

BUSINESS REVIEW – AEROSPACE



As a leading manufacturer of aero engines for the civil large aircraft, corporate jet and defence markets, the growing global requirement for cleaner, more efficient, better power, continues to create opportunities for our Aerospace Division.

TONY WOOD
President – Aerospace

Within the civil market we continue to see increasing numbers of people travelling by air. The International Air Transport Association (IATA) reported that available seat kilometres (a measure of civil air traffic) grew by nearly 6% in 2014 and the long-term growth outlook remains at around 5% per annum for the foreseeable future.

In the defence market, despite ongoing pressure on budgets, aviation remains a vital component of defence forces around the world and we secured several important new orders during the year.

In 2014, our engines powered the first deliveries of two new airliners; one for each of our major airframe customers, Airbus and Boeing. We launched the seventh member of our Trent engine family, achieved major milestones for existing Trent engine

OVERVIEW

CIVIL AEROSPACE

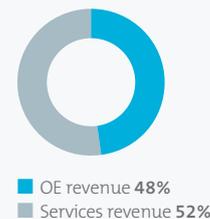
KEY HIGHLIGHTS

- First Trent XWB delivered and Trent XWB-97 version on test
- Trent 7000 chosen to power new Airbus A330neo
- Latest Trent 1000 entered service on Boeing 787-9 and Trent 1000-TEN on test
- BR725 selected for Gulfstream G650ER and AE 3007C2 entered service on Cessna Citation X+

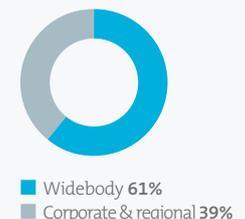
 **23,900** Employees



CIVIL UNDERLYING REVENUE MIX



CIVIL UNDERLYING REVENUE BY SECTOR



DEFENCE AEROSPACE

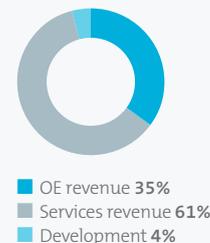
KEY HIGHLIGHTS

- Lockheed Martin agreement signed for 600 AE 2100 engines
- A330 MRTT now fully operational in UK and selected by France and Singapore
- A400M transporter deliveries continue
- Business resizing to reduce costs and improve competitiveness is progressing

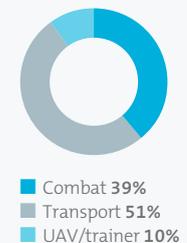
 **7,000** Employees



DEFENCE UNDERLYING REVENUE MIX



DEFENCE UNDERLYING REVENUE BY SECTOR



programmes and made important announcements about civil engine technologies for the future.

Business jet owners and operators continue to seek greater speed, range and the highest levels of service. 2014 saw Rolls-Royce selected by Gulfstream for a new ultra-long range business jet and we powered a new version of the fastest civilian aircraft in the world into service for Cessna. We continue to invest for the next generation of large business jet engines.

Our defence customers are focused on extending the lives and improving the efficiency of their in-service aircraft. Rolls-Royce is helping air forces to do more with less by delivering new or improved engines and services. Looking to the future, we see opportunities to power new

programmes, such as the Korean K-FX combat aircraft and the Anglo-French Future Combat Air System.

We continue to focus on reducing costs to support our strategy of customer, innovation and profitable growth. The investments we have made in new technology and capacity will enable us to increase output and improve efficiency. Delay in a number of customer programmes did result in some capacity being ready earlier than needed, however these programmes are now coming on stream. In June, we opened a new facility in Washington, UK, specialising in advanced manufacturing techniques and robotics which will halve the time to manufacture fan and turbine discs. We are accelerating our plans to consolidate older facilities and transition to newer ones. Towards the end

of the year we announced a programme to further improve operational efficiency and reduce costs across the Aerospace Division over the next 18 months.

Although revenue remained broadly flat through 2014 due to current market conditions and lower defence spending, our cost reduction actions have yielded benefits during the year and laid the foundations required to support mid-term margin improvement for the Division.

