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RR.L - Full Year 2015 Rolls-Royce Holdings PLC Earnings Presentation

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PRESENTATION

John Dawson ***- Rolls-Royce Holdings plc - Head of IR***

Excellent. Okay. Well, it looks like everybody's in, so good morning, ladies and gentlemen, and welcome to you all here in London and to those joining on our webcast presentation today. My name is John Dawson; I'm the Head of Investor Relations for Rolls-Royce. And it's my pleasure to welcome you and to introduce Warren East, our Chief Executive, and David Smith, our Group Finance Director.

The running order of today is as follows; Warren will take you through the highlights of 2015. David Smith will then review our financial results in more detail and take you through some additional business disclosures. Warren will then return to share some further thoughts on the next steps we're going to be taking. We'll then turn the proceedings over to questions.

We have quite a lot to cover so we're expecting the presentation to run for about 40/45 minutes, but we've allowed time for questions at the end. We will be able to field some questions from the webcast so if you wish to submit a question, please enter it into the system and one of the IR team will read it out. If we don't get a chance to cover all those questions, we'll make sure we follow up with you later.

(Conference Instructions).

It's worth saying, we may also include some forward-looking statements, so please refer to the disclosures in the back of our results pack.

(Conference Instructions).

Thank you, and without further ado, I'll hand you over to Warren.

Warren East ***- Rolls-Royce Holdings plc - CEO***

Great. Thank you, John. Good morning, everybody.

Well, the last time I was presenting in this room, it was actually to a bunch of lawyers at the London Patent Summit, so this morning is much more interesting. And it's actually going to be a little bit longer than our usual presentation as well because, as promised in November, we're including a little bit more disclosure, and David's going to take you through that in a few moments. I'll start off, however, just with having a quick review of 2015, some of my thoughts on that as well.

So we've delivered 2015 in line with the expectations that we set out earlier in the year, with revenue at just under GBP13.5 billion. That produced a gross margin of just over GBP3 billion, and I think it's well known that -- the reduction in gross margin there was driven by weakness in our marine sector and through various mix effects in our civil aerospace sector. So the underlying profit was down as well, and that had an effect on the operating margin.

I think the cash -- at the very, very end of the year, did surprise us slightly on the upside, ahead of our expectations in November, and David's going to cover that shortly.

I think the news this morning, although we did again talk about this in November, as far as dividend is concerned, it's very important that we make the transformations that we've been talking about in this business happen. And those transformations do require investment, and that does put pressure on cash.

At the same time, we need to retain a healthy balance sheet, which gives us flexibility and preserves our credit rating, and so the Board has decided that we will halve the payment to shareholders for the final payment for 2015, and halve the interim payment for 2016.

But it is our intention to keep that under review, and, subject to the short-term cash requirements, we intend to rebuild that, which reflects mine and the Board's confidence in the future cash generation of the business. So that dividend move is important for us.

Now I just wanted to share some of my thoughts on what really went on in 2015. I'll start -- and I think there were some good things and some bad things with the things that went well in the markets in which we operate.

In the civil market, we saw Trent XWB, our new engine, do its first full year of service, and we've passed that milestone now. The ramp-up in production that we foresee over the coming years, we're well positioned for that. Overall in Q4 last year, we delivered nearly 100 engines, including XWB. That's -- large engines; out of a total of just over 300 for the year. So you can see the trajectory developing there. The capacity is in place as a result of the investment that we've been making, so we're now very well positioned to exploit that new capacity and deal with the XWB ramp-up.

Trent 1000 TEN, the latest version of the Trent 1000 engine, we did incur a few extra costs there to push that through tests during 2015. But that's now happened, and it's clear that we've made a major advance with the Trent 1000 TEN, and we're very, very pleased with the performance of that engine; and that positions us very well to gain market share on the platform for that engine on the 787.

So from an orders point of view, it was also a strong year for new orders in the civil sector. Clearly, the highlight was probably the Trent 900 engine order from Emirates halfway through the year, but also towards the back end of the year with orders from the Chinese airlines. And you saw some noise about that as well.

So overall, we delivered just over 300 large civil engines and we took orders for nearly 500 large civil engines during the year. The backlog is therefore up, and it's up about 4%, which is good.

Switching to defense aerospace, I think the story there, revenue slightly down; is weakness in demand particularly in helicopters and some of our transport business. But in spite of that, there was a modest increase in the profit from that group, and that's being driven by the effectiveness of the cost activities that we've been undertaking there. So that, I think, was a highlight for that business.

Moving around the other parts of the business, in power systems, that was a very good result for the full year. There was a strong mix effect -- playing into different [end] applications there, and a strong finish to the year, and a strong finish in terms of taking orders as we look forward as well. So we're quite well positioned now going into 2016 in power systems.

In marine, we all know that our business is exposed to the offshore sector; and we all know that there are serious problems in the offshore sector driven by the price of oil. But we have taken swift action on cost reduction. There's some very challenging reorganizations going on. But the focus in the business there have really taken -- they've grasped that nettle and getting on with it, and I found that very encouraging.

And in nuclear, we've had some very steady performance.

So Group-wide, there have been some good news stories in 2015 but, of course, it hasn't all been glorious, I do understand there were some issues in 2015, and these issues emerged. We talked a lot about them in the second half of

2015; changes in the civil aerospace market, and in particular how we communicated about those changes over the period.

Now some of that was directly linked to the speed and complexity of decision making within our organization, and that's highlighted to me that we're just not nimble enough and we need to do something about it.

Some of that is associated with how we're integrated together and how we work together in the business. And that's a real issue. Part of our transformation program is addressing that.

Another part of our transformation program is addressing the thing which became very stark with our announcement in November, the fact that our fixed costs base is simply too high; it makes us very sensitive to market changes. And that's not acceptable and we are doing something about it.

And underlying all of that, of course, the famous TotalCare Accounting complexity. Now when I look at that, there's nothing intrinsically wrong with it; absolutely nothing particularly in steady state. But clearly, when we move from one business model to another, it doesn't handle that transition very well. And compounding that, I understand we haven't done a very good job at explaining it.

So these are the issues which emerged in 2015; some good things and some bad things.

So my first month in the business last July, I have to say it was interesting month to say the least. And at the end of July, I had established five goals for the remaining part of 2015, and these are the five goals.

It was to thoroughly understand the business, the products, the processes, the management structure we had, to try to identify areas of improvement; at the same time keep the wheels turning on the business. And we delivered what we said we were going to deliver in 2015, and we've not changed our outlook for 2016 this morning. So that was also done. And we are making progress on working out how to communicate better, and you're going to see some of that from David's talk in a moment or two.

And there's a lot more to be done. And another one of my objectives was to work out what those priorities for 2016 would be, and I'll come back and talk about those priorities in a moment when David has just talked through some of the numbers.

So with that, I'll hand to David at this stage.

David Smith *- Rolls-Royce Holdings plc - CFO*

Thank you, Warren, and good morning to everybody. Well, I hope you found the statement informative as we provide greater disclosure and context. We've also included within this presentation further slides to paint a clearer picture as we navigate through some of the challenging market conditions, the product transitions and civil aerospace, and our significant transformation program.

As Warren said, I should warn you that this will make it a longer commentary than normal given the introduction of the new disclosures, but I think we've improved how we talk about expectations, for the current year. And I hope we're, therefore, meeting -- as we meet with many of you on our road show, help you to progress your understanding of those new disclosures as well.

So let me turn now to the review of 2015, and during this, when I give a percentage figure, I'm going to be doing that at constant FX rates unless I specify otherwise.

So starting with the Group highlights.

As Warren said, 2015 was a solid trading performance given the outlook deteriorating in some of our key markets, particularly marine. Our trading outlook for 2016 is also unchanged from the one that we shared in November. Our order book grew 4%, particularly in aerospace, including the record $9 billion order from Emirates, but there's no surprise that our marine order intake was very weak.

While revenues held up well, after adjusting for FX, profit before tax declined by 12%, and that included two credits for an intellectual property settlement and an R&D credit. Free cash flow also reduced from last year.

On the shareholder payment, as Warren said, I think it's essential that we take a disciplined approach to our financial policy here and manage both the expectation of our shareholders in a balanced way; and I believe that the 50% reduction is a prudent and measured response to what we see before us and the current macro environment.

