Rolls-Royce Holdings PLC Full-Year 2019 Results

Friday, 28th February 2020

Introductions

Peter Lapthorn

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Okay, good morning everyone and thank you for joining us here at the London Stock Exchange and for those of you joining online. My name is Peter Lapthorn; I work in the Investor Relations team here at Rolls-Royce and it is my pleasure to welcome you to our 2019 results. The agenda for today's presentation is that our CEO, Warren East, will give an overview of the year's performance and some of the strategic highlights and then our CFO, Stephen Daintith, will take you through some of the more detailed financials. Warren will then wrap up and give his view for the year ahead, as well as the longer-term outlook.

Our presentation is expected to take around 50 minutes and then we will have time for Q&A, both from the audience and here online – and online. You can do online questions through the webcast services. Finally, can I ask you to switch off mobile phones? We are not expecting any drills today, so if you do hear an alarm, please exit in an orderly manner.

I think that is all of the safe harbour and the boring stuff out of the way, so with that I will hand over to Warren East.

Highlights

Warren East

Chief Executive, Rolls-Royce Holdings PLC

Good morning everybody, thank you for coming along. I hope you enjoyed the video rolling while you were having coffee and pastries out there, a little bit of subliminal messaging and the picture of the electric plane on the front cover of the little handouts we have got there: we are just one quarter away from flying that now, so some exciting highlights to come in the year ahead.

Results summary

But, before we get there, I am going to talk about 2019 to start with. So, here's a summary and we are very pleased that we ended up with very strong progress across the Group; we ended up with a strong finish to the year. It was a tough first half in 2019 but we saw very encouraging behaviour changes around the Group and we could really see the effects of the transformation that has been ongoing within the company in some of the behaviours which were necessary to drive that performance into the end of the year.

Delivery

So, very pleasing to have an underlying operating profit strongly up and that is really what's underpinning the quality of that cashflow number that is delivered as well. We have, as a board, held payment to shareholders. There are some environmental risks out there which I will be talking about in a little while but, in summary, a strong set of results because 2019 was a year of delivery.

In 2019, we delivered strong trading performance; we delivered significant progress on the Trent 1000. The Trent 1000 has dominated a lot of the conversation about Rolls-Royce for the last 18 months but actually, underneath that – and I will show you a slide in a few moments – we have had some excellent progress on that. Restructuring has been going on for a little while but, again, we have continued with the progress on that, we have continued with delivering on portfolio simplification and we have delivered on our forward-looking strategy to capitalise on the upcoming energy transition and the journey to low carbon for the world at large.

I am very pleased with the momentum that we established, particularly in the second half of the year, particularly in Q4, particularly around the behaviours of our people and that momentum has carried forward into 2020 and that underpins our confidence in 2020.

Market environments

Stepping back and looking at market environments, I am just going to go around the three key areas of our business. So, in Civil Aerospace, which is half our business, we continued to build our installed base. It is now over 5,000 large widebody engines. Passenger air traffic demand has settled back to a steady-state rate. We have had a few years of some quite superior growth but it is, in 2019, more of a steady state, long-term trend. Build rates from airframers were adjusted during 2019 and as a consequence, our forward-looking projections of build rates for large widebody engines has changed. In some ways, I think this build rate adjustment from the airframers has alleviated somewhat the concerns which were growing in the industry about oversupply and so that is actually quite a positive – quite a positive thing from a market environment point of view. And of course it is led by what's effectively been slower-than-anticipated retirements over recent years of older aircraft and I've got a little picture, later, showing pictures about retirements and so on.

In our Power Systems business and the sector there, you know, we have had a cyclical downturn in the markets served by our Power Systems business, particularly following a pull forward a year or so ago from some of the traditional markets. However, from our point of view, we have seen encouraging growth opportunities in new applications and new geographic regions.

Defence: in our Defence business, after several years of pause, we are now seeing new programmes coming through from the key defence customers, particularly the US Department of Defense and here in Europe, with the UK Ministry of Defence as well. And so the new programmes are getting closer in the defence environment.

Down the bottom of the slide here, we are on our journey towards zero net carbon and across all of our markets, our customers, we have found, in 2019, getting much, much more receptive to our thoughts on this and we are pleased to have, I think, established in 2019 a position of thought leadership.

Decarbonisation of our core markets

Before I go into detail of the business, I will just build on that last point. Thought leadership, in terms of leading a trend within our industry towards zero carbon, taking the responsibility that we need to take for this and that is in products, that face up to the market, it is in the underlying technologies, which feed those products, where we have seen, you know, great acceleration in our capabilities around electrification, for instance; we have seen progress on

nuclear reactors, with small modular nuclear reactors, a great source of zero-carbon electrical power and we have seen a lot more industry engagement in the reality that the world needs to solve the synthetic sustainable fuel challenge ahead.

A little bit of practising what we preach on the bottom of the slide here, for our own operations; this is a picture of our site in Friedrichshafen, where we have installed a microgrid. We are starting to sell microgrids but, you know, we have installed our own microgrid and this solar-powered microgrid is generating about 30% of the energy requirements for our plant in Friedrichshafen.

2019 full-year results overview

Enough of the future for the time being, I will now have a quick update on what's been going on in the business. So, in our Civil Aerospace business, we have seen a year of sustaining improvement in underlying operating profit. If you look, that is been happening over the last several years and 2019 was no exception, a significant increase in underlying operating profit in our Civil business, driven by the usual drivers that we have been tracking for the last several years.

Customer confidence is pretty good as well, so from a forward-looking point of view, from orders coming in through the door, approximately, nearly, there you see two-thirds of widebody new orders in 2019 coming to Rolls-Royce. From an operational point of view, you know, our operations are getting into much better shape, we are improving performance there, improving stability, improving cycle times and generally improving performance.

It is not just about our widebody engines in Civil Aerospace; we do have some exciting programmes in business aviation as well and in 2018 we launched the Pearl family of engines. The first Pearl family engine entered into service in 2019 and the second Pearl family engine was launched in 2019 and that is going to power the new Gulfstream aircraft.

In Power Systems, I mentioned, you know, from a market point of view, there was a bit of downturn in the sector by our Power Systems business and so, you know, we were encouraged to be able to grow our business into that environment, grow our business at the top line and grow the profitability of our business. And how do we do that? Well, we did that through targeting new applications, the newer applications, particularly strong in mission critical power, backup power and also by pushing hard on developing our business in what are new geographic regions for us and particularly in China. And it was great, on some of the new technologies as well, to see progress on things like microgrids and hybrids and that hybrid I will probably come back to a bit later in the presentation but you know, in the space of 2.5 years, we have gone from concept to proposal, to MOU, to order, to, in the next several months, delivery of hybrid rail power packs. So, very solid progress from our Power Systems business.

Defence – Defence, you know, the standouts for 2019 in Defence was about orders, another year of record book to bill, taking our order book to a record level as well and it was another good year for delivery of cash.

In the background, I mentioned, we are getting closer to those new programmes. So, actually, you know, our R&D is going up a bit, so we will see the margins coming off a bit over the next couple of years in Defence but we are capping off a period of 4–5 years of building the order book and over the last five years book to bill has been above one and so our future

in Defence, particularly driven by some of the service contracts, is in, looking like, very good shape.

