

Investor Briefing

19 June 2014

Strategy

John Rishton

19 June 2014

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Overview of morning

Strategy

Capital allocation & guidance

TotalCare[®]

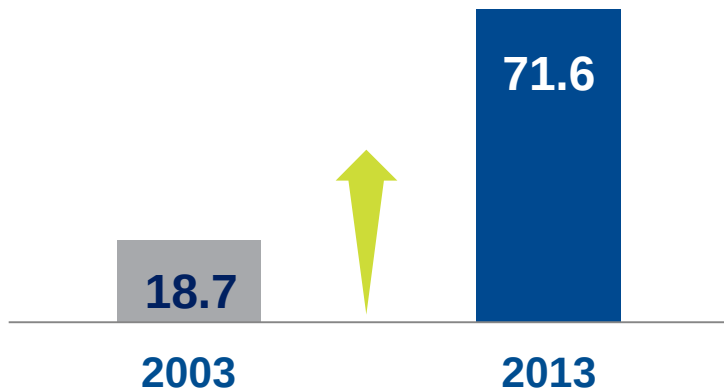
Q&A

Strategy – evolution, not revolution

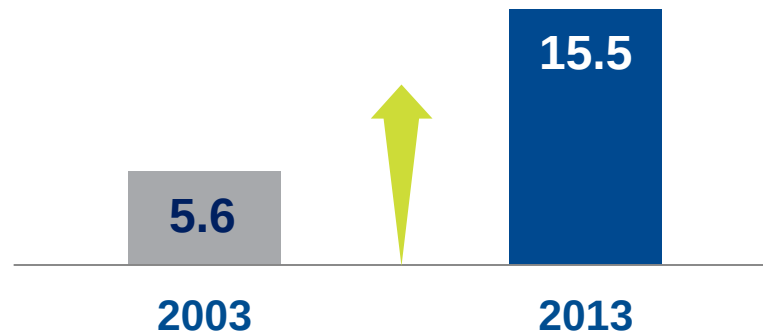
Customer	Place the customer at the heart of the organisation Understand and shape their requirements Relentless focus on delivering our promises
Innovation	Value innovation in everything we do Ensure competitive technology ahead of product requirements Establish an environment and culture in which innovation thrives
Profitable growth	Grow our market share and installed base Competitive portfolio of products and services Focus on cost and cash

Consistent long-term delivery

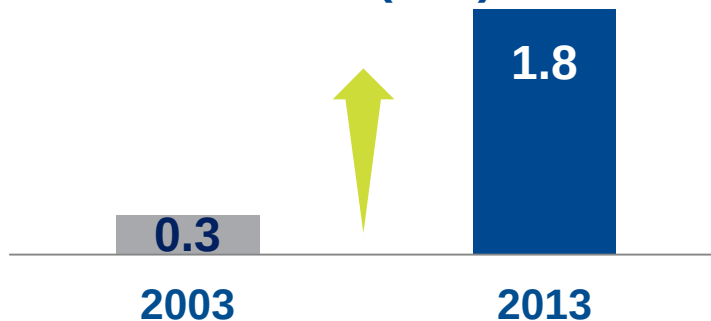
Order book (£bn)



Revenue (£bn)



Profit (£bn)



Who we are

“ ...for use on land or water or in the air.”*

Group

Rolls-Royce

Complex power systems & services group

Power

Gas turbines

Reciprocating engines

Nuclear

Systems

LiftFan, engine controls, propulsion, deck machinery, I&C

Services

Aftermarket services

Divisions

Aerospace

Marine & Industrial Power Systems

Businesses

Civil
Aerospace

Defence
Aerospace

Power
Systems

Marine

Nuclear

* from Rolls-Royce Ltd. Memorandum & Articles of Association 1904

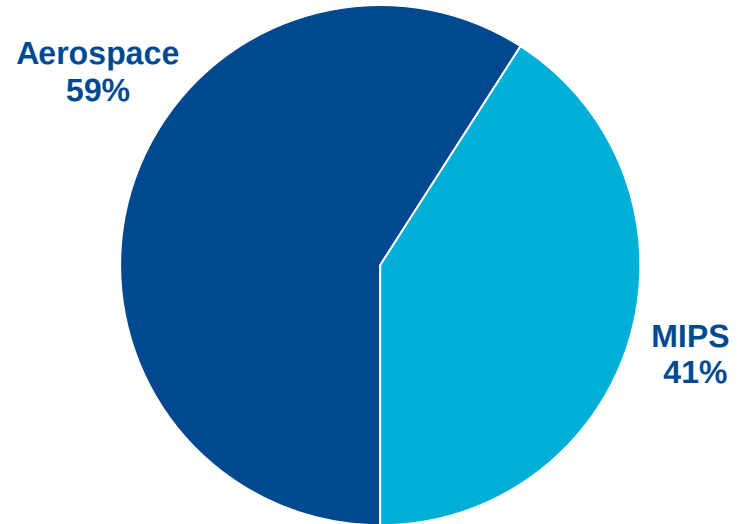
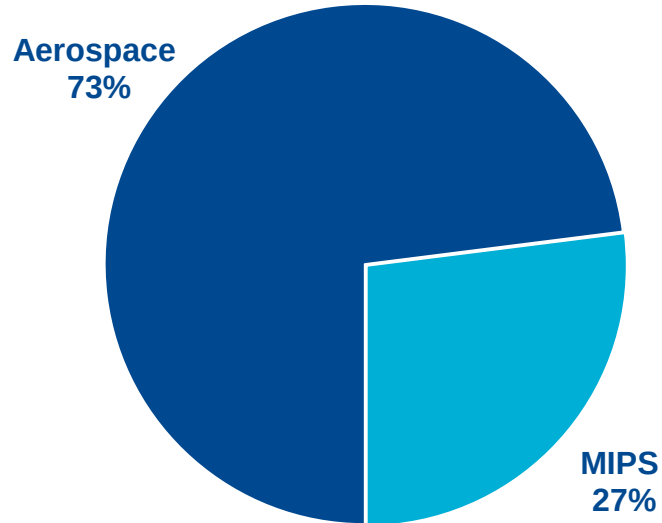
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Rolls-Royce

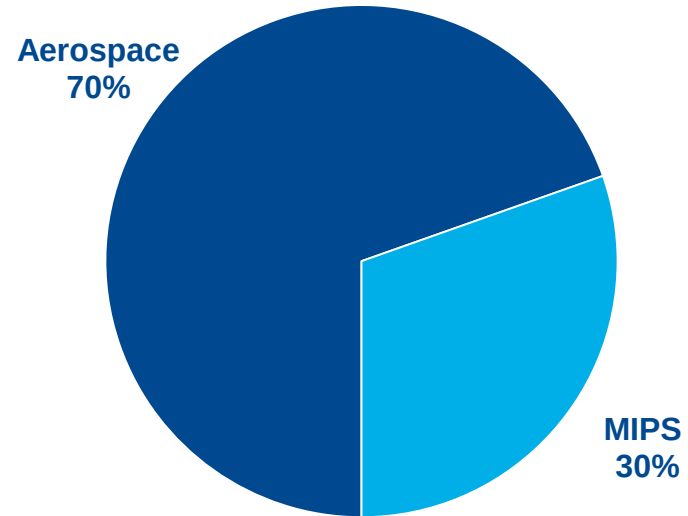
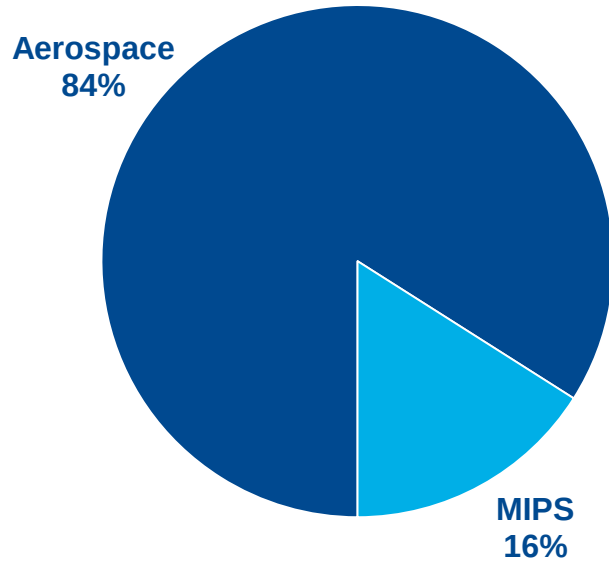
Strong growth and better revenue balance

2003: £5.6bn — 11% CAGR → 2013: £15.5bn



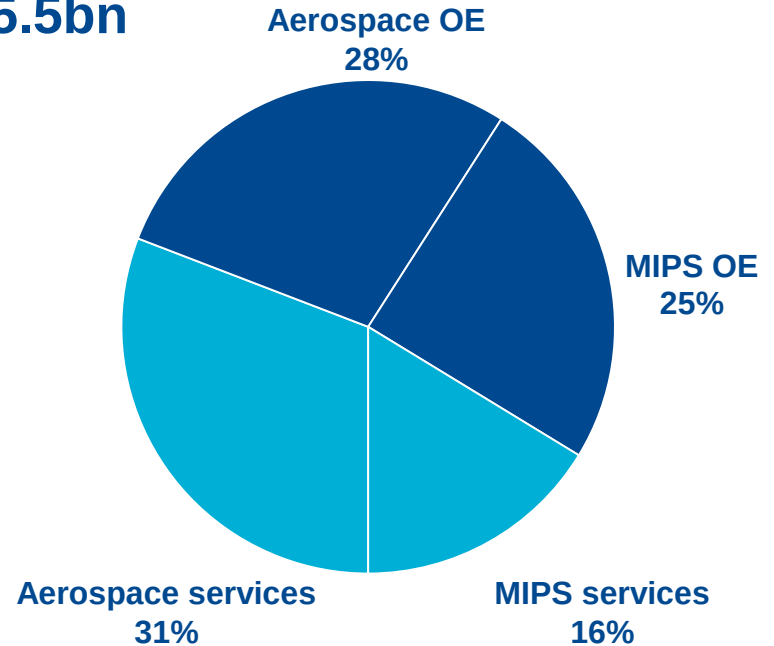
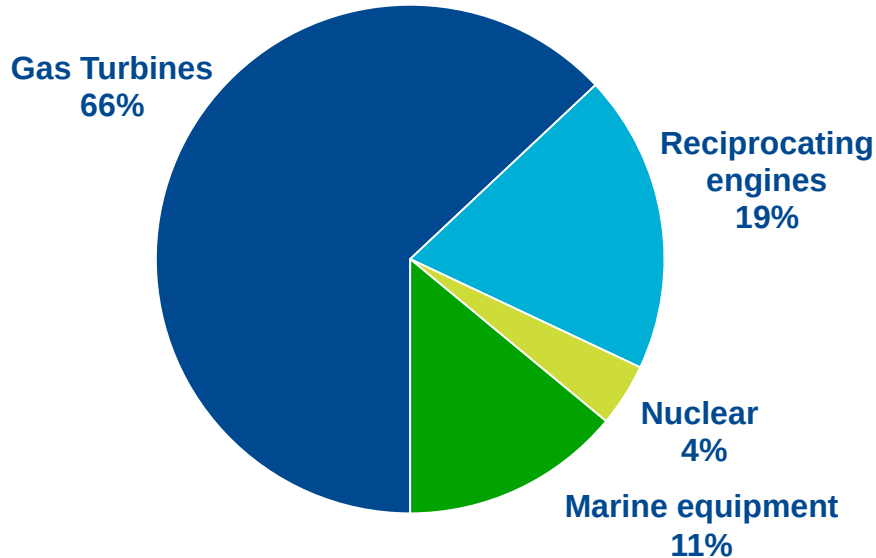
Strong growth and better profit balance

2003: £0.4bn — 17% CAGR → 2013: £1.8bn



Balanced revenue by product & type

2013: £15.5bn



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Growth and balance driven by portfolio approach

Similar ROCE, complementary profiles

Civil gas turbines

Reciprocating engines

ROCE*	18% - 23%	25% - 30%
Investment risk	High	Low
Entry barriers	High	Medium
Net R&D spend	~£1bn	~£150m
Capex	~£0.5bn	~£100m
Programme launch to EIS	5 – 7 years	3 - 5 years
EIS to cash neutral	10 - 15 years	3 -10 years

** Based on Rolls-Royce and Goldman Sachs analysis*

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Our 5 priorities

Fix the Basics – “4C’s”

Culture

Bedrock

Wide body civil GTs

Narrow body civil GTs

Medium-speed reciprocating engines

Investment choices

Fix the basics: the "4C's"

Customer

Concentration

Cost

Cash

Customer

On time delivery – trend improving but much more to do

	On time to customer		On time to internal plan	
	2013	2012	2013	2012
Civil Aerospace	100%	80%	25%	4%
Defence Aerospace	93%	88%	39%	7%
Marine	95%	55%	77%	30%

Concentration

Focus on where we add most value

	When	What	Why
Sold	2014	Energy gas turbine business to Siemens	Scale
	2013	RTM322 helicopter engine business	Non-core
	2012	Tidal Generation, Fuel Cells	Non-core
Bought	2011 - 2014	Tognum	Product
	2011 - 2013	Various Civil Nuclear businesses	Technology
	2010 - 2012	Aero Engine Controls	Technology

Cost

Area	Action
Product redesign	• 600 engineers
Structural change	• LCC sourcing to 40% by 2020 • 20% lower footprint by 2020
New manufacturing Plants & technology	• New plants hitting targets • 160 new projects via AMRCs
Logistics & inventory	• Reduce logistics costs - 20% • Continue to improve inventory turns
Lean enterprise	• Substantial reduction in time to market • Adopting automotive industry practices
Overheads	• Indirect headcount down 11% • Business Process Optimisation – 20% opportunity

Cash

Type	2013	Action
Capex spend	£0.7bn	Drive down from current 4.9% revenue to c. 4% in next 3-5 years.
R&D spend	£0.8bn	Ease as % of revenue
Inventory year-end total	£3.3bn	Continue to drive turn times by reducing buffers, improving productivity and increasing manufacturing stability.

Cash

Inventory turns improving but more to do

	2013	2012
Civil	3.4	3.0
Defence	4.6	3.4
Marine	3.6	3.4
Group	3.4	3.0

Our 5 priorities

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Narrow body civil GTs

Medium-speed recips

Investment choices

Culture

Importance of culture:

“Culture eats strategy for breakfast”

Innovation

Cost

Ethics

Our 5 priorities

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Wide body civil GTs

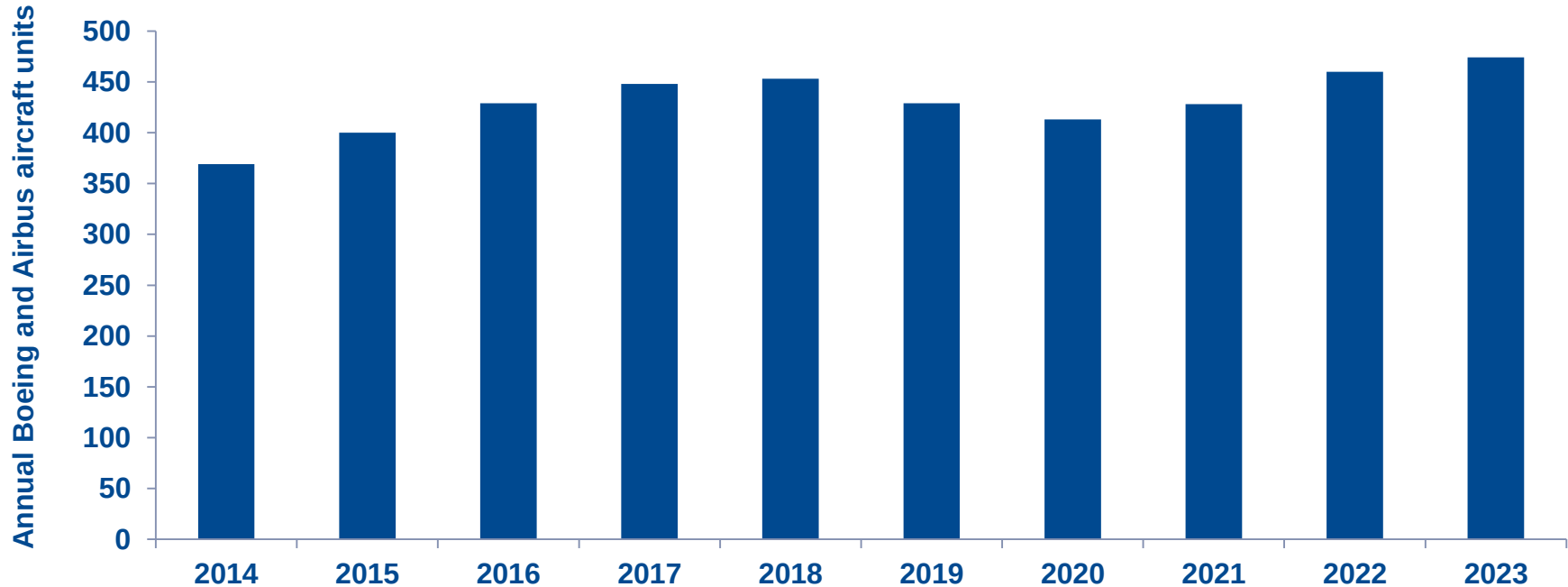
Narrow body civil GTs

Medium-speed reciprocating engines

Investment choices

Wide body aircraft deliveries to 2023

Over 4,000 deliveries vs. over 2,000 in last decade



Source: Jefferies.

