled off the production line. We are proud to have enabled the UK's continuous at-sea deterrent to operate since 1969. And our Model 250 remains a mainstay of the small helicopter market over 60 years after its first deliveries.

Our customers have benefited from the technology and capability that we have developed in partnership with them. Our shareholders have benefited as well, and that continues.

Products we are designing today will be generating sustained and profitable returns for this company many decades into the future.

Capturing performance improvement opportunities – strategic initiatives driving margin improvement

But we know we can do more to contribute to the Rolls-Royce transformation in the short to midterm through a combination of prioritizing our growth markets and delivering improvements in areas that are within our control.

Our half-year results demonstrated margin improvement through work already underway. This will help us unlock our full potential. Looking forward, over the midterm, we aim to grow that margin to 14% to 16%.

Revenues are increasing in our core markets of transport, combat, and submarines, which has a positive impact on our operating profit. I will take you through some of the growth drivers on the next slide.

As with our other divisions, we believe that transformation will deliver tangible efficiency and simplification benefits in the short term. I've already mentioned the significant margin improvement we have realized through its early stages. The work we are doing on organization design, third-party cost, inventory reduction, and other work streams will further improve our financials and sharpen our competitive edge.

For example, I believe we will find synergies as a result of consolidating our engineering and procurement activities that will enable us to prioritize resources and generate significant financial benefits.

While we will experience some legacy retirements over the midterm, the actions I have mentioned will enable us to improve our overall operating profit performance.

Capturing performance improvement opportunities – Key drivers of operating profit improvement

We are targeting key areas to provide margin uplift over the midterm. For instance, on volume and mix, the overall transport fleet is growing, generating higher flying hours and more shot visits. For example, AE shot visits increased by 22%. In combat, changes to the product mix yield higher profit due to the scale of newer programs.

It's a similar story in submarines, which will see an increase in volume, funded development, and infrastructure. All of this is underpinned by our exceptional order pipeline, $8.5 billion at the end of 2022, which provides high certainty to our midterm revenue projections. On commercial optimization, all of our major contracts will be renewed over the midterm, which provides us with the opportunity to work with our customers to offset external impacts, such as inflation, and ensure we capture the fair value for our products and services.

From an investment prioritization standpoint, the strategic review process enabled us to take a more focused view on where and how we invest. Our major customers strongly support our core differentiated strengths in transport, combat, and submarines. And as a result, our customer-funded R&D is due to increase by 150%.

And there are more opportunities for funded programs in these areas. Our choices are customer led and reflect their priorities.

And on cost management, our half-year results demonstrate that defense is already making progress in this area, and will capture additional benefit from the group-wide transformation activity.

Long-term growth momentum

So in the midterm, we are improving performance largely through being smarter about how we operate, making sure we are doing all we can to achieve our potential. And this is positioning us to better execute the new generational programs that we have won.

Early in the last decade, we realized that our portfolio was maturing. We needed new programs to replace anticipated fleet retirements, or our competitors would replace us. So we focused on winning big programs in our core markets, and we did this by utilizing our strengths.

We leveraged our partnership experience to secure our position with Bell on the US Army's future long-range assault aircraft, and also on Tempest and the Global Combat Air Partnership. We worked as One Rolls-Royce to win the United States Air Force contract to re-engine the B-52. And our capability enabled our selection to power the new AUKUS submarine fleet. All of this underpinned by the innovation which is in our DNA.

These wins start to increase our volumes just beyond the midterm horizon, and our position on them can unlock even greater growth over the long term. We are anticipating a CAGR of between 4% to 5% between now and 2040, which will be faster than the market.

In transport, the US Army's FLORA program is just one element of the future vertical lift market. With this win, we are in good position to capture other DOD and international sales that are likely to follow. If you would like to learn more about these opportunities, please talk to John Shade and [Jena Wright] in the export side.

They led our FLORA team and are excited to tell you how we did it in partnership with Bell.

In combat, we are very proud of our B-52 win, which enhanced our reputation as a major US defense supplier and has opened many doors as a result. As we re-engine an aircraft that has been in service for around 70 years, we are also positioning to power the Air Force's future autonomous combat platforms. We can offer military variants of civil engines in this space.