CIVIL AEROSPACE

PERFORMANCE REVIEW

WHO WE ARE

The Civil aerospace business is a major manufacturer of aero engines for the commercial large aircraft and corporate jet markets. We power 35 types of commercial aircraft and have more than 13,000 engines in service around the world.

FINANCIAL REVIEW

The Civil order book increased 5%. Our net order intake was £11.7 billion. Aftermarket services now constitute 31% of the Civil order book.

Underlying revenue grew 3% (up 4% at constant foreign exchange), on 8% growth in OE that was partially offset by a 1% decline in services. OE growth was primarily driven by a ramp up in Trent 1000 engine production. This was partially offset by a 9% reduction in business jet engine deliveries. The decline in services reflects the expected 24% decline in the RB211 programme. Aftermarket revenue from our Trent fleet increased 6%.

Underlying profit improved by 12%, driven by higher volumes and improved aftermarket margins. Profit benefited from approximately £150 million in improved retrospective TotalCare contract profitability, reflecting lower cost, changing operating patterns and reduced contract risk. Profit also benefited from lower commercial and administrative (C&A) and bonus costs. This was partially offset by £63 million in higher restructuring costs and £151 million in higher R&D costs.

AEROSPACE LOCATIONS



Key

- Aerospace locations
- Corporate locations
- Aerospace and Corporate
- Multiple Aerospace locations:
 - England 18
 - Germany 3
 - Scotland 2
 - Singapore 2

BUSINESS REVIEW – AEROSPACE

CONTINUED

CIVIL AEROSPACE – KEY FINANCIAL DATA

	2010	2011	2012	2013	2014
Order book £m*	48,490	51,942	49,608	60,296	63,229
	+3%	+7%	-4%	+22%	+5%
Engine deliveries*	846	962	668	753	739
Underlying revenue £m	4,919	5,572	6,437	6,655	6,837
	+10%	+13%	+16%	+3%	+3%
Underlying OE revenue £m	1,892	2,232	2,934	3,035	3,265
Underlying service revenue £m	3,027	3,340	3,503	3,620	3,572
Underlying profit before financing £m	392	499	743	844	942
	-20%	+27%	+49%	+14%	+12%

* all years before 2012 include IAE order book and engine deliveries include IAE V2500.

The investments we are making in R&D and restructuring will support future profitable growth.

In 2015, we expect revenue between £7.0 and £7.3 billion, with continued growth in Trent XWB and Trent 1000 OE sales and good growth in aftermarket revenue. We expect this to be partially offset by fewer Trent 900 and Trent 700 sales. We expect profit to be between £800 and £900 million, as the retrospective TotalCare accounting adjustments do not repeat at similar levels. This guidance is based on 2014 average exchange rates.

OUR YEAR

We have over 50% of the engines on order for the widebody airliner market. A number of developments during 2014 helped to consolidate our position as the leading supplier in this sector.

The first Airbus A350 XWB aircraft, powered by our Trent XWB engines, was delivered to launch customer Qatar Airways at the end of the year, marking the start of our largest production programme. Earlier, in July we ran the more powerful 97,000lb thrust version of the Trent XWB for the first time. This version will power the larger Airbus A350-1000 due to enter into service in 2017. In June, Emirates announced the cancellation of its order for 70 A350 XWB aircraft. This was partially offset by new orders and at the end of the year the Trent XWB order book stood at more than 1,500 engines.

The latest version of the Trent 1000 entered into service in July, powering Boeing 787-9 Dreamliners for Air New Zealand and ANA.

Work progressed on the Trent 1000-TEN which will be available from 2016 and will be capable of powering all variants of the Dreamliner.

Airbus received the 1,500th Trent 700 in August, 20 years after the first engine was delivered. Rolls-Royce powers 58% of the Airbus A330s currently in service or on order. A new more fuel-efficient version, the A330neo, will be exclusively powered by our new Trent 7000 engine. By the end of the year we had received commitments for Trent 7000 engines to power 120 A330neo aircraft. This included an order from the major US airline Delta for 25 Trent 7000-powered A330neos together with 25 Trent XWB-powered A350-900s.

