



2018

Half Year Results

2 August 2018





Jennifer Ramsey

Head of Investor Relations



Agenda for today

Introductions

Jennifer Ramsey

Highlights

Warren East

Financial Review

Stephen Daintith

Business outlook

Warren East



Safety

Safe
Harbour

Mobile
Phones



Notices



Highlights

Warren East

Chief Executive



Results summary

“Good progress in a breakthrough year”

Full Year 2018 now expected to be in the upper half of our guidance range

Underlying core revenue

£6.7bn ↑ 16%*

Underlying core gross profit

£870m ↑ 12%*

Underlying core PBT

£81m ↑ £182m*

Underlying core operating margin

2.2% ↑ 300bps*

Core free cash flow

£10m H1 2017: £(264)m

‘Dividend’ per share

4.6p H1 2017: 4.6p



2018 Half Year overview

Civil Aerospace

- Large engine production up; installed fleet growth; OE loss reduced; new engines launched; continued to manage in-service engine issues

Power Systems

- Continued strong growth across almost all end markets

Defence

- Strong cash performance with healthy H2 pipeline

Restructuring

- Focused on removing duplication and complexity

Financial

- Increased confidence in 2018 full year; in-service engine issue costs up; exceptional charge



Trent 1000 update



- Unacceptable level of customer disruption
- Closely working with affected airlines

Operational update

- Peak Aircraft on Ground (AOG) passed
- Significantly increased MRO capacity
- Fixes expedited

Expected cash cost profile*

- 2018 around £450m
- 2019 around £450m
- Reducing by £100m in 2020
- Falling significantly beyond 2020

* Trent 1000 and Trent 900 combined cash cost

Trent 1000 P&L treatment

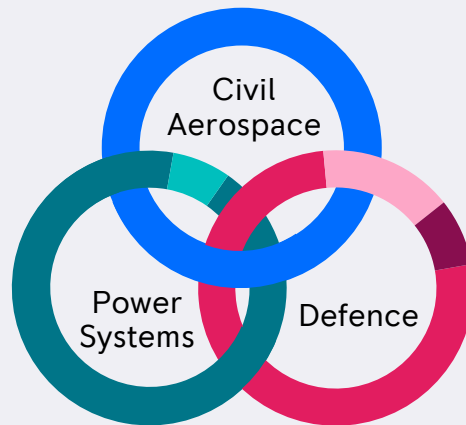
- £554m exceptional charge for “abnormal” costs
- “Normal” costs taken through margin over contract length



Structure to enable change

“Creating the conditions for the businesses to solve the problems themselves”

Much smaller
light-weight
Head Office



Following ITP Aero acquisition in December 2017, it will operate and report as a separate business unit

- Significantly reduced central costs
- Empowered businesses, more control of own costs
- Shared vision and clear accountability

Each business to deliver improving returns



Restructuring progress

- Established Group Business Services, to bring together 2,000 employees as a multi-function service delivery organisation
- Established an Innovation Hub to create genuine competitive advantage
- Executive team face-to-face discussions with thousands of employees to help set priorities and identify key opportunities
- Target run-rate savings of £400m per annum by end 2020





Progress in Civil

“Our strong position on new widebody aircraft is underpinning substantial growth”

Aero engines for the large commercial aircraft, regional jet and business aviation markets



Growth

20%
growth in
large engine
invoiced flying
hours

Ramp up

24%
growth in
large engine
deliveries;
progress on
OE losses

Trent 7000

A330neo
received EASA
certification

Pearl 15

First of a new
family of
business jet
engines

New technology

Ultrafan® core
demonstrator
now running at
full power in
test



Progress in Power Systems

“Encouraging momentum”

Provides high-speed and medium-speed reciprocating engines, propulsion systems, distributed energy solutions and Civil Nuclear



Markets

Recovery in commodity markets has driven strong volume growth

Gas Power

Demand driven by gas availability and fast response capability

Simplify

>30% reduction in product variants

Service

Roadmap implementation for Power Systems 2030

R&D

Focus on efficient and disciplined development investment



Progress in Defence

“Positioned well for a solid year of operating performance”

One Defence business with market-leading Defence aerospace, Naval and Submarines operations



