

09 July 2020

ROLLS-ROYCE HOLDINGS PLC H1 2020 TRADING UPDATE

First half 2020 summary

- Widebody engine flying hours (EFH) down approximately 50% in H1 and 75% in Q2
- Good progress on Trent 1000 fixes; achieved single-digit aircraft on ground target
- Defence remained resilient; low double-digit percent decline in Power Systems revenue
- Free cash outflow of approximately £3bn, reflects £1.1bn reduction in receipts from EFH and engine deliveries and £1.1bn one-time impact from the cessation of invoice factoring
- £1.0bn cost mitigation actions for 2020 on track; approximately £300m achieved in H1
- Expect improved H2 performance with FY free cash outflow of approximately £4bn
- Restructuring underway supporting free cash flow recovery to at least £750m in 2022
- \$10bn reduction in hedge book to de-risk and re-align to expected mid-term demand
- Liquidity increased to £8.1bn including new undrawn £2bn 5-year term-loan facility

Warren East, CEO, said: *"These are exceptional times. The COVID-19 pandemic has created a historic shock in civil aviation which will take several years to recover. We started this year with positive momentum and strong liquidity and acted swiftly to conserve cash and cut costs to protect Rolls-Royce during the pandemic. We are taking steps to resize our Civil Aerospace business to adapt to lower medium-term demand from customers and help secure our future. This means we have had to take the very difficult decision to lose people who have helped us become the company we are and who have been proud to work for Rolls-Royce. It is my first priority to treat everyone – whether they are leaving or staying – with dignity and respect. We will take the lessons of how we have dealt with this unprecedented challenge with us and position ourselves to emerge as an even stronger company in the future."*

Protecting our people and communities

We have worked hard to safeguard our people while ensuring our operations have been able to continue during this difficult period. We have implemented measures to protect against the spread of the virus at our sites around the world and increased our focus on employee mental health and wellbeing. Furthermore, we have been providing practical assistance to aid the recovery for the countries and communities in which we operate. This included launching the Emergent Alliance, a global community with over 140 members that is using data analytics to assist the global economic recovery.

Financial update

Our cashflows have been significantly affected by COVID-19 and as a result our free cash outflow in the first half was approximately £3 billion. The main impacts in the period included:

- approximately £1.1 billion less cash inflow due to lower receipts associated primarily with widebody engine flying hours together with lower engine deliveries
- approximately £1.1 billion one-off adverse impact from the cessation of invoice factoring, an industrywide practice which in the past has been used to align the timing of cash receipts with engine deliveries
- increased inventory and debtor balances in addition to the typical seasonal working capital outflows, which averaged approximately £200 million outflow per year over the last two years
- positive impact of approximately £300 million from savings related to the mitigating actions achieved in the first half.

Our rate of cash outflow is expected to ease in the second half supported by increased benefits from cash mitigation actions, the timing of working capital movements and the anticipated ongoing recovery of commercial aviation from the trough reported in April.

Due to the deterioration in the medium-term outlook caused by COVID-19, absent mitigating actions, we forecast a shortfall of US\$ denominated cash receipts over the next seven years compared to our hedged position. As a result, it is financially prudent to mitigate the future risks of this hedge book by closing out hedges that are no longer required. We have therefore reduced the hedge book from \$37 billion to approximately \$27 billion. This will result in cash settlement costs totalling approximately £1.45 billion comprising approximately £100 million of cash costs in 2020 (incurred in the first half), £300 million in each of 2021 and 2022, and £750 million spread over 2023 to 2026. The related underlying financing charge will be recognised in our first half 2020 underlying income statement.

We have pro-forma liquidity of £8.1 billion including an undrawn revolving credit facility of £1.9 billion and commitments for a new 5-year term-loan facility of £2.0 billion underwritten by a syndicate of banks and to be supported by a partial guarantee from UK Export Finance, which has not yet been drawn. Our cash balance was £4.2 billion at the end of June. During the first six months of the year we accessed £300 million under the Bank of England's Covid Corporate Financing Facility (CCFF) and drew £2.5 billion under our revolving credit facility.

Actions to reduce cash expenditure and ongoing cost base

We have made good progress executing the one-off actions announced in April to address our discretionary expenditure in 2020. We delivered around £300 million of these in the first half, with savings expected to accelerate in the second half of the year. We remain on track to deliver in-year cash savings in 2020 of up to £1.0 billion.

Separately, our major reorganisation to right-size the Group, which was announced on 20 May 2020, is progressing well and is forecast to deliver at least £1.3 billion in annual pre-tax cash savings by the end of 2022 (including remaining savings of around £100m from the restructuring programme announced in 2018). We expect a reduction of over 17% of our workforce, equivalent to more than 9,000 roles across the Group worldwide, including approximately 8,000 in our Civil Aerospace business which we are reducing by about a third to adapt to the new level of market demand we are expecting. Last month we opened voluntary severance in the UK, including an enhanced early retirement scheme. To-date, we have received more than 3,000 expressions of interest for voluntary severance in the UK with approximately two-thirds of these currently expected to leave by the end of August.