1,500 Trent XWB engines have been ordered



Throughout 2014 we have been engaged in Trent 900 sales campaigns to power new orders for Airbus A380s. Decisions on engine choice have yet to be made in these ongoing campaigns. We continue to work closely with Airbus to support the future of this important programme.

We took significant steps in the development of our future engine programmes. In February, we announced two innovative new engine designs; the Advance turbofan and UltraFan which will feature a power gearbox. These will be available from 2020 and 2025 respectively. A new test bed for power gearboxes is to be built at our site in

Dahlewitz, Germany, representing an investment of €65 million. An additional test bed for future extra-large engines of up to 150,000lbs thrust was also opened in Dahlewitz in November. We maintained our leading position in the business jet market. Our BR725 was selected to power Gulfstream's new ultra-long-range business jet, the G650ER. The year also saw the entry into service of the world's fastest civilian aircraft, the AE 3007C2-powered Citation X+.

To support operators of Rolls-Royce powered business jets we continued to expand our global network of authorised service centres. The number of engines powering corporate aircraft covered by our CorporateCare® programme reached more than 1,600. The level of TotalCare coverage in the commercial transport installed engine base increased to 83% this year and 210 incremental corporate jets were signed up to our CorporateCare programme.

LOOKING AHEAD

In support of our future growth strategy, we will make investments that enable us to deliver our significant order book and develop the next generation of civil engines with new technologies, advanced manufacturing techniques and more efficient processes.

We will develop TotalCare in line with changing market requirements for services. We will leverage our world-class data management capability through our newly created Controls and Data Services business. We will remain focused on the 4Cs and will embed a modern, dynamic and ethical culture across all areas of the business.

DEFENCE AEROSPACE

PERFORMANCE REVIEW

WHO WE ARE

We are the leading engine maker for the military transport market and the second largest provider of defence aero-engine products and services globally. Defence has 16,000 engines in service with 160 customers in over 100 countries.

FINANCIAL REVIEW

The Defence order book grew 12% in 2014, the first increase since 2010. Total order intake increased 55% to £2.54 billion, from £1.64 billion in 2013.

Underlying revenue fell 20% (down 18% at constant foreign exchange), reflecting a 41% decline in OE partially offset by 4% growth in aftermarket services. OE reductions were due to lower volumes across several programmes, including major deliveries in 2013 of two export contracts that were nearing completion: EJ200 to Saudi Arabia and Adour to India. Services revenue grew modestly, as LiftSystem™ and TP400 maintenance started to ramp up.

A smaller decline in underlying profit of 16% (down 14% at constant foreign exchange) reflects significant cost reduction actions and the favourable mix shift towards aftermarket, which represented 61% of Defence revenue. Profit also benefited from lower C&A and bonus costs.

In 2015, we expect revenue of between £1.9 and £2.1 billion and profits of between £360 and £410 million, based on average 2014 exchange rates. Cost reduction activity will continue across our supply chain, operational footprint, headcount and service provision.

OUR YEAR

Customers in our principal markets of North America and Europe face continued pressure from constraints on government defence spending. As a consequence, pricing and innovation have become even more important as our customers look for ways to do more with less.

DEFENCE – KEY FINANCIAL DATA

	2010	2011	2012	2013	2014
Order book £m	6,506	6,035	5,157	4,071	4,564
	+1%	-7%	-15%	-21%	+12%
Engine deliveries	710	814	864	893	744
Underlying revenue £m	2,123	2,235	2,417	2,591	2,069
	+6%	+5%	+8%	+7%	-20%
Underlying OE revenue £m	1,020	1,102	1,231	1,385	816
Underlying service revenue £m	1,103	1,133	1,186	1,206	1,253
Underlying profit before financing £m	309	376	395	438	366
	+22%	+22%	+5%	+11%	-16%

In order to be closer to our customers whilst reducing cost, we have concentrated our UK maintenance, repair and overhaul activity into one site in Bristol. We also moved support for the Rolls-Royce LiftSystem® to Indianapolis to support the F-35B Lightning II aircraft programme as it progresses to Initial Operating Capability with the US Marine Corps in 2015. The F-35 programme continues to ramp up, with orders received for production and support of the LiftSystem in 2014 totalling US\$548 million.