We also have proven rapid development capability through the MOD-funded ORPHEUS program, which offers international opportunities, and which again, you can learn more about via the online expo. In the UK, our leading partner status in Tempest has led to our participation in the Global Combat Air Program, which has further international export potential, while our full-engine capability is providing other opportunities to partner with governments seeking to develop their own combat capability.

It's also worth pointing out that digital capability was crucial in winning B-52 and continues to be a key game changer for us as we develop our GCAT power system. And in submarines, what we always thought of as a UK-only market has now expanded to include Australia through the AUKUS agreement. It represents a large expansion for our submarines business in Raynesway. And the unique capabilities that we have developed there have the potential to be leveraged into other growth markets.

For example, micro-reactors can play a big role in helping energy security and resilience and energy transition, both in the defense and civil environments.

Again, you can learn more about this in our online expo.

Key messages

So, in summary, we have a strong and resilient business today. We know we can do more and are taking specific actions to realize greater value and grow our margins tomorrow. We are transforming as part of One Rolls-Royce to deliver even better performance in the midterm through improving volumes, commercial optimization, investment prioritization, and cost management.

We are leveraging our recent wins to deliver an exciting future with long-term growth in programs that will run for decades. And finally, I want to finish where I started. That last picture shows the importance of what we do. It is the inside of a Rolls-Royce-powered aircraft during an evacuation, taking people in peril out of harm's way.

We are here today because somebody, somewhere, is keeping us safe. They are relying on us to deliver each and every day, and we are exceptionally committed to our duties.

Thank you. I will now hand you back to Isabel.

Q&A

Isabel Green: Thank you, Adam. So, we're now going to welcome all of our presenters back up onto the stage for our second Q&A. We've got about half an hour for that. As a reminder to those of you in the room, first, you don't sit in this corner because Tufan can't see you, so I think Ian has now moved. But make sure you use your microphone. Everyone online does want to hear your question.

If you are online, if you put a question into the Q&A box, we are monitoring that. I hope we will get time for one or two questions from online at the end.

Over to you, Tufan.

Tufan Erginbilgic: Thanks, Isabel. I'll try to pick people who weren't actually able to ask questions in the first session. So, but anybody, let's go -- let's start there, then we'll go there.

Ross Law: Yeah. Hi, everyone. It's Ross from Morgan Stanley. A couple for Rob, please. Firstly, on your shop visit assumptions, you've said 11,000 to 1,200 total shop visits, 700 to 750, which are large overhauls. That implies that C&R shop visits are actually lower in 2027 versus 2022. Is that math correct? And if so, what's driving that?

Secondly, on fleet size, how many large engines do you expect to have in service in 2027? And what proportion of that is the new generation programs? So, T1000, XWB, and the 7000. Thanks.

Rob Watson: So, Ross, just checking if you can hear. Thanks for those questions. So, yeah, your math is correct. So, we see a significant increase in our large refurbishments, and therefore there is a corresponding slight drop in C&R, about 10%. That's largely driven by T1000s coming out of a more intense program of check and repair by the end of the medium term plan.

Second question was, what's the distribution of -- I mean, around 60% of that large engine fleet in 2027 is XWB, so 84 and 97. And then I would say probably about 80% of the total fleet are those new engines with the balance, the 700, 800, and 900.

I'll have to get you the absolute number.

Tufan Erginbilgic: Thanks, Rob. There was one question there, if I can go there.

Unidentified Participant^ Thank you. A couple of questions. First of all, this morning, earlier today, you mentioned that electric air mobility is something you're not basically going to pursue. Is that because you don't believe in the overall opportunity, or it doesn't reach certain thresholds in terms of, you know, profitability that you think you can make out of it? Curious to get your views. It's obviously an area that's getting a lot of hype. There's some very highly valued company, which obviously we wonder where the value is.

But your thoughts on that?

And the second question has to do with the engine issues that you faced when you came out with the 787s, with the Trent 1000, I believe. And obviously the problems that Pratt is facing today with the GTF. What are the lessons learned? How will Rolls-Royce look in the future to mitigate and not have these issues? Because as we know, these are multi-billion dollar cost issues for a company like yours.

