

TotalCare[®] Accounting

Mark Morris

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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

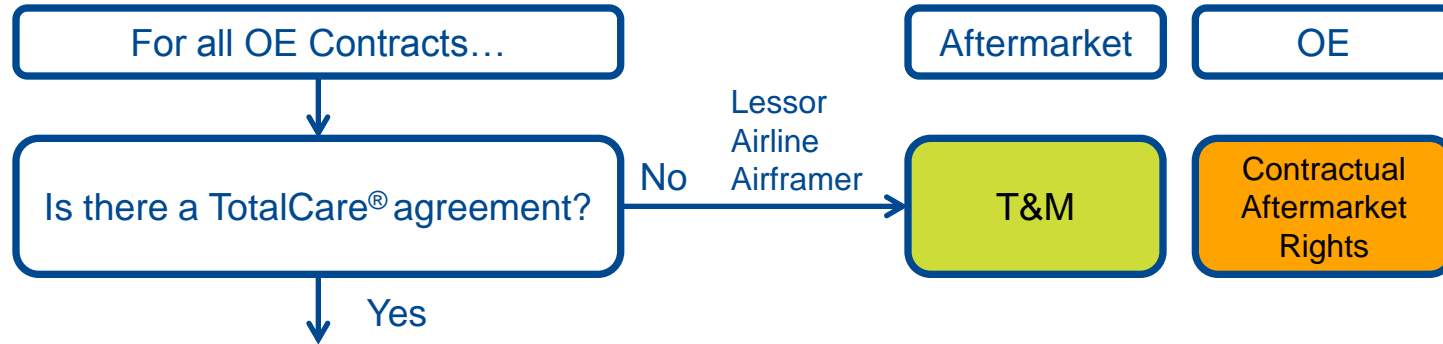
OE commercial terms are agreed with one of 3 parties:

1. Airline
2. Lessor
3. Airframer

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

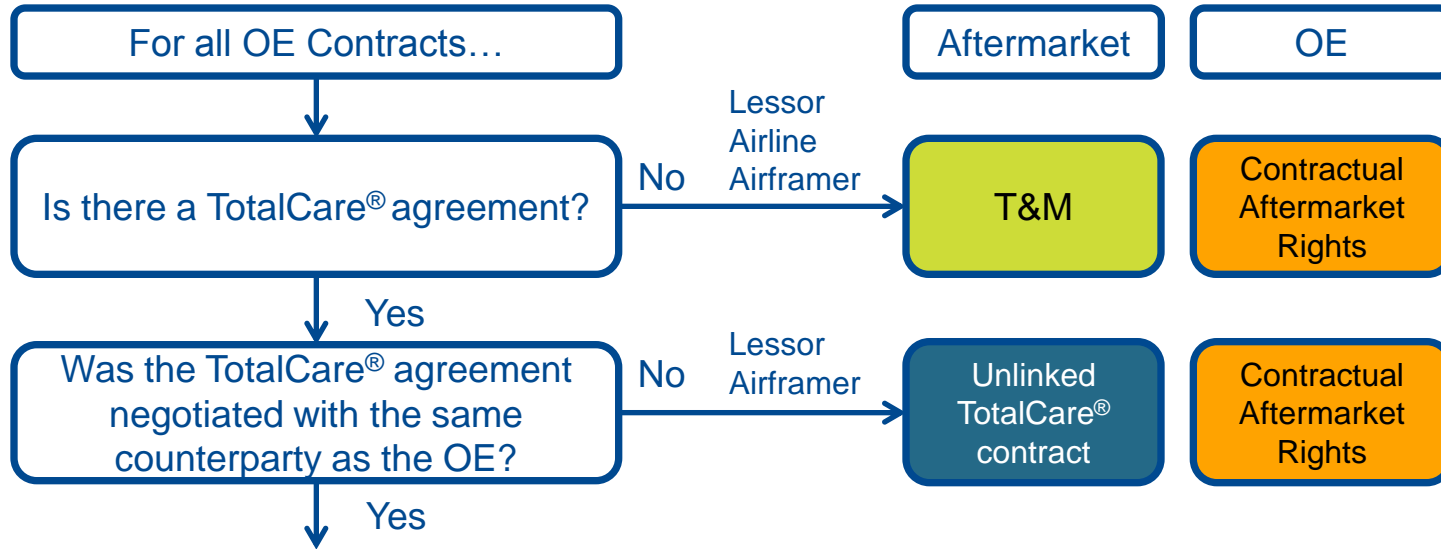
- Time & Materials (“T&M”); or
- TotalCare[®]

Linking commercial arrangements to accounting

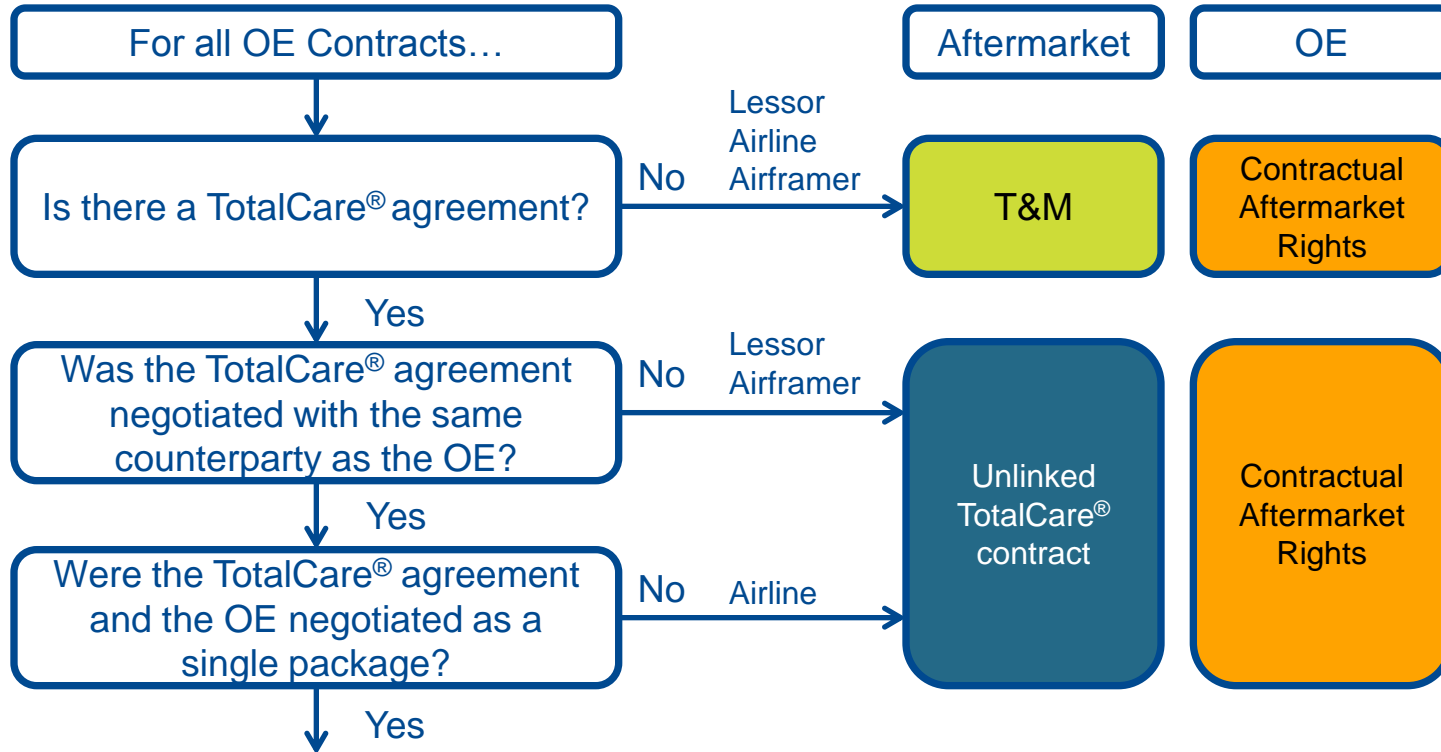


*formerly known as Recoverable Engine Costs (REC)

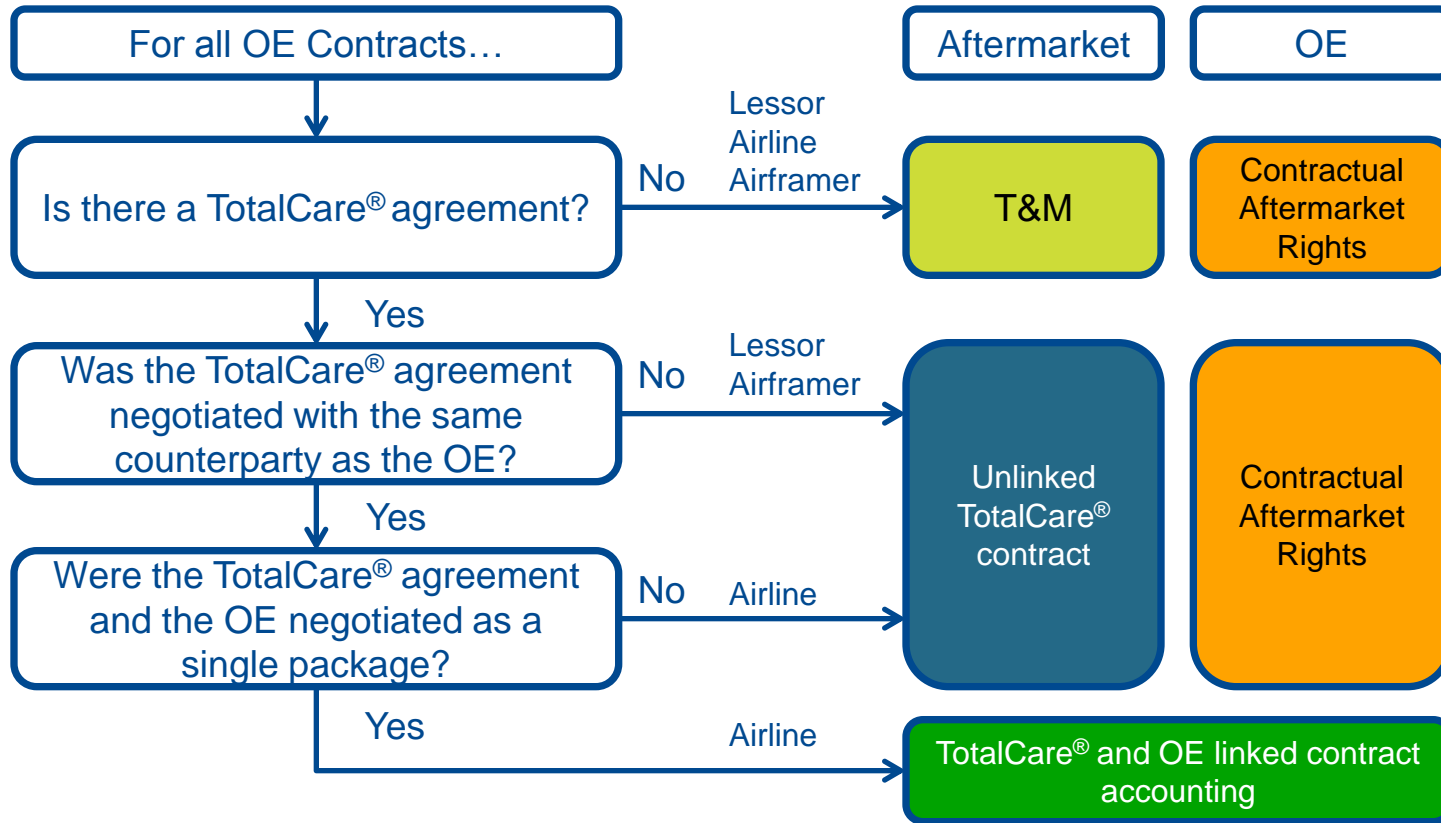
Linking commercial arrangements to accounting



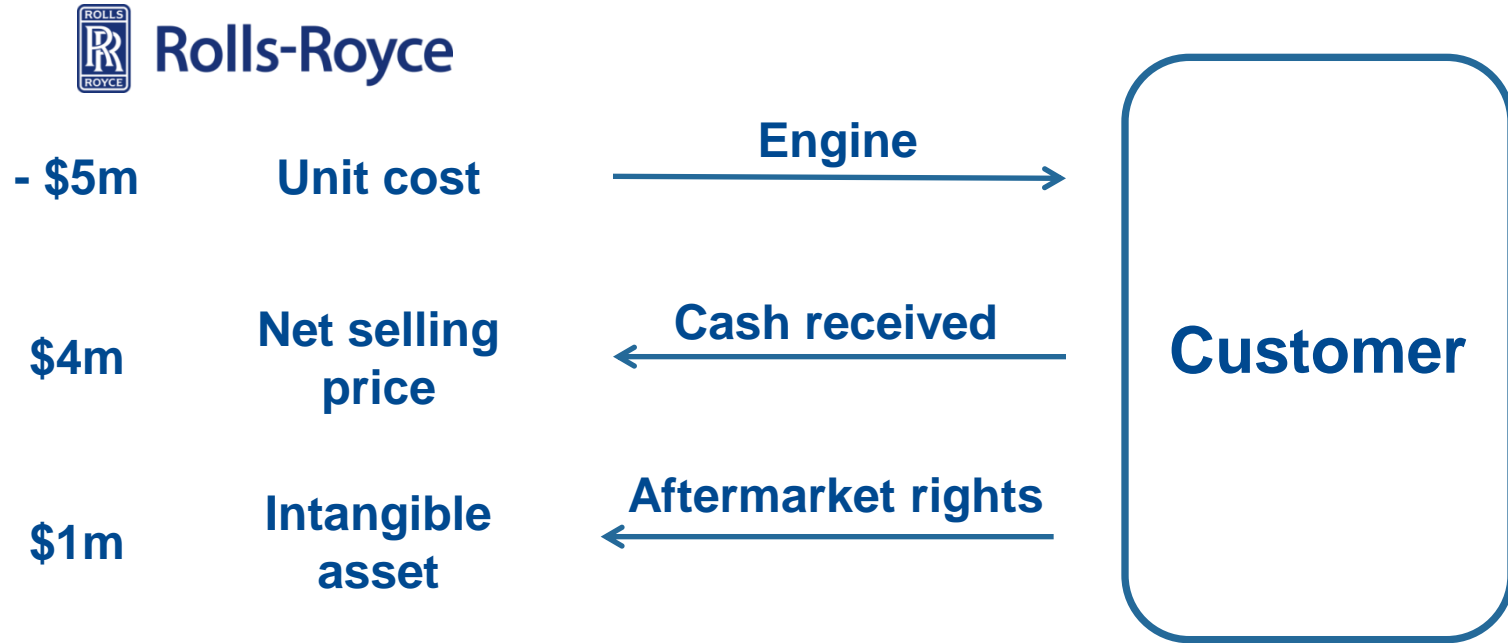
Linking commercial arrangements to accounting



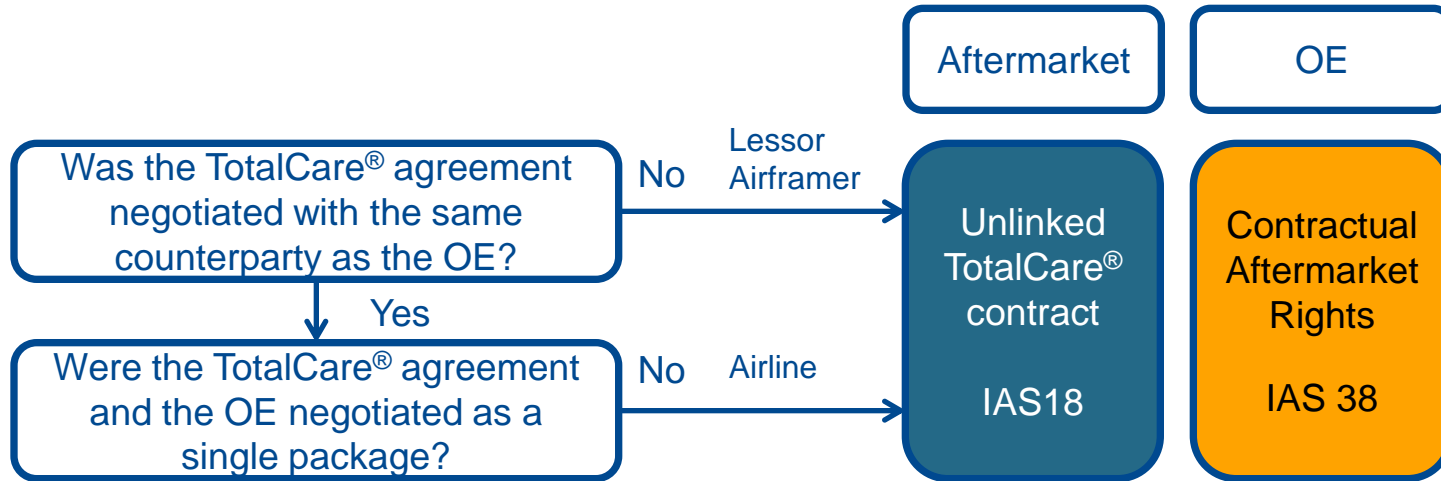
Linking commercial arrangements to accounting



Contractual Aftermarket Rights



Unlinked TotalCare®



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

Unlinked TotalCare®

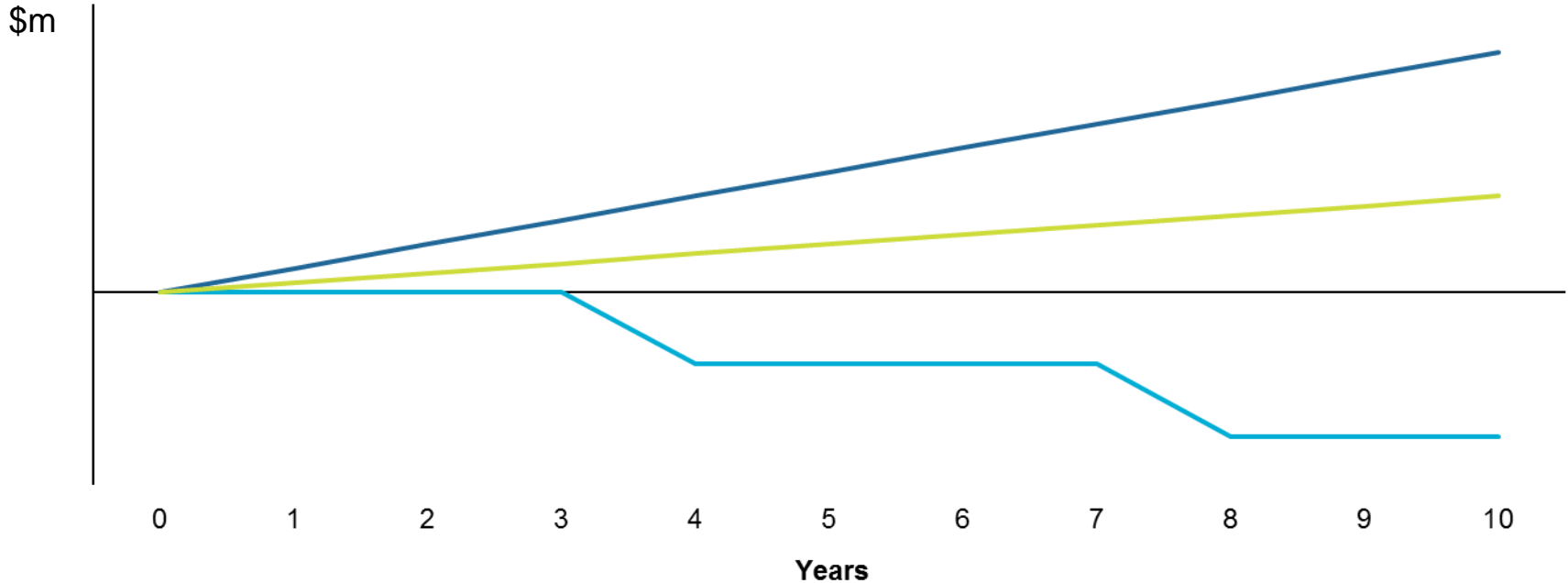
Single engine example

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[®]

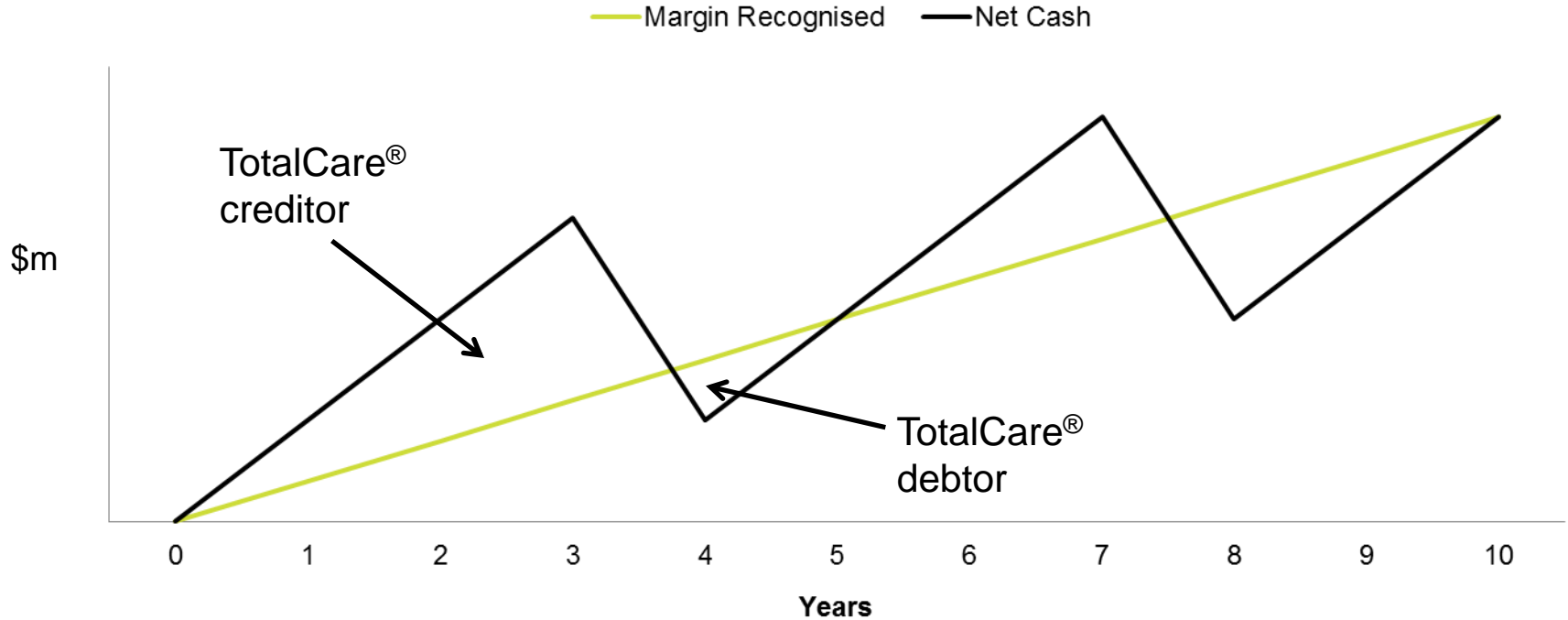
Cash vs. margin recognised

— Cash Revenue — Cash Costs — Margin Recognised

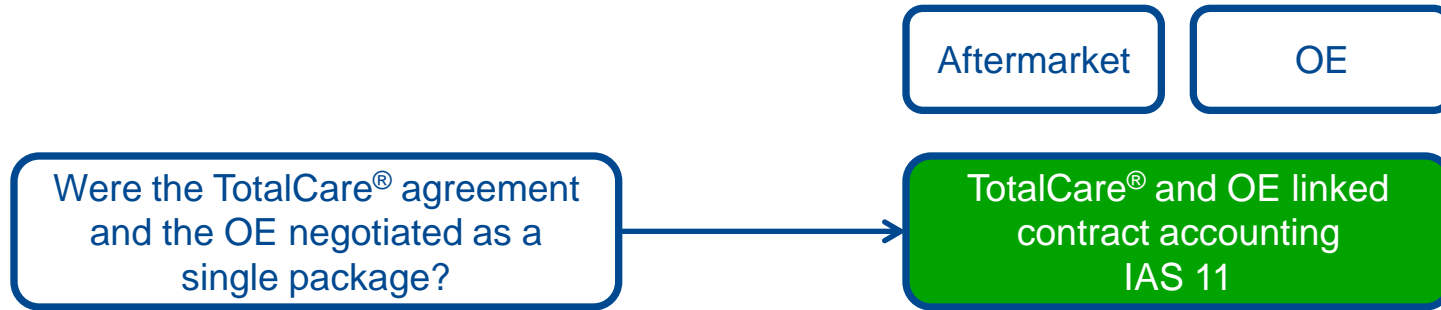


Unlinked TotalCare[®]

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®

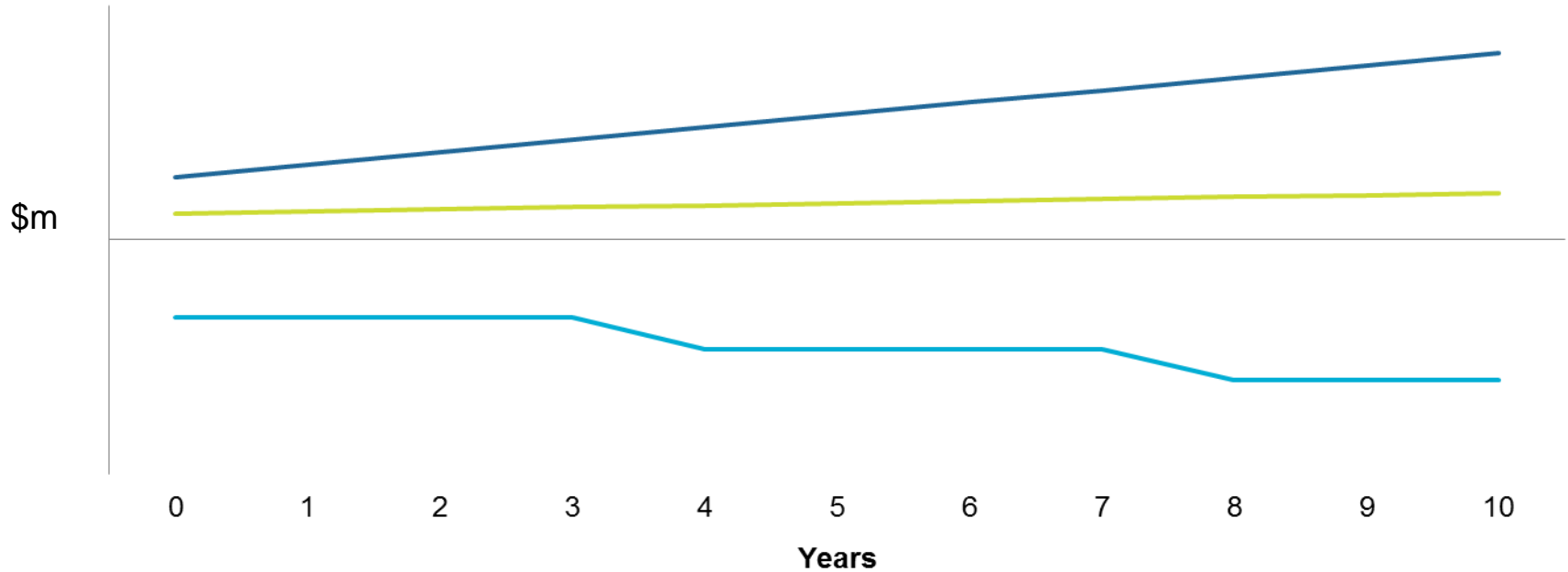
Single engine example

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[®]

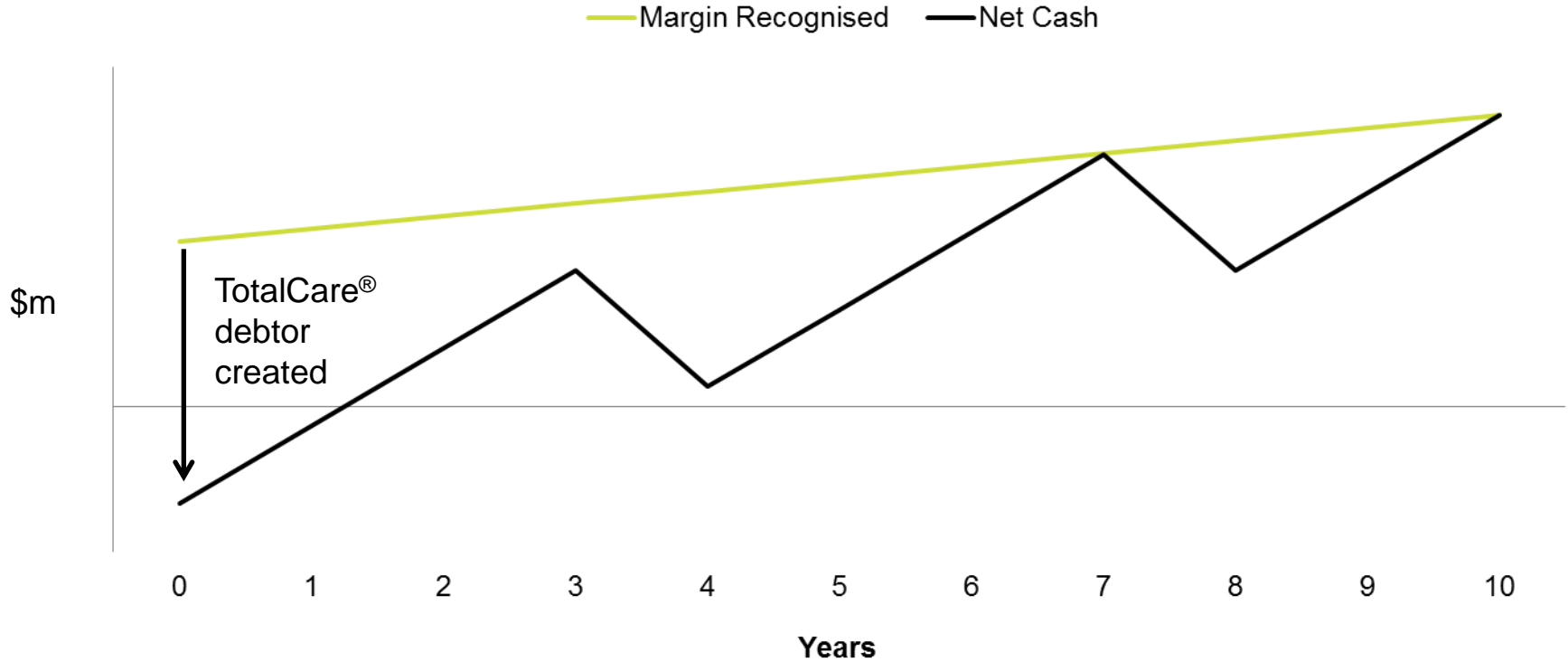
Cash vs. margin recognised

— Cash Revenue — Cash Costs — Margin Recognised



Linked TotalCare[®]

Net cash vs. margin recognised



What can change the forecast margin?

Revenue forecast

- Stage length
- Utilisation

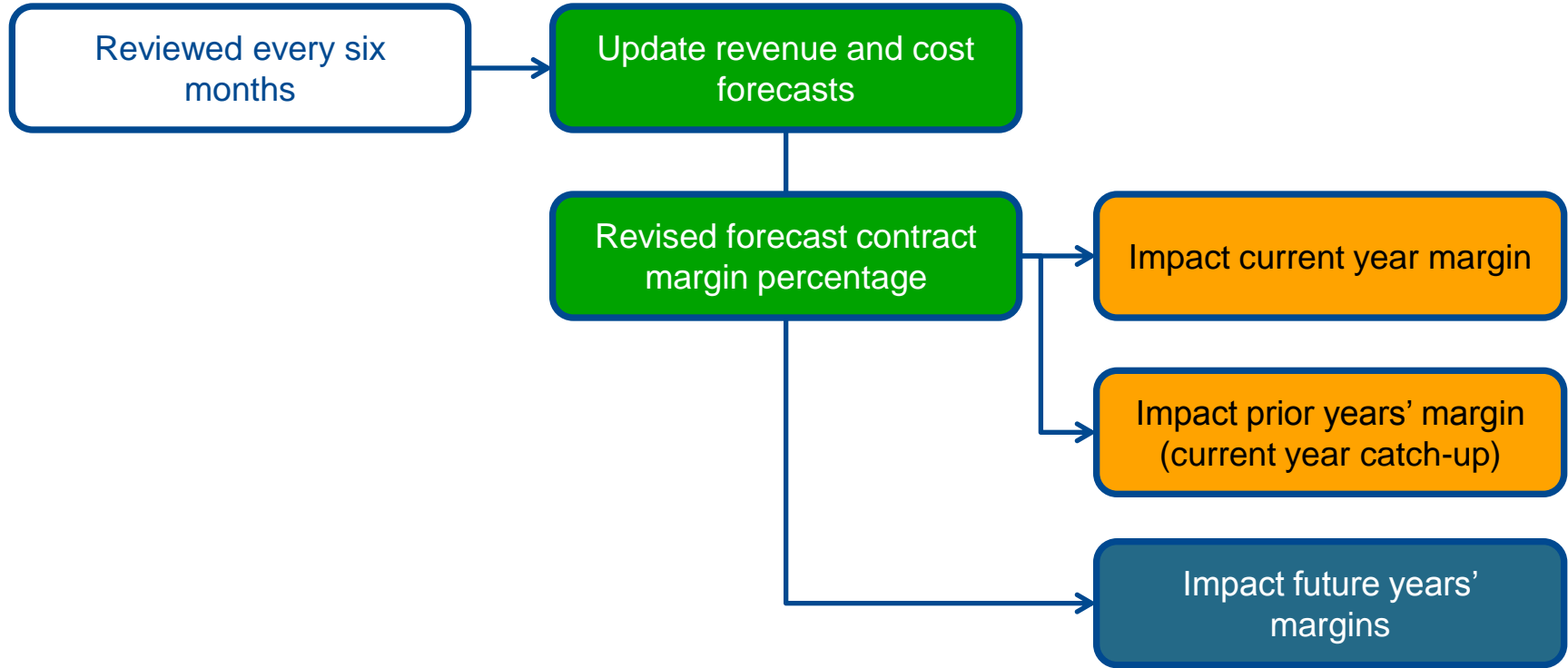
Cost and reliability forecast

- 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

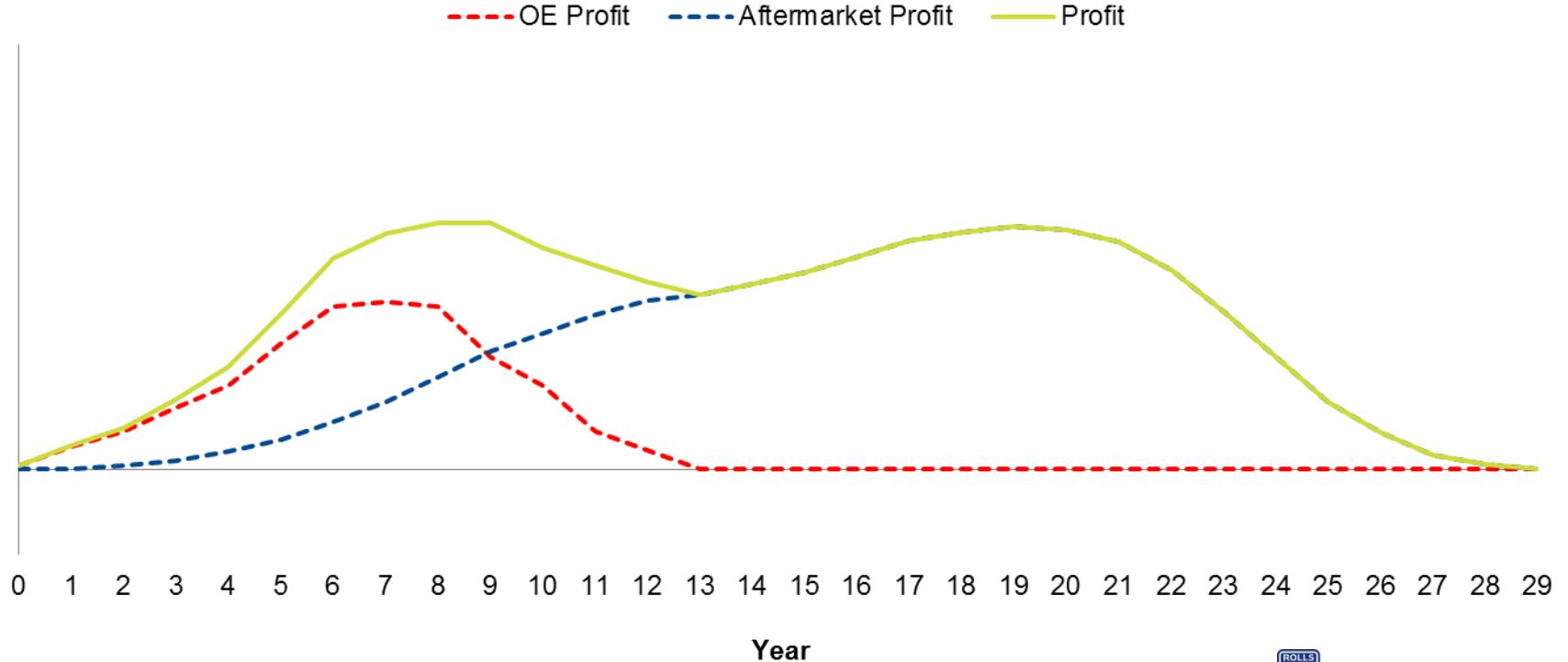


TotalCare[®] accounting summary

- **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**

