Event: Rolls-Royce Holdings Operating Review Update & Interim Management Statement

Date: 12.11.2015 @ 08:30 GMT

Speakers: John Dawson, Warren East and David Smith

Call Duration: 56:33

Conference Ref No: EV00033711

Operator: Hello, and welcome to today's Rolls-Royce Holdings Plc Update on the Operating Review and Interim Management Statement. Throughout this, all participants will be in listen-only mode, and afterwards there will be a question and answer session. And just to remind you, this is being recorded. And I'm now very happy to pass you over to John Dawson at Rolls-Royce. John, please begin.

John Dawson: Thank you very much operator, and good morning ladies and gentlemen. Welcome to the call. My name is John Dawson, Head of Investor Relations at Rolls-Royce, and with me today are Warren East, our Chief Executive, and David Smith, our Group Finance Director. Warren will be taking the lead on the presentation today. Before I hand you over to him, I would remind you to review our safe harbour statement, which is attached to our presentation and is also available on our website.

We will have plenty of time for questions at the end of the presentation which should last around five minutes. So as the operator said, please wait for instructions to register for a question at the end, and then we'll be able to take your questions. Without further ado, let me hand you over to Warren.

Warren East: Thanks, John. Good morning everybody, and thank you very much for joining the call today. We appreciate this was very short notice. Right now we have an hour available for the call, but I know that our investor relations team will be spending the rest of the day talking to as many people as possible. And if we need to talk more, we will. So as you've seen, we've issued the statement this morning, and that contains information in three main areas. Firstly, initial findings from the review of operations that I've been doing. Secondly, an update on the outlook for 2015. And finally, our current best views on 2016 and the headwinds that we're facing there.

Now, all of this I know includes some very difficult messages, and that's why we wanted to hold a conference call to explain more about these issues, and importantly what we plan to actually do about them. So let's switch to the first slide. I'd like to reiterate that after – I'll just start. I'd like to reiterate: after four months of being in the business, everything I've seen has confirmed my view that the company has a strong portfolio of products and services. We certainly have a world-class engineering capability, and we're well positioned to generate high market shares, strong cash flow and higher returns on capital in the longer term. We're also preparing for an increase in the wide-body engine production from approximately 300 to approximately 600 engines per year. That is a reflection on the strength of our order book, and that is the most significant reason why we have to undertake fairly significant transition in our manufacturing capability.

During the year, we've also taken a number of steps to improve our balance sheet and liquidity, and that puts us in a strong position. We have, however, been faced with a number of headwinds, and we've talked previously in the year about that. And that will continue to impact the 2015 performance, and it's going to have some material implications for 2016. And I'll discuss these headwinds in more detail in a moment. But in summary, and in common with most industry participants, we are seeing significant changes in some of our end markets. It is primarily lower demand within corporate and regional markets, and reduced utilisation of older wide-body jets. We're also seeing continued and more severe deterioration in the offshore Marine part of our business.

For the current year our overall guidance is unchanged, although we do expect profit to be at the lower end of the range. Our assessment of the profit headwinds for 2016 total some £650 million in total, and that equates to a further £350 million of headwinds compared to what we expected in July. In cash flow terms, however, we expect a more consistent year-on-year performance, and I'll explain that in a moment or two. Clearly the conditions we are facing are challenging, and our expected performance I find disappointing. But as you know, I have been undertaking a review of operations over the past few months, and I've been preparing to present the conclusions of that to you later in November, on 24th November. But given today's news, I decided that we absolutely needed to bring forward some of the highlights from that, and make sure that today's news is – which is obviously unpleasant – is balanced with some news about what we're doing about this.

So let's have a look at 2015. Turning to guidance on 2015: we've guided to the lower end of the profit range that we gave in July, but otherwise this guidance is unchanged on a constant exchange rate basis. And this is a reflection of the growing headwinds that we've seen through this year, but it is offset by some of the mitigating actions that we've already taken. The impact on 2016 is more severe, and we're going to feel the full force of some of the market changes, and some of those changes have come faster than we'd previously anticipated. So let's look at 2016.

We've set out in the statement and outlined on the slide the key factors that we see providing the challenges for the coming year. £650 million headline figure comprises £300 million which we identified in July; in particular, relating to the impact of the slowdown in the Trent 700 order book. I'd note that we believe our initial estimation of this impact remains absolutely valid today. The next component is £100 million in corporate and regional jets. That's because we're seeing further weakness in the demand for business jet engines, in particular for new orders, as well as further weakening in demand for aftermarket services for the smaller 50–70-seat regional aircraft.

Then, in our large engine business, we have between £100–150 million of headwind. We're seeing good growth in installed thrust, but that's being offset by some short-term weakness on older, wide-bodied programmes. And this is where our engines are being temporarily parked up, as some people in the industry manage a transition to newer and more efficient aircraft. Finally, there's between £75–100 million of further headwinds in the Marine part of our business, where the market in offshore in particular continues to weaken both for original equipment sales and for services.

So the profit effects are really quite dramatic, but the impact on cash flow is a lot less. And the reason for that is the non-cash nature of the TotalCare accounting adjustments in both 2015 and 2016. And there's a difference where those adjustments are much more significant in 2015 than they are in 2016. And there's an expected benefit in 2016 of improved working capital as well.

So now we'll switch to the restructuring programme, because I'd like to say a few words about the restructuring programme that we've announced today. When David first became CFO this time last year, he said one of the jobs was to improve our management information forecasting and business systems. And that was already in motion when I joined the company at the beginning July; it's a very complex programme, and it's well underway. But I think the substance behind the news we're announcing today shows that we need to do a lot more there, and so further work definitely needs to be done on that.

I want to add some significant pace to that. I want to add some simplicity into our processes and make sure that there is greater accountability around the decision-making in the business, because the business has shown itself far less able to respond to changes in the market conditions than really we should be able to do. I believe that we're carrying too much fixed cost in certain parts of our business as well, and we're just not sufficiently flexible at managing that cost base in response to changing market conditions. Market conditions are going to change anyway, and it's something that we have to get used to. This is therefore totally unacceptable for a world-class business, and particularly where we operate in a very competitive environment. So we need to make very significant changes to make ourselves more resilient and sustainable. And we need to move rapidly with the restructuring, because that's in the light of this further weakening that we've seen in some of our key markets.

It's too early right now to provide detailed costings of the proposed restructuring, but I do intend that we'll give you some further information on this on 24th November, as previously planned, and we'll be giving even more detail with our results in February. In the meantime, the previously announced restructuring and cost-cutting that's going on within our Marine and Aerospace business: that's going well, and I'm confident that the benefits of today's actions will have a significant impact too, by the end of 2017. So with that, let's open the call up and we'll have some questions.