Trent 1000

Now, I know that everybody wants to hear a bit more about Civil than they do about Defence and Power Systems, so we are going to have a couple of deep-dives on Civil.

I can't stand here and not talk about Trent 1000. Obviously, we did a little bit of an update in November and in the results announcement this morning, you will see no change from what we announced in December: no change in terms of projected return of AOGs to single digits, no change in exceptional costs and so on.

During the year, we made some pretty good progress, good progress in actively managing the situation, continuing to extend our MRO capability and our MRO capacity and we are confident that that £578 million of cash cost in 2019 is the peak year of cash costs for Trent 1000, so we are beyond that peak. As we look forward in 2020 to a single-digit position around the mid-year, then we will be underpinning that with more spare engines, as we announced in November.

And the histogram here on the bottom of the chart is about just that reduction in aircraft on ground. And you'll see, in 2019, we had to take a step back and we took a step back, proactively, by – because we needed to pull forward replacement of intermediate-pressure turbine blades on one of the variants of the engine. And having originally generated indigestion in our MRO network and having been eating off some of that indigestion, we then generated a load more and so pushed the AOGs down again and that effectively pushed out the period when we'd get back to single digits but there has been no further deterioration on that since we announced that in Q4 last year, so we are currently sitting around the mid-30s, in terms of disruption.

This slide is an update of the slide that we showed in November, which summarises the three engine marks for Trent 1000 and the three key issues and you know, we are now in a position of eight out of nine of the design changes are done. We have got one there, the Pack B IP Compressor, waiting to be certified. There's no change to that design, we are totally confident that that will get certified; it is simply a question of priorities, in terms of the fact that that is the last one, other than the final box over there, where, as we said in November, the design work for the high-pressure turbine blade on the TEN, that is still underway. As I stand here this morning, I am a lot more confident than I was last November about that design work; it is progressing well and in the coming weeks, we will be running an engine with that new design, we will be going to type test and hopefully then on to certification.

The chart has been updated, though, with these little pies to show that it is not just about doing the designs; it is about rolling those designs into the fleet. That is what minimises the disruption and ensures a healthy fleet. And the pies on the left, in each box, are a snapshot of where we were 12 months ago and the pies on the right in each box represent, you know, where we are today, in terms of rolling those fixes into the fleet. So I hope you get a sense of momentum here, of how the fleet is getting healthier as we go.

Trent XWB

So, moving on, it is not all about Trent 1000. Trent XWB has now reached five years in service and the leading engines are surpassing our expectations in terms of durability. In terms of performance, it is our most reliable engine and its efficiency holds up very well in service. So the airlines love it and actually the customers love flying on the aeroplane as well; the 350 is a great aeroplane.

Points on the XWB, it is today just over 10% of our installed fleet but it is approximately half of our widebody deliveries and it is on a journey to be around a third of our fleet in the mid-term. So this is a very important engine for us, so it is very important that it has an outstanding record of performance.

Other large engine programme performance

There are other programmes as well. I've already talked about the Trent 1000. Trent 700 is still our largest volume; it is a third of our fleet, nearly. It is the major workhorse of the Trent fleet. We have seen great progress, over the years, in extending the time on wing for the Trent 700 and so it is a little bit of a benchmark and barometer for the newer engines that are coming along behind. And it is an auspicious day today because it is 25 years to the day that the first Trent engine went into service. It was a Trent 700, 25 years ago, on 28th February and you know, it is still going strong after 25 years.

At the newer end of the spectrum, Trent 7000 – and we put this up because the Trent 700 powers the A330, the Trent 7000 powers the A330neo and we are putting all the lessons we have learnt from the Trent 1000 into that engine. It is based on the same architecture as the Trent 1000 TEN but putting all the lessons in, then we are confident in the performance of that engine.

Widebody: medium-term outlook

Looking a little bit further forward, at our installed base, because it is the size of our installed base that underpins the medium-term business confidence and the size of our installed base is about new aeroplanes going in, it is about older aeroplanes retiring and this chart shows that, actually, if you look at the older aeroplanes that are going to retire, i.e. the ones on the left-hand side of the slide at the bottom, it is dominated by our competitors. And at the right-hand side of the slide, the present day, you see our market share and you recall our market share in terms of orders, approximately two-thirds of the orders in the last 12 months, for instance. So we think we are well positioned through this retirement cycle that is going to be coming up over the next several years, well positioned to continue to grow our market share and that underpins the installed base.

Enough of deep-dive on Civil. By the way, the clock in the back of the room, guys, has stopped working at 09.07, so I've just realised that it is actually 09.20, so sorry about that. We are now going to move on – I thought, 'Blimey, it is going slowly.'

Corporate structure

Change and transformation: change and transformation is at the heart of creating a high-performance business, which is capable of delivering quality results and you know, over the last 18 months or so, we have seen great change in the management, we have change in pace, we have seen change in process and the development of a forward-looking strategy, so

we now have a very different business than we had a few years ago to face the challenges that are around today.

Just recapping some of what we talked about on the Capital Markets Day in 2018, we talked about simplifying our organisation structure, streamlining process and investing in automation to enable our people. So, during 2018, we sorted out the structure. During 2019, we made great strides in terms of reducing process, removing duplication and installing automation to enable our people and that is carrying on in 2020. So, A&M are continuing to help us to actually deliver the benefits of this transformation but basically we are on track for what we set out at the Capital Markets Day, delivering what we said we were going to deliver and that is measured, in some ways, by achieving run-rate savings.

And if I look, for instance, at some specifics: product change process and end-to-end digital design, that sort of reduction in engineering hours, that sort of improvement in productivity is baked into our plans and that frees up resource to concentrate on the future. And I talked about improvements in our operations earlier. There's a focus area there and I think other good indications of a change in trajectory of that inventory that we saw halfway through the year, demonstrating a sharpening up in our operations.

And in our Service business, we have had to grow our MRO capacity but the good news is we are growing our MRO capacity faster than our investment in MRO because we are getting better and smarter at doing it.

So, improved productivity across all these three areas and these are the fundamental three areas that make our business tick. We are either developing this stuff, or we are building this stuff or we are looking after it when it is in service.

Balancing our capital allocation

And why are we doing all that? Well, we are doing it to position our business for the future. At the Capital Markets Day, we talked about bending the cost curve and this is a focus on R&D, for instance but bending the cost curve, reducing the cost as a percentage of sales. So, in the R&D domain, that means effectively keeping our R&D flat as the sales grows. And within that fixed envelope, you can see here how we are tilting the amount of money spent towards future-looking technologies, so that is why we are doing this transformation, so that we can position the – we can deliver the business performance and position ourselves for the future.

So, with that, I am going to hand over to Stephen to talk about our 2019 numbers in a bit more depth.

Financial Review

Stephen Daintith

Chief Financial Officer, Rolls-Royce Holdings PLC

Full-year results at a glance

Morning everybody. So, I am going to take you through the full-year results, give an update on the key drivers that we first highlighted back in the middle of 2018, at our

Capital Markets Day, then we will go through a quick review of each business and then we will go into guidance for 2020. So, just running through these.

So, at a glance, we gave ourselves a lot to do in the second half but we are pleased to be reporting today a strong underlying operating profit growth of 25%. And what's most encouraging about this: this is the core driver of the growth in our free cash flow and we will see that again in 2020.