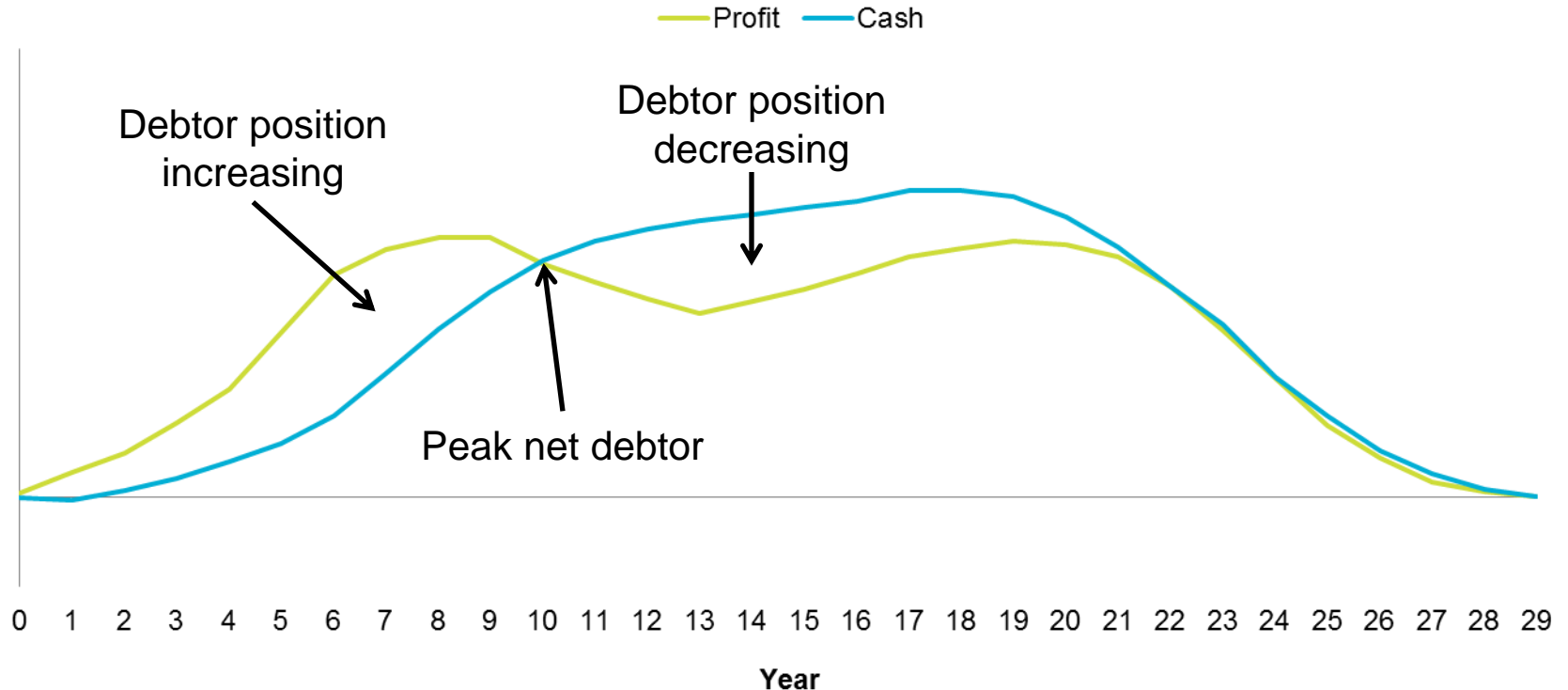
Linked TotalCare[®] programme

OE and aftermarket profit



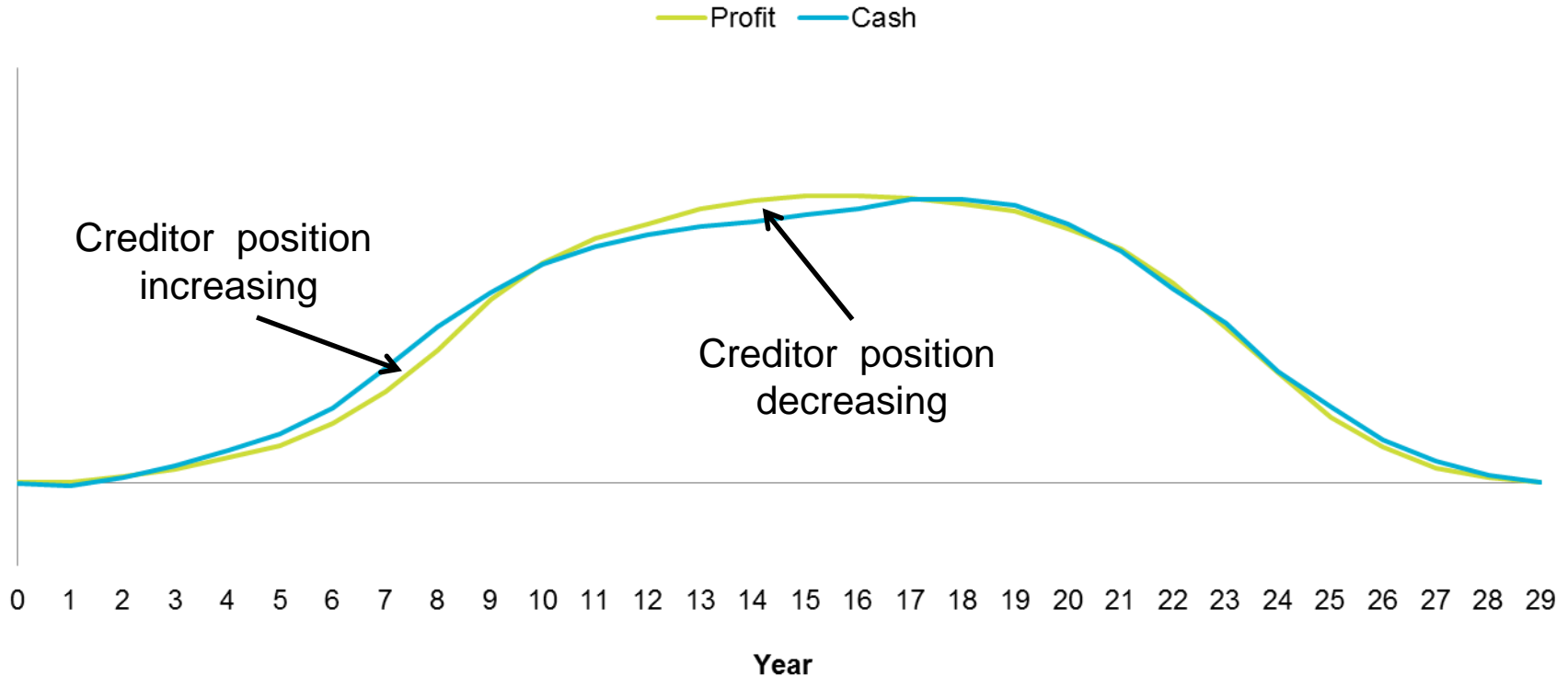
Linked TotalCare[®] programme

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**

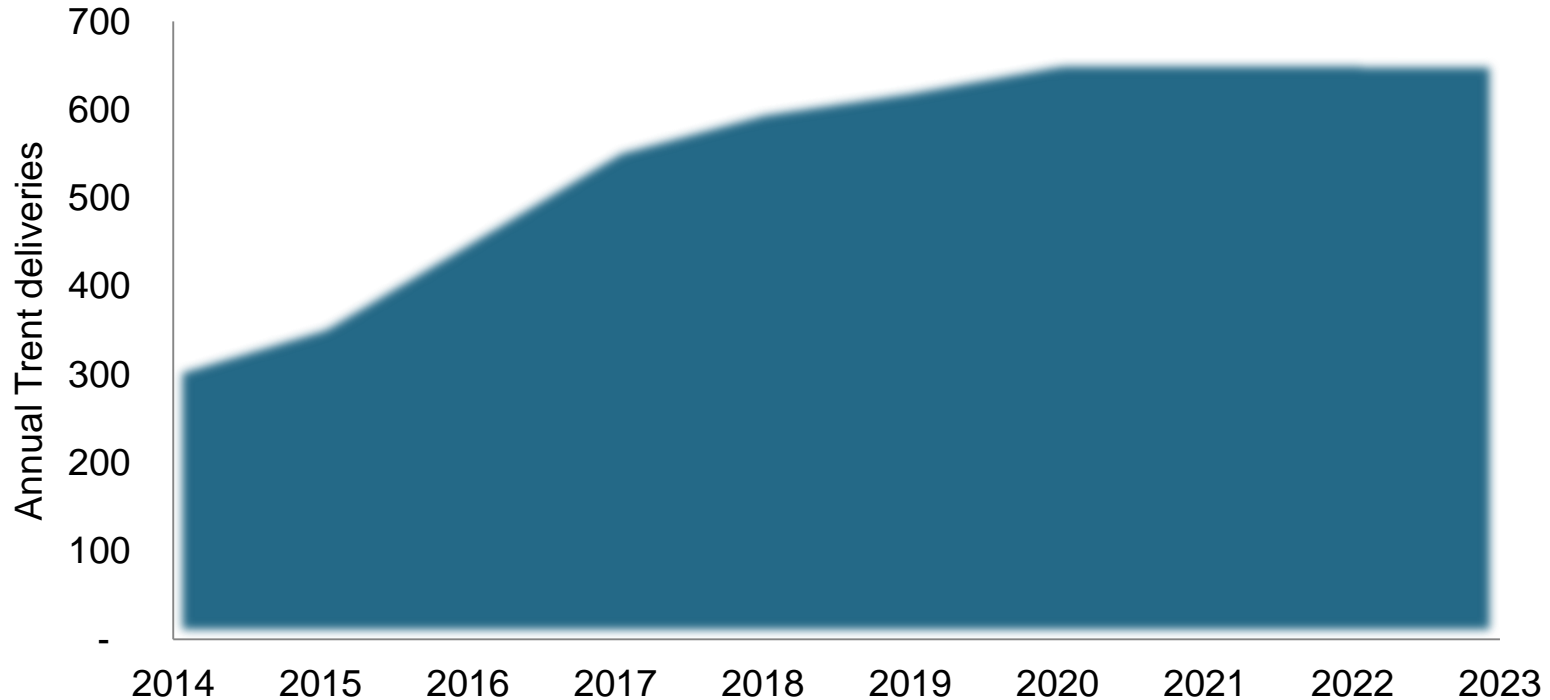
Debtor falls due to :

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

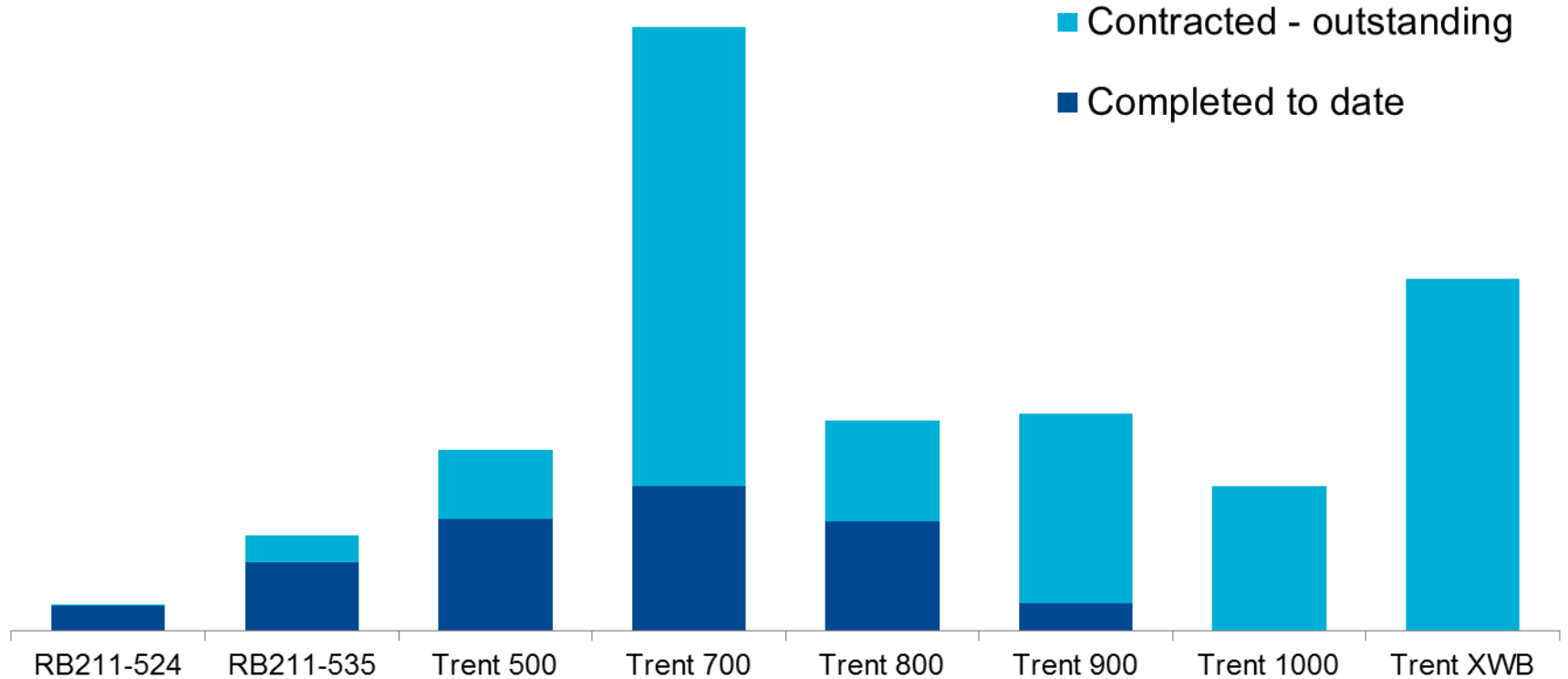
Valuation allowance changes can result in a rise or fall in the debtor

Projected Trent deliveries to 2023

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



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