Report from Dame Helen Alexander Chairman of the remuneration committee

Our commitment remains to align pay with performance.

Rolls-Royce has followed a consistent strategy towards executive remuneration over many years. We believe that a significant proportion of senior executives' remuneration should be made up of performance-related incentives so that overall reward is closely aligned to the creation of long-term stakeholder value. These principles are well-established in Rolls-Royce. In our report this year, we are showing the link between performance and remuneration in Rolls-Royce even more clearly.

Base salaries

Base salaries are set by the committee at levels required to recruit and retain high quality senior executives with reference to the marketplace for companies of similar size, global reach and complexity, taking account of pay elsewhere in the Group. Salaries are set annually on March 1 with performance taken into account.

Annual bonus outcome 2011

It is an important principle of the Rolls-Royce executive bonus arrangements that no bonus can be paid to anyone unless the entire Group has achieved the financial targets set by the committee. During 2011, the Group delivered 21 per cent growth in underlying profit before tax and, before the cost of acquisition and foreign exchange translation effects, a net cash inflow of £210 million. This strong performance was achieved in challenging economic circumstances whilst maintaining the long-term investment programmes needed to deliver our record order book and future growth.

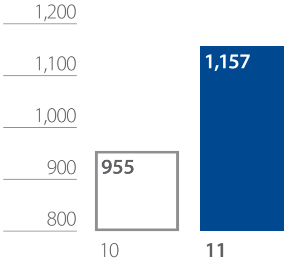
The committee is satisfied that the annual bonus outcome for the executive directors for 2011 appropriately reflects these results and the significant value delivered to all stakeholders.

For executive directors, 40 per cent of the bonus is delivered in deferred shares which must be held for a period of two years.

2011 PERFORMANCE

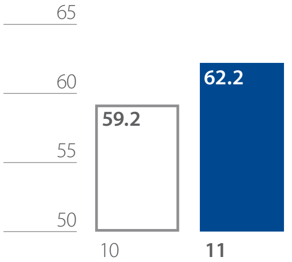
Underlying profit before tax (£m)

+21%

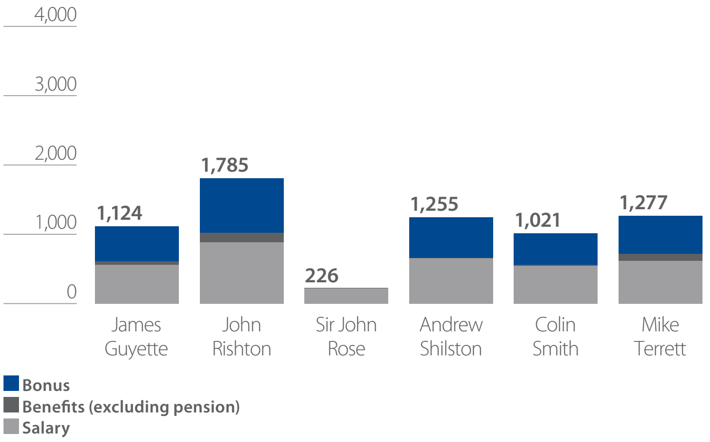


Order book (£bn)

+5%



2011 REMUNERATION (£000)



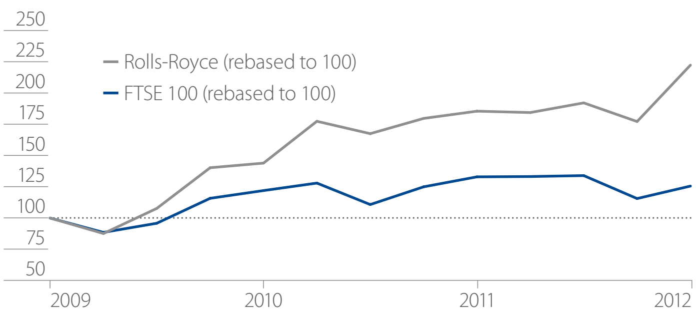
Bonus (cash and shares). This is the total bonus award for performance in 2011. Forty per cent of the bonus is deferred into shares which are released after two years (ie in early 2014) subject to continuing employment. Sixty per cent of the bonus is delivered in cash in early 2012.
Benefits (excluding pension). This is the value of total benefits (excluding pension) received during 2011.
Salary. This is salary paid during 2011.
Pension. In addition to the annual pay and benefits in the table above, the directors received pension benefits, as described on page 60 of the Directors' remuneration report.

Performance Share Plan (PSP) outcome 2009-2011

The long-term incentive plans at Rolls-Royce are designed to reward long-term value creation, are calculated over three years and measured against Total Shareholder Return (TSR), earnings per share and cash generation. Against all these measures Rolls-Royce has performed well. The Rolls-Royce share price, for example, has increased by 187 per cent between March 10, 2009 (date of grant for the 2009 PSP award) and December 31, 2011, compared to an increase in the FTSE 100 index over the same period of 58 per cent. This has benefited all Rolls-Royce shareholders including many employees. We have arrangements such as ShareSave which we put in place specifically to encourage employees to have a long-term interest in our success. The March 2009 PSP award was made on the basis of a share price of 260.42 pence. By the close of the three-year performance period in December 2011 the share price had increased to 746.50 pence.

The following chart tracks the value of £100 invested in Rolls-Royce shares (to be clear, without taking account of dividends) versus the FTSE 100 index from January 1, 2009 to December 31, 2011, in line with the performance period for the March 2009 PSP award.

Rolls-Royce versus FTSE 100



Rolls-Royce TSR over the ten-year period to December 31, 2011 was 372 per cent. Only 69 of the companies which made up the FTSE 100 at the beginning of that period are still trading independently and the median TSR amongst these 69 companies over the same ten-year period is 30 per cent.

Total returns over the period to December 31, 2011

	FTSE 100	Rolls-Royce
Last year	1%	13%
Last 3 years	30%	116%
Last 5 years	4%	71%
Last 7 years	48%	217%
Last 10 years	30%	372%

LONG-TERM PERFORMANCE

Rolls-Royce versus FTSE 100 TSR growth in each performance year

	FTSE 100	Rolls-Royce
2009	+14%	+41%
2010	+19%	+37%
2011	+1%	+13%

LONG-TERM REMUNERATION IN 2011[1] (£000)

PSP (appreciation in share price). This is the increase in value of the PSP awards due to share price appreciation over the period, from 260.42 pence at March 10, 2009 to 746.50 pence at December 31, 2011.

PSP (value at grant in 2009). This is the value of performance share awards vesting during March 2012, using a share price at grant of 260.42 pence as at March 10, 2009. These shares relate to performance over the three-year period 2009-2011. The cash flow per share target was achieved in full and a 1.5 multiplier was achieved because the Group's TSR exceeded the upper quartile of the FTSE 100. Fifty per cent of the after-tax shares must be held until retirement or until minimum shareholding requirements are achieved.

[1] John Rishton was not an employee and did not receive a grant of PSP shares in 2009.

Note: All TSR numbers on this page are calculated based on start and end values for Rolls-Royce and the FTSE 100 averaged over the previous six months. This is consistent with the rules of the PSP. The TSR chart on page 58 is based on spot values and does not therefore align to the numbers on this page, but both spot and average methodologies confirm Rolls-Royce TSR has consistently out-performed the FTSE 100.

Over the three-year performance period for the 2009 PSP grant, our performance in terms of cash flow and earnings per share was sufficient to release 100 per cent of the conditional shares originally granted. The Company's TSR was eighth in the FTSE 100 over the three-year performance period. This TSR performance triggers an increase of 50 per cent in the shares released to executive directors and other members of the GLT and an increase of 25 per cent for other executives. The value of the shares vesting under the PSP scheme for the three-year performance period to the end of December 2011 has been estimated using the share price as at December 31, 2011 (the actual value will depend on the share price at the vesting date in March 2012). Executives must retain 50 per cent of the shares they receive under the scheme until they retire from the Company or achieve a minimum shareholding requirement which is 200 per cent of salary for the Chief Executive or 150 per cent for other executive directors. This ensures the directors have a personal financial interest in the long-term success of the business.

Remuneration and opportunities for other employees

All employees worldwide have the opportunity to benefit from our success through participation in our global bonus and share plans. All employees who were with us throughout 2011 will be receiving a bonus of at least two weeks' pay as a result of our 2011 performance. More than a third of our employees currently participate in our global ShareSave plan. More than 6,000 participate in our SharePurchase and ShareBonus plans which allow employees to purchase shares on a regular basis and to convert bonus payments into shares. It is worth noting that Rolls-Royce employees also enjoy competitive salaries, benefits and career opportunities which are made possible through the Group's robust performance in recent years.

The work of the committee during 2011

In February 2011, the committee endorsed the outturn for bonus and long-term incentive plans. It also considered a benchmarking report by Deloitte LLP and assessments of performance before approving salary increases for senior executives. The committee approved the terms for the appointment of the Group HR Director and considered a draft of the Directors' remuneration report which it agreed to recommend to the Board for approval.

In May, the committee selected the Organisation for Economic Cooperation and Development (OECD) index of consumer prices as a measure of the earnings per share (EPS) growth hurdle for the PSP 2011 grant. In 2011, it was confirmed that the personal element of management bonuses would be based on overall performance development ratings rather than on the achievement of specific performance objectives, thereby strengthening the link between overall performance and reward. The committee also agreed the basis for the launch of the 2011 ShareSave offer.

In September, the committee considered the principles to be applied when setting bonus targets and discussed, in particular, whether the cash hurdle could be refined. It also considered the terms of appointment for the new Finance Director. Shareholders are asked to note that in line with the policy applied elsewhere in the Group, the Finance Director's salary has been set at a level which is at the lower end of a market competitive range, allowing headroom for future performance-related growth.

In November, the committee discussed the Department of Business Innovation and Skills (BIS) consultation paper referred to above and agreed its response. It also reviewed the 'Principles of Remuneration' issued by the Association of British Insurers (ABI) in September 2011 and resolved to make every effort to ensure it complied with its overarching principles.

In December, the committee considered the nature of the bonus and PSP targets to be set for 2012. The committee discussed the methodology applied by Deloitte LLP when benchmarking senior executive salaries against current market practice.

Directors' remuneration report

This year's remuneration reflects a strong performance against all measures of success. Rolls-Royce has achieved record underlying revenues, underlying profits, and has a record order book which should ensure that the business will remain strong for many years to come. We support the clear message on executive remuneration sent by BIS in the UK that: 'generous rewards for leading executives are not an issue where executive remuneration is well-structured, clearly linked to the strategic objectives of a company, and which rewards executives that contribute to the long-term success of that company'. The committee's view is that the performance of the Group, backed by the growth in the Rolls-Royce share price in recent years, warrants the rewards which our executives will receive in 2012.

Dame Helen Alexander
Chairman of the remuneration committee