Moving on to free cash flow, £911 million, so driven by that growth in profit and especially strong performance in the Civil Aerospace aftermarket. We are going to see, shortly, the Civil aftermarket cash margin and how that is developed over the last couple of years. We also received, very late in the year, some insurance receipts in respect of insurance that we had in respect of grounding of our widebody engine fleet and we could claim against that on the Trent 1000. At the – we have been negotiating these for well over 12 months, this particular insurance arrangement and we reached the conclusion of those negotiations towards the end of the year and hence the receipts that arrived right at the very end of the year as well. So, about halfway through the year, limited visibility around that and not much certainty.

Civil Aerospace: we saw a strong improvement in operating profit in Civil Aerospace as well. It is the first time that we have seen profit in Civil under IFRS 15. As a reminder, that came in at the start of 2018. We no longer capitalise the losses on the OE sales and so very encouraged to move to operating profit in Civil Aerospace.

And finally, gross debt reduction. We reduced our gross debt by £1.1 billion. We are reporting today a net cash position that is improved to £1.4 billion. An important priority for us, we will come onto the details a little later, to strengthen our balance sheet and return to a single A rating.

Revenue

Let's go to the revenue slide, revenue business by business. Our delivery in 2019 was in line or better than guidance for every business. I won't go through the exact numbers but you can see there, in the blue, just to the right of centre, what we guided a year ago and then, in the middle there, the growth for each business. Really solid growth in Civil Aerospace: 10% growth driven by both OE and aftermarket, strong growth in Power Systems – and we will go into the detail – in a challenging market; Defence growth in line with guidance and good growth in ITP, which we will go through shortly when we go through the business reviews but largely driven by increase in Civil Aerospace volumes.

Operating profit

Moving on to profit – and there's the profit profile for each business in 2019 – and again, margin guidance that we gave a year ago met or exceeded in every business. A relatively modest margin in Civil Aerospace but moving into profitability. Power Systems back into double-digit territory. Defence: increased investment in R&D, as Warren mentioned, causing that drag. And ITP: good improvement in margin in ITP, largely around our simplifying of the contractual relationship between ITP and Civil Aerospace, with ITP very much now as a full-fledged member of the Group, very much a traditional parts supplier to Rolls-Royce and we simplified those contracts there.

So, good performance in operating profit and a strong performance in particular into the year end, especially in Power Systems, that delivered on much of the projects that had been built up during the course of 2019.

Strong core free cash flow

Moving on to free cash flow, so, we had a strong end to 2019, following a challenging first half and just three or four items here to just call out that helped us deliver this good free cash flow: inventory reduction, we will go through the detail very shortly but a very significant inventory reduction in the final quarter. Disciplined spend control as well: you'll see that today we are reporting C&A costs down 4%, year on year. That was another good achievement, largely around discipline, around discretionary spend. Capital expenditure was also down year on year and good discipline there as well but driven largely by some large projects coming to their conclusion during the course of the year and I will go through that detail. And as I just mentioned, the Trent 1000, we secured those insurance receipts.

What's not included in this list is a strong Civil aftermarket performance as well, in the second half and we will see that when we go into the details of the long-term contract creditor and how that moved, year on year. We also saw, in our cash flow, an improved quality as well. There's materially lower contribution from net receivables payables: still a large contribution but materially lower than last year and I will talk about that in a second.

Cash return on invested capital was stable, at 12% and that is despite our R&D investment being at the highest levels of cash spend, of £1.1 billion per annum.

And the chart down the bottom shows material free cash flow improvement from the low base of 2016, when we were generating just £100 million of free cash flow. So bear that £800 million improvement in mind, which I am going to come to as we go through the cash drivers of performance that we first highlighted in the middle of 2018.

Drivers of £305 million year-on-year improvement

So, when we look at those drivers of cash flow and we break them down, looking at our summary funds flow statement, looking at the balance sheet movements, tying that in with operating profit, here's the composition of our free cash flow improvement of £305 million. And what's most encouraging is that £507 million of that was driven by operational cash flow improvements, increased operating profit, the growth in the Civil deferred revenue balance, that long-term service agreement creditor on the balance sheet, representing deferred revenue, cash receipts that have not been traded through the P&L account and then, lower, a capex as certain large projects have come to a conclusion.

R&D cash spend is stable, so it is not through any reduction in R&D that these numbers are being delivered. A lower working capital contribution of £50 million is a headwind and the peak year for the Trent 1000 costs of £152 million is also a headwind and that includes the insurance receipt as well.

So, you put all that together, you get to your £305 million and it is colour-coded there, which matches this next table, which goes through the summary funds flow statement itself to show you how we have allocated the individual lines to deliver those numbers, so that is how the maths all works.

Working capital improvements

Working capital improvements: now, just on this one as well, because it does attract a lot of attention and often it is regarded as always bad, which is far from the case. First of all, in the second half, we saw a £390 million reduction in inventory. That was the task that we had ahead of us at the half-year after that big build of inventory in the first half of the year. Civil Aerospace and Power Systems had particularly strong fourth quarters; there's been a tight focus on supply chain management that will continue through 2020. The buffer inventory that we built up on the Sirius 1600 in Power Systems: as that production moves to India, that will start to unwind. The sales and operations planning process in Civil Aerospace: I think I've mentioned previously, a lot of room for improvement there. We are starting to see the signs of improvement. It is taking place more regularly, with a smaller number of people, perversely working a lot better than all the various committees that often cause complications there but that is a lot more efficient as well and that is helping drive that inventory improvement. We expect to see the vast majority of working capital contribution in 2020 from further inventory reductions. We have just over £4 billion of inventory on our balance sheet. About half of that is in finished goods, which ought to flow through quite quickly. There was a £574 million increase in net receivables and payables; our Defence business had a very good year for cash flow generation, driven by that strong order book intake of just over £5 billion and £200 million contribution towards that £574 million.

And then, another example here of what I regard as good working capital management, a more disciplined collection of overdue debts, reducing those from 20% to 15% of trade debtors and driving that £130 million contribution. So do not be surprised if there's more of this in future years; there should be, this is good, healthy discipline. And these are what I would regard as durable working capital improvements.

Significantly improved cash position

So, putting this together, we have a significantly improved cash position at the year end. We have year-end net cash of £1.4 billion; that is led by that Group free cash flow number of £873 million. Of course, we received the Commercial Marine and Power Development proceeds, in aggregate, of £453 million. There was a £1.1 billion reduction in gross debts, as we repaid the £500 million bond and then the EIB loan as well. We have one maturity in 2020, a $500 million in the second half of the year and we will consider whether to refinance or retire that bond in due course. That gives us – together with the cash that we have in our revolving facility, of £2.5 billion, that gives us almost £7 billion of liquidity. We do, though, have a credit rating challenge right now, given where we are and we have a strong ambition to return to a single A rating. We highlighted this as a strategic priority for us in 2018 and it remains and we are very much determined and focused to get back to that rating. It will be around operational delivery and delivering the Trent 1000 fixes and demonstrating that we have retired that risk.

Progress on our three fundamental levers

So, the progress on the key levers: these are the three key levers of cashflow growth that we first highlighted in 2018 at our Capital Markets Day and they remain as true today as they were then and they will be for the next five years as well.

So, what are they? First of all, reducing the loss on our OE widebody deliveries. There was a further improvement in the year of around £200,000 per engine in the reduction of the loss. The Trent XWB-84 leads the average loss reduction. There has been a £400,000 improvement per engine since 2017, which was the base year that we are comparing against from when we first unveiled these drivers in 2018. So let's just use 500 engines, £400,000 improvement per engine. That is around a £200 million improvement from this particular initiative.

The widebody aftermarket cash margin delivered a further £300 million improvement, moving from £1.6 billion to £1.9 billion aftermarket cash margin. That is a £500 million increase over the 2017 base. It is worth reminding ourselves as well that in 2018 our 2022 goal for the aftermarket cash margin was £2 billion and we are already at £1.9 billion. This should grow further as aftermarket flying hours grow but also as we extend time on wing and the gap between shop visits as well, a core priority for us in Civil Aerospace.

And then finally, bending the fixed cost curve on the right-hand side there and this is the aggregate of commercial and admin costs, R&D and capex put together. Right now, we are 280 basis points lower, as sales reduction during the course of the year, which, in aggregate, brings us to around 400 basis points lower since the 2017 base.

So, put all that together, that is about £100 million contribution there. So it is not – the maths is not quite exactly the same but the point is, if you add up the £200 million, the £500 million and the £100 million from those three key drivers, you get to an £800 million improvement over the last two years, which happens to conveniently be the free cash flow improvement as well, although they are – there is a mixing of drinks a little bit here but it gives you an idea of the direction and the contribution from these three key drivers.

Reduced OE average loss per engine

Here's a bit more detail on the widebody engine deliveries: 510 in 2019, a record year for deliveries; that is how the profile of losses has improved over the last three years, in the top right there. It is worth pointing out, as well, on the deliveries, the big pick up in volumes of the Trent 7000 in 2019 versus 2018. So, very small, just 2% of the pie down there, Trent 7000 and on the right-hand side, 21% Trent 7000 deliveries. Just calling out on the left-hand side here the Trent XWB-84. We saw a 22% reduction in OE losses and by the end of next year we expect the Trent XWB-84 to be a break-even engine.

Civil Aerospace aftermarket cash margin

The aftermarket cash margin has now moved from £1.6 billion to £1.9 billion. This is driven by the – on the – above the horizontal line there is the cash coming in, this is widebody, 15.3 million engine flying hours and then, on – from the 5,000 installed engine base. And then down the bottom there are the costs that could go out during the course of the year in respect of the major refurbishments. That is the scheduled every five years or so shop visits. The check and repair visits are the sort of more the case is sort of ad hoc, depending on specific instances. And this one, for example, is where most of the Trent 1000 check and repair visits, in respect of the issues that Warren ran through, is going through that line in there and then there's various other costs as well.

So, delivering ahead of our Capital Markets Day ambition, at £1.9 billion and within touching distance of the 2022 goal.

On the right-hand side there, the key drivers of growth: 7% engine flying hour growth in the year, strong time and material growth as well. We will see this shortly in the Civil Aerospace profit and loss account: 14% growth, yield improvement as well and growth in pay at shop visit events. Now, this is important: there are many of our customers who prefer to be paid at the shop visit, rather than through the flying hour process. That has a higher yield per flying hour than had they just paid as they – as they hours were generated but it is an important dynamic.

Driving value from services across the Group

This is an important slide and it is a reminder of the trajectory that Rolls-Royce is on to become increasingly a services business. It is a reminder of our installed base, when you add up the Civil Aerospace installed base of 14,000 engines, the Power Systems installed base of 146,000 and then 16,000 in Defence. The 176,000 engines driving this service revenue and you can see the make up there: long-term service agreements, £3.8 billion and other services of £4.1 billion growing at 13% and 8% respectively. So, now representing 52% of our revenues and a growing source of revenues, with recurring, visible, higher-margin business. There's a lot more certainty around these revenues from this large installed base.

Key initiatives for us to drive higher returns: extending the time on wing in Civil and Defence Aerospace, the point that I mentioned earlier, which will only help improve that aftermarket cash margin. Optimising repair technologies and increasing use of digital capabilities, better predictability about the health of the engines and when they're going to be required to be serviced and how quickly to turn them around.

Bending the fixed cost curve

Bending the fixed cost curve: C&A costs were down 4%, year over year. Capital expenditure was down £158 million year over year, beating the guidance that we gave, as those large projects came to completion. C&A costs I've mentioned and you can see the charts there. Just as a reminder, R&D is at its highest levels, at just over £1.1 billion of cash spend and then you can see the progress that we have made as a percentage of sales for each of those lines of the cost curve.

Trent 1000 in-service cash costs

Trent 1000 in-service cash costs: 2019 is the peak year of those cash costs, gross cash costs of £578 million before the benefit of that £173 million of insurance receipts and you can see the profile that we are expecting and guiding to over the next three or four years.

Civil Aerospace

So, a quick run-through our businesses: operating profit of £44 million in Civil Aerospace driven by widebody, OE – sorry, driven by OE revenue growth of 4%, services growth of 14% and equal measure across LTSA and time and materials, still a very healthy source of high-margin business for us, delivering that 10% overall, driving the gross profit improvements and subsequently the operating profit that we are reporting today.

Power Systems

Our Power Systems business: good revenue growth in what are challenging markets. You'll see some of the others in this sector having – reporting less – much lower revenue growth than Power Systems has experienced and good growth in Power Systems and

Power Generation and good opportunity in China, where we see a good progression there as well.

Defence

Our Defence business: pretty much as we guided, underlying revenue broadly stable at just 1% growth, a little bit of a margin decline, given that increased investment in research and development but some good opportunities for that business in its pipeline and we were hopeful for even more big order wins in 2020 for our Defence. But a really knockout year for our Defence business and I should call out here the very high cash conversion in our Defence business driven by those big order wins and a big contributor to the cash flow performance for the Group, so an outstanding year for our Defence business.

ITP Aero

And then finally, ITP. ITP is a business now full – a fully-fledged member of the Group. It reported very good revenue growth of 21%, largely driven by Aerospace volumes. As a reminder, ITP is a risk and revenue sharing partner on certain Rolls-Royce engines but also on Pratt & Whitney and GE engines as well, so it is a partner to various players in the aerospace sector.

The operating profit growth was partly driven by a £25 million one-off benefit in respect of the adjustment of those trading terms between Civil Aerospace and ITP to better simplify arrangements between the two companies.

2020 outlook

So, moving on to the guidance for 2020, underlying revenue: we are looking Civil Aerospace revenue being stable to low-single-digit growth, very much driven by that revision to OE volumes, 450 to 500 or so engines in 2020. Power Systems: low-single-digit growth anticipated there. Defence: stable-to-low-single-digit growth. ITP and – ITP stable at £936 million. And then operating profit: Civil growing by 50–100 basis points improvement in margin in Civil Aerospace but as a reminder, we are guiding today that our R&D, capitalised R&D, will be between £100-150 million lower in 2020 than in 2019 and that will mostly be in Civil Aerospace. So one might think that that is a slightly low margin improvement in Civil but we should bear that into mind. Power Systems: further margin improvement there of another 100 basis points, Defence business stable and then ITP, a small margin improvement there as well.

