

13 February, 2014

ROLLS-ROYCE HOLDINGS PLC **2013 FULL YEAR RESULTS**

Group Highlights

- Order book of £71.6bn, up 19%
- Underlying revenue of £15.5bn, up 27%
- Underlying profit before tax of £1,759m, up 23%
- Reported profit before tax of £1,759m, down 36%
- Payment to shareholders of 22 pence per share, up 13%
- Tognum, now part of Power Systems, consolidated for the first time in the full year results

<u>Rolls-Royce Holdings plc</u> <u>£ millions</u>	<u>including Tognum</u>			<u>excluding Tognum</u>		
	<u>2013</u>	<u>2012**</u>	<u>Change</u>	<u>2013</u>	<u>2012**</u>	<u>Change</u>
Order book	71,612	60,146	19%	69,978	60,146	16%
Underlying revenue*	15,505	12,209	27%	12,919	12,209	6%
Underlying profit before tax	1,759	1,434	23%	1,502	1,357	11%
Return on sales***	11.8%	12.2%	-0.4pp	12.1%	11.6%	0.5pp
Underlying earnings per share	65.59p	59.59p	10%			
Full year payment to shareholders	22.0p	19.5p	13%			
Reported revenue	15,513	12,161	28%			
Reported profit before tax	1,759	2,766	-36%			
Reported earnings per share	73.26p	125.38p	-42%			
Net cash	1,939	1,317				
Average net cash/(debt)	350	(145)				

* See note 2 on page 21 for explanation

** Certain profit figures restated, see note 1 on page 19

*** By reference to underlying profit before financing costs and tax

John Rishton, Chief Executive, said:

“2013 was a year of good progress, in which our order book, underlying revenue and underlying profit all grew.

Our priorities remain the 4 Cs: Customer, Concentration, Cost and Cash. There has been good progress on Customer, particularly with on-time delivery. On Concentration, we continue to focus on our two technology platforms of gas turbines and reciprocating engines. We achieved a cash inflow of £359m and improved our inventory turns. On cost, there is more to do.

The Trent XWB, our largest single programme, is performing well in test flight and will power the new Airbus A350 into service later this year.

In 2014, we expect a pause in our revenue and profit growth, reflecting offsetting trends across the business. This is a pause, not a change in direction, and growth will resume in 2015. Cash flow is expected to be broadly similar to 2013. Our record order book underpins our confidence in the long-term growth of our business.”

Group Overview

In 2013, the Group increased its order book by 19%, underlying revenue by 27% and underlying profit by 23%. The order book of more than £71bn provides good visibility of income streams for many years to come, and gives us the confidence to increase the dividend by 13% to 22p.

Our financial results now fully reflect our joint acquisition of Tognum, now part of our Power Systems business. This is an important business and we are confident that it will prove a good investment. It has brought additional scale and technology to our reciprocating engine portfolio and strengthened our market access through the MTU and L'Orange brands. Power Systems plays a key role in our strategy to go to market via two strong technology platforms: gas turbines and reciprocating engines.

We continue to focus on the 4 Cs of Customer, Concentration, Cost and Cash.

Customer

It is essential that we deliver on the promises made to our customers. Across the business we have significantly improved on-time delivery. This foundational step will strengthen our customer relationships and drive more efficient use of resources, such as inventory. In Civil Aerospace, on-time delivery to our widebody customers was 100% in 2013 for the first time.

In 2013, major milestones were achieved in a number of important programmes. The Airbus A350 XWB flew for the first time powered by our Trent XWB engines. We have now received orders for more than 1,600 XWBs, making this our best-selling Trent engine. The Trent 1000 engine, which powers the Boeing 787 Dreamliner, has achieved the best performance of any new widebody engine entering service, with 99.9% despatch reliability. In June, it was selected by Singapore Airlines to power 50 Boeing 787 aircraft. In Marine, the first of our innovative Environships went to sea. This vessel combines a wave-piercing bow, gas-powered engines and advanced propulsion systems that together reduce CO₂ emissions by 40%, compared with equivalent diesel-powered vessels. Lastly, BAE Systems announced that the UK's Type 26 Destroyer programme will feature four MTU diesel gen sets from Power Systems, together with our Trent-derived MT30 gas turbines.

Concentration

Concentration means deciding where to invest for future growth and where not. We have two technology platforms: gas turbines and reciprocating engines. Within gas turbines, we have a strong Civil Aerospace business, with over £60bn in orders. We will continue to invest here, including the next generation of narrowbody aircraft engines. We will also look for opportunities to expand in reciprocating engines.

In 2013, we acquired Hyper-Therm a specialist ceramics company, to increase our capabilities in ceramic matrix materials that will, in the future, play a critical part in improving the performance of gas turbine engines. We also acquired a Norwegian company, SmartMotor AS, a leader in the permanent magnet technology employed in our Marine business. We integrated PKMJ Technical Services, a US-based nuclear engineering services business with expertise in extending the life of nuclear plants.

Areas where we have decided not to grow include the sale of our 50% holding in the RTM322 helicopter engine programme to Turbomeca, a Safran company.

Cost

The highly regulated nature of the aerospace industry means that it will take both time and tenacity to drive cost out of the business, and we are still not where we need to be. However, there are a number of areas where progress is being made. We reduced indirect headcount by 11%, with further savings identified for 2014. Unit cost fell in Marine, Energy and Power Systems, although this was more than offset by an increase in Civil, where capacity growth has preceded volume growth and the cost per unit has predictably risen. We are building newer, more efficient facilities and capacity that will support a doubling of production of Trent engines. We are moving production away from high cost countries, and we are consolidating our supply chain. These actions will deliver benefits over time.

We have prioritised investment that improves operational performance, adds to our technical capability and reduces cost. This includes a shop floor IT modernisation programme that will increase operational efficiency and an Integrated Production Systems programme that will improve delivery to customers while reducing cost.

Cash

The Group delivered a cash inflow of £359m (£312m excluding Tognum), after payments to shareholders, prior to acquisitions, disposals and foreign exchange. Inventory has been an area of significant focus. While substantially improving our on-time delivery to customers and preparing for the ramp-up in volumes, we have improved inventory turns from 3x to 3.4x, excluding Tognum. This is one of the largest one year improvements in our stock turns.

We continue to invest significantly to deliver our order book. In 2013, capital expenditure was £687m (£590m excluding Tognum and £491m in 2012), with new aero engine test facilities at the Stennis Space Centre in Mississippi, USA and in Dahlewitz, Germany; a new Marine services facility in Guangzhou, China; and turbine blade facilities in Rotherham in the UK and at Crosspointe in the US, as well as a disc factory in Washington Tyne and Wear.

Group Trading Summary

<u>Rolls-Royce Holdings plc</u> <u>£ millions</u>	<u>Including Tognum</u>			<u>Excluding Tognum</u>		
	<u>2013</u>	<u>2012**</u>	<u>Change</u>	<u>2013</u>	<u>2012**</u>	<u>Change</u>
Order book	71,612	60,146	19%	69,978	60,146	16%
Underlying revenue*	15,505	12,209	27%	12,919	12,209	6%
Underlying profit before tax	1,759	1,434	23%	1,502	1,357	11%

* See note 2 on page 21 for explanation

** Restated, see note 1 on page 19

Order Book

- The order book increased 19%, to £71.6bn, up 16% excluding Tognum. Power Systems' order book of £1.9bn, reflects growth of 6%. We received orders for engines to power 334 widebody aircraft; a significant year for Civil Aerospace. The order book increased in Civil Aerospace, Marine, Energy and Power Systems, but decreased in Defence Aerospace. The order intake in 2013 included new orders of £18.9bn in Civil Aerospace, £1.6bn in Defence Aerospace, £2.7bn in Marine, £1.1bn in Energy and £2.7bn in Power Systems. The regional composition is broadly unchanged, with Asia and the Middle East representing 49% of the total order book.

Income Statement

- Underlying revenue increased 27% to £15.5bn, including £2.6bn in revenue from Tognum. Excluding Tognum, the Group's revenue increased 6% to £12.9bn, with 7% growth in original equipment and 4% growth in services. In 2013, 47% of the Group's revenue was generated by the sale of aftermarket parts and services (52% in 2012).
- Underlying profit before tax increased 23% to £1.8bn, including a £180m increase from Tognum. Excluding Tognum, profit increased 11% to £1.5bn, reflecting volume growth, continued strong margins in Defence Aerospace and the restructured relationship with International Aero Engines.
- Following a review with the Financial Reporting Council (FRC), we have changed our accounting policy for entry fees. In prior years, entry fees were recognised as other operating income at the time they were paid. This policy has been refined to align with our policy for capitalising development costs. The 2012 impact of the change in policy has been to increase underlying profit before tax by

£25m and to reduce net assets by £184m. The impact of this change in 2013 has been to reduce underlying profit by £39m. Additional details can be found in note 1, page 19.

- Both underlying profit before financing and reported profit before financing in 2012 have been restated by -£20m to reflect amendments to IAS 19, as further explained in note 1 on page 20.

Balance Sheet

- The Group remains committed to maintaining a strong balance sheet and a strong, investment grade credit rating. Standard & Poor's retains a rating of A/stable and Moody's a rating of A3/Stable.
- The Group continues to have good liquidity with £1.9bn of cash and £3.6bn in facilities. Debt maturities remain well spread through to 2026.
- On an accounting basis, pension liabilities reduced by £100m, largely as a result of adopting the amendments to IAS 19, which requires the use of AA corporate bonds to value pension assets. The acquisition of Tognum increased the liabilities by £397m and there was a reduction of £49 million as a result of changes in assumptions during the year. The Group also provided a discretionary cost of living increase to our largest pension, at a cost of £64m.

Cash Flow

- A cash inflow of £359m, prior to acquisitions, disposals and foreign exchange, reflects good progress on inventory and working capital, in a year of significant investment in capital expenditure and intangibles. Free cash flow, defined as operating cash after pensions and taxes, but before payments to shareholders, acquisitions & disposals, and foreign exchange was £781m (£669m excluding Tognum).

2014

Segment Reporting

To better align our reporting structure with our organization, going forward we will report as: Aerospace and Marine & Industrial Power Systems (MIPS). Aerospace comprises our Civil Aerospace and Defence Aerospace businesses. MIPS comprises our Marine, Power Systems and Energy & Nuclear businesses. Our nuclear submarines business will be reported within our Energy & Nuclear business. We will continue to report the same level of financial detail for our businesses as we normally do.

Guidance

For the full year 2014, we expect underlying Group revenue and profit to be flat. This reflects a 15-20% decline in Defence revenue, the consequence of well-publicised cuts in defence spending among major customers, and completion of the delivery phase of two major export programmes. Additionally, Marine will generate lower revenue in 2013, driven by Offshore. We expect growth to resume in 2015.

We expect profitability to be stronger in the second half of 2014, reflecting the timing and mix of trading and cost reduction. To be more consistent with market practice, our cash guidance in the future will be based on free cash flow. We expect our 2014 free cash flow to be similar to 2013 (£781m). Across the businesses, we expect underlying results as follows in 2014:

In Civil Aerospace, we anticipate modest growth in revenue and good growth in profit. In Defence Aerospace, we expect 15-20% reductions in revenue and profit. In Marine, we expect a modest reduction in revenue and modest growth in profit. In Energy & Nuclear, we expect good growth in revenue and profit. In Power Systems, we expect modest growth in revenue and good growth in profit. Additional details follow in our business reviews and financial results.

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A PDF copy of this report can be downloaded from www.rolls-royce.com/investors.

