

## CHIEF EXECUTIVE'S REVIEW

In 2013, Rolls-Royce continued to grow its order book and expand its portfolio. The Group increased its underlying profits, and underlying revenues. The order book increased to £71.6 billion.

This performance demonstrates both the long-term demand for our products and services, and the confidence our customers place in us.

We strive continually to improve quality, performance and cost. To that end we invest in innovation, infrastructure and in the global workforce upon whose ability and ambition our current and future success entirely depends. I am impressed every day by the commitment and professionalism of my colleagues around the world and I thank them for their hard work.

The leaders of the Group have devoted considerable time and energy into articulating the vision, values, strategy and business priorities that we share, as well as setting out the standards of behaviours expected from everybody at Rolls-Royce. Providing clarity on these core beliefs, and making sure they are understood by everyone in the Group will enable us to better serve our customers and secure a profitable future for our employees and shareholders.

**Vision: better power for a changing world**

**Values: trusted to deliver excellence**

**Strategy: customer, innovation, profitable growth**

These are described in greater length on pages 8 and 9.

Our business priorities in 2013 remained the same as in previous years, and have been characterised as 'The 4 Cs':

**Customer – deliver on the promises we have made**

**Concentration – decide where to grow and where not to**

**Cost and Cash – improve financial performance**

In 2013, we have made progress in all of these, although there remains much more to do.

**Customer**

It is essential that we deliver on the promises made to our customers. Across the business we have significantly improved on-time delivery. This foundational step will strengthen our customer relationships and drive more efficient use of resources, such as inventory. In Civil aerospace, on-time delivery to our wide-body customers was 100 per cent in 2013 for the first time.

In 2013, major milestones were achieved in a number of important programmes. The Airbus A350 XWB flew for the first time powered by our Trent XWB engines. We have now received orders for more than 1,600 Trent XWBs, making this our best-selling Trent engine. The Trent 1000 engine, which powers the Boeing 787 Dreamliner, has achieved the best performance of any new wide-body engine entering service, with a 99.9 per cent despatch reliability. In June, it was selected by Singapore Airlines to power 50 Boeing 787 aircraft. In Marine, the first of our innovative Environships went to sea. This vessel combines a wave-piercing bow,

gas-powered engines and advanced propulsion systems that together reduce CO<sub>2</sub> emissions by 40 per cent, compared with equivalent diesel-powered vessels. Lastly, BAE Systems announced that the UK's Type 26 Destroyer programme will feature four MTU diesel gensets from Power Systems, together with our Trent-derived MT30 gas turbines.

**Concentration**

Concentration means deciding where to invest for future growth and where not. We have two technology platforms: gas turbines and reciprocating engines. Within gas turbines, we have a strong Civil aerospace business, with over £60 billion in orders. We will continue to invest here, including in the next generation of narrow-body aircraft engines. We will also look for opportunities to expand in reciprocating engines.

In 2013, we acquired Hyper-Therm HTC, a specialist ceramics company, to increase our capabilities in ceramic matrix materials that will, in the future, play a critical part in improving the performance of gas turbine engines. We also acquired a Norwegian company, SmartMotor AS, a leader in the permanent magnet technology employed in our Marine business. We integrated PKMJ Technical Services, a US-based nuclear engineering services business with expertise in extending the life of nuclear plants.

Areas where we have decided not to grow include the sale of our 50 per cent holding in the RTM322 helicopter engine programme to Turbomeca, a Safran company.



**John Rishton**  
Chief Executive

### Cost

The highly regulated nature of the aerospace industry means that it will take both time and tenacity to drive cost out of the business, and we are still not where we need to be. However there are a number of areas where progress is being made. We reduced indirect headcount by 11 per cent, with further savings identified for 2014. Unit cost fell in Marine, Energy and Power Systems, although this was more than offset by an increase in Civil, where capacity growth has preceded volume growth and the cost per unit has predictably risen. We are building newer, more efficient facilities and capacity that will support a doubling of production of Trent engines. We are moving production away from high cost countries, and we are consolidating our supply chain. These actions will deliver benefits over time.

We have prioritised investment that improves operational performance, adds to our technical capability and reduces cost. This includes a shop floor IT modernisation programme that will increase operational efficiency and an Integrated Production Systems programme that will improve delivery to customers while reducing cost.

### Cash

The Group delivered a cash inflow of £359 million (£312 million excluding Tognum), after payments to shareholders, prior to acquisitions, disposals and foreign exchange. Inventory has been an area of significant focus. While substantially improving our on-time delivery to customers and preparing for the ramp-up in volumes, we have improved inventory turns from 3 times to 3.4 times, excluding Tognum. This is one of the largest one-year improvements in our stock turns.

We continue to invest significantly to deliver our order book. In 2013, capital expenditure was £687 million (£590 million excluding Tognum and £491 million in 2012). This included two new aero-engine test facilities: one at the NASA Stennis Space Center in Mississippi, US, and the other at Dahlewitz, Germany. We have extended our global Marine services network with a new facility in Guangzhou, China. An advanced aerofoil machining facility at Crosspointe in Virginia, US, will begin production in 2014. In the UK, production has started at our new state-of-the-art fan disc factory in Washington, Tyne and Wear and we are also close to completing a new turbine blade factory in Rotherham.

In January 2013, we appointed Lord Gold to lead a review of our process and procedures regarding compliance and business ethics. This followed our report to the Serious Fraud Office (SFO) of concerns about bribery and corruption involving intermediaries in overseas markets. In December, the SFO confirmed that it had begun a formal investigation into these matters. We have co-operated fully with the regulatory authorities and will continue to do so.

During the year, we published a new Global Code of Conduct. Under a programme implemented in 2013, all employees are asked to certify they have: received a copy of the Global Code; read and understood it; will comply with it; and have received a management briefing. I have made it explicit that we will not tolerate improper business conduct of any sort. We have updated and re-launched our confidential reporting line for employees, now known as the Ethics Line, available 24 hours a day, to make sure that we can hear about and address any matters of concern.

It is important that everyone at Rolls-Royce recognises that they are an ambassador for the Group. We have set out three common behaviours that will make sure we maintain high ethical standards, build trust with our customers and each other and help secure the long-term success of our business:

**win right** – securing business fair and square;

**focus with firm resolve** – decide what needs to be done, then focus relentlessly on delivery – refusing to be distracted; and

**communicate** – simply, consistently and often.

Every aspect of the Group's performance results from the endeavours of the 55,000 men and women who share a vision of delivering 'better power for a changing world'. It is their ingenuity and commitment alongside our continued investment in technology, that allows us to seize the opportunities that our changing world presents and to face the future with confidence.

**John Rishton**  
Chief Executive

12 February 2014