Operating profit growth, putting all this together, of at least 15% and that gets you to around £1 billion of operating profit in 2020: core free cash flow of at least £1 billion and I should call out that this guidance excludes any material impact from COVID-19 in 2020.

2020 funds flow guidance

How does that bridge to cash flow, profit and – so how does that bridge from profit to cash? So, here are the big moving parts: £1 billion of operating profit, the core driver of the free cash flow growth. The LTSA deferred revenue, we think, will be broadly stable, year on year, at around £750 million. Capital spend above depreciation and amortisation, again, broadly stable at £600 million. Working capital contribution of £600 million in 2020 but reinforcing my earlier point that that will be led by inventory unwind and I think around, sort of, three-quarter or so of that £600 million being an inventory unwind. The movement in

provisions, around £500 million, that is largely the Trent 1000, as you would expect and then other: tax, interest, pension, broadly stable at around £250 million. And that is how we get to our £1 billion of free cash flow – at least £1 billion of free cash flow – in 2020.

With that, I should add, one more thing, there's other, more detailed guidance, by the way, in the appendix of the slides that you've got here, around various other drivers.

With that, I will hand over to Warren, thank you.

Business Outlook

Warren East

Chief Executive, Rolls-Royce Holdings PLC

2020 outlook

Right, I am going to look forward a little bit more. Earlier I talked about momentum and I talked about momentum around changes of behaviour and changed levels of performance. That continuing momentum, coming in from the second half of 2019, is what gives us the confidence in 2020. As Stephen said, a little footnote here on the left-hand side of the slide and the guidance that he just stepped through and in fact all the guidance that we have in our earnings release, is subject to the fact that it excludes material impact from COVID-19 in 2020. But, that said, you know, we would expect our operating profit growth to be around 15%, the number that Stephen mentioned at least £1 billion free cash flow in 2020.

Importantly, we look through COVID because we see the fundamental drivers of the business and that is what's driving our confidence in £1 of free cash flow per share in the mid-term.

Managing COVID-19

Now, I am not going to ignore the COVID situation at all. We are taking it very seriously and what's important is what we are doing to manage the situation, as far as our business is concerned. So, our priority is, of course, our own people and we have daily monitoring of the situation in all of our locations and that is coordinated and comes into our Chief Medical Officer, who reviews that situation every day. We are also doing daily monitoring of the business risks and the business risks break down into, you know, what's happening, potentially, to our revenue and importantly, although we are not a business that is subject to lots of just-in-time deliveries and that sort of thing, it is important that we keep a daily track on our supply chain and you know, that is – that is what we are doing at the moment through our supply chain leadership.

This is clearly one of those known unknown situations. The things we do not know are how long the disruption is going to go on for and to what extent the disruption is going to spread around the world. So, here on the bottom of the slide, we have got a few data points so that you can scope out some of the potential impact to our business. And I say potential impact because, of course, the third unknown is the extent to which we are able to mitigate the damage, should there be material damage.

Here are some parameters: you know, Chinese airline customers, it is about 10% of our backlog today. Flights touching China is about 20% of our engine flying hours. How much of that should we take into account? I can't tell you but what I can tell you is that, year to date,

flights touching China are down by approximately 15% – between 15-ish-percent in January and 50% in February. So, I can also tell you, from our daily monitoring of the supply chain and our daily interaction with customers through our Power Systems business that, you know, operations in China are getting back to normal. Our key suppliers – we have a handful of key suppliers in China – these suppliers are all back at work and we have had, actually, no interruptions in our Civil Aerospace supply chain as a result of the shutdown there.

So, that is kind of the scope of the situation, the monitoring of the situation that we are doing. And in terms of contingencies and how we can mitigate against that, well, you know, we are the same as any other business, so we look at the financial impacts and what can we do about deferring expenditure? What can we do about deferring investment? What can we do about deferring or freezing hiring? And what can we do about the actual staff costs that we take on a day-to-day basis. And like any other business, we are pulling on all of those levers.

So, that is the situation for – as far as COVID is concerned, for our business. COVID is a reality and we have to manage through that and I say manage through that because, you know, though it is a reality and I mentioned earlier, I think we are in better shape than we ever have been to deal with that reality, we must look beyond. And looking beyond takes us to our priorities for 2020.

2020 priorities

Customer priorities are very clear, about meeting our commitments and about getting the Trent 1000 AOGs down.

From an operations point of view, we need to continue the improvements that we have made over the last 18 months or so, particularly driving towards achieving the £400 million of run-rate savings. Having successfully changed the trajectory on inventory, we need to continue driving that forward. From a financial point of view, obviously, the emphasis is on quality of cash and strength of operating profit and from a people and culture point of view, we need to build on the fantastic changes that we have seen, embedding those behavioural changes, building on the encouraging momentum that we have seen so that, in the longer term, we can be a leader. We can be a leader in terms of behaviours, we can be a leader in terms of business performance and we can play a leading role, that we want to play, in the energy transition over the coming decades in all of the sectors in which we operate because we see that as a fantastic business opportunity.

And with that, I will stop and we will hand over to Q&A.

Q&A

Rob Stallard (Vertical Research Partners): Thank you very much. Morning, a couple of questions, if I may? First one, easy one for Stephen: 2020 guidance, what sort of embedded Commercial Aerospace aftermarket growth rate have you built into your forecast? And if you could break it down by long-term service and the time and material, that would be great.

And then perhaps one for Warren and a longer-term question. You have cut your forecast for widebody engine deliveries going forward, so you are coming down from roughly 500 last

year to potentially 400 in the out years, what sort of impact does that have, particularly in terms of your targets for reducing the loss per engine on OE? Thank you.

Stephen Daintith: Okey-doke. So, the Civil drivers. Well, we talked about 450 or so – 450–500 engine deliveries, that is a key driver. The average loss per widebody engine, we'd hoped to get that to around £1 million per engine, so a further £200,000 improvement, that is the goal for us there. Trent XWB is clearly on the road to break-even by the end of the year, so an average on that number will be sort of 0.2, 0.3 I would expect, that is what we are looking for.

Engine flying hour growth: you should be thinking high-single digits, 8–9% engine flying hour growth is a key driver for us.

And then, in number of shop visits, we did just short of 1,000 shop visits in 2019 and I would suggest that using something around 1,100, 1,200 shop visits is a good guide. Major refurbs, roughly as it was in 2019, of between – 300–350 or so and then about 800 or so check and repair visits is the rough composition of the – so those are the key drivers of the Civil profits and cashflow in 2020.

Warren East: And coming onto the widebody deliveries, yes, the widebody deliveries that we would expect to make over the next several years is lower than, perhaps, the estimates we had a year or two ago but what drives our business is actually the size of that installed base and so we will still be at north of 6,000 widebody engines in a few years because the size of the installed base is about the retirements and the rate of retirement, as well as the rate of new aeroplanes going into the market.

And the – so that is the sort of key point. The other point to bring out, of course, as you saw in Stephen's presentation: our mid-term ambition is underpinned by that aftermarket margin growth, the total aftermarket margin contribution, which we estimated at £2 billion in 2022 and as Stephen just showed, you know, we are at £1.9 billion in 2019. So we are an awful long way through that process already and in fact we are probably going to exceed our assumptions and it is those assumptions which underpin our mid-term ambition.