This Full Year Results Announcement contains forward-looking statements. Any statements that express forecasts, expectations and projections are not guarantees of future performance and will not be updated. By their nature, these statements involve risk and uncertainty, and a number of factors could cause material differences to the actual results or developments. This report is intended to provide information to shareholders, is not designed to be relied upon by any other party, or for any other purpose and the Company and its directors accept no liability to any other person other than under English law.

Business Reviews¹

Civil Aerospace

<u>£ millions</u>	<u>2013</u>	<u>2012**</u>	<u>Change</u>
Order book	60,296	49,608	22%
Engine deliveries	753	668*	13%
Underlying revenue	6,655	6,437	3%
Underlying OE revenue	3,035	2,934	3%
Underlying services revenue	3,620	3,503	3%
Underlying profit before financing	844	743	14%
Return on sales	12.7%	11.5%	1.2pp

* Revised from 888 deliveries in 2012 to exclude V2500 engine deliveries

** Certain profit figures restated, see note 1 on page 19

Financial

- The order book increased 22%, including new orders of £18.9bn (£10.3bn in 2012). Trent engines and aftermarket services now constitute 73% of the Civil Aerospace order book.

2013 was a significant year for widebody orders, with agreements to power 334 aircraft. We were also pleased to finalise previously announced orders with Air France-KLM and Philippine Airlines. Significant orders in 2013 included:

- Trent XWB engines and TotalCare for 227 Airbus A350 XWB's, including orders from Etihad, Japan Airlines, Singapore Airlines, United Airlines, Air Lease Corporation, Lufthansa, and IAG;
 - Trent 1000 engines and TotalCare for 75 Boeing 787 Dreamliners, including orders from Singapore Airlines, IAG, and Air Lease Corporation;
 - Trent 700 engines and TotalCare for 32 Airbus A330's, including orders from Qatar, SriLankan Airlines, SAS and CIT Aerospace.
- Revenue increased 3%, including 3% growth in OE revenue. There was a 20% increase in business jet engine deliveries and a small increase in Trent engines. Revenue growth was offset by Trent 1000 launch pricing and lower V2500 revenue. Aftermarket revenue increased 3%, where growth in the installed fleet was tempered by a 20% decline in RB-211 revenue.
 - Profit increased 14%, reflecting higher volumes, the £112m higher benefit from the restructured trading relationship with IAE and £26m higher entry fees. Profit growth was offset by additional investments in future programmes and slow progress on unit cost. Unit costs deteriorated, in part because some of our factories experienced low utilisation levels as they prepared to ramp up deliveries in 2014 and 2015.
 - In 2014, we expect modest growth in revenue and good growth in profit. We continue to see stable aftermarket growth, consistent with our large installed base. Revenue growth will be tempered by launch pricing, declining utilization of older engines and lower deliveries of business jets. We expect a return to good growth in 2015.

Portfolio

- Our Trent XWB is the world's most fuel-efficient, large turbofan, with over 1,600 engines ordered. With over 200 flights, more than 800 flying hours and over 6,000 testing hours, the engine is performing well and is on schedule to power the A350 XWB's entry into service later this year.
- Our Corporate and Regional business delivered the 3,000th BR700 series engine. We also delivered more business jet engines in 2013, than ever before.
- We affirmed our commitment to develop engines for the next generation of mid-size aircraft, while ending our potential collaboration with United Technologies Corp in this market segment.

¹ Commentaries in all reviews relate to underlying revenue and underlying profits, unless specifically noted.

Defence Aerospace

<u>£ millions</u>	<u>2013</u>	<u>2012*</u>	<u>Change</u>
Order book	4,071	5,157	(21%)
Engine deliveries	893	864	3%
Underlying revenue	2,591	2,417	7%
Underlying OE revenue	1,385	1,231	13%
Underlying services revenue	1,206	1,186	2%
Underlying profit before financing	438	395	11%
Return on sales	16.9%	16.3%	0.6pp

* Certain profit figures restated, see note 1 on page 19

Financial

- The Defence order book declined 21% (15% decrease in 2012) reflecting continued budgetary pressures on our major customers. The net order intake of £1.6bn was 5% higher than the previous year. We are working aggressively to reduce our costs, to deliver better value to customers.

Significant orders in 2013 included:

- Over US\$500m in spares and support contracts for the T56 engine, powering C-130s and P-3s;
 - Contracts worth over US\$400m to supply and support LiftSystem™ technology for the F-35B STOVL variant of the Lightning II;
 - US\$193m of contracts for engines and support for the V-22 Osprey's AE 1107 engines with the US Air Force and the US Marine Corps; and
 - Significant support agreements for combat engines powering the Royal Saudi Air Force.
- Revenue increased 7%, reflecting a 13% increase in OE and a 2% increase in services. Strong OE growth was driven by higher export sales, particularly of our EJ200 and Adour engine programmes. Our large installed base of over 16,000 engines continues to deliver aftermarket revenue, but this growth was moderated by lower flying hours and some aircraft retirements.
- Profit increased 11% due to higher volumes and lower R&D spending.
- In 2014, we expect a decline in revenue and profit of between 15 – 20% before growth resumes in 2015. This one year decline is the consequence of well publicised cuts in defence spending among major customers, and the completion of the delivery phase of a number of major export programmes.

Portfolio

- We delivered our 40th LiftFan for the Joint Strike Fighter F35B, continuing our legacy as the world's most successful provider of power systems for vertical take-off and landing.
- Our TP400 engines powered the A400M's entry in service with the French Air Force in August. With over 20,000 flying hours, the A400M will form an important part of the next generation of transport aircraft.
- We delivered our 1,500th AE2100 engine, which powers the C130-J.
- In September we concluded the sale of our share in the RTM322 helicopter program for a £250m consideration.

Marine

<u>£ millions</u>	<u>2013</u>	<u>2012*</u>	<u>Change</u>
Order book	3,996	3,954	1%
Underlying revenue	2,527	2,249	12%
Underlying OE revenue	1,438	1,288	12%
Underlying services revenue	1,089	961	13%
Underlying profit before financing	281	294	-4%
Return on sales	11.1%	13.1%	-2.0pp

* Certain profit figures restated, see note 1 on page 19

Financial

- The order book increased 1% including new orders of £2.7bn (£3.3bn in 2012). In 2013 we saw stable order inflow in our Merchant and Naval businesses. This was offset by weaker order flow in Offshore, where the phasing of projects has slowed growth in some of our key products. We continue to invest in technology and cost reduction to position ourselves competitively in these markets.

Significant orders in 2013 included:

- An £800m contract agreed with UK MoD on future nuclear submarine propulsion;
- The MT30 engine was selected for the UK MoD's new Type 26 Frigate programme, with vessels expecting to enter into service towards the end of this decade; and
- More than £250m of offshore contracts in China including seismic, platform supply vessels and construction platforms.
- Revenue increased 12%, reflecting higher sales in both new equipment and in services. Growth was particularly strong in Offshore and in Naval, offset by further weakening in our Merchant business, which declined 11%.
- Profit decreased 4% as volume growth was more than offset by pricing pressure and a less favourable mix. In 2013, profitability was also offset by investments in Marine to better position the business for future growth, including higher spending on R&D and restructuring costs.
- In 2014, we expect a modest decline in revenue, with a modest increase in profit. The lower revenue reflects the decline in 2013 order intake in Offshore due to deferred customer investment decisions. Profitability will be helped by good progress on cost reduction. The nuclear submarines business will be reported in Energy & Nuclear going forward.

Portfolio

- In China, which manages a growing share of the world's offshore vessels, we designed and equipped our first high-end seismic vessel (UT830) from a Chinese yard.
- In Merchant, we achieved several important milestones with engines powered exclusively by liquefied natural gas (LNG): Our first LNG-powered Environship set sail; and we delivered engines to power the world's first LNG-powered ferry and the world's first LNG-powered tug.
- Our 2013 acquisition of SmartMotor AS will provide capabilities in permanent magnet technology. This will benefit a range of marine products, including tunnel thrusters for our Offshore business, where it will reduce noise, vibration and size, while improving efficiency.

Energy

£ millions	2013	2012*	Change
Order book	1,469	1,290	14%
Underlying revenue	1,048	962	9%
Underlying OE revenue	415	344	21%
Underlying services revenue	633	618	2%
Underlying profit before financing	26	19	37%
Return on sales	2.5%	2.0%	0.5pp

* Certain profit figures restated, see note 1 on page 19

Financial

- The order book increased by 14%, with new orders of £1.1bn (£0.8bn in 2012). The business saw a strong recovery in order intake in Oil & Gas. Power generation markets remain suppressed. In Civil Nuclear, we continue to extend the suite of products and services that we offer to nuclear utilities to enable them to achieve safe, efficient and reliable lifetime reactor operations.

Significant orders and agreements in 2013 included:

- 33 RB211s ordered for oil and gas applications including a US\$175 million contract from Asia Gas Pipeline;
 - A US\$138m five-year contract from Petrobras to support 15 of their RB-211 industrial gas turbine power generation units; and
 - A tripartite agreement with Rosatom and Fortum to assess reactor design for UK new build.
- Revenue increased 9%, driven by higher OE volumes in our oil & gas business.
- Profit increased by £7m, reflecting higher volumes, partially offset by strong pricing pressure and continued investment in our Civil Nuclear business. We continue to work to improve the financial performance of the business.
- In 2014, the Energy business will also include our nuclear submarines business to form our Energy & Nuclear business. We expect good growth in revenue and profit, with further improvement in the return on sales.

Portfolio

- Our new packaging, assembly and test facility in Santa Cruz, Brazil, became operational, with the first units delivered to Petrobras.
- In Civil Nuclear, we delivered Instrumentation & Controls systems and components for seven new nuclear reactors currently under construction in China.
- We acquired PKMJ Technical Services, a US-based nuclear engineering services business with expertise in extending the life of nuclear plants.

Power Systems

AS REPORTED:

<u>£ millions</u>	<u>2013</u>	<u>2012</u>	<u>Change</u>
Order book	1,927	272	609%
Underlying revenue	2,831	287	886%
Underlying OE revenue	2,004	118	1598%
Underlying services revenue	827	169	389%
Underlying profit before financing	294	109	170%
Return on sales	10.4%	38.0%	-27.6pp

THE FOLLOWING TABLE SHOWS A TRADING COMPARISON AS IF BOTH TOGNUM AND BERGEN ENGINES HAD BEEN FULLY CONSOLIDATED IN 2012 AS WELL AS IN 2013. THE COMMENTARY BELOW IS DONE ON THIS BASIS.

<u>£ millions</u>	<u>2013</u>	<u>2012</u>	<u>Change</u>
Order book	1,927	1,823	6%
Underlying revenue	2,831	2,846	-1%
Underlying OE revenue	2,004	1,938	3%
Underlying services revenue	827	908	-9%
Underlying profit before financing	294	293	0.3%
Return on sales	10.4%	10.3%	0.1pp

Financial

- The order book increased 6%, with new orders of £2.7bn (£2.8bn in 2012). The final quarter of 2013 saw strong sales, driven by the pre-purchase of engines for agricultural customers ahead of the introduction of tighter environmental standards in Europe. Marine revenue is well supported by demand from navies in Asia and the US. In defence, major programmes to power military tanks provide stability despite continued pressure on Government spending.

Significant orders in 2013 included:

- 8 LNG powered Bergen engines to power the Fjord Line Shipping company's cruise ferries;
 - A contract from Cosco to deliver engines into two Rolls-Royce Marine designed UT vessels; and
 - Orders for MTU Powerpacks with rail engines for Hitachi's Intercity Express Programme in the UK, which will enter service in 2017 on the Great Western Main Line and East Coast Main Line routes.
- Revenue decreased 1%, with good growth in the Marine and Industrial divisions offset by lower revenue in Oil & Gas, medium speed engines and lower aftermarket sales.
- Profit increased 0.3%, reflecting a strong second half in a challenging year.
- In 2014, we expect modest growth in revenue and good growth in profit driven by growth in Marine and the land power systems markets.

