



Sir John Rose  
Chief Executive

## Developing the business for the longer term

The consistent strategy the Group has pursued for over 20 years has created a broadly based business which is resilient in the face of short-term challenges and which is well positioned for future growth.

### **Rolls-Royce performed strongly in 2008 in the face of increasingly challenging conditions.**

Our results demonstrate the value of our consistent strategy. The strength of our technology, the breadth of our product and service portfolio, our knowledge of the customer and the capabilities of our people continue to increase our resilience and enable us to develop the business for the longer term.

Our financial results reflect the strength of our business model. In 2008, Group sales increased to £9,082 million (2007 £7,435 million), with underlying sales growth of 17 per cent. The published loss before tax was £1,892 million (2007 profit £733 million). This loss was caused primarily by the effects of the marking to market of various financial instruments, as is explained further in the Finance Director's review on page 55, and the reported earnings do not reflect the underlying trading performance of the Group in 2008. Underlying profit before tax rose by ten per cent to £880 million (2007 £800 million). We ended the year with a net cash balance of £1,458 million (2007 £888 million) and a record order book of £55.5 billion (2007 £45.9 billion).

As I write, the global economic crisis continues to intensify and it is impossible to be precise about its ultimate severity and duration. What is certain is that all companies will be affected to varying degrees and it is clear that Rolls-Royce, its customers and suppliers will not be immune from this global crisis. However, as a strong power systems company, Rolls-Royce has a number of characteristics which give me confidence that we will be able to deal effectively with the very considerable challenges and uncertainties that lie ahead.

### **A very different company**

It is worth recalling at the outset that the current crisis is not the first to which Rolls-Royce has had to respond.

In recent years our markets have been impacted by the events of September 11, 2001, the Gulf War in 2002 and the SARS epidemic in 2003.

As a business, we have also had to deal with a wide range of negative developments such as a weakening US dollar, high oil and commodity prices and delays in major new airframe programmes. All these challenges have been effectively managed by the Group.

The drivers of the current global economic crisis clearly differ significantly from previous downturns. However, Rolls-Royce itself is also a very different company.

Our turnover in 2001 was around £6 billion, with only 38 per cent of our revenues derived from services. We had a geared balanced sheet with average net debt of around £1 billion and a large and volatile pensions deficit. Our order book of £16.7 billion was concentrated on traditional Western markets such as the UK and the US. As a result, in the downturn that started in 2000 but was exacerbated by the tragedy of 9/11, the Group was less resilient than today.

Rolls-Royce is now well diversified by product, customer and geography. Our revenues have increased to over £9 billion with over 50 per cent now derived from services. Our order book has increased more than threefold to over £55 billion and is broadly spread across all the world's principal markets. Most significantly of all, we have a strong balance sheet with no net debt. Our long-term strategy of hedging currency risk has served us well, allowing a manageable and predictable deterioration in the sterling/US dollar achieved rate over the past five years.

Our large installed base of over 54,000 engines supports a growing services business. The scale of this services activity, together with the size of the order book and the longevity of our programmes, gives us much clearer visibility of future revenues. All these characteristics increase the Group's resilience and despite the uncertain outlook, give us confidence for the future.

In this more challenging environment, operational performance, cost reduction and matching capacity to load will be particularly important.

In January 2008, we took early action to reduce costs by taking the difficult decision to reduce staffing in support functions by 2,300 people. This programme has been completed at no net cost to the Group and in 2009 will reduce our costs by £100 million. A further proposed reduction of 1,500–2,000 jobs in 2009 is expected to be cost neutral in the year, while delivering similar savings in 2010. These programmes demonstrate our commitment to achieving and sustaining world-class levels of operational efficiency and improving our competitiveness.

### Developing the business

It is clearly impossible to provide a forecast of the precise impact that the global crisis will have on Rolls-Royce. However, it is clear that the Group's power systems portfolio – whether for use on land, at sea or in the air – provides products and services for which there will be a strong, global demand for the foreseeable future. Importantly, the sectors in which the Group operates are characterised by high barriers to entry because of the advanced technologies required and routes to market which have to be established and maintained. Rolls-Royce will be able to exploit these advantages over many years as the global economy recovers and resumes growth.