And as for the volume and its impact on that trajectory of OE loss reduction, I do not actually see a material impact by the difference in volume. This is not a hugely sort of high-volume activity anyway and the costs are dominated by the costs of those components and the cost of the components is dominated by the design of those components. We continue to spend engineering effort on modifying designs to take cost out. We take cost out on an annual basis and you know, those plans are proceeding according – you know, just unaffected by volume. You saw in the numbers that Stephen talked about, you know, it is led by XWB. I said XWB is half of the total volume. We will ship our first break-even XWB in the fourth quarter of this year, which takes us to the average that Stephen mentioned and we are confident of achieving that.

Stephen Daintith: If I can just – I didn't answer your question about the LTSA split and the time and materials split. I would say, time and materials, I mean a great performance in 2019, probably sort of high-single digits or so in 2020 and the LTSA – the number of – volume of shop visits, clearly, is a key driver there but one thing to watch out for is that – and again, this was true in 2019: where we have Trent 1000 shop visits, check and repair visits, that are related to the exceptional cost activity, we trade those costs through the

provision that we have – and it won't therefore hit the LTC, the long-term creditor balance. So the deferred revenue is not reduced. The LTC balance is not reduced by those shop visits, if you see my point? It is like the accounting but it – and that partly explains the growth in the long-term creditor this year.

Warren East: Okay, Celine.

Celine Fornaro (UBS): Hi, good morning. I was just wondering if you could explain the mechanics through the Civil trading cash, which had a nice improvement this year to £400 million and so how do we think about that for 2020, because potentially it could be slightly worse, depending on all the dynamics you've assumed?

And then my second question would be on the 787 overall market share and in terms of the, you know, recent announcement from ANA to go with GE and thoughts there and your assumption on potential volume on the TEN. Thank you.

Warren East: Okay, do you want to have a go at the mechanics, or shall I – shall I do the ANA one while you are just doing –

Stephen Daintith: Yeah, sure. Yeah, yeah.

Warren East: Yeah. So, our 787 – you know, we look at it from a sort of fairly macro position and it is not just about share on 787, it is about share of widebody orders. I think approximately two-thirds of the widebody orders in 2019 is a reasonable result. We are taking orders on Trent 1000 as well. Obviously, we are disappointed with the decision from ANA. We are disappointed but realistic. ANA, already 83 of their aircraft are powered – of their 787s – are powered by Rolls Royce.

And to be 100% dependent on Rolls Royce when you have the choice is, is perhaps an unrealistic assumption when you get to a fleet that is growing at that sort of size. And so to have 15 aircraft and a few options going to be GE is not something that particularly surprises us, but of course we are disappointed.

We retain a very close relationship with ANA. And I think if you talk with them, you'll find that they're very pleased with the way in which we have handled the situation for their fleet. The importance of their fleet, notwithstanding COVID, for the Japanese Olympics this year, and, in fact, in the next several weeks, all of the Trent 1000-powered aircraft will be in the air rather than on the ground.

Stephen Daintith: Sorry. And on the improvements in this Civil Aerospace trading cash flow. Well, again, going back to those drivers, our cash flow grows generally across the Group. Our original equipment losses coming down and lower volumes, at the same time as well, there's going to be a contribution there.

The aftermarket cash margin will continue to grow maybe think couple of hundred million or so, maybe £100 million or so from the first one that I mentioned. I have not yet mentioned business jets as well. Business jets had a very strong 2019, and is well placed for 2020. So we are going to see some further improvements in the business jet contribution.

Trent 1000 costs coming down as gross costs but, of course, we do not have the benefit of the insurance receipts, so that is a headwind there. And we are expecting further

improvements in C&A costs generally across the Group in 2020, building on the momentum that we developed in the second half of 2019.

Most of the headcount reductions in – that we are announcing today, the cumulative reductions is 2,900. I think 2,000 of those are Civil Aerospace. And you are going to start to see that full year benefit of that 2,000 headcount reduction flowing through in Civil Aerospace. So putting all of those together gives us confidence around few – further improvements in trading cash flow in Civil Aerospace.

Warren East: Okay. I think we have got one in middle.

Nick Cunningham (Agency Partners): I apologise in advance because this is in great danger of being nerdy, both of my questions in fact. Thank you for the disclosure on factoring, which is really interesting. And I just wanted to try and understand it better in terms of how it moves across the year, and what the rationale of using it is? Does it reduce the cost of capital and so on? And then second, I think, probably equally nerdy, but possibly more generally interesting. If we look at the decarbonisation, if you like, roadmap, how do you see that playing out in sort of very broad timescales and route to market? And what kind of mode of power source do you see developing? Thank you.

Warren East: Okay.

Stephen Daintith: Okay. So let me cover factoring. And we are – as you know, we have been very keen over the last few years to add transparency to our numbers. And our guidance is pretty detailed, and we kind of explained our numbers at length as well. And an extra piece of transparency that we are bringing today is our details of around invoice discounting or factoring as it is otherwise known.

And let me just explain where we are on this. Factoring is a commonplace activity in the aerospace sector. We have been doing it for over a decade now. I would say 2016, there was the first time that we materially got into invoice discounting, and it was – that was largely around the time when the air framers change their own settlement terms.

And we introduced it to normalise the cash flows with physical delivery of engine volumes. So you've got a symmetry around those cash flows. The last three years it is averaged at the year-end at just over a £1 billion as it does in this year. The way to think about it is that if we have not done any invoice discounting this year, our cash flows will be £95 million lower, which is the delta between this year's activity and last year's activity.

But the average over the last three years has been, as I said just – I think £1,037 million over the last three years. That is the rationale for why we do it. It works well for us. And you are right, there is a cost of capital attached to it, but it is pretty modest. And it is only for a short period of time as well, because really you are just advancing November, December invoices into current year rather than waiting until January and February. So it is only in place for a very short time.

Warren East: And the other one around the decarbonisation roadmap. I mean, obviously I am not going to be too specific on dates here and basic principle is the smaller the aircraft, the more electric. And so we see an opportunity in the sort of helicopter size market disruption, new products for all electric to hybrid.

And then in the regional space, we see an opportunity for hybrid coming sooner than we do into the narrow body space. So hybrid designs in the mid-to late-20s moving through to larger airplanes in the early to mid-30s. And then in the larger place, we do not see an alternative to kerosene in terms of energy storage, but we do see opportunities for sustainable synthetic fuels.

And there, the decarbonisation bit is all about the source of the electricity that is used in the synthesis process. So clearly, it is not very sustainable if the electricity comes from a carbon rich source. But as the world electrifies in a cleaner away, then there will be opportunities for clean electricity to generate synthetic fuel. We do see a potential role for hydrogen in that mix and we are spending effort with some of our partners on exploring the opportunities for hydrogen. But it is going to be about the challenge of storing that hydrogen. And, again, about the clean source of electricity to produce the hydrogen in the first place.

Synthetic fuel is going to be limited by the ecosystem and the rate at which the ecosystem can develop. And the faster it develops, the faster the cost will come down. The more the cost is up there, the more delay there is in that. And I suspect as with any new technology, there will be a bit of a, history says, a tipping point. And then we will get there.

