Investors' Update

April 2019

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IR activity: H1 2019 dates

3 April
ESG Event

2 May
AGM

17-19 June
Paris Airshow

6 August
Half Year results

Welcome to the first Investors' Update of 2019. After the usual intense period in the run up to the Full Year Results announcement, the team has been busy answering your questions.

In addition to the Full Year Results materials and our 2018 Annual Report published on our IR website, you'll also find a set of slides answering some of the most common questions, the content of which is also included in this newsletter.

We have been busy on our London and Edinburgh roadshows and preparing for our first ESG Event which was held on 3 April. In the coming days we'll be travelling to see investors in the US and further out we are looking forward to the Paris Air Show.

On the IR team front, we look forward to Peter Lapthorn joining the team in mid-April from Goldman Sachs where he was part of the equity research team. Peter is replacing Richard Foster, who left the team at the end of the year, to join Aggreko. Georgina Ashby will also be joining the team from within Rolls-Royce. And finally, please join me in congratulating Elena who is expecting her first baby in July.

Jennifer Ramsey
Head of Investor Relations

Jennifer Ramsey
Head of Investor Relations
020 7227 9087

Elena Prentice
Investor Relations & ESG Manager
020 7227 9237

Investors' Update
April 2019

Corporate news

2018 Full Year Results

28 February

The 2018 Full Year Results is the first full set of results reported under IFRS 15. Given that we have been guiding investors to focus on our Free Cash Flow generation, we're finding one question, in particular, recurring:

"How should we understand the relationship between the year-on-year change in widebody aftermarket services cash contribution, shown in your Civil Aerospace trading cash flow on slide 49 of your 2018 Full Year Results presentation, with the change in Civil Aerospace LTSA net creditor given in your Funds Flow Statement?"

Read more – see Appendix page 5

Completion of Commercial Marine sale

1 April

Rolls-Royce confirmed that the completion of the sale of our Commercial Marine business to KONGSBERG took place on 1 April. The completion of the transaction, which was announced on 6 July 2018, follows recent clearance from the relevant regulatory authorities.

Net proceeds after transaction costs and other adjustments are estimated to be around £350m to £400m. In 2018, Commercial Marine reported underlying revenue of £726m and an underlying loss of £35m.

Read more

ESG Event

3 April

On 3 April, Rolls-Royce held its first Environment, Social and Governance (ESG) Event. With ESG becoming increasingly important for investors, we took the opportunity to clarify the various ESG-related actions that are currently under way at Rolls-Royce. The event was hosted by our Chairman with both Non-Executive Board members and members of the Executive Team presenting and participating in Q&A sessions. We had reports from the Board Sub-Committee Chairs, shone a light on our technological innovation in areas of electrification, digitalisation, hybridisation of rail travel and hybrid-electric flight and discussed how we are implementing the cultural change needed to bring our strategy and vision to life. To watch the webcast and download our presentation, please click on the link below.

Read more

IR news

We finished our 2018 Full Year Results Roadshow with Warren and Stephen in the UK and will depart to New York, Boston and Toronto in the coming days. A second trip to the US is planned for mid-May with Director of Financial Planning & Analysis, Ben Fidler. Next on our Agenda is the AGM on 2 May and we look forward to seeing several of you at the Paris Air Show in June. Now that the ESG Event is behind us and assuming a sufficient number of analysts publish updated forecasts we will look to generate an updated consensus before the Half Year.

Business news: Civil Aerospace

Trent 1000 and Trent XWB orders

13 March

Rolls-Royce has been selected by Lufthansa Group to power 40 new aircraft. Its Trent 1000 engine will power 20 Boeing 787 Dreamliners and its Trent XWB will power 20 Airbus A350 XWBs. Rolls-Royce will also provide its flagship TotalCare® long term services for both engine types.

The Trent XWB is the world's most efficient large aero engine flying today and the world's fastest-selling widebody engine with more than 1,800 in service or on order. The airline will also operate the latest version of the Trent 1000, the Trent 1000 TEN (Thrust, Efficiency and New Technology), offering high fuel efficiency and low noise.