So Group revenue, and this is the comparison to 2014. Underlying Group revenue declined by 1%, with growth in civil aerospace offsetting weakness in marine. OE revenue fell by 5%, but was partially offset by a 4% increase in service revenue, particularly in civil. FX translation effects totaled GBP414 million, and that took 3% off the revenue line and primarily reflected weaker European currencies.

So turning now to profit. The underlying result was in line with the guidance range of GBP1.325 billion to GBP1.475 billion that we gave at the half year, albeit at the lower end when I adjust for the two credit items that I've already mentioned. There were significant reductions in marine and civil profits of similar absolute amounts year over year, and a more modest decline in power systems.

The impacts by business driver were primarily from gross margin, GBP311 million gross margin reduction. I'm going to talk about that in more detail as I go through each of the businesses; a small overall improvement in C&A costs.

On R&D, we did invest further on R&D for the new Trent programs, plus the work that we're doing on the next generation technologies across a number of our businesses, and that together increased the net R&D charge by GBP83 million for the year. And within that, the R&D spend was up by about 5%, and there was also a significant decline in capitalization of R&D and an increase in amortization and further higher development cost contributions. So those net brought about this GBP83 million increase in the charge.

On restructuring, we had a lower underlying restructuring charge for the year at GBP108 million, less than 2014. That was principally because we took the charges, as you know, for the big programs at the end of 2014 that we announced before November.

And as I mentioned, we benefited from a GBP58 million gain on intellectual property and GBP19 million for an R&D credit in nuclear. FX wasn't a major factor for profits net in the year.

So let's move now to cash flow. Free cash flow for the year was GBP179 million. As Warren said, that was ahead of our expectations, principally due to customer receipts coming very late in the year which we'd been expecting in 2016. So those will naturally reverse early in this year, and our outlook reflects that.

Having added back depreciation and amortization, which was slightly down from last year, the most significant movements were as follows.

So within net working capital of GBP544 million negative, that was predominantly around a GBP406 million increase in the civil long-term contract balance, which now stands at GBP2.2 billion.

There were also higher trade receivables, but that was offset by a reduction in inventory, and our inventory turns improved to 3.4 times.

Our cash spend on capital expenditure was GBP479 million; that was lower than the prior year. But it still included new test facilities together with the turbine blade and disc manufacturing and other production facility upgrades that we've been talking about.

Our intangibles additions of just over GBP400 million were principally within civil aerospace and included the growth in contractual aftermarket rights that comes from additional unlinked engine sales; and further beyond that, our certification software and development costs.

And then finally, the other, the GBP229 million was one of the main drivers of cash outflow, and that essentially is because we took the restructuring provisions in 2014 and the cash came out in 2015.

So we get, therefore, to a trading cash flow of GBP385 million, and that was then further reduced by GBP160 million of tax payments and GBP46 million of pension contributions over and above the profit charge within the profit number, and that gets you to the GBP179 million for the year.

So cash conversion was down year over year from 54% to 27%, and I'll just remind you again that we do cash conversion on trading cash flow compared to profit.

Turning now to our balance sheet. We've maintained a strong investment grade credit rating. We've worked very hard at this. Standard & Poor's updated their rating in January. We moved to an A negative outlook while Moody's have maintained their current rating at A3/stable. And that did follow very detailed discussions with the two agencies, who I believe took a very constructive and considered approach to a more challenged outlook.

Also last year, following the October refinancing and the debt raise, we've now total liquidity of around GBP5 billion and have also extended our average maturity out to over six years.

Our plans for this year include redeeming a couple of smaller facilities which total just over GBP200 million, and we obviously had that in mind when we raised the $1.5 billion bond in October.

So I'll come back to FX hedging in a moment, but I wanted to go straight to the shareholder payment. And as Warren said, the Board has taken the decision now to halve the level of the final payment to shareholders when compared to last year's final payment, and to do this again at the 2016 interim stage against the 2015 interim. So as a consequence, going forward, cumulatively this will have reduced by 50% the shareholder payments over the next 12 months.

As we pay both interim and final in the subsequent year to when they're declared, our 2015 cash wasn't affected by this decision; but, clearly, 2016 cash flow -- below trading cash flow will benefit.

Beyond this, our future dividend policy will have a stronger relationship with our cash generation capabilities, as noted in the statement, and I think Warren has already covered that quite well.

In terms of foreign exchange translation, just to remind you. Our main foreign exchange exposures are really within the aerospace division where we hedge our net US dollar long position against pounds and euros respectively. And at year end, we had a hedge book on the dollar of $29 billion, which is roughly five years of cover. We also have a $3 billion roughly euro/dollar hedge book, which is around three years of cover.

And the objective of our FX hedging policy is to reduce FX volatility over time and smooth the achieved rates over that period. It's a very conservative policy; it sets maximum and minimal levels of hedging and allows us to take advantage of attractive FX rates while not exceeding certain cover ratios.

We do build flexibility in the instruments that we use to do the hedging, and manage changes in forecast exposure in any one period through all the pull-aheads or delays. Consequently, in my view, analysis of the hedge book split by calendar year is not particularly relevant and I don't believe that's particularly helpful. And we've told you here what the average hedge book rate is over the whole hedge period.

So let's move on now to the business reviews, starting with civil.

Consistent with the plans that we late out in November, we have enhanced the financial disclosures for all of our reporting segments, and within civil aerospace in particular, we've provided some additional revenue segmentation and a trading cash flow breakdown for the first time.

So starting with revenue, for civil, our revenues increased by 3%. We saw growth in the aftermarket revenues, and that was partly offset by a reduction in OE sales. And that's largely down to reduced corporate engine volumes as opposed to widebody.

The services growth did include GBP189 million of total care retrospective adjustments, and I'm going to come back to that in a moment.

We sold a similar number of large engines in 2015, as we did in 2014; just over 300 in each case. But our corporate engine volumes fell back because of weaker customer demand.

The impact of foreign exchange on civil was GBP105 million adverse, and that made about one point of difference on the numbers as well.

So civil aerospace revenue, let's break that down now and look at the performance in the various categories, as we said that we would do in November. And I'll also be giving, or our views on 2016, based on the same segmentation.

So revenue from large engines linked and other, which includes spare engines, reduced by 11%, and that reflected the reduction in the Trent 700 and Trent 900 production volumes, and was partly offset by the increase in linked Trent 1000 sales.

Unlinked installed large engines increased by 29%, albeit from quite a low base, and largely reflected the higher deliveries of unlinked Trent XWBs for the Airbus A350.

We had good OE revenue growth from within corporate from the recently launched BR725 which powers the Gulfstream's 650ER, but this was more than offset by lower volumes of other products, as we saw weaker demand in the sector due to weaker demand for Russia, Brazil, China, etc.

Revenues from our V2500 original equipment sales: so these are the modules that we provide into the consortium also reduced on the back of lower volumes. So the airframer is starting to migrate now obviously to the A320neo production, and that impacted us last year, as it will further this year and next year.

As part of our work on refining the disclosures, we've also made a change to the breakdown that we give you on reported 2014 revenue, and that resulted in GBP198 million movement or reclassification between aftermarket and OE sales. While it doesn't have any impact on the accounting or the business or Group level, I think it does give a better alignment of the reporting that we do to you to how the accounting actually works on those long-term contracts.

So turning now to civil revenue aftermarket. The large engine aftermarket revenues were up by 17%. That was driven by increased flying hours from the growing fleet of our newly installed Trents, but offset by lower utilization on the older Trent 800s, Trent 500s and RB211s, as we talked about in the last couple of meetings.

These 2015 aftermarket revenues also benefited from the non-recurring GBP189 million refinement that we made in 2015 to the way we measure our valuation risk contingency, which effectively is the way that we look at credit on airlines. And that improves the granularity of the credit analysis. For example, we can now under our new policy apply a 400% haircut to a specific contract value if we perceive a customer default is more likely, but we've reduced contingency rates for stronger credit airlines. And the net effect of those adjustments had been considered as we gave our updates earlier last year.

Our installed base of corporate engines continued to grow, however, and contributed also to a 13% increase in service revenues on corporate. As expected, our revenues from the regional aftermarket business declined, reflecting retirements and reduced utilization of our fleets, primarily by North American operators. This will continue as we move forward, as we discussed again last year.

The aftermarket revenues for the V2500 are actually broadly unchanged in the year. Now those will increase over time, as we've also discussed previously.