And it is important that we do things like our UltraFan and more efficient gas turbines because whether we are burning hydrogen or whether we are burning synthetic fuel, there's still a cost associated with producing that. And so the less of it that we can use, the better.

And so we see a very firm role for UltraFan and more efficient gas turbines. Whether they used it directly for the UltraFan propulsion or whether the core out of UltraFan, the more efficient core is used in a hybrid application in a smaller aircraft. The project is absolutely vital.

Harry Breach (MainFirst): Could I just ask you, Warren, you touched on coronavirus in the slide earlier on. Can you just say, have you had any deferrals of delivery dates for on-wing or spare engines that have been cited to be coronavirus capacity-related? Secondly, if I remember well, and I probably do not, back in July at the interims, if I remember you were saying that the breakeven date across the large engine deliveries, including spares, if I remember, was to 2023. Firstly, have I got that number right? And the secondly, is there any change given your lower wide-body delivery expectations? And then just final one, maybe for Stephen. Stephen, just in 2019 for the Civil Aero LTSA revenue stream, is it possible for you to give us an idea of the pay-at-shop visit versus the sort of paper flying our monthly settlement?

Warren East: Let me kick off. We have not seen any deferrals attributed to the impact of COVID yet. But of course, that is a phenomenon, which is in the realm of our sort of planning and our sort of scoping the size of the potential impact from COVID. But as of today, we have not seen any of that. The breakeven point and the volumes – I mean, first of all, the volumes do not make any difference as the answer to the previous question. Do you – you are jumping in.

Stephen Daintith: Yes, I will probably go along this one, is a £400,000 average loss per engine by 2022. Sorry, what was the number you quoted, 2023 –

Harry Breach: Those across the portfolio for installed engine deliveries [inaudible] I do not quite remember that date well.

Warren East: We have not actually – I mean, I think I remember a little bit the conversation where there was a slight bit of miscommunication from the presentation. As Stephen says, the line that we are sticking to is just under £0.5 million across the portfolio by 2022. And the other data point that we are sticking with is breakeven on XWB 84K by the end of 2020. As I said, we will achieve that second one. It is close. We are going to get there in 2020.

Stephen Daintith: Okay. And on the – sorry, the mix of – I will come back. On the mix of shop visits as well, and I am talking here around the sort of the major refurb shops.

Harry Breach: [Inaudible] revenues by pay-to-shop versus.

Stephen Daintith: Sorry, say it again?

Harry Breach: So I think my question is just I was trying to get at the – for Civil Aero LTSA revenues what the mix there was between the pay-at-shop [inaudible].

Warren East: I would – okay, I would take at least 20% pay-at-shop visits perhaps sort of mid-high teens and then the rest would be flying. The important point dynamic is 2019 was we had three times the number of pay-at-shop visits in the second half of the year than we had in the first half of the year, which somewhat explains the strong second half performance from cash generation on the long-term creditor that we are seeing in the numbers today. That is an important dynamic.

Harry Breach: Thank you.

Warren East: Just pass it along, I think, is the best answer.

Speaker: Couple of questions. First of all, presumably the Trent XWB-97 is one of the big lose – big loss-makers of the moment. Is there any reason why it shouldn't get to breakeven like the Trent XWB-84?

Stephen Daintith: The – you are right. The Trent XWB-97 is two years younger than Trent XWB-84 in terms of entry into service. And so that is one of the loss-making contributors. It will follow the trajectory. We – I can't commit today that that will actually get to zero. I mean, what you've seen because it depends how far out you take these things. And we have put a lot of effort into extending the time on wing.

It is possible, that we do not want that to get the breakeven, because it is possible, but we actually want to spend the money and have the components that improve the durability and the time on wing for service of a given engine because we have to make more profit over that than we make from trying to squeeze a technical profit on the OE.

So generally it is a good idea to make as little loss as possible on the OE. But when you get in the detail and you get to the smaller numbers, then it might actually be better not to do that economically for the programme and for the – for our overall profit.

Speaker: The next question is – well, a group of questions, is you've tripled the number of spare engines on the Trent 1000. How come it was so low?

Stephen Daintith: Capacity, capital, simple as that. I mean, we – it is a new engine and it is obviously had issues. And the reason that we were able to improve the spare engines a

little bit last year and we are going to take another big step forward this year is because we now have the capacity to do that.

Speaker: Maybe related to that, it must be a bit pretty tough job being the Trent 1000 salesman at the moment. Why on earth would any airline sign up to buy one right now? This is [inaudible] question. Is there enough in your backlog to see you through to H1? Is there any chance to see that in Trent 1000 all of this year?

Stephen Daintith: Yeah. Well, I mean, there are Trent 1000 opportunities for us this year. And we do hope to take orders this year. Why would anybody do it? Well, because of the overall performance of the engine, the overall actual reliability of the engine. And the fact that actually, our competitor while having spare engines to protect against the disruption that we have seen, when you get in the detail there are issues with our competitors engine as well.

Now I am not going to stand on the platform and talk about that. You can talk to Boeing, you can talk airlines about their experiences of their engines on 787. But the answer is we wouldn't be taking new orders we are taking now. If our engine was so bad that it was such a tough job being the salesman.

Speaker: And the final one is bit of a philosophical one. A couple of years ago, you said that you typically had four in-service problems at any one time. It would take a couple years to sort out each and one to solve [inaudible]. So there's probably 200 million-ish of cost underlying. With the Trent 1000, you've had three problems and it cost you £2.5 billion. There will be undoubtedly in-service problems with your order for their engines at some stage. How can you give us any reassurance that it is going to be a £100 million problem, not a £2.5 billion problem?

Warren East: Well, and the answer, of course, is that we can't give any guarantees but we can give assurance based on the very data that generated that original assumption in the first place. It wasn't based on thin air. It was based on our experience of 25 years of Trent engines. And that is the experience we have had.

And some of it does come of our own making when we are trying to actually sort of extend the life of time on wings of the engine and we have made great progress on the Trent 700 over 25 years in doing that, but it hasn't all been linear. And sometimes we end up with a great idea to extend the life or reduce the cost.

And then two years later in service, we find some issue. And those are the sorts of issues that I am talking about that crop up regularly. The Trent 1000 has been absolutely unprecedented in our history. That is what everybody tells me. And we are grinding through it.

Obviously, we have spent a lot of time and effort learning from those lessons. So we can take steps to minimise the probability of that happening again. I think if you look at the later engines, Trent XWB is our example of the later engine. Then, as I said, we are fleet leaders at five years now, achieving the number of cycles that they set out to achieve. And the airlines seeing excellent reliability during that process and excellent hanging on to the engine performance as well as it goes through time.

Peter Lapthorn: If I could, quickly here with a couple from the webcast. We have had two on the LTSA creditor inflow from David Perry and Zafar Khan both asking it was an encouraging inflow in 2019, we are guiding to a similar level in 2020. What might 2021 look like and what are the drivers around that being a bit higher than previously thought? And then secondly a quick – a second one from David on delivery guidance and whether we think 400 to 450 is a floor for wide-body deliveries.

Stephen Daintith: Okay.

Warren East: Shall I do the first one or shall I do the second one?