We secured a major long-term agreement with Lockheed Martin worth up to US\$1 billion to supply up to 600 AE 2100 engines for the C-130J aircraft, in addition to over US\$200 million in support contracts for AE 2100 engines. Deliveries were made to Turkey, France, Germany and the UK of the TP400-powered Airbus A400M transport aircraft. The 100th TP400 production engine was delivered in November and in the same month, we announced an £18 million investment in facilities at Bristol to support this programme. 2014 saw good progress in the tanker aircraft market where we are a shareholder in AirTanker which operates the A330 Multi Role Tanker Transport (MRTT) on behalf of the Royal Air Force. In 2014, the A330 MRTT was also selected by the defence forces of France and the Republic of Singapore.

There was a softening of demand in the civil helicopter market and this impacted our engine manufacturing load. However, a long-term agreement was signed to install upgraded M250 engines in future Bell 407GX helicopters. The M250 turboprop variant was also selected by Jiangsu A-Star of China to power its Extra EA500 aircraft in a deal worth over US\$50 million.

Service delivery contracts worth US\$1,843 million were secured with defence customers globally, many of which will provide our popular MissionCare® level of engine support. We have further improved the time on wing for our V-22 Osprey customers, delivering a 30% reduction in support costs. The T56 engine enhancement kit, aimed at legacy C-130 Hercules and P-3 customers, was certified by the US Air Force and has exceeded fuel efficiency targets. The US Navy declared Initial Operational Capability for the new T56-powered E-2D Advanced Hawkeye Airborne Early Warning Aircraft.

In the unmanned aircraft market our stealthy, integrated, propulsion system successfully demonstrated its capability in the second round of flight trials of the UK's Taranis demonstrator. Our AE 3007 engine also powered the US Navy's Triton unmanned aerial system on its first trans-America flight. We were named a 'superior supplier' by both the US Navy and US Defense Logistics Agency in 2014 and recognised by Northrop Grumman for our support of its Global Hawk unmanned aerial vehicle programme.

Together with Snecma, we signed an Anglo-French agreement for further funded studies as part of the Future Combat Air System.

LOOKING AHEAD

We are focused on maintaining our leading position in the transport and patrol markets and will continue to invest in the industrial and technological capability to support future growth in this area. We are actively engaged in offering propulsion solutions to customers in India, Turkey and Korea as they pursue ambitions for indigenous combat aircraft programmes.

We anticipate continued pressure on defence budgets and remain committed to improving both the service lives of products and our cost performance. Cost reduction activity will continue across our supply chain, operational footprint, and service provision, ensuring our business is well placed for the future in the defence sector.

BUSINESS REVIEW – LAND & SEA



As the world’s population expands and becomes more affluent, as trade increases and we travel more, the requirement for the technology produced by our Land & Sea Division will grow.

LAWRIE HAYNES
President – Land & Sea

According to the World Bank, approximately 200 million people per year will join the middle classes in the decades ahead, requiring the type of power that we deliver to support their rising living standards and to transport the goods they will buy.

Our Land & Sea Division provides power for a wide range of vehicles and vessels. On land we supply engines to power vehicles as varied as locomotives, battle tanks and mining trucks, applying world-leading technology to set new standards of fuel efficiency. We also deliver distributed power generation and support the world’s civil nuclear power industry. At sea we supply

OVERVIEW

POWER SYSTEMS

KEY HIGHLIGHTS

- Nearly 1,000 MTU rail PowerPacks contracted by PESA
- Launch of new efficient Bergen B33:45 medium-speed engine
- New MTU Onsite Energy 4000 natural gas engine
- MTU and Weir agree to develop power systems for hydraulic fracking industry

10,700 Employees

POWER SYSTEMS

Underlying revenue (£m)*



POWER SYSTEMS UNDERLYING REVENUE MIX



OE revenue 70%
Services revenue 30%

POWER SYSTEMS UNDERLYING REVENUE BY SECTOR



Marine 39%
Industrial 20%
Energy 28%
Defence & other 13%

MARINE

KEY HIGHLIGHTS

- Largest ever UT vessel designed
- 40 years of leadership in offshore vessels celebrated
- Naming of HMS Queen Elizabeth and launch of USS Zumwalt
- Service network further expanded