Portfolio

- We are starting to see progress towards the revenue synergies envisioned with the acquisition. The UK's Type 26 Destroyer programme will feature four MTU diesel gen sets, together with our Trent-derived MT30 gas turbines.
- Power Systems is a market leader in backup power for nuclear power plants. Last year, we delivered a further 6 units into our global network of over 300 emergency diesel generators.

Additional financial information

Comparative figures have been restated to reflect the change in accounting policy for RRSAs and the amendments to IAS 19 – see note 1.

Underlying income statement

£ million	2013	Restated 2012	Change	
Revenue	15,505	12,209	3,296	27%
Civil aerospace	6,655	6,437	218	3%
Defence aerospace	2,591	2,417	174	7%
Marine	2,527	2,249	278	12%
Energy	1,048	962	86	9%
Power Systems	2,831	287	2,544	886%
Intra-segment	(147)	(143)	(4)	
Profit before financing and taxation	1,831	1,495	336	22%
Civil aerospace	844	743	101	14%
Defence aerospace	438	395	43	11%
Marine	281	294	(13)	-4%
Energy	26	19	7	37%
Power Systems	294	109	185	170%
Intra-segment	2	(11)	13	
Central costs	(54)	(54)	-	
Net financing	(72)	(61)	(11)	-18%
Profit before taxation	1,759	1,434	325	23%
Taxation	(434)	(317)	(117)	-37%
Profit for the year	1,325	1,117	208	19%
EPS	65.59p	59.59p	6.00p	10%
Payments to shareholders	22.0p	19.5p	2.5p	13%
Other items				
Gross R&D investment	1,118	919	199	22%
Net R&D charged to the income statement	624	531	93	18%

Underlying revenue increased £3.3 billion to £15.5 billion, of which £2.6 billion was due to the inclusion of Tognum from 1 January 2013. The remaining increase (six per cent) reflects a seven per cent growth in OE revenue and a four per cent increase in services revenue. Original equipment performance included growth of 21 per cent in Energy, 13 per cent in Defence aerospace and 12 per cent in Marine. Underlying services revenue continues to represent around half (47 per cent) of the Group's underlying revenue. In 2013, services revenue grew in all businesses, as the installed base of products continued to grow and the services network expanded.

Underlying profit before financing and taxation increased 22 per cent to £1.8 billion, including £190 million from the consolidation of Tognum from 1 January 2013. Excluding Tognum, the increase was due to a number of factors: increased revenue; continued strong margins in Defence aerospace and the restructured relationship with International Aero Engines AG.

Further discussion of trading is included in the business reviews on pages 6 to 10.

Underlying financing costs increased 18 per cent to £72 million, including £10 million from RRPS.

Underlying taxation was £434 million, an underlying tax rate of 24.7 per cent compared with 22.1 per cent in 2012.

Underlying EPS increased 10 per cent to 65.59 pence, lower than the increase in the underlying profit after tax due to the NCI share of Tognum.

Payments to shareholders: at the AGM on 1 May 2014, the directors will recommend an issue of 134 C Shares with a total nominal value of 13.4 pence for each ordinary share. Together with the interim issue

on 2 January 2014 of 86 C Shares for each ordinary share with a total nominal value of 8.6 pence, this is the equivalent of a total annual payment to ordinary shareholders of 22.0 pence for each ordinary share. Further details are on page 25.

Net underlying R&D charged to the income statement increased by 18 per cent to £624 million including £174 million from Tognum, reflecting a combination of increased spend of £33 million offset by higher net capitalisation of £61 million (due to the phasing of major new programmes, in particular the certification of the Trent XWB 84k), R&D tax credits of £28 million and net deferral of RRSA entry fees of £26 million. The Group continues to expect net R&D investment to remain within four to five per cent of Group underlying revenue.

Reported profit before tax has reduced from £2,766 million to £1,759 million. In addition to the changes in underlying profit before tax described above, reported profit before tax has been affected by the impact of mark-to-market of derivative contracts (£497 million reduction); (ii) the impact of consolidating Tognum (£322 million reduction, comprising the unrealised profit on reclassification to a subsidiary, the additional amortisation on recognised intangible assets and the revaluation of the put option on NCI); (iii) the net impact of disposals (£483 million reduction, disposal of RRTM in 2013 more than offset by the restructuring of IAE in 2012); and (iv) the cost of providing discretionary pension increases (£64 million). The reported tax charge is affected by the related tax impact of these items and the reduction of tax rates in the UK. This is set out in more detail in note 2 to the financial statements.

Balance sheet

		1 January 2013 including RRPS	Restated 31 December 2012
£ million	2013		
Intangible assets	4,987	4,866	2,901
Property, plant and equipment	3,392	3,109	2,564
Net post-retirement scheme deficits	(793)	(842)	(445)
Net working capital	(970)	(819)	(1,321)
Net funds	1,939	1,354	1,317
Provisions	(733)	(741)	(461)
Net financial assets and liabilities	(1,587)	(154)	(127)
Joint ventures and associates	601	523	1,800
Other net assets and liabilities	(533)	(515)	(232)
Net assets	6,303	6,781	5,996
Other items			
USD hedge book (US\$ billion)	\$24.7		\$22.5
TotalCare assets	1,901		1,629
TotalCare liabilities	(314)		(317)
Net TotalCare Assets	1,587		1,312
Gross customer finance contingent liabilities ¹	356		569
Net customer finance contingent liabilities ²	59		70

The balances recognised on 1 January 2013 as a result of the consolidation of Tognum are set out in note 11. The comments below relate to the changes after the consolidation of Tognum.

Intangible assets (note 7) represent long-term assets of the Group. These assets increased by £121 million with additional development, certification and software costs being largely offset by annual amortisation charges.

The carrying values of the intangible assets are assessed for impairment against the present value of forecast cash flows generated by the intangible asset. The principal risks remain: reductions in assumed market share; programme timings; increases in unit cost assumptions; and adverse movements in discount rates. There have been no significant impairments in 2013.

Property, plant and equipment increased by £283 million due to the ongoing development and refreshment of facilities and tooling as the Group prepares for increased production volumes.

Net post-retirement scheme deficits (note 9) reduced by £100 million as a result of adopting the amendments to IAS 19. During the year, the net deficit fell by £49 million, principally due to the movements in the assumptions used to value the underlying assets and liabilities in accordance with IAS 19. This reduction in the deficit was after agreeing to fund additional pension increases in the Rolls-Royce Pension Fund, where there is no indexation for pre-1997 service, at a cost of £64 million.

Overall funding across the schemes has improved in recent years as the Group has adopted a lower risk investment strategy that reduces volatility going forward and enables the funding position to remain stable: interest rate and inflation risks are largely hedged, and the exposure to equities is around 11 per cent of scheme assets.

The Group's funding of its defined benefit schemes is expected to increase modestly in 2014, largely as a result of funding the discretionary benefits.

Net funds increased by £0.6 billion to £1.9 billion due in part to the £250 million proceeds received on the sale of the Group's interest in the RTM322 engine. Average net funds were £350 million.

Investments in joint ventures and associates increased by 15 per cent, largely as a result of retained profits in existing joint ventures.

Provisions largely relate to warranties and guarantees provided to secure the sale of OE and services.

Net financial assets and liabilities relate to the fair value of foreign exchange, commodity and interest rate contracts, financial RSAs and the put option on the NCI of Rolls-Royce Power Systems Holding GmbH, set out in detail in note 8. The change largely reflects the inclusion of the put option. There is also an impact of the change in the GBP/USD exchange rate on the valuation of foreign exchange contracts and the movement in put options on NCI of £259 million.

The USD hedge book increased ten per cent to US\$24.7 billion. This represents around four years of net exposure and has an average book rate of £1 to US\$1.59.

Net TotalCare assets relate to Long-Term Service Agreement (LTSA) contracts in the Civil Aerospace business, including the flagship services product TotalCare. These assets represent the timing difference between the recognition of income and costs in the income statement and cash receipts and payments.

Customer financing facilitates the sale of OE and services by providing financing support to certain customers. Where such support is provided by the Group, it is generally to customers of the civil aerospace business and takes the form of various types of credit and asset value guarantees. These exposures produce contingent liabilities that are outlined in note 10. The contingent liabilities represent the maximum aggregate discounted gross and net exposure in respect of delivered aircraft, regardless of the point in time at which such exposures may arise.

During 2013, the Group's gross exposure reduced by £213 million to £356 million, due largely to the expiry of guarantees. On a net basis, exposures reduced by £11 million.

Segmental reporting

During 2013, we have revised the internal structure of the business to focus on aerospace and marine and industrial markets and the internal reporting structure has been developed to reflect this.

Consequently, in accordance with IFRS 8 *Operating Segments*, from 1 January 2014, we will report the Group's segments as follows:

- Aerospace – comprising Civil aerospace and Defence aerospace; and
- Marine and Industrial Power Systems (MIPS) – comprising Marine, Power Systems, Nuclear and Energy.

The 2013 figures on the revised basis are included in note 12.

Condensed consolidated financial statements

Condensed consolidated income statement

For the year ended 31 December 2013

	Notes	2013 £m	Restated* 2012 £m
Revenue	2	15,513	12,161
Cost of sales		(12,197)	(9,432)
Gross profit		3,316	2,729
Other operating income	3	65	-
Commercial and administrative costs		(1,323)	(993)
Research and development costs	3	(683)	(531)
Share of results of joint ventures and associates		160	173
Operating profit		1,535	1,378
Profit on reclassification of joint ventures to subsidiaries		119	-
Profit on disposal of businesses (2012 IAE restructuring £699m)	11	216	699
Profit before financing and taxation		1,870	2,077
Financing income	4	327	797
Financing costs	4	(438)	(108)
Net financing		(111)	689
Profit before taxation ¹		1,759	2,766
Taxation		(380)	(431)
Profit for the period		1,379	2,335
Attributable to:			
Ordinary shareholders		1,367	2,321
Non-controlling interests (NCI)		12	14
Profit for the period		1,379	2,335
Earnings per ordinary share attributable to shareholders	5		
Basic		73.26p	125.38p
Diluted		72.44p	123.73p
Underlying earnings per ordinary share are shown in note 5.			
Payments to ordinary shareholders in respect of the period	6		
Pence per share		22.0p	19.5p
Total		414	365
¹ Underlying profit before taxation	2	1,759	1,434

Condensed consolidated statement of comprehensive income

For the year ended 31 December 2013

	Notes	2013 £m	Restated* 2012 £m
Profit for the period		1,379	2,335
Other comprehensive income (OCI)			
Items that will not be reclassified to profit or loss			
Movements in post-retirement schemes	9	48	(305)
Share of OCI of joint ventures and associates		-	(46)
Related tax movements		10	105
		58	(246)
Items that may be reclassified to profit or loss			
Foreign exchange translation differences on foreign operations		(64)	(118)
Share of OCI of joint ventures and associates		(6)	(12)
Related tax movements		1	(1)
		(69)	(131)
Total comprehensive income for the period		1,368	1,958
Attributable to:			
Ordinary shareholders		1,356	1,945
Non-controlling interests		12	13
Total comprehensive income for the period		1,368	1,958

* Restated to reflect the amendments to IAS 19 *Employee Benefits* – see notes 1 and 9 and an amendment to the accounting policy for Risk and Revenue Sharing Arrangements – see note 1.

