

CHAIRMAN'S REVIEW

In 2013, Rolls-Royce delivered another year of growth in underlying revenues, underlying profits and orders.

The Board is proposing an increase in the final payment to shareholders of 13.4p bringing the full year payment to 22.0p.

This is my first Chairman's review. Before I joined Rolls-Royce I sensed that it would be an extraordinary privilege to serve such a great company with such a rich history. So it has proved to be. In the past nine months I have travelled widely and met a broad cross-section of colleagues, customers, suppliers and investors. All have been free with their time and open with their perspectives.

I have two dominant initial impressions. The first is of the pride that people across the world have in the activities and achievements of the Group. We have a team that really does aspire to be 'trusted to deliver excellence' in everything it does, yet is under no illusions about what this will take. There is pride but no sense of complacency.

The second impression is of opportunity. Some of our business segments face strong headwinds and there will be some inevitable volatility. But, overall, Rolls-Royce competes in markets characterised by long-term demand growth and the opportunity to add value. This is as true of the services we provide as it is of our products. These opportunities are increasingly global in nature. Rolls-Royce has a great British history but its future has to be as a great global company.

In 2013, Rolls-Royce delivered another year of growth in revenues, profits and order book. This performance was achieved against a background of significant global economic and political uncertainty. The 13 per cent of increase in the payment to shareholders to 22.0 pence reflects the confidence that the Board has in the fundamentals of the business as well as in its future prospects.

The increase in the payment to shareholders also recognises the importance that many of our investors place on annual cash returns. Nevertheless a key characteristic of Rolls-Royce is that it is a long-term business

with technologies that take years to develop. This creates the necessity of a long-term view and for long-term investment, together with a commensurate attitude and mindset for risk.

Our strategy must be directed towards creating a sustainable business. For Rolls-Royce that means driving profitable growth whilst achieving a positive economic, social and environmental impact. We will deliver better power to our customers, use innovation to secure a better future, and build on today's achievements to develop a better business, ready to meet the challenges ahead.

Research and development, and innovation more broadly, are crucial. They will become more so as we strive to improve the quality and performance of our power systems and services. The Trent XWB, for example, has proved to be the most efficient large civil aero engine in the world. Design and development of that engine started in 2006. In our Marine business, innovation and the development of liquefied natural gas (LNG) power systems has led to the possibility of a 40 per cent reduction in a ship's CO₂ emissions and the virtual elimination of sulphur and oxides of nitrogen emissions compared with conventional, diesel-powered craft. This presents a clear environmental and commercial opportunity. These innovations have also taken years to develop.

We are committed to both the short-term performance and to the long-term health of the Group. It is a matter of 'both-and', not 'either-or'. In my experience the most successful, most enduring organisations invest equivalent resource and imagination in the long-term health of their business as they do in their short to medium-term performance.



Ian Davis
Chairman

Dwelling on performance, I am totally supportive of John Rishton and the management team's operational focus on the 4 Cs – customer, concentration, cost and cash. John describes the progress, and the continuing opportunities, of these 4 Cs in this report. I am particularly pleased at the progress in improving customer service and delivery reliability. Engineering and technology companies can have an inbuilt tendency to focus on product rather than on customer. Yet it is our customers who pay our bills and finance our investments. It is of the highest strategic and commercial importance that we deliver on our product and service commitments to our customers.

Over and above the continuing need for investment, I would like to comment on a couple of themes relating to long-term health: diversity and good governance.

I have remarked already on the need for Rolls-Royce to establish itself as an even more global Group. This will require us to become more diverse in our workforce and in our people development. To achieve our aspirations we have to attract, retain and develop the best talent everywhere we operate – commercial as much as engineering, female as much as male.

We are making real progress. Our global apprenticeship programme enjoys world-wide renown. Our record graduate intake in 2013 includes 32 nationalities from 97 universities around the world. Additionally we continue to broaden internationally our network of University Technology Centres which are so important to our future. But more needs to be done.

We can and need to do more to attract and, particularly, retain exceptional women. The engineering sector has not always been a favoured destination for well-qualified

women and there may be cultural and historical reasons for this. For a Group like Rolls-Royce, this should be as much an opportunity as a problem. Purposeful diversity is an important part of our long-term planning.

Fundamental to a healthy company are strong ethical standards and behaviours, supported by good governance. As John Rishton has repeatedly made clear, the Group will not tolerate improper conduct. We are striving to ensure that every single Rolls-Royce employee knows what is expected of them and understands the standards to be met. The Board and management are united in this endeavour. In particular, I will focus on ensuring that we have the appropriate governance arrangements and structures in place to reinforce the required conduct and behaviours, wherever we operate.

Over recent years, the Board and management have been greatly assisted by the wise counsel of our International Advisory Board (IAB) whose membership is described on page 38. The IAB's primary role is to provide context on political and economic developments around the world and to alert the Group to possible long-term opportunities, threats and risks. They are also available to provide counsel and support in specific areas of expertise. I am grateful to the IAB members for their contributions.

I am also indebted to my fellow Board directors for their hard work and remarkable commitment to our Group as well as for their patience and good humour in dealing with the new Chairman. The Board has been augmented in January 2014 by Lee Hsien Yang and Warren East, both of whom bring a wealth of experience in global technology oriented industries. Further details of their careers are included on pages 36 and 37. I am delighted that they have joined the Group.

In the Queen's Birthday Honours, Michel Dubarry, Rolls-Royce International President – France, Head of Europe and Northern Africa, was awarded an OBE. In the New Year's Honours, Hamid Mughal, Director of Manufacturing, received an OBE and my fellow Board member, Warren East, a CBE. Their recognition is well deserved and I congratulate each of them.

I would also like, in closing, to acknowledge Sir Simon Robertson for his inspirational chairmanship and leadership of the Board. I am sure that, over time, I will forgive him for being such a hard act to follow.

I feel honoured to have the opportunity to serve as Chairman of Rolls-Royce. We have, and will have, challenges. However, I would be disappointed if this review does not convey my deep sense of opportunity to improve both short-term performance and to build the long-term health of the Group. 2013 was a good year for Rolls-Royce and I would like to thank my colleagues for their hard work and efforts in making this happen.

Ian Davis
Chairman

12 February 2014