6,400 Employees

MARINE

Underlying revenue (£m)*

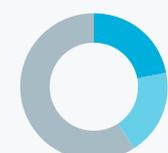


MARINE UNDERLYING REVENUE MIX



OE revenue 63%
Services revenue 37%

MARINE UNDERLYING REVENUE BY SECTOR



Naval 22%
Merchant 19%
Offshore 59%

NUCLEAR

KEY HIGHLIGHTS

- New propulsion plant design submitted for Vanguard class replacement submarine
- US regulatory approval granted for Spline™ I&C technology
- Business developed across US, Europe (including UK programme) and Asia

3,900 Employees

NUCLEAR

Underlying revenue (£m)*



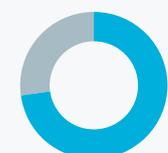
* Following the creation of the Land & Sea Division in 2014, information on a comparable basis is not available prior to 2013.

NUCLEAR UNDERLYING REVENUE MIX



OE revenue 37%
Services revenue 63%

NUCLEAR UNDERLYING REVENUE BY SECTOR



Submarines 73%
Civil Nuclear 27%

engines, propulsion and advanced engineering products for craft ranging from submarines to complex anchor handlers and seismic vessels used in the offshore oil & gas industry. This broad portfolio of products and services has direct relevance to the long-term demand for better power in our fast-changing world.

Whereas the power supplied from our Aerospace Division is based on gas turbine technology, our Land & Sea Division is to a large degree focused on reciprocating engines. Our high-speed reciprocating engines go to market under the MTU brand and medium-speed engines are from Bergen.

Although the long-term requirement for our technology is certain, a number of the markets that we address are volatile. During 2014, sharp falls in oil and other commodity prices caused a number of our customers to delay or cancel orders. In particular this has affected parts of our Power Systems and Marine businesses. Power Systems was also affected by the trade sanctions imposed by the European Union on Russia.

On land, business has grown across our defence, power generation and services markets and we have had success in launching innovative products in our MTU Onsite Energy range to provide secure, clean

power for industrial applications. We continue to invest in skills and capability in our Civil Nuclear business ahead of significant growth in the world's nuclear power capacity. Although this business is currently relatively small for Rolls-Royce, we already provide components, systems or services to more than half the world's 435 operating reactors, enabling safe and efficient power generation.

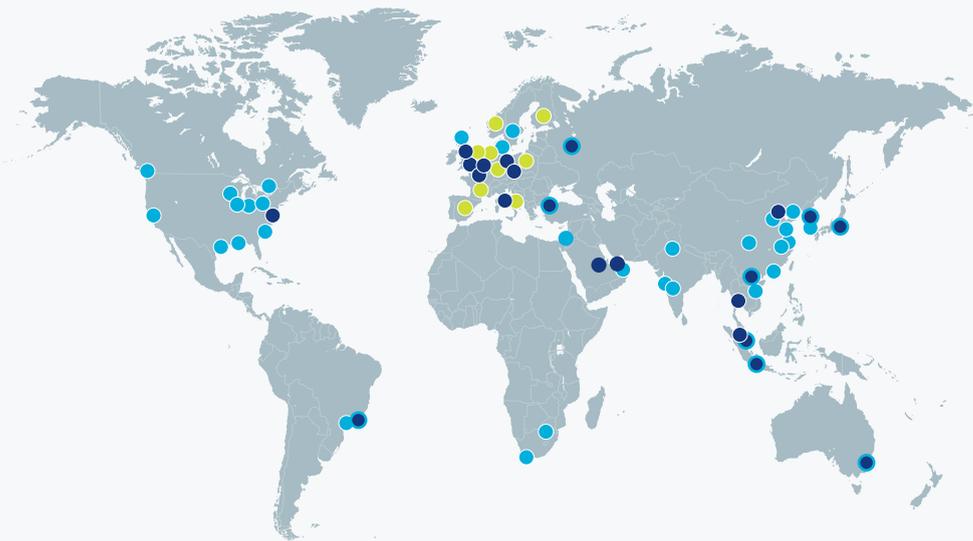
At sea, our Naval business has done well despite continued pressure on defence budgets. Nuclear reactors designed and manufactured by us have been powering the Royal Navy's nuclear submarine fleet for the last 55 years and our engineers are currently designing the next generation for the fleet of the future.

