



Rolls-Royce

Group Update

November 2015

John Dawson

Director, Investor Relations



Rolls-Royce

Agenda for today



Introductions	John Dawson
Chairman's remarks	Ian Davis
Highlights of the review of operations	Warren East
Financial review	David Smith
Update on priorities, strategy and actions	Warren East
Questions	



Ian Davis
Chairman



Rolls-Royce

Warren East
Chief Executive



Key topics for today



Outcome of review of operations Strong portfolio of products and services –highly differentiated power systems	Civil Aerospace performance Improved disclosure and clarity on the key drivers of growth and value	Cash generation and capital allocation Strong long term cash flows driven by growth in wide-body aftermarket, industrial transformation and business simplification	Improved disclosure and transparency Increase revenue segmentation, gross margin disclosure and trading cash flows by business	Areas for business improvement
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Based on the initial findings of ongoing review of operations
Addressing some of the feedback from investors around their key issues

Review of Operations



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Committing to regular updates on progress – not a static process.

Today:

- Initial findings
- Focus on high-level
 - Analysing and prioritising and engaging teams

First and second quarters of 2016:

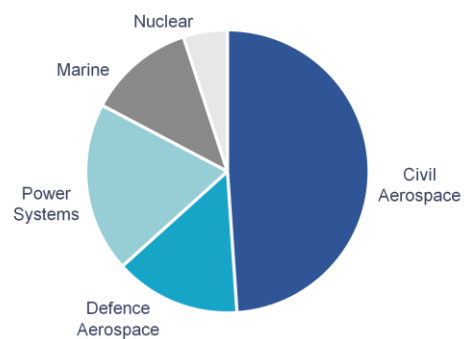
- Provide details on areas of business improvement
 - Plans, costs and timescales
- Guidance on tracking our progress

By end 2016:

- Review the plan and our progress
 - Modify pace and scope as required
- Provide further updates

Current focus on operating review; in 2016, will review strategy and portfolio

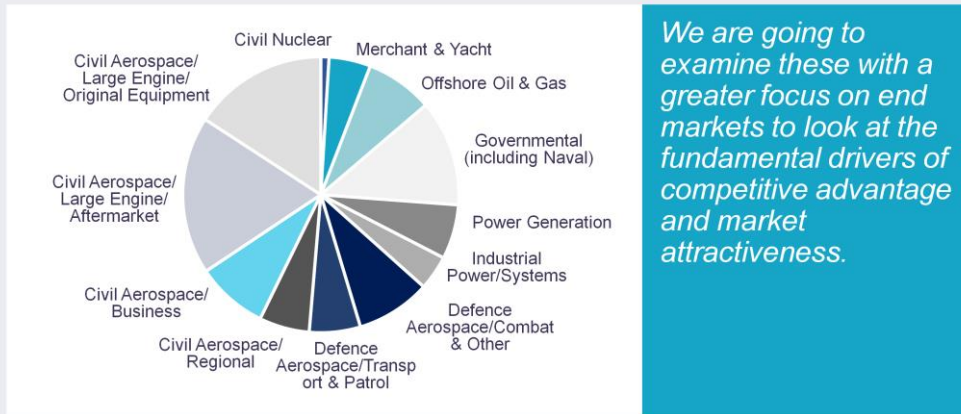
What We Do: Traditional View



A traditional view of the business looks at Rolls-Royce through a mix of products, markets and 'businesses'.

Historic disclosure through divisional and business unit lens

What We Do: Focus On End Markets



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Review takes a customer/market-led view

Provides more detailed/granular analysis looking at individual markets

Review has evaluated:

- Competitive strengths and weaknesses; products and technology
- Fundamental market attractions; long-term growth demand and customer needs

Allowing focus on:

- Capital requirements
- Growth rates
- Expected returns

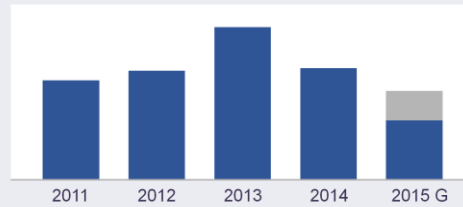
Land & Sea



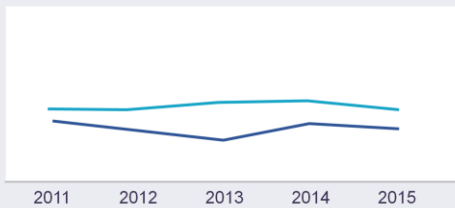
Revenue



Profit



Capex



R&D



— Business — Group ■ Guidance Range

Tognum equity accounted until 2013

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Historically a strong provider of:

- Free cash flows
- Margins

Market headwinds 2014, 2015 including:

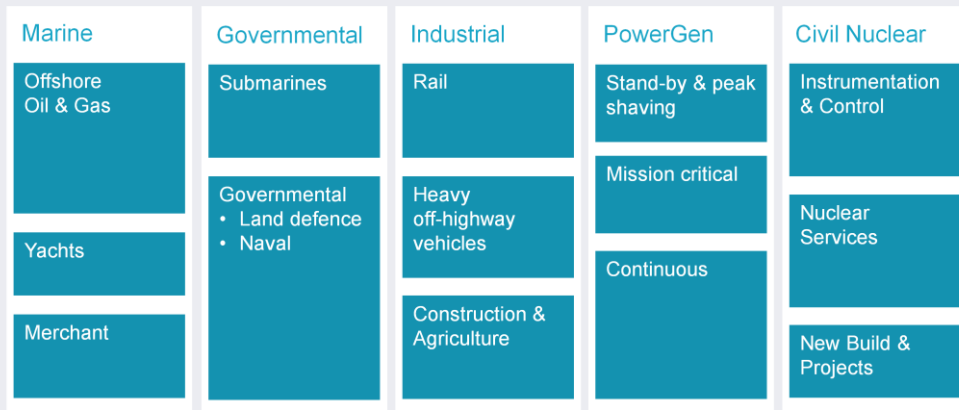
- Oil price
- Commodity prices

Relative to Aerospace:

- Low capital intensity
- Modest R&D

Tognum fully consolidated 2013 onwards

Land & Sea: Market Driven Focus



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Taking customer and market-led view:

- Turnover over £4bn, across:
 - 5 market categories
 - 14 separate end markets

Land & Sea: 2015 Market Attractiveness



Rolls-Royce



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Near-term view of our addressable markets

Market attractiveness to Rolls-Royce determined by a number of factors including:

- Growth potential
- Margin potential

Example:

Nuclear Services

- Growing market
- Rolls-Royce expertise can command a premium

Land & Sea: Competitive Position



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Rolls-Royce's competitive position determined by a number of factors including:

- Strength of our technology and services
- Our cost position
- Our reach and route to market

Mixed picture presents opportunities and challenges

- Technology gives us strong position in some areas
 - e.g. World-leading UT ship-design
- Geographic reach and route to market
 - e.g. Scope to improve servicing capability in Asia

Land & Sea Portfolio Analysis



Assessed portfolio against these two criteria

Complex picture – few businesses sit solely in one category

But this exercise does show:

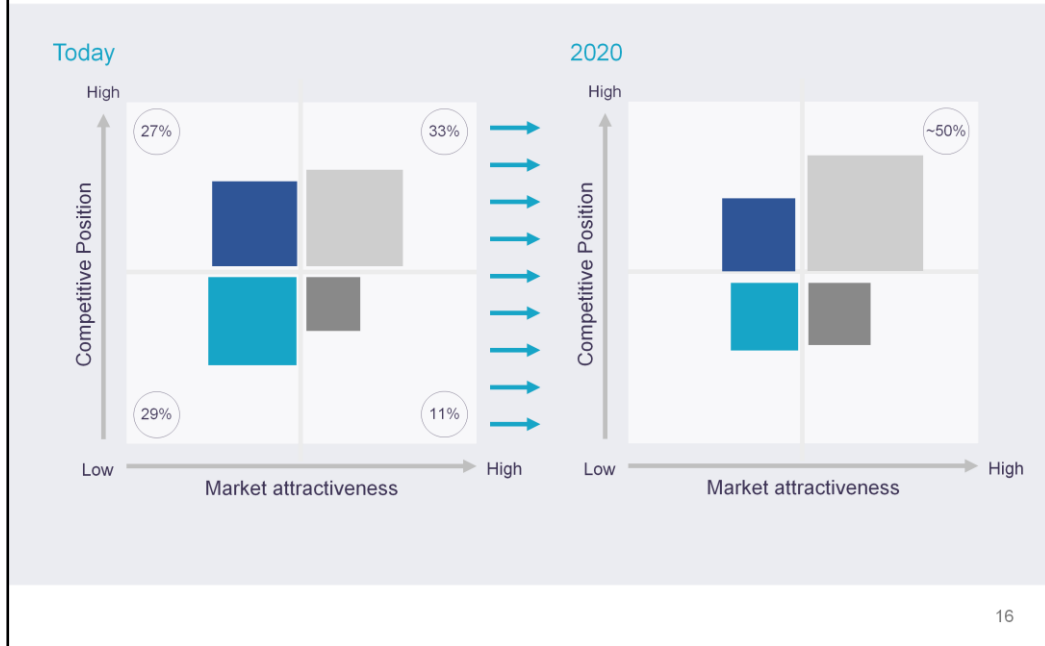
- Where we need to improve
- Opportunities exist across portfolio

Action required to:

- Drive business into the top right quadrant

Bottom left quadrant does not signal sale, but greater need for improvement or rationalisation

Land & Sea Portfolio Analysis



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Significant opportunity to change mix by 2020 through:

- Focus on core markets (ranked by Attractiveness & Competitiveness)
- Invest in appropriate opportunities

Excludes Acquisitions or Disposals

- Position could be further strengthened

Nuclear

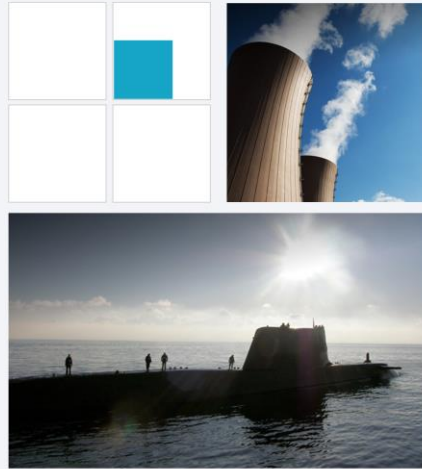


Submarines

- Key driver: SDSR outcome
- Targets: successor to Vanguard and Astute; in service support
- Focus on build-delivery performance
- Continue to deliver contracted efficiency savings agreed with MoD in 2012

Civil Nuclear

- Large and growing market
- Long-life cycle with mission critical assets
- Strategic industry with high barriers to new entrants
- Provision of safety critical I&C technology and nuclear services for operational plant
- Potential for greater systems/ services opportunity



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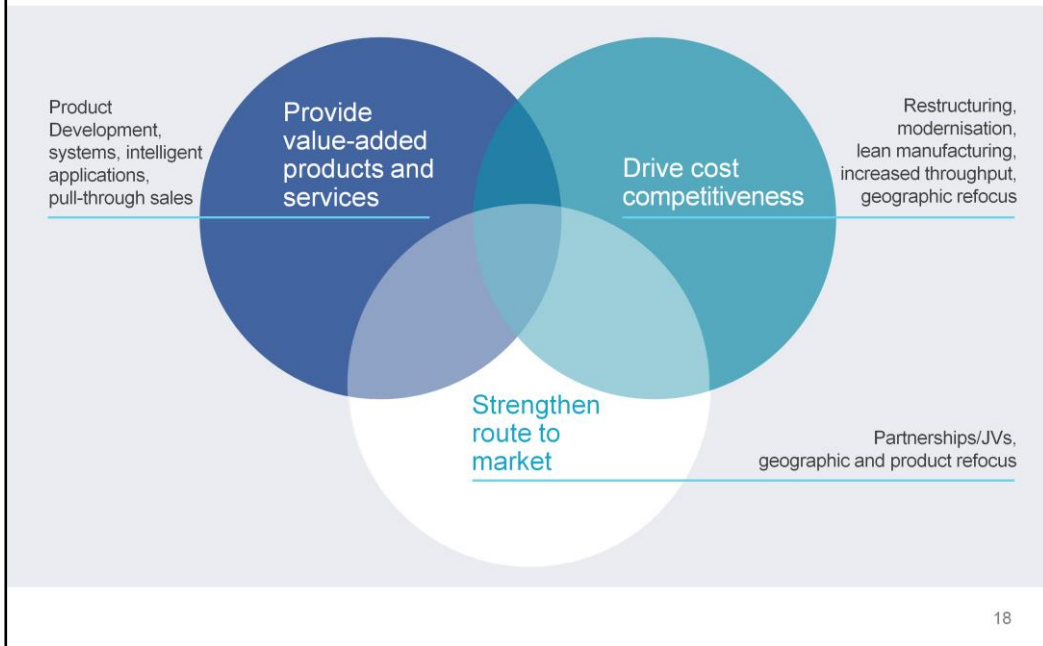
Attractive market:

- Submarines – Strategic Defence and Security Review underlines long-term potential
- Civil – large and growing

Rolls-Royce has strong competitive position:

- Nuclear Technical Authority for the Royal Navy's Submarine Fleet
- I&C and services on over 200 reactors in more than 20 countries
- Potential to expand geographic reach

Profit expansion & growth opportunities



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Focus business development on 3 areas:

- Provision of value added products and services
- Strengthening route to market
- Driving cost competitiveness

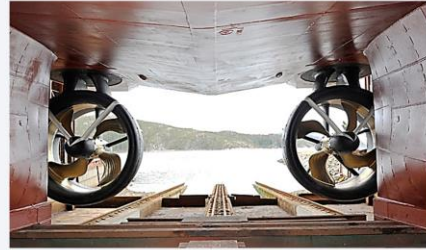
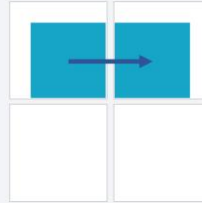
Value-add: Marine Product Development



- £30m product development spend
 - will double over 2-3 yrs

Eg New permanent magnet (PM) azimuth thruster:

- Latest development of PM technology family
 - Already includes tunnel thrusters and a newly developed winch
- Significant implications for future ship sustainability in marine and offshore sectors
 - Improved fuel economy; 7-13% vs conventional
 - More power vs equivalent propeller
 - Reduced noise and vibration
 - Scope to service without dry-docking



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Permanent Magnet technology – example of focused R&D on value added products and services offering potential for growth and margin enhancement through:

- Strong customer proposition
 - Improved fuel economy and better lifetime value
- Potential £200m - £300m market opportunity
- Minimal competition

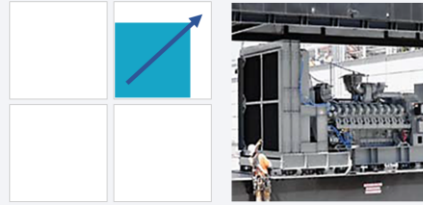
Route to market: Backup Power



- Market-leading capability in large-scale backup and mission critical power
- Design & build: customer-specific emergency power supply generating sets
- Value-add: 24/7 Service, ultra-rapid response
- Increased flexibility and optimisation of lifetime cost with peak shaving

Enhanced US Market Access

- Now 6 of top 10 major tech companies rely on MTU; 20% market share
- Strong market & new geographies opportunity



"One of the reasons we chose MTU Onsite Energy was because these generators can start and assume full load in just 7.5 seconds."

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Back up power – example of strengthening reach and route to market offering potential for growth and margin enhancement through:

- Build on existing technology and services
 - IP in large scale, mission critical backup power
- Lacked US market exposure
 - Acquired small US business with relevant capability
- Now 6 of the top 10 US technology companies use MTU Onsite Energy
 - Close to 20% market share
- Global market
 - Focus on improving routes to market in Asia and China

Cost competitiveness: Marine repositioning



Reducing capacity/cost – by end 2016

Factories	Direct headcount	Indirect headcount
32 down to <15 sites	-600	-400

Changing the focus

- Market-oriented: Asia region & China strategy
- Organisation reactive to market dynamics
- Leaner product portfolio: targeted at growth
- Increase product development: simplified, but targeted at high IP-high margin opportunities



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Marine repositioning – example of driving cost competitiveness offering potential for growth and margin enhancement through:

- Reducing operational footprint and headcount
- Creating an organisation that acts with pace and simplicity

Strengthen reach and route to market:

- Asia strategy

Strengthen technology and services:

- Leaner product portfolio
- Based on market-leading technology

Strengthening the potential for profitable growth despite headwinds

Land & Sea Summary



Strong competitive position in several attractive markets

- Over 60% in growth markets

Core market positions backed by high quality technology

- Nuclear, marine deck handling, specialist power

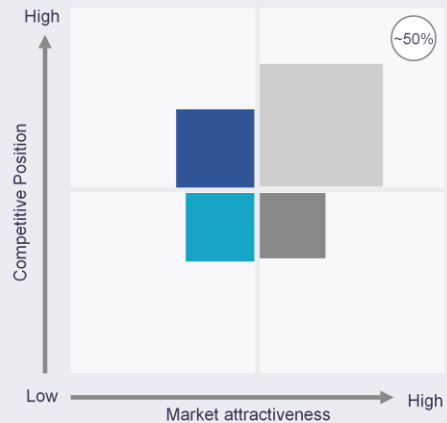
Focused investments to enhance offering

- Geographic opportunities; targeted product development

Clear near-term priorities

- Fixing the basics: footprint, headcount, portfolio
- Focus on realignment with customer base
- Achieving improved margin & cash performance

2020



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Land & Sea today:

- Diverse business
- Exposed to growth markets and some challenging markets

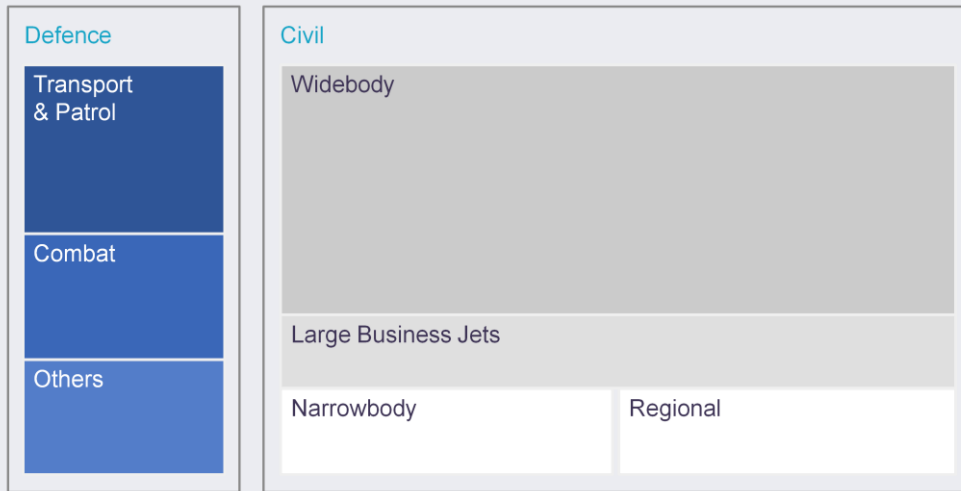
Land & Sea by 2020:

- Exposure to highly attractive markets in which we enjoy a strongly competitive position expected to increase by around half.
- Not dependent on market recovery
 - Position could be further strengthened if market strengthens

Focus business development on 3 areas:

- Provision of value added products and services
- Strengthening route to market
- Driving cost competitiveness

Aerospace: Market Driven Focus



Focused investments in industrial and technology transformation

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Taking customer/market-led view:

- Turnover ~£9bn, across:
 - 2 market categories
 - 7 separate end markets

Current areas of focus:

- Defence; Transport & Patrol and Combat
- Civil; Widebody and Large Business Jets

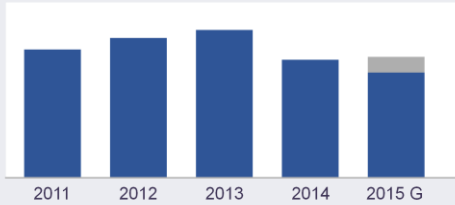
Period of significant investment:

- Bring new products to market
- Once in a generation investment in new engine technology for the next family of products
- Transform industrial base to deliver the right cost base

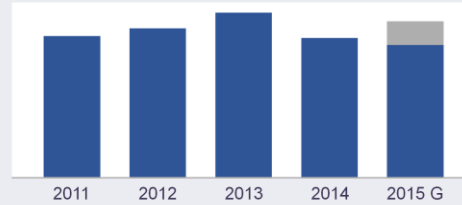
Defence Aerospace



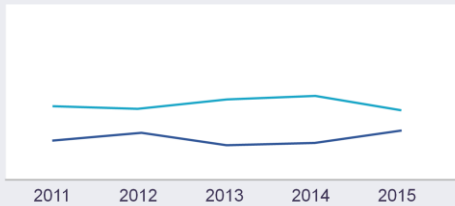
Revenue



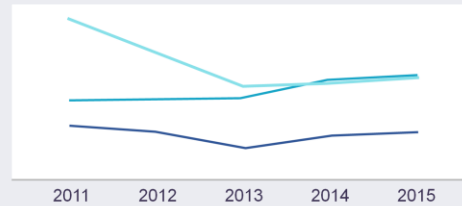
Profit



Capex (% of sales)



R&D (% of sales)



— Business — Group — Gross R&D (Defence) ■ Guidance Range

Relative to Group average:

- Lower capital intensity due to:
 - Governmental support for product development
 - Ability to leverage civil aerospace R&T programmes
 - Lower level of new programmes

Market headwinds in 2014 including:

- Contracting Government budgets
- Resulting reduction in load
- Action already taken to address cost base

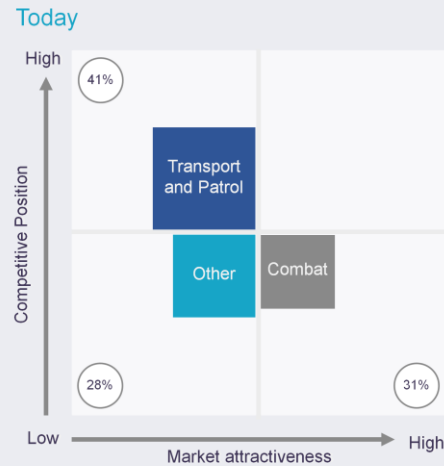
Defence Aerospace Portfolio



- Very long cycle business
- Profitable and cash generation in OE and aftermarket
- Competitive but technology and service driven
- Strong customer relationships

Defending current applications

Positioning for growth opportunities in Transport and Combat post 2020



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Assessed portfolio against:

- Market attractiveness
- Rolls-Royce's competitive position

Portfolio dictated by current programmes and potential future opportunities

Transport and Patrol:

- Market leadership
- Ensure customer satisfaction to
 - Protect current position
 - Exploit future opportunities

Combat:

- Focus on future indigenous fighter competitions
- Vertical Lift System showcases market-leading technology
- UK's future combat air system programme provides some capability protection

Large installed base in Trainers and Helicopters

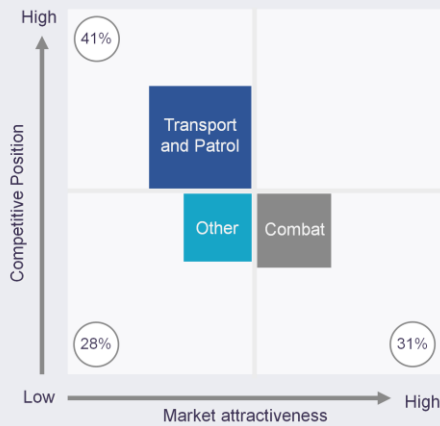
- Niche positions.