Operator: Thank you. Ladies and gentlemen, if you wish to ask a question could you please press 0 and then 1 on your phone keypad now in order to enter the queue. And then after you're announced, just ask your question. And if you find that question has been answered before it's your turn to speak, just press 0 and then 2 to cancel. And there'll be a brief pause while questions are being registered.

The first question is from the line of Ben Fidler, Deutsche Bank. Please do go ahead, your line is open.

Ben Fidler: Yes, good morning, can you hear me?

Warren East: We can, Ben.

Ben Fidler: Thank you. If possible, I'm going to squeeze in three quick ones. The first of which is just to understand, I suppose, how come the deterioration in a number of your Civil Aerospace businesses has accelerated so much since July? We're not that far on for businesses where you should have reasonably good visibility around corporate and regional OE deliveries, for example. I just wondered why the pace of that has surprised?

The second issue is: I know you haven't provided a view for 2017, and you may be limited about how you want to answer this question. But just to understand: some of the effects dragging on 2016 – do they continue? You yourself, Warren, used the language of 'a temporary parking up' of some of your older wide-bodied programmes. Do you expect things like that to reverse in 2017, and therefore should we see 2017 as a strong rebound year, or is it more of a progressive recovery from that point onwards?

And the third question is: just with some of these older programmes, where you're suffering an excess level of groundings – I suspect it may be 340s it may be 777s – does that create any asset write-down risk on some of the TotalCare assets, or are you comfortable that that is not a risk? Thank you very much.

Warren East: Right, let me start with the first two questions there, thanks Ben. Why has the pace of change really surprised us? Well, I think that this has been a building effect, and certainly when we talked in July, there was – some of this effect was there. I think we've just been through a process where we've looked at our budgets for 2016, and this is our estimate based on where we are today. The very reason that we're also announcing the restructuring and the programme that I'm going to talk about in a bit more detail on the 24th, is because these changes will happen and they do happen fast. And the issue is our ability to respond, and our ability to take data from the market and turn that into information and do something with it. And so I think that, you know, there is a combination of effects here. You know, it's well – the actual issue is documented and has been reported by other companies, and it probably has accelerated, the pace of that has accelerated since the middle of this year, but that combines with the fact that we also need to do a better job at being able to deal with that. So that's really what I'd like to say on the pace. It has been quite quick since July.

Now, we've given a 2017 view just in terms of saying that, you know, we expect the impact of some these new changes that we're announcing to impact in 2017. It's too early to talk about the impacts of the parked-up aeroplanes on 2017. Some of this – you know, it's a very select number of airlines that are involved at the moment. Some of them are – they're basically balancing capacity and demand, and there's new, more efficient aeroplanes out there, and those planes are being bought to increase capacity. Meanwhile demand wobbled slightly, and so the obvious thing to do is park up the less efficient engines, and use the planes with more efficient engines. I think it won't be – it's really too early to say, you know, is it a temporary effect that will be over and done with by 2017? In the long term the demand is certainly there, so we do expect to see the overall number of aeroplanes being used continue to increase. And so I suspect that it is temporary, and that it is going to be a progressive recovery, but it's really a bit too early to say, 'This will all be complete by 2017.'

As for asset write-downs, do you want to have a quick comment on that?

David Smith: Yeah, and maybe I'll just add to Warren's points. So Ben, you'll remember when we talked about the £300 million and the Trent 700 effects, we did say that we thought that effect would be about the same in 2017, so that view hasn't changed.

The – and what I would say in terms of improvements: this is really going to be driven by the new installed base on the Trent as opposed to, I think, any improvement on the legacy programmes, because they will continue, obviously, to reduce over time, as we would expect. To some extent, this may be a pull ahead of that, but we've yet to really bottom that out. And clearly also the Marine business is really very much on what – how we will see market developments over the next year, so again that's really much too early, I think, to comment on that.

In terms of specific – your question on specific asset write-downs: no, not in general overall. We still have sufficient cushion on those programmes. But of course, as you know we actually undertake a very detailed review, and we will look at specific valuation reserves against individual airlines. That's a normal part of our process, but it won't be an overall effect in terms of a need to write down the assets.

Ben Fidler: Okay, thanks very much.

Operator: Okay, our next question is from the line of Jeremy Bragg, at Redburn Partners. Please go ahead, your line is open.

Jeremy Bragg: Hello, guys. A couple of questions, please. Firstly: do you think now that this 2016 guidance is fully conservative, or there are some areas where you think there are still risks?

Second question: if it's too soon to talk about 2017, are you still confident that in the longer term, cash flows and margins can improve from now?

And third question, which I think I asked last time on the last similar conference call, was: is this an attempt to reset the accounting again for TotalCare, given that the downgrades to EBIT have been bigger than the downgrades to free cash flow? Thank you.

David Smith: Yeah, so we're going to take each of those – in terms of, 'Is this a conservative forecast?', I think we will continue to view it as a balanced forecast based on the market headwinds as we've seen them. We've tried to give a much earlier view: we started that in July, we're updating that now, clearly we'll update that further in February. I think it's very balanced in terms of how we see the market at the moment, but clearly the market is changing, and we will have to continue to react to that.

In terms of long-term margins: no, I'm still very confident about that. That's driven – as I hinted in the last answer about the long-term growth in the installed base for the new Trent engines, that will generate significant improvements in cash flow and operating margins and return on capital, over time. I think we're talking about the transition effects on the legacy programmes primarily, here.

And is this an attempt to reset accounting? No, there's no change in accounting within this guidance. This is really driven by what we're actually seeing physically in the market, and trying to do the best we can at forecasting how we see that developing over the next year.

Jeremy Bragg: Thank you. So can I just follow up very quickly? On the long-term margins, the obvious question is: as your starting point is now lower, is your endpoint also lower in the long term, please?

David Smith: No, I don't believe so, because the long-term margins will be driven by the new portfolio that's coming in place over the next five years. So that's what's going to drive it. What we're really talking about is the effects of the run-out of the legacy portfolio here.

Jeremy Bragg: Thank you.

Operator: Our next question is over to the line of David Perry at JP Morgan. Please do go ahead, your line is open.

David Perry: Yeah, good morning, Warren and David. I've also got three questions, please. The first is: when you talk about the need to improve management information systems, I just wondered how much of that is operational issues, and how much of it is related to the complexity of TotalCare and all the inputs that go into that? And whether perhaps your thinking, Warren, on TotalCare accounting has evolved relative to comments you've made previously, that you're okay – probably comfortable with the accounting?

The second question is: what do you think are the major downside risks from here? I mean, David, I know you've said this is a balanced outlook. I think on the last warning in July, you said the new guidance was robust. I appreciate, you know, there are things out of your control, markets changing, but I just wondered what you thought were the major areas of risk, still?

And then the third question is: I was just wondering if, from 24th November, we would expect any medium-term earnings – or sales and earnings targets, please? Thank you.