The Division is firmly focused on cost reduction and the management of cash in all areas. We have rationalised a number of our Marine facilities and this work will continue in the year ahead. We will also drive improvement in cost through better supply chain management and continuing to move more of our production to lower-cost countries. We will see further benefits from this during the coming year.

During 2014, we acquired the remaining interest in Rolls-Royce Power Systems from Daimler. Power Systems extends our portfolio and adds deep technical knowledge of high-speed engines and fuel injection systems. It also extends the scale and scope of our market presence.

We have strong long-term relationships with customers, deep product knowledge, powerful and clean engines, efficient propulsion system designs and an established global network. These linked to a truly experienced workforce provide remarkably strong roots, from which the Land & Sea Division can grow.

LAND & SEA LOCATIONS



Key

- Land & Sea locations
- Corporate locations
- Land & Sea and Corporate

Multiple Land & Sea locations:

- | | |
|------------|------------------|
| Finland 2 | Netherlands 2 |
| France 2 | Norway 8 |
| Germany 10 | Poland 2 |
| Italy 2 | Spain 2 |
| | United Kingdom 4 |

1 in 5 of the world's shipping vessels has Rolls-Royce equipment installed



BUSINESS REVIEW – LAND & SEA

CONTINUED

POWER SYSTEMS – KEY FINANCIAL DATA

	2013	2014	Change
Order book £m	1,927	1,971	2%
Underlying revenue £m	2,831	2,720	-4%
Underlying OE revenue £m	2,004	1,893	-6%
Underlying services revenue £m	827	827	–
Underlying profit before financing £m	294	253	-14%

Following the creation of the Land & Sea Division in 2014, information on a comparable basis is not available prior to 2013.

POWER SYSTEMS

BUSINESS PERFORMANCE REVIEW

WHO WE ARE

The business consists of the MTU, MTU Onsite Energy, Bergen and L'Orange product ranges. MTU high-speed engines and propulsion systems power ships, railway locomotives, defence and heavy off-highway vehicles. They are also used for applications in the oil & gas industries. Diesel and gas genset systems from MTU Onsite Energy deliver heat and power. Bergen medium-speed engines are used in both marine and land-based power generation applications. L'Orange is a world-leading specialist company that designs and manufactures complex fuel injection systems for large engines.

FINANCIAL REVIEW

The Power Systems order book grew 2%. Order intake was £2.6 billion.

Underlying revenue declined 4% mainly due to adverse foreign exchange effects. Growth in defence and power generation was offset by substantially lower sales to European construction, industrial and agricultural customers. Marine revenue also declined, driven by weaker yacht markets. As in previous years, revenue was biased towards the second half.

Underlying profit declined 14% due to adverse foreign currency effects and losses in the Bergen business. Profit benefited from lower C&A and bonus costs.

In 2015, we expect revenue between £2.5 and £2.75 billion and profit between £200 and £250 million. We expect growth in the industrial, power generation and

commercial marine end markets, offset by lower revenue from defence customers, particularly naval marine. We expect profit headwinds from a deteriorating mix. We are taking actions to improve the operating performance and cost controls at Bergen. Our guidance is based on 2014 average exchange rates.

OUR YEAR

Slower growth in Eurozone countries and emerging economies presented challenges to our business in 2014. However, the breadth of our portfolio presented opportunities for growth in some parts of the business.

Our Naval marine business benefited from stronger defence budgets in Asia and an increased demand for security at sea in the region; this resulted in orders to power several types of military vessels.

The market for the commercial marine application of both our medium and high-speed diesel engines recovered in 2014. The demand for mega-yachts weakened in 2014 due to fewer vessels being built, particularly in Europe.