Operational update

Our **Civil Aerospace** business has experienced a significant reduction in demand due to the effects of COVID-19. Widebody engine flying hours fell by approximately 50% in the first half, compared to the prior year period with an approximate 75% decline in the second quarter. Since the low point in April, when flying hours were down 80% compared to April 2019, we have seen early signs of recovery with a marginal improvement in May and June led by an increase in flights in China, Asia Pacific and the Middle East. Business jet and regional flight activity has been recovering more quickly due to lower exposure to cross-border routes.

MRO (Maintenance, Repair and Overhaul) activity in the first half was broadly stable compared to the prior year period but lower than the pre-COVID-19 first half schedule. We have completed the backlog of overhauls related to the Trent 1000 durability issues and have achieved our target to reduce the number of related aircraft on the ground (AOG) to single digits. We are progressing well with the type test of the replacement high pressure turbine blade for the Trent 1000 TEN, the final durability issue to be fixed, and remain on track for its incorporation into the fleet by the end of H1 2021.

The deterioration in the medium-term market outlook for the commercial aviation industry will need to be reflected in our contract accounting assumptions and we will also be assessing the carrying value of our engine programmes and deferred tax assets. We are currently undertaking a review of these matters, the impact of which may result in non-cash accounting adjustments in our first half results.

Output of new widebody engines was consistent with our revised guidance of 250 engines for the full year, with 130 engine deliveries in the first half.

The commercial aerospace activities of **ITP Aero**, which account for approximately 75% of its business, have experienced a similar deterioration in end market demand as our Civil Aerospace business unit. Its defence related activities remained stable.

Our **Power Systems** business experienced varying levels of COVID-19 related disruption and utilisation with low double-digit percentage revenue decline compared to the prior year period. Our customers in industrial markets were the most impacted by lower activity levels, particularly those with exposure to oil & gas and mining. PowerGen activity also slowed down in the second quarter, most notably in the US. We experienced a reduction in demand for smaller yacht engines with some marine yards closed for much of the second quarter. Defence related activities and the rest of our Marine business performed relatively robustly. Long-term demand growth for reliable power solutions is expected to remain intact with demand in data centre mission critical applications increasing above pre-COVID levels. We are growing market share in developing markets, particularly in China where we continue to expect growth in our revenues in 2020.

Our **Defence** business has remained resilient with continued demand from key government customers. We have not experienced any material operational or financial disruption as a result of COVID-19. We remain committed to the development of new products and programmes in Defence including Tempest in the UK. In the US, we are poised to submit our RFP for the new B-52 engine opportunity and the consortium of which we are a member recently went through to the next round in the competition for the US Army's Future Long Range Assault Aircraft.

Outlook

We currently anticipate a gradual recovery of our end markets as travel restrictions ease in the coming months, while acknowledging the elevated level of uncertainty in the industry outlook. We currently forecast widebody engine flying hours to be down in the region of 55% this year, with more long-haul routes opening up in the fourth quarter. We continue to plan for about 250 widebody engine deliveries in 2020, based on announced build rates from our airframer customers.

As a result of our cash mitigation actions and supply chain management we expect our rate of cash consumption to significantly reduce in the coming months, resulting in a full year free cash outflow of approximately £4 billion. This reflects an unwind of the inventory in the second half along with a gradual improvement in engine flying hour receipts and an acceleration of cash savings. We have strengthened our liquidity position to absorb the near-term cashflow pressures and continue to review our options to strengthen our balance sheet and position ourselves for the recovery.

We remain positive about the long-term outlook for sustainable power solutions. We expect Defence to continue to experience good demand. In Power Systems, many of our impacted end markets are forecast to recover by the end of 2021. We currently expect our widebody engine flying hours to recover to approximately 70% of 2019 levels in 2021 with OE deliveries likely to remain subdued. The steps we have taken to substantially resize and restructure our Civil Aerospace business will help deliver a sustainably lower cost base for the future and ensure it is well positioned for the recovery in demand. As a result, even after the additional cost associated with de-risking our currency exposure,

we are targeting at least £750 million Group free cash flow in 2022 and growth in our returns into the medium-term.

Our first half 2020 results announcement and webcast will be published on 27 August 2020.

This announcement has been determined to contain inside information.

About Rolls-Royce Holdings plc

1. Rolls-Royce pioneers cutting-edge technologies that deliver clean, safe and competitive solutions to meet our planet's vital power needs.
2. Rolls-Royce has customers in more than 150 countries, comprising more than 400 airlines and leasing customers, 160 armed forces, 70 navies, and more than 5,000 power and nuclear customers.
3. Annual underlying revenue was £15.3 billion in 2019, around half of which came from the provision of aftermarket services.
4. In 2019, Rolls-Royce invested £1.45 billion on research and development. We also support a global network of 29 University Technology Centres, which position Rolls-Royce engineers at the forefront of scientific research.
5. Rolls-Royce Holdings plc LEI: 213800EC7997ZBLZJH69

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The merits or suitability of investing in any securities previously issued or issued in future by the Company for any investor's particular situation should be independently determined by such investor. Any such determination should involve, inter alia, an assessment of the legal, tax, accounting, regulatory, financial, credit and other related aspects of the transaction in question.