Defence Aerospace Portfolio



Focus on new product innovation and investments, to drive efficiency, ready for opportunities in Transport and Combat post 2020

Today



2020

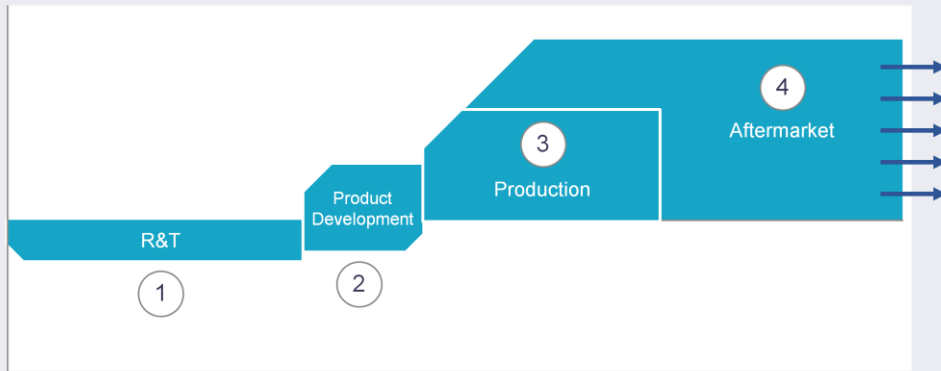


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Key to outlook in 2020:

- Winning a position on Future programmes (Transport & Patrol)
- New opportunities in emerging markets (e.g. India Advanced Medium Range Combat Aircraft)
- Steady aftermarket in mature markets
- Investment in value added products and services (engines and aftermarket support)
- Driving cost-competitiveness

Long term cash flow cycle for Defence Aerospace products



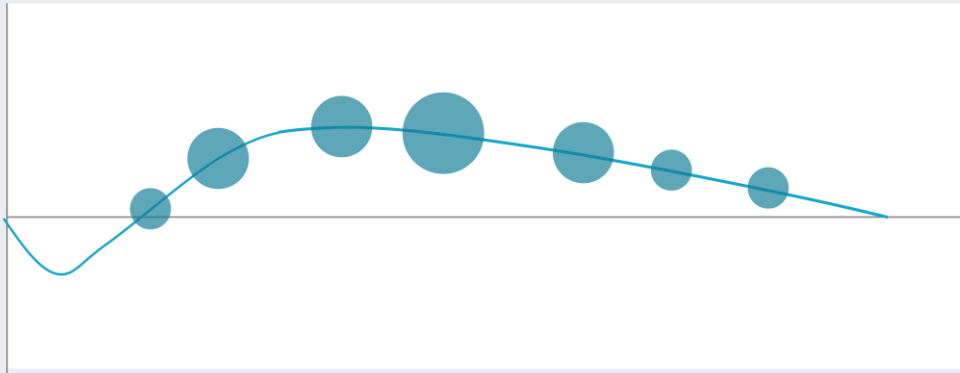
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Long business cycles, which can easily reach 50 years:

1. Investment in technology acquisition, which can be up to 20 years before any entry into service
2. Technology maturation and production development supported by customer funding. Creates more balanced cash flow than civil aerospace
3. Engine in service. OE sales at reasonable margins. Cash breakeven typically achieved in 2 years or less depending on funding support and production ramp-up. Production phase can extend for 20-30 years, including upgrades
4. Aftermarket, incorporating performance-based logistics support packages typically contracted every 5 years

Cash flows tend to reduce over time as installed base declines

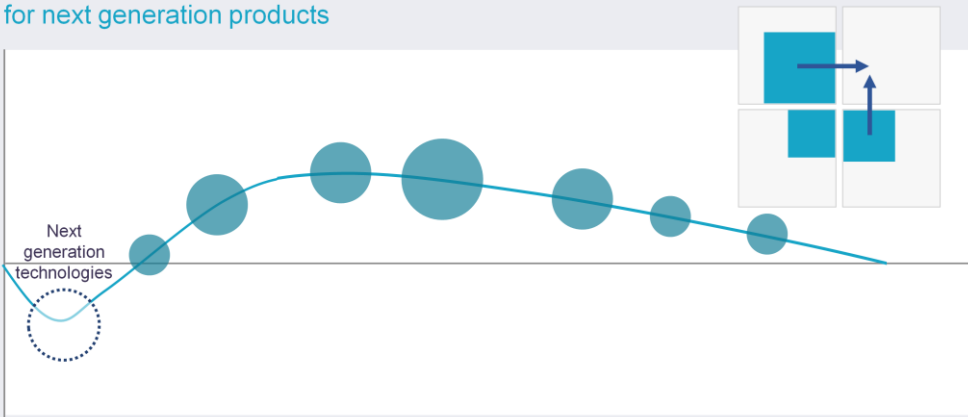
Our portfolio is relatively mature



Current portfolio reaching mature stage of product lifecycle:

- Continued steady stream of production & aftermarket revenue in near term
- Investing in technology development to ensure new products in pipeline

Next generation technologies in the pipeline
for next generation products



Investments focused on Transport & Patrol, and Combat

Defence Aerospace benefits from transformation initiatives



Continuing investments in manufacturing capability and technology

\$600m transformation in Indianapolis

280,000 m²



140,000 m²



...while leveraging benefits from 56,000 m² reduction in Ansty

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Continuing the transformation of industrial base:

- Announced \$600m 5 year transformation of Indianapolis
 - Creating a more cost effective manufacturing environment
- Ansty footprint reduced by 56,000 m² – work moved to other facilities including Bristol and Germany
- Investing in facilities to help prepare for future Transport & Combat opportunities

Defence Aerospace Summary



- Maintain market leadership positions
 - Investment in future technology
 - Grow services around large installed base
 - Indigenous combat opportunities
- Reduced fixed cost via plant modernisation & lean manufacturing and employee engagement initiatives
- Sustainable long term profit and cash generative business



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Defence by 2020:

- Maintain market leadership positions
- Invest to strengthen principally in Transport & Patrol

Focus on:

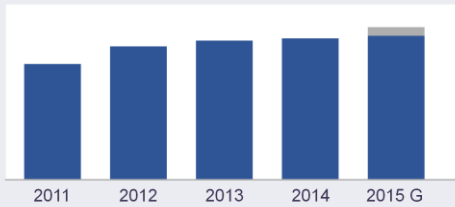
- New technologies
- Greater cost competitiveness through leaner manufacturing

Potential for incremental Combat business through indigenous programmes, export sales and innovative aftermarket services

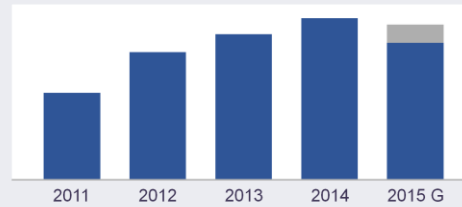
Civil Aerospace



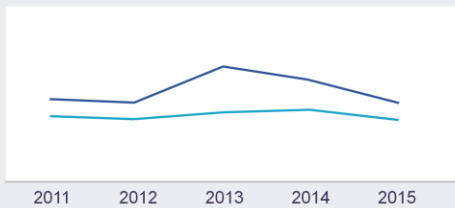
Revenue



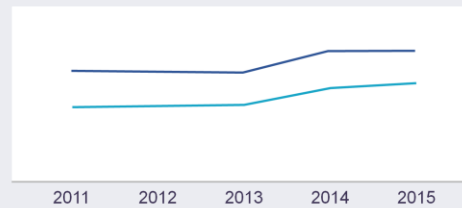
Profit



Capex (% of sales)



R&D (% of sales)



— Business — Group ■ Guidance Range

Relative to Group average:

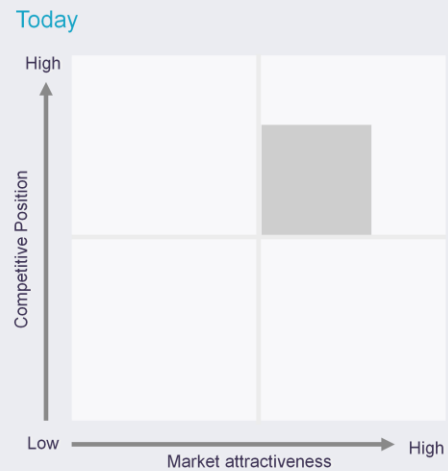
- Higher capital intensity due to:
 - Preparation for increase in widebody volume
- Higher product development spend due to:
 - Expansion of Trent product portfolio to support growing market share

Significant market headwinds in 2015 and 2016

Large Business Jets



- Strong brand, product and aftermarket services
- Strong but declining market share
- Attractive market in the long term but short term volatility
- Positioning with customers to re-establish clear leadership



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Assessed portfolio against:

- Market attractiveness
- Rolls-Royce's competitive position

Attractive long-term market:

- Driven by growth in high net worth individuals
- Volatility from year to year for OE revenues but steadier Aftermarket

Strong competitive position:

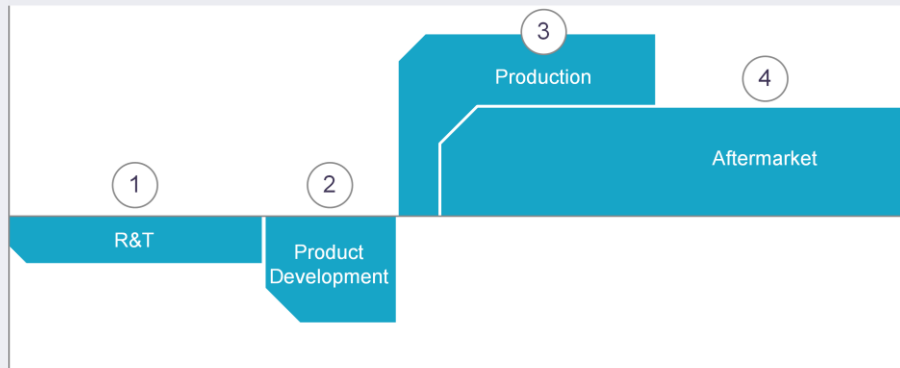
- High current market share
- Set to decline following platform losses
- Strong customer relationships – driven by availability and comprehensive aftermarket support

Investing to re-establish market leadership

Large Business Jets



Long term cash flow cycle for Large Business Jet products



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Similar characteristics to defence market, however:

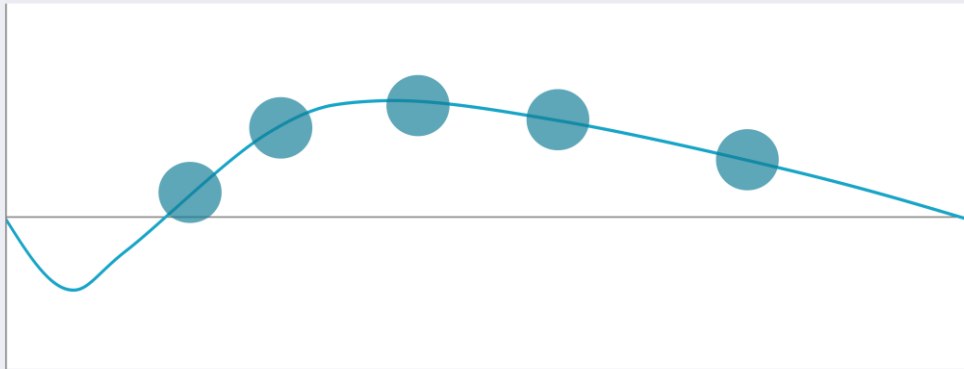
- Product development entirely Rolls-Royce funded
- OE sales tend to be cash positive at good margin
- Aftermarket smaller due to lower utilisation

1. R&T largely common with widebody
 - 10-20 years prior to in service
2. Product Development starts at point of engine selection
 - Typically 5-7 years ahead of Entry Into Service
3. Production runs shorter than Civil Large
 - Typically 5-15 years
4. Products in service up to 20 years

Large Business Jets



Balanced portfolio of products but with declining market share in the medium term



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Current portfolio is mix of products at different stages of maturity:

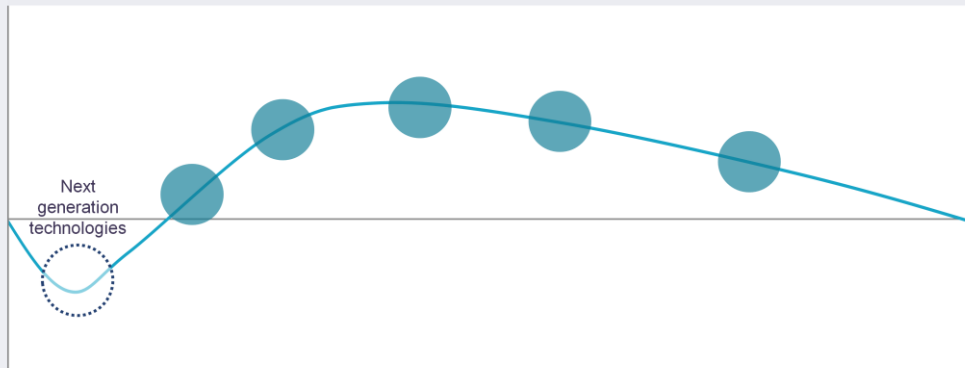
- Initially, deeper negative cash as product development entirely company funded
- Turns cash positive quickly through good OE margin sales

