DEFENCE AEROSPACE

We are focused on managing costs to ensure we can effectively compete and win in today's challenging market.

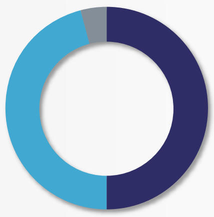
Tom Bell
President – Defence aerospace

OVERVIEW

Underlying revenue (£m)

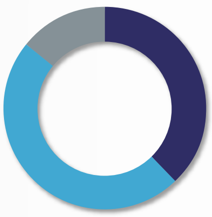
£2,591m
Underlying revenue 2013

Revenue mix 2013



- 50% OE revenue
- 46% Services revenue
- 4% Development

Revenue by sector 2013



- 38% Combat
- 48% Transport
- 14% UAV/trainer

Highlights

- TP400-powered A400M entered service
- MissionCare contract for Saudi Arabian EJ200 engines secured
- 1,500th AE 2100 engine delivered
- Upgraded AE 1107 engines for V-22 Osprey
- T56 enhancement kits gained first sales
- Delivered 40th Rolls-Royce LiftFan for F-35B Lightning II fighter programme
- RTM322 helicopter engine programme sold to Turbomeca

Key financial data

	2009	2010	2011	2012	**2013**
Order book £m	6,451 +17%	6,506 +1%	6,035 -7%	5,157 -15%	**4,071** **-21%**
Engine deliveries	662	710	814	864	**893**
Underlying revenue £m	2,010 +19%	2,123 +6%	2,235 +5%	2,417 +8%	**2,591** **+7%**
Underlying OE revenue £m	964	1,020	1,102	1,231	**1,385**
Underlying service revenue £m	1,046	1,103	1,133	1,186	**1,206**
Underlying profit before financing £m	253 +13%	309 +22%	376 +22%	395 +5%	**438** **+11%**

We are the second largest provider of defence aero-engine products and services globally, with around 16,000 engines in service with over 160 military customers in more than 100 countries.

What we do

Our engines power aircraft in every major market sector including transport, combat, patrol, trainers, helicopters, and unmanned aerial vehicles.

2013 financial review

The Defence order book declined 21 per cent (15 per cent decrease in 2012) reflecting continued budgetary pressures on our major customers. The net order intake of £1.6 billion was five per cent higher than the previous year. Revenue increased seven per cent, reflecting a 13 per cent increase in OE and a two per cent increase in services. Strong OE growth was driven by higher export sales, particularly of our EJ200 and Adour engine programmes. Profit increased 11 per cent due to higher volumes and lower R&D spending.

In 2014, we expect a decline in revenue and profit of between 15-20 per cent before growth resumes in 2015. This one year decline is the consequence of well publicised cuts in defence spending among major customers, and the completion of the delivery phase of a number of major export programmes. After two record years, this re-basing, supported by cost reduction programmes, will position the business well for future growth.

How we are performing

2013 was a challenging year as traditional markets continued to experience unprecedented budgetary pressures. While this environment creates risks for existing business, it also presents opportunities for us to develop innovative solutions to meet the evolving needs of our customers. Nowhere is this more evident than in the area of services where we have the opportunity to help customers manage their budgets and costs more efficiently.

We also continue to pursue new equipment sales opportunities in global markets such as Asia and the Middle East where budgets are less constrained.

MissionCare contracts worth £492 million were secured in 2013. These included the first MissionCare contract for the support of EJ200 engines in Saudi Arabia.

In order to get closer to our customers, we are expanding our presence at operational bases. During 2013, we opened a new support facility at RAF Marham in the UK and announced another at Tinker Air Force Base in the US.

In-service fleets continue to benefit from technology enhancements, with the upgraded AE 1107 now providing 17 per cent more power for the V-22 Osprey aircraft. The latest T56 enhancement kits achieved Federal Aviation Authority (FAA) certification and recorded their first sales in the US, where fuel savings in the US Air Force C-130 fleet could amount to billions of dollars.

Our leading position in transport was underpinned by the entry into service of the A400M powered by TP400 engines, broadening our portfolio in a market where the Rolls-Royce powered C-130 is the leading player. This year we delivered our 1,500th AE 2100 engine for the C-130J.

The Rolls-Royce LiftSystem® continued to perform well as the F-35B Lightning II aircraft expanded its flight test programme and deliveries to the US Marine Corps accelerated. We delivered the 40th Rolls-Royce LiftFan and the 50th 3 Bearing Swivel Module (3BSM).

In order to concentrate our resources on markets where we can add greatest value, we sold our share in the RTM322 helicopter engine programme to Turbomeca, a Safran company, in September 2013. To further improve efficiency, we have reconfigured our organisation to bring us closer to our major customers.

We expect our services business to continue to grow as we continue to provide customers with greater capability.

Future priorities and opportunities

We are focused on managing costs to ensure we maximise our ability to compete and win in an increasingly uncertain market.

Our inclusion in the Hawk Advanced Jet Training System team to pursue the US Air Force T-X training contract provides just one of several paths to growth. Customers also continue to invest in their transport aircraft fleets, where we have a strong position. Defence applications for the Trent 700 should increase as the Airbus A330 tanker aircraft is selected by more military customers. The UK's fleet of tankers continues to expand with Rolls-Royce benefiting both as the engine supplier and as an AirTanker shareholder.

Market outlook: We estimate a business opportunity over the next 20 years of US$155 billion in original equipment and US$260 billion in services. *Source: Forecast International 2014.*