Warren East: Okay, let me kick off the first one. And no, I think the comments on the information systems have nothing really whatsoever to do with the TotalCare accounting and the accounting. It's more of a comment on: broadly, we have a lot of people engaged with customers, engaged with the market; we pick up lots of data, we turn that data into information, and we make decisions about it. And some of those decisions are what we expect in terms of financial out-turn, and some of it is sort of normal operational planning decisions.

But the issue is that we take too long, and the process by which that data gets turned into information is too complex. So what we need to do is make the whole process more simple, but also increase, essentially, the clock frequency as they say, so that we are able to respond more quickly within the business to changes in the market which are going to happen anyway.

David, do you want to talk about the second question on here, or…?

David Smith: Yeah, I think on your question about downside risk, it's really as I described it earlier; that, you know, I wouldn't say that any of us is in a position to talk authoritatively about how the oil and gas industry is going to develop. We are trying to give the view on offshore Marine that we think is based on the order intake that we've seen, which has been very low; I've described that previously, but it continues to be very low. And therefore, that's our view through 2016 I think. We'll have to take a call on how that moves through 2017–2018 during next year, but clearly I would be more conservative than I would've been six months ago, just going on the experience of the last six months.

In terms of the downside risk on the legacy aftermarket portfolios: we've modelled that and looked at that as closely as we can, but there clearly is a big transition going on both in the narrow-body and the wide-body side of the business. And I think that we are not alone in experiencing this; I've seen comments from several other companies, both on the airline side and the supplier side within the industry over the last few weeks, and I think what we're seeing is part of a pattern. And that may well change further, and we've got to be prepared, as Warren said, for that, and therefore more resilient to those sort of fluctuations; that's really why we're taking the action that we're taking.

Warren East: Okay. And so your third question, talking about medium term guidance on 24th November. 24th November we're going to talk about what I've concluded from reviewing the operations, and right now I've decided that comprehensive guidance for 2016 is not a good idea, which is why we're talking a bit more directionally about this and we're explaining the factors behind the profit headwinds from 2015 into 2016. And I don't think it makes good sense to reiterate medium-term guidance now, either. But what we will be talking about is the nature of the businesses, how they work, and the sorts of things that we're doing to improve the operational performance of those businesses, so that people can form a judgement about how quickly we can improve the margins within the business.

David Perry: Okay. And if I may just ask a follow-up, please? Thank you for those helpful answers. If the management info isn't in any way related to TotalCare accounting, do you still stand by your comments on the first call that you're broadly comfortable with the accounting, and that TotalCare doesn't need radically revisiting, at least from an accounting perspective?

Warren East: I do stand by that. It's – TotalCare accounting that we do, I agree it's complex. But, you know, part of the complexity in that comes from the necessity to be suitably conservative. The TotalCare programmes are all about providing appropriate – what the customer wants, and it's important that we remember in all this that the accounting will be what the accounting will be. We need to concentrate on delivering value for our customers, and then it's up to us to make the whole process as simple as we can possibly make it, so that we can respond quickly to the changes there. But no, I stand by the Total accounting that we have at the moment.

Would I like it to be simpler? Yes, I would like it to be simpler. And as we've already said earlier this year, the complexity associated with this is partly to do with the fact that some contracts are linked, some are not linked to the OE sales, and that the balance of linked and unlinked is shifting as we move to newer engines over the next several years. So the issue will, in time, largely disappear.

David Perry: Thank you very much indeed.

Warren East: Thank you.

Operator: Our next question is from the line of Andrew Gollan at Berenberg. Please do go ahead, your line is open.

Andrew Gollan: Good morning, thank you very much for taking my questions. I've got three as well, if I may. First one – quite complex, really – I'm just trying to understand more about the changes in assumptions that you're alluding to within the contract accounting. David, if – you mentioned in one of the earlier questions, you know, you're confident of the longer-term returns and cash flows. Part of the message today is telling us that the legacy fleet is not as profitable right now or – you know, you say temporary effects. I'm just trying to work out whether there is a structural change in your expectations for the profitability of that, let's say, the legacy fleet over the longer term. I mean, we're going through a transition, we're seeing maybe some short-term temporary effects, but does that mean that, you know, the life of these engines are perhaps shorter than you expected, and that we are structurally changing our longer-term assumptions? Because a lot of us sort of look at that as, you know, the profit and cash driver on a 5–10-year view is the maturity of all of that fleet. So I'm just trying to understand that a bit better; what are you telling us here?

Secondly, a couple of questions on cash, just a very short-term one. The cash flow effects are less, you've mentioned. Can you just give us a feel for the kind of drop-through or quantum, if you like, of the profit impacts that you are guiding to next year, on that additional £300 million of profit?

And then just longer-term and, I guess, linked to the first question. You know, as profits move closer to cash, clearly that's a good thing, something that would have happened over the very long term anyway. Can you give us a sense of maybe some metric like free cash conversion profile over the next, say, two or three years, through this transition period, and then longer term? It's the kind of metric that a lot of your peers talk about, and it's really quite helpful for us to understand what's going on in the business through these big transitions.

David Smith: Yes, however I'll just take the first point. So this is really about, you know, as far as we understand – and each airline will be in a different situation, because it very much depends on their fleet, what they've got on order, how they're managing capacity and operating patterns. So I don't think this is a pricing/margin issue. This is absolutely about volume of flying hours, utilisation of the fleet for those legacy programmes, and I guess what we and others in the business are seeing is actually that that transition that everybody has seen coming in terms of wide-bodies is going to require a bigger degree of change on the legacy than we expected. So that's really our change in assumptions, which is looking very specifically airline by airline, but overall about how we see the level of flying hours on each of those legacy products developing.

To your maybe longer-term question about engine life: that's clearly a very sensitive thing that we look at, and as we model each of our new programmes, such as the XWB or the Trent 1000, we look at that very carefully based on the evidence that we have. The truth is, that number really hasn't actually changed over the last 20 years. It's still about 25 years on average. Now, that doesn't mean that we are necessarily not more conservative when we do our own modelling, because we are. However, the objective evidence actually hasn't changed, even though we may be getting some short-term acceleration of that for some programmes and some airlines. But I think, as I said, that is much more to do with the individual capacity and operating situation of those airlines, rather than a systemic issue as far as we see it at the moment.

In terms of cash flow, this is a very important point. And we did point out in July that, as Warren said, many of the profit effects were going to have a much more muted effect on cash flows simply because of the linked accounting of the Trent 700, which I think everybody got that. When we think about 2016 compared to 2015, clearly there are a number of things quite negatively affecting working capital in 2015, you know, in the Marine business for instance. We believe that therefore, although we are going to see a £650 million profit headwind, we will not see that degree of cash headwind. I am not brave enough to tell you that cash will be exactly the same in 2015 and 2016, because to be quite honest we always give quite a wide range around cash flow given that it's a year-end number, but it won't be anything like as different as the profit impact. So we see a much more consistent view on cash flow between the two years. And the primary reason is that the working capital changes in 2016 will be much lower than they are in 2015.

In terms of cash conversion profile, therefore mathematically that will improve cash conversion in 2016. We said previously that we still think that, when we go out four or five years looking at cash conversion north of 80% – and I've said before, you know, some years that may well be north of 100% – is absolutely right. Because that's really driven by the physical things that are happening in the business: as we get up our ramp curve, as the after-market installed base grows on the XWB and the Trent 1000 and other products. So that's absolutely right. What I know is more difficult to do is exactly predict how that cash conversion will move between now and then, but I would say that we are going to have a couple of years where it will be better than it was this year, because of all the effects we have just been describing. And then we'll progress up to that higher level by the time we get to the end of the decade. So it will be a transition.

Andrew Gollan: Okay, thanks very much indeed.

Operator: We are now over to the line of Charles Armitage at UBS. Please do go ahead, you line is open.

Charles Armitage: Good morning. Two questions; I feel somewhat emasculated I don't have three. First of all, just to be absolutely clear: that £300 million headwind that you are talking about in 2017, that is versus 2015? It's not an incremental worsening from 2016?

David Smith: Yeah, that's correct, yeah.

Charles Armitage: Excellent. Secondly, the dividend: when are you going to make a decision on that, and can you just talk us through your thinking? It just seems to me that you are spending £400–500 million on dividends; a small cut to that really doesn't make an awful lot of change in the whole scheme of Rolls-Royce and the transition, so should we be looking for a suspension for a couple of years?

Warren East: Yeah, I think – you know, we've put these comments about the dividend in the release here, and we talked about the actions that have been taken over the last few months to improve our financial liquidity and strengthen the balance sheet as well. And we've put them in there because, given that we are talking today about profit headwinds as large as we're talking about for the transition from 2015 into 2016, it is just common sense to tell people that, you know, of course we're considering the strength of the balance sheet and we're considering the dividend in the light of changes that will be evident to dividend cover. But I'd stress the fact that, you know, we talked about the balance sheet being strong, liquidity being strong, and we also talked about the fact that the Board will be reviewing this. The Board will be reviewing it at the normal time, and changes, if any, will be announced at that time.

Charles Armitage: Okay, thank you.

Operator: We are now over to the line of Christian Laughlin at Bernstein. Please go ahead, your line is open.

Christian Laughlin: Yes, thank you. Good morning gentlemen, just a couple of questions from me please. One: there are some positive comments on the strength of the business portfolio in the start of the press release this morning. So that implies, Warren, that you have not changed your view on the value of retaining the existing mix of Aerospace and Land & Sea businesses over the long term: is this a fair interpretation? That's the first question.

And then the second question is: Warren, also if you could just elaborate a bit on what you mean by the inability to respond to changes in market conditions? Is that really referring to production or service offerings, or pricing? Or just generally you have too many people doing too few activities, or an inflexible supply chain? If you could just kind of elaborate a bit on that second point, that would be helpful as well, thanks.

Warren East: Okay. First point on the portfolio, I think we are going to talk a bit more about this on 24th November. Don't forget, 24th November has always been billed as an update on a review of the operations of the business, but what I have found is that it is impossible to really do that without taking into account, you know, essentially reviewing the portfolio of product and market activities. However, you know – and so I'll talk more about that on 24th November, but for the time being then certainly I haven't changed my views that over the long term this is a business with very strong engineering and technology. We need to focus on what we are really good at, which is engineering engines and propulsion systems, and the fact that we deploy that expertise out into a range of different market applications, which all have a little bit of a common theme – and again, I can talk about it in greater detail, I don't want to waste too much time on that now – but the view hasn't really changed over the long term.

Our inability to respond quickly and so on: I think it's a combination of the fact that, you know – an observation I take out of the review is we clearly have too much fixed cost in some parts of our business. And we're just simply slow to react to changes in what's going on in the market. I think we've evolved over time a very good ability to deal with supply chain and make sure that we are not building mounds and mounds of excess finished goods, and we're not ordering vastly too many materials and components from our supply chain either. But in the short term, we are generally not fast enough at being able to take all those things and translate that into what impact that has on our financial results, and communicate both with ourselves around the business and with the outside world.

Christian Laughlin: Okay, great, thanks.

Operator: We're now over to line of Nick Cunningham at Agency Partners. Please do go ahead.

Nick Cunningham: Thanks very much, good morning gentlemen. Yes, a couple of questions. One: talking about the strong cash conversion indications for the end of the decade; does that include any assumptions about major development programmes? In particular, there has been a lot of coverage of A350 Stretch including your UltraFan, and of course I suspect you'll be bidding on Boeing's middle of the market new narrow body. So that's one question.

Second one: looking at the mix impact of accounting changes, obviously IFRS 15 is now moving into view. Do you have any view yet on that? And in particular whether it intensifies the impact of the shift from linked to unlinked, and whether you can still capitalise OE losses under unlinked?

And finally an unlinked question, in that, I – just on the biz jets, is that a loss of market share that you're suffering which you're being impacted by, or is it a weak market overall for Gulfstream and Bombardier? Thank you very much.

Warren East: Let me deal with the first one, and then David you can deal with the IFRS 15 implications. Is that alright?

So I think one of the things, as we go through this restructuring and improving the simplicity of our business, pace of decision-making and so on, then one of the things that we need to take care of is to make sure that we continue to invest in technology and we continue to invest in the product roadmap. And the opportunities that you talked about in the question – the A350 Stretch, possible 757 successors and so on – absolutely these are on our radar, and absolutely these are taken into account when we talk about our forecasts for the end of the decade. Do you want to…?

David Smith: Yeah. I mean, specifically IFRS 15, which as you know went back a year – or at least a year in terms of the implementation timing. There is a lot of fairly intense activity going on. If we look at that, both with our own accountants but also talking to other industry peers, we would like as an industry to try and get to reasonably aligned views around this. And the changes maybe are quite fundamental, I think, in some areas, although I'm not sure that we fully understand what will happen on the portfolio at the moment. I would love it to be simpler. I am not – what I'm seeing is it probably won't be simpler, it will be different, and that may actually have some effects on the portfolio that we're going to have to talk about. But it's too early for us to do that yet. The industry really is still talking, and obviously talking with the regulators and just trying to understand how best to model – which are still, fundamentally, the heart of our business, very strong long-term business contracts that we're trying to make sure we find the right way to model from an accounting point of view.

Warren East: Okay. And to comment on the unlinked question about corporate jets: we're coming from a position of actually very good market share, particularly the higher end of the corporate jet market. And it is well known that we have lost some positions on subsequent aeroplanes that are coming along to replace some of those where we are incumbent today.

And so, as we look over the next several years, we can see a headwind from that loss of position. But what we're seeing in the short term right now is a softening of the market, and that softening of the market manifests itself in reduced demand for these planes, generally. And people who would otherwise buy a more expensive, higher end of the market plane are buying a lower end of the market plane, where our market share just doesn't exist today. So, some of it is a longer term that Rolls-Royce has, over previous years, lost out on some of the positions at the higher end, but that's because we're coming from a very, very strong position at the high end. And some of it is due to softening in the market, and we're absolutely seeing that softening in the market at the moment. It's happening a bit quicker than we expected it to happen.

However, I'd also stress that we're still very well positioned to capitalise on the opportunities that are there to get back into some of these higher-end planes that are coming along in the next generation. And I'd also stress that our strong market share that we had going into this situation still means that we have an excellent installed base, which is still growing. The aftermarket is largely proportional to the installed base, and the installed base is still growing. It's just not growing at quite the rate that it was growing.

Nick Cunningham: Thank you very much for that. Could I just make a plea on the IFRS 15 process? Could – would it be possible to involve the other stakeholders in the industry, including the investors and the analysts over the next couple of years? Thank you.

Warren East: Thank you.

Operator: Okay, the next question is from the line of Zafar Khan at Société Générale. Please go ahead, your line is open.

Zafar Khan: Thank you very much, good morning everybody. I've got two business-related questions please, and two general ones, if I may? The first one is just on the 2016 outlook. Power Systems, interestingly there isn't really very much mentioned on that, beyond saying Q3 has been fine. Cummins offshore – sorry, off highway hasn't been particularly good. I think standby power probably in some of the areas is difficult, and there's 20% exposure to energy for the Power Systems. And I'm surprised that there's no real mention on that. So, I'm interested to know the view on that visibility.

Also, on Defence: United Technologies, GE, PCP they've all warned on the aftermarket for military transport aircraft. I know, for yourselves in Defence, that's a pretty big exposure. I think it's more than half the Defence business. So, I just want to know, on those two businesses, how much due diligence has been done and how firm your kind of outlook is on those? That's the first one.

The second is: you mentioned, Warren, the high cost base. You haven't said very much on the potential for cash liberation from the business. And I know in the past, there's been admission that the inventory levels, etc. were too high because you were building a lot of factories and needed buffer stocks. So those are the two specific ones.

Just a couple of general ones, if I may please? The first one is on the review that you're undertaking/have undertaken. Has it been purely internal, or have you sought help from some external consultants on this one, just somebody to hold your hand? Because I would imagine, having worked in a high-growth business with a very different business model, I just wonder how much experience you would have had of actually looking at something which is more mature and needs huge amounts of cost reduction.

And then the fourth one is: again, Warren, you're in a unique position of having been a non-exec on the board of this grand company, and for the last five months, as a CEO. So you've sat there as a non-exec: what were your expectations in April when you took on the job form the non-exec position? And are the challenges far greater than you envisaged at the time when you took on this position?

Warren East: Okay, quite a lot of questions there.

David Smith: Shall I start with the Power Systems question?

Warren East: Yes, if David starts with Power Systems.

David Smith: I can cover about defence as well. So, in terms of Power Systems: yes, we haven't talked about Power Systems specifically. If you recall, when we talked about the half-year results Power Systems had actually reached a record order book of £2.2 billion. They've progressed well, in terms of that order book, through the subsequent months. So, our view at the moment is actually reasonably balanced on Power Systems. You're absolutely right, there are areas that are linked into global commodity markets, for instance by mining or oil, that are weak. But they were weak anyway, and they have just continued to be weak, so that's not really a change from our perspective.

On the other hand, we do have some positive developments, I think. We continue to do well in governmental areas and things like the electric locomotive, so overall we still think that that's a reasonably balanced view for Power Systems, for the balance of this year and going into next year.

On Defence, we have done a very detailed review. I'd say Defence is probably going to be more impacted over the next 18 months just by the scheduling of OE deliveries as opposed to aftermarket. We're pretty confident in that, and we are not seeing significant change in aftermarket for Defence; that continues a strong part of the business. And clearly, there's actually more activity around the world, unfortunately, at the moment. So that, if anything, might actually be some upside for us. So I think the Defence picture, as well for Power Systems: yes, there'll be some ups and downs, but it's a pretty balanced picture I think.

John Dawson: Yeah. And if I might add one thing, David, to that: the – obviously on Transport and Patrol we are largely now an aftermarket business, we have a very mature portfolio. Much more interesting for us is making sure that the technology investments address the need to have viable technology to tackle the next round of development of the Transport and Patrol market for our applications. But we're doing fine as regards life extensions and providing support for in-service Transport and Patrol activities, which is the core area at the moment. So it's less sensitive to the OE side.

Warren East: Absolutely. Right, I'll pick up on the last three questions then. Cash liberation from the business, and what's been talked about before: yeah, absolutely. Everything that's been talked about before is ongoing and continues, and I've said the transition that we're going through is an important transition, and that needs to be driven through to conclusion. The performance improvement programmes that have already been announced prior to today are absolutely on track, and they're on track to delivering year-on-year cost savings in the parts of the business that they apply to at the moment, and also to improve inventory turns and reduce working capital. So that's happening. What we're talking about today, and what I've identified in the review, is the need to do other things, to do additional things. And one of those is about reducing the fixed costs, not about reducing the working capital; that's happening anyway.

External consultants: no, we haven't used external consultants. I have thought – one of the things I need to do, coming into this business new, is absolutely get under the skin of the business myself. So simply delegating that to some external consultants didn't seem like a very good idea.

With regard to your third question, pointing out that I have actually seen this business – certainly before I got involved in the process of joining the executive, I've seen this business from the non-executive side of the table for some nine months or so. Have my expectations changed? Well, you know, I've only been in the business just over four months, and so no, actually things haven't changed that much. What's happened is, I would say, the challenges are the same sorts of challenges that I had identified from the outside.

But it has been important to get under the skin, and I now have a much greater understanding of what lies behind some of those challenges, and the things that we need to do to address them. And you can only really get that visibility from being inside the business, rather than outside it; it's quite hard to actually see that from the Board. All you see is the symptom, and you don't really understand the causes to the same extent. So I'm actually quite pleased to be inside, to be getting my head around what's really causing some of these issues, so that we can get on with fixing them.

Operator: Our next question is over to the line of Alexi Yannas at PIMCO. Please do go ahead, your line is open.

Alexi Yannas: Morning, thank you for taking my question. So what is your commitment to your current credit rating? What measures would you be willing to take, in addition to revisiting the dividend, to maintain it? Would you reduce CAPEX? What else would you do? And should we now consider it a distinct possibility that there could be a rating downgrade? Thank you.

David Smith: Yeah, I mean we view that maintaining the credit rating at the kind of level that we're at at the moment is an important part of our financial policy. Clearly we will have, as we have over the last year, further discussion with the rating agencies, but they will have to take their view on that. But it is an important part of our financial strategy.

I don't believe that it would be – just to your specific question on CAPEX – so we've previously given guidance that CAPEX and R&D over time may come down as a percentage of revenue. However, I don't think they're going to change that much in absolute terms. We will continue to invest as we think we need to do in terms of new product. That's a very important part of delivering the long-term cash flow for the business, and therefore that's absolutely an important – the kind of actions that Warren is describing that we want to take, in terms of improving break-even, I think are the more significant ones where we're trying to take out fixed costs rather than investment spend.

Alexi Yannas: Okay. Is there a sense that your current ratings could potentially be downgraded? Your A3, A, A ratings?

David Smith: Well, as I said, we'll have discussions with the rating agency. We've obviously already contacted them, we have planned discussions already with them, so we'll need to go through that process.

Alexi Yannas: Alright, thank you.

Operator: Okay, the next question is from the line of Rami Myerson at Investec. Please do go ahead, your line is open.

Rami Myerson: Good morning gentlemen.

Warren East: Morning Rami.

Rami Myerson: A few questions from me. On the restructuring, just to understand: you still haven't decided whether or not the charges there will be made above or below the line, and I assume we'll have an update on the 24th. And just to clarify: you expect the £150–200 million as a run rate exiting 2017, or is it from 2017? And have you started discussions with the various UK unions on the restructuring plans?

And the second question on aftermarket and cash flows. If I understand correctly, a lot of the downgrades today are actually cash items rather than TotalCare, the old engine aftermarkets etc. So can you explain why – is there an offset from working capital, or is it actually more TotalCare than time or materials? Thank you.

Warren East: Let me deal with the first two of those questions, to start with. So the restructuring, and £150–200 million per annum that we expect in terms of cost saving from this during 2017: the word is 'during 2017', as in I expect the impact of this to be felt during 2017, it to be progressive, and the full per annum benefit will be from 2017 onwards. So by the end of 2017 we expect to be at about that level.

In terms of how it's going to be charged: you know, right now – we will give some further details of 24th November, and we'll give some further details when we report again in February. Because I don't think we'll have all the answers on 24th November in terms of exactly how much these things are going to cost, and exactly when we're going to have to get those costs – when we're going to have to spend that money, and exactly when we're going to see the benefits.

There are a lot of people issues involved, and so we need to consider that as well. However, I would stress that a lot of this is not just about people, it's about processes and what the people are actually doing. And so in terms of consultations, that's something that we have ahead of us rather than stuff that's already been done. But this programme is incremental to the programmes that have already been announced, and so there will have to be some additional consultations as we go forward.

David Smith: Just on your cash flow question: so I think it was really as I explained earlier, which is the – you're absolutely right: some of these profit headwinds, as opposed to the linked accounted ones we talked about in July, will have cash impact. However, we also, as we talked about on inventory and other areas of working capital, are improving performance in those areas. So we believe the drag that we've seen on what I would describe as normal trade-related working capital will not be anywhere near as significant in 2016 as it has been in 2015.

Rami Myerson: Thank you.

John Dawson: Excellent. Operator, I think we said we'd take an hour, and we're just coming up to the end of that, so I suggest we use that as a chance to finish the call. For those who are in the queue we will give you a ring, just to make sure your questions are answered by the team over the next couple of hours. But if I can just say thank you very much for taking part, and hand you back to the operator.

Operator: This now concludes today's call. Thank you all very much for attending, you may now disconnect your lines.

Event: Rolls Royce Holdings Operating Review Update & Interim Management Statement

Date: 12.11.2015 @ 16:00 GMT

Speakers: John Dawson, Warren East and David Smith

Call Duration: 25:27

Conference Ref No: EV00033716

Operator: Hello and welcome to today's update on RV operating review and interim management statement. Throughout this, all participants will be in listen-only mode, and afterwards there will be a question and answer session. And just to remind you, this is being recorded. And today I'm very pleased to pass you over to John Dawson at Rolls Royce. John, please begin.

John Dawson: Thank you, Hugh. And good afternoon ladies and gentlemen for those in the UK, and good morning to those of you in the United States. This call is primarily for the benefit of our US shareholders, who hopefully have an opportunity to dial in this afternoon, and of course to analysts and investors here in the UK who may have further questions that they wish to ask management. My name is John Dawson. I am head of Investor Relations at Rolls Royce. With me are Warren East, our Chief Executive, and David Smith, our Chief Financial Officer. Warren will be taking the lead on the presentation today. Before I hand over to him, I would remind you to review our safe harbour statement which is attached to the PowerPoint and is available on our website.

We will have plenty of time for questions at the end of the presentation, which should last about five minutes. Please wait for the operator's instructions to register for a question at the end of our opening remarks. Thank you, and without further ado let me hand you over to Warren.

Warren East: Thanks, John. Good morning everyone in the call in the US. Thanks for joining us today. And I apologise about the short notice. We've an hour available for the call, but our IR team will be able to communicate after the call and we'll set up meetings and telephone conferences as required.

So as you've seen in the UK this morning, we issued an interim management statement and that covered three main areas. Firstly, initial findings from the operational review that I've been doing. Secondly an update on the outlook for 2015. And finally, our current views on 2016 and the headwinds that we're facing, transitioning from 2015 into 2016 from a profit point of view.

Now, this IMS included some very difficult but necessary messages, and that's why we want to take time to hold conference calls, and to be able to spend time with investors explaining more about the issues, and importantly what we plan to do about things. So let's go onto the key messages slide, the first slide. I'd like to reiterate to start with that after four months of being in the business, everything I've seen has confirmed the good things that I saw: my view that the company has a strong portfolio of products and services, definitely has a world-class engineering capability, and actually it's well-positioned to generate high market shares and strong cash flow and actually, in the longer term, higher returns on capital. And we're preparing for an increase in wide body engine production, an increase which doubles production from around 300 to around 600 engines per year. And that is a reflection of a very strong order book, and a growing market share.

So that is the good stuff. During the year, we've also taken steps to improve our balance sheet – strengthen our balance sheet and improve liquidity and that puts us in a strong position as well. But we've been faced with a number of headwinds that continue to impact 2015, and they have material implications for 2016. And I'll discuss that in a bit more detail shortly. But in summary, and in common with most industry players, we are seeing significant changes in some of the end markets in which we operate. This is primarily lower demand within the corporate jets and regional jet markets, reduced utilisation of older wide-body jets as well. And we're also seeing a continued and even more severe deterioration in the offshore sector to which our marine business is exposed.

So for the current year, our overall guidance is actually unchanged, although we do expect profit to be at the lower end of that range. And our assessment of the profit headwinds for 2016, however, totalled some £650 million in total, and that equates to a further £350 million of headwinds compared with what we talked about in July. Good news, in cash flow terms, however, we expect a much more consistent year-on-year performance, and we can explain that difference in a little while. So, clearly the conditions that we face are challenging, and our expected performance is disappointing. But for me it's also striking that the revenue impact of these changes in the market – that the revenue impact is relatively small but the profit impact for us is large. Interesting observation, and we'll come back to that.

So as you know, I have been undertaking an operational review for the past few months, and I had been preparing to present conclusions to you later in November. But in the light of the numbers coming together for today and reflecting on the size of that, we decided that I should definitely bring forward the announcement of at least the headlines of the – what I think we need to do as a result of the operational review that's been going on. And I understand that the whole thing makes unpleasant news and it is a good opportunity to make sure that people have time to digest this before we start talking on 24th November.

So let's look at some guidance – 2015 guidance. We've guided to the lower end of the profit range that we gave in July, but otherwise it is unchanged on a constant exchange-rate basis. It is a reflection of the growing headwinds that we've seen coming through the year, but these growing headwinds are offset by some of the mitigating actions that we've already taken. But the impact in 2016 is more severe, as we feel the full force of these market impacts and some of the market changes, and in particular some of those changes which have come along a bit faster than we had previously anticipated. So let's turn to 2016 now.

We've set out in the statement and we've outlined on this slide the key factors that we see that are making up the challenges for the coming year. The £650 million headline figure consists of £300 million that was identified in July, in particular relating to the impact of the slowdown in the Trent 700 order book. I note that we believe the initial estimation that we made in July remains absolutely valid. So this is essentially the same position that we were in in July. However, since then, we can also see a further approximately £100 million impact if we look at corporate and regional jets together. And in the corporate jet market, we're seeing further weakness in demand for those business jet engines, particularly for new orders, and then in the regional market, we're seeing weakening demand for aftermarket services in the 50 to 70 seat category, where people are simply not flying those aeroplanes for a variety of reasons.

If we look in the large engines area, then we have about £100 to £150 million headwinds in large engines. We're seeing good growth in installed thrust, but that's being offset by some selected short-term weaknesses on some older, wide bodied programmes. And this is where aircraft are being temporarily parked up by some players in the industry as they manage a transition to new and more efficient aircraft. And the net effect of that is about £100 to £150 million of profit.

Finally, there's an additional £75 million to £100 million of further headwinds for the marine business, as the market there continues to weaken for both the original equipment sales and for services in the offshore sector. So these profit effects taken all together are quite dramatic. However, as I mentioned earlier, the impact on cash flow is a lot less and that's because of the non-cash nature of adjustments as a result of TotalCare accounting. The TotalCare accounting adjustments in 2015 compared with those adjustments in 2016. There's a bigger adjustment in 2015, a positive, and a smaller adjustment in 2016. Therefore, the negative profit swing is somewhat less by the time you look at it from a cash point of view. And if you add that reduced cash – add to that reduced cash impact expected benefit of improved working capital, you get the broadly neutral position that we're talking about in the guidance today. Or in the estimations today.

So now let's look at a slide on restructuring, because I'd like to say a few words about this in this context. This was going to be talked about initially on 24th November. We'll come back on 24th November and obviously add a lot more colour to this, and we'll probably add even more colour in February as well, because it's an ongoing programme. Now let's say, when David first became CFO this time last year, he said one of the jobs was to improve our management information forecasting and business systems. So that was already in motion when I became CEO in July. It's a major and complex programme and that's well underway. But from what I've seen over the last several months, and importantly illustrated by the news today, we've got a lot more work to do on that. Right now, it's not working properly and it needs to work better.

My key requirement is to add a bit of pace to this, and simplicity and accountability into decision making in the business. And the business itself has really shown itself over the last several months to be much less able to respond to changes in the market conditions than should be the case. I also think, referring to the point made earlier about the small revenue changes resulting in large profit changes, I think we're carrying far too much fixed cost, and we're not sufficiently flexible in managing the cost base in response to changing market conditions. And actually that's just unacceptable for a world class business, and particularly where we are operating in a very competitive environment.

So we need to put into place some significant changes to make this business more resilient and sustainable. And we need to move a bit more rapidly with the restructuring, in the light of the fact that we are facing further weakening in some of our key markets.

It's too early to provide detailed costings of the proposed restructuring, and we will give further information, as I said, later in this month on the 24th, and we'll provide, I'm sure more detail with our results in February and updates after that. In the meantime, the previously announced restructuring that's going on in our marine and aerospace businesses – I'm pleased to report that's actually going well and I'm also confident that the benefits of the actions that we're announcing today will also have a significant impact, and will be having a significant impact by the end of 2017.

And with that we'll open up to questions. Thank you.

Operator: Thank you. Ladies and gentlemen, if you wish to ask a question please can you press 0 and then 1 on your phone keypad now in order to enter the queue. And then after I announce you just ask that question. And if you find that question has been answered before it's your turn to speak just press 0 and then 2 to cancel. And could I please also ask you to restrict your questions to three per round? And there'll be a brief pause whilst questions are being registered.

We go over to the line of Avi Hoddes at Millennium Partners. Please go ahead, Avi, your line is open.

Avi Hoddes: Thank you. I have two questions. Earlier today BAE said that they were going to be cutting Eurofighter production by about 50%. If you think about Defence next year, earlier this morning you expressed optimism about chance for after-market. How would the headwind from the Eurojet going down compare with the potential tailwind from the after-market? Is it a disproportionately profitable OE business?

And then on Land & Sea, I was wondering if I could just ask on the order side, how are orders shaping up in Marine and Power Systems in the second half versus the first half? Could you give us some sort of colour/flavour on what magnitude of change we're seeing there sequentially? Thank you.

Warren East: You do the first one then, okay?

David Smith: Yes, so – sorry I – I did see the BAE announcement although I haven't had a chance to discuss that with our Defence team. But in terms of our own views on that we – we've already had basically a fairly conservative view on the engine production. Clearly there are two recent opportunities, one around the Dubai contract which was announced a few weeks ago and then one that's still speculative at the moment around Saudi Arabia that could provide some – or one of which will and the other could provide some upside. But we already had a fairly low view in terms of our own forecasts around production on that engine.

In terms of Land & Sea orders, very different picture here. And partly reflects the fact that Power Systems is actually exposed to quite a wide range of markets. Yes, they do have some exposure to global commodities in mining and in oil but we were already experiencing a very low level of demand in those markets anyway. So Power Systems went out of June with a record order book. They've actually had a decent order intake since then so their order book is in reasonable shape.

Clearly it's a shorter cycle business so we don't tend to be fully covered for the next year on orders anyway. But in terms of the progression that's pretty satisfactory.

Offshore Marine is a very different picture though. We – we've seen actually since the mid-year a – quite a significant drop in further order intake which is the reason that we're taking, based on that now having continued for three or four months, taking a view that that's likely to result in a fairly significant downgrade in revenue next year. So quite different pictures, I think between the two businesses.

Avi Hoddes: Okay, thank you.

Operator: Okay, we're now over to the line of Harry Breach at Raymond James. Please go ahead, your line is open.

Harry Breach: Good morning – good afternoon even, Warren and David. Can you hear me?

Warren East: Yes.

David Smith: Yes.

Harry Breach: Perfect. Three questions. Firstly, can you give us any flavour on the 330 programme? One of the concerns back in July was about potentially sort of increasing competitive pressure for the remaining undecided customers for the remaining 330 CEO productions slots if I can call it that? How are things progressing in terms of your campaign wins on that? Is it sort of in line with or better than or worse than what you were hoping? And can you give us a flavour similarly on the pricing for that?

Second question was just looking at the time and materials side of the business, aside from the specific operators of certain older wide bodies that you touch on in the press release, can you give us any feel for your time and material after-market demand in particular outside of those specific operators?

And then final question is, David, earlier on you touched on no change to your expectations or maybe the Civil guys' expectations of 25-year service life on average for large engines. But I'm wondering if, within that 25 years, are they making any change about the average annual flying hours within that? Are we – I guess specifically what I'm getting at is, are we perhaps seeing an environment where there is a greater propensity prematurely to part these older wide bodies because there's so much new supply coming on stream and therefore are they just – is it going to be across the board issue for wide bodies or do you feel that we can concentrate what's happened today on certain operators that had issues quite specific to them?

David Smith: Yes. Okay, let me take those and Warren can obviously add anything as I go through. But in terms of the 330 actually the estimate that we made at the end of June/early July of the impact here has actually proven remarkably resilient. So I said at the time we thought the volume would be between 80 and 100 over the next couple of years and that's proved to be a good assumption and the pricing assumptions we made also. So actually that number is pretty well – was pretty accurate. We absolutely did see intense pricing pressure but we've now – the majority of those deals are now firm. There may be one or two that still need a bit more work, but certainly with the Chinese orders that were agreed as part of the President's visit a couple of weeks back then, that's looking in pretty good shape in terms of the 330. So not good news in terms of margins, but in line with what we thought.

In terms of T&M specifically, I mean, there's sort of couple of aspects of that. Firstly, clearly one of the things that we're doing is continuing to increase reliability which does, you know, perversely unfortunately push out shop visits. And certainly, you know, in terms of the discretion of people to do that then that gives them a bit more flexibility. But the basic issue is much more around flying hours and the – and those older aircraft being parked than particularly T&M-driven at the moment.

And then on the 25 years, maybe I just repeat what I said again. So I didn't say or what I said was – this morning was the actual evidence is actually pretty consistent over the last 20 years in terms of being about 25 years on average. That really – that number really hasn't moved. It's remarkably the same over the last 20 years. However, when we think about programmes ourselves, we clearly look at different scenarios there and that's not necessarily the assumption that we use when we're looking at individual programmes, individual airline deals. We will take scenarios around that and coming up with our own pricing assumptions and evaluating the programmes. All I was really saying is actually the evidence hasn't changed, but we are more cautious than that when we do our own evaluations.

Harry Breach: Can I possibly just press just a little bit more on the T&M side? If we were to sort of isolate the specific carriers that you mentioned in the press release, is your T&M revenues in the second half so far, sort of, up year on year, or about the same, or something else?

Warren East: I think in a way the issue is all about utilisation. It's not about T&M contracts at all, it's about the fact that, you know, planes are simply not being used, and that's what causing the issue that we're flagging as an issue that's going to be a headwind in 2016.

Harry Breach: Okay, Warren, I'll leave it there. Thank you, thank you David, too.

Warren East: Thanks.

Operator: Okay, we now go onto Tristan Sanson at Exane BNP Paribas. Please go ahead, your line is now open.

Tristan Sanson: Yes, good afternoon everyone, it's Tristan Sanson from Exane. I wanted to come back to the pressure that you're seeing on the older wide bodies aftermarket, and you mentioned that the key issue was a number of our aircraft being parked. Now if we look at how this park rate evolved over the year, the impression that the main recent evolution was an acceleration of groundings on 777 powered by Trent 800 at a handful of airlines. What I struggle to understand is how you get to the £100 million, £150 million of impact, because a number of aircraft, and engine, I think, is not so high in the end. So can you give us a bit of a feel for how you look at it? Is it a question of lower numbers of hours flown or is it driven by LLP content at your visits that will not happen? Is it all cash? Anything that can help us to understand how you built the 100, 150 would be helpful.

And the second question is, I understand the marketing of these aircraft is made complex by debates on the residual values of the engine in the absence of an independent maintenance network for time and materials for these, how can you work on improving the remarketing ability of these aircraft going forward, with what you're going to do or what you're doing with more modern programmes with TotalCare Flex? Happy to see Cathay Pacific signing on that one, what can you do for older ownership programmes?

David Smith: Yes, I mean, on the first part of the question, I think, as I said this morning, actually in the first half of this year we really didn't see an effect, and we actually experienced good aftermarket growth year over year in the first half of this year – I'm just trying to recall the percentage of it. It was sort of 5% or 6%, that kind of level. So this is quite a recent thing in terms of what we're seeing. So you're absolutely right, there have been some specific cases. What we're essentially doing, therefore, is looking at the whole fleet and taking an assessment across all the airlines, which causes us to be more conservative about how that might develop during next year as well. So it's not just what's already happened, it's what we expect may well happen over the next year. We all hope we're being cautious about that, but that's how we get to the higher number.

Tristan Sanson: Okay, so the ratio per engine is – it doesn't mean anything. I understand. And on the remarketing ability?

David Smith: Yeah, as you say, TotalCare Flex is something that we are just launching and may help. We're obviously having – you know, none of these situations is one that – if we could avoid it happening, we'd much prefer it, so we will work with the airlines affected to see if there are alternative solutions. But the primary issue is really around their own capacity organisation, not – that's what they're trying to address, and therefore, sort of, us trying to make it more viable for them to continue to fly isn't necessarily the right answer for them either. So the solution may actually be to try and facilitate those engines moving on to – or aircraft and engines, moving on to different owners. Which is one of the things that the TotalCare Flex product enables us to do in terms of working with other customers.

Tristan Sanson: Thanks very much.

Operator: Just to remind all participants that if you wish to ask further questions, please can you press 0 and then 1 on your phone keypad now to enter the queue.

Okay, as there are currently no more questions in the queue, gentlemen, may I please pass the call back to you?

John Dawson: Thank you very much, Hugh, and thank you all very much for taking part. As normally the case, a shorter list of questions than the afternoon. Hopefully that's no reflection of interest from shareholders, but please don't hesitate to contact our investor relations team if you have any questions, and of course we'll continue to reach out to you all over the next few days to provide further information and understanding of what we said today. Thank you all very much for taking part, thank you Warren, thank you David. Good night.

Operator: This now concludes the call. Thank you all very much for attending, you may now disconnect.