Civil aerospace gross margin. So this is the first slide in our new format now that we're providing greater disclosure around the elements of profit within each of our business segments.

Our gross margin for civil reduced by GBP139 million to GBP1.5 billion in 2015, and the main trading factors here were the reduction in linked OE Trent 700 sales, the weaker performance in corporate jet sales, and the declining regional aftermarket. And that was partially offset by growth, as I mentioned previously, in the installed base of Trents.

The margin also benefited from catch-up contract accounting adjustments, and they totaled GBP222 million in absolute terms for the year, as set out in the statement. And that comprises the methodology refinements I've just mentioned, the GBP189 million, plus GBP140 million of in year lifecycle cost improvements, partially offset by GBP107 million of other operational factors; so a total of GBP222 million. And that compares to GBP150 million last year, which is where we get the GBP72 million year-over-year effect.

These different items were all broadly expected at the half year and reflected in the guidance we gave at that time. And on the waterfall slide in front of you, as I said, this produces a year-over-year movement of GBP72 million; so the GBP189 million of catch up less the GBP117 million of net movements over 2014 from the lifecycle course and operational factors.

We also had in addition to that an GBP84 million year-over-year movement on the Trent 1000, and that follows some detailed and positive engine analysis on the first service. This was recorded as a GBP65 million in-year benefit by reversing a balance sheet provision that we'd taken to previously impair contractual aftermarket rights.

So a lot there, but hopefully, that's providing more granularity. Turning now, therefore, to the overall civil profit movement.

In addition to that gross margin move, we had some big swings in both net R&D and restructuring costs, and that's consistent with civil's share of the Group analysis that I covered earlier, and primarily driven by the spend, obviously, on the Trent 7000 and the spend as we approach flight testing on the -TEN and the XWB-97k.

Entry into service of the XWB-84k also had an effect not on spend, but through capitalization and amortization of R&D.

So, again, a new slide here; trading cash flow for civil aerospace. So civil aerospace for the year was break even, and that compared to roughly GBP181 million inflow in 2014. It was up about GBP48 million; however, before we take account of working capital movements.

The GBP130 million lower underlying profit was a clear driver. We also had a slight reduction in the level of total care net debtor growth in the year and an increase in contractual aftermarket rights additions.

The year-on-year change of GBP268 million (sic - see slide 24, "GBP286 million") in working capital was effectively down to timing and differences of payments to suppliers, and an increased drawdown of deposits in 2015.

Other significant movements include around GBP110 million of lower CapEx as we slowed down major development efforts in 2014, GBP135 million of lower certification and development costs, and GBP29 million higher D&A.

Right. Now let's turn now to the outlook, and again with civil. This is the slide format that I shared with you in November and follows the segmentation disclosure that we gave on 2015.

For OE revenues, we expect an increase in large engine revenues. Overall, there will be an increase in widebody engines deliveries from just over 300 to around 400 engines in 2016, led by higher volumes on Trent 900 and XWB deliveries offsetting somewhat the decline in Trent 700 production we've talked about many times before.

Other dynamics within OE revenue include the market-led corporate jet declines and the ongoing reduction in V2500 module revenues.

Within the aftermarket, I'd expect large engine to be slightly lower year on year as increased revenue from our growing installed base is offset with the aftermarket headwinds that we discussed in July and November. And this is after excluding the non-repeat catch up on the risk methodology; so the GBP189 million, we've taken that out of this analysis.

Corporate jets are expected to be broadly flat, while regional aftermarket revenues will continue their decline. And V2500 aftermarket revenues should be broadly unchanged to slightly up in 2016; reflected expected maintenance activity on our modules.

On this slide, really I just wanted to remind you again of what we've told you before in terms of the profit headwinds that we see for the civil business, which in aggregate comes to a net GBP550 million. This is unchanged from the expectation that we gave previously, and we don't see any reason to change that absent any external market conditions or rate changes from the airframers.

Turning now to cash flow outlook and looking at trading cash flow outlook, and this is -- I've struggled a little bit this slide so bear with me. We start with identifying the GBP550 million of headwinds impacting profit. So this will reduce cash flow, and that's why we've shown it with a downward pointing arrow. So that's the logic here that a downward pointing arrow shows a reduction in cash flow, not a change in the magnitude of the figure.

We would expect an increase in the net debtor for 2016 as linked high-margin Trent 700s are delivered, but not of the magnitude of this year. This movement is expected to be as much related to cost improvements coming through and renewed activity in link programs as being from any other adjustments. We've therefore shown that with an upward arrow as it's less of a drain in 2015; the growth is less than the prior year.

We'd expect the civil debtor peak to be around GBP2.5 billion as we continue to be more confident over achievable lifecycle cost improvements coming from the successful launches and first service.

As a quick reminder, the net debt figure in the Group balance sheet is a little bit lower than the civil number because there's some negatives in other business. It was about GBP39 million lower last year.

The CARs balance will also increase in 2016 because we'll sell more unlinked engines, but while volumes will rise, we're also looking for some improvements in unit costs which will moderate that growth to be about the same as it was in 2015.

One of my personal challenges to the business is to improve the various inputs to trade working capital, particularly better inventory turns, through leaner manufacturer techniques and supply chain improvements. We'd expect this to improve cash flow for the year.

And then finally, within other, there will be an increased spend on development costs, certifications and PPE, as we ramp up our production capability, and that will reduce cash flow.

So, overall we'd expect trading cash flow to be negative in 2016 compared to the break even in 2015, and that will form a significant portion of the Group movement in cash flow we've indicated for the year.

So turning now to defence. The defence revenue chart shows a 5% decline split pretty evenly between OE and services by category. The lower OE volumes were due to slower volumes in helicopter and trainers, partially offset by growth in transport and patrol and combat.

Lower volumes in helicopter-related spares also impacted on service revenues, although revenues were supported by higher volumes related to long-term service contracts on combat aircraft.

The FX impact was around GBP67 million, so relatively modest.

For the gross margin analysis, it pretty well mirrors the revenue profile together with a one-off margin improvement on existing long-term service contracts. These LTSA improvements reflect changed flying patterns and improved cost on various combat platforms.

And just to note, the benefit in 2015 was at an exceptionally high level, representing an increase of GBP47 million over 2014. We don't think that that's going to be a repeat in 2016. This helped overall gross margin, however, which improved from 27.4% to 28.4% for the year.

In terms of the profit overview then, underlying profit performance rose by 4% from the prior year. There was a GBP20 million increase in R&D costs, and that reflects some of the increased investments we're making in next-generation technology platforms. Offsetting that was a lower restructuring cost, again, because some of the major downsizing exercise came in 2014.

So the outlook for defence. We're very positive still on this, or pretty positive still on this about the long-term outlook. Defence includes a high proportion of revenues from availability based service contracts where we've had significant experience in maximizing productivity and returns.

However, shorter term, there is going to be some operating market pressure over the next few years as a consequence both of pricing pressure, some increase in R&D, and also the operational restructuring that we announced at Indianapolis. Ongoing free cash flow is, however, expected to remain strong, although at a lower level due to some of those investments.

So whilst a drag for at least a couple of years, the benefits of a modern plant on a significantly smaller footprint will be very notable when those come through.

Power systems. Turning to power systems, underlying revenue of GBP2.6 billion was 3% lower. That comprised lower OE revenue offset partially by a small rise in service revenue. The FX impact of around 10% was significant and was due to the euro weakness coinciding especially with higher sales activities later on in the year.

In part, the OE decline was impacted by strong governmental business in the prior year where we'd had several significant project orders, but also reflected the negative oil and gas market.

More positively, the luxury yacht business grew strongly, and we also saw growth in construction and agriculture, helped by demand for new emissions regulation-compliant products.

The order book at the end of the year was broadly unchanged at GBP1.9 billion, reflecting quite a diverse set of end markets and a resilience particularly within the defence sector.

For gross margin, looking at this gross margin waterfall, the drivers of the decline from 2014 really fall into three buckets: firstly, lower overall volumes impacted by about GBP20 million, and that was broadly offset by a decline in warranty costs from the prior year where we'd had some previous technical challenges which we've now been successfully able to overcome.

Overall, the GBP41 million impact of pricing pressure and adverse mix, business mix on margins, such as, for example, lower naval mix but higher agricultural sales, was the most significant influence on our gross margin for the year.

And then the overview on profit, other than the gross margin just discussed, the other slightly material event was the FX impact of the sterling/euro movement which was GBP22 million for the year which was a drag on the reported numbers.

So turning now to the outlook, the outlook is steady. As we stand here today the outlook remains positive, supported by a healthy order book for a number of key markets.

So turning to marine, the revenue and gross margin slides for marine show just how challenging this market environment has been for us. OE sales were down 19%, while service revenues were more robust but still 10% lower. The large FX impact was from the movement in the Norwegian krone in particular.

The order book fell sharply during the year from GBP1.6 billion to GP1.1 billion, with very weak order take in the offshore parts of the business. And this reflected the fact that ship owners in both offshore, and to some extent merchant segments, are significantly reducing their activity, both in terms of replacement vessels, but also deferring overhaul and maintenance work.

The merchant business did make some progress, however, in specialist areas such as wind farm support vessels, but overall, the markets are subdued.

The naval business was also down a little, particularly in spare volumes, but continued actually to focus on long-term development work and deliveries such as for the US and UK navies.

In terms of gross margin then, the decline in volumes, including some cancelled contracts, placed increased pressure and further strain on our gross margins. Together, these produced a negative GBP139 million movement in gross profit.

These included some financial charges which were a provision related to an offshore customer contract terminated due to market decisions, as well as some other smaller contracts; and the product quality provision that we took in 2014 wasn't repeated this year.

So while we take all these factors into account, total gross margins declined to GBP286 million, and as I said that was GBP139 million lower at constant FX.

And really, that's the story for marine. Because we're operating effectively very close to break even in marine now, that relatively small drop in revenue produced quite a significant drop in gross margin and, therefore, a big drop in underlying profit of 94%, reflecting the gross margin impact.

This was partially offset by some improved C&A costs as we reduced indirect headcount and footprint, especially in the second half of the year; but also, we therefore incurred some higher restructuring costs as well.

During the year, we announced two large restructuring programs, and that will lead to the reduction of around 1,000 employees in operations and back office functions. We're well through this process now.

So the marine outlook. With continuing volatility in all the markets, I think it's very unlikely that the offshore market will see much improvement in confidence and activity within 2016. As a result, we are continuing to focus on the positioning of the business and addressing its cost base.

As Warren discussed in November, part of the cost savings will derive from the programs, but we will be investing some of that back into additional R&D. We'll also seek to develop further relationships and make inroads into the Asian merchant marketplace.

Naval is likely to fare better, with some long-term contracts reflecting the greater stability of the business.

For the nuclear business, underlying revenues increased by 9%, with OE revenues up 12% and service revenues up 7%. The OE growth came particularly from the Vanguard refueling project, together with a Finnish instrument in controls upgrade.

Within services, growth came through the refueling project and also a broader spread of civil projects. Gross margin was lower due to the submarine servicing program and the impact of recognizing revenues where we passed through some subcontractor costs to the project manager at zero margin.

At the profit level, lower R&D expenditure was largely due to that R&D credit. This included a retrospective element back to 2013 where we elected to join the R&D credits regime for the first time for the submarine business. While having no impact on profit after tax, it did move GBP19 million of credits from the tax charge up to the R&D charge.

Overall, the outlook for the nuclear business remains steady.

So I'd just like to comment on some more technical elements within our business. In addition to the segment analysis that we've provided you with, we also actually created an 'other' category this time which contains some smaller residual retained assets relating to the energy business. They were previously reported within nuclear. The value of those isn't particularly material, but we think it helps to split them out.

We also included within that the one-time gain that we saw last year from the intellectual property gain. So I hope that will make things a little clearer as well.

On finance charges, in 2015, the finance charge number benefited from around GBP34 million of intra-Group dividend hedging, and that was mainly associated with prior-year M&A activities. So the true comparison is really the GBP94 million to GBP90 million to GBP110 million that we're showing on this slide; and the GBP90 million to GBP110 million splits roughly two-thirds between interests and one-third within commercial arrangements.

Our effective tax rate will rise from a 24.5% level in 2015 to probably around 26% in 2016, and that's actually just being driven by the mix of where we make profits into higher tax regions.

CapEx will be focused on our aerospace transformation activity, including the Indianapolis investments. We expect this to increase a little bit from last year's GBP494 million.

Our net R&D spend, we'll continue on new development programs as we complete some significant new product launches such as the 97k XWB, and we expect net R&D spend should be broadly unchanged or slightly lower.

For free cash flows, in 2015, we did come up ahead of expectations, probably GBP200 million plus ahead of expectations, and that's been led by strong cash receipts, including the IP receipt that we got, and good management at year end of inventories. This reflects how varied our cash flows can be at any one moment in time. For 2016, I believe that we'll be in line with our previous expectations of a modest overall outflow, somewhere in the GBP100 million to GBP300 million negative range.

So thank you for your patience. I know that was a longer presentation.

In conclusion, the full-year results were in line with our earlier expectations, albeit at the bottom end of the range. That reflected the challenging oil and gas markets and the transition effects in civil aerospace. Both of these we see continuing throughout this year. However, from what we know as we stand here today, our outlook for 2016 is unchanged.

With the prudent financial policy and actions we've taken in 2015, we have a stronger balance sheet; a significant growing market share, particularly in our key aerospace markets; and a transformation plan set to deliver meaningful and sustainable savings. And it's for that reason I remain very positive on the long-term future of this business.

I'm going to now hand back to Warren.

Warren East ***- Rolls-Royce Holdings plc - CEO***

Thank you, David. Thanks very much. Well, there was a lot of information there, but I hope that helps you all to better understand our business, set it in the context of all the other information that you're able to get about the markets in which we're operating. So I'm just going to share a few thoughts now on 2016 and what we're going to be doing in 2016.

In November, we put this slide up outlining our vision and strategy, and I said at the time that the actual articulation that you see here on the slides is work in progress, but the thrust of what's said here is correct, and that remains the case as we go into 2016.

Now I finished the first part of the presentation talking about the five goals for 2015, and the last one of those was to establish our priorities for 2016. So these are our priorities for 2016.

And alongside the five goals in 2015, I quickly realised that we needed to add more pace and simplicity into this business. And so for 2016, we've just got three priorities, and actually, the first of those three priorities is to strengthen our focus on the three strategic themes that I talked about in November that is engineering excellence. This business is all about our engineering excellence, and what we need to do now is strengthen our operational excellence. And together, those two will enable our strong business model to really work, and that's all about leveraging the installed base.

So the first priority for 2016 is to focus our efforts on those three strategic themes.

The second one is the transformation program that I announced in November, together with the transformations which were in-flight, both in our aerospace [and marine] business, improving our industrial base and the like, that absolutely we need to continue. And we need to get off to a good start in the transformation program I announced in November. 2016 is going to be a pivotal year, and getting off to a good start on that is essential.

And the third point, the third priority for 2016 is about rebuilding trust and confidence in our long-term growth prospects. This is a fantastic business. We are playing into structurally growing markets. We have a great set of products and technologies that people actually want to buy, and all the transformation we're talking about is about improving our profitability fundamentally; what's missing is the confidence. And so it's a priority to rebuild that.

So I'll start on the left-hand side of the slide with the first of the three strategic themes.

Now the first one is engineering excellence. Rolls-Royce is all about engineering excellence, and the example here on the left of the slide is showing how we're making our contribution to improving the emission performance of airplanes over the next several decades.

And already over the last several years, we've moved to well over 10% improvement on the 2000 original carbon emissions with Trent XWB. And with the new engine programs that we have in flight at Rolls-Royce, then you can see that we're making really big strides through our engineering excellence.

But it's not just about the underlying technology and the products that we design. It's also about the technology that goes into how we make these products and how we make the components for these products, our manufacturing technology too. We don't do all of that ourselves. Some of that is done in partnership with other companies and with universities. And this is an example of one such manufacturing technology center.

Now such facilities as those, of course, help us with our second priority about driving operational excellence, and those sorts of things are already making a difference.

And for instance, in 2015, in our aerospace products, we achieved a product cost reduction overall of nearly 2%. Some of that came about through better collaboration and partnership with our external suppliers, and some of it came by really being able to tightly constrain our cost increases against upward pressure caused by lower utilization of new facilities and inflation. We managed to constrain that against those pressures to 1%. So overall, an almost 2% improvement in product cost in the year.

A real example of that would be this component, our wide chord fan blade, where by applying some of the manufacturing technology I talked about a moment ago, by basically increasing the amount of automation around one particular critical process, this is quite innovative, patented technology, it enables us to get much, much better consistency, reducing scrap, reducing processing time, producing an overall improvement of 6% in that component cost.

So the whole transformation, of course, is the sum of many such projects but these projects are happening.

In November, I talked about a new form of 80/20 rule where we're able to produce 80% more components in 20% less footprint. And I talked in November about our aspirations with those goals for 2020. Actually, 2015 was a pretty good year on that journey. In 2014, the footprint actually went up as we invested in new facilities, but in 2015, we began to come down on this trajectory towards 2020. And so an 11% reduction versus our 2013 base achieved by the end of 2015.

And that was at the same time as -- if you will recall the first part of the presentation when I talked about our volumes being on an increasing trajectory, although the year-on-year volumes look pretty flat there, as I said, by the time we got to Q4, we were pushing out engines at a much higher rate - on that journey to 80% more by 2020.

So good progress in operational excellence as well, and we need to keep focusing on that as we go through 2015.

Now the third strategic theme is the installed base, and the big thing about the installed base is that we are in the middle of a transition. We're in the middle of this period. If you take from, say, 2005 to 2025, then we're more than doubling the number of large engines in our installed base. And that obviously puts big pressure on our repair and overhaul network, and it puts big pressure on because we need more capacity, but also because we need more flexibility.

So we have made changes in our repair and overhaul network, and we've made changes to increase that capacity, to increase that flexibility, and actually as a consequence as well, to increase the competition within the network and so provide better value.

But it isn't just more engines that are out there. There's a change in the nature of those engines, because, if we look between 2005 and 2025, we're increasing by a factor of 100, more than 100, the number of engines that are over 10 years old. And when the engine gets older, then it needs different type of maintenance; customers need a different type of care. And so not only are we changing the structure of our network, we're changing the business models associated with that to deliver better value for our customers as they deal with older engines. And that better value, of course, is then shared with us and makes our business more resilient.

The second priority for 2016 is all about transformation, and I talked about this a lot at the end of last year. We have since then installed a transformation team. We've got that team up and running. It's building. We're adding people to that as we speak.

And that team is going to ensure governance over all the programs; not just the new program that we announced in November, but actually making sure that we really deliver on the programs that have already been started.

And it's important that this team achieves a really enduring impact on the business with this transformation activity, and that's what they're doing through process simplification and making sure that our cost reductions are sustainable.

And they're also helping to update how we manage that with our key performance indicators. By the time we're done, we'll have much more robust management of not only the transformation process, but much more robust management of our ongoing performance.

So what's actually happening in all these transformation programs? Well, we put this slide up in November. This is a snapshot of the programs announced prior to November; one program in the aerospace markets and one in marine. And they are on track come the end of November, and the good news is that reviewing the programs then, it looks like there's possibly a modest upside in the benefits that we get from aerospace program. The one going on in marine is at an earlier stage, but that is also on track. So we're on-track to deliver these programs.

In the power systems part of our business, we kicked off a new program in the back half or in the back quarter of the year, and this is quite an overreaching one. This is looking at all the processes and capabilities that we have in our power systems business. It's looking at the market opportunities, making sure that the products are better aligned with the market opportunities, and looking at the actual operational performance and how we can improve that.

That's underway now, a few months underway. We've got seven work streams up and running on that. And I think this part of our business offers great potential.

Now to the program that we announced in November. We are off to a good start. It's a mixture -- if you remember in November I talked about organizational hardware -- that's really the sort of structure of the business -- and organizational software, which is about the processes and behaviors that you wrap around the organization. And we've got off to a good start. We've made some structural changes already. We've already identified about one-half of the target that we set out in November, and we've established that the costs to achieve that for 2016 looks like it's going to be somewhere between GBP75 million and GBP100 million.

But as we go from Q1 into Q2, we'll be moving from structure more into the processes, from the organizational hardware into the organizational software, and we'll be doing that -- most of the planning for that will be done in Q2. And by the time we get to the end of Q2, we'll be able to update you on progress as we go into implementation on that in the second half of the year.

I think we can now move on to the third goal for 2016. This is about rebuilding trust.

Now this is a hard one. It's obviously going to take some time. I hope we're making our first steps, and I hope you've seen the first steps with the improved disclosure. And you've see an example of that this morning.

Not only what we produce in the slides, and what we produce in the release, I hope you're going to see us more open in our discussions. When you talk with us, I hope you'll see us more open and ready to discuss the challenges and opportunities that we have.

Now to that end, quick update on so where are we on that November program. We set out this timeline in November. I think we've done with the analysis; we've done with the prioritizing. We've got the team up and running. I just talked about some of the initial costings. We're making progress on that. We're starting to develop measures, addressing things like unit cost improvements. There will be measures addressing things like cycle time improvements. And we will be communicating along with that timeline that we set out during this year.

Crucial to rebuilding confidence and trust, of course, is keeping an eye on the ball so that we actually realize some of this great future potential, that we deliver what we say we're actually going to deliver. And there is tremendous underlying growth in our long-term markets. We can see passenger volumes set to continue to increase. Yes, these things will wobble around a bit year on year, but over multiple years, there's a very solid underpin to our growing markets.

The quality of our products and our technology is there. You can see that in our growing market share. And the fact that our customers actually want to buy this you can see in our growing order book.

So what we need to do is keep up our investment in R&D to fuel the sort of innovation, some of which I talked about a moment ago, to complete the transformation in our supply chain internally and improve the collaboration with our external suppliers. And our backlog is already starting to reflect the value of our products.

I'm very confident that our pricing is robust, and our visibility, is good for the long term. Of course, there will be some short-term fluctuations, but you can see evidence which is there to support our confidence in the long-term strength of the business.

Now there are opportunities in the portfolio, as we discussed in November. My focus for 2016 is much more operational. But the opportunities are there. Remember what we said in November. 75% of this business is very well positioned from a competitive and market attractiveness point of view. Clearly, there is stuff we can do to improve some of the other parts of the portfolio, and we've not forgotten that. We will be getting on with it.

So what sort of things can we do to improve those other -- business in those other parts of the portfolio? Well, within our power systems and marine sectors, we talked about improving value-added products and services. By looking at the systems and the products in that portfolio that actually work together, we're able to pull through sales and make a difference. To drive the cost competitiveness, yes, there are certain parts of the business where we need to really focus on driving the cost competitiveness, but that can be achieved.

And, for instance, improvements that we're now making in some of the project management within parts of our nuclear business, not only improving the delivery for customers, but of course removing a lot of the cost because we're removing a lot of the rework. And strengthening our routes to market, we're already seeing examples of that happening and being reflected in the order book in our power systems business.

In aerospace, it really does remain the fact that installed thrust is a good proxy for aftermarket revenue potential. Installed thrust is all about volume, number of airplanes that are there, and the price per flying hour. The price per flying hour increases with thrust because more thrust means more passengers; means more value for our customers.

And you can see we remain on that cusp of really seriously increasing the size of the installed base, and I think some of the data points that I highlighted earlier in the presentation about how the volumes of orders taken last year compared with the deliveries going out of the door accurately reflect the fact that we're on that cusp.

So that's why we shared these slides with you in November. That's why we're confident about the cash generation of the business. I'm confident that the analysis is robust based on what we can see today, what we can see in our order book, what we can see in our pricing, what we can see in our expected costs, and what we can see in the expected utilization of our facilities. And so today, at just over a 30% market share, with a journey to a 50% market share, this is what continues to fuel our confidence and what I hope will improve some of the confidence that's out there.

I just want to remind people there are a few legacy issues, and we haven't forgotten those. We are committed to ensuring the promise of the Rolls-Royce brand, which means we're doing everything we can to cooperate about these legacy issues. We have addressed and we continue to address the underlying factors behind the issues, and we're absolutely totally firm on zero tolerance to anything untoward.

So in summary, the messages I want to leave this morning. We delivered what we said we were going to deliver in 2015. We're not changing anything about our expectations for 2016. We do understand the issues that we face within our business, and we are dealing with them and we're injecting some pace into the way in which we're dealing with them. And I remain very confident in the future as we play into growing markets, growing our market share, and take steps to grow our profitability.

So with that, we'll take some questions. Thank you.

QUESTION AND ANSWER

Nick Cunningham *- Agency Partners - Analyst*

Nick Cunningham, Agency Partners. First of all, thanks for the extra disclosure, although I think it will be a mixed blessing because I'm probably going to lose the next month rebuilding the model.

A question on the point you were making about better value for owners of older engines. Does that roughly translate to lower pricing for, say, maintaining 15-year-old-plus engines? And does that have any effect on the business case when you're looking at, say, an Airbus A380neo with a Trent 9000, or whatever it is?

And then a second even broader question, if you like. In the absence of external surprises, macro issues you were mentioning, it's a big caveat, looking at the moving parts that you do know about within the Group, would they make 2016 the worst year in terms of profitability and cash flow? Do those known bits start to get better in 2017?

Thank you.

Warren East *- Rolls-Royce Holdings plc - CEO*

Okay. So the question about the aftermarket and the new models that we've introduced in the aftermarket, and delivering extra value. The point here is to better match the customer needs. If you've got an old engine that the customer's only going to keep for a relatively limited period of time, then tying in a long period of service agreement doesn't make sense. More of a sort of a pay-as-you-go makes it much easier for the customer.

And for us being able to deliver on that through not necessarily supplying totally new parts but being able to recycle parts from older engines improves our costs of dealing with that. So it's a genuine win-win, and it's trying to be flexible and understanding the position from our customer's point of view.

I believe if we're delivering real value like that, then we stand a much better chance when it comes to the front end and signing up the longer-term agreements in the first place.

The actual impact that that has on things like the A380neo program, well, the A380neo program, of course, completely the other end of the timeline. And it doesn't have an impact as far as our business case is concerned, because when we do our business cases, we're only taking into account the first part of the lifecycle of the engine when we're building our business cases.

David Smith ***- Rolls-Royce Holdings plc - CFO***

So, Nick, on your second question, I think this is very consistent that, as you said, there are always external factors, and I've been pretty clear I'm not betting on improvement in the offshore marine outlook in the future. But we are taking action on the cost of the marine business.

And essentially, I think all of the things that we're doing, as we've discussed before, are addressing two or three different issues. One is we've got to get the cost right as we ramp up the Trent ramp. We are dealing with the industrial footprint there. The cost improvements for that are going to start coming through as we go through the rest of this decade.

We're dealing with the issues that we see in marine. Warren showed a slide with the RRPS program. That's actually a really well thought through program. And they're looking at revenue, cost and business structure issues as well.

So in my view, 2016 is where we start transitioning from dealing with a lot of legacy issues to getting ahead of the curve on driving the business. And we will start seeing the benefits of that, both lifted by growing aftermarket revenues and civil as installed base grows, but also lifted by the benefits of the cost improvements that come through.

And we clearly have to work hard at that because the macro environment is not kind to anybody at the moment. And we're cautious about that, but we think, as I say, we've been through all the plans again for 2016 and we're very comfortable we've got that in the right place. But 2016 is about delivering on those plans and driving that transformation that will improve 2017, 2018, 2019, 2020.

Ed Stacey ***- Haitong Research - Analyst***

Ed Stacey, Haitong. Two questions. The first one's on the risk provisioning in that civil gross margin slide, GBP189 million of benefits for 2015. I just wanted to check whether that was historical risk provisioning that had been taken that had been excessive and so you're still getting a one-off write-back, or whether that GBP189 million is an ongoing benefit annually; you're going to book GBP189 million less of provisioning.

And then the second question is the 2016 guidance, and apologies if I've missed something that you actually told us, but it's IAE and the profit contribution. Because you've given us additional detail on IAE revenues, but I wondered if I'd missed something there and what the profit was. Is it more than one-half of the civil division profit for 2016 is IAE?

Thanks.

David Smith ***- Rolls-Royce Holdings plc - CFO***

So on the risk provisioning, so effectively three years ago, we put in both an accounting policy and a methodology for looking at credit risk, so effectively our risk on airline contracts from the credit risk of those airlines. And we had a policy that was almost directly derived from the credit ratings.

Our accountants for a couple of years had been flagging that as a bit cautious. We said that we would look at it after three years, and we did that during this year, and we concluded actually we were being over cautious on the higher credit rating airlines, but under cautious on some of the higher risk airlines. And I'm certainly not going to give you any names.

And, therefore, the policy was both over cautious and not very well focused, so we've changed the policy now. The outcome of that is this one-time change in the risk provision. But it will fluctuate over time, so if we see a general trend in credit around airlines, that's going to change that number over time. But the policy is, I think, a much better way to think about the credit risk on these long-term contracts.

The second question around IAE, we've discussed this a few times in terms of the profitability. You're right. It is over one-half of the civil profit this year. The revenue, as we've discussed before, is in three parts. The modules that we supply, which is obviously now going to decline to zero over the next couple of years; the revenue from spare parts that we provide; and then our ongoing MRO activity around those as well. Both of the latter will increase a bit over time. But IAE is a significant part of the civil profit because we're quite close to break even on civil at the moment.

Ed Stacey ***- Haitong Research - Analyst***

Thank you.

Christian Laughlin ***- Bernstein - Analyst***

Christian Laughlin, Bernstein. Two questions from me, please. Firstly, Warren, specifically for you with regards to the ongoing strategic review, I was just wondering if you can add any color or commentary on incrementally what you have learned since November. It's a broad open question there, I guess, on that.

And then secondly, David, you had mentioned in your presentation that inventory turns, particularly in 2016 and the implication is onward in 2017 and 2018, an area focus for operational improvement with respect to working capital management cash flow, etc., and so on. I was just wondering if you could add some color as to what provides the comfort or confidence in trying to tackle issues like inventory turns, or just in general being very aggressive in performance improvement during a time where you are doubling production and delivery of large commercial engines over the next five years. How do you balance going after costs and, say, trimming some fat against the risk of schedule risk in execution?

Warren East ***- Rolls-Royce Holdings plc - CEO***

On strategic review, I think I've been fairly clear that this is a background activity and we must set that as a context. Basically, the focus for right now and for 2016 is on operational activity. It's on improving the operational performance of our business.

Now as I said in November, it turns out that it's absolutely impossible really to separate that from thinking about the way the portfolio is built up, but that doesn't mean to say that we're diving right into the portfolio and changing bits here and there.

So my brain cycles spent on the portfolio versus brain cycles spent on the operational transformation are very heavily weighted in favor of the operational transformation at the moment.

That said, since November, specifically, my understanding of the opportunities that we have in front of us in our power systems business I would say is definitely improved. I'm actually feeling a lot more optimistic that by applying the efforts that we're applying from an operational point of view into that part of the business, we can make that an interesting opportunity.

And also, my understanding of some of the detail of the product portfolio in our marine business and how some of those system components work with other parts of our business, and 'or not' as the case may be, I would say has improved. And as and when we are able to spend a bit more time on that strategically, then probably my own understanding of that has improved. But it's not really a priority for now.

David Smith ***- Rolls-Royce Holdings plc - CFO***

So on the second part of your question, I will answer that in two parts.

Firstly, I don't think anybody who goes around our businesses would say that we are where we want to be on inventory performance. One of my Board members told me that yesterday, so I agree with him (laughter). So I think from a lean systems point of view, we have lots of opportunity within the business.

We're at just under 3.5 which I turn round and say that's around 100 days; there are certainly people who are able to operate at 60 days to 75 days. Whether that's investing class we can debate, but that's more like 5 turns. So we have plenty of opportunity here.

And it's the lean manufacturing that will really drive that. And as we change our industrial footprint, if we don't get it right now, clearly, we'll lock in inefficient practices for a long time. So this is actually the time to do it.

But you make a very, very good point about competing priorities, so just in that case, as we want to develop lower cost sources, we extend our supply chain, so we've got to watch that balance as well. And particularly, as you say, as we ramp production, it's extremely important that we meet our customer delivery schedule.

Now in my experience, that's a virtual circle, not a trade-off, because if you can get much more effective at delivering to schedule, it means you've actually fixed a lot of the issues which create the inventory and the buffers in the system.

So they are not trade-offs; they are reinforcing things. But it's clear our priority has to be to make sure that we can deliver to schedule as we go at this ramp, and we are doing that and will continue to really focus on that. And we will be making that one of really key metrics that we measure people's performance on as well.

Christian Laughlin ***- Bernstein - Analyst***

That's helpful. Thanks.

David Perry ***- JPMorgan - Analyst***

David Perry, JPMorgan. I've got two questions, one on civil aero and one rather broader one on everything that's short cycle.

Just on civil aero, and I really hope I'm not going to make myself look silly here, that I've missed something obvious, I'm just trying to understand the guidance, because it seems you've told us there's GBP550 million of headwinds, but there's GBP80 million of cost savings, and yet the profit guidance seems to be very clearly GBP550 million down. So I'm not sure where the savings are. And certainly, the guidance you've given today does appear to be below the consensus that you disseminated yourselves in civil aero. So if you could just explain that to me.

Secondly, and as I said, it's a broader question, if I take the shorter cycle businesses, and I would include in that the oil and gas piece of marine, a lot of what Tognum does, and business jets, it feels like the world has changed quite a bit since November 2015 for the worse in all those markets, and yet your guidance is unchanged. Is that because you were extremely prudent you think in November? Or do you think you're just being a bit optimistic in terms of what you're expecting now?

Thank you.

David Smith ***- Rolls-Royce Holdings plc - CFO***

So on the first bit, you're right. We have cost savings coming through. But as I said, I think we will see a lower level of one-time adjustments coming from contract accounting. So that's a bit of a negative from profit. So the GBP550 million is still we feel about right.

Now there's a little tweak on that I guess in that we've also said within the statement, we didn't have it on the slide, that we think that the transformation program will probably deliver something between -- sorry, I'm talking about the program that we announced in November -- an incremental saving of GBP30 million to GBP50 million. We haven't allocated that by the businesses at the moment because we're still working through that. So that will provide a little bit of support also to the civil business. So overall, I think the numbers are still about right for civil.

In terms of the macro environment, I would agree with you. I think just the first three days of the year caused me to shudder a little bit in terms of all the things that people are talking about around the world. And certainly, we've seen that over the last week or so in terms of the concern about financial markets as well.

So, yes, there are. But I think we took a pretty deep view when we came up with the outlook in November around how we saw the marine market. We've not assumed any uplift from the oil and gas sector there.

Oil and gas is remember a relatively small part of RRPS's revenue. I know it's less than 10%. I actually think it's closer to 5% at the moment. So it really is marine that's affected by that.

And we took a more conservative view on how we saw the legacy Trent business developing based on what we were seeing during the second quarter. I think we probably got ahead of everybody there because I think some of the things that we said and told you about have now been demonstrated, I think, by some of the external evidence. And certainly, we took a more conservative view on the corporate jet market, which again, I think is being reinforced with what the airframers are saying now.

So all of that we have taken into account. We've been round it. We've been round it in a lot of detail and we didn't want to change the outlook based on what we see.

Clearly, we understand our responsibility if things change to tell you about that, but we absolutely don't see the need to do anything at the moment.

Jaime Rowbotham ***- Morgan Stanley - Analyst***

Jaime Rowbotham, Morgan Stanley. Two questions, please. David, very useful to get the trading cash flow table for the civil division, and understand why you think that goes into negative territory in 2016. I just wondered. Given further CARs additions linked to XWB in 2017, do you think we're looking at another step down year on year in 2017, or can it flat line or can it start to inflect the trading cash flow in civil?

And the second question, a bit of a follow on from David's but just focusing specifically on power systems. In 2014, I think the order book grew a little bit from GBP1.9 billion to GBP2 billion, and yet in 2015, ex-FX, revenues fell GBP72 million and profit by GBP37 million. In 2015, the order book has actually come down a little bit from -- we're talking small beer, but GBP2 billion back to GBP1.9 billion, and yet you're projecting growth in revenues and profits.

Again, what drives the confidence there and where do you think that growth is coming? Is it in mining? Is it in agriculture, construction, rail? Any color -- or is it linked to the work share programs you've talked about? Any color would be much appreciated.

Thanks.

David Smith ***- Rolls-Royce Holdings plc - CFO***

On civil trading cash flow, I'm not going to get drawn into giving a 2017 guidance I wasn't planning to do. But the dynamics are going to be favorable because we will start getting the benefits coming through of the cost improvements, as I was describing earlier. We'll start picking up further engine flying hours on the Trent installed growth.

So you're absolutely right. There will still be negatives going in from CARs. We're working on bringing the cost per engine down, which will mitigate that somewhat. And we actually will see some benefit in 2016 versus 2015 from that source as well. But absolutely we will be inflecting to more positive views, but I'm going to stop short of giving any specific numbers, certainly around 2017.

On your RRPS question, this unfortunately is one that you have to go into a bit more detail because of the mix of businesses, so some of the shorter order book and longer order book contracts. And I think there's actually positives actually in the order book, even though the absolute number has gone down, because we are seeing stronger order book coming in on some of the shorter cycle business; things like power generation, for instance, which aren't necessarily longer contracts that have replaced some of the governmental business we saw.

Power systems has got an order book over quite a wide variety of end sectors. That area of power generation is certainly a positive one for us at the moment. We see some upside in some other areas. Warren mentioned the locomotive businesses. That's a very successful product line. And I think there will be some positives also in some of the defense-related businesses for MTU. So as I said, oil and gas is actually quite a small part of their business at the moment so the commodity exposure is quite low.

So I think, yes, the absolute number is about the same, but we are actually quite positive that we'll see some revenue and profit growth in 2016.

Rami Myerson ***- Investec - Analyst***

Rami Myerson, Investec. Three questions, first on the new maintenance facilities and the maintenance contracts that you've announced and the way you've split the facilities. Will these new facilities be able to part out existing engines by themselves, or will they be able to develop their own techniques to fix secondhand spare parts? Or are they going to compete on labor only? And, of course, all the spares will be coming out of Derby. And because you encourage a secondhand market in your engines.

A second question is just on pricing, because we've heard anecdotes that there's a lot of pressure on pricing on wide bodies. The market looks like it's becoming more saturated, increasing parked wide bodies. And what's the comment on A330ceo; and, of course, a lower oil price environment?

And lastly, just on the defence aerospace. Is the increase in revenues related to increased flying of export customers in the Middle East, or is it increased flying of RAF aircraft?

Warren East ***- Rolls-Royce Holdings plc - CEO***

Okay. To comment on the increased flexibility within the repair and overhaul network then today, the individual companies are able to move around the activity that they're doing, and absolutely we're seeing some doing more of the reconditioning of old parts. And the structural change we made was more about the geographic region in which these people operate rather than the scope of activity that they're actually doing. And that geographic region means that somebody in Asia, for instance, can service a customer from Europe, and vice versa, which was not the case previously.

So that's where the flexibility comes in, or the increased flexibility comes in, and it actually increases the competition as well, which probably stimulates some of the more creative thinking for the former.

Your question about general softness in widebody, concerns about overcapacity and the like, then there are some very specific issues associated with some of the aircraft that are parked at the moment. They're specific to individual airlines. What we see is underlying growth continuing in the demand for a number of people who are flying and the amount of flying that they're doing. We saw that happening throughout 2015 through to the end of 2015. And even in China, we're seeing continued growth there.

So I think I'd fall back on some of the fundamentals to understand how we're not getting a basic imbalance between the rate at which the industry is able to supply new capacity and the rate at which the industry is able to consume it.

In the detail, there are certain airlines and certain planes which it gets a bit out of balance, and sometimes, as evidenced in the numbers we talked about in November, we get a little bit caught in the crossfire.

Rami Myerson ***- Investec - Analyst***

And are you seeing an impact on pricing?

Warren East ***- Rolls-Royce Holdings plc - CEO***

In terms of pricing, no. It's always competitive out there. And where we are competing engines then, yes, we're seeing competition. But I wouldn't say it's in any way directly correlated to some of the issues that we're seeing in parked aircraft.

We have to work hard with the customers that we have, but we are placing secondhand aircraft, and we're placing secondhand aircraft at the absolutely competitive rate.

David Smith ***- Rolls-Royce Holdings plc - CFO***

Just to add, clearly, the area that we have seen the most pricing pressure was on the A330ceo. We talked about that and that was a big impact on the GBP250 million headwind that we talked about for the Trent 700. So that's clearly an area where we have, but I think on the A350 perspective, Trent 7000, A330neo, I don't see any evidence of that at the moment.

On your last point, last year, it was really around UK combat, but I think we will see some more Middle East-related benefit in 2016, Rami.

Ben Fidler ***- Deutsche Bank Research - Analyst***

Ben Fidler, Deutsche. Three questions, please. Sorry if they're a bit nitty gritty. Thank you for the ultimate guidance on where the TCP net debtor comes out at. I just wondered for CARs, which I think was about GBP400 million at the year end 2015, where do we see that ultimately peaking and when?

The second question was thanks for the new disclosure. On the C&A allocation to civil aerospace, just a question about the order of magnitude of that number. It seems that the central admin cost allocation of civil aerospace is about the same as marine, for example. Marine is 11% of Group sales, civil aero is 60%-ish of Group sales. Just trying to understand why that apparent allocation is in place.

And then maybe if you could deal with those, I'll come back with a third question because it's a bit more complicated.

Warren East ***- Rolls-Royce Holdings plc - CEO***

Okay. I'll deal with that one.

David Smith ***- Rolls-Royce Holdings plc - CFO***

On CARs, so interestingly, the CARs growth last year was a combination of Trent 1000, which was actually about one-half of it, and a smaller number on XWB and some Trent 700, obviously because of the lower pricing that we got on the ceos coming through.

We will see, as I think was mentioned on the slide, about the same level of CARs growth in 2016, or slightly higher. So that's a combination of higher volume but actually better unit cost. So the two are beginning to mitigate.

So over time, this better unit cost is going to be the thing that creates the peak. And as I've said previously, I think that's going to peak probably around the 2020/2021 range. If I tried to give you an estimate now, I think I might have mentioned numbers before in the GBP1 billion/GBP1.1 billion sort of level, but it's going to be volume increase but each year better cost position that will essentially get us to a peak situation, and then, obviously, that will start falling off.

Remember every year also within the CARs growth there's a negative, because we're obviously amortizing a bit, and that will start growing over time as well.

On C&A, actually, a larger part of the C&A than maybe is implied is actually within civil itself. So this is civil's own C&A to run the civil business. They do get clearly an allocation of central services, accounting and things like that, but the larger part of civil C&A is actually what they're spending to run their business.

It is much lower as a percentage of revenue than marine or power systems, for instance. You can easily do the math on that now. And that's a real focus actually, because that's quite a large part, for instance, of what the RRPS program is trying to address that clearly hits a higher percentage. So it tells us that we need to do more work in those areas.

So the allocation methodology of anything that's in the central is fairly standard. It's much more about what it actually takes to run the businesses.

Ben Fidler ***- Deutsche Bank Research - Analyst***

It's great to hear that there's some good efficiency there in civil. Gross margin in civil, if I can now come back to that, just to clarify. And sorry if you've mentioned this already and I missed it. So that gross margin, the gross profit number of GBP1,526 million, includes the GBP200 million IAE earn-outs; it includes the TCP net debtor growth of GBP400 million or so. Correct? And the CARs movement of GBP160 million is included in that number. Is that right?

David Smith ***- Rolls-Royce Holdings plc - CFO***

Yes.

Ben Fidler ***- Deutsche Bank Research - Analyst***

It doesn't appear lower down in the table.

David Smith ***- Rolls-Royce Holdings plc - CFO***

I'm staring at Helen, but, yes.

Ben Fidler ***- Deutsche Bank Research - Analyst***

So if I take those numbers to try and get a broadly comparable, let's call it, a unit accounting type approach, you've got gross profit about GBP750 million for civil, which is an 11% gross margin in 2015, that's coming down quite materially in 2016 with the GBP550 million headwinds you've talked about.

You're a high IP business. You've got 53% of your revenues that are already in services, decent services mix, and just wondering why those gross margins are where they are. And circling back with Warren's comment about pricing is robust, I'm just in my own mind trying to reconcile all of these data points and getting confused.

David Smith ***- Rolls-Royce Holdings plc - CFO***

So if you'll forgive me, I'll maybe answer it slightly differently to the way that you've constructed the question, but hopefully helpfully.

Yes. IAE is a part of that. We talked about that earlier; part of the GBP1.5 billion. A large part of the rest of that is essentially the gross margin on our aftermarket business, whether it's in TCA or spare parts or T&M contracts. And we've talked before about margins there being in the 30% to 40% range across that range of businesses, so that's a large part of the rest of it.

Clearly, there's some profit contribution from the corporate jets. When you look at the widebody market at the moment, I think, where we are, you can see it very obviously in the CARs, in terms of the unlinked contracts and the losses on those, which as you say, are contributing to gross margin in a negative sense. They're not contributing in a negative sense because they go on the balance sheet, but they are negative because we are having to amortize some CARs each year.

When you looked at the linked part of that and think about, well, how is that linked part made up, it's essentially the same concept in the sense that we have losses on the original linked engine sales that go into the contract packs, and then we pull ahead effectively some of the contract aftermarket revenues on those linked sales. And some of that goes into the revenue that we book and, therefore, the margin we book at the beginning on those linked engine sales.

So because we've still got quite a negative cost position on the XWB and the Trent 1000, and we will have on the 7000 at the start in terms of unit cost, because we're not up the learning curve, the net effect of all that is negative to the business at the moment. And, therefore, the fact that we now have the Trent -- this is a long explanation, I know, but the Trent 700 -- I'm sensing it's over long now, but the Trent 700 margin's coming down as well because of the pricing pressure means the overall gross margin contribution at the moment of that large engine business is relatively small within the GBP1.5 billion.

And that's really what has to change over the next five years. As we get the cost structure right, we improve the unit cost to those engines, we get the benefit coming through the aftermarket on the installed base. That's the thing that's really going to swing over the next few years.

Does that help? It's a different way of answering your question.

Ben Fidler ***- Deutsche Bank Research - Analyst***

No. It's helpful, I suppose, pulling it all together and keeping a big picture. What is the right ultimate long-term gross margin for your sort of business?

David Smith ***- Rolls-Royce Holdings plc - CFO***

Well, you can now see across the businesses they're ranged apart, I think, from nuclear -- in the 20% to 25%. We clearly have to get that up if we're going to get EBIT margins where they should be, which is in the mid-teens long term.

So you can walk backwards a little bit from how much we spend on R&D, how we spend on C&A to work out where that gross margin has to be to be able to deliver that kind of profit level, but clearly, it needs to be north of where it is at the moment.

Warren East ***- Rolls-Royce Holdings plc - CEO***

I think we're going to have to just say that was the penultimate question. We've got one more from the middle there and then that's going to have to be the last one.

Unidentified Audience Member

So I've got one question, which is regarding the CapEx and how you think about this investment. Now if you look over the last 10 years, I think Rolls have spent around GBP4 billion, and even plus on that on CapEx. And it just feels that we always hear every year there's new plans, new facilities and upgrading, and it's been for a while.

So how do we judge or how do you judge that the investments that have been made in 2008 or 2009 were actually the appropriate ones and are now paying off? Because we still hear in 2016 that you need to do new plans, refurbish all facilities, etc. How do we get traction on this, because it was a huge number?

Warren East ***- Rolls-Royce Holdings plc - CEO***

Yes. And I think the numbers are what the numbers are over that period of time, but actually, we haven't specifically changed what we're about doing. A lot of what we're talking about today is actually following through on a lot of what was talked about in 2008 and 2009. It is the same facilities. We're now talking about some of the facilities that the program's kicked off in that time. They're coming to fruition now.

Yes, we have kicked off some additional ones. So, for instance, the rationalizing of the footprint in Indianapolis, we only made that decision earlier in 2015. We started working on it before, and we had plans to work on that before, but we only kicked it off in 2015. And it will take until the next several years to finish that.

So you'll still hear us talking about it, but this is in the round between 2010 and 2020 one program of industrial transformation that is changing the nature of our facilities. And so I think by the time we get to 2020 and we've finished this transformation, we'll be very well positioned looking forward.

Are we going to continue with our manufacturing technology research that I put in that presentation a few moments ago? Absolutely, we will. Will some of that involve CapEx? Absolutely, it will. But we think we're right-sizing the footprint for being a competitive business in 2020 and beyond.

I think we have rather overrun and so we're going to have to finish at that point, but thank you all very much for your attention.