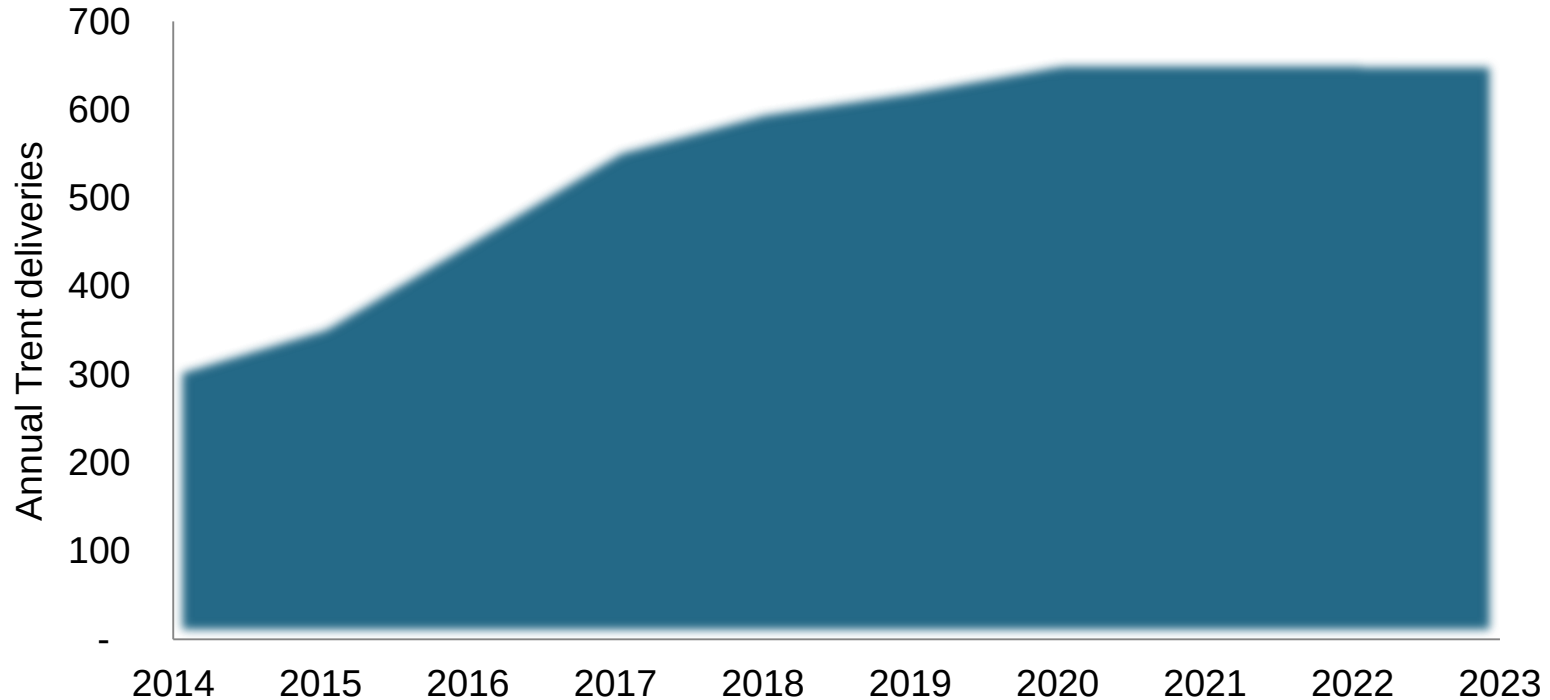
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Projected Trent deliveries to 2023

Over 4,000 deliveries vs. over 1,600 in last decade



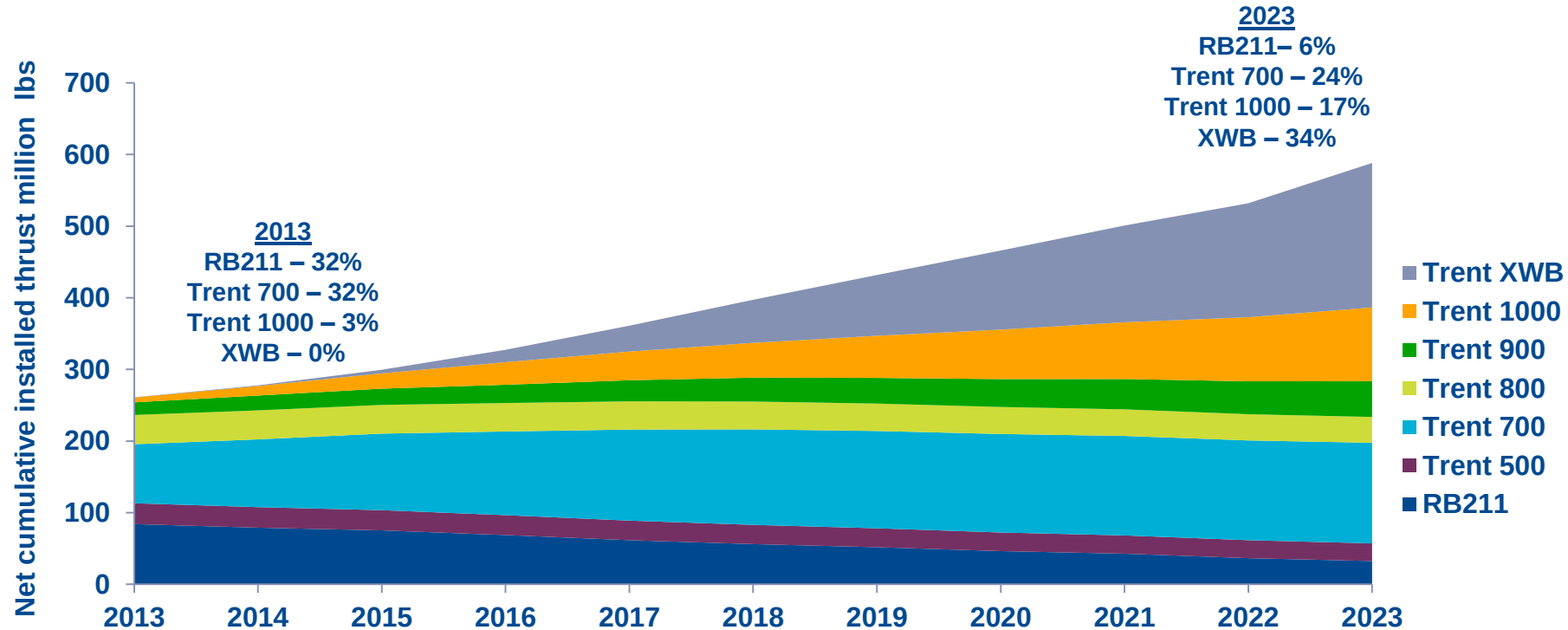
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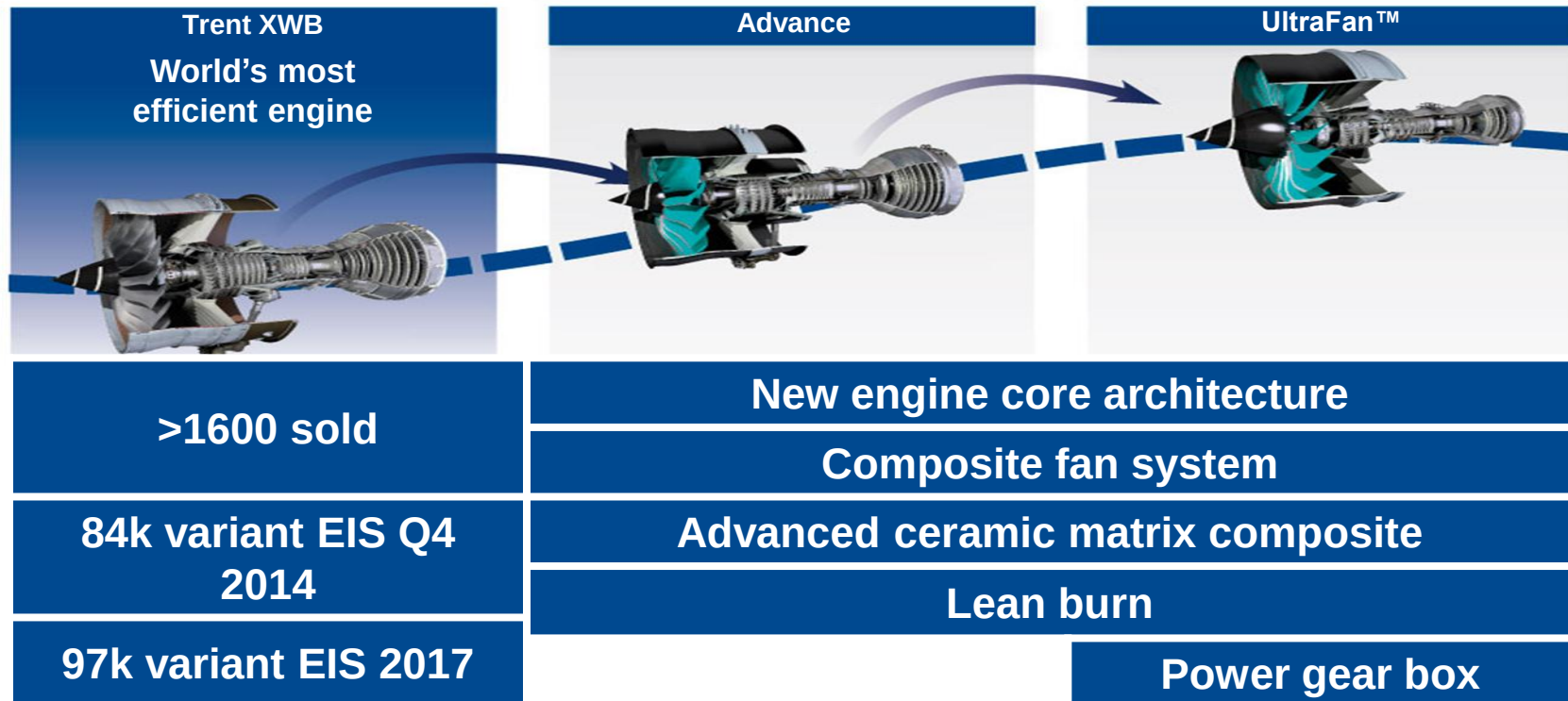
Rolls-Royce wide body installed thrust

More than doubles in next decade



Future products

Continuous improvement essential to remain competitive



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Wide body civil GTs

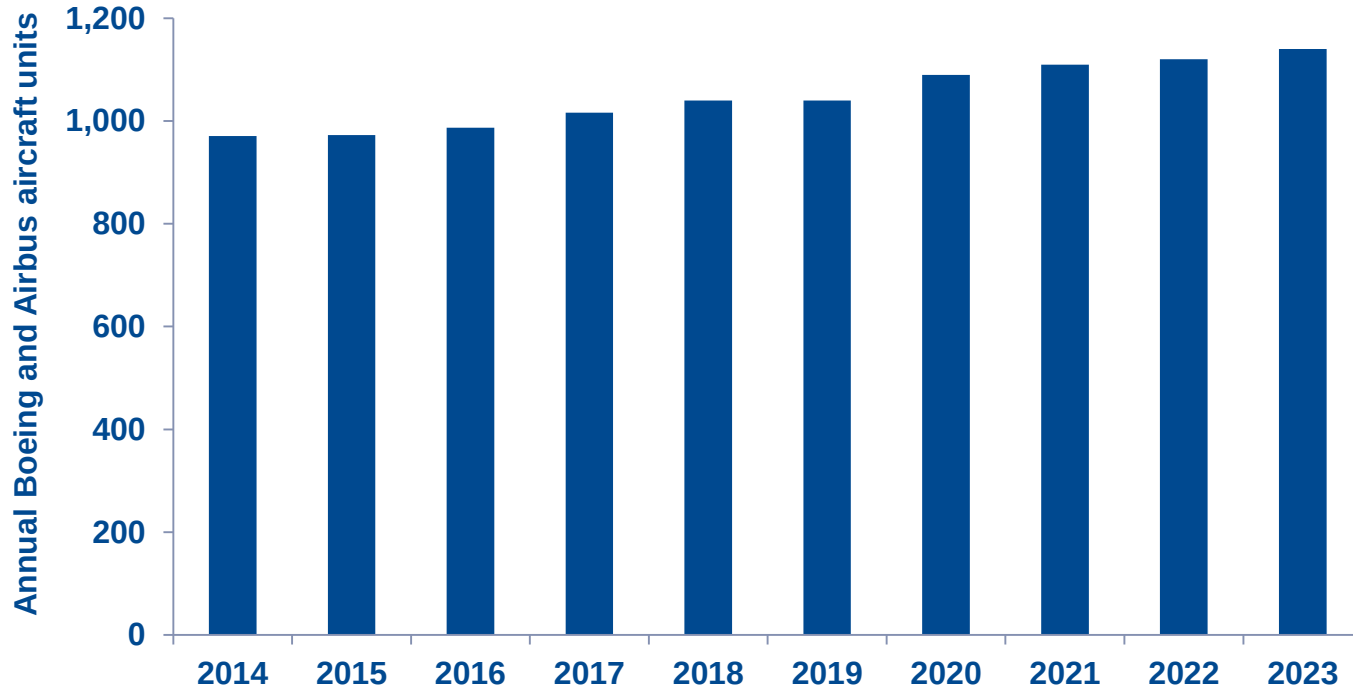
Narrow body civil GTs

Medium-speed reciprocating engines

Investment choices

Narrow body deliveries to 2023

71% market units, 48% market value



Benefits

- Customer intimacy
- Technology
- Volume
- Large market

Source: Jefferies

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Investment choices

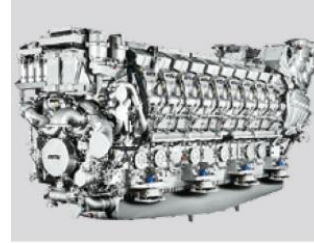
Low speed recip characteristics

rpm	50 - 300
Power (MW)	3 - 85
Weight (tonnes)	50 – 2400
Length (m)	4 – 24
Fuel type	Diesel (HFO), gas
Competitors	MAN Diesel, MHI
Typical uses	Large merchant vessels



High speed recip characterisitics

rpm	1000 – 2500+
Power (MW)	<1 – 10
Weight (tonnes)	<1 - 40
Length (m)	<1 - 8
Fuel type	Diesel (distillate), gas
Competitors	Caterpillar, Cummins, Yanmar, GE Jenbacher, Volvo Penta, Weichai
Typical uses	Marine leisure craft, naval, construction, rail, mining, standby PG etc.
Features	• Common technologies and shared R&D with medium speed • Volume production enables lower unit cost



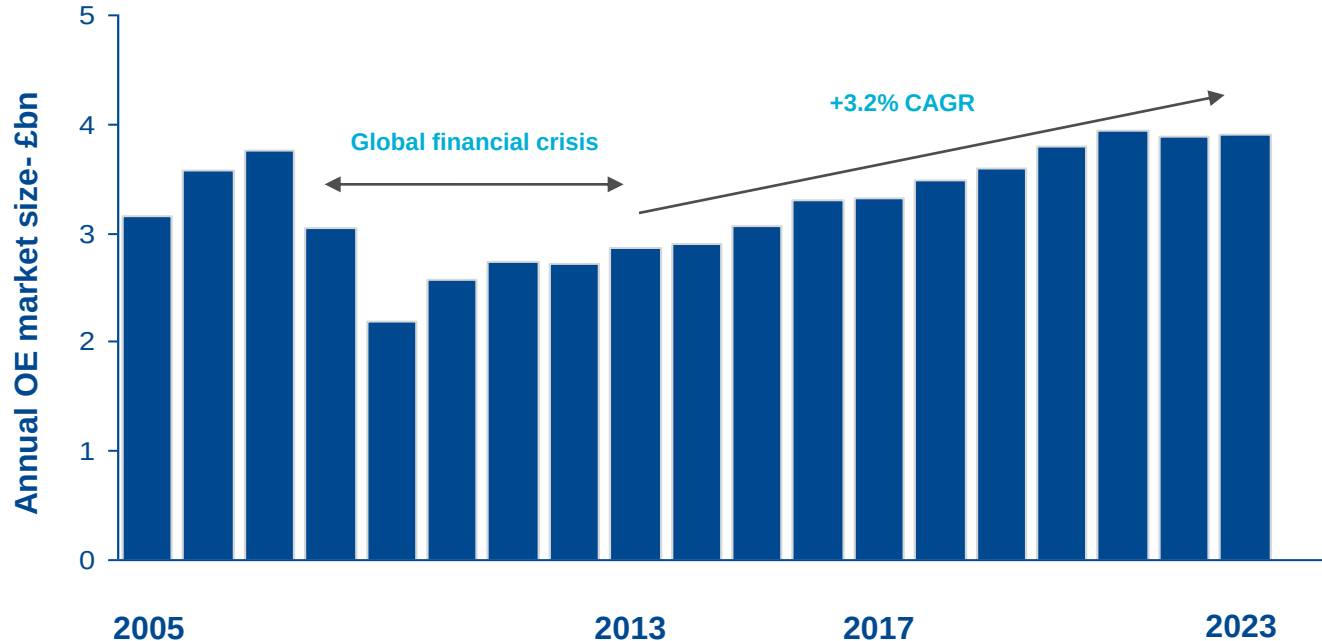
Medium speed recip characteristics

rpm	300 – 1000
Power (MW)	1 – 25
Weight (tonnes)	18 – 350
Length (m)	3 – 14
Fuel type	Diesel (distillate, residual/HFO), gas
Competitors	Wärtsilä, MAN Diesel, Caterpillar, Hyundai, Niigata
Typical uses	Offshore, small-medium merchant, distributed PG • Extensive use in Offshore industry (complex, mission-critical etc.)
Features	• Opportunities in land PG • Access to larger merchant marine market enables pull through



Medium speed market

Growing marine and land power forecast



Market growth drivers:

- GDP
- Population growth
- Emerging markets power generation demand
- Environmental legislation
- Oil price
- Gas price / availability
- £35bn market to 2023

Source: Rolls Royce - data excludes Marine auxiliary engines

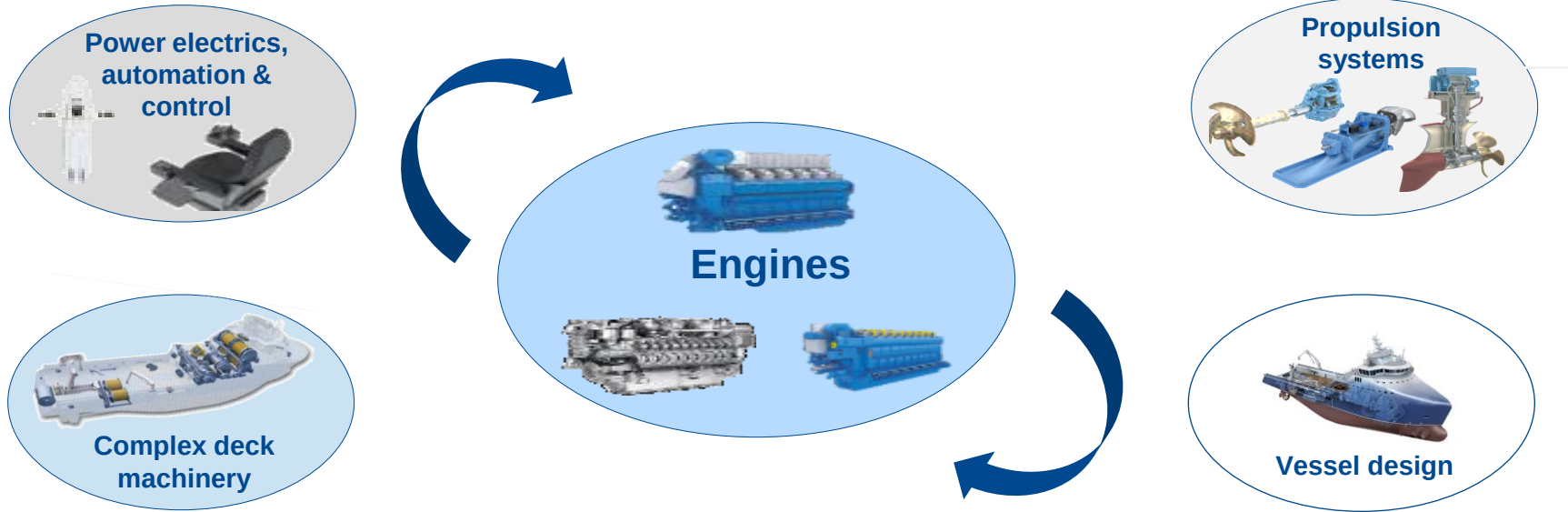
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Portfolio pull through

Each product gives access to others



- Early customer engagement
- Access systems integration opportunities
- Portfolio helps pull-through of other equipment

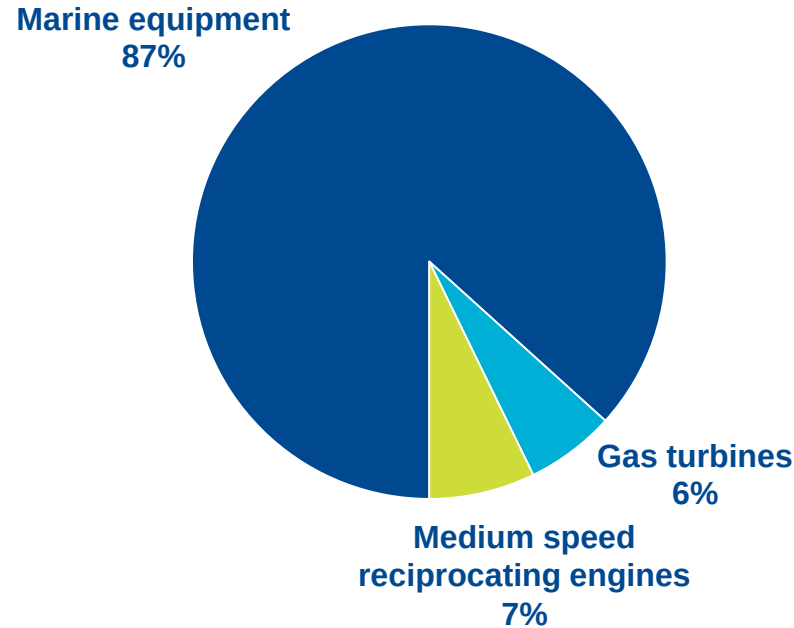
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Marine revenue strong in by product type

2013: £2.0bn* - strong in marine equipment



** pro-forma excluding Submarines revenue to be reported in Energy & Nuclear from FY14*

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Our 5 priorities

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Wide body civil GTs

Narrow body civil GTs

Medium-speed recips

Investment choices

Summary

Strong position in growth markets

Concentrating on what we know

Significant opportunities

Financial framework

Mark Morris - CFO

19 June 2014

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Agenda

- Linking strategy to our financial decision framework
- Capital allocation drivers
- Future guidance framework

Strategy: evolution not revolution

Measured steps to improvement

Our strategy

Customer

Innovation

Profitable growth

Delivering shareholder value

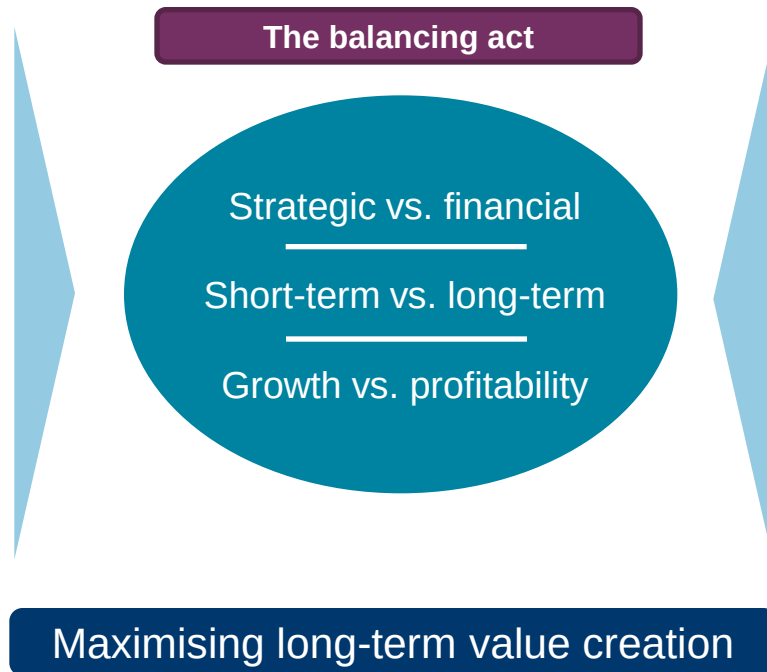
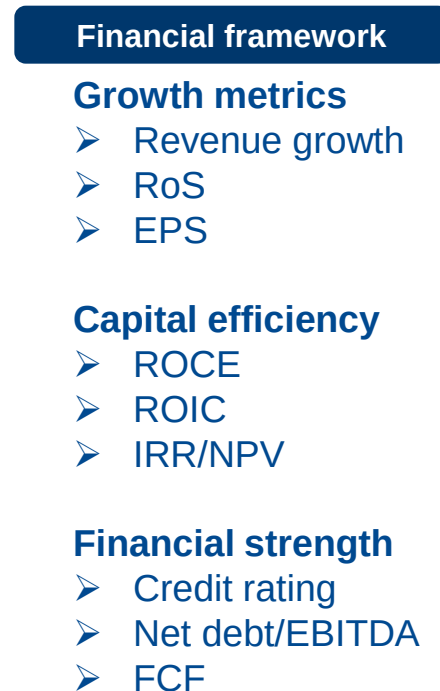
- Execute on organic growth programmes
- Exit non-core and underperforming assets
- Drive financial performance (the 4C's)
- Integrate RR Power Systems (Tognum)
- Clear strategy two pillars – Aerospace and MIPS
- Disciplined M&A

Our decision framework

Where we invest



How we invest



Importance of credit rating

Considerations

- Long cycle capital intensive business
- Long term contracts
- Provide confidence to customers and governments
- Access to long term finance (debt capital markets)

Criteria

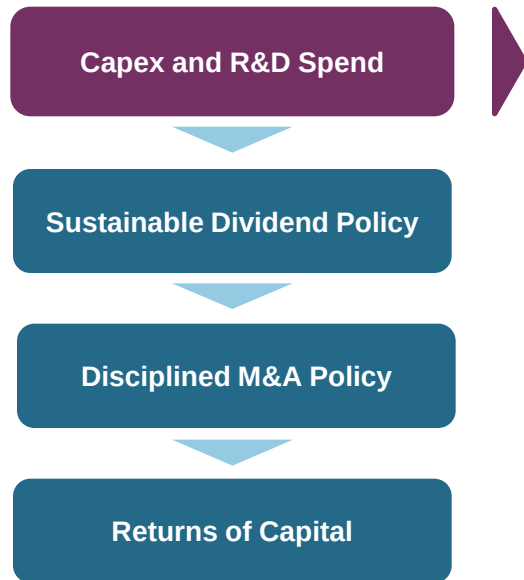
- Maintain an investment grade credit rating
- Normal target range: A- to A+ through the cycle

Current rating

S&P: A
Moody's: A3

Disciplined approach to capital allocation

Investing for growth



Net R&D spend

- Currently 4.9%
- Ease as a % of revenue as business grows

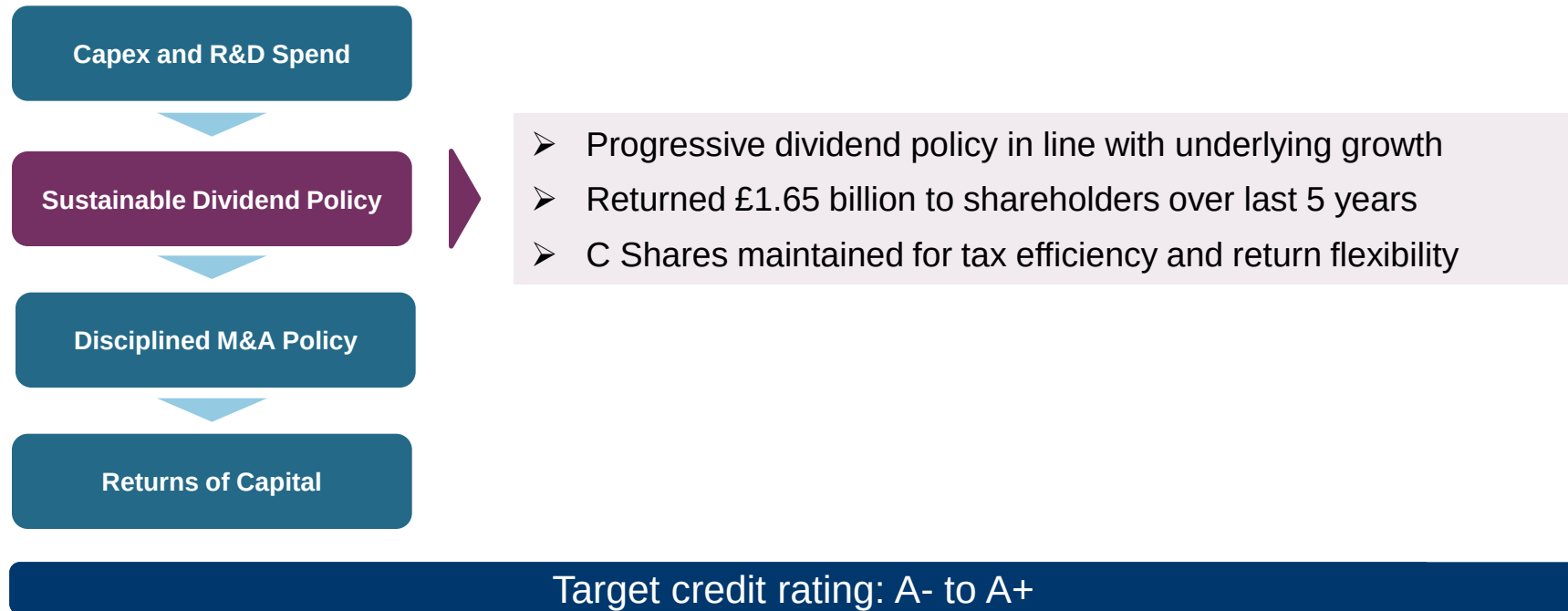
Capex spend

- 3% - 5% of revenue through cycle
- Driving to 4%

Target credit rating: A- to A+

Disciplined approach to capital allocation

Investing for growth



Disciplined approach to capital allocation

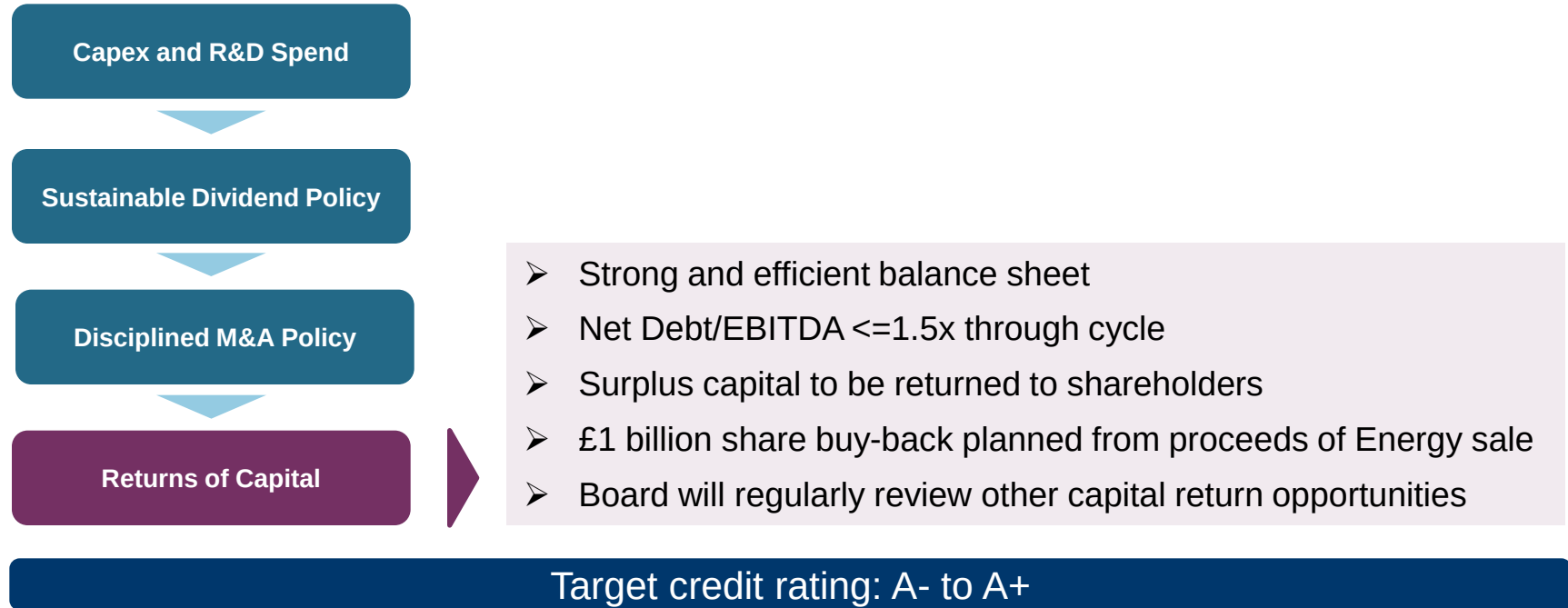
M&A focus and criteria



Target credit rating: A- to A+

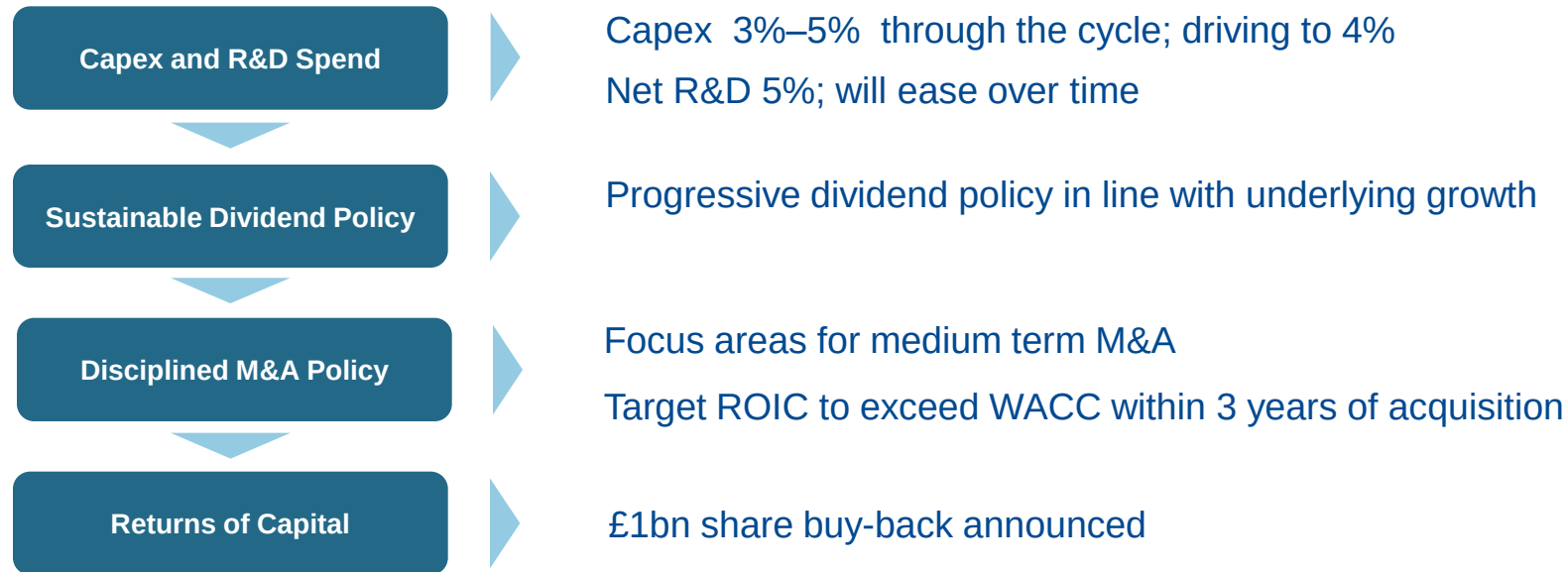
Disciplined approach to capital allocation

Maintaining balance sheet flexibility and efficiency



Disciplined approach to capital allocation

In summary



Target credit rating: A- to A+

Future guidance framework

What we will give

	In year	Next year	Medium term outlook (3-5 years)
Group	Revenue PBT Cash flow FCF	Revenue PBT	Revenue RoS Cash flow
Segments	Revenue PBFCT		Civil RoS
Other	Capex R&D spend/charge Civil TCA net debtor FX Tax rate		Civil peak TCA debtor + REC and year

Future guidance framework

How we will give

	In year	Next year	Medium term outlook (3-5 years)
Group	Banded range of figures (Xm to Ym etc.)	Banded range of figures (Xm to Ym etc.)	Banded range of figures or %s
Segments	Banded range of % (X% to Y%)		Banded range of % (X% to Y%)
Other	Approximate figures or banded range		Approximate figure and year

Future guidance framework

When we will give

	In year	Next year	Medium term outlook (3-5 years)
February Prelims	✓	-	-
May IMS	✓	-	-
July Interims	✓	-	-
November IMS	✓	✓ (Annual Budget cycle)	✓ (Annual 10 year planning cycle)

Summary

- Clear on our strategy
- Clear on our priorities
- Disciplined approach to capital allocation
- More guidance going forward

Break

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TotalCare®

Tony Wood

19 June 2014

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Agenda

1. TotalCare®

- Business model
- Programme life cycle
- Embedded value – risk transfer and growth
- Managing TotalCare® – revenue and cost drivers

2. Accounting for TotalCare®

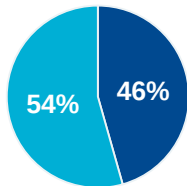
- Commercial arrangements and accounting principles
- Accounting mechanics
- Portfolio dynamics

Group business model

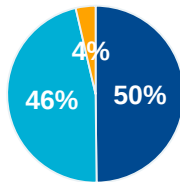
Complex power systems, long service lives, strong positions in growing markets

Aerospace

Civil Aerospace

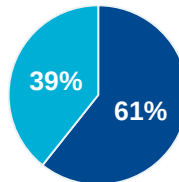


Defence Aerospace

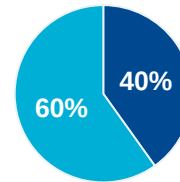


Marine & Industrial Power Systems

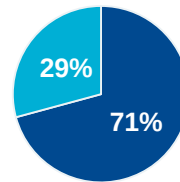
Marine



Energy & Nuclear



Power Systems



- 47% of FY13 total revenue (£7.3bn) from services
- 47% of FY13 services revenue from Long-Term Services Agreements

▪ OE ▪ Services ▪ Development

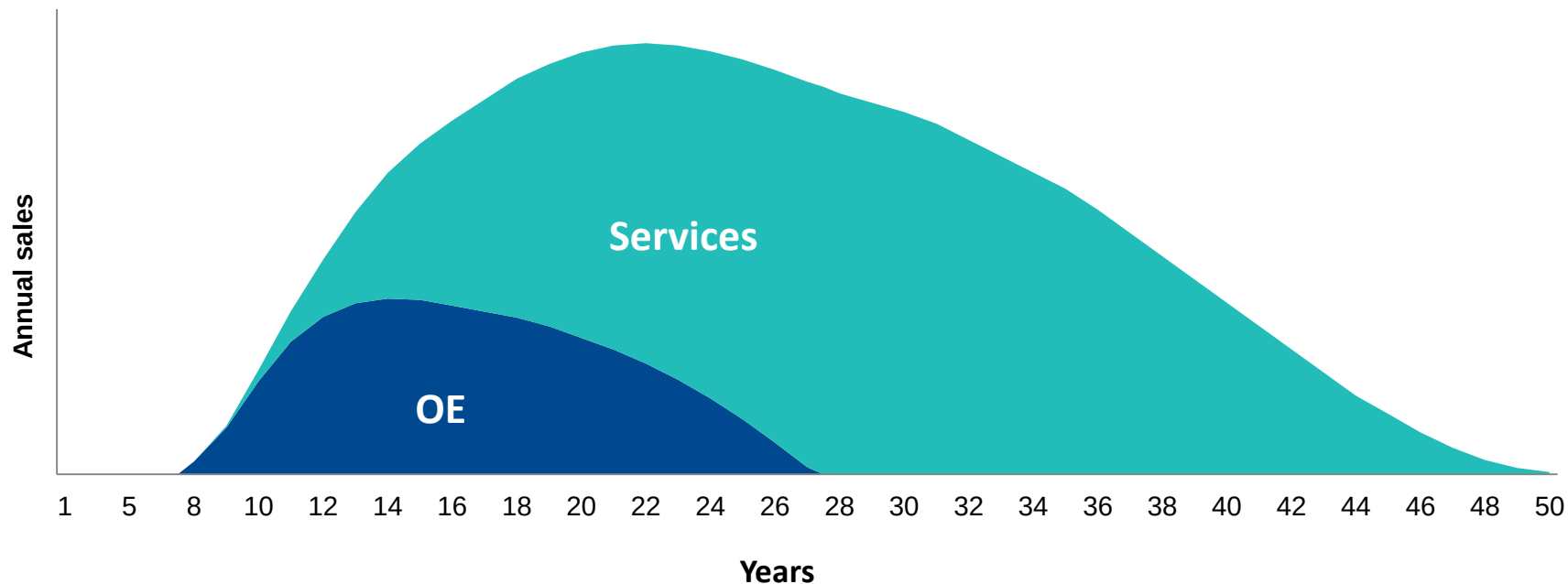
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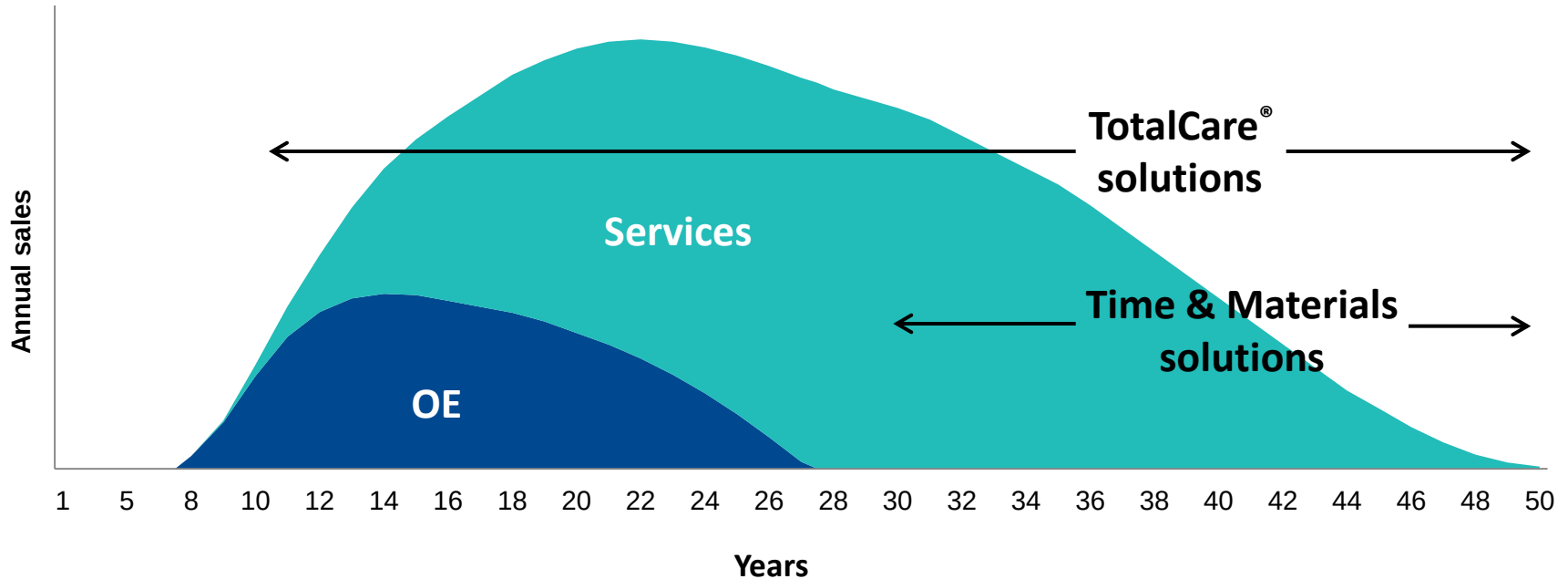
Typical programme life cycle

Services revenue is at least 4 times net OE selling price



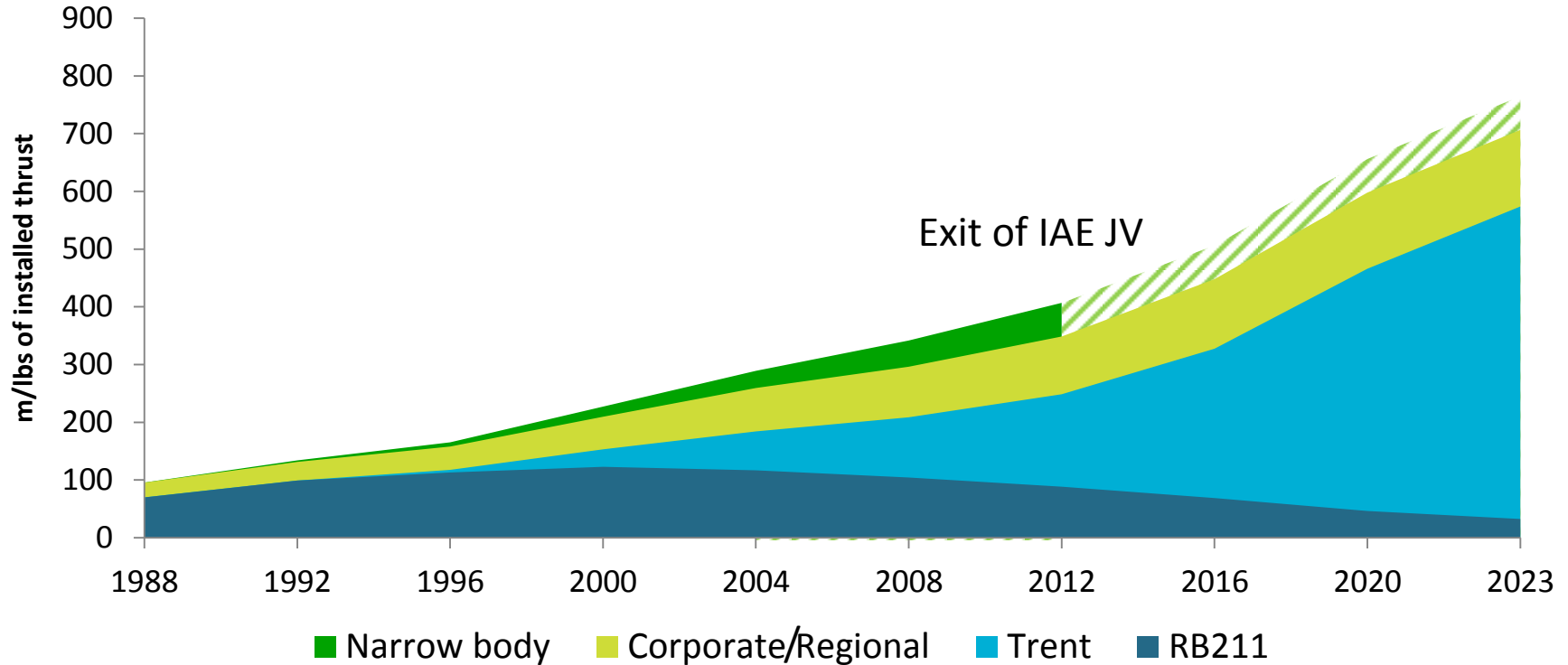
Typical programme life cycle

Value from both TotalCare® and Time & Materials



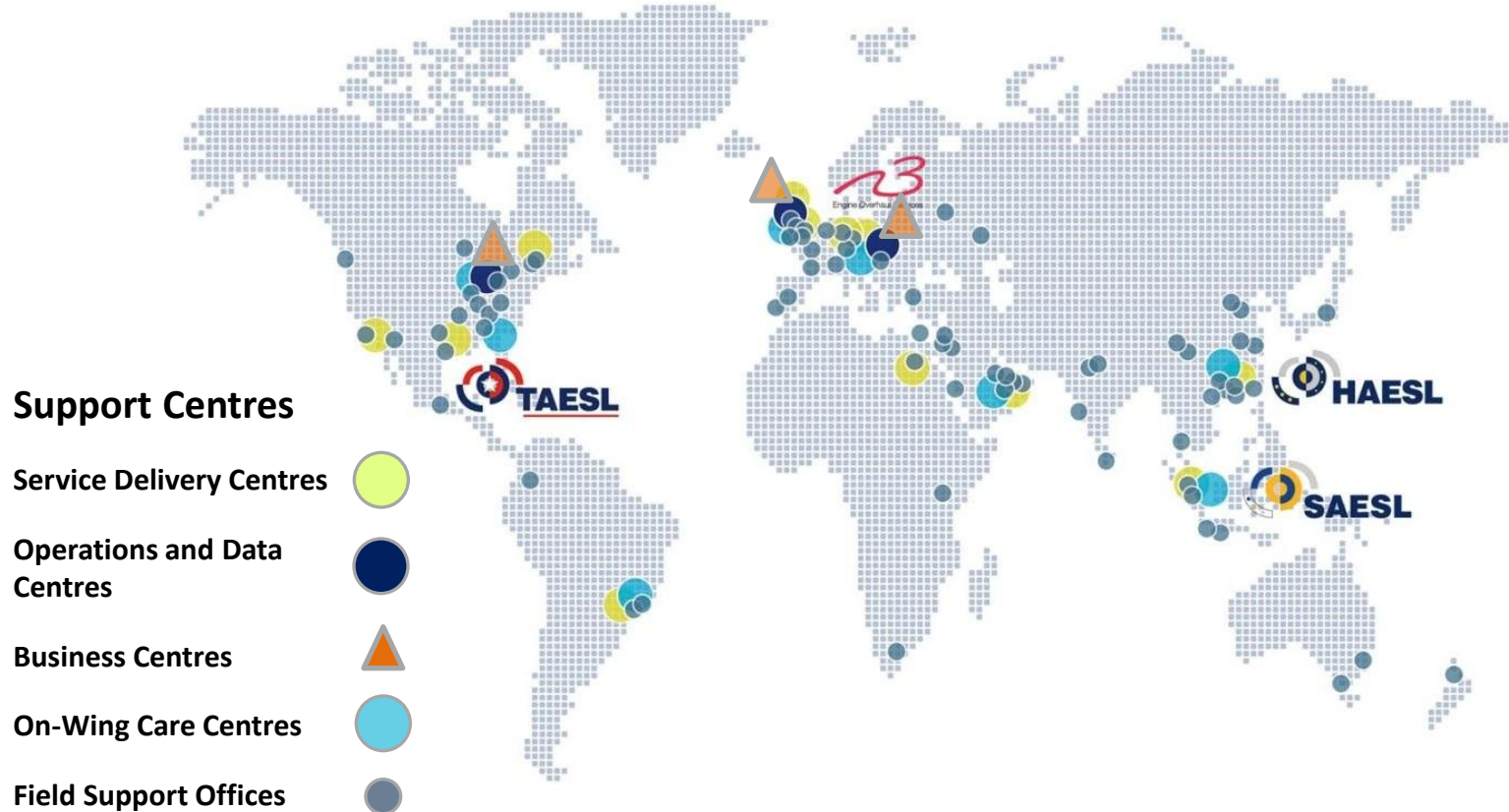
Embedded services value driven by thrust

Installed thrust doubles by 2023*



*Excludes Narrow body

Global Service Capability



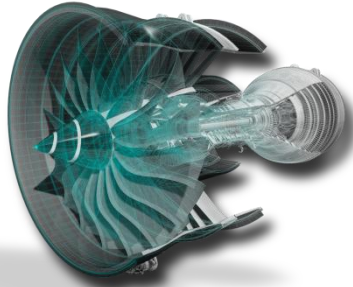
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Deep knowledge of our engines as OEM

As Designed



Validation



As Validated



Service
experience



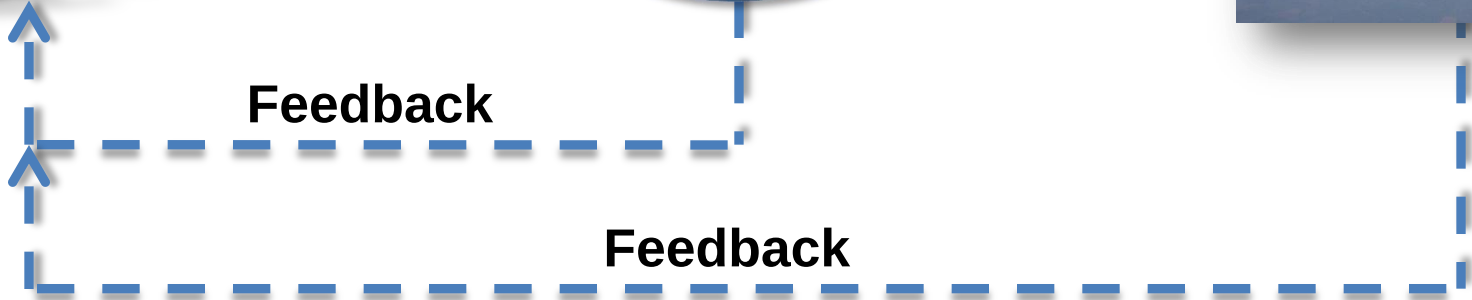
In Service



Feedback



Feedback



Airline perspective

Selecting the appropriate support model

- Line maintenance
- Initial provisioning
- Spare engines
- Lease engines
- Rotable assets
- Powerplant engineering
- Engine overhaul
- Maintenance logistics
- Fuel burn optimisation



Balancing risk, capability & cost

Trusted to deliver excellence



Rolls-Royce

TotalCare® – value from risk management

Predictable engine service costs through risk transfer to Rolls-Royce

	TotalCare®	Time & Materials
Engine overhaul	✓	X
Engine reliability improvements	✓	X
Engine Health Monitoring	✓	Basic
Fleet management	✓	X
Warranty	✓	Basic
Guarantees	✓	✓

Revenue drivers

TotalCare[®] revenue generation = hours flown x rate per hour

Hours flown

- Global RPK growth
- ~4000 hrs per engine p.a.
- Minimum utilisation



Rate per hour

- Customer mission and service level
- Operational price matrix (de-rate and stage length)

Cost drivers

TotalCare[®] lifecycle costs = number of shop visits x cost per shop visit

Number of shop visits

- Time on wing
- Hours flown
- Mission type

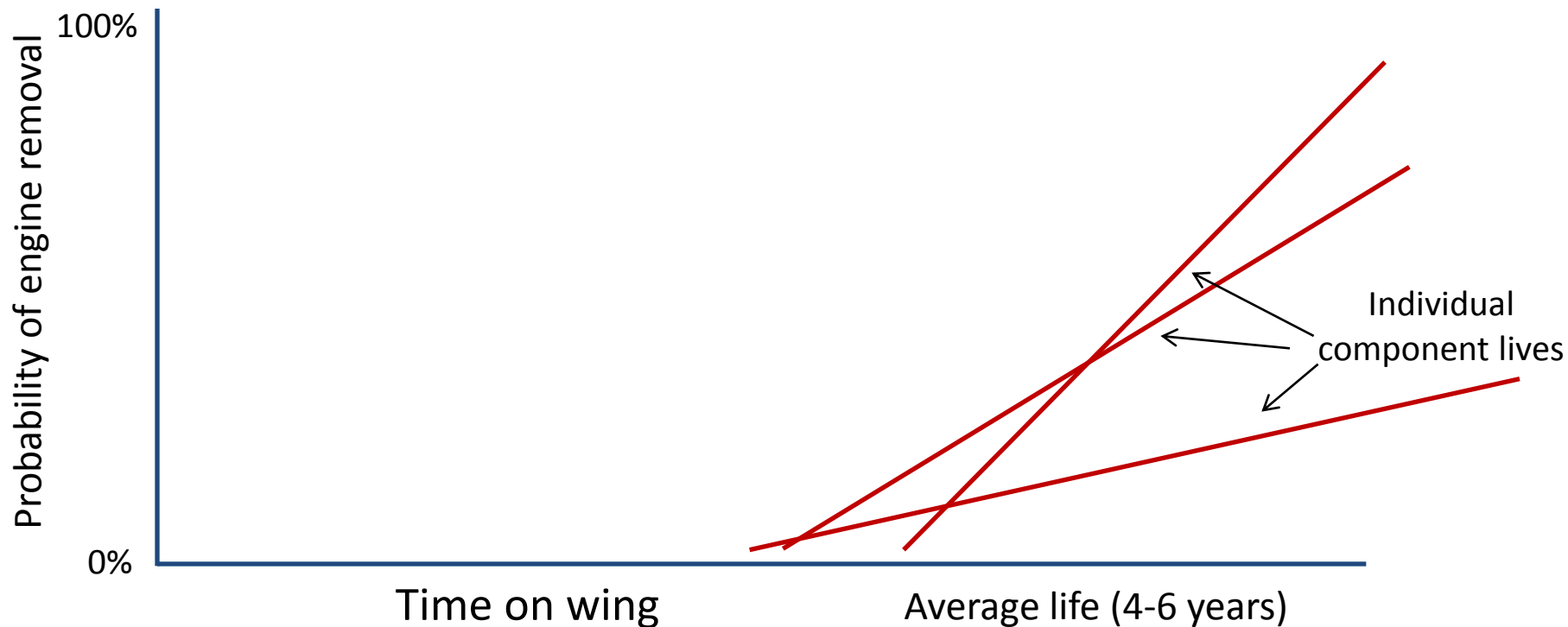


Cost per shop visit

- Workscope
- Parts re-used, repaired, replaced
- Overhaul labour

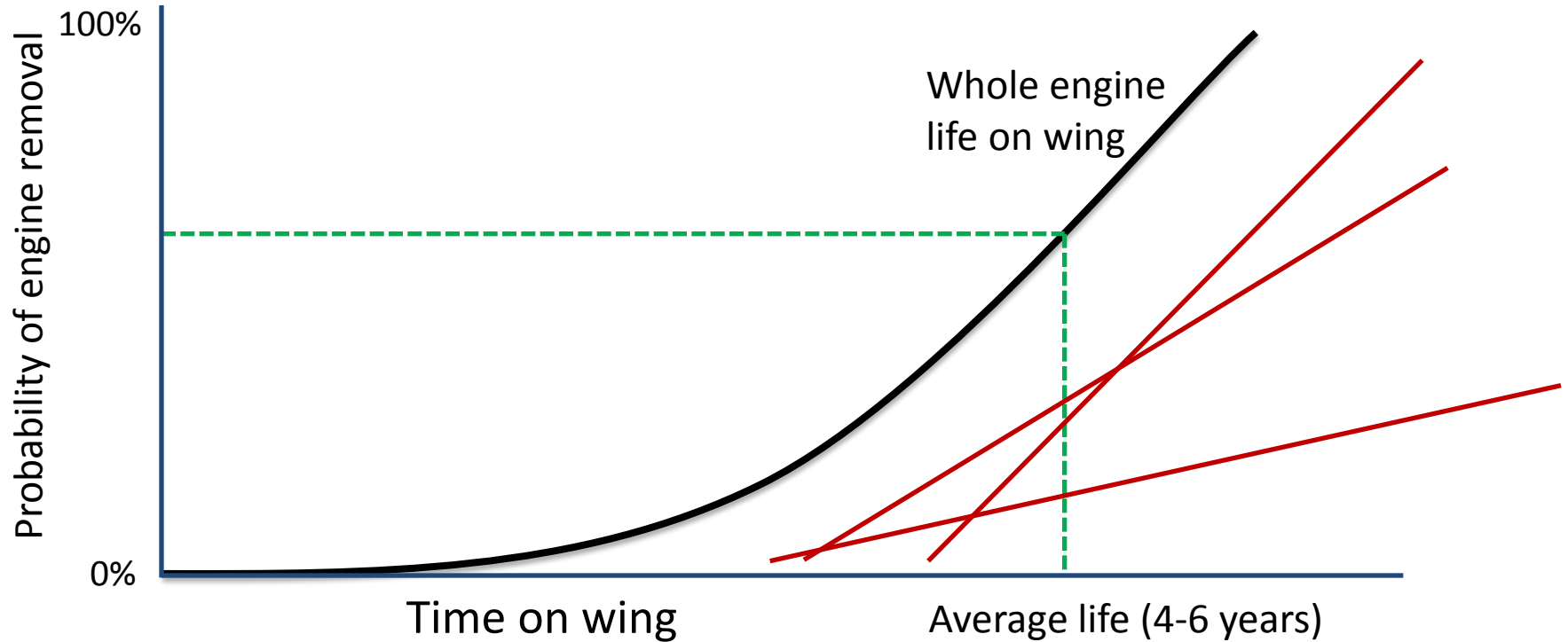
Time on wing – engine life

Deep design knowledge enables optimisation of engine life



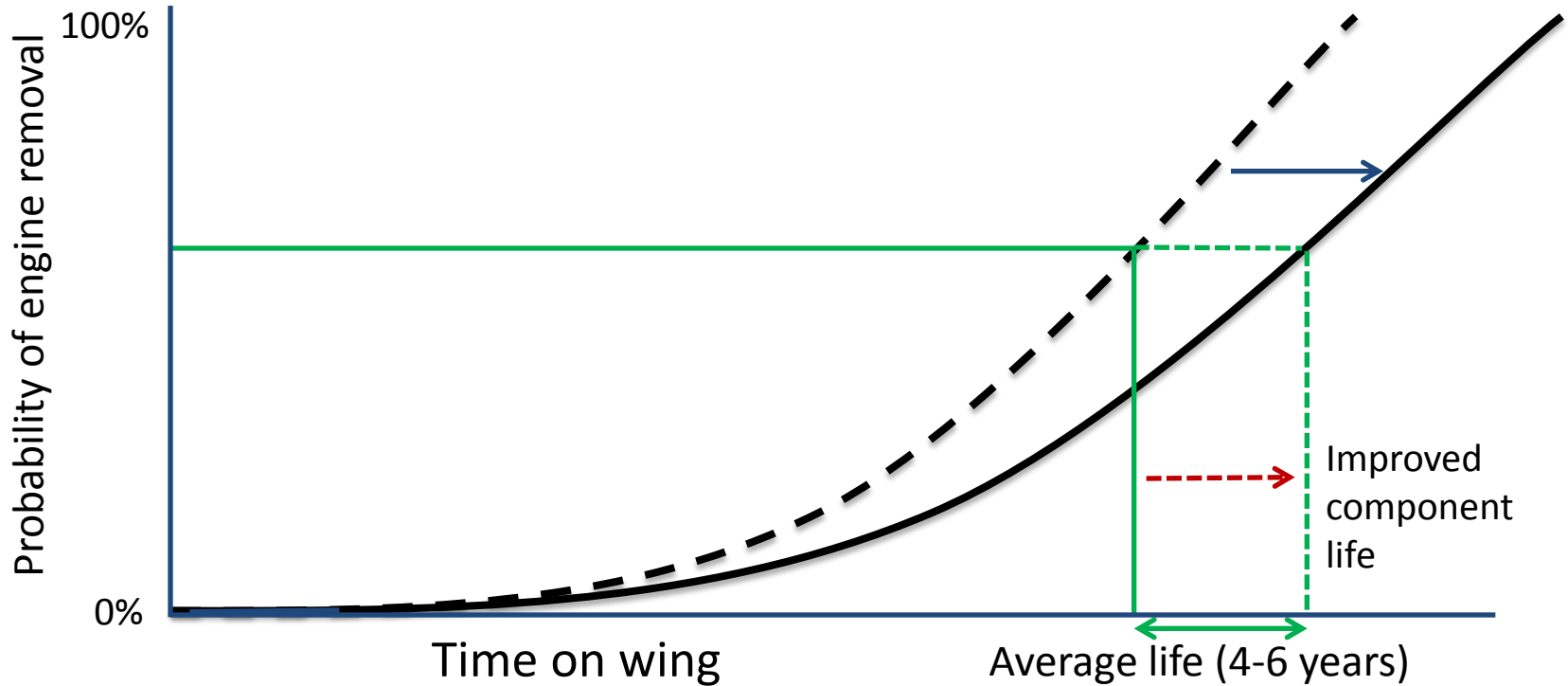
Time on wing – engine life

Deep design knowledge enables optimisation of engine life



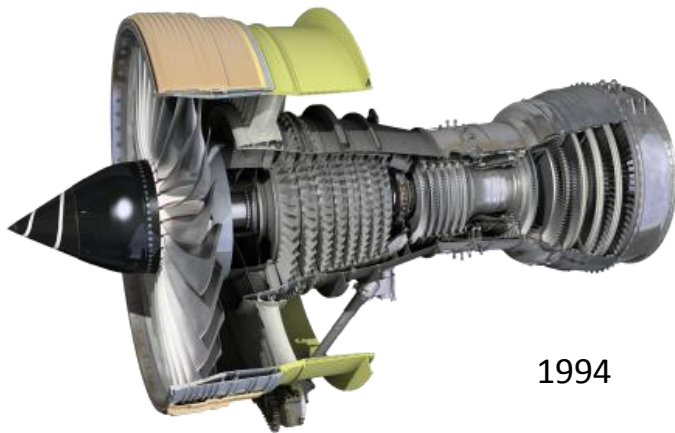
Time on wing – engine life

Deep design knowledge enables optimisation of engine life



Time on wing – engine life

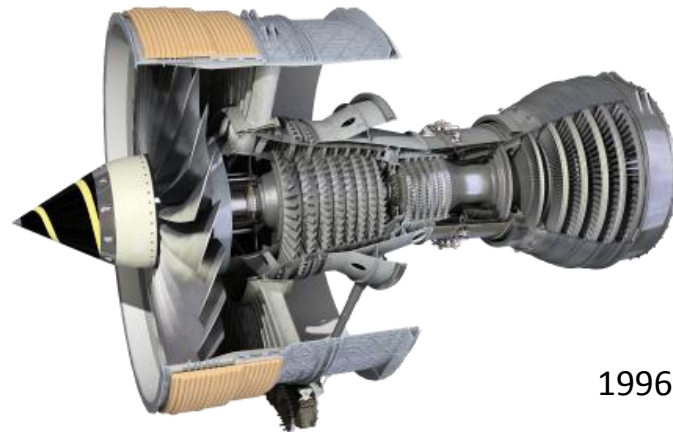
Delivered improvements since EIS



1994

Trent 700

x2



1996

Trent 800

x2

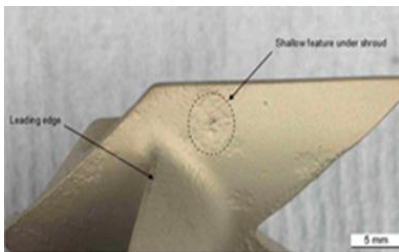
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Cost focus

Driving value through cost reduction

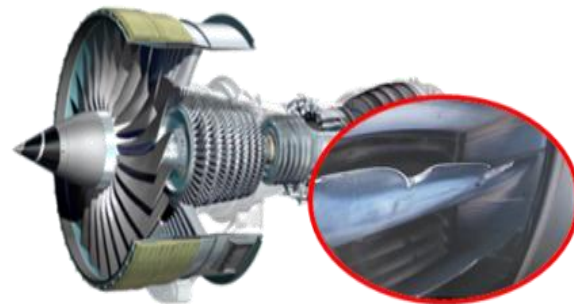


Improved inspection criteria

- Life extension

Engine Health Monitoring

- Deeper understanding of performance



Repair technology

- Better component re-use

Trusted to deliver excellence



Rolls-Royce

Summary

- Growing installed base, long services lives, growing markets
- Services at least 4 times net OE revenue through life
- Installed thrust doubles over the next decade
- Best placed as OEM to take on risk and extract value via TotalCare®
- Deep design knowledge enables optimisation of engine life and minimum customer disruption
- Nearly 2 decades of success with TotalCare®

TotalCare[®] Accounting

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Agenda

1. TotalCare®

- Business model
- Programme life cycle
- Embedded value – risk transfer and growth
- Managing TotalCare® – revenue and cost drivers

2. Accounting for TotalCare®

- Commercial arrangements and accounting principles
- Accounting mechanics
- Portfolio dynamics

Our commercial arrangements

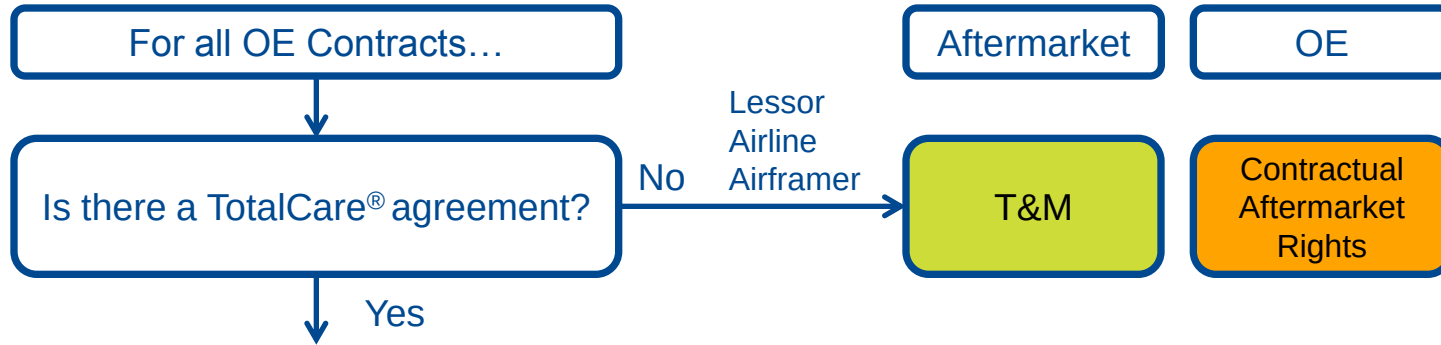
OE commercial terms are agreed with one of 3 parties:

1. Airline
2. Lessor
3. Airframer

Aftermarket commercial terms are agreed with the Airline, either as:

- Time & Materials (“T&M”); or
- TotalCare[®]

Linking commercial arrangements to accounting



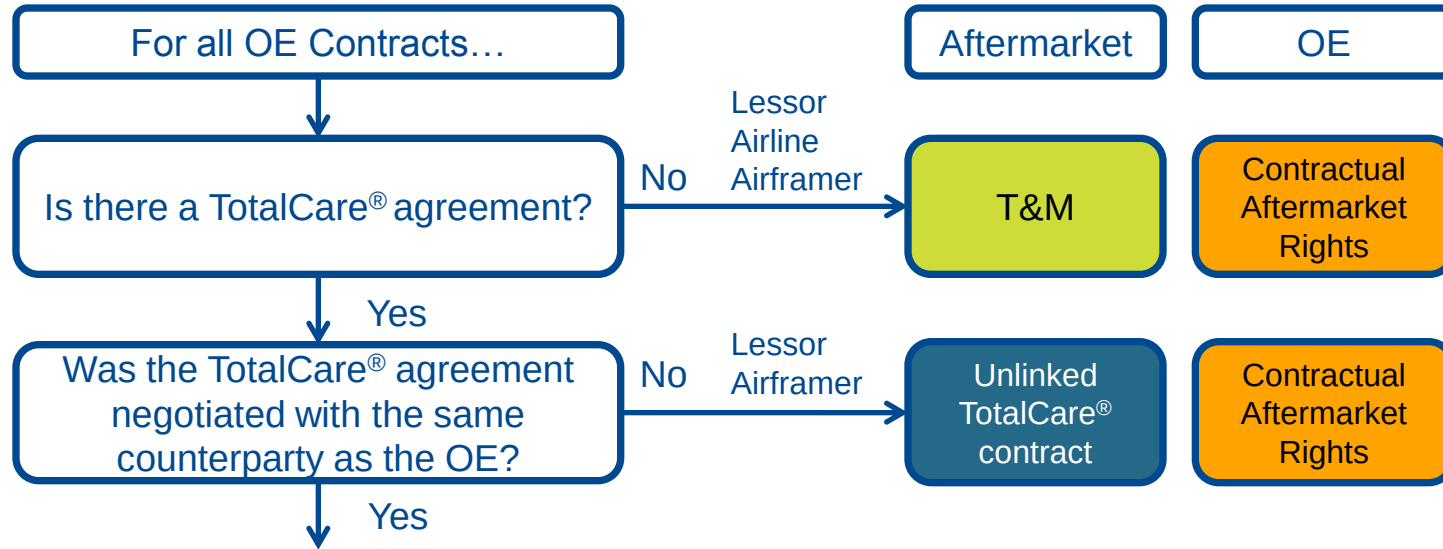
*formerly known as Recoverable Engine Costs (REC)

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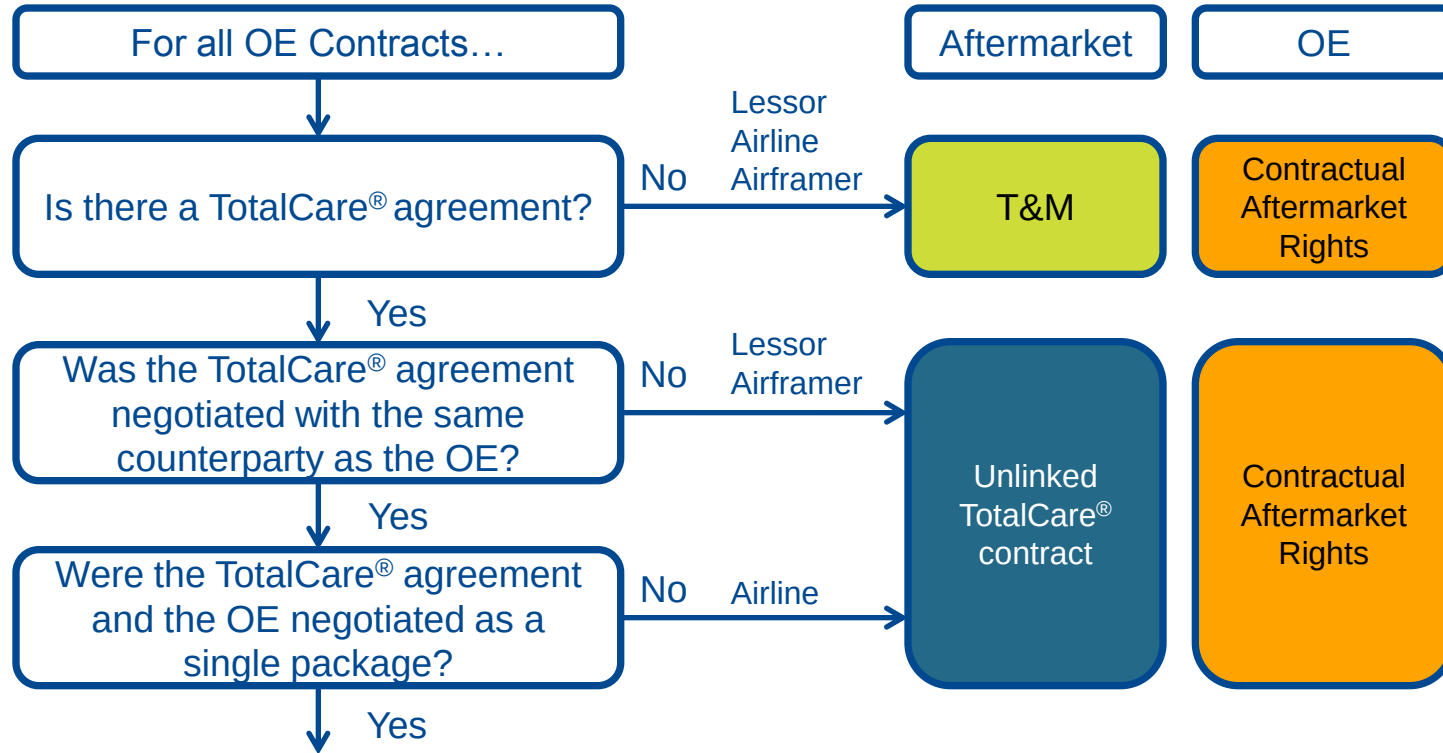


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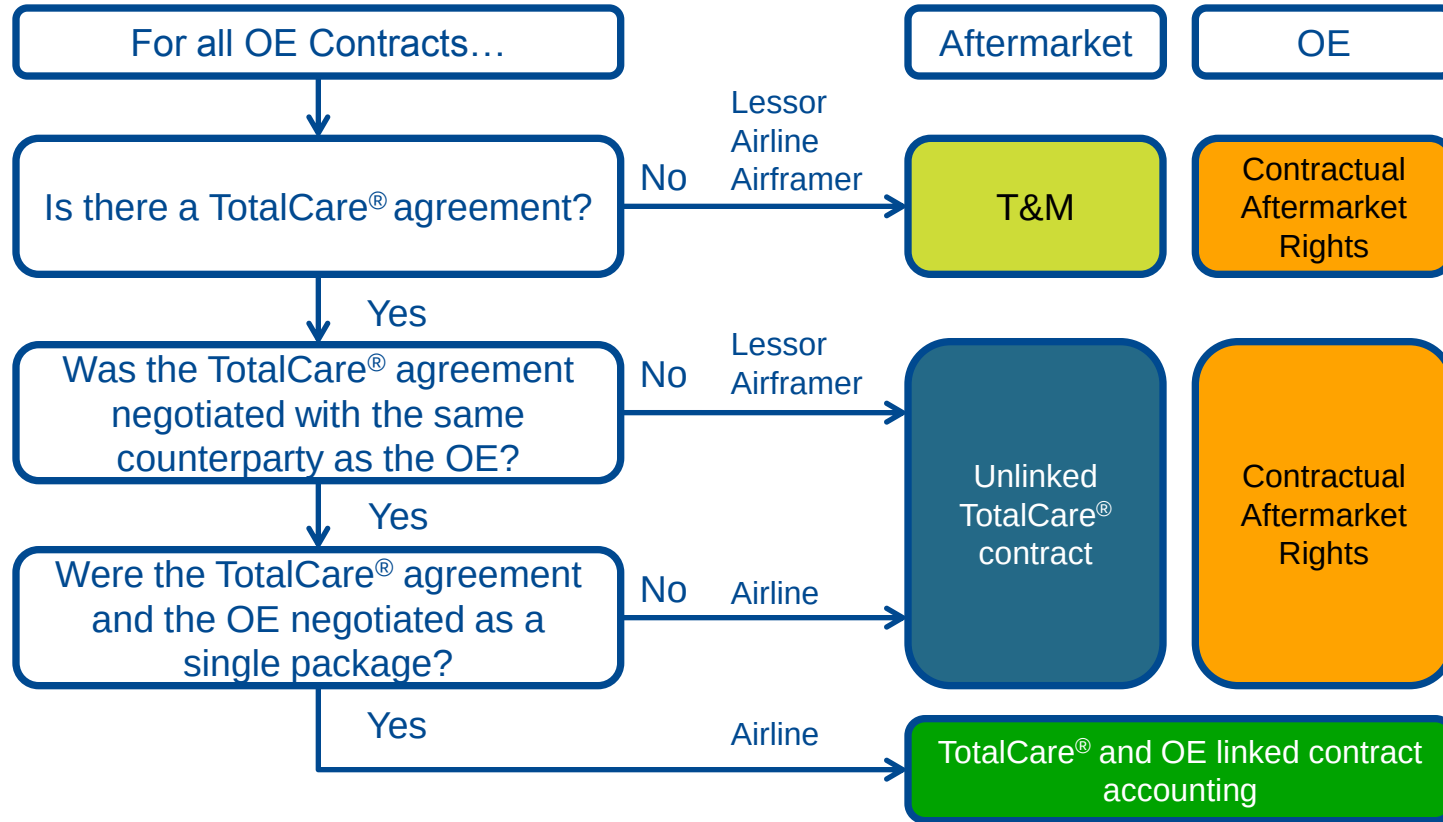
Linking commercial arrangements to accounting



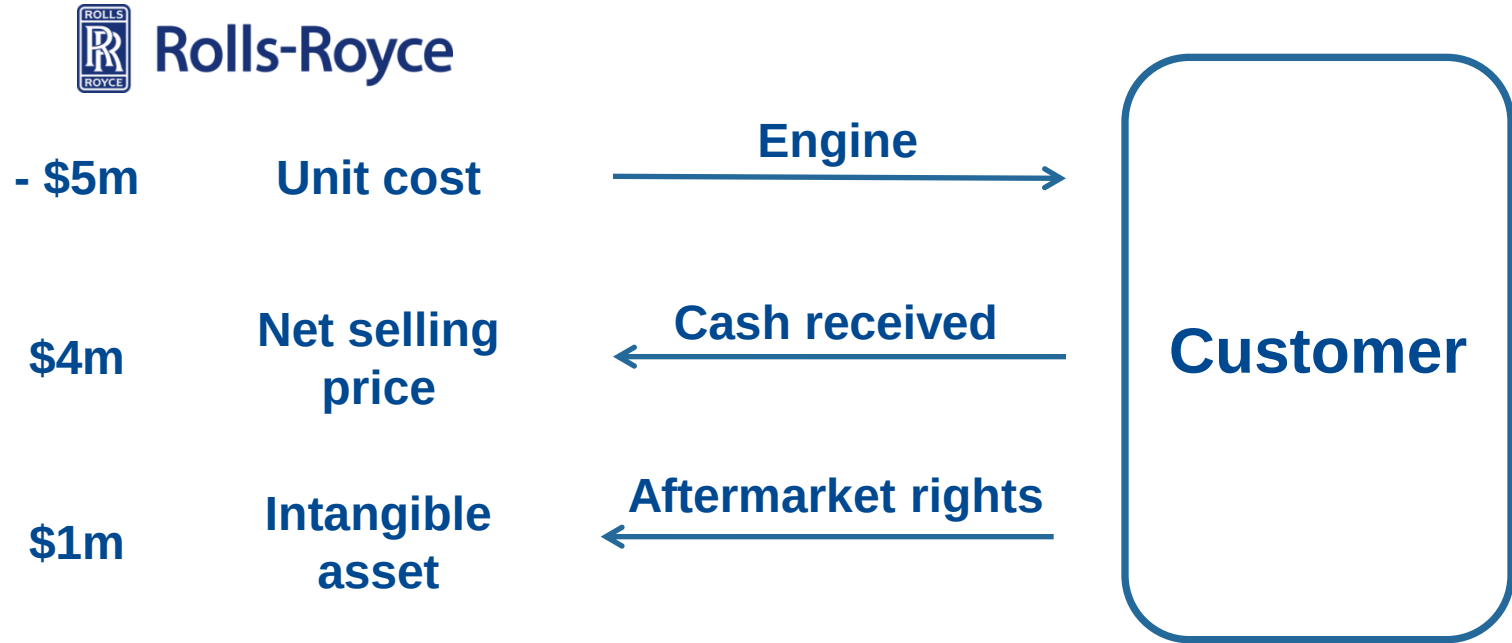
Linking commercial arrangements to accounting



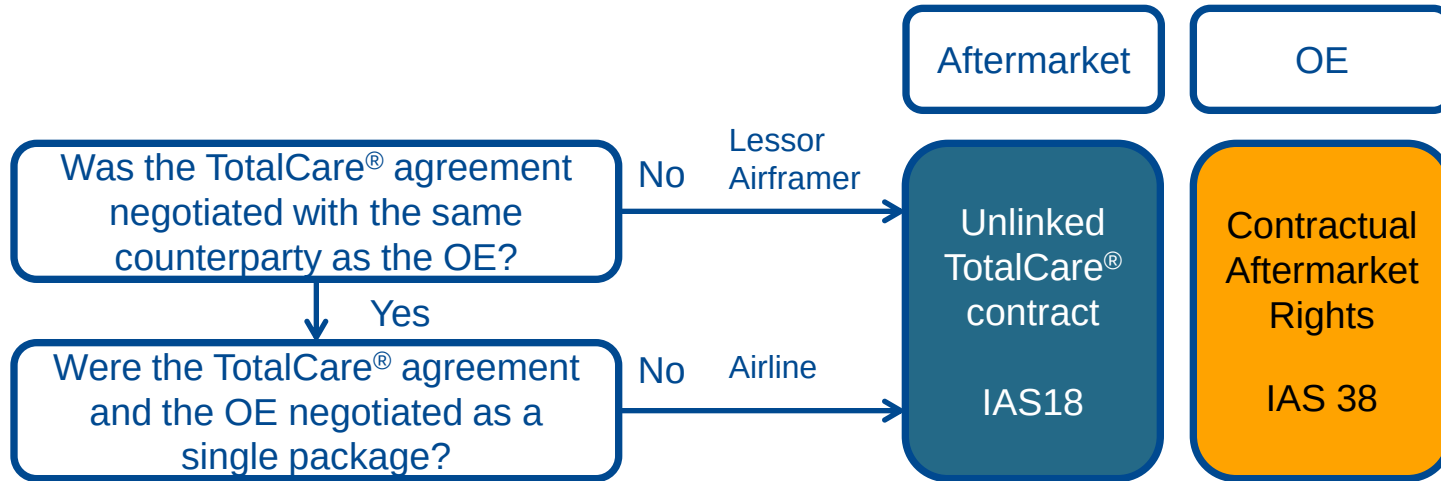
Linking commercial arrangements to accounting



Contractual Aftermarket Rights



Unlinked TotalCare®



Cannot link as not negotiated as a single package as required by IAS11

Unlinked TotalCare®

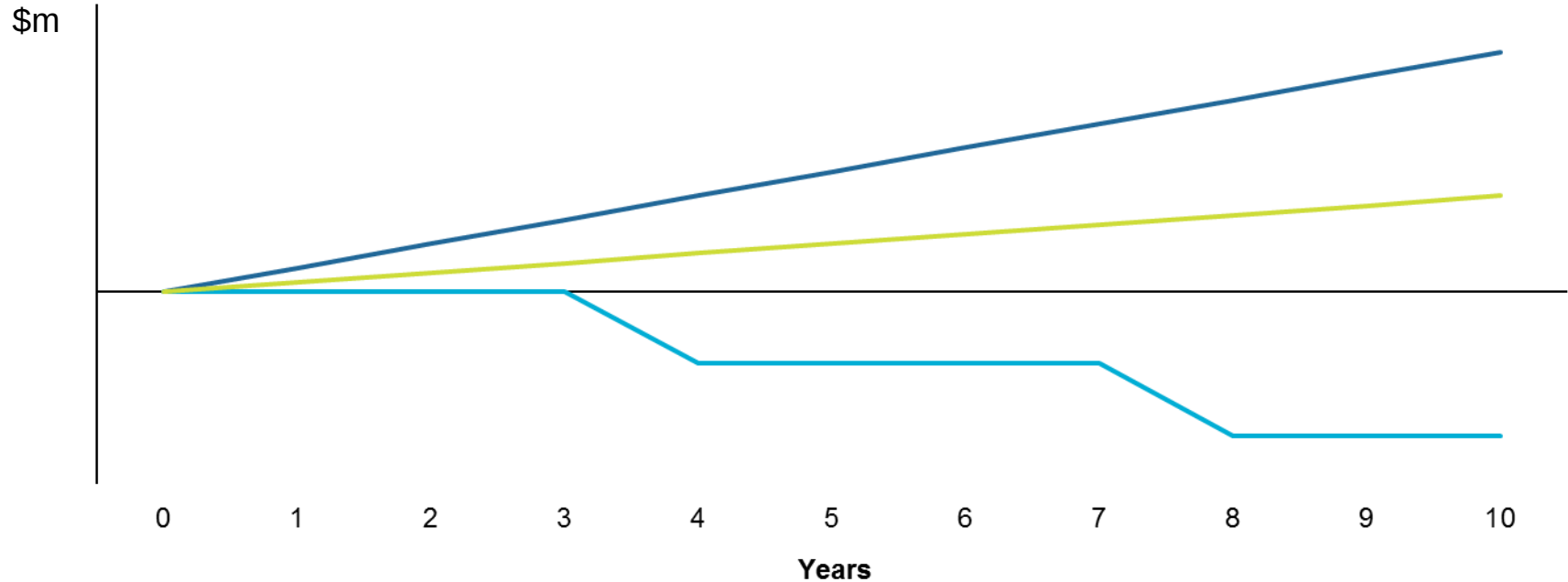
Single engine example

Example	Length	Flying hours	Revenue	Cost	Margin
Contract expectations	10 years	40,000	\$10m	(\$6m)	\$4m
Rate per flying hour \$/hr			\$250	(\$150)	\$100
At end Year 1	1 year	4,000			
Revenue			\$1m		
Cost accrued				(\$0.6m)	
Margin					\$0.4m

Unlinked TotalCare®

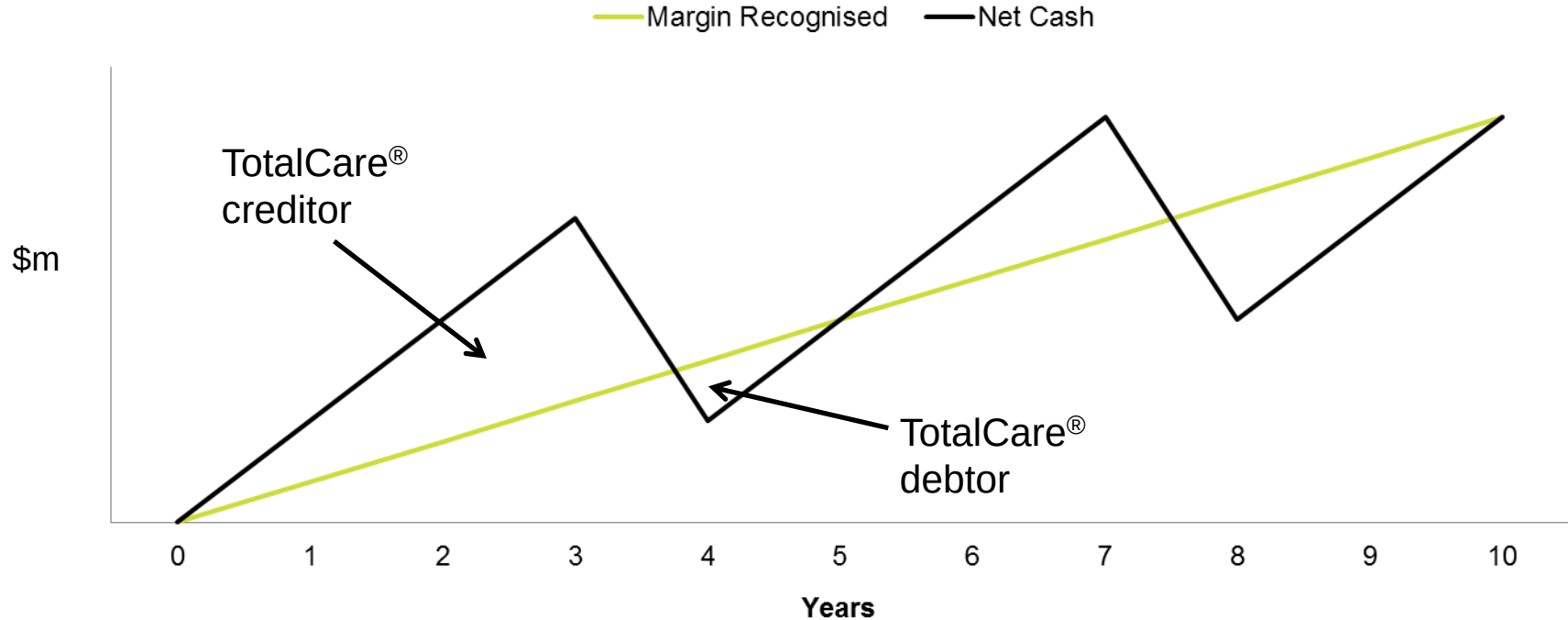
Cash vs. margin recognised

— Cash Revenue — Cash Costs — Margin Recognised

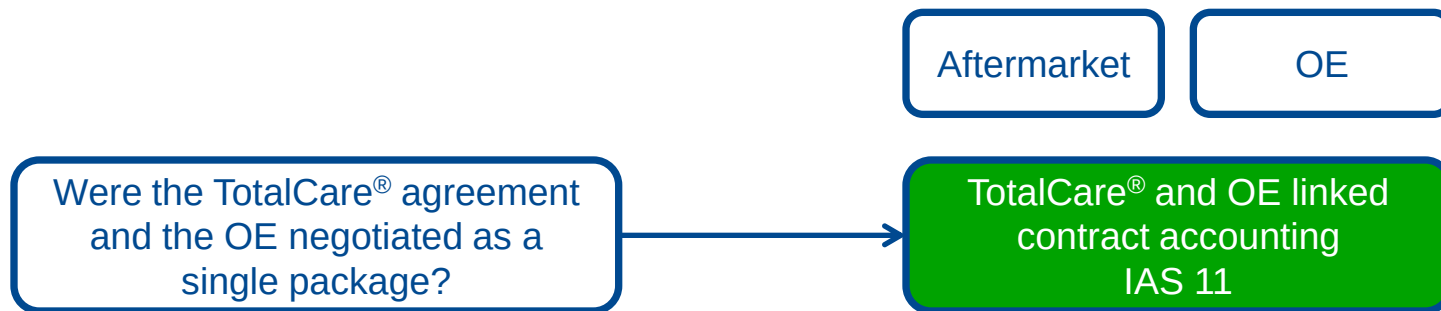


Unlinked TotalCare®

Net cash vs. margin recognised



Linked TotalCare®



Satisfies IAS11 criteria for accounting as a single contract

- Negotiated as a single package
- Closely interrelated – part of a single project with overall profit margin
- Contracts performed concurrently

Linked TotalCare®

Single engine example

Example \$m	OE	TotalCare® (say 10 years)	Linked
Revenue	10	8	18
Less concessions	(6)	-	(6)
Net revenue	4	8	12
Cost	(5)	(4)	(9)
Cash	(1)	4	3
<i>Overall margin %</i>			<i>25%</i>

Linked TotalCare®

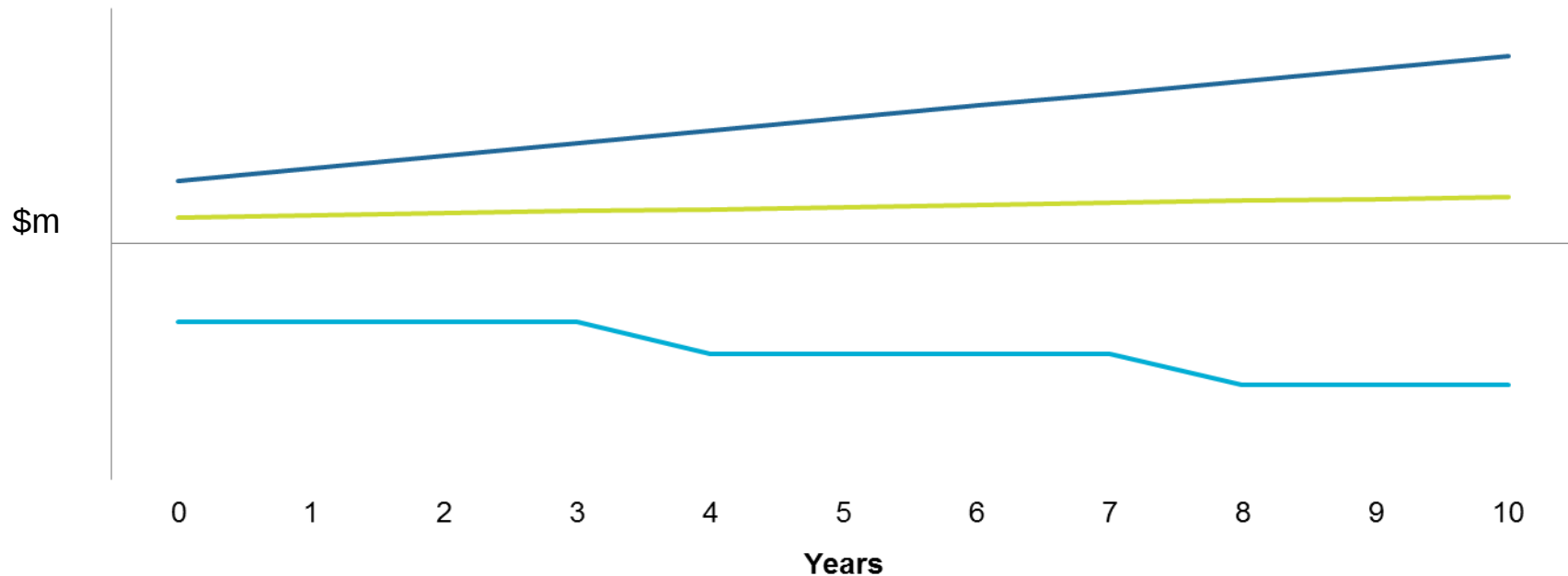
Single engine example

Example \$m	OE	TotalCare® (say 10 years)	Linked
Cash net revenue	4.0	8.0	12.0
Margin adjustment	2.7	(2.7)	-
Net revenue	6.7	5.3	12.0
Cost	(5.0)	(4.0)	(9.0)
Profit recognised	1.7	1.3	3
Overall margin %	25%	25%	25%
Cash flow	(1.0)	4.0	3.0
Profit vs. cash	2.7	(2.7)	-

Linked TotalCare[®]

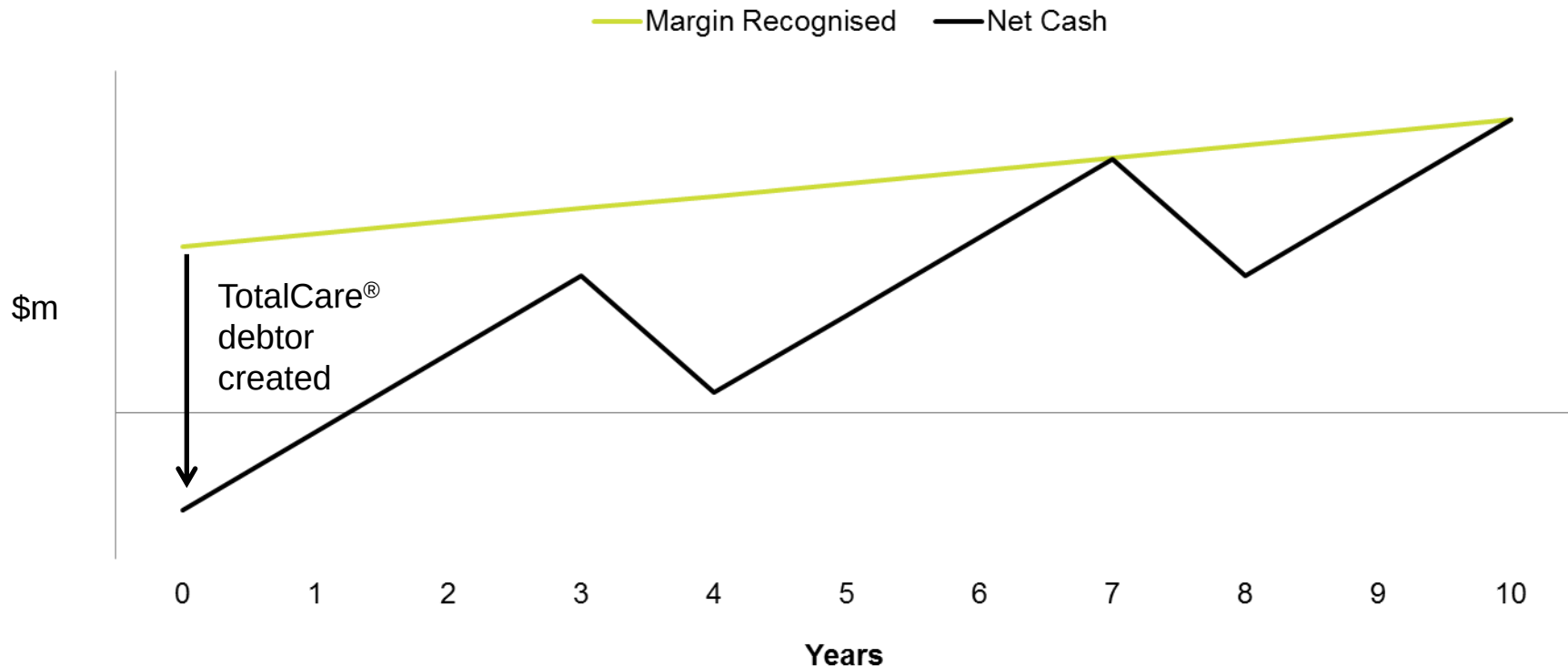
Cash vs. margin recognised

— Cash Revenue — Cash Costs — Margin Recognised



Linked TotalCare®

Net cash vs. margin recognised



What can change the forecast margin?

Revenue forecast

- Stage length
- Utilisation

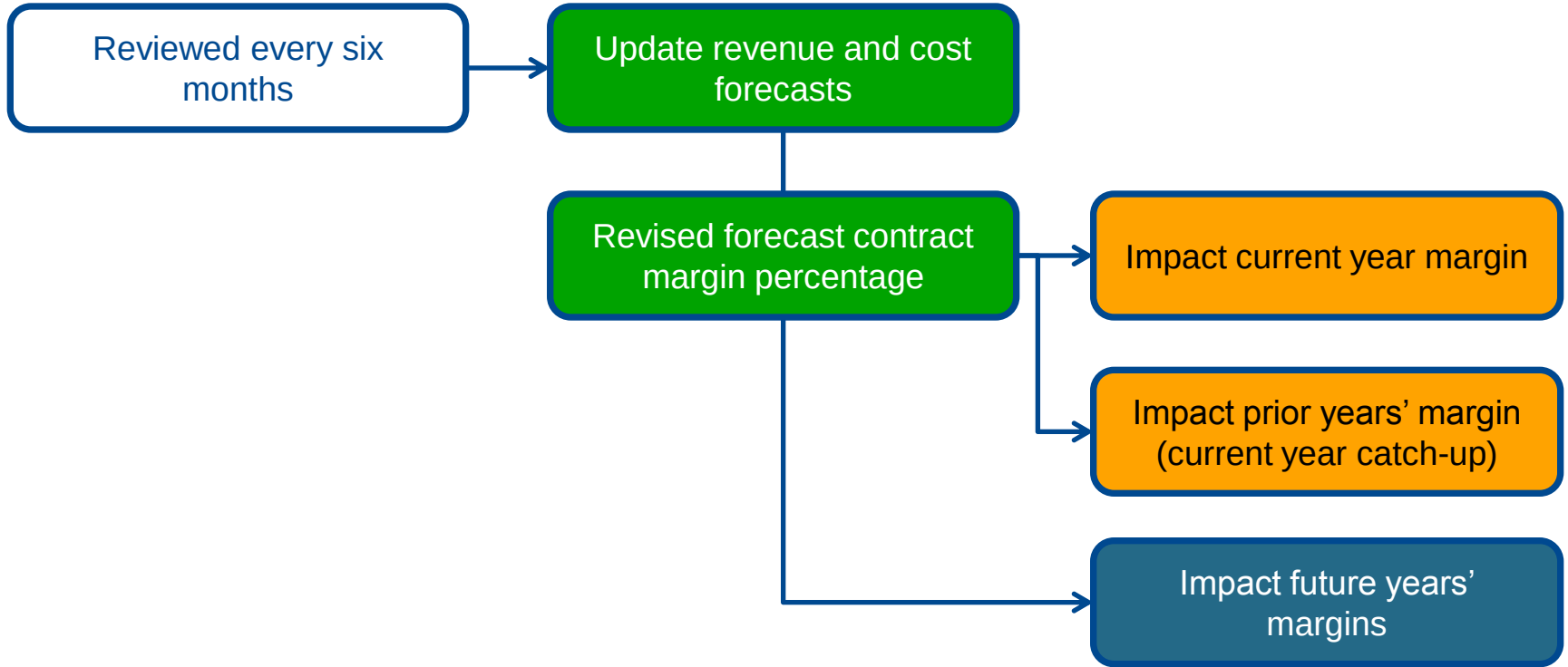
Cost and reliability forecast

- Time between shop visits – time on wing
- Cost at each shop visit
- “Estimation Risk” – best estimate of cost

Asset recoverability

- Counterparty risk – credit rating
- Fleet fit
- “Valuation Allowance”