Read more

Business news: Power Systems

Rolls-Royce and ABB announce global microgrid cooperation

2 April

Rolls-Royce and ABB have announced a global partnership on microgrid technology and advanced automation. Together the two companies will offer an innovative, energy-efficient microgrid solution for utilities, commercial and industrial entities.

A microgrid is a small-scale electric grid that combines power from distributed energy generation sources such as combined heat and power plants, diesel- and gas-powered gensets and renewable sources with batteries. The microgrid provides the overall control to coordinate these resources to meet the requirements of industrial, residential or consumer loads. Microgrids can either function off-grid or connected to the main power grid. The ability of microgrids to seamlessly separate themselves from the main grid, in the event of a potential grid fault or emergency, is an increasingly important feature.

Read more

Business news: Defence

Bell and Rolls-Royce collaboration on advanced propulsion systems

22 March

Bell Helicopter, a Textron Inc. (NYSE: TXT) company, announced a teaming agreement with Rolls-Royce for the development of an optimised propulsion system and continued risk reduction efforts aimed at the V-280 Valor and V-247 advanced vertical lift platforms. The collaboration will focus on the integration of Rolls-Royce's proven low-risk and advanced propulsion systems into future Bell aircraft.

As part of this teaming agreement, Bell will lead the design, development and production of advanced vertical lift systems, and Rolls-Royce will provide its technical expertise in propulsion systems to provide potential customers with tested, high-performance solutions. This collaboration extends a successful relationship between Bell and Rolls-Royce that has existed for more than 50 years.

Research and Technology, Product Development

Rolls-Royce takes major step towards electrifying flight

14 March

Rolls-Royce has taken a significant step towards realising our ambition to provide hybrid-electric propulsion systems for the next generation of aviation, with successful ground tests of a hybrid system using our M250 gas turbine – a highly successful engine usually powering helicopters. The tests are part of one of the world's most comprehensive hybrid aerospace turbine engine development and integration programmes and pave the way for experimental flights on aircraft in 2021.

Read more

Rolls-Royce withdraws from engine competition for new midsize airplane platform

28 February

Rolls-Royce has decided to withdraw from the current competition to power Boeing's proposed middle of the market – or New Midsize Airplane (NMA) – platform. While we believe the platform complements Boeing's existing product range, we are unable to commit to the proposed timetable to ensure we have a sufficiently mature product which supports Boeing's ambition for the aircraft and satisfies our own internal requirements for technical maturity at entry into service.

At the same time, we remain committed to the development of new technologies and will continue to mature and de-risk our next generation UltraFan® engine architecture in preparation for future applications. UltraFan is a scalable jet engine design suitable for widebody or narrowbody aircraft and will offer a 25% fuel efficiency improvement over the first-generation of Rolls-Royce Trent engines.

Read more

Rolls-Royce UltraFan one step closer as Advanced Low Pressure System (ALPS) testing gets underway

25 February

Engineers at Rolls-Royce in Derby, UK, have successfully tested a key component of the UltraFan® engine design. For the first time, all composite elements of the Advanced Low Pressure system (ALPS), including fan blades, a fan case and annulus fillers, were tested together on a donor engine.

The engine parts are manufactured using state-of-the-art, fully automated construction methods at Rolls-Royce's Composites Technology Facility, a Composites Centre of Excellence.