Tufan Erginbilgic: So I'm going to ask the second one, Rob, to answer. Let me pick up the first one, electrical. I think I don't want to say more because there are confidentiality around some of the conversations. But one thing I will say, if you look at what the team presented, we have great growth opportunities in our business, in our core businesses.

Then in addition to that, we are actually like, take microreactors, given our distinctive position, we should be natural leaders, not a player, leader in microreactors. Battery storage in Jorg's team, that's highly transferable skill set. And in this time period, you have seen it from my chart as well as Jorg's chart, that business in a very short period of time will be profitable, then grow from there. In this period, actually, it is becoming profitable. And not to mention the growth picture in the core businesses that Adam, Jorg, and Rob talk about.

So it is really simply to say two things. We have great growth opportunities, and we need to actually allocate our resources more effectively there.

Second thing, we believe we built very good capability in advanced air mobility. We believe it is going to be a better value to a third party. But having said all that, people need to understand, we are not ruling out like regional aircraft with hybrid. I mean, I can totally see our technologies is there, so I need to be careful. But I can totally see hybrid, and we are actually working on it, hybrid solution in regional setup. And that business already established business, it needs to be transformed to lower carbon version, if you like.

And I can totally see us playing there. Therefore, in the presentation, I talk about keeping the capabilities to support aerospace defense and power system businesses.

Rob?

Rob Watson: So on the Trent 1000, I think there are two elements to consider. I think the first lesson learned was around just making sure that when we bring an engine into service, that we are satisfied with the maturity of the technology in the engine, and that we have done the right level of maturity testing to support it once it is entered into service.

So the right testing regime in advance of entry becomes really, really important, so you properly understand and you have a stable set of product attributes. The second point, learning specifically for Rolls-Royce, I think was our reaction to the Trent 1000 after we had an issue that we needed to respond to. And we learned a huge amount in how we need to scale up and prepare as an organization for that kind of in-service events. So alongside making sure when we do new NPI programs, that we got the right testing schedule, and that we are pacing that program properly.

The second element, which gives us greater confidences, we absolutely understand what we need to have around us to support that engine at EIS and in the early years of its service, so that we can respond quickly and intervene if we need to, rather than we end up with something of a larger scale magnitude.

Tufan Erginbilgic: Thanks Rob. I'll go, same name, sort of faces, so why don't we start with you, it seems like.

Rob Stallard: All right, Rob from Vertical Research. A couple of questions. First of all, Adam, that margin increase in the Defense Division in the industry, that would generally come from a mix shift, but I was wondering if your split between cost plus and fixed price is altering materially in this medium term time period.

And then a bigger picture question for you , Tufan and Helen as well. Both of you have spent a lot of time in the energy industry, obviously. What would you see as the key similarities and differences you've identified coming over to aerospace and defense? Thanks.

Tufan Erginbilgic: Okay, Adam, do you want to start?

Adam Riddle: So when looking at the margin, I think it's important to look at all the contracting types we have throughout the globe. So when specifically focused on RR 15, the US SSRO and here, that is a place where we have to make sure that we fully substantiate our costs and maximize reward.

Specific to your question, there is volume growth in combat, transport, and submarines. Within that growth, there are places where we are benefiting from mix. And then on the margin point, we also have to focus on, as I mentioned in the presentation, transformation, reducing costs, focused investment, being as efficient as we possibly can, TCC to GM ratio, and being good stewards for our customers as we run our business.

Tufan Erginbilgic: So on the second question, I'll start and Helen, please jump in. I think, I mean, I'm not sure. Some of it is energy sort of driven, but most of it is really similarities coming from one aspect of it, large, complex, multi-business, multi-divisional, global business.

Managing that business is very different because obviously when I was coming through the ranks, first business I managed was not a global business. I know the differences, right? So it is very different. You need to know how to think about that. It is very different. And that's common.

Second common is this business is driven by technology, engineering, and safety is very important, including obviously our customer safety and the people safety who use our products. Again, those three are very critical. Frankly, I come from the businesses, all technology we use as a differentiator. Okay. Same thing is obviously happening here.

And I think those are big similarities.

And then Helen and I come from sort of customer end of Aiden's team. So we deal with customers and all the airlines were my customers, right? So just to give you an air BP, all the air BP was in my portfolio. All of them were my customers. So sort of you have a view about B2B, B2C, branded business and customer management aspects of it is very, very sort of important.

And energy transition is the last one I'm going to say. You come obviously spending lots of time on energy transition. And it comes handy on some areas right now, because you have a view like I talk about SAF versus hydrogen, for example, and so on.

Helen.

Helen McCabe: Thank you. So I'll be additive. So a couple of similarities. So Tufan and I worked together in a previous life. We did a couple of transformations together. I think two we did together. This is our third. And I think the rigor and the success of transformation is quite transferable. And there's a couple of things which are fundamental to how you think and go about transformation. The importance of being really clear as to what your strategy is and take that to a granular level cannot be underestimated, which is why you've heard us today all talk about the depth and the detail and the process that we've gone through.

I think Tufan, you talk about 400 to 500 people being engaged in this process. It's not just us sitting up here. So the clarity of strategic thought direction, very, very important. Your ability then to galvanize the organization behind that and to align the organization behind that strategic clarity is incredibly important so that everyone knows what they're working in service of and the objectives that are aligned. And we saw that in your previous transformations.

And then two other things I would say, the importance of execution, discipline and the rigorous performance management around that is very important. Things always happen that you don't expect. So having that fleet of foot of ensuring that you are rigorously performance managing your strategic performance day in, day out. And that's why I talk about integrated performance management, that you link it from strategic objectives through to your annual plan, through to your in-year performance management.

And because some things always don't work as you expect, the importance of resilience, ensuring that your strategy has to have the right balance between top line and bottom line growth and that you actually build up that very, very solid base from which to grow.

So that as you capture margin improvement, that actually falls to your bottom line and you're building a very, very strong foundation. So those are a couple of additives.

Tufan Erginbilgic: Very good points, Helen. Thank you. I'll go there, then one.

George Zhao: Hi, George Zhao from Bernstein. So a lot of discussion on margin so far. So I wanted to ask about the revenue side. If I take your midpoint of the operating profit and margin guide, that implies about GBP19 billion of revenue by 2027 at the midpoint, about a 7% CAGR from where we're this year.

So if we assume civil aerospace above that, defense and power systems somewhere in the low to mid-single digit, is that what you're assuming in the targets there? And related to that, given the plan to dispose some of the electrical business, what is the 13% 15% margin target assumed for the absolute losses for the new markets division? Thanks.

Tufan Erginbilgic: So I mean, I'll very briefly answer it. Sort of we are not going to give you sort of numbers because this event is not about that. But I think you can calculate the revenue the way you did. Obviously, that would be perfectly legitimate way of calculating.

Effectively, in new markets, if you actually think about this period, it is benefiting effectively from two things. Obviously, exit on electrical, although we will keep some capabilities, as I said, to support our businesses.

Second thing it is going to benefit from, effectively, we are planning in a value creating way, we will still be the biggest shareholder, but we are going to be less than 50% on SMR. That is sort of our thinking in this period. And that happens not immediately, but in this period.

And those two things, effectively, you may want to think when you think about new markets. I won't give you numbers, but you will sort of figure out what that means.

Okay. Let's go there.

Ian Douglas-Pennant: Thanks very much. It's Ian Douglas-Pennant at UBS.

Jorg, could you help us understand within the power business, which are the subdivisions within your business where there are greater or lesser synergies with businesses outside of power, let's say?

And Helen, inventory release and the cash flow that comes from that, what allowances have you made for the supply chain getting better or worse from here, especially given the ramp up in volumes?

Tufan Erginbilgic: Jorg, do you want to --

Jorg Stratmann: Question number one. If I got the question right, you are asking for synergies, power systems with Rolls-Royce, right? So, and, you know, I would say the beauty of our business model is that we are using the same engine platforms across our applications. And we do then application engineering to have them ready for the different markets.

And with some -- we have some large volume business, some smaller, but the large volume business gives us the scale to be very competitive in the smaller markets in the niches.

So, when we're talking now about synergies, it's across the platforms. This is what I want to say. So, it's not in single applications, but it's, for example, if you look to ET&S, it might be in software, it might be in electronics, it might be also in the arena of procurement, in particular, indirect, but also some direct. And, of course, across the board for processes, methods, tools we are using. These are actually the synergies we are looking for.

Tufan Erginbilgic: Thanks, Jorg. By the way, ET&S, you may not --

Jorg Stratmann: I'm sorry.

Tufan Erginbilgic: You may not know …

Jorg Stratmann: It's our R&D, so engineering and technology, basically.

Tufan Erginbilgic: We now created new organization as you know, which is going to serve all three divisions. We call it Engineering, Technology, And Safety. And Jorg was referring to that. Thanks, Jorg.

Jorg Stratmann: Yeah, sure.

Unidentified Participant: So, one thing to highlight on synergies, York's business, the defense business, is commonality of customers. So, we often work together in working with our customers. For instance, our two teams were just together in Washington, D.C., at the AUSA conference. That's the place where there is overlap and synergy between the two orgs.

Tufan Erginbilgic: So, to summarize, I think you will see sort of synergies at customer level. Definitely engineering and technology synergies you will see. Then the procurement and supply chain synergies is the third area, which we haven't really explored before. None of the things, except the customer one, which we can get better and better, others actually will be new, new synergies, if you like.

Helen McCabe: Inventory. So, thank you for the question. So, actually, we were just as a leadership team discussing risks last week. And supply chain and inventory risks was something which Adam, Jorg, and Rob all spoke to. So, yes, we are mindful for those. We see the next particularly probably 18 to 24 months remaining challenging.

However, that said, as I mentioned earlier, we still expect to release inventory the second half of this year. Why? Because we've identified areas in the supply chain where we weren't being efficient. So, Rob and the team getting after pockets of buffer stock that they were holding, which were not required, 100 million. Jorg has had his team out looking at sites, factories, where they were actually holding inventory of quite a few years of stock, which was not required.

So, there's some areas of, I don't want to say low hanging fruit, but areas of inefficiency that the team are getting after at the moment, where they're improving processes and systems. And we will continue to do that. But we are mindful of the industry supply chain challenges out there. Despite that, we have a detailed plan where we do expect to release inventory over the midterm.

And to your question on growth, have we built growth in for inventory? Yes. If you go back to and have a look at the chart that I showed when I spoke to working capital, you can actually see that we have built some growth in both for inventory and as we think about our debtors and creditors. So, we have built growth in to support our revenue growth going forward.

Tufan Erginbilgic: Thanks, Helen. If I can go there.

Christophe Menard: Yes. Good afternoon. It's Christophe from Deutsche Bank. Two questions. The first one is on the shop visit cost reduction on the Trent XWB. Last year, I think you mentioned minus 40%, which was a good target. It's minus 50% this year. So, what enabled that further improvement and what headroom do you further have on this?

And the other one is on power system. Services seems to be one of the areas where you can do some improvements. It was highlighted already in the CMD in 2018. You were looking for a target of 40% of the total sales. Do you have a similar target now or is it more specific to power? I think you said a lot on power generation, but is it other areas as well?

Tufan Erginbilgic: Okay, Rob, then Jorg.

Rob Watson: So, I think on shop visit cost reduction, I think a good example of the progress we're making. I was in Singapore a couple of weeks ago and we have a joint venture there with Singaporeans.

And we've been investing in some repair technology that we'll use in that shop. So, we need to build capacity across our MRO network. We're looking at how we scale that up for the midterm. And we've been really thoughtful about how we use that opportunity to address cost.

So, in Singapore, partnered with EDB, government agency, which provided some funding to allow us to focus on developing some technology, some R&D activity that would drive some short-term benefit for the group by looking at introducing repair technology, repair technology cell on the shop floor with the shop that allows us to identify and repair components rather than just replace them with new parts. What that does is bring the cost down. It means we don't have to wait for a part to be delivered to the shop. So, we're speeding up the amount of time that the engine spends in the shop.

And it's that kind of example where we're getting some good government gearing. We're prioritizing our R&D spend for those short-term returns. And we're thinking about how we improve time in the shop and the scope of the work that we do on an engine to give us access to that kind of improvement on shop visit cost.

Jorg Stratmann: Yeah, on service, service is obviously a very important part of our business. I said this is roughly one-third of our business. And so, we have some areas where the service share is higher. I mentioned this for marine where we are above 40%. But we see the, let's say, the opportunity to grow here actually in all the different applications. So, I mentioned PowerGen. There will be retrofit solutions. There will be upgrades.

We see this also in governmental. So, don't forget governmental is very important on the new equipment, but also in the in-field service. Also, here we see product upgrades. So, we stay on the same platform, but we upgrade the product. And with this comes additional service.

Industrial, high-running hours applications. I mentioned rail. I mentioned mining. We have really opportunities across the board in service. And it's not only, it's very important to grow it and to take this opportunity. But if you offer a great service, it's also a competitive advantage you can play in the new equipment because this is the reason why customers want our products. So, service will gain importance in the midterm.

Tufan Erginbilgic: Thanks, Jorg. Yes.

Nick Cunningham: Thank you. Nick Cunningham again from Agency Partners. A couple of questions. One on the LTSA balance, that's increasing 800 to 1,200 million a year through the five-year period.

At what point do you expect that to neutralize or do you indeed expect it to neutralize? Because from memory, I think that was expected to have happened before that point. So, sort of kind of what's going on with that if you like.

And then the other thing is we used to talk a lot about the unit loss on large engines, OE, a $1 million or GBP1 million, you know, whatever. That's not been specifically brought up in this presentation, although I guess it's covered by product cost. But do you foresee a point at which, at least in terms of direct costs, an OE engine can get to break even? Thank you.

Tufan Erginbilgic: So, I'm going to ask Rob to answer the second question. But obviously, Helen and Rob, feel free to add to the first question as well. Frankly, LTSA balance, like you, I was thinking, okay, well, how should I think about this sort of going to the future? It is actually more straightforward than you think. So, short answer, for a long time. Therefore, you need to think about LTSA balance increase as a sustainable increase.

Why? I think Helen covered that. But it's very simple and very complex. But I'm going to simplify it. So, as long as your installed engine base grows, right, and you are increasing your unit rate, not to mention time on wing improvements we will be making, but even if you don't make, let's say, status the time on wing at some point, if your installed engine base continues to grow and your EFH rate improves because of your commercial optimization, LTSA will continue to grow, especially if your engines are young.

And that is the case in our case.

Therefore, I said earlier today that actually you need to think about our cash delivery is effectively better quality operating profit, better quality in the sense that it is more cash based. Okay? It's good quality right now as well, but it is more cash based in midterm, in that sense, cash terms, and LTSA, which is actually sustainable beyond this period because our engines will grow well beyond this period, right? Our installed engines.

And because we are actually capturing market share, Rob talked about it, I talked about it, sort of, and that's how you need to think about it. Those are the drivers in force here, effectively. Rob, on the second one.

Rob Watson: You're right. I mean, product cost is the focus for us, and it's one of the biggest drivers that underpins that margin improvement. We have made huge progress the last five years on that OE cost reduction, and we're always focused on it, both because of the OE benefit that it brings, and also in our services business, if we're bringing the cost of parts down. So we continue to target improvement in that. We're more or less around the industry benchmark. I think it's about 3% gross product cost out each year, and we continue to prioritize allocation of engineering resource and CapEx to continue to drive that cost reduction program.

Isabel Green: Sorry, we're running out of time. I'm going to look at the last question online, if I may. So the question comes online from [Michelle Beater] from J.O. Hambro, saying your slides in the first section indicated SMRs could be bigger than defense and power systems in the long term. Please could you comment on the clarity you've had from the UK government on plans there, and where internationally you could take the Rolls-Royce SMR technology? And I think you did give a list of some of those nations in the earlier presentation.

Tufan Erginbilgic: So I think that's the revenue chart. I just remind everybody.

So yes, I think if you go to the future, I mean, you need to think about big picture. Somebody said I came from energy industry, so I have a view, right? I always took a view. Frankly, Europe will never go to net zero unless nuclear plays a role. US has a few other options. I'm not going to dwell on it here, but that's the big picture. When you come to nuclear, you have choices. You have SMR or nuclear projects, big nuclear projects. Their risk profile is very different, and history demonstrates that that's true.

So then you conclude SMRs need to play a big role. And we are actually bringing know-how from our submarine business. It is a proven technology in that sense. So let's go to your question. But big picture, it makes lots of sense.

Yes, UK process continues at this point. I think it is important that, frankly, if you think about how advanced we are in generic design assessment, we are probably two years ahead of anybody else for Europe and UK because technology is sort of specific for UK and Europe.

We are actually ahead of anybody else. So second thing is, therefore, it's not about we will be selected or not. I would be very surprised, frankly, if we are not. So it will be hard to explain to anybody, to myself as well. But the point is not that. Point is, actually, in this process, I said this to the government, frankly, very openly, you need to come with committed projects at the end of it so that we go into execution and with some funding.

But given latter part of that question, what other countries you are working with, I actually listed there. I'm not going to give you the same list, but I'm going to say Chris and the team is working very, very closely with Czech Republic. So we have actually joined work streams and so on.

And we also have even a sort of an opportunity in the in the US as well that Chris is progressing. And other countries I mentioned, Scandinavian countries like Sweden and Finland, et cetera, they are actually genuinely interested. Once this thing sort of gets on the ground, people can touch and feel because with new technologies, there is always some hesitation. When you start to touch and feel, frankly, this is going to be a little bit like again, energy sort of industry talking offshore wind. This is going to explode.

I actually say to Chris, worry about the supply chain catching up with you. But he's working with on supply chain already.

So I think there is the opportunity set here in the period that I was talking about.

With that, I think we are going to I'm going to make some sort of closing remarks given that Isabel disappeared. That's my cue to say, actually, maybe it is time to conclude.

Closing Remarks

Tufan Erginbilgic
Chief Executive Officer, Rolls-Royce Holdings Plc

Transforming the business for sustainable growth

So, first of all, thank you for your questions and thanks for coming here. I think unfortunately, there were more questions in some sessions than we could answer, but hopefully we answered many questions you had. And if you have more questions, Isabel and team definitely they are waiting for you.

So we can help you there. But before we close, I would like to remind you of the key messages from today. Rolls-Royce is at a pivotal point in its history. We are transforming our performance and we have a clear vision for the journey we need to make. We have a strategic framework that will deliver a step change in financial performance in the midterm. We are making choices about where we will invest and the shape of our future portfolio, where we should partner and where we should exit.

We have advantage businesses in attractive markets with differentiated technologies. Our strategic initiatives will unlock our potential and create more value for our all of our stakeholders. Our group wide efficiency and simplification program will deliver sustainable benefits, making us more resilient and competitive. And we are becoming a lower carbon and digitally enabled business.

Playing our part in the energy transition and benefiting from the advantages AI and data can bring. We are already in action and there are lots of opportunities for us here in the future.

I think this part we haven't spent lots of time, but the second part of lower part of this slide, but that is a very key part of key difference which is actually causing these outcomes that I would like to sort of summarize very quickly.

We are working as One Rolls-Royce. All of our people are aligned and mobilized to succeed. We have a new mindset and stronger performance management. We are embracing new ways of working and over time this will develop into a distinctive performance culture.

We are executing with strategic clarity. This strategic clarity combined with granular strategic plans focuses and aligns the organization and makes strategy delivery relevant to all our people. So everyone has a role to play and we will manage performance closely to ensure delivery.

We are externally focused and benchmarking our business against the competition commercially and financially so that we constantly improve our business to world class levels. And we have simplified our organization and are strengthening our capabilities in key areas.

I am confident and excited about the opportunities we have at Rolls-Royce. Now that I laid out our plans, I hope you are too. We have the expertise, the drive and crucially the team that can deliver. All of this will help us deliver our Rolls-Royce proposition to become a high performing, competitive and resilient business with growing sustainable cash flows, a strong balance sheet and growing shareholder returns.

This Rolls-Royce will be able to do things tomorrow it wasn't able to do before. We are transforming our business ready for our changing world, fit for today, tomorrow and the future.

Thank you for joining in the room and online today and I hope to see you all in the near future in our February results presentation. But before we close, I would like to also thank the whole leadership team. It is a very strong leadership team. It is actually a privilege and pleasure to work with them. Not only because of what they have done today, but what they have delivered so far and more importantly what they will deliver in the next couple of years.

And one last word, these events don't happen without lots of people working really hard behind the scenes and I would like to thank, really personally thank, all of our employees who make this happen.

Thank you very much. Have a great day.