Condensed consolidated financial statements

Condensed consolidated balance sheet

At 31 December 2013

		Restated*		
			31 December 2012 £m	1 January 2012 £m
	Notes	2013 £m		
ASSETS				
Non-current assets				
Intangible assets	7	4,987	2,901	2,882
Property, plant and equipment		3,392	2,564	2,338
Investments – joint ventures and associates		601	1,800	1,680
Investments – other		27	6	10
Other financial assets	8	674	592	327
Deferred tax assets		316	342	387
Post-retirement scheme surpluses	9	248	348	520
		10,245	8,553	8,144
Current assets				
Inventories		3,319	2,726	2,561
Trade and other receivables		5,092	4,119	4,009
Taxation recoverable		16	33	20
Other financial assets	8	74	115	91
Short-term investments		321	11	11
Cash and cash equivalents		3,990	2,585	1,310
Assets held for sale		6	4	313
		12,818	9,593	8,315
Total assets		23,063	18,146	16,459
LIABILITIES				
Current liabilities				
Borrowings		(207)	(149)	(20)
Other financial liabilities	8	(1,976)	(312)	(111)
Trade and other payables		(7,045)	(6,401)	(6,263)
Tax liabilities		(204)	(126)	(138)
Provisions for liabilities and charges		(348)	(220)	(276)
Liabilities associated with assets held for sale		-	-	(135)
		(9,780)	(7,208)	(6,943)
Non-current liabilities				
Borrowings		(2,164)	(1,234)	(1,184)
Other financial liabilities	8	(360)	(418)	(919)
Trade and other payables		(2,138)	(1,672)	(1,533)
Tax liabilities		(10)	-	-
Deferred tax liabilities		(882)	(584)	(445)
Provisions for liabilities and charges		(385)	(241)	(226)
Post-retirement scheme deficits	9	(1,041)	(793)	(807)
		(6,980)	(4,942)	(5,114)
Total liabilities		(16,760)	(12,150)	(12,057)
Net assets		6,303	5,996	4,402
EQUITY				
Attributable to ordinary shareholders				
Called-up share capital		376	374	374
Share premium account		80	-	-
Capital redemption reserve		163	169	173
Cash flow hedging reserve		(68)	(63)	(52)
Other reserves		250	314	433
Retained earnings		4,804	5,185	3,473
		5,605	5,979	4,401
Non-controlling interests		698	17	1
Total equity		6,303	5,996	4,402

* Restated to reflect the amendments to IAS 19 *Employee Benefits* – see notes 1 and 9 and an amendment to the accounting policy for Risk and Revenue Sharing Arrangements – see note 1.

Condensed consolidated financial statements

Condensed consolidated cash flow statement

For the year ended 31 December 2013

	Notes	2013 £m	Restated* 2012 £m
Reconciliation of cash flows from operating activities			
Operating profit		1,535	1,378
Loss/(profit) on disposal of property, plant and equipment		7	(9)
Share of results of joint ventures and associates		(160)	(173)
Dividends received from joint ventures and associates		99	129
Amortisation and impairment of intangible assets		428	231
Depreciation and impairment of property, plant and equipment		372	256
Impairment of investments		-	2
Decrease in provisions		(17)	(40)
Decrease/(increase) in inventories		119	(158)
Increase in trade and other receivables		(533)	(284)
Increase in trade and other payables		376	242
Cash flows on other financial assets and liabilities held for operating purposes		9	(29)
Net defined benefit post-retirement cost recognised in profit before financing	9	279	173
Cash funding of defined benefit post-retirement schemes	9	(315)	(299)
Share-based payments		79	55
Net cash inflow from operating activities before taxation		2,278	1,474
Taxation paid		(238)	(219)
Net cash inflow from operating activities		2,040	1,255
Cash flows from investing activities			
Additions of unlisted investments		(1)	-
Disposals of unlisted investments		1	4
Additions of intangible assets	7	(503)	(250)
Disposals of intangible assets		-	1
Purchases of property, plant and equipment		(669)	(435)
Government grants received		21	10
Disposals of property, plant and equipment		7	30
Acquisitions of businesses	11	(37)	(20)
Reclassification of joint ventures to subsidiaries		245	-
Acquisition of preference shares in subsidiary		(34)	-
Restructuring of International Aero Engines AG	11	-	942
Disposals of businesses	11	273	-
Investments in joint ventures and associates		(43)	(24)
Repayment of loan to Rolls-Royce Power Systems Holding GmbH		-	167
Transfer of subsidiary to associate		-	(1)
Net cash (outflow)/ inflow from investing activities		(740)	424
Cash flows from financing activities			
Repayment of loans		(133)	(99)
Proceeds from increase in loans	8	1,013	221
Net cash flow from increase in borrowings		880	122
Interest received		15	11
Interest paid		(58)	(52)
Increase in short-term investments		(313)	-
Issue of ordinary shares and cash received on share-based schemes vesting		32	-
Purchase of ordinary shares		(3)	(94)
Dividend to NCI		(60)	-
Redemption of C Shares		(357)	(318)
Net cash inflow/(outflow) from financing activities		136	(331)
Net increase in cash and cash equivalents		1,436	1,348
Cash and cash equivalents at 1 January		2,585	1,291
Exchange losses on cash and cash equivalents		(34)	(54)
Cash and cash equivalents at 31 December		3,987	2,585

* Restated to reflect the amendments to IAS 19 *Employee Benefits* – see notes 1 and 9 and an amendment to the accounting policy for Risk and Revenue Sharing Arrangements – see note 1.

Condensed consolidated financial statements

	2013 £m	2012 £m
Reconciliation of movements in cash and cash equivalents to movements in net funds		
Net increase in cash and cash equivalents	1,436	1,348
Net cash flow from increase in borrowings	(880)	(122)
Net cash flow from increase in short-term investments	313	-
Change in net funds resulting from cash flows	869	1,226
Net funds (excluding cash and cash equivalents) of businesses acquired	(204)	(78)
Exchange losses on net funds	(43)	(54)
Fair value adjustments	105	2
Movement in net funds	727	1,096
Net funds at 1 January excluding the fair value of swaps	1,213	117
Net funds at period end excluding the fair value of swaps	1,940	1,213
Fair value of swaps hedging fixed rate borrowings	(1)	104
Net funds at 31 December	1,939	1,317

The movement in net funds (defined by the Group as including the items shown below) is as follows:

	At 1 January 2013 £m	Funds flow £m	Net funds of businesses acquired £m	Exchange differences £m	Fair value adjustments £m	Reclassi- fications £m	At 31 December 2013 £m
Cash at bank and in hand	674	333	-	(25)	-	-	982
Money market funds	408	754	-	(5)	-	-	1,157
Short-term deposits	1,503	352	-	(4)	-	-	1,851
Overdrafts	-	(3)	-	-	-	-	(3)
Cash and cash equivalents	2,585	1,436	-	(34)	-	-	3,987
Short-term investments	11	313	-	(3)	-	-	321
Current borrowings	(149)	133	(4)	-	17	(201)	(204)
Non-current borrowings	(1,233)	(1,013)	(200)	(6)	88	201	(2,163)
Finance leases	(1)	-	-	-	-	-	(1)
Net funds excluding the fair value of swaps	1,213	869	(204)	(43)	105	-	1,940
Fair value of swaps hedging fixed rate borrowings	104	-	-	-	(105)	-	(1)
Net funds	1,317	869	(204)	(43)	-	-	1,939

Condensed consolidated financial statements

Condensed consolidated statement of changes in equity

For the half-year ended 31 December 2013

	Attributable to ordinary shareholders							Non-controlling interests	Total equity
	Share capital	Share premium	Capital redemption reserve	Cash flow hedging reserve	Other reserves ¹	Retained earnings ²	Total		
	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2012, as previously reported	374	-	173	(52)	433	3,590	4,518	1	4,519
Effect of amendments to IAS 19 – see note 9	-	-	-	-	-	67	67	-	67
Effect of change in accounting policy for RRSAs – see note 1	-	-	-	-	-	(184)	(184)	-	(184)
At 1 January 2012, as restated	374	-	173	(52)	433	3,473	4,401	1	4,402
Total comprehensive income for the year	-	-	-	(11)	(119)	2,075	1,945	13	1,958
Issue of C Shares	-	-	(328)	-	-	4	(324)	-	(324)
Redemption of C Shares	-	-	324	-	-	(324)	-	-	-
Ordinary shares purchased	-	-	-	-	-	(94)	(94)	-	(94)
Share-based payments – direct to equity	-	-	-	-	-	47	47	-	47
Transactions with NCI ³	-	-	-	-	-	116	116	48	164
Initial recognition of put option on NCI ⁵	-	-	-	-	-	(121)	(121)	(45)	(166)
Related tax movements	-	-	-	-	-	9	9	-	9
Other changes in equity in the year	-	-	(4)	-	-	(363)	(367)	3	(364)
At 31 December 2012	374	-	169	(63)	314	5,185	5,979	17	5,996
Total comprehensive income for the year	-	-	-	(5)	(64)	1,425	1,356	12	1,368
Arising on issue of ordinary shares	2	80	-	-	-	(81)	1	-	1
Issue of C Shares	-	-	(366)	-	-	3	(363)	-	(363)
Redemption of C Shares	-	-	360	-	-	(360)	-	-	-
Ordinary shares purchased	-	-	-	-	-	(3)	(3)	-	(3)
Share-based payments – direct to equity	-	-	-	-	-	99	99	-	99
Reclassification of Rolls-Royce Power Systems AG ⁴	-	-	-	-	-	-	-	669	669
Initial recognition of put option on NCI ⁵	-	-	-	-	-	(1,477)	(1,477)	45	(1,432)
Transactions with NCI	-	-	-	-	-	-	-	(45)	(45)
Related tax movements	-	-	-	-	-	13	13	-	13
Other changes in equity in the year	2	80	(6)	-	-	(1,806)	(1,730)	669	(1,061)
At 31 December 2013	376	80	163	(68)	250	4,804	5,605	698	6,303

¹ Other reserves include a merger reserve of £3m and a translation reserve of £247m.

² At 31 December 2013, 11,960,535 ordinary shares with a net book value of £91m (2012 20,365,787, 2011 22,541,187 ordinary shares with net book values of £125m and £116m respectively) were held for the purpose of share-based payment plans and included in retained earnings. During the year, 16,603,840 ordinary shares with a net book value of £118m (2012 13,533,646 shares with a net book value of £85m) vested in share-based payment plans. During the year, the Company acquired 298,588 of its ordinary shares via reinvestment of dividends received on its own shares. In addition, the Company issued 7,900,000 new ordinary shares to the Group's share trust for its employees share-based payment plans with a net book value of £81m.

³ On 2 January 2012, the Group contributed its interest in Bergen Engines AS to Rolls-Royce Power Systems Holding GmbH (RRPSH - previously Engine Holding GmbH), a company jointly held by Rolls-Royce and Daimler AG. Under the terms of agreement with Daimler, Rolls-Royce retained certain rights such that Bergen Engines continued to be classified as a subsidiary and consolidated.

⁴ On 1 January 2013, the Group exercised rights in RRPSH that resulted in Rolls-Royce Power Systems AG (RRPS – formerly Tognum AG) being classified as a subsidiary and consolidated – see note 11.

⁵ As part of the RRPSH shareholders' agreement, Daimler has the option to sell its shares in RRPSH to Rolls-Royce for a period of six years from 1 January 2013. The initial fair value of the exercise price of this option in respect of Bergen Engines AS (£166m) was recognised in 2012 and that amount in respect of Rolls-Royce Power Systems AG (£1,432m) has been recognised in 2013 has been charged to retained earnings. In addition, £45m of the initial recognition of the put option on NCI relating to Bergen Engine AS, recognised in 2012, has been reclassified from NCI to retained earnings. Subsequent movements in the value of this liability are included in the income statement, but excluded from the underlying results.

1 Basis of preparation and accounting policies

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted for use in the EU (Adopted IFRS) in accordance with EU law (IAS Regulation EC 1606/2002).

The financial information set out above does not constitute the Company's statutory accounts for the years ended December 31, 2013 or 2012. Statutory accounts for 2012 have been delivered to the registrar of companies, and those for 2013 will be delivered in due course. The auditors have reported on those accounts; their reports were (i) unqualified, (ii) did not include references to any matters to which the auditors drew attention by way of emphasis without qualifying their reports and (iii) did not contain statements under section 498(2) or (3) of the Companies Act 2006.

Amendment to accounting policy for Risk and Revenue Sharing Arrangements

The Group has changed its accounting policy in respect of entry fees arising from Risk and Revenue Sharing Arrangements (RRSAs) following discussions with the Conduct Committee of the Financial Reporting Council (FRC).

RRSAs with key suppliers are a feature of our civil aerospace business. Under these arrangements the workshare partner shares in the risks and costs of developing an engine and, during the production phase, supplies components and receives a share of the programme revenues over the life of the engine programme. The share of development costs borne by the workshare partner and of the revenues it receives reflect the proportionate forecast cost of providing their parts compared to the overall forecast manufacturing cost of the engine.

The contribution to the development costs is achieved by the workshare partner performing its own development work, providing parts in the development phase and paying a non-refundable cash entry fee, such that both parties bear their proportionate share of the forecast nonrecurring development costs.

Historically, we recognised the entry fee as income when received, which we believed matched it to the recognition of non-recurring development costs incurred on behalf of the workshare partner. However, this did not take account of the fact that we capitalise some of our non-recurring development costs. Therefore, where we capitalise those costs, we will now defer the equivalent portion of the entry fee received and recognise it as the related costs are amortised in the production phase. As required by Adopted IFRS, we have made this change retrospectively; the impact of the change in policy in 2012 has been to increase profit before tax by £25 million and to reduce net assets at 31 December 2011 and 2012 by £184 million and £170 million respectively. Had the policy not been amended, profit before tax in 2013 would have been £39 million higher and at 31 December 2013 net assets £208 million higher.

Adopted IFRS does not explicitly deal with payments of this nature from suppliers and so, in developing an accounting treatment for entry fees that best reflects the commercial objectives of the contractual arrangement, we have analysed key features of RRSAs in the context of relevant accounting pronouncements and have had to weigh the importance of each feature in faithfully representing the overall commercial effect. Consequently this is a judgemental area. In summary, our view is that the development and production phases of the contract should be considered separately in accounting for the RRSA, which results in the entry fee being matched against the non-recurring development costs as described above.

The FRC Conduct Committee's view is that the RRSA contract cannot be divided into separate development and production phases, as the fees and development components received by the Group during the development phase are exchanged for the obligation to pay the supplier a pre-determined share of any sales receipts during the production phase. On this basis the entry fees received would be deferred in their entirety and recognised over the period of production.

The FRC Conduct Committee has confirmed that, in view of the change to the policy and the additional disclosure we have made, it does not intend to pursue its consideration of this accounting policy further. We will keep the size of the difference under review, and do not currently expect the difference between the two approaches to become material in the foreseeable future.

We consider that the policy we have adopted best reflects the commercial effect of the agreements and is accordance with Adopted IFRS. So far as we can tell it is also aligned with the approach taken by others in our industry under both IFRS and US accounting standards (which we believe does not conflict with IFRS in this regard).

The impact of the two different approaches on profit before tax and net assets is as follows:

	2013			2012		
	Reported profit before tax £m	Underlying profit before tax £m	Net assets £m	Reported profit before tax £m	Underlying profit before tax £m	Net assets £m
Previous policy	1,798	1,798	6,511	2,741	1,409	6,180
Difference	(39)	(39)	(208)	25	25	(184)
Adopted policy	1,759	1,759	6,303	2,766	1,434	5,996
Difference	(37)	(37)	(365)	(10)	(10)	(323)
Alternative policy ¹	1,722	1,722	5,938	2,756	1,424	5,673

¹ Consistent with FRC Conduct Committee's view

Condensed consolidated financial statements

As required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, this change has been made retrospectively; the impact of the change in policy in 2012 was been to increase profit before tax by £25 million and to reduce net assets at 31 December 2012 by £170 million. Had the policy not been amended, profit before tax in 2013 would have been £39 million higher and at 31 December 2013 net assets £208 million higher.

Amendments to IAS 19 *Employee Benefits*

With effect from 1 January 2013, the Group has adopted the amendments to IAS 19 *Employee Benefits* issued by the IASB in June 2011. A description of these amendments and their effect is set out in note 9. In summary, the amendments require:

- recognition of certain administrative costs as operating costs rather than being included in net financing;
- net financing to be calculated on the net asset or liability recognised on the balance sheet using a 'AA' corporate bond rate rather than using an expected rate of return for scheme assets;
- immediate recognition of previously unrecognised past-service credits.

The impact of adopting the amendments is:

- profit before financing £15 million higher (2012 £22 million higher);
- net post-retirement financing cost: £107 million higher (2012 £56 million higher); and
- net assets £73 million lower (2012 £100 million lower).

There were no other revisions to Adopted IFRS that became applicable in 2013 which had a significant impact on the Group's financial statements.

Where relevant, 2012 figures in the notes to the condensed consolidated financial statements have been restated to reflect the effect of both of the above. Restatement figures are marked “‡”.

Condensed consolidated financial statements

2 Analysis by business segment

The analysis by business segment is presented in accordance with IFRS 8 *Operating segments*, on the basis of those segments whose operating results are regularly reviewed by the Board (the Chief Operating Decision Maker as defined by IFRS 8), as follows:

- Civil Aerospace** – development, manufacture, marketing and sales of commercial aero engines and aftermarket services.
- Defence Aerospace** – development, manufacture, marketing and sales of military aero engines and aftermarket services.
- Marine** – development, manufacture, marketing and sales of marine propulsion systems and aftermarket services.
- Energy** – development, manufacture, marketing and sales of power systems for the offshore oil and gas industry and electrical power generation and aftermarket services.
- Power Systems** – development, manufacture, marketing and sales of diesel engines and aftermarket services.

Engineering & Technology and Operations and Services operate on a Group-wide basis across all the above segments.

The operating results reviewed by the Board are prepared on an underlying basis, which the Board considers reflects better the economic substance of the Group's trading during the year. The principles adopted to determine the underlying results are:

Underlying revenues – Where revenues are denominated in a currency other than the functional currency of the Group undertaking, these reflect the achieved exchange rates arising on settled derivative contracts.

Underlying profit before financing – Where transactions are denominated in a currency other than the functional currency of the Group undertaking, this reflects the transactions at the achieved exchange rates on settled derivative contracts. In addition, adjustments have been made to exclude one-off charges on post-retirement schemes, the effects of acquisition accounting and profits arising on acquisitions and disposals.

Underlying profit before taxation – In addition to those adjustments in underlying profit before financing:

- Includes amounts realised from settled derivative contracts and revaluation of relevant assets and liabilities to exchange rates forecast to be achieved from future settlement of derivative contracts.
- Excludes unrealised amounts arising from revaluations required by IAS 39 *Financial Instruments: Recognition and Measurement*, changes in value of financial RRSA contracts arising from changes in forecast payments, changes in value of put options on NCI and the net impact of financing costs related to post-retirement scheme benefits.

This analysis also includes a reconciliation of the underlying results to those reported in the consolidated income statement.

	2013			2012		
	Original equipment £m	Aftermarket £m	Total £m	Original equipment £m	Aftermarket £m	Total £m
Underlying revenues						
Civil aerospace	3,035	3,620	6,655	2,934	3,503	6,437
Defence aerospace	1,385	1,206	2,591	1,231	1,186	2,417
Marine	1,438	1,089	2,527	1,288	961	2,249
Energy	415	633	1,048	344	618	962
Power Systems	2,004	827	2,831	118	169	287
Eliminate intra-segment revenue	(72)	(75)	(147)	(22)	(121)	(143)
	8,205	7,300	15,505	5,893	6,316	12,209
				2013 £m	2012† £m	
Underlying profit before financing						
Civil aerospace				844	743	
Defence aerospace				438	395	
Marine				281	294	
Energy				26	19	
Power Systems				294	109	
Eliminate intra-segment profit				2	(11)	
Reportable segments				1,885	1,549	
Underlying central items				(54)	(54)	
Underlying profit before financing and taxation				1,831	1,495	
Underlying net financing				(72)	(61)	
Underlying profit before taxation				1,759	1,434	
Underlying taxation				(434)	(317)	
Underlying profit for the period				1,325	1,117	
Attributable to: Ordinary shareholders				1,224	1,103	
Non-controlling interests				101	14	
				1,325	1,117	

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	Total assets		Total liabilities		Net assets/(liabilities)	
	2013	2012†	2013	2012†	2013	2012†
	£m	£m	£m	£m	£m	£m
Civil aerospace	10,082	9,123	(6,243)	(5,819)	3,839	3,304
Defence aerospace	1,454	1,412	(1,660)	(1,797)	(206)	(385)
Marine	1,916	2,063	(1,312)	(1,467)	604	596
Energy	1,461	1,329	(688)	(570)	773	759
Power Systems	3,956	1,478	(3,034)	(282)	922	1,196
Eliminations	(744)	(682)	733	671	(11)	(11)
Reportable segments	18,125	14,723	(12,204)	(9,264)	5,921	5,459
Net funds	4,358	2,700	(2,419)	(1,383)	1,939	1,317
Tax assets/(liabilities)	332	375	(1,096)	(710)	(764)	(335)
Post-retirement scheme surpluses/(deficits)	248	348	(1,041)	(793)	(793)	(445)
	23,063	18,146	(16,760)	(12,150)	6,303	5,996

Group employees (average)

	2013	2012
Civil aerospace	23,400	21,500
Defence aerospace	7,900	7,800
Marine	9,200	8,800
Energy	4,000	3,700
Power Systems	10,700	1,000
	55,200	42,800

Reconciliation to reported results

	Total reportable segments	Underlying central items	Total underlying	Underlying adjustments	Group
	£m	£m	£m	£m	£m
Year ended 31 December 2013					
Revenue from sale of original equipment	8,205	-	8,205	70	8,275
Revenue from aftermarket services	7,300	-	7,300	(62)	7,238
Total revenue	15,505	-	15,505	8	15,513
Operating profit excluding share of results of joint ventures and associates	1,726	(54)	1,672	(297)	1,375
Share of results of joint ventures and associates	159	-	159	1	160
Profit on reclassification of joint ventures to subsidiaries	-	-	-	119	119
Profit on disposal of businesses	-	-	-	216	216
Profit before financing and taxation	1,885	(54)	1,831	39	1,870
Net financing		(72)	(72)	(39)	(111)
Profit before taxation		(126)	1,759	-	1,759
Taxation		(434)	(434)	54	(380)
Profit for the year		(560)	1,325	54	1,379
Attributable to: ordinary shareholders			1,224	143	1,367
NCI			101	(89)	12