Read more

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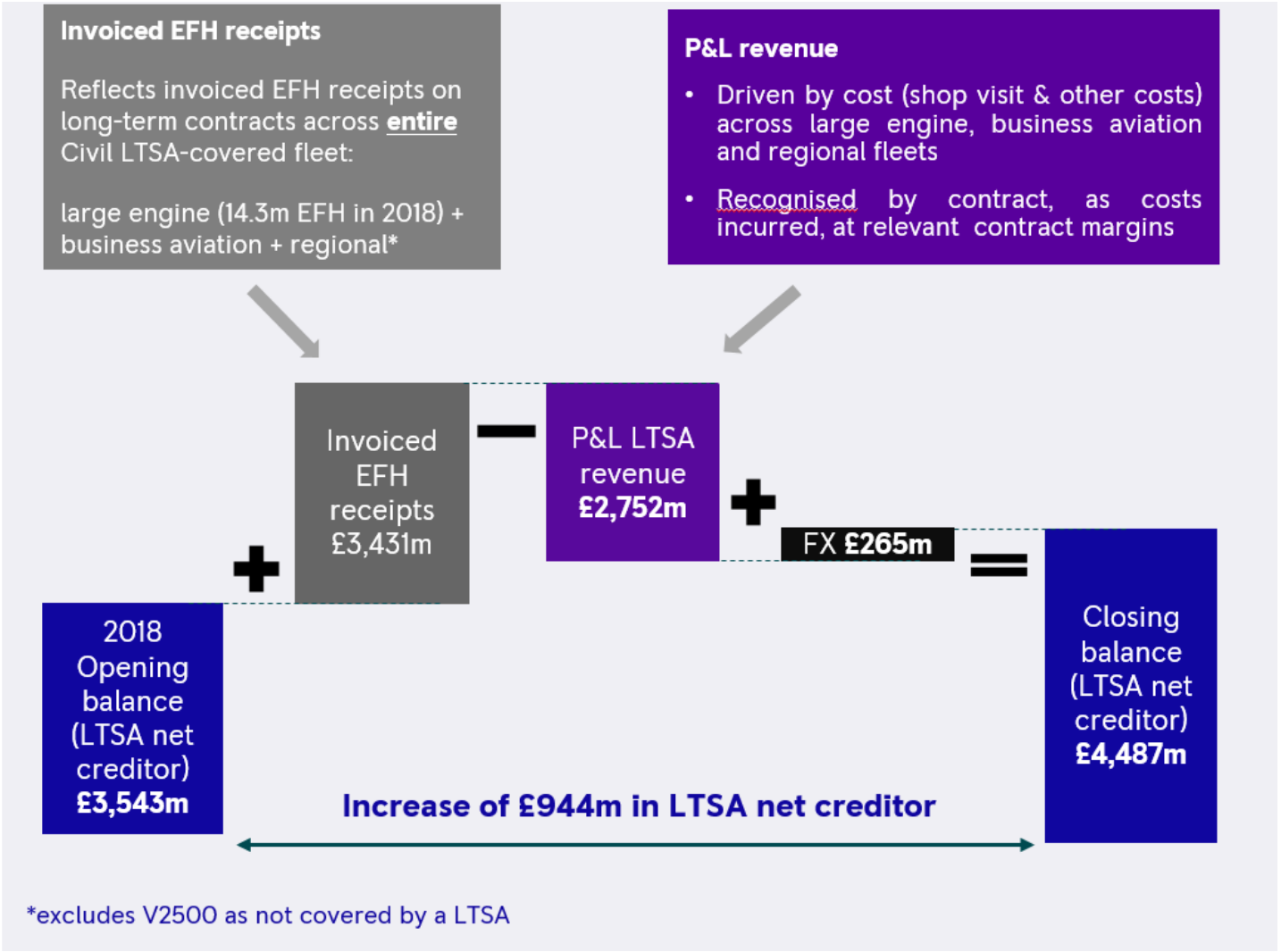
Appendix I: Drivers of net LTSA balance change and correlation to Civil trading cash flow

01 Net LTSA balance explained

Civil Aerospace: Drivers of LTSA balance

Is driven by the difference between Invoiced EFH receipts and P&L revenues traded

£m	2018
Total Civil invoiced EFH receipts	**3,431**
Negative revenue catch-ups	(303)
EFH receipts > underlying revenue	(376)
Civil underlying LTSA revenue	**2,752**



*excludes V2500 as not covered by a LTSA

Civil Aerospace net LTSA balance

Total increase **£944m at reported balance sheet level**

Increase of **£376m** once catch-ups and FX adjustment are removed

How to understand the £944m balance sheet movement

	£m
Total increase in net LTSA creditor	**944**
Exclude FX-driven increase	(265)
Increase at achieved FX rates	**679**
Less balance sheet impact from negative revenue catch ups	(303)
Derived EFH receipts > underlying revenue	**376**

Adjusts out FX difference between underlying P&L and reported P&L/balance sheet

£303m* increase in net LTSA creditor due to **negative catch-up adjustments** (reducing revenues recognised in prior years)

£376m represents underlying higher level of EFH receipts received in excess of underlying P&L revenue traded (driven by costs incurred in year)

Broken down:

c.2/3 Widebody

c.1/3 Business & Regional

*£303m was the revenue effect of negative catch-ups. An offsetting £27m was accounted for in cost of sales reflecting RRSP share. Net profit impact £276m

Civil Aerospace:

LTSA balance change vs simple view of cash flow

Change in Civil net LTSA balance **does not reconcile directly** with the Civil trading cash flow summary

- Because they are **fundamentally different** things

Summary funds flow statement

£m	2018
Opening net (debt)/funds	(305)
Closing net funds/(debt)	611
Change in net funds	916
Underlying profit before tax	466
Depreciation and amortisation	756
Capital expenditure (PPE)	(905)
Expenditure on intangible assets	(680)
Working capital change	581
Civil Aerospace net LTSA balance change	944
Other	(405)
Trading cash flow	757

Civil trading cash flow

£bn		2018
Original equipment	419@ £1.4 m	(0.6)
Underlying services	14.3 m TotalCare EFH	1.6
Spare engines		0.3
WB Cash Margin (underlying)		**1.3**
Trent 1000 disruption costs		(0.4)
WB Cash Margin		**0.9**
Business, regional, & V2500		1.0
Operations & engineering costs		(0.7)
Cash Gross Margin		**1.2**
R&D, Capex & C&A costs		(1.7)
Working capital		0.7
Trading Cash Flow		**0.2**

Net LTSA balance change £944m =

- FX in contract accounting (£265m)
- Contract accounting adjustments (£303m)
- Underlying EFH receipts in excess of underlying P&L revenue for all LTSA contracts (£376m) – widebody (c.2/3), business aviation & regional (c. 1/3)

Difference between all LTSA invoiced receipts & LTSA P&L revenues

WB aftermarket cash margin of £1.6bn =

- WB EFH cash receipts + T&M cash receipts
- LTSA and T&M shop visit costs, net RRSP flows and other LTSA costs

Difference between just WB aftermarket cash receipts & cash costs, including T&M

02

Explanatory notes

- IFRS 15 impact on revenue
- Catch ups
- FX

IFRS 15:
Application to Civil long-term service agreements

- **Cost** (overhauls and other contract support costs) **drives revenue recognition** under IFRS 15
- **Cost is recognised as incurred in the P&L –** within cost of sale
- The **difference** between **invoiced EFH receipts in the cash flow and revenue recognised in the P&L goes to the balance sheet - in the LTSA balance**
- **The net LTSA balance does not reflect the difference between invoiced EFH cash receipts and overhaul/other LTSA costs** - i.e. it is discrete to aftermarket cash margin
- **The LTSA balance includes** widebody, business aviation & regional activities

Civil Aerospace: Catch-up adjustments

Impact P&L revenue

Impact the LTSA balance

How & why do catch-up adjustments impact the LTSA balance?

Changes in forecast revenue or cost assumptions, lead to adjustments (positive or negative) to profit recognised on a contract to date . This adjustment to profit is primarily achieved through revenue

Such catch-up adjustments:

- **reduce** (negative adjustments) or **increase** (positive adjustments) revenue recognised in year
- So, **reduce** (positive adjustments) or **increase** (negative adjustments) the LTSA creditor balance

Negative catch-up	Positive catch-up
Revenue (P&L) ⬇	Revenue (P&L) ⬆
LTSA net creditor (balance sheet) ⬆	LTSA net creditor (balance sheet) ⬇
Less revenue has been recognised. So difference between revenue and EFH receipts increases. Thus LTSA net creditor increases	More revenue has been recognised. So difference between revenue and EFH receipts reduces. Thus LTSA net creditor reduces

Civil Aerospace: Contract accounting FX

Why do we need to consider FX?

How & why does FX impact LTSA movements?

FX adjustments need to be considered when looking at the underlying change in LTSA net creditor balance due to the fact that reported balance sheet and income statement use different FX rates to the underlying income statement:

- **Reported balance sheet and reported income statement** translated using spot FX rates*
- **Underlying income statement** is translated using achieved FX rates (i.e. hedge rates)*

In **2018** the **currency-driven difference** between underlying and reported rates contributed to **£265m** of the £944m increase in the net LTSA creditor balance

**Note that there is also some dependence on the estimated long-term planning FX rate*