### A long-term business

The longevity of our programmes, the scale of our order book and the increasing importance of our services activity suggest that over the next ten years the Group can double in size through organic growth alone. In civil aerospace, for example, based on our understanding of the order book and the long-term programmes in which we are involved, we see a market potential for around 8,000 wide-bodied aircraft over the next 20 years, a very significant opportunity for our Trent engine family.



#### Organic growth – Trent aero engine

Rolls-Royce has developed the Trent aero engine into a market leading family of large engines.

### Investing for growth

Rolls-Royce has a strong track record of developing businesses by investing in organic growth, partnerships and acquisitions. Our civil aerospace business is a case in point. Our acquisition of the Allison Engine Company in 1995 helped Rolls-Royce build up a strong position in the corporate and regional jet market through the highly successful AE 3007 programme. Our joint venture with BMW in 1990 enabled us to establish a new centre of excellence in Germany for two shaft engines, an important strategic development which culminated in the Group buying out BMW's share of the joint venture in 1999. Collaboration also played a key role in the development of the Trent programme, with Rolls-Royce agreeing an important series of risk and revenue sharing partnerships with a wide range of global companies.



#### Allison acquisition

Our acquisition of the Allison Engine Company provided a strong presence in the regional aircraft and US defence markets.





#### Partnerships – BR700

The BR700 engine series for corporate and regional jets was first developed in our joint venture with BMW. The latest engine variant is the BR725 for the Gulfstream G650 aircraft.

#### A consistent approach

We are taking the same approach to develop our marine business which was transformed by the acquisition of Vickers in 1999. We gained access to new capabilities including design and integration systems, propulsion and control equipment, a global sales and services network and routes to market for the offshore and merchant sectors. This combination of a strong ship design capability and the provision of high technology equipment and systems has enabled marine to improve its market access and broaden its product offering.

Defence aerospace has similarly been transformed from a narrowly focused business which was overly dependent on the UK to one which provides engines and service support on a global basis and across a wide range of sectors including fast jets, transport aircraft, unmanned vehicles, trainers and helicopters. We have more than 160 customers in 103 countries, with the USA now accounting for around 45 per cent of defence aerospace revenues.



#### Vickers acquisition

The Group already had a naval marine business but the acquisition of the Vickers group expanded our capability across the world in the commercial marine market.

#### Exploring new opportunities as a power systems company

Looking ahead, the Group can take full advantage of its strong systems integration capability based on its knowledge of technology, its close understanding of customers' needs and its ability as a power systems company to apply these integration skills in support of the customer. This will enable the Group to exploit its technological strengths in adjacent markets and to develop its existing businesses through partnerships and acquisitions.

A good example of this is civil nuclear. In 2008, we established a new business unit to address the rapidly expanding global market for nuclear power generation which we estimate could be worth around £50 billion per year within 15 years. The civil nuclear opportunity plays to our strengths.

It requires technological expertise, systems integration capabilities and a global supply chain, all of which we have developed during the 50 years we have designed, manufactured and supported nuclear reactors for the Royal Navy's submarine fleet.

We will also use this approach to take advantage of other opportunities to address distributed power and alternative energy.



#### **New opportunities**

Our experience in the design, manufacture and support of nuclear plant for submarines allows us to address the growing civil nuclear market.

### **World-class people**

In responding to the short-term challenges we are currently facing and in developing the business for the longer term, our people are our strongest asset.

Rolls-Royce is a power systems company, powered by the knowledge, experience and imagination of all our employees across the world. Our advantages are dependent on the contributions they make and in this increasingly challenging period I am particularly indebted to all of our people for everything they do in support of the business.

### **Future prospects**

The Group expects that in 2009 its global markets will be affected by reducing demand and the impact of financing constraints. We will continue to manage the consequences of airframe programme slippages.

Cash generation will be affected by the reduction in new orders and associated deposit intake and the impact on inventory of any delays or cancellations. There are also likely to be requests for customer and supplier financial support which will be considered by the Group on a case by case basis. In the current environment it is expected that in 2009 despite a cash outflow, the average net cash balance of the Group will increase. The Group's current view is that underlying revenues will continue to grow and underlying profits for the year will be broadly similar to those achieved in 2008.

#### **Sir John Rose**

Chief Executive  
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