Process overview

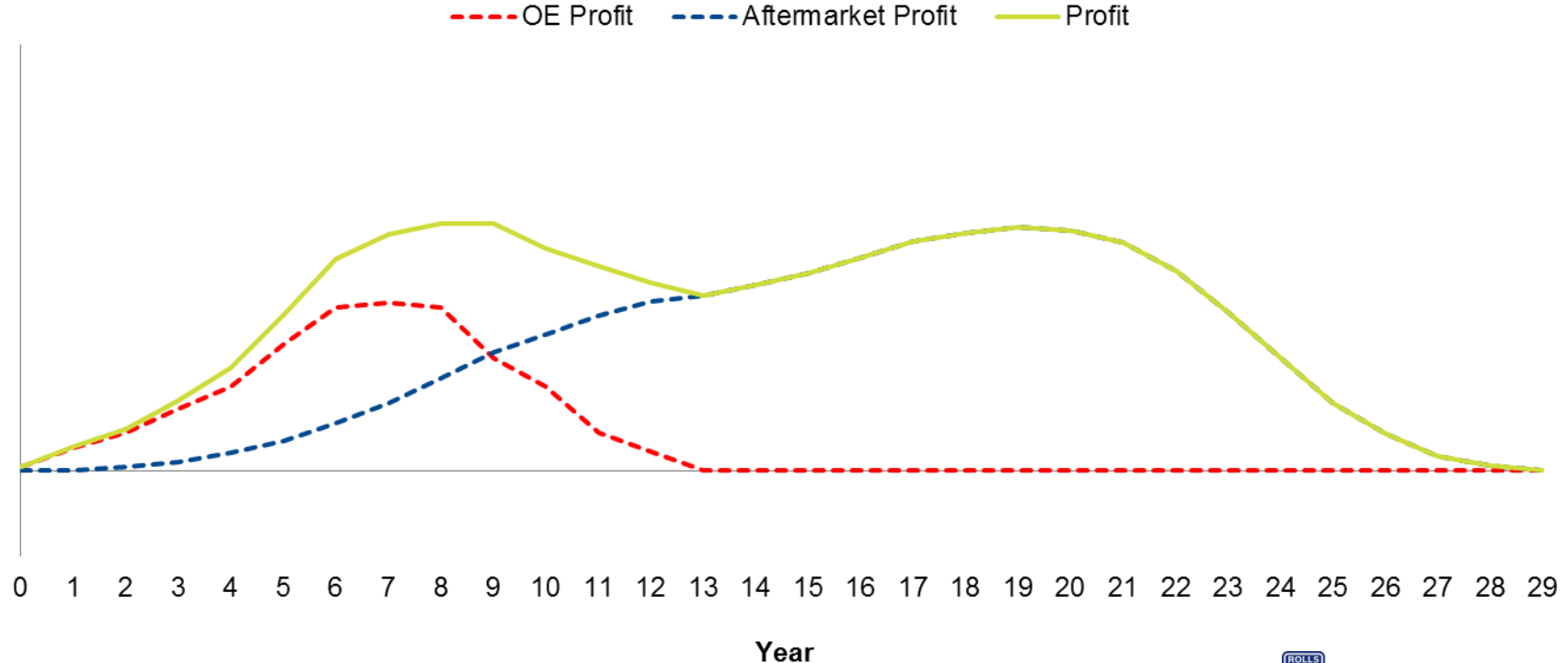


TotalCare[®] accounting summary

- **Unlinked TotalCare[®]:**
 - Recognise revenue and accrue costs in line with flying hours
- **Linked TotalCare[®]:**
 - Recognise revenue in line with engine delivery and flying hours
 - Accrue Aftermarket costs in line with flying hours
 - Equalised margin percentage across OE and Aftermarket
- Estimation risk and valuation allowances factored into margin
- Relevant standards: IAS 18; IAS 38; IAS 11
- RECs renamed “Contractual aftermarket rights”
- Accounting treatments agreed with the FRC

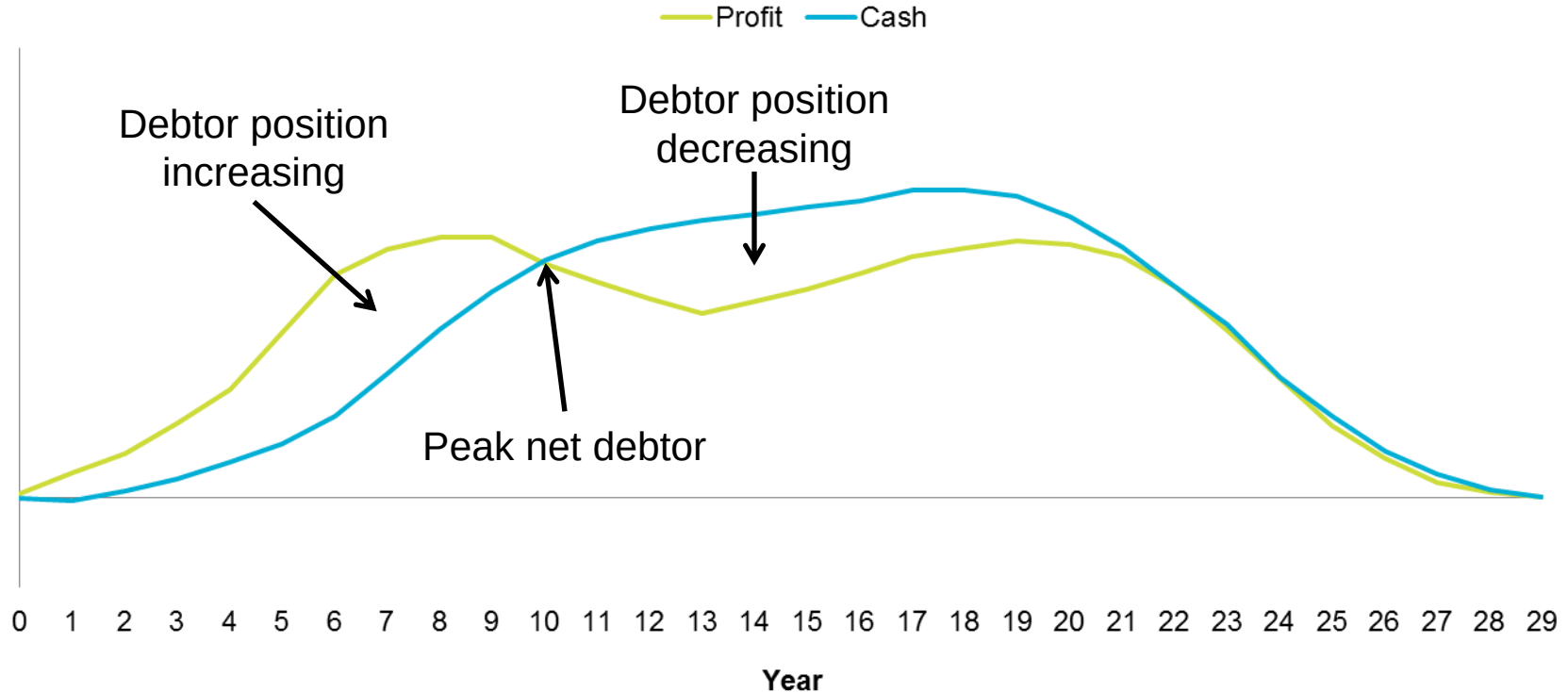
Linked TotalCare[®] programme

OE and aftermarket profit



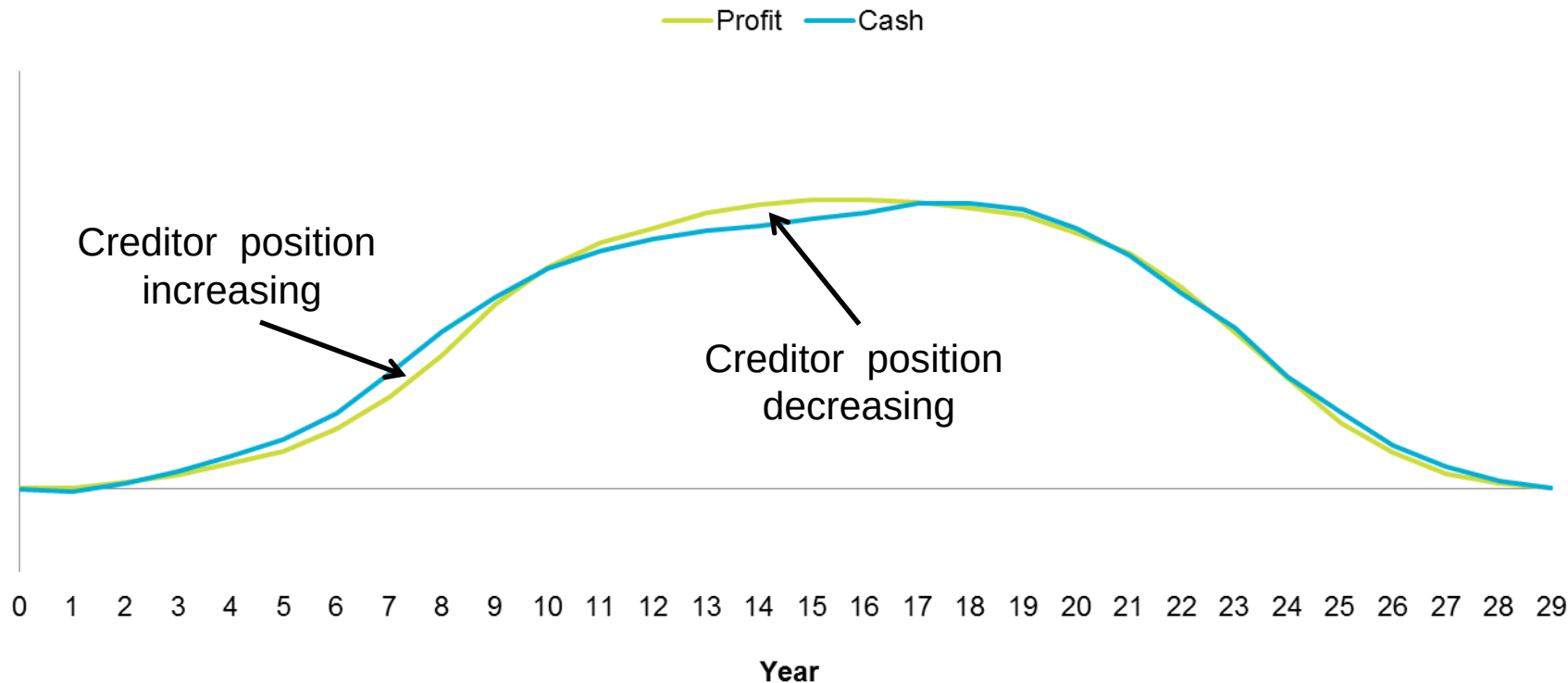
Linked TotalCare[®] programme

Net cash vs. margin recognised



Unlinked TotalCare[®] programme

Net cash vs. margin recognised



Drivers of the TotalCare[®] net debtor

Debtor rises due to :

- **Linked OE deliveries**
- **As shop visits take place**
- **When contract outlook improves i.e. lower forecast costs improved overall profitability**

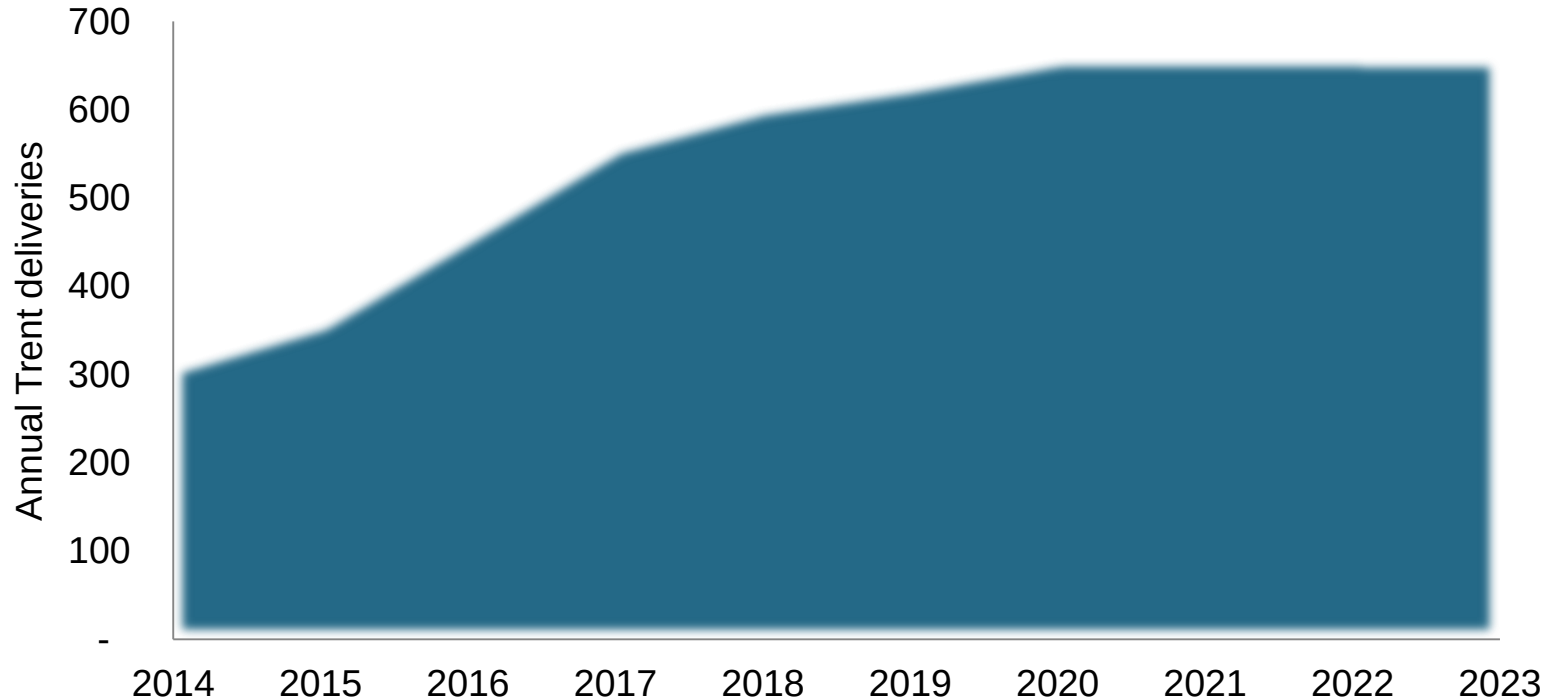
Debtor falls due to :

- **Flying hour receipts**
- **When contract outlook worsens i.e. higher forecast costs**

Valuation allowance changes can result in a rise or fall in the debtor

Projected Trent deliveries to 2023

Over 4,000 deliveries vs. over 1,600 in last decade

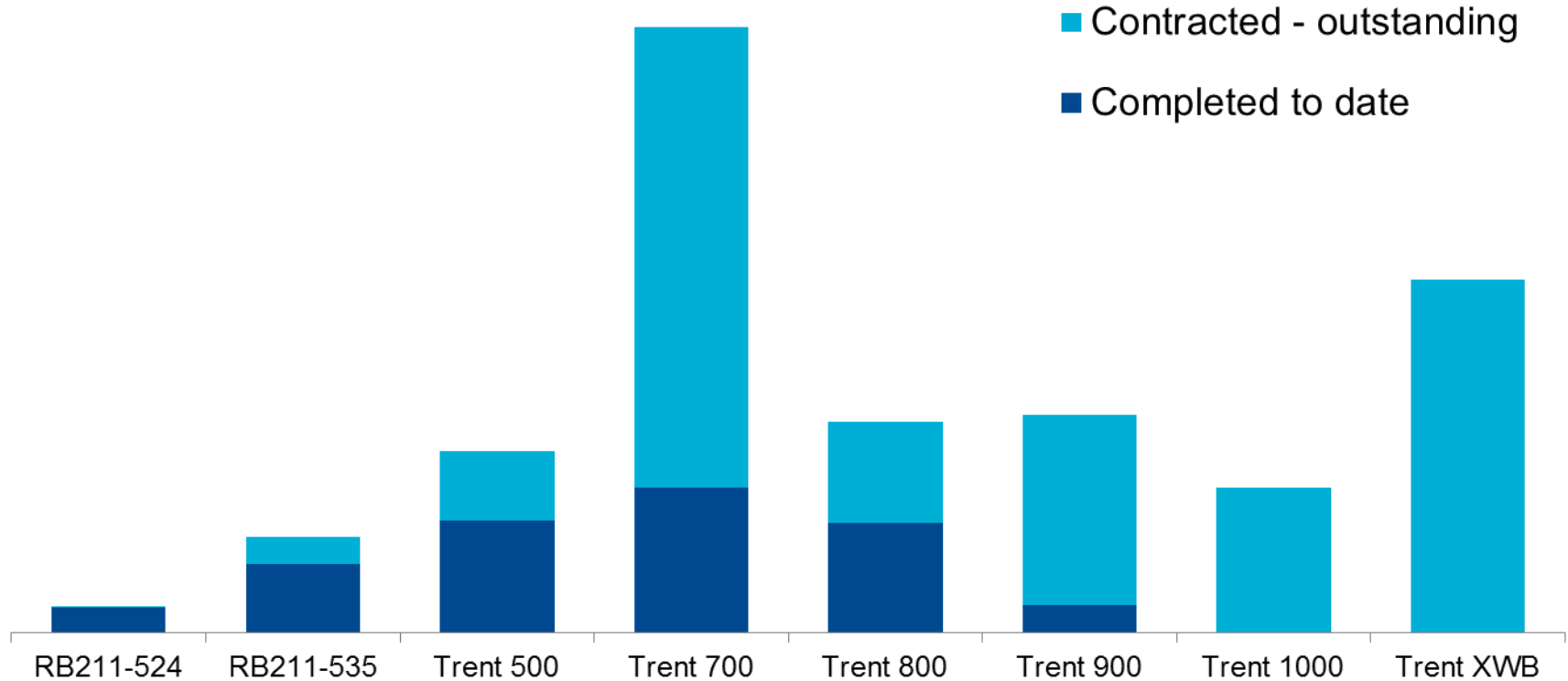


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Status of TotalCare[®] contracts



Accounting for TotalCare®

Earnings are ahead of cash whilst OE is growing

Significant embedded value in the aftermarket

Strong focus on cost reduction and improving reliability to drive margins and realise the embedded value.

Accounting follows the substance of the commercial arrangements – treatment agreed by the FRC

Summary

Strong position in growth markets

Concentrating on what we know

Significant opportunities

Q&A

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Samstag, 12. April 2014

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