Stephen Daintith: I will do the first one. I will get the long-term creditor out of the way. So as a reminder, this is the balance on our balance sheet, the credit balances, the deferred revenue from flying hour cash going in there and then revenue gets traded through as the shop visits to take place. We had a very strong second half, £500 million better than the first half, in fact.

There's three or four key drivers of it. So first of all engine flying hours seats, good flying hours growth, but we also, as you know, that we reconcile, at the end of each quarter, the actual engine flying hours compared to the invoice engine flying hours and we do often see upside there. It is not so straightforward. It is just number of flying hours flown. It is the type of flying hours as well.

There are different prices around different parts of the flight experience. So that – it is a pretty complicated reconciliation. We run that through. And we saw some good upside from that activity in the second half.

Pay-at-shop visits. We have three times the volume of short visits in the second half as we had in the first half. I talked to you about the high yield that was a driver of growth as well, particularly strong business jet performance in the second half, which gives us encouragement for 2020.

And then finally, the – well, the penultimate point, the £100 million revenue catch-up that we had, that suppresses the drag – the pull-out of revenue as well that we reported. And then the final piece is the number is Trent 1000 check and repair visits in the second half that goes through the provision, again, which is not hitting the creditor, but you are still getting cash generated from those flying hours flowing through in any event.

So those are the four or five key drivers. 2020, you'll be thinking about the same sort of drivers. I think it is too early to talk about 2021. What I would say though is that flying hour growth high single-digit, sort of approaching double-digit flying hour growth is, it remains the fundamental principal driver of cash flow generation in 2021.

Warren East: And on the question of build rate and is our current estimate, the floor, well, what I can say is that the current run rate supports the demand, the final demand. We have seen the demand fall to what appears to be more of a longer term run rate growth in demand.

And I think if I go back six, 12, 18 months even, there was a lot more noise about overcapacity in the industry and the overcapacity being ahead of that underlying demand, and therefore, there's been a little bit of an overhang. And I think the build rate adjustments have been pretty well sort of expected.

Obviously, short-term we do not know of an impact in 2020 of the virus outbreak and the disruption that results from that and what – to what extent that might spill over into some deferrals. I already answered that question.

And so technically, there might be a little bit of deferral there. But actually, I can see more indicators to increase that demand for build rates. The underlying demand is going to carry on growing at along with economic growth. And I think with the changes in sort of public opinion, around flying, airlines are going to want to deploy cleaner, more efficient aeroplanes as and when they can afford to do so. So if anything, I can see a little bit of a sort of demand increase signal, but we are not going to call that just yet.

I think we got one – we have got the microphone over there. So we will come back to you. We have got about four minutes.

Speaker: Yeah. This is really, really [inaudible]. If I've paid you for a flying hour, is there any way I can get the money back from you?

Stephen Daintith: No, not technically. Same around the back of the [inaudible].

Warren East: No. I mean, it is a very good point because I know what you are getting at here with the question because there is some commentary that we should regard the credit balances debt. Well, that, the cash is contractually ours and remains ours, even if the airline stopped flying the planes forever. The cash is still our cash contractually. So that is the way we should regard it.

Speaker: But still you are my creditor [inaudible]?

Stephen Daintith: Now it is deferred revenue. It is on the balance sheet. It is deferred income. Yeah.

Ben Heelan (Bank of America): Hi guys. Just one on the credit rating. You said you want to get back to A rating. What sort of metrics do you think we should be looking at in terms of that path? And what you think you need to get A? Thank you.

Stephen Daintith: We have had a lot of dialogue as you might imagine with the rating agencies with both Standard & Poor's and Moody's on this one. I mean, what is very clear, and their priority is aligned with our priorities, operational performance improvement to that we are in the high-quality operating profit growth and cash flow generation. If you are looking for a metric, Standard & Poor in particular, looking for a 14%, 15% EBITDA margin, so that to get us to sort of movers into that single-A rating category.

What I can say is that when we look at our plans, and then we look at the numbers that we are talking around in the mid-term, we can see good progress over the course of the next two years on that ambition. And what is critical though is clearly de-risking the Trent 1000.

Warren talked about delivering that final fix on the high-pressure turbine blade on the TEN, getting it the design through in 2019. And certified in early 2021, and then we can start installing those blades and we get the Trent 1000 back to a healthy engine. So that is very much how the rating agencies are looking at it. And what we know what we need to do and are absolutely focused on it.

Peter Lapthorn: And we had one in the middle.

George Zhao (Bernstein): Hi. Could you talk about the capex spend you did in 2020 to build the spare of these [inaudible] engines to support the Trent 1000?

Warren East: Sure.

George Zhao: And given that not all the fixes will be done by 2020, is there concerns that you may need to continue to build more spares beyond next year? Thank you.

Stephen Daintith: So our capex was around £750 million in 2019. And that include an element about £100 million in round numbers and investments in Trent in spare engines. A large proportion of which is Trent 1000. In 2020, we are going to be maintaining the underlying spend, that is before the Trent 1000 build. But we are going to be increasing overall capital expenditure by £100 million to £150 million or so. And we expect that that additional engine built for the Trent 1000.

The way to think about this is that, let's use a proxy of £4 million, £5 million per engine, that is about sort of 20 engines or so that we are building in addition – in 2020, in addition to those 20 or so that we built in 2019, if that makes sense.

Warren East: And to answer is there a danger that we are going to have to build some more? Well, what we are effectively doing is, is pulling forward space that we would otherwise have built anyway as the size of the fleet grows.

And so I do not think we are going to need to do an extraordinary number of spare engines. I mean, certainly from an operational point of view, if we do the spares that we plan to do in 2020, then we should be able to protect the fleet and then over the subsequent years we will grow back into that volume. And then we will continue to build spares as the size of the fleet grows. So I do not anticipate any 2021 enormous step up in the capex for more Trent 1000 spares.

Stephen Daintith: But as it stands today, this build of Trent 1000 engines will be a very good return on capital, when we consider the cost that we are currently seeing for every day that an aircraft is on the ground.

Warren East: Okay. It is 10.30 on the clock, so let's assume the clock is now telling us the right time. So thank you all for coming. I mean, the key takeaway messages here, I think, is a strong set of results for 2019, our performance to deliver on that, particularly after a very tough first half.

As Stephen said, we left ourselves a lot of things to do in the second half. But the team has delivered and shows what this organisation is capable of doing in terms of delivery. I think COVID-19 and the disruption which flows from that, this is a macro for everybody is a known unknown at the moment. We will keep you updated with the implications.

But we are in pretty good shape on that at the moment with daily monitoring of the situation. Daily contact with the supply chain. And we are already seeing suppliers and the customers with whom we deal in regions, which were first affected by the virus, i.e. Greater China, and we are seeing a return to levels of normality there.

But we look through that and we can see the fundamental drivers of our business performance, having improved. The fundamental levers that we talked about at our Capital

Markets Day and before we can see progress on that, we can see momentum, and we can see those drivers continuing. And that is what underpins confidence in the medium term.

And we also want you to take away the fact that we are not ludicrously short-term focused on £1 billion in 2020 and £1 per share of free cash flow in 2023. We are thinking beyond that as well, and developing a future for this business to build on that platform through the energy transition.

And with that, we will be back in July, late July, to tell you about how we have got on in the first half of this year. Thank you.

Stephen Daintith: Thank you.

[END OF TRANSCRIPT]