Example: BR725 on Gulfstream G650 entered into service in 2012 vs Spey, entry into service (EIS) 30 years ago, powering Gulfstream G2 and G3, several thousand still in service

Large Business Jets



Investing in technologies to position for future applications



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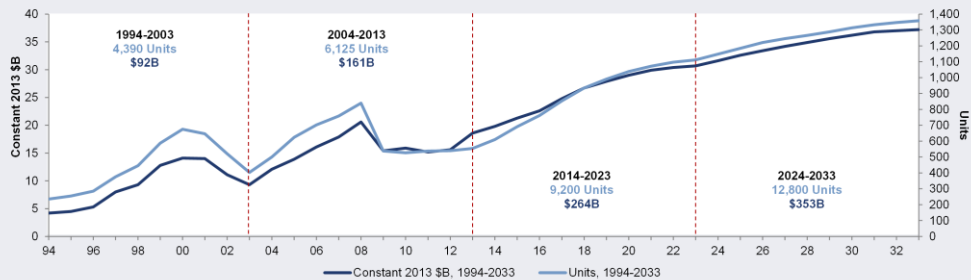
- Investing in new technologies to position for future applications
- R&T and product development will help re-establish clear market leadership
- Despite investment in new products, overall sector is cash generative

Business Jet Market & Drivers



Growth in high net worth individuals drives top end of business jet market

Business Jet 20-Year Revenue and Delivery Outlook



Source: Goldman Sachs

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Cyclical market currently experiencing headwinds

Attractive long-term underlying growth driven by growth in high net worth individuals

10 and 20 year outlook very positive

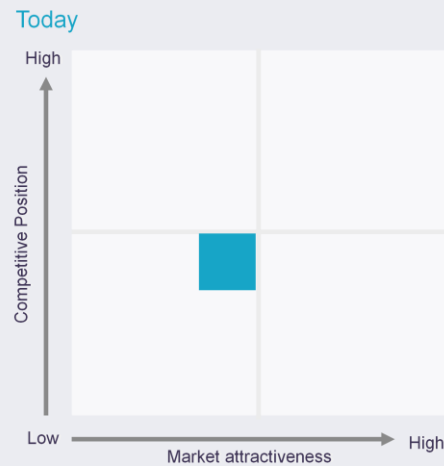
Regional



- Small player in market
- Dominated by aftermarket revenues
- No significant new opportunities
- Revenue expected to decline by 2/3rds over 5 years



- Not a focus area for investment



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Assessed portfolio against:

- Market attractiveness
- Rolls-Royce's competitive position

Small player in a relatively unattractive market

- Profile dominated by a legacy aftermarket position on Embraer's ERJ-145 family
- Revenues set to decline as products retire – we expect to be at around one third of today's revenue in the next five years
- Do not anticipate major new market opportunities over next 10 years

Narrowbody



Strong, attractive growing market

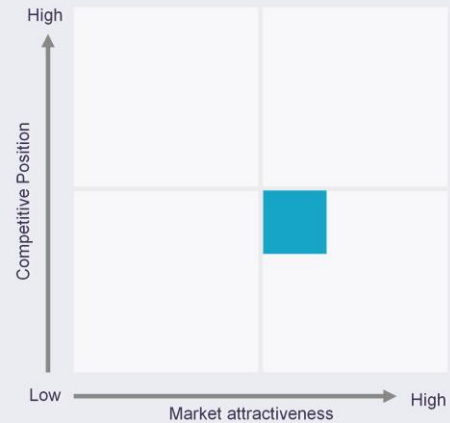
Exited Joint Venture with P&W in 2012

- Module supply ends ~2017
- Long-term spares and flying hour revenue set to sustain for 10+ years

Future participation?

- Significant cost of re-entry so business case would need to be compelling
- Technologies and architectures developed through widebody investments
- Long-term opportunity to re-enter through A320/B737 replacements c. 2030
- Decisions to be taken early 2020s

Today



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Assessed portfolio against:

- Market attractiveness
- Rolls-Royce's competitive position

High volume market

Current position:

- Supplier of modules
- Receive aftermarket revenue

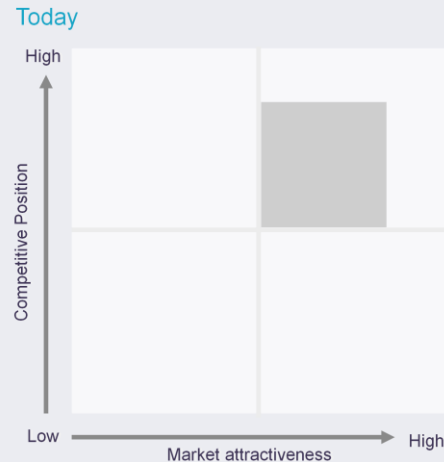
Only sold interest in JV with P&W: retained a profitable aftermarket that will continue long into the future

– similar in many ways to a post investment aftermarket in widebody

Widebody



- Strong, long-term growth market
- High barriers to entry
- Strong position
- Order book visibility: >50% of installed base by early 2020s
- Headwinds



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Market attractiveness:

- Strong, long-term growth market
 - 4-5% CAGR driven by “mega-trends” of population and affluence
- High barriers to entry
- Aircraft typically stay in service 20-25 years

Rolls-Royce's competitive position:

- Targeted product investment over two decades
- Strong technology portfolio
- Strong customer relationships
- Proven reliability
- Broad engine portfolio
- Order book visibility: greater than 50% of order backlog since 2008
- On course to achieve >50% of installed base of passenger wide-body in early 2020's

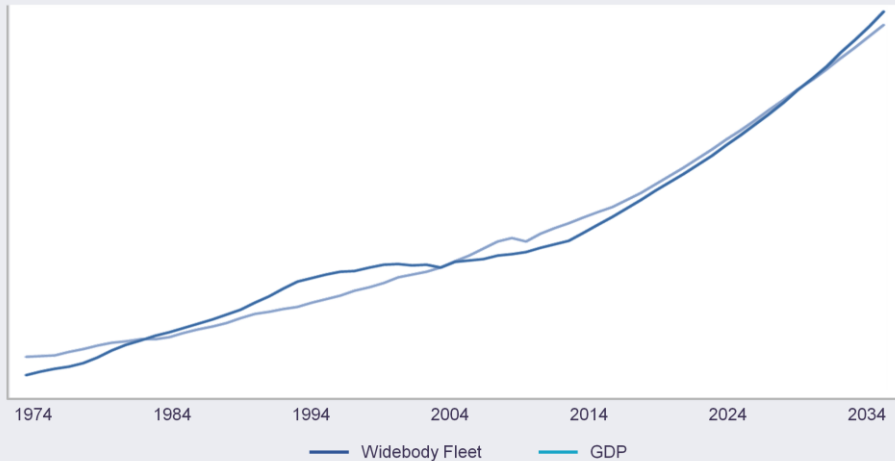
Headwinds:

- Launch pricing, requirement for technology refresh and engine retirements

Strong Outlook for Widebody Market



Passenger Widebody Aircraft in Service



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Demand for aircraft principally driven by global GDP

- Relationship has proven resilient over long-term
- Market has previously recovered rapidly from GDP shocks

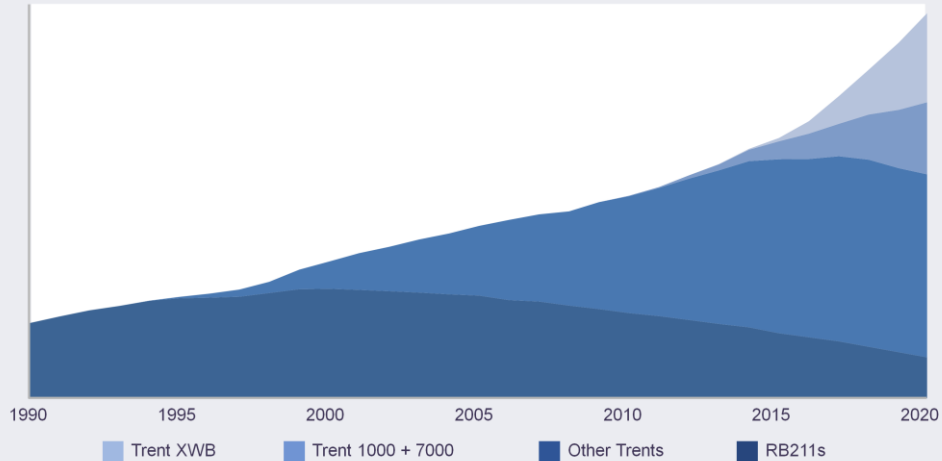
Short-term shows more complex relationship between supply and demand:

- e.g. shifts in load factors, aircraft seat density

Widebody Installed Thrust Growth



Installed thrust drives aftermarket revenue growth



*Installed thrust is shown net of retirements. Includes parked and stored engines.

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Value driven by aftermarket revenue from installed base

- Growth in installed thrust over the next 5 years is driven by XWB and Trent 1000
- Higher thrust engines command premium price per flying hour

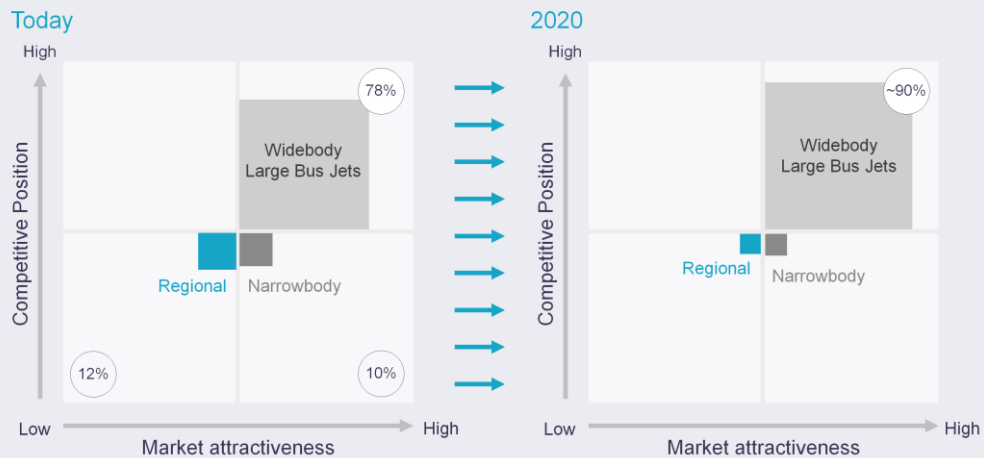
Balance between OE and aftermarket drives cash flow:

- OE sales tend to be loss-making
- Long-term aftermarket is where we make our return
- Expect to enter period where aftermarket revenue will outgrow OE revenue as installed base grows

Civil Aerospace portfolio progression



Widebody growth and cash generation through existing order book;
short term decline in business jets market share



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Three-quarters of portfolio in good competitive position/attractive market:

- Widebody
- Large business jets

Rising to 90%+ by 2020 due to:

- Growing widebody market share

Business Jets:

- Short-term market-share declines but still strong
- Expect to recover market leadership in longer-term

Group portfolio conclusions

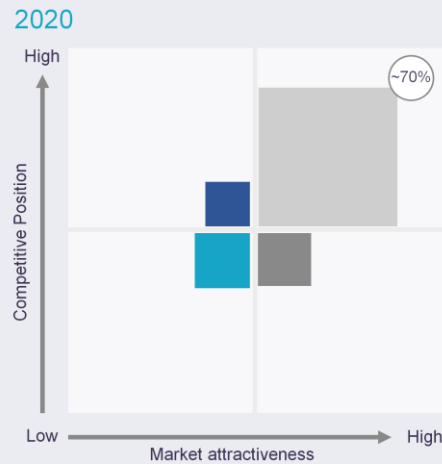


Strong mix of business

- Over 80% in attractive growth markets
- Over 75% in with strong competitive advantages

Competitive advantage strengthened by investments

- 2/3rds of group will benefit from transformation programme



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Pulling the analysis together and looking at Rolls-Royce as a whole

Strong mix of business across gas turbines and reciprocating engines:

- Highly differentiated products and services with high engineering content
- Proven track record
- Deep technical expertise

By 2020 we expect to have:

- Over 80% exposed to attractive growth markets
- Over 75 % with strong competitive advantages
- And 70% with both
- Over 80% will benefit from our current industrial transformation initiatives
- Over two-thirds will benefit from growth investments in the coming years

Opportunity to invest selectively to strengthen this further

Legacy Issues



Co-operating with
authorities including
UK & US

Significant actions to
improve ethics/ABC
culture & processes

Zero tolerance to
misconduct

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Carrying forward some issues from the past

- Cooperating with all relevant authorities including those in UK and US
- Taken significant actions
 - Fundamental and consistent education initiatives
 - Embedded throughout the business
- Clear, zero tolerance to misconduct

Fuelling long-term growth critical to success Rolls-Royce

Successful product innovation

- Address emerging customer needs
- Drive growth in installed base which in turn drives profitability and cash
- Scale efficiencies in the aftermarket help drive higher achieved returns on sales

Order book reflects significant future value

- Widebody order book is strong
- Pricing robust
 - future performance is about driving cost savings on new engine programmes as we have on older ones – continuous improvement
- But visibility strong for only certain elements of the business
 - limited foresight on balance in volatile market conditions – e.g. oil prices, Asia growth and short-term changes in aircraft utilisation

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Essential to drive growth in installed base to drive future aftermarket revenues

Continue to innovate on products and services:

- To address emerging customer needs
- Open up new routes to market

Our order book reflects significant future value:

- Tested integrity against business plans, our approval processes and assessed value
- Aftermarket growth is critical to driving value
- Order book visibility varies by business and within segments

We must continue to drive cost competitiveness:

- Deliver on industrial transformation
- Continue to reduce costs in aftermarket

Common themes will drive our success



Engineering excellence

- Focused on high performance power systems
- Leverage engineering excellence to build market share and long-life installed base

Capturing aftermarket value

- Performance critical assets provide the platform for value added services and systems
- Potential to leverage knowledge to drive additional value added for customers and build attractive margins

Operational excellence

- Manufacturing transformation to drive higher margins
- Sustainably lowering costs through continuous improvement

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Fundamentally an engineering business, focused on high performance, mission critical power systems

Success will depend upon:

- Engineering excellence
- Driving cost competitiveness
- Creating value-added products and services, which will drive long-term sustainable returns

With a clear focus on operational excellence

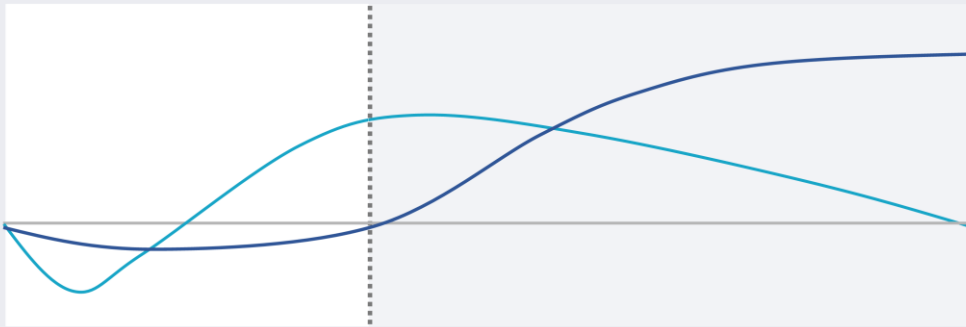
Cash flow analysis



Rolls-Royce

Key piece of market feedback:

- Desire for greater clarity on future cash flows, especially from widebody programmes



Cash flow dynamics – a cumulative cash flow (dark blue line) for a typical engine programme

In order to fully understand annual cash flow impacts you need to look at the rate of change in the curve and what that looks like for *each* engine programme

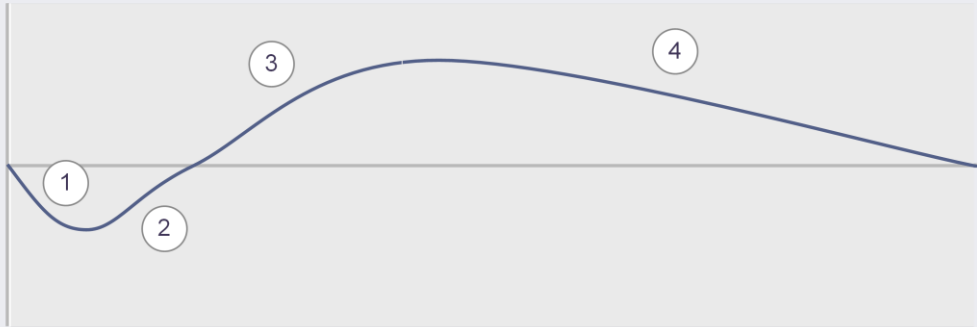
Annually (the light blue line) the breakeven point is earlier than the cumulative position – the dotted line shows just how far into a programme you have to be before it typically starts generating positive cash flows on a cumulative basis

- 15-20 years in some cases

The life of an engine programme can extend into many decades

- In some cases 40 to 50 years from first investment to last aftermarket revenues

Cash generation over time

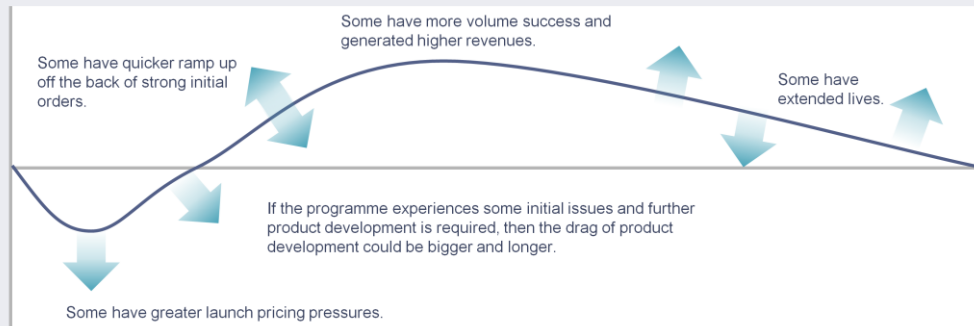


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1. Research and Development and capital investment – as we build test engines, production equipment and engineer new advanced materials
2. Start manufacturing, reduce product development and start to generate aftermarket revenues
 - But the programme is still making cash losses on OE sales as we invest in building market share
3. Aftermarket revenues exceed OE losses and ongoing investment in product optimisation
 - This phase can run through to the end of production, perhaps after ten years for some programmes but 15-20 years for others
4. OE sales have largely ended and we are supporting an installed base in service – providing essential aftermarket support and improving on-wing performance
 - This phase may continue for anywhere between a further 20 and 25 years

In summary: a very long-cycle product with distinct cash flow phases

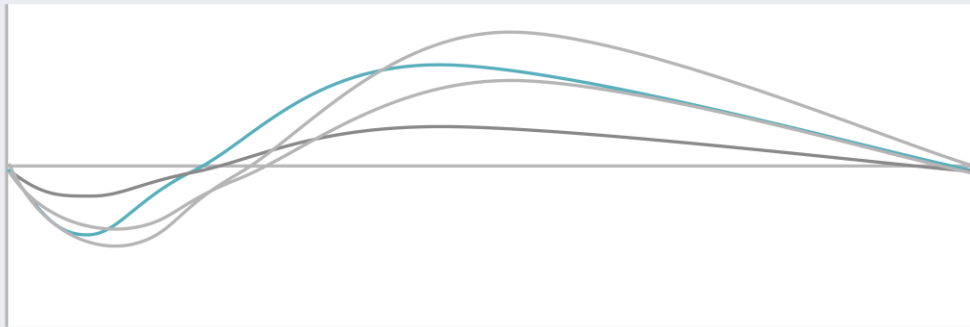
Not every programme is the same



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Not every engine programme's cash flow profile is the same:

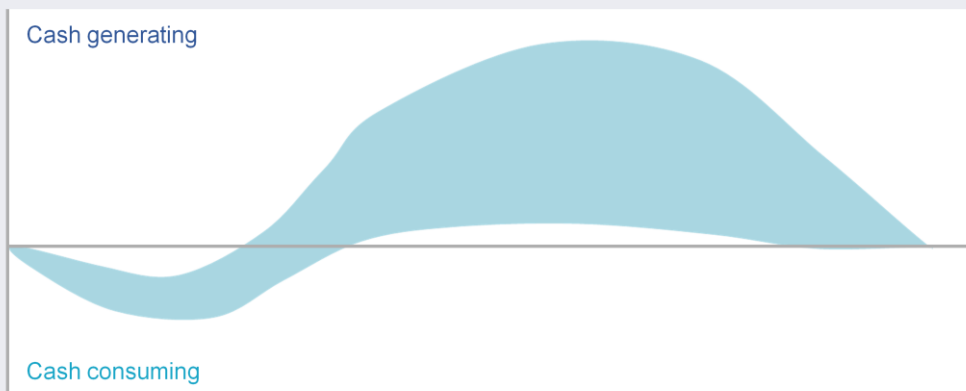
- Some have quicker ramp-ups in production and the aftermarket builds more quickly
- Others may require more engineering investment
- Some have more volume success than others, reflecting stronger demand for the engine or airframe, lengthening the production phase
- Some programmes have longer service lives than originally expected (e.g. RB211)



As a result, portfolio of engines with variations in the cash flow curve

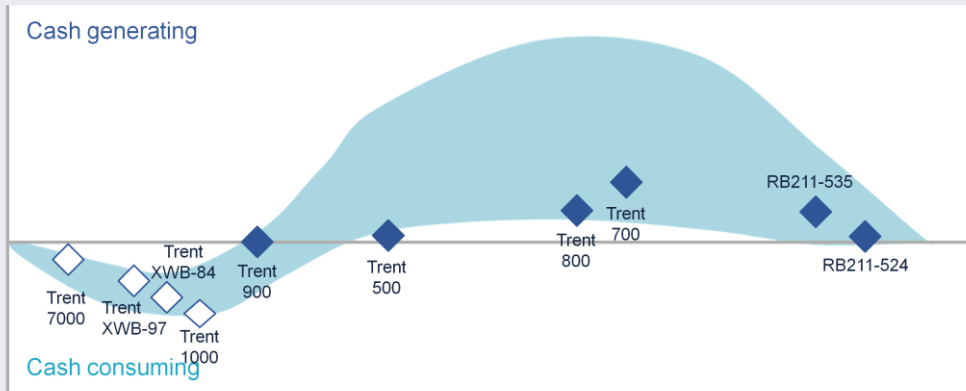
The basic shape is the same, but the details are different

Portfolio today...



Aggregate all the programmes and look at them as a whole, there is a broad spread of cash flow performance

Portfolio today...



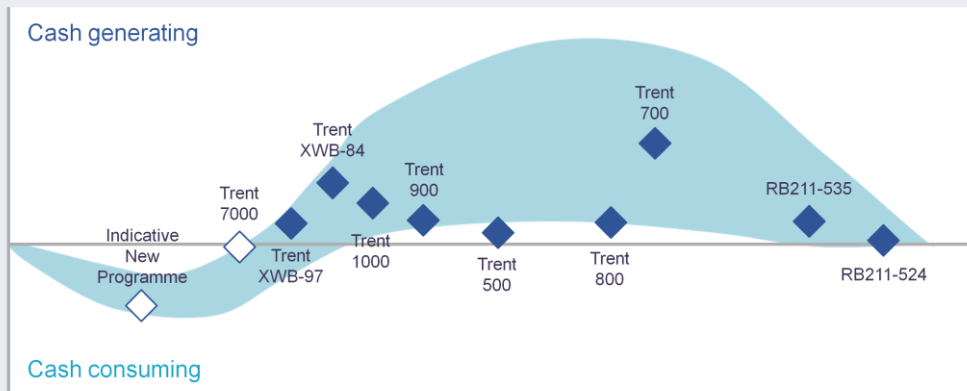
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Today, this is how they map out

Significant proportion in the early stages of development and cash generation

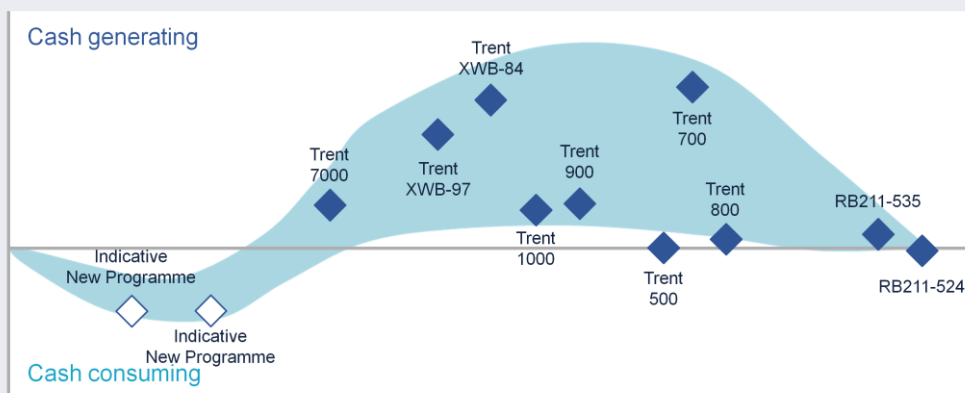
Confident that this investment in the growth of our installed base will deliver attractive returns

In 5 years...



Looking forward five years, moving the balance to cash generation

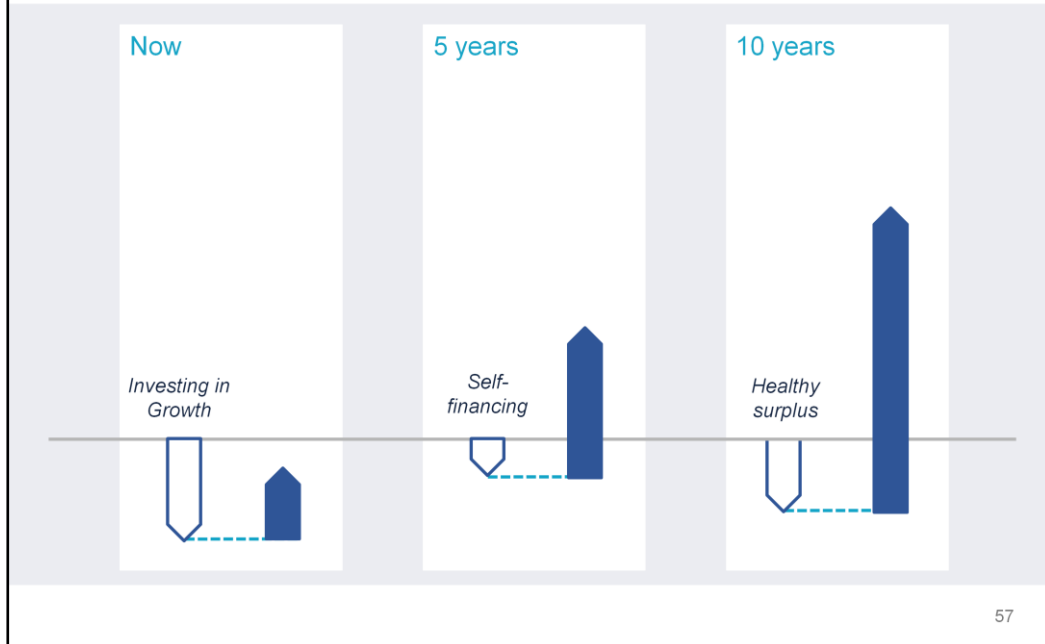
In 10 years...



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And another five years, with the Trent XWB in the aftermarket and generating strong cash flows, expect a much more cash generative position

Widebody cash progression



Current situation; investing in growth

- Cash flow impacts from production programmes and development programmes out-weigh the cash flows generated by the Trent 700 and now-out of production engines

But in five years, expect to be moving strongly into positive territory

And then in 10 years, expect engine programmes will be generating a very healthy surplus and contributing to very strong free cash conversion

Focus on operational efficiency



Delivering the ramp up in engine production

Delivering the schedule delivery while benefitting from the cost savings above

Aftermarket performance

Outstanding aftermarket service and efficiency to capture cash flows from programmes

Industrial transformation

Accelerate learning curve to benefit manufacture and aftermarket as quickly as possible

Engineering Efficiency, well resourced and focused

Key part of costs and efficiency if we are to be successful

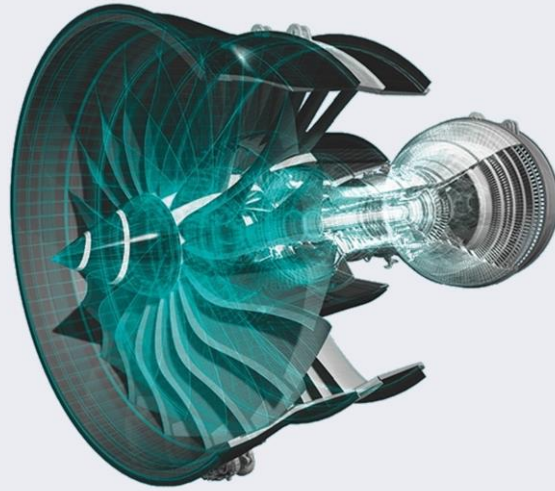
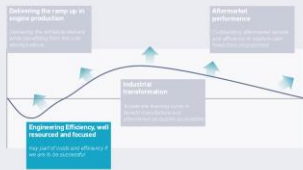
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Recap: not all engine programmes are the same and as a result drive different cash curves

Operating priorities in aerospace will be largely driven by the enablers or barriers to success highlighted here, if we are to maximise our potential performance

Going forward these four areas underpin the priorities and actions for the team

Engineering efficiency



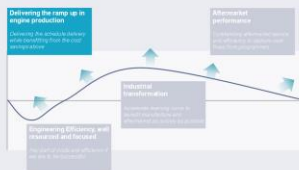
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Efficient engineering underpins the outstanding market leading products produced today

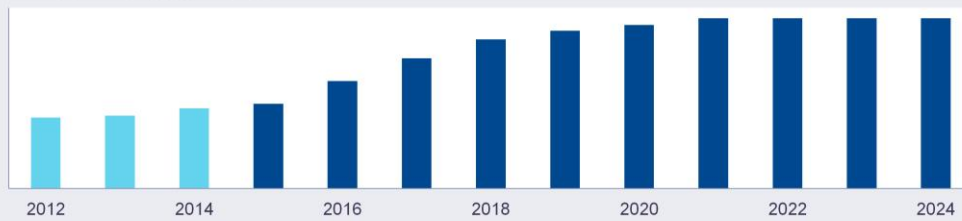
But with an ever greater focus on designing for production and designing for service

All at lower and lower overall cost

Delivering the ramp up



Annual Trent deliveries

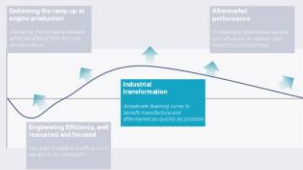


The ramp up of the Trent XWB will be critical to getting strong cash flows on this programme faster than any other programme we have launched

Need to:

- Match Airbus demands
- Deliver the schedule
- Improve production costs faster than ever before

Industrial transformation

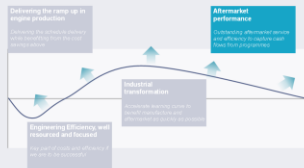


Industrial transformation well underway and essential to maximise manufacturing efficiencies

This will:

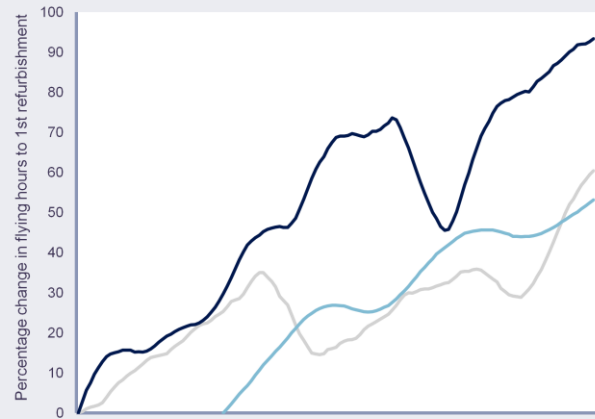
- Reduce production losses
- Enhance margins in the aftermarket with cost competitive spares

Aftermarket performance



- Keep engines on wing for longer
- Inspect, replace or repair every part appropriately
- Make full use of data

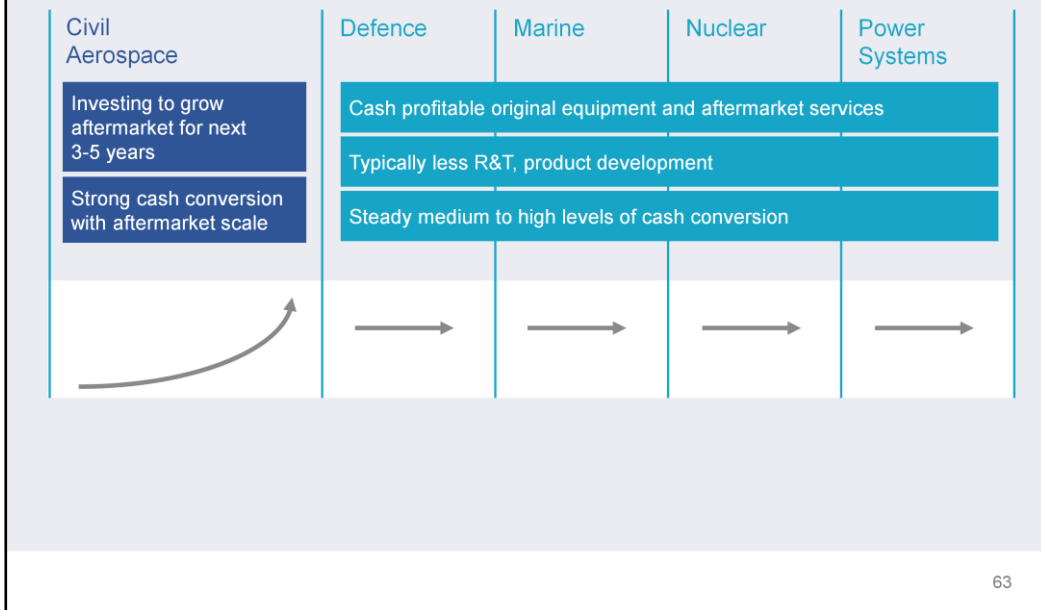
Trent engines time to first refurbishment



Need to maximise our aftermarket performance by:

- Continuous improvement in engine performance
- Improving customer experience
- Leveraging insights into engine and airframe performance to help customers unlock more value and strengthen partnership with them

Future value and cash flows



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Rolls-Royce is not about just one business

Portfolio of activities with different cash flow characteristics enables it to manage current period of investment

- Defence Aerospace – more positive cash flow cycle due to product development funding, cash margin generative production and long aftermarket cycles
- Marine – historically it has experienced strong cash conversion, partly as a result of high customer deposits. But current market downturn will restrict its cash performance, in stark contrast to its historic performance when it supported aerospace investment
- Nuclear – strong positive cash flow, although the phasing of Government product development support does mean that it will be somewhat less in the future
- Power Systems – good cash margins with potential to unlock higher returns on capital employed by reducing working capital

Key topics for today



Outcome of review of operations

Strong portfolio of products and services –highly differentiated power systems

Civil Aerospace performance

Improved disclosure and clarity on the key drivers of growth and value

Cash generation and capital allocation

Strong long term cash flows driven by growth in wide-body aftermarket, industrial transformation and business simplification

Improved disclosure and transparency

Increase revenue segmentation, gross margin disclosure and trading cash flows by business

Areas for business improvement



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5 key topics

Covered:

- Outcome of review
- Views on the civil aerospace business, the outlook and its foundations for success
- The strength of future cash generation

David will now share some further thought on:

- Capital allocation
- Initiatives to improve disclosure and transparency across the business

Return to talk about the key areas for business improvement including:

- More details on ambitions for the business
- How we should be working
- Our priorities and strategic focus

David Smith
Chief Financial Officer



Priorities and agenda



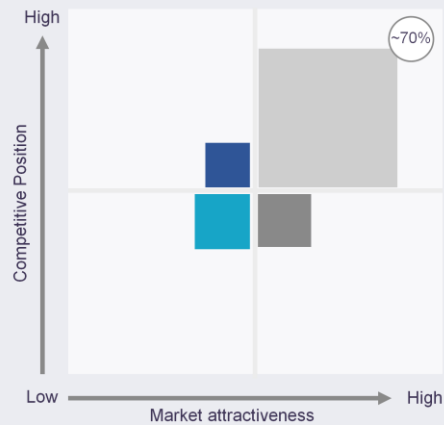
Key conclusions

- Widebody is an outstanding opportunity largely built into order book
- Strong growth products and services across the portfolio
- Major opportunities to improve operational performance
- Focused investment/Capital discipline
- No “special cases” – value can be created in many different ways

Agenda

- Financial framework and outlook
- Transparency and guidance
- Investment returns – our goals

2020



Examined the fundamental strengths and weaknesses of our businesses

- Reinforced the need for focus on improving operating performance, cost and cash in the near-term
- Evaluating the priorities for investment to support the long term growth of the business

Number of areas where business outlook can be changed

Make those decisions with a clear focus on return on capital employed

Financial position remains healthy



Managed robust cash position over the last year

- Targeted working capital efficiencies
- Cancelled buy-back programme
- Close control of Capex/R&D

Balance sheet well-positioned

- Gearing remains low
- Targeting long-term investment grade rating – “A” since 2006
- Recent debt raising provides strong liquidity for medium-term

'Dividend' policy will be reviewed in February

- Payments to shareholders regarded as an important part of long-term investment proposition but must be balanced with credit rating

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The developments over the past year create a number of major challenges
Managed our cash position thoughtfully, and taken the necessary actions
when needed

Improving our financial framework



- Financial analysis and reporting remains work-in-progress
- Pricing and investment decisions good
- Inconsistent strengths in forecasting, analysis and systems support
- Improve disclosure of in year and near-term performance

Current disclosure

Revenue

- By business
 - OE
 - AM

Profit before FCT

- By business

Group Finance charges

Group PBT

Recent news flow emphasises that our financial analysis and reporting remains work in progress

Areas of strength are not consistent across the group and this is where new investments will help

Additional margin disclosure



Group 2014 Underlying income statement*

	Group		Civil	Defence	Power Systems	Marine	Nuclear	Eliminations/ Central Costs	Group
OE Revenue	7,220	→							7,220
AM Revenue	6,644	→							6,644
Total Revenue	13,864	→							13,864
Cost of Sales**	(10,466)	→							(10,466)
Gross Margin	3,398	→							3,398
Net R&D (including dev cost contributions)	(730)	→							(730)
Aggregate other costs including C&A	(987)	→							(987)
PBFCT	1,681	→							1,681
**Capacity under-utilisation and 'double running costs'	~(100-200)								~(100-200)

* On a continuing basis. **Capacity under-utilisation and 'double running costs' included in cost of sales

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Proposing to expand our level of disclosure to include a group level underlying gross margin and to introduce a breakdown of gross margin, R&D and "aggregate other costs below gross margin" for each our segments

Enables better understanding of the relative gross margin performance across our businesses

Break out estimates of 'capacity under-utilisation' or 'double running costs' currently in the cost of sales line

Provide figures when we present our preliminary results in February

Additional revenue disclosure
Civil Aerospace



Revenue 2015

7,000-
7,300

Original Equipment 46-49%

Large Engine: linked and other	22-25%
Large Engine: unlinked	~8%
Corporate	~12%
V2500	~4%

Aftermarket 51-54%

Large Engine	32-35%
Corporate	~5%
Regional	~6%
V2500	~8%

Under-utilisation costs
included in cost of sales ~ (100-200)

Gross Margin x - y

R&D charged (x) - (y)

Other costs (x) - (y)

PBFCT 800 - 900

Expand breakdown of revenue for Civil Aerospace

Current plan for OE is to separate out revenue from our large engines into “linked and other”, which includes spare engines and “unlinked”, and also by corporate and V2500

Within aftermarket; large engines, corporate, regional and V2500

Provide the actual revenues for these categories in addition to total gross margin, R&D and other costs in February 2015

Modelling the business



	2015	CY+1	CY+2	CY+3	CY+4
Revenue 2015					
Original Equipment	46-49%				
Large Engine: linked and other	22-25%	➔	Future disclosure		
Large Engine: unlinked	~8%	➔			
Corporate	~12%	➔			
V2500	~4%	➔			
		Indicative only			
Aftermarket	51-54%				
Large Engine	32-35%	➔	Future disclosure		
Corporate	~5%	➔			
Regional	~6%	➔			
V2500	~8%	➔			

Provide additional directional guidance on the absolute trends in each of the important revenue lines

Include in appendices going forward

Civil trading cash flow



	2015	CY+1	CY+2	CY+3	CY+4
PBFCT by Business	£800-900m				
TotalCare net debtor movements	(x)	➔	Future disclosure		
CARs movements	(x)	➔			
Working Capital Movements	x	➔			
Other non-cash movement in depreciation, capital and intangibles	(x)	➔			
Trading cash flow*	X				
		Indicative only			

*Trading cash flow is cash flow before pensions, tax, M&A, payments to shareholders and FX

Extend disclosure down to trading cash flow

Doing this on an annual basis, and then providing directional guidance, should enable modelling of views on cash conversion

NPV of embedded cash flow should be the most appropriate way of valuing our Civil Aerospace business

2016 headwinds



- Disappointing market outlook for offshore marine, corporate jets and regional
- Rolls-Royce particularly impacted by specific exposures
 - 50-70 seat regional jets
 - Large business jets
 - Legacy RB-211/Trent utilisation
 - Offshore capex
- Aerospace trends broadly reflect an acceleration of expected developments – the end point in 2019 is expected to be similar
- Free Cash Flow less impacted in 2016 pre restructuring

2015 PBFCT (£m)	1,325–1,475
Trent 700	~250
Large engine aftermarket	~50-80
Large Engine other	~50-70
Business jets	~75
Regional jets	~75
Marine weakness	~75-100
Headwinds	~650

Modelling implications

Trent 700



~£250m

~ £100m	Volume
~ £100m	Pricing
~ £50m	Spares

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Significant volume and price effect - £100m each – and loss of spare engines
Modelling the volume reduction; impact from:

- revenue segmentation
- average engines sold
- view on achieved margin

Pricing impact on margin means the average achieved margin for our new linked and other OE sales would have reduced significantly

Cash flow impact significantly less - reflects only change in net cash loss of engines sold vs prior expectation

Other widebody headwinds



£100–150m

~ £50-80m	Widebody aftermarket
~ £25-35m	Other volume/mix/cost factors
~ £25-35m	Reduced JV profitability

Modelling - large engine effects – adjust assumptions on the degree of margin erosion

**Regional and V2500 headwinds
are more structural**



~ £150m for Business and Regional

~ £75m	Lower Business Jet OE revenues
	Revenues reduced by around 15-20% in 2016
	Some pricing pressure
~ £75m	Regional and V2500
	Regional aftermarket decline accelerated
	Conservative assumptions on V2500

Some business jet effect on pricing and therefore margins
Regional business and V2500 programme - headwinds more structural and reflect an acceleration of already anticipated trends

Reviewing our business forecasting and analysis



Need to improve performance transparency – link of physical drivers to financial results

Issues around link between profit and cash (TotalCare)

Inconsistent guidance – short- or long-term

Difficult for market to analyse or predict performance based on market factors

Several changes underway

- Major update to management information and forecasting systems
- Strengthening control framework
- Review of accounting for IFRS 15 implementation

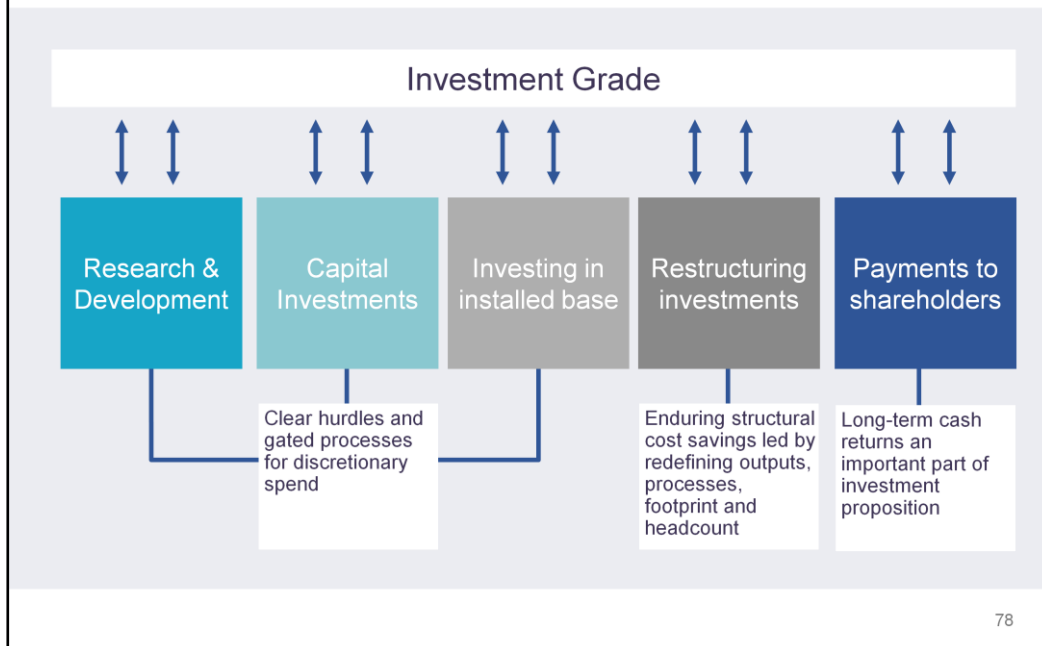
In the meantime...

- Update our framework for short, medium and long term guidance

Identified the need to improve performance transparency through better communication, both inside and outside Rolls-Royce

Major project - next year further updates on this project and its outputs, together with assessments of IFRS15 and its likely impact on financial reporting from 2017 onwards

Disciplined capital allocation will be critical to our success



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The decisions we make as to how we prioritise and best make our discretionary investments are fundamental to the long term shape and scale of the business and the enduring benefits we will create

- Clear view on the metrics both by project and for the group as a whole
- Drive greater discipline to robustly challenge and monitor the programmes
- Judge dividend policy in light of the priority uses of cash

Summary



- Strong financial liquidity supported by a healthy balance sheet
- Management information systems improvements well underway to support decision-making but will take time to implement
- Clearer financial framework for modelling the business
 - Enhanced disclosure
 - Cash margins by business
- Updated 2016 headwinds
- Disciplined approach to capital allocation and returns

Warren East
Chief Executive



Initial findings

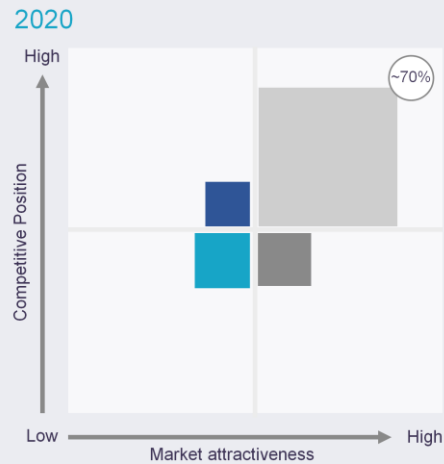


Strong mix of business

- Over 80% in attractive growth markets
- Over 75% in with strong competitive advantages

Competitive advantage strengthened by investments

- 2/3rds of group will benefit from transformation programme



Convinced we have a strong portfolio of products and services with strong competitive positions and many in sustainably attractive markets

Some need investment, to strengthen products, routes to market or to reduce their costs so they can be more competitive in the future

Common themes will drive our success



Engineering excellence

- Focused on high performance power systems
- Leverage engineering excellence to build market share and long-life installed base

Capturing aftermarket value

- Performance critical assets provide the platform for value added services and systems
- Potential to leverage knowledge to drive additional value added for customers and build attractive margins

Operational excellence

- Manufacturing transformation to drive higher margins
- Sustainably lowering costs through continuous improvement

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Clear common themes for investment and focus will drive our success

- Engineering Excellence
- Capturing aftermarket value
- Operational excellence

During operating review, have met extensively with customers, who said:

- Strongly supportive of working with Rolls-Royce
- Appreciate world-leading products, support and services
- Want Rolls-Royce to be more commercial and focused

Clear opportunity to build on this foundation by doing our job better:

Can leverage our relationships and technical expertise, especially our exploitation of data:

- Providing more value to the customer
- Creating culture of continuous improvement
- Being more efficient, largely from our existing footprint, so without major capital investment as well

On a journey to becoming world-class in aerospace and nuclear

- More to do in power systems and marine

We are a Power Systems business...

Vision

"... to be the market leader in high performance power systems where our engineering expertise, global reach and deep industry knowledge deliver outstanding customer relationships and solutions"

Strategic focus

"... focus on differentiated, mission critical power systems markets with high barriers to entry where we can leverage our leading engineering skills and manufacturing excellence to drive growing market shares"

We are a power systems business

Defines a clear vision and strategic focus

Will be more ruthless in managing the portfolio and making the tough decisions around how we deploy capital

Will be making changes to our products and services over time, as we refine:

- What we do
- Where we make or buy products
- How we realign our service and product offers

Operating priorities and investment needs



5 years
2015-2020

Driving performance,
delivery and transformation

Focus investments in digital
expertise, advanced materials
and leading technology for next
generation products

+10 years
2020-2030

Leveraging market share
to drive cash and returns

+20 years
2030-2050+

Delivering the
next growth cycle

Three periods define our priorities

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Three very clear periods of development for the business, not just in aerospace but in reciprocating engines

First two periods are key:

The next five years will be all about driving performance, delivery and transformation

- Will continue to invest, focusing on enablers of future success:
 - Digital expertise
 - Advanced materials
 - Specific product development

The ten years after that, as we reap the benefits of our investments over the last ten years in terms of cash flows and returns, will be about making the right selected investments for the future - but decisions we don't need to be taking until then

Investing in our common themes



Focus

Engineering
strength

Leverage
installed base

Operational
excellence

Resources

Defining what's
absolutely needed



Restructuring
around focus

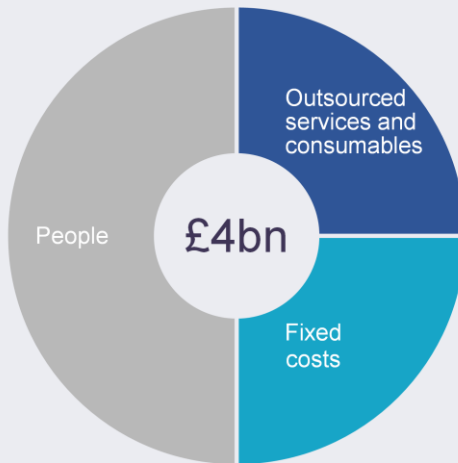
Near term and focus on restructuring:

- 3 focus areas for development, to ensure we are competitive and driving continuous improvement
- Focus our resources better, by defining what we absolutely need to do and restructure accordingly

Significant costs embedded in our organisation



Focus Resources



- ~32,000 people
- ~55 million man hours

Spending around £4bn a year on being a sales and engineering organisation:

- Developing products
- Driving growth
- Administration

That excludes direct product costs and core manufacturing overheads

Are we doing this as efficiently as we can? No

Announced Programmes to Date



Incremental changes

Aerospace	2015	2016	2017
Net improvement	£0m	£80m	£0m
Headcount reduction	2,200*	400	–

Marine	2015	2016	2017
Net improvement	£(10)m	£35m	£40m
Headcount reduction	600	400	–

*: includes 545 who left the business in 2014

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Change already underway

Aerospace and marine restructuring will lead to improvements

Need now to focus on root causes of inefficiency:

- Growth in corporate and overhead costs
- Expansion of senior management structures
- Complexity in the organisation

Manufacturing Transformation



Aerospace

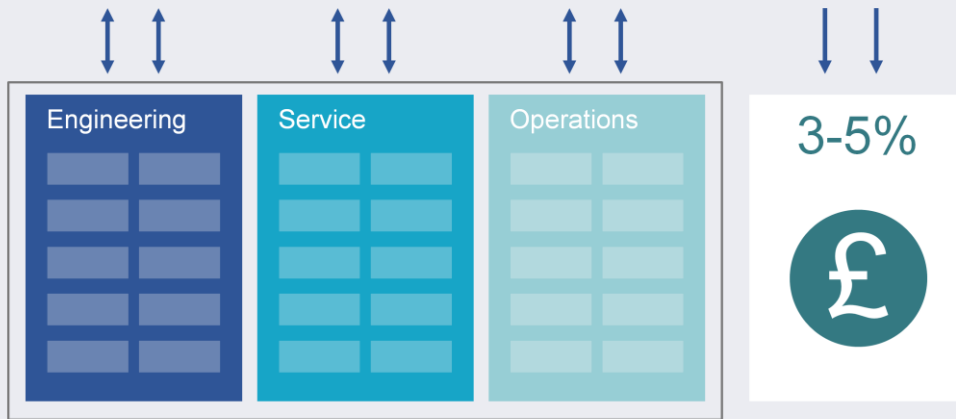
	2015	2020	
Footprint	1.4m sq m ²	1.1m sq m ²	↓ 20%
Double Running costs in Gross Margin	~£(100-200)m	—	Improvement in gross margin
Output #	~330	~600	↑ 80% large engine output

Manufacturing transformation programme will lead to significant improvements in Aerospace as we nearly double our output from a lower, more streamlined cost base

New programme creates significant incremental savings



Focus and deploy resources to maximise value to customer



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New incremental programme to drive significant savings

- Just the first step
- Targeting 3-5% is sensible first goal
- Should be able to do more through continuous improvement
- Must tackle key drivers of the problem

New £150-200m programme



Organisational hardware

Primarily fixed costs

Senior level

Corporate and divisional

Organisational software

Significant process simplification

£150-200m reduction, targeting a 1-2 year payback

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Not only the organisational hardware of the business:

- The fixed costs
- Management structures
- Corporate

But the organisational software too

- Focusing on the processes and ways of working that embed cost

What's missing and what needs changing?

- Dealing with change and ambiguity
- Approval processes
- Accountability
- Ensuring the right people have the right conversations at the right time
- Internal Reporting
- Improved management information

...the processes and behaviours that wrap around an organisation

Organisational software:

- The processes and behaviours that wrap around an organisation

Rolls-Royce has built up challenges in the way it works:

- Very good at defining problems and solutions
- Not good at dealing with change, ambiguity or pace of change
- Organisation is too complex and hinders accountability for key tasks
- Makes clarity on goals and incentives less effective
- Very hierarchical, which impacts pace and quality of management information

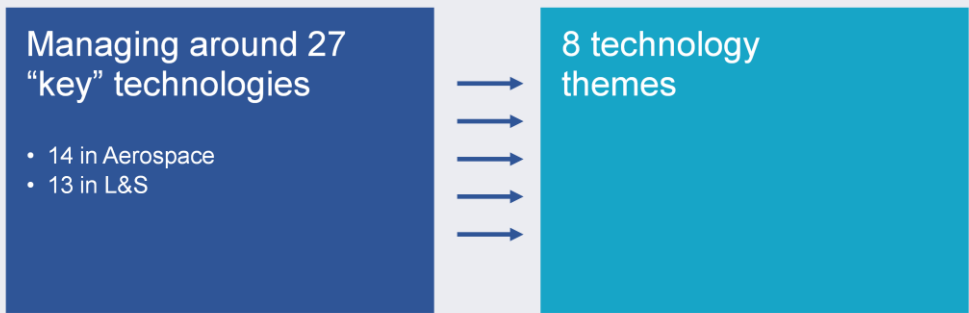
What is needed? Simplicity and pace:

- In systems
- In the attitudes and objectives of our people

Example: Simplifying Key Technologies



Rolls-Royce



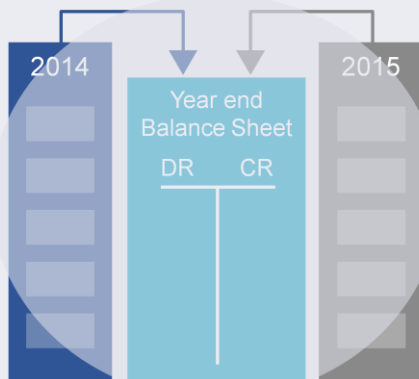
Simplification of management and process

Example: Key technologies

Improving our operational measures of performance



Accounting complexity...
obscures goals and achievements



Clearer operational measures of success...
helping drive change in behaviour

Productivity measures

Unit cost measures

Working capital efficiency

Innovation efficiency

Process waste

Must transform our approach to performance measurement:

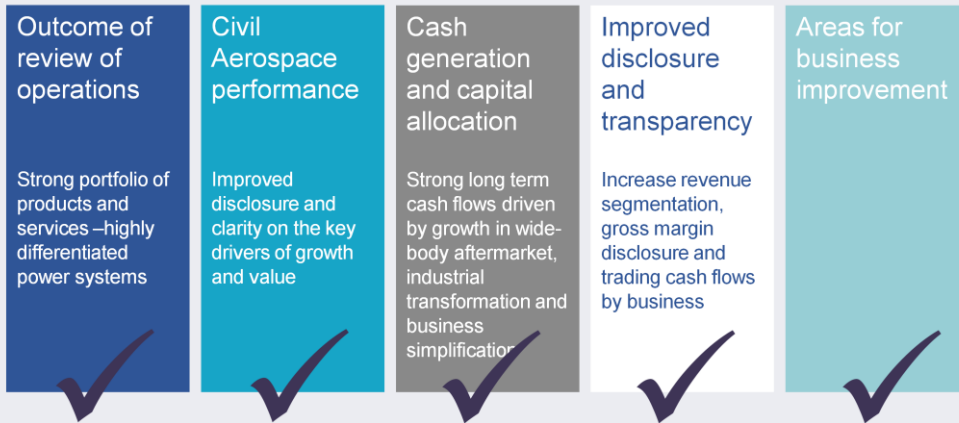
- Drive accountability down in the organisation
- Remove the fog created by TotalCare accounting
 - Creates external confusion
 - Obscures clarity of goals and accountability internally

Updates in 2016



Review has set out a clear timeline for further updates
Will be reporting back on this in due course, at the full year and progressively throughout 2016

Key topics for today



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To recap...

- Shared views on the portfolio :
 - Strong overall
 - Outstanding products and services
 - Focused on highly differentiated power systems markets
- Given more clarity on our civil aerospace business:
 - Plans to drive even more changes to reduce costs and complexity
 - Improved disclosure should provide better framework for modelling
- Set out expectations around cash generation:
 - The transformation over coming years
 - Our disciplined approach to capital allocation
- Updated you on our restructuring agenda:
 - The potential for continuous improvement

Conclusions



Period of unprecedented change

- In our mix of business and how we account for it
- In our industrial footprint as we invest in a wide-ranging transformation
- As we double production of our widebody engines
- As we invest in technology for post-Trent product family

Review underpins confidence about the future

- Outlook remains very positive
- Industrial transformation proceeding well
- Set to gain significant market share and build a strong cash generative platform

Laying the foundations for long-term profitable growth

- Financially stronger, more resilient business
- Restructure organisation to drive material cost and process improvements

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Safe harbour statement



This announcement contains certain forward-looking statements. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. In particular, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of interest or exchange rates, the availability of financing to the Company, anticipated cost savings or synergies and the completion of the Company's strategic transactions, are forward-looking statements. By their nature, these statements and forecasts involve risk and uncertainty because they relate to events and depend on circumstances that may or may not occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements and forecasts. The forward-looking statements reflect the knowledge and information available at the date of preparation of this announcement, and will not be updated during the year. Nothing in this announcement should be construed as a profit forecast. All figures are on an underlying basis unless otherwise stated. See note 2 of the Financial Review for definition.