Structure

Business solutions now possible to better serve our customers

F-35B

Lightning II aircraft – first deployment to the UK

MT30

Maintained its position as core naval engine platform of choice

Pipeline

Full year orders supported by strong pipeline in Combat, Naval and Submarines

Team Tempest

Progress to secure role to develop UK's future Combat Air Strategy



Portfolio restructure

“These transactions build on the actions we have taken over the last two years to simplify our business”



L'Orange sale completed

- L'Orange supplies fuel injection technology
- Sale agreed at enterprise value of €673m
- Purchased by Woodward Inc, USA
- Completed 1 June 2018

Commercial Marine sale announced

- Sale includes propulsion, deck machinery, automation & control, a service network, ship design capability & Ship Intelligence
- Sale agreed at enterprise value of £500m
- Purchased by KONGSBERG, Norway
- Trading agreement with Bergen, part of Power Systems
- Completion expected Q1 2019



Financial Review

Stephen Daintith

Chief Financial Officer



Agenda for today

01

Half year results

02

Business unit review

03

Accounting policy updates

04

Guidance



Half year results



Core & Non-core business reporting format

This section will focus on the Core business of Rolls-Royce: Civil Aerospace, Power Systems, Defence and ITP Aero

Commentary is provided on an underlying basis, at constant currency and excluding M&A

£m

Civil Aerospace	X
Defence	X
Power Systems	X
ITP Aero	X
Corporate/eliminations	X
Core business	X
Commercial Marine	X
L'Orange	X
Other	X
Non-core business	
Group underlying result	X

Core business

Key focus of Group operations

Non-core business

- Commercial Marine
- L'Orange

Plus

- Other smaller entities



Group Underlying results

Strong revenue
growth

Significant operating
profit and FCF
improvement

£m	Underlying Revenue	Organic change	Underlying op. profit	Organic change
Civil Aerospace	3,600	+26%	(112)	149
Defence	1,415	-	162	(6)
Power Systems	1,471	+13%	80	52
ITP Aero*	375	+19%	40	32
Corporate/eliminations	(181)	-	(24)	-
Core business	6,680	+16%	146	183
Non-core business**	360	-15%	(5)	12
Group underlying result	7,040	+14%	141	205

Group free cash flow **+£267m** reported &
+£211m organic to **£(72m)**



Core Business Underlying results

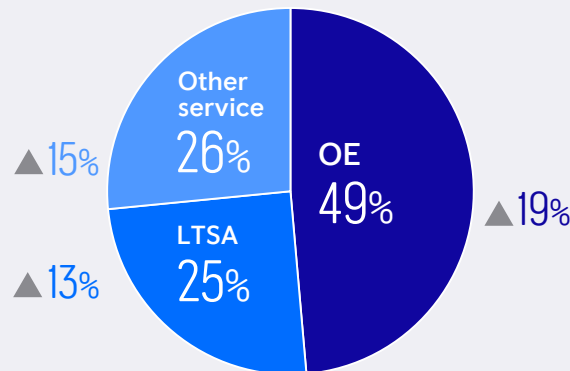
£m	H1 2018	H1 2017	Change	Organic change
Core underlying revenue	6,680	5,611	+19%	+16%
Core underlying gross profit	870	712	+22%	+12%
<i>Gross margin %</i>	<i>13.0%</i>	<i>12.7%</i>	<i>+30bps</i>	<i>-50bps</i>
Research and development costs	(296)	(396)	-25%	-28%
C&A	(479)	(436)	+10%	+4%
Joint ventures & associates	51	50	+2%	+8%
Core underlying operating profit	146	(70)	216	183
<i>Underlying operating margin</i>	<i>2.2%</i>	<i>(1.2)%</i>	<i>+340bps</i>	<i>+300bps</i>
Core free cash flow	10	(264)	274	214

“Strong first half progress
in core profit and free cash flow”



Continued underlying growth in Core OE & LTSA revenue

£m	H1 2018	H1 2017	Change	Organic change
OE revenue	3,247	2,594	+25%	+19%
LTSA service revenue	1,659	1,455	+14%	+13%
Other service revenue	1,774	1,562	+14%	+15%
Core underlying revenue	6,680	5,611	+19%	+16%
Gross margin (%)	13.0%	12.7%	+30bps	-50bps