Year ended 31 December 2012†

Revenue from sale of original equipment	5,893	-	5,893	41	5,934
Revenue from aftermarket services	6,316	-	6,316	(89)	6,227
Total revenue	12,209	-	12,209	(48)	12,161
Operating profit excluding share of results of joint ventures and associates	1,318	(54)	1,264	(59)	1,205
Share of results of joint ventures and associates	231	-	231	(58)	173
Profit on disposal of businesses	-	-	-	699	699
Profit before financing and taxation	1,549	(54)	1,495	582	2,077
Net financing		(61)	(61)	750	689
Profit before taxation		(115)	1,434	1,332	2,766
Taxation		(317)	(317)	(114)	(431)
Profit for the year		(432)	1,117	1,218	2,335
Attributable to: Ordinary shareholders			1,103	1,218	2,321
NCI			14	-	14

Condensed consolidated financial statements

Underlying adjustments

	2013				2012†			
	Revenue £m	Profit before financing £m	Net financing £m	Taxation £m	Revenue £m	Profit before financing £m	Net financing £m	Taxation £m
Underlying performance	15,505	1,831	(72)	(434)	12,209	1,495	(61)	(317)
Revenue recognised at exchange rate on date of transaction	8	–	–	–	(48)	–	–	–
Realised gains on settled derivative contracts ¹	–	(10)	(5)	–	–	(25)	–	–
Net unrealised fair value changes to derivative contracts ²	–	–	250	–	–	–	747	–
Effect of currency on contract accounting	–	(18)	–	–	–	(23)	–	–
Put options on NCI and financial RRSPs - foreign exchange differences and other unrealised changes in value	–	–	(251)	–	–	–	11	–
Effect of acquisition accounting ³	–	(265)	–	–	–	(69)	–	–
Profit on reclassification of joint ventures to subsidiaries	–	119	–	–	–	–	–	–
Post-retirement scheme past service costs	–	(64)	–	–	–	–	–	–
Net post-retirement scheme financing	–	–	(26)	–	–	–	(8)	–
Profit on disposal of businesses	–	216	–	–	–	–	–	–
Other ⁴	–	61	(7)	–	–	–	–	–
Related tax effects	–	–	–	54	–	–	–	(151)
IAE restructuring	–	–	–	–	–	699	–	37
Total underlying adjustments	8	39	(39)	54	(48)	582	750	(114)
Reported per consolidated income statement	15,513	1,870	(111)	(380)	12,161	2,077	689	(431)

1 Realised gains on settled derivative contracts include adjustments to reflect the (gains)/losses in the same period as the related trading cash flows.

2 Unrealised fair value changes to derivative contracts: (i) include those included in equity accounted joint ventures; and (ii) exclude those for which the related trading contracts have been cancelled when the fair value changes are recognised immediately in underlying profit.

3 The adjustment eliminates charges recognised as a result of recognising assets in acquired businesses at fair value.

4 Other includes the exclusion of other operating income of £63m and the revaluation of preference shares in RRPS AG, which have now been acquired.

3 Other income and expenses

In October 2011, Rolls-Royce and United Technologies Corp. (UTC) announced their intention to form a new joint venture to develop an engine to power future mid-size aircraft (120-230 passenger aircraft). In September 2013, the parties agreed not to proceed with the partnership. Other operating income includes £63m from the settlement received by the Group as a result of this decision.

Research and development

	2013	2012
Expenditure in the year	(750)	(572)
Capitalised as intangible assets	110	38
Amortisation of capitalised costs	(130)	(55)
Net research and development cost	(770)	(589)
Entry fees received	126	33
Entry fees deferred in respect of charges in future years	(50)	(5)
Recognition of previously deferred entry fees	11	30
Net cost recognised in the income statement	(683)	(531)
Underlying adjustments relating to effects of acquisition accounting and foreign exchange	59	–
	(624)	(531)

Condensed consolidated financial statements

4 Net financing

	2013 Per consolidated income statement £m	Underlying financing £m	2012 Per consolidated income statement £m	Underlying financing £m
Financing income				
Interest receivable	15	15	10	10
Fair value gains on foreign currency contracts	287	-	750	-
Put options on NCI and financial RRSAs – foreign exchange differences and changes in forecast payments	8	-	11	-
Financing on post-retirement scheme surpluses	17	-	26	-
	327	15	797	10
Financing costs				
Interest payable	(58)	(58)	(51)	(51)
Fair value losses on foreign currency contracts	(3)	-	-	-
Put options on NCI and financial RRSAs – foreign exchange differences and changes in forecast payments	(259)	-	-	-
Financial charge relating to financial RRSAs	(9)	(9)	(10)	(10)
Fair value losses on commodity derivatives	(34)	-	(3)	-
Financing on post-retirement scheme deficits	(43)	-	(34)	-
Net foreign exchange losses	(5)	-	-	-
Other financing charges	(27)	(20)	(10)	(10)
	(438)	(87)	(108)	(71)
Net financing	(111)	(72)	689	(61)
Analysed as:				
Net interest payable	(43)	(43)	(41)	(41)
Net post-retirement scheme financing	(26)	-	(8)	-
Net other financing	(42)	(29)	738	(20)
Net financing	(111)	(72)	689	(61)

5 Earnings per ordinary share (EPS)

Basic EPS are calculated by dividing the profit attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period, excluding ordinary shares held under trust, which have been treated as if they had been cancelled. Diluted EPS are calculated by adjusting the weighted average number of ordinary shares in issue during the period for the bonus element of share options.

	2013			2012† Potentially dilutive share options		
	Basic	Potentially dilutive share options	Diluted	Basic	Potentially dilutive share options	Diluted
Profit/(loss) (£m)	1,367	-	1,367	2,321	-	2,321
Weighted average shares (millions)	1,866	21	1,887	1,851	25	1,876
EPS (pence)	73.26	(0.82)	72.44	125.38 ¹	(1.65)	123.73

The reconciliation between underlying EPS and basic EPS is as follows:

	2013		2012†	
	Pence	£m	Pence	£m
Underlying EPS / Underlying profit attributable to ordinary shareholders	65.59	1,224	59.59²	1,103
Total underlying adjustments to profit before tax (note 2)	-	-	71.96	1,332
Related tax effects	2.89	54	(6.17)	(114)
Related NCI effects	4.78	89	-	-
EPS / Profit attributable to ordinary shareholders	73.26	1,367	125.38	2,321
Excluding IAE restructuring	73.26	1,367	85.62	1,585
IAE restructuring	-	-	39.76	736

¹ The impact of the restatement on the previously reported EPS of 123.23p was an increase of 1.40p relating to the IAS 19 amendments and an increase of 0.75p relating to the change in the accounting policy for RRSAs.

² The impact of the restatement on the previously reported underlying EPS of 59.27p was a decrease of 0.71p relating to the IAS 19 amendments and an increase of 1.03p relating to the change in the accounting policy for RRSAs.

Condensed consolidated financial statements

6 Payments to shareholders in respect of the period

Payments to shareholders in respect of the period represent the value of C Shares to be issued in respect of the results for the period. Issues of C Shares were declared as follows:

	2013		2012	
	Pence per share	£m	Pence per share	£m
Interim (issued in January)	8.6	162	7.6	142
Final (issued in July)	13.4	252	11.9	223
	22.0	414	19.5	365

7 Intangible assets

	Goodwill £m	Certification costs and participation fees £m	Development expenditure ¹ £m	Recoverable engine costs £m	Customer relationships ¹ £m	Software ¹ £m	Other ¹ £m	Total £m
Cost:								
At 1 January 2013	1,111	740	1,028	499	45	385	142	3,950
Exchange differences	(18)	3	5	-	(3)	(1)	17	3
Additions	-	185	110	52	-	69	87	503
Acquisition of business	773	-	508	-	433	-	286	2,000
Disposal of business	(5)	-	(5)	-	-	-	-	(10)
At 31 December 2013	1,861	928	1,646	551	475	453	532	6,446
Accumulated amortisation:								
At 1 January 2013	9	225	323	295	12	144	41	1,049
Exchange differences	(1)	-	(7)	-	(8)	-	5	(11)
Charge for the period	-	40	130	28	61	54	91	404
Impairment	17	-	3	-	4	-	-	24
Disposal of business	(2)	-	(5)	-	-	-	-	(7)
At 31 December 2013	23	265	444	323	69	198	137	1,459
Net book value at:								
31 December 2013	1,838	663	1,202	228	406	255	395	4,987
31 December 2012	1,102	515	705	204	33	241	101	2,901

¹ Following the acquisition of RRPS on 1 January 2013, intangible assets relating to R&D, customer relationships and software have been reclassified from 'other' into their respective categories from 1 January 2012 onwards.

Goodwill has been tested for impairment during 2013 on the following basis:

- The carrying value of goodwill has been assessed by reference to value in use. These have been estimated using cash flows from the most recent forecasts prepared by management, which are consistent with past experience and external sources of information on market conditions. Given the long-term and established nature of many of the Group's products (product lives are often measured in decades), these forecast the next ten years. Growth rates for the period not covered by the forecasts are based on a range of growth rates (2.0 – 2.75 per cent) that reflect the products, industries and countries in which the relevant CGU or group of CGUs operate.
- The key assumptions for the impairment tests are the discount rate and, in the cash flow projections, the programme assumptions, the growth rates and the impact of foreign exchange rates on the relationship between selling prices and costs. Impairment tests are performed using prevailing exchange rates.
- The pre-tax cash flow projections have been discounted at 13 per cent (2012 13 per cent), based on the Group's weighted average cost of capital.

Certification costs and participation fees, customer relationships, technology, patents and licences, order backlog, development expenditure and recoverable engine costs have been reviewed for impairment in accordance with the requirements of IAS 36 *Impairment of Assets*. Where an impairment test was considered necessary, it has been performed on the following basis:

- The carrying values have been assessed by reference to value in use. These have been estimated using cash flows from the most recent forecasts prepared by management, which are consistent with past experience and external sources of information on market conditions over the lives of the respective programmes.
- The key assumptions underlying cash flow projections are assumed market share, programme timings, unit cost assumptions, discount rates, and foreign exchange rates.
- The pre-tax cash flow projections have been discounted at 11% (2012 11%), based on the Group's weighted average cost of capital.
- No impairment is required on this basis. However, a combination of changes in assumptions and adverse movements in variables that are outside the Company's control (discount rate, exchange rate and airframe delays), could result in impairment in future periods.

Condensed consolidated financial statements

8 Financial assets and liabilities

Other financial assets and liabilities comprise:

	Derivatives				Put options on NCI	Financial RRSAs	C Shares	Total
	Foreign exchange contract s	Commodity contracts	Interest rate contracts	Total				
At 31 December 2013								
Non-current assets	631	-	43	674	-	-	-	674
Current assets	72	2	-	74	-	-	-	74
Current liabilities	(63)	(16)	(1)	(80)	(1,858)	(22)	(16)	(1,976)
Non-current liabilities	(142)	(25)	(48)	(215)	-	(145)	-	(360)
	498	(39)	(6)	453	(1,858)	(167)	(16)	(1,588)
At 31 December 2012								
Non-current assets	498	4	90	592	-	-	-	592
Current assets	104	6	5	115	-	-	-	115
Current liabilities	(97)	(8)	-	(105)	(167)	(30)	(10)	(312)
Non-current liabilities	(233)	(15)	(7)	(255)	-	(163)	-	(418)
	272	(13)	88	347	(167)	(193)	(10)	(23)

Derivative financial instruments

	2013				2012
	Foreign exchange £m	Commodity £m	Interest rate £m	Total £m	Total £m
At January 1	272	(13)	88	347	(378)
Acquisition of businesses	4	(1)	-	3	-
Movements in fair value hedges	3	-	(91)	(88)	(2)
Movements in cash flow hedges	-	-	-	-	(4)
Movements in other derivative contracts	284	(34)	-	250	748
Contracts settled	(65)	9	(3)	(59)	(17)
At 31 December	498	(39)	(6)	453	347

Put options on NCI and financial risk and revenue sharing arrangements (RRSAs)

	Put options on NCI		Financial RRSAs	
	2013 £m	2012 £m	2013 £m	2012 £m
At January 1	(167)	-	(193)	(230)
Cash paid to partners	-	-	33	35
On acquisition of business ¹	(2)	-	-	-
Additions	(1,432)	(167)	-	-
Exchange adjustments included in OCI	-	-	(4)	1
Financing charge ²	-	-	(9)	(10)
Excluded from underlying profit: ²				
Exchange adjustments	(45)	5	4	9
Changes in estimated put options exercise prices	(212)	(5)	-	-
Changes in forecast payments	-	-	2	2
At 31 December	(1,858)	(167)	(167)	(193)

¹ Arising on the reclassification of RRPS to a subsidiary – see note 11.

² Included in net financing.

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9 Pensions and other post-retirement benefits

Movements in the net post-retirement position recognised in the balance sheet were as follows:

	UK schemes £m	Overseas schemes £m	Total £m
At 1 January 2013, restated – see below	199	(644)	(445)
Exchange adjustments	-	(3)	(3)
Current service cost	(153)	(55)	(208)
Past service cost	(66)	(5)	(71)
Net financing recognised in income statement	12	(38)	(26)
Contributions by employer	249	66	315
Acquisition of business	-	(397)	(397)
Recognised in OCI:			
Actuarial gains recognised in OCI	(222)	135	(87)
Returns on plan assets excluding financing	(363)	(42)	(405)
Movement in unrecognised surplus ¹	407	-	407
Movement on minimum funding liability ²	133	-	133
Other	-	(6)	(6)
At 31 December 2013	196	(989)	(793)
Analysed as:			
Post-retirement scheme surpluses - included in non-current assets	242	6	248
Post-retirement scheme deficits - included in non-current liabilities	(46)	(995)	(1,041)
	196	(989)	(793)

¹ Where a surplus has arisen on a scheme, in accordance with IAS 19 and IFRIC 14, the surplus is recognised as an asset only if it represents an unconditional economic benefit available to the Group in the future. Any surplus in excess of this benefit is not recognised in the balance sheet.

² A minimum funding liability arises where the statutory funding requirements require future contributions in respect of past service that will result in a future unrecognisable surplus.

Amendments to IAS 19

Prior period figures have been restated to reflect the adoption of the amendments to IAS 19 *Employee Benefits*. Consequential tax effects have been reflected in deferred tax.

	Note	As previously reported			Amendments			As restated		
		UK	Overseas	Total	UK	Overseas	Total	UK	Overseas	Total
At 1 January 2012	A	252	(649)	(397)	17	93	110	269	(556)	(287)
Exchange adjustments		-	24	24	-	-	-	-	24	24
Current-service cost	B	(123)	(38)	(161)	(6)	(4)	(10)	(129)	(42)	(171)
Past-service cost	A	(2)	12	10	-	(12)	(12)	(2)	-	(2)
Net financing	C	(41)	(23)	(64)	58	(2)	56	17	(25)	(8)
Contributions by employer		250	47	297	2	-	2	252	47	299
Acquisition of business		5	-	5	-	-	-	5	-	5
Actuarial gains/(losses)	C	(659)	(118)	(777)	-	-	-	(659)	(118)	(777)
Return on plan assets excluding financing	C	(30)	20	(10)	(125)	6	(119)	(155)	26	(129)
Movement in unrecognised surplus	C	465	-	465	64	-	64	529	-	529
Movement in minimum funding liability	C	63	-	63	9	-	9	72	-	72
At 31 December 2012		180	(725)	(545)	19	81	100	199	(644)	(445)
Post-retirement scheme surpluses		317	12	329				336	12	348
Post-retirement scheme deficits		(137)	(737)	(874)				(137)	(656)	(793)
		180	(725)	(545)				199	(644)	(445)

^A Previously, the Group had an unrecognised past-service credit related to the restructuring of certain overseas healthcare schemes in 2011. This has now been recognised in full at 1 January 2012. As a consequence, the amortisation of this past-service credit in 2012 is eliminated. In addition, an adjustment has been made in the calculation of the defined benefit obligation on one of the UK schemes to put it on a consistent basis with the other schemes.

^B Previously, all administrative costs were offset against the expected return on scheme assets. The amendments only allow this in respect of the costs of managing scheme assets, other administrative expenses are now included in the current service cost.

^C Previously, net financing comprised the expected return on scheme assets based on the actual assets held and a financing charge on scheme liabilities calculated using a 'AA' corporate bond rate. The amendments require net financing to be calculated on the net asset or liability recognised on the balance sheet using a 'AA' corporate bond rate. The net financing charge has reduced principally because the Group's UK scheme assets include significant liability driven investment portfolios. The expected return on these is largely driven by UK Government gilt rates and this was lower than the 'AA' corporate bond rates required by the amendments. The amendments to financing have a consequential impact on amounts recognised in OCI: (i) the change in assumed return on scheme assets affects the related actuarial gains or losses; and (ii) the implicit financing on movements in the unrecognised surplus and the minimum funding liability is now included in OCI rather than the income statement.

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10 Contingent liabilities and contingent assets

On 6 December 2012, the Company announced that it had passed information to the SFO relating to concerns in overseas markets. Since that date the Company has continued its investigations and is engaging with the SFO and other authorities in the UK, the USA and elsewhere. In December 2013, the Company announced that it had been informed by the SFO that it had commenced a formal investigation. The consequence of these disclosures will be decided by the regulatory authorities. It remains too early to predict the outcomes, but these could include the prosecution of individuals and of the Group. Accordingly, the potential for fines, penalties or other consequences (including debarment from government contracts, suspension of export privileges and reputational damage) cannot currently be assessed. As the investigation is ongoing, it is not yet possible to identify the timescale in which these issues might be resolved. In connection with the sale of its products the Group will, on some occasions, provide financing support for its customers. The Group's contingent liabilities related to financing arrangements are spread over many years and relate to a number of customers and a broad product portfolio.

The discounted values of contingent liabilities relating to delivered aircraft and other arrangements where financing is in place, less insurance and indemnity arrangements and relevant provisions were:

	2013		2012	
	£m	\$m	£m	\$m
Gross contingent liabilities	356	589	569	925
Value of security	(217)	(360)	(381)	(620)
Indemnities	(80)	(132)	(118)	(191)
Net commitments	59	97	70	114
Net commitments with relevant security reduced by 20% ¹	78	129	133	216
Security includes unrestricted cash collateral of:	50	83	64	104

¹ Although sensitivity calculations are complex, the reduction of the relevant security by 20% illustrates the sensitivity of the contingent liability to changes in this assumption.

There are also net contingent liabilities in respect of undelivered aircraft, but it is not considered practicable to estimate these as deliveries can be many years in the future, and the relevant financing will only be put in place at the appropriate time.

Contingent liabilities exist in respect of guarantees provided by the Group in the ordinary course of business for product delivery, performance and reliability. The Group has, in the normal course of business, entered into arrangements in respect of export finance, performance bonds, countertrade obligations and minor miscellaneous items. Various Group undertakings are parties to legal actions and claims which arise in the ordinary course of business, some of which are for substantial amounts. While the outcome of some of these matters cannot precisely be foreseen, the directors do not expect any of these arrangements, legal actions or claims, after allowing for provisions already made, to result in significant loss to the Group.

11 Acquisitions and disposals

Acquisitions

Rolls-Royce Power Systems AG (RRPS - previously Tognum AG)

From 25 August 2011 to 31 December 2012 the Group's interest in RRPS was classified as a joint venture and equity accounted. On 1 January 2013, conditions were fulfilled which gave the Group certain rights that resulted in RRPS being classified as a subsidiary and consolidated. Accordingly, Rolls-Royce's joint venture interest in Rolls-Royce Power Systems Holding GmbH (RRPSH) has been reclassified as a subsidiary. The fair values of the identifiable assets and liabilities assumed are £1,339 million, giving rise to goodwill of £773 million, as set out in the table below. Rolls-Royce and Daimler AG (Daimler) each hold 50 per cent of the shares of RRPSH, which itself held over 99 per cent of the shares of RRPS. During 2013, RRPSH acquired the remaining 1 per cent of shares of RRPS. RRPS is a premium supplier of engines, propulsion systems and components for marine, energy, defence, and other industrial applications (often described as 'off-highway' applications).

Other

On 30 April 2013, the Group acquired 100% of the issued share capital of HyperTherm High-Temperature Composites, Inc., a producer of state-of-the-art composite materials, including ceramic matrix composites, engineered coatings and thermal-structural components.

On 15 August 2013, the Group acquired 100% of SmartMotor AS, a leading specialist in the development of permanent magnet technology.

On 24 December 2013, the Group acquired the remaining 49% of shares not held in Composite Technology and Applications Limited, a business engaged in the development of composite fan blades and containment cases for the next generation of advanced turbofan engines.

For each of the other acquisitions noted, the acquisition cost (net of cash and borrowings acquired) has been allocated to identifiable assets and liabilities – principally technology, patents and licences, customer relationships, trademark, order backlog and other intangible assets.

Condensed consolidated financial statements

Identifiable assets acquired and liabilities assumed

	RRPS £m	Other £m	Total £m
Intangible assets	1,192	35	1,227
Property, plant and equipment	545	1	546
Investments in joint ventures, associates and other unlisted investments	50	-	50
Inventory	737	-	737
Trade and other receivables	487	2	489
Taxation recoverable	48	-	48
Cash and cash equivalents	240	5	245
Trade and other payables	(693)	(3)	(696)
Current tax liabilities	(77)	-	(77)
Borrowings	(203)	(1)	(204)
Other financial assets and liabilities	(27)	-	(27)
Deferred tax	(283)	1	(282)
Provisions	(280)	-	(280)
Post-retirement schemes	(397)	-	(397)
Total identifiable assets and liabilities	1,339	40	1,379
Goodwill arising	773	-	773
Total consideration	2,112	40	2,152
Exercise price of put option on NCI	(1,432)	-	(1,432)
	680	40	720

Consideration satisfied by:

Cash consideration	-	37	37
Existing shareholding	1,443	3	1,446
NCI	669	-	669
	2,112	40	2,152

Net cash flow arising on acquisition:

Cash consideration	-	37	37
Less: cash and cash equivalents acquired	(240)	(5)	(245)
Cash flow per cash flow statement	(240)	32	(208)

In accordance with the provisions of IFRS 3 *Business Combinations*, the Group has opted not to recognise goodwill in respect of the non-controlling interest. The existing joint venture investment holding in RRPSH has been revalued, giving rise to a gain of £115 million.

As part of the RRPSH shareholders' agreement, Daimler has the option to sell its shares in RRPSH to Rolls-Royce for a period of six years from 1 January 2013. The initial fair value of the exercise price of this option in respect of RRPS has been recognised as a liability (£1,432 million), which has been charged to retained earnings. Subsequent movements in the value of this liability will be included in the income statement, but excluded from the underlying results.

Disposals

On 29 January 2013, Alstom acquired the Group's wholly owned subsidiary Tidal Generation Limited.

On 2 September 2013, Turbomeca (a Safran company) acquired the Group's 50 per cent shareholding and interest in the RTM322 helicopter engine programme for which it has received a cash consideration of €293 million. Rolls-Royce will progressively transfer its operational responsibilities in the engine programme to Turbomeca over a multi-year period.

	RTM322 £m	Tidal Generation £m	Total £m
Intangible assets – goodwill	-	3	3
Investments in joint venture	2	-	2
Cash and cash equivalents	-	2	2
Trade and other payables	-	(2)	(2)
Provisions for liabilities and charges	(2)	-	(2)
Net assets	-	3	3
Profit on disposal of business	194	22	216
Disposal costs	3	-	3
Proceeds deferred in respect of transitional services and retain obligations	53	-	53
Disposal proceeds	250	25	275
Cash and cash equivalents disposed	-	(2)	(2)
Cash inflow per cash flow statement	250	23	273

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12 Segmental analysis from 1 January 2014

During 2013, the management structure of the business has been revised and the internal reporting structure has been developed to reflect this. These changes will be reflected in the segmental analysis with effect from 1 January 2014. Had they been in place during 2013, the segmental analysis shown in note 2 would be as follows:

	Aerospace			Marine & Industrial Power Systems					Inter-segment £m	Total reportable segments £m
	Civil £m	Defence £m	Total £m	Marine £m	Power Systems £m	Nuclear & Energy £m	Intra-segment £m	Total £m		
Year ended 31 December 2013										
Underlying revenue from sale of:										
Original equipment	3,035	1,385	4,420	1,236	2,004	617	(72)	3,785	-	8,205
Aftermarket services	3,620	1,206	4,826	801	827	921	(75)	2,474	-	7,300
Underlying revenue	6,655	2,591	9,246	2,037	2,831	1,538	(147)	6,259	-	15,505
Underlying operating profit excluding share of results of joint ventures and associates	708	424	1,132	233	296	63	2	594	-	1,726
Share of results of joint ventures and associates	136	14	150	-	(2)	11	-	9	-	159
Underlying profit before financing and taxation	844	438	1,282	233	294	74	2	603	-	1,885
Segment assets	9,587	1,437	11,024	1,701	3,927	1,616	(10)	7,234	(734)	17,524
Investments in joint ventures and associates	495	17	512	5	29	55	-	89	-	601
Segment liabilities	(6,243)	(1,660)	(7,903)	(985)	(3,034)	(1,015)	-	(5,034)	733	(12,204)
Net assets	3,839	(206)	3,633	721	922	656	(10)	2,289	(1)	5,921
Investment in intangible assets, property plant and equipment and joint ventures and associates	891	103	994	23	142	80	-	245	-	1,239
Depreciation, amortisation and impairment	349	53	402	63	272	63	-	398	-	800

Principal risks and uncertainties

The following table describes the risks that the risk committee, with endorsement from the Board, consider to have the most material potential impact on the Group. They are specific to the nature of our business notwithstanding that there are other risks that may occur and may impact the achievement of the Group's objectives.

The risk committee discussions have been focused on these risks and the actions being taken to manage them.

Risk or uncertainty and potential impact	How we manage it
Product failure Product not meeting safety expectations, or causing significant impact to customers or the environment through failure in quality control.	• Operating a safety first culture • Our engineering design and validation process is applied from initial design, through production and into service • The safety committee reviews the scope and effectiveness of the Group's product safety policies to ensure that they operate to the highest industry standards • A safety management system (SMS) has been established by a dedicated team. This is governed by the Product Safety Review Board and is subject to continual improvement based on experience and industry best practice. Product safety training is an integral part of our SMS • Crisis management team led by the Director – Engineering and Technology or General Counsel as appropriate
Business continuity Breakdown of external supply chain or internal facilities that could be caused by destruction of key facilities, natural disaster, regional conflict, financial insolvency of a critical supplier or scarcity of materials which would reduce the ability to meet customer commitments, win future business or achieve operational results.	• Continued investment in adequate capacity and modern equipment and facilities • Identifying and assessing points of weakness in our internal and external supply chain, our IT systems and our people skills • Selection and development of stronger suppliers • Developing dual sources or dual capability • Developing and testing site-level incident management and business recovery plans • Crisis management team led by the Director – Engineering and Technology or General Counsel as appropriate • Customer excellence centres provide improved response to supply chain disruption
Competitor action The presence of large, financially strong competitors in the majority of our markets means that the Group is susceptible to significant price pressure for original equipment or services even where our markets are mature or the competitors are few. Our main competitors have access to significant government funding programmes as well as the ability to invest heavily in technology and industrial capability.	• Accessing and developing key technologies and service offerings which differentiate us competitively • Focusing on being responsive to our customers and improving the quality, delivery and reliability of our products and services • Partnering with others effectively • Driving down cost and improving margins • Protecting credit lines • Investing in innovation, manufacturing and production • Understanding our competitors
International trade friction Geopolitical factors that lead to significant tensions between major trading parties or blocs which could impact the Group's operations. For example: explicit trade protectionism; differing tax or regulatory regimes; potential for conflict; or broader political issues.	• Where possible, locating our domestic facilities in politically stable countries and/or ensuring that we maintain dual capability • Diversifying global operations to avoid excessive concentration of risks in particular areas • Network of regional directors proactively monitors local situations • Maintaining a balanced business portfolio in markets with high technological barriers to entry and a diverse customer base • Understanding our supply chain risks • Proactively influencing regulation where it affects us
Major product programme delivery Failure to deliver a major product programme on time, to specification or technical performance falling significantly short of customer expectations would have potentially significant adverse financial and reputational consequences, including the risk of impairment of the carrying value of the Group's intangible assets and the impact of potential litigation.	• Major programmes are subject to Board approval • Major programmes are reviewed at levels and frequencies appropriate to their performance against key financial and non-financial deliverables and potential risks throughout a programme's life cycle • Technical audits are conducted at pre-defined points performed by a team that is independent from the programme • Programmes are required to address the actions arising from reviews and audits and progress is monitored and controlled through to closure • Knowledge management principles are applied to provide benefit to current and future programmes

Risk or uncertainty and potential impact	How we manage it
Compliance Non-compliance by the Group with legislation or other regulatory requirements in the regulated environment in which it operates (for example: export controls; offset; use of controlled chemicals and substances; and anti-bribery and corruption legislation) compromising our ability to conduct business in certain jurisdictions and exposing the Group to potential: reputational damage; financial penalties; debarment from government contracts for a period of time; and/or suspension of export privileges or export credit financing), any of which could have a material adverse effect.	• An uncompromising approach to compliance is now, and should always be, the only way to do business • The Group has an extensive compliance programme. This programme and the Global Code of Conduct are promulgated throughout the Group and are updated and reinforced from time to time, to ensure their continued relevance, and to ensure that they are complied with both in spirit and to the letter. The Global Code of Conduct and the Company's compliance programme are supported by appropriate training • A legal and compliance team has been put in place to manage the current specific issue through to a conclusion and beyond • Lord Gold has reviewed the Group's current compliance procedures and an improvement plan is being implemented
Market shock The Group is exposed to a number of market risks, some of which are of a macro-economic nature, for example, foreign currency exchange rates, and some which are more specific to the Group, for example liquidity and credit risks, reduction in air travel or disruption to other customer operations. Significant extraneous market events could also materially damage the Group's competitiveness and/or credit worthiness. This would affect operational results or the outcomes of financial transactions.	• Maintaining a strong balance sheet, through healthy cash balances and a continuing low level of debt • Providing financial flexibility by maintaining high levels of liquidity and an investment grade 'A' credit rating • The portfolio effect from our business interests, both in terms of original equipment to aftermarket split and our different segments provide a natural shock absorber since the portfolios are not correlated • Deciding where and what currencies to source in, where and how much credit risk is extended or taken and hedging residual risk through the financial derivatives markets (foreign exchange, interest rates and commodity price risk)
IT vulnerability Breach of IT security causing controlled data to be lost, made inaccessible, corrupted or accessed by unauthorised users.	• Establishing 'defence in depth' through deployment of multiple layers of software and processes including web gateways, filtering, firewalls, intrusion, advanced persistent threat detectors and integrated reporting • Security and network operations centres have been established • Active sharing of information through industry, government and security forums

Annual General Meeting (AGM) and directorate change

This year's AGM will be held at 11.00am on Thursday, 1 May 2014 at the QEII Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE. The AGM notice and the annual report will be available to view on the Group's website.

In accordance with the UK Corporate Governance Code and the Company's Articles of Association, all directors are required to retire at each AGM. All of the current directors intend to put themselves forward for election or re-election at the AGM on 1 May 2014 with the exception of Iain Conn who is not seeking re-election and will retire from the Board at the conclusion of the meeting. Mr Conn has served as a non-executive director since 2005 and as the Senior Independent Director since 2007. Lewis Booth, subject to his re-election at the AGM, will succeed Iain Conn as the Senior Independent Director with effect from the conclusion of the AGM. Mr Booth has been a non-executive director since 2011.

Payments to shareholders

Payments to shareholders: at the AGM on 1 May 2014, the directors will recommend an issue of 134 C Shares with a total nominal value of 13.4 pence for each ordinary share. The final issue of C shares will be made on 1 July 2014 to shareholders on the register on 25 April 2014 and the final day of trading with entitlement to C Shares is 22 April 2014. Together with the interim issue on 2 January 2014 of 86 C Shares for each ordinary share with a total nominal value of 8.6 pence, this is the equivalent of a total annual payment to ordinary shareholders of 22.0 pence for each ordinary share.

The payment to shareholders will, as before, be made in the form of redeemable C Shares which shareholders may either choose to retain or redeem for a cash equivalent. The Registrar, on behalf of the Company, operates a C Share Reinvestment Plan (CRIP) and can, on behalf of shareholders, purchase ordinary shares from the market rather than delivering a cash payment. Shareholders wishing to redeem their C Shares or else redeem and participate in the CRIP must ensure that their instructions are lodged with the Registrar, Computershare Investor Services Plc, no later than 5.00pm on 2 June 2014. Redemption will take place on 3 July 2014.

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The statements below have been prepared in connection with the Company's full Annual report for the year ended 31 December 2013. Certain parts thereof are not included in this announcement.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position and a summary of the principal risks affecting the business are set out in the strategic report. The financial position of the Group, its cash flows, liquidity position, borrowing facilities and financial risks are also described in the strategic report and the directors' report. In addition, the consolidated financial statements include the Group's objectives, policies and processes for financial risk management, details of its cash and cash equivalents, indebtedness and borrowing facilities and its financial instruments, hedging activities and its exposure to counterparty credit risk, liquidity risk, currency risk, interest rate risk and commodity pricing risk.

The Group meets its funding requirements through a mixture of shareholders' funds, bank borrowings, bonds, notes and finance leases. The Group has facilities of £3.6 billion of which £2.4 billion was drawn at the year end. £200 million of these facilities mature in 2014.

The Group's forecasts and projections, taking into account reasonably possible changes in trading performance, show that the Group has sufficient financial resources. If the put option on Rolls-Royce Power Systems Holding GmbH (formerly named Engine Holding GmbH) is exercised by Daimler AG, (estimated cost £1.9 billion), the directors consider that the Group would be able to raise additional resources in the necessary timeframe to meet this commitment. As a consequence, the directors have a reasonable expectation that the Company and the Group are well placed to manage their business risks and to continue in operational existence for the foreseeable future, despite the current uncertain global economic outlook.

Accordingly, the directors continue to adopt the going concern basis (in accordance with the guidance 'Going Concern and Liquidity Risk: *Guidance for Directors of UK Companies 2009*' issued by the FRC) in preparing the consolidated financial statements.

Responsibility statements

Each of the persons who is a director at the date of approval of this report confirms that to the best of his or her knowledge:

- i) each of the Group and parent company financial statements, prepared in accordance with IFRS and UK Accounting Standards respectively, gives a true and fair view of the assets, liabilities, financial position and profit or loss of the issuer and the undertakings included in the consolidation taken as a whole;
- ii) the strategic report and the directors report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and
- iii) the annual report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

By order of the Board

John Rishton
Chief Executive
12 February 2014

Mark Morris
Chief Financial Officer
12 February 2014