2014 saw the launch of a new family of medium-speed engines for the marine market, with future variants for land-based power generation. The Bergen B33:45 uses diesel or gas fuel and features a new modular design that can be developed to suit a wide range of ship types. It uses less fuel, has lower emissions and produces 20% more power per cylinder than the previous Bergen range. Together with our Marine colleagues, we secured orders for it to power two ships, with the first entering operation in 2015, there is also strong interest from the merchant vessel market.

Two projects further highlighted the synergies between our Marine and Power Systems businesses: as part of a Rolls-Royce UT ship design, we supplied MTU diesel-electric propulsion systems and onboard power generators for two platform supply vessels for Chinese shipbuilder COSCO; and, in Brazil, MTU engines were specified for Rolls-Royce UT 535E oil-spill response vessels.

Sales in the European construction, industrial and agriculture sectors were substantially lower in 2014 compared with the high volumes ordered in 2013. Sharp falls in commodity prices led customers in the mining and oil & gas industries to delay or cancel orders for OE.

The Energy business for high-speed engines showed stronger growth in the higher power ranges and in the market for packaged MTU Onsite Energy power systems, for example in data centres and other industrial applications. We introduced an upgraded Series 4000 L64 natural gas engine with improved efficiency.

In the medium-speed market served by the Bergen range, sales decreased. Nevertheless we see an ongoing trend towards gas fuel. One example is a 100MW power plant in Mozambique where Bergen will deliver gas-driven B35:40 generating sets.

2014 saw an improvement in our land defence business. This was helped by a production increase for the German infantry fighting vehicle, the MTU-powered Puma.

Growth in the market for injection systems made by L'Orange continued in 2014, driven by increased demand for injection systems used by dual-fuel engines.

LOOKING AHEAD

We will invest in future technologies such as gas engines for commercial marine applications and are configuring our different engine series to meet tougher emissions standards in Europe and North America. At the same time, we will continue to improve efficiency and maintain our focus on costs and cash in all areas.

MARINE – KEY FINANCIAL DATA

	2013*	2014	Change
Order book £m	1,622	1,567	-3%
Underlying revenue £m	2,037	1,709	-16%
Underlying OE revenue £m	1,288	1,070	-17%
Underlying service revenue £m	749	639	-15%
Underlying profit before financing £m	233	138	-41%

*2013 figures restated due to transfer of Submarines to Nuclear business.

MARINE**BUSINESS PERFORMANCE REVIEW****WHO WE ARE**

Marine supplies complex propulsion and handling systems to the maritime market, across three distinct sectors: Offshore, Merchant and Naval. We have more than 4,000 customers, and our equipment is installed on around 25,000 vessels.

We have an extensive range of technology for propulsion and cargo handling that allows us to provide fully integrated systems for a variety of ship types.

Our capability in ship design means we can also combine our technology into complex vessels, where Rolls-Royce technology can account for around 40% of the total value of a typical offshore vessel and up to 10% of a high specification naval combatant.

As part of the Land & Sea Division, we now also offer MTU high-speed diesel engines as part of our propulsion systems, particularly for naval craft, ferries and offshore vessels.

FINANCIAL REVIEW

The Marine order book declined 3% in 2014, with a 1% reduction in order intake to £1.82 billion. At constant exchange rates, the order book increased 6%.

Underlying revenue decreased 16% (down 9% at constant foreign exchange), reflecting a 17% decline in OE and a 15% decline in services. OE reduction was driven by a combination of pricing and the expected decline in Offshore, driven by 2013's weak order intake. Service revenue declined in Offshore and Merchant, as ship owners deferred overhaul and maintenance.

Underlying profit fell 41%. Excluding foreign exchange translation and a one-off charge of £30 million to cover the resolution of a quality issue, profit declined 25% as a result of lower revenue and an adverse mix, reflecting pricing pressure and lower services revenue. The business also incurred restructuring costs as it continued to streamline its global footprint, reduce indirect headcount, and consolidate manufacturing activity. Profit benefited from lower C&A and bonus costs.

In 2015, we expect revenue between £1.45 and £1.65 billion and profit between £90 and £120 million. We anticipate that the market will remain challenging in the short term, reflecting external factors, particularly in Offshore. We will accelