

PRINCIPAL RISKS AND UNCERTAINTIES

The Group places great importance on the identification and effective management of risks. Our approach to enterprise risk management helps us to deliver our objectives and maximise the returns of the Group.

The following table describes the risks that the risk committee, with endorsement from the Board, considers to have the most material potential impact on the Group. They are specific to the nature of our business notwithstanding that there are other risks that may occur and may impact the achievement of the Group's objectives.

The risk committee discussions have been focused on these risks and the actions being taken to manage them.

| Risk or uncertainty and potential impact | How we manage it |
|---|---|
| <p>PRODUCT FAILURE Product not meeting safety expectations, or causing significant impact to customers or the environment through failure in quality control.</p> | <ul style="list-style-type: none"> • Operating a safety first culture • Our engineering design and validation process is applied from initial design, through production and into service • The safety committee reviews the scope and effectiveness of the Group's product safety policies to ensure that they operate to the highest industry standards (see safety committee report on page 52) • A safety management system (SMS) has been established by a dedicated team. This is governed by the Product Safety Review Board and is subject to continual improvement based on experience and industry best practice. Product safety training is an integral part of our SMS • Crisis management team led by the Director – Engineering and Technology or General Counsel as appropriate |
| <p>BUSINESS CONTINUITY Breakdown of external supply chain or internal facilities that could be caused by destruction of key facilities, natural disaster, regional conflict, financial insolvency of a critical supplier or scarcity of materials which would reduce the ability to meet customer commitments, win future business or achieve operational results.</p> | <ul style="list-style-type: none"> • Continued investment in adequate capacity and modern equipment and facilities (see operations section on page 25) • Identifying and assessing points of weakness in our internal and external supply chain, our IT systems and our people skills • Selection and development of stronger suppliers (see operations section on page 25) • Developing dual sources or dual capability • Developing and testing site-level incident management and business recovery plans • Crisis management team led by the Director – Engineering and Technology or General Counsel as appropriate • Customer excellence centres provide improved response to supply chain disruption |
| <p>COMPETITOR ACTION The presence of large, financially strong competitors in the majority of our markets means that the Group is susceptible to significant price pressure for original equipment or services even where our markets are mature or the competitors are few. Our main competitors have access to significant government funding programmes as well as the ability to invest heavily in technology and industrial capability.</p> | <ul style="list-style-type: none"> • Accessing and developing key technologies and service offerings which differentiate us competitively (see engineering and technology section on page 24) • Focusing on being responsive to our customers and improving the quality, delivery and reliability of our products and services • Partnering with others effectively • Driving down cost and improving margins (see Chief Executive's review on pages 6 and 7 and Chief Financial Officer's review on page 10) • Protecting credit lines (see additional financial information on pages 137 and 138) • Investing in innovation, manufacturing and production (see operations section on page 25) • Understanding our competitors |

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| <p>INTERNATIONAL TRADE FRICTION Geopolitical factors that lead to significant tensions between major trading parties or blocs which could impact the Group's operations. For example: explicit trade protectionism; differing tax or regulatory regimes; potential for conflict; or broader political issues.</p> | <ul style="list-style-type: none"> • Where possible, locating our domestic facilities in politically stable countries and/or ensuring that we maintain dual capability • Diversifying global operations to avoid excessive concentration of risks in particular areas • Network of regional directors proactively monitors local situations • Maintaining a balanced business portfolio in markets with high technological barriers to entry and a diverse customer base • Understanding our supply chain risks • Proactively influencing regulation where it affects us (see sustainability on page 28) |
| <p>MAJOR PRODUCT PROGRAMME DELIVERY Failure to deliver a major product programme on time, to specification or technical performance falling significantly short of customer expectations would have potentially significant adverse financial and reputational consequences, including the risk of impairment of the carrying value of the Group's intangible assets and the impact of potential litigation.</p> | <ul style="list-style-type: none"> • Major programmes are subject to Board approval (see additional financial information on page 137) • Major programmes are reviewed at levels and frequencies appropriate to their performance against key financial and non-financial deliverables and potential risks throughout a programme's life cycle (see additional financial information on page 137) • Technical audits are conducted at pre-defined points performed by a team that is independent from the programme • Programmes are required to address the actions arising from reviews and audits and progress is monitored and controlled through to closure • Knowledge management principles are applied to provide benefit to current and future programmes |
| <p>COMPLIANCE Non-compliance by the Group with legislation or other regulatory requirements in the regulated environment in which it operates (for example: export controls; offset; use of controlled chemicals and substances; and anti-bribery and corruption legislation) compromising our ability to conduct business in certain jurisdictions and exposing the Group to potential: reputational damage; financial penalties; debarment from government contracts for a period of time; and/or suspension of export privileges or export credit financing, any of which could have a material adverse effect.</p> | <ul style="list-style-type: none"> • An uncompromising approach to compliance is now, and should always be, the only way to do business • The Group has an extensive compliance programme. This programme and the Global Code of Conduct are promulgated throughout the Group and are updated and reinforced from time-to-time, to ensure their continued relevance, and to ensure that they are complied with both in spirit and to the letter. The Global Code of Conduct and the Group's compliance programme are supported by appropriate training (see ethics committee report on pages 49 and 50) • A legal and compliance team has been put in place to manage the current specific issue (see ethics committee on pages 49 and 50) through to a conclusion and beyond • Lord Gold has reviewed the Group's current compliance procedures and an improvement plan is being implemented |

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| <p>MARKET SHOCK</p> <p>The Group is exposed to a number of market risks, some of which are of a macro-economic nature, for example, foreign currency exchange rates, and some which are more specific to the Group, for example liquidity and credit risks, reduction in air travel or disruption to other customer operations. Significant extraneous market events could also materially damage the Group's competitiveness and/or credit worthiness. This would affect operational results or the outcomes of financial transactions.</p> | <ul style="list-style-type: none"> • Maintaining a strong balance sheet, through healthy cash balances and a continuing low level of debt • Providing financial flexibility by maintaining high levels of liquidity and an investment grade 'A' credit rating (see additional financial information on page 138) • The portfolio effect from our business interests, both in terms of original equipment to aftermarket split and our different segments provide a natural shock absorber since the portfolios are not correlated • Deciding where and what currencies to source in, where and how much credit risk is extended or taken and hedging residual risk through the financial derivatives markets (foreign exchange, interest rates and commodity price risk – see additional financial information on page 137) |
| <p>IT VULNERABILITY</p> <p>Breach of IT security causing controlled data to be lost, made inaccessible, corrupted or accessed by unauthorised users.</p> | <ul style="list-style-type: none"> • Establishing 'defence in depth' through deployment of multiple layers of software and processes including web gateways, filtering, firewalls, intrusion, advanced persistent threat detectors and integrated reporting • Security and network operations centres have been established • Active sharing of information through industry, government and security forums (see risk committee report on page 51) |

The strategic report was approved by the Board on 12 February 2014.

By order of the Board
Nigel T Goldsworthy
 Company Secretary