- Good visibility of revenues
- Strong growth in other service revenue led by Civil Aerospace T&M



Core business R&D

Net R&D cash spend up £79m

Capitalisation policy application change absent from H1 2017

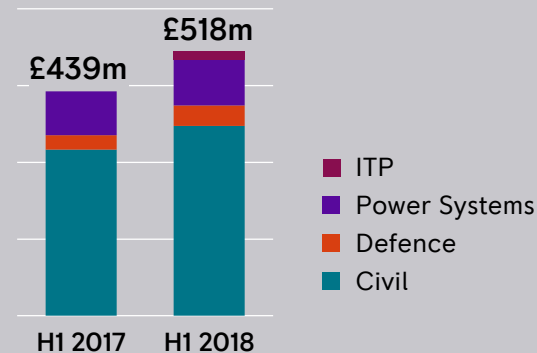
P&L charge £100m lower vs H1 2017

Full Year expectations unchanged

£m	H1 2018	H1 2017	Organic Change
Gross R&D	663	620	+4%
Third party contributions	(145)	(181)	-20%
Net R&D cash spend	518	439	+14%
Capitalised	(239)	(84)	+177%
Amortisation	17	41	-64%
Core R&D P&L charge	296	396	-28%

£518m net R&D cash spend in H1 2018

- Increased investment in **Civil Aerospace**:
 - Advance development programmes
 - Ultrafan® progress continues
 - New business aviation family (Pearl 15)
- **Increase spend in Defence** on future programme investment





Restructuring

Good start

Targets delivery of
net £400m
reduction in costs
by end 2020

Savings focused on
C&A & Engineering
spend

- H1 Exceptional P&L charge of £132m for restructuring
- Good start on delivering plan

Benefits

- **Savings** – £400m net saving run rate by end of 2020
- Reduced fixed costs & headcount
- Simpler, more responsive business structure
- Improved efficiency and effectiveness

Costs

- **Total Costs** – £500m cash costs to implement
 - Redundancy costs
 - Cost of enabling systems
- **Treatment** – Underlying profit & FCF excludes one-offs of restructuring



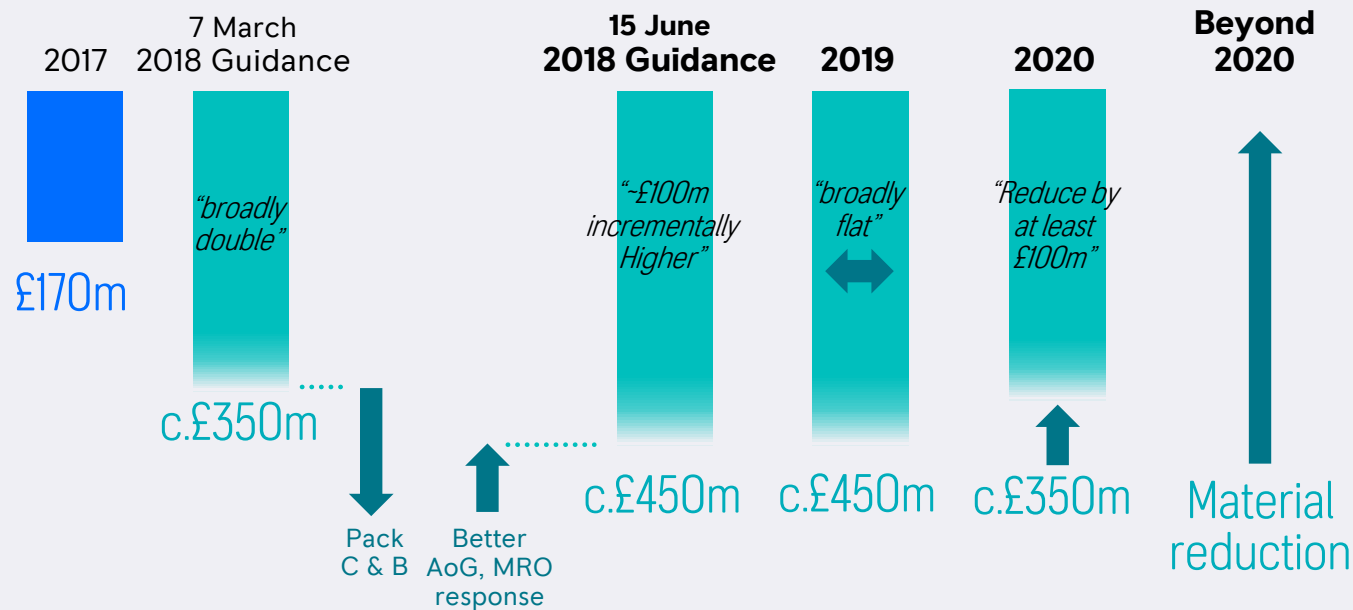
Trent 1000/900 cost update

Financial impact

Mitigations offset
incremental ~£100m
cost in FY18

Still expect Group
FCF growth in 2019

Trent 1000/900 in-service cash costs



Updated impact reflects:

- Compressor rotor blade costs
- Significant ongoing customer disruption



Trent 1000 exceptional charge

Triggers for exceptional treatment

- A **series of abnormal events**, giving rise to a **significant level of cost**, of a **nature not normally expected**, which is **not reflected in contract price**

For example:

- When we suffer **material technical issues arising from regulatory** airworthiness directives
 - With a **wide ranging impact across the fleet** of an entire product type
 - Causing **significant disruption** to customers
- In these cases then cost of disruption, wasted material, labour etc will be treated as exceptional in the P&L



Trent 1000 exceptional charge

Income statement impact

- Trent 1000 **£554m** H1 exceptional charge covers abnormal costs which fall outside the scope of our normal TotalCare costs
- Represents c.40% of total costs of resolving Trent 1000 issues for the period to 2022 - **Not incremental to the cash costs**
- The remainder of these costs will be recognised over time in the P&L through our normal contract accounting margins
- Cash costs will continue to be fully reflected in underlying free cash flow



Drivers of cash flow

Significantly ahead of prior year led by Civil & Defence

Reduced benefit from working capital vs. PY.

Increased confidence around FY18 cash flow

Drivers of reported £267m Group FCF improvement vs. prior year

- + Increased cash inflows from Civil aftermarket and EFHs
- + Higher spare engine volumes – Better H1:H2 balance
- + Defence & other business WC improvements
- + Mitigation actions (discretionary spend, capex)
 - Trent 900/1000 engine in-service costs
 - Power Systems modestly lower due to order book composition
 - Higher future programme R&D investment (Civil / Defence)

Group Trading cash flow

£230m increase to **£(26)m**

Of which: Core Trading Cash flow

*£241m increase to **£45m***

- Higher tax
- + Pension reduction in contributions reflecting UK plan surplus

Group Free cash flow

£267m increase to **£(72)m**

Of which: Core Free Cash flow

*£274m increase to **£10m***



Group Net working capital change

Overall H1 2018
working capital
cashflow benefit of
£129m (H1 2017: £324m)

Main drivers in H1 2018 (£129m benefit vs £324m in H1 2017)

Increase in inventories

£(427)m

- Volume growth in both Civil Aerospace & Power Systems
- Phasing of product deliveries in Defence

Increase in trade and other receivables

£(300)m

- + Increase in risk and revenue sharing partner related debtor balances in Civil Aerospace
- Power Systems decrease due to timing of sales

Increase in trade and other payables

£997m

- + Material increase in Civil LTSA creditor balances: EFH growth in advance of revenues recognised; £154m prior year contract catch up adjustment
- + Phasing ahead of H2 volume ramp up at Power Systems
- + Underlying volume growth at Civil Aerospace



Group balance sheet:

Ambition to return to a single A rating

FY 2017 net debt of £(305)m* improved to H1 2018 net cash position of £165m

- Completed disposal of L'Orange; net proceeds of €673m (£584m) received
- Announced sale of Commercial Marine; EV of £500m. Expected net proceeds of ~£350m to £400m
- Successfully issued €1.1bn (£968m) of bonds at attractive rates to pre-fund all existing debt maturities until end of 2019

**Net cash
H1 2018**

£165m

**Strong liquidity
position**

£6.9bn



Shareholder payments

- 2018 Interim payment maintained; 4.6p per share
 - Expected cash cost £86m
-
- Committed to restoring shareholder payments to an appropriate level over time; FCF key driver of growth
 - Aspire to mid-term 2.5x FCF / dividend cover through cycle
 - View in the context of overall capital allocation



02

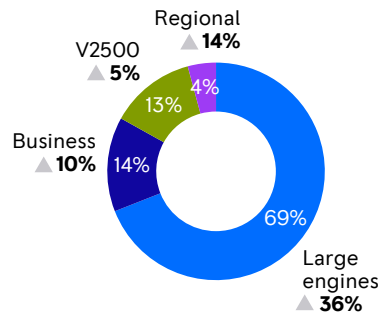
Business Unit review



Civil Aerospace Overview

Strong growth in revenue. Operating loss reduced by £149m on an organic basis

Revenue by type



£m	H1 2018	H1 2017	Change	Organic change
OE revenue	1,530	1,151	+33%	+32%
Services – LTSA	1,328	1,190	+12%	+12%
Services – T&M/other*	742	517	+44%	+43%
Underlying revenue	3,600	2,858	+26%	+26%
Gross profit	148	137	+8%	+12%
Gross margin %	4.1%	4.8%	-70bps	-50bps
Operating profit	(112)	(250)	138	149
Operating margin %	-3.1%	-8.7%	+560bps	+590bps

*Other includes contract payment from IAE based on V2500 flying hours

- **Underlying revenue** - strong OE and T&M services growth; negative contract catch-ups suppressing LTSA growth
- **Gross profit** - service activity growth & higher spare part sales; offset by £154m negative contract catch-up (£64m higher)
- **Operating loss** - £174m net R&D capitalisation increase driving significantly lower R&D charge; C&A broadly flat



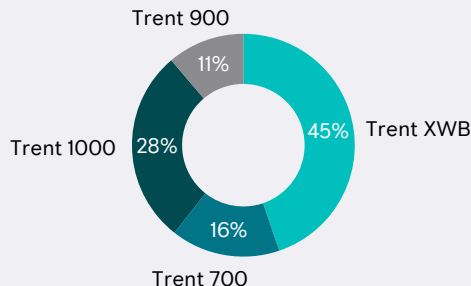
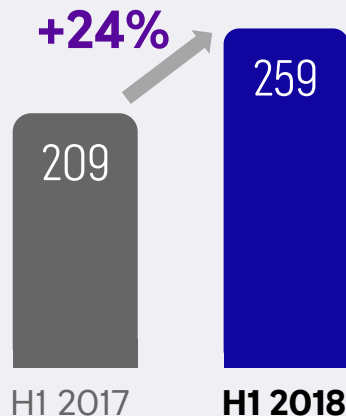
Engine deliveries

Widebody engine production ramp continuing

Over 2,400 WB engines on order

	In service	On order
Trent 700	1,614	61
Trent 7000	0	458
Trent XWB	358	1,379
Trent 900	364	187
Trent 1000	490	331

Widebody deliveries



Installed OE engine deliveries:

- + Trent XWB and Trent 1000 growth
- Trent 700, A330ceo production slowing down

Increased spare engines: more balanced H1/H2 delivery profile

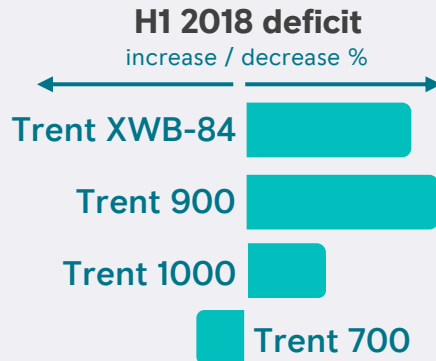
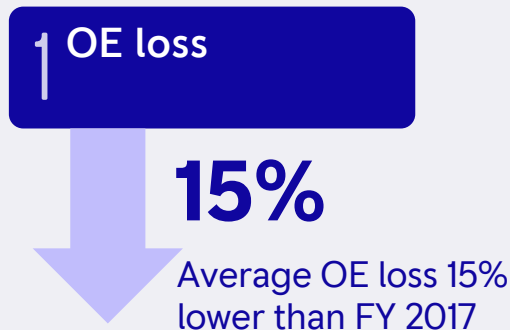
+7 Business aviation engines: driven by improving market



Civil Aerospace: key cash drivers

Good progress on
widebody OE unit loss
reduction

Continue to work
towards break-even
target on Trent XWB-84
by 2020



Ongoing drive for OE
cost reductions across
the portfolio

XWB-84:
cost & price reductions

Trent 900:
2017 temporary pricing impact

Trent 700:
end-of-life pricing headwind

Increase in volume of newer,
higher loss-making engines in H2



Civil Aerospace: key cash drivers

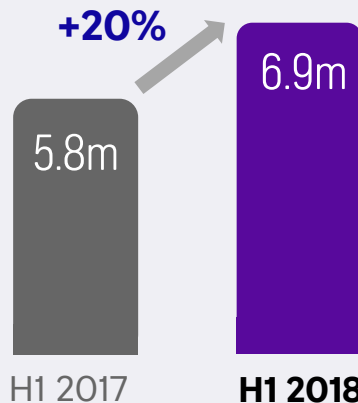
Strong Widebody EFH
growth

Modest increase in
Business Aviation EFH

Expected aircraft
retirements driving
lower regional EFH

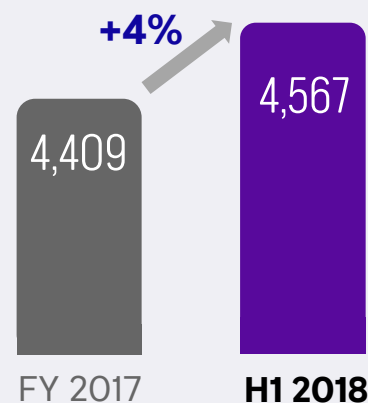
2 EFH growth

Large engine invoiced EFH



- Continued growth of Trent 700, Trent 1000 and Trent XWB fleets

Large engine in-service fleet



- Growth in Trent 1000 and Trent XWB fleets
- Good performance in mature engine transitions

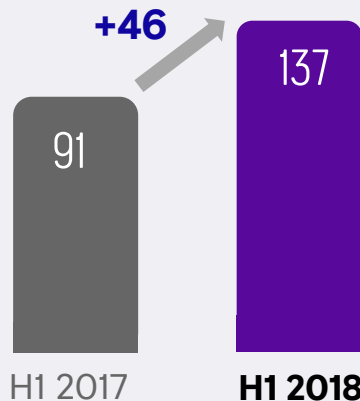


Civil Aerospace: key cash drivers

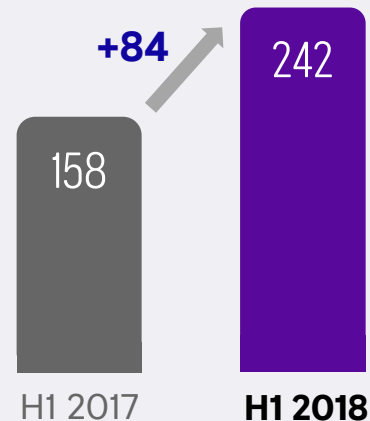
Growing fleet driving
increased shop visits

3 Shop visits

Widebody LTSA
major shop visits



Widebody LTSA
check & repair visits



- Increase in Trent 700 engine first overhauls

- Accelerated maintenance activity on Trent 1000/900



Trent XWB

Excellent entry
into service

Trent XWB-84

352 in service

19 operators

Trent XWB-97

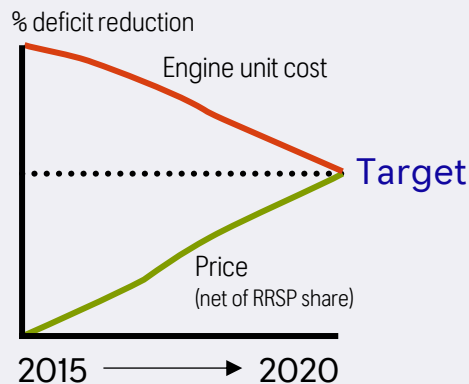
entered into service in February

Total cumulative fleet hours
>2m

Dispatch reliability in
first half

99.9%

Solid progress on engine cash deficit reduction



Engine performance
in-service in line with
expectations



Power Systems Overview

H1 performance driven by strong OE volumes and services growth with strength across end-markets

£m	H1 2018	H1 2017	Change	Organic change
OE	945	814	+16%	+14%
Services	526	461	+14%	+12%
Underlying revenue	1,471	1,275	+15%	+13%
Gross profit	354	283	+25%	+23%
<i>Gross margin %</i>	24.1%	22.2%	+190bps	+180bps
Operating profit	80	26	54	52
<i>Operating margin %</i>	5.4%	2.0%	+340bps	+330bps

- Underlying revenue - double-digit growth in both OE and Services
- Gross Margin - 180bps improvement reflects higher volumes
- Operating margin - improvement of 330bps



Power Systems Overview

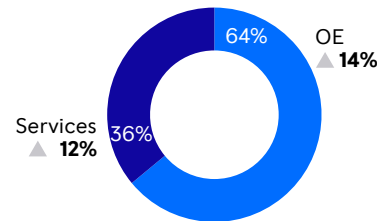
On track;
confident over
outlook for 2018

- **H1 OE revenue growth of 14% led by strong end markets**
Volume driven; strength across almost all markets; PowerGen down due to tough PY comparison base
- **H1 services revenues +12%**
Strong growth in commodity exposed markets
- **Good order intake; +27% versus prior year**
Pre-buy effect in Construction & Agriculture markets, strength in commodity related end markets and PowerGen wins
- **On track to deliver FY18**
FY order coverage over 80%; significantly better than prior year

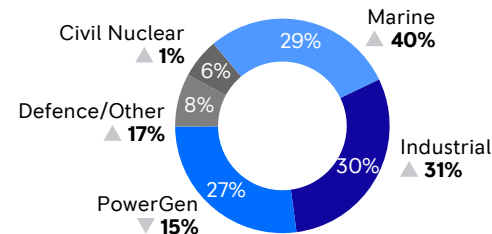
Underlying revenue

£1,471million

By type

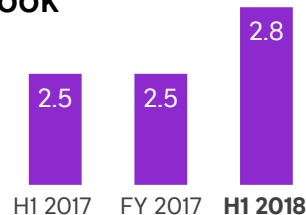


By end market



Order book

£bn





Defence Overview

Solid performance;
margins impacted by
higher R&D spend on
future technology

£m	H1 2018	H1 2017	Change	Organic change
OE (& Development)	608	629	-3%	+1%
AM - LTSA	250	227	+10%	+16%
AM - T&M	557	622	-10%	-7%
Underlying revenue	1,415	1,478	-4%	-
Gross profit	281	292	-4%	+1%
Gross margin %	19.9%	19.8%	+10bps	+30bps
Operating profit	162	180	(18)	(6)
Operating margin %	11.4%	12.2%	-80bps	-40bps

- Underlying revenue - broadly flat
- Gross Margin - stable versus prior year
- Operating margin - down 40bps; higher R&D spend partly offset by reduced C&A



Defence Overview

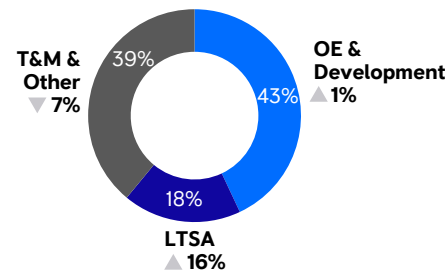
Confidence in the
outlook for remainder
of the year

- **Solid OE revenue**
Transport and Submarines
growth offset lower Combat
volumes
- **Services revenue flat**
Increased LTSA and Combat
spares offset Submarines (shift
in contract phase)
- **Orders weighted to H2**
Good pipeline in Combat, Naval
& Submarines
- **Remain confident on FY18
outlook**
Expect similar H2 weighting to
profit as 2017 (60:40)

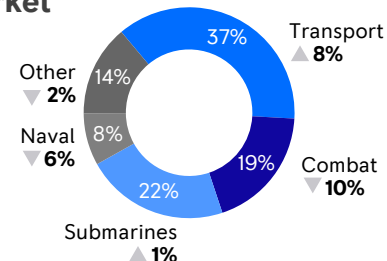
Underlying revenue

£1,415million

By type



By end market





ITP Aero Overview*

Outlook positive
despite near-term cash
investment cycle

£m	H1 2018	H1 2017	Change	Organic change
Underlying revenue	375	309	+21%	+19%
Gross profit	85	50	+70%	+67%
Gross margin %	22.7%	16.2%	+650bps	+650bps
Operating profit	40	8	32	32
Operating margin %	10.7%	2.6%	+810bps	+820bps

*ITP Aero was acquired on 19 December 2017. Prior year comparatives are unaudited and are presented for comparison purposes only

- **Underlying revenue** driven by the growth in Civil Aerospace programme deliveries in ITP Aero's portfolio +21%
- **Gross margin** - significant improvement; higher aftermarket volumes, improved OE mix
- **Operating margin** - driven by gross margin improvements in Civil



03

Accounting policy update



Accounting policy updates

IFRS 9 Financial Instruments

Amendments to accounting for financial instruments

- Effective from 1 January 2018 with adjustment to reserves on that date
- No restatement of comparatives
- No change to hedge accounting for foreign exchange
- No material effect on the H1 2018 numbers

IFRS 16 Leases

All leases on balance sheet

- Effective from 1 January 2019 with adjustment to reserves on that date
- No restatement of comparatives
- Continue to make good progress on policies, impact assessment and system implementation.
- Property and aircraft engines most material



04

Guidance



2018 Cash Outlook

Cash flow guidance now expected to be in the upper half of our guidance range

Free cash flow (FCF) guidance updated

Prior FCF guidance for Group (excl. ITP Aero) as provided at FY17 Results



Updated FCF guidance on a **like-for-like** basis



Now expected to be in the upper half of our guidance range:

- Improved Defence margin
- Better Power Systems growth

Core business FCF (incl. ITP Aero) guidance



Adjusted for:

- £(50)m Inclusion of ITP Aero
- Removal of Commercial Marine & L'Orange (Net £nil)

Now expected to be in the upper half of our guidance range



2018 Profit Outlook

Profit guidance now expected to be in the upper half of our guidance range

Profit guidance updated

Prior profit guidance for Group (excl. ITP Aero) as provided at FY17 Results



Profit guidance on a **like-for-like basis**



Now expected to be in the upper half of our guidance range:

- Improved Defence margin
- Better Power Systems growth

Core business operating profit (incl. ITP Aero) guidance



Adjusted for:

- +£50m Inclusion of ITP Aero
- Removal of Commercial Marine & L'Orange (Net £nil)

Now expected to be in the upper half of our guidance range



Business outlook

Warren East

Chief Executive



UltraFan®



Priorities for 2018 remain unchanged

Customers

- Large engine production ramp-up
- Expanding service network
- Mitigating disruption from in-service issues

Technology

- Service revitalisation
- Development of new engine architecture
- EVTOL concept personal flight

Resilience

- Cultural change
- Improving adaptability
- Diversity & inclusion
- High ethical standards

Financial Progress

- Improving free cash flow
- Strengthened balance sheet
- Disciplined capital allocation



Restructuring



Must do:

- 01 Drive out unnecessary costs
- 02 Remove complex & duplicative processes
- 03 Develop a real performance culture
- 04 Create ownership behaviour



Develop:
Our long-term
vision and strategy

“Creating the leading
Industrial Technology
Company”

Pioneering the Power that Matters

Rolls-Royce pioneers cutting edge technologies that deliver the cleanest, safest and most competitive solutions to meet our planet's vital power needs

Champion
electrification



Reinvent with digital



Vitalise existing capabilities



Transform our
Business



Build balanced portfolio



Q&A





Safe harbour statement

This announcement contains certain forward-looking statements. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. In particular, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of interest or exchange rates, the availability of financing to the Company, anticipated cost savings or synergies and the completion of the Company's strategic transactions, are forward-looking statements. By their nature, these statements and forecasts involve risk and uncertainty because they relate to events and depend on circumstances that may or may not occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements and forecasts. The forward-looking statements reflect the knowledge and information available at the date of preparation of this announcement, and will not be updated during the year. Nothing in this announcement should be construed as a profit forecast. All figures are on an underlying basis unless otherwise stated - see note 2 of the 2018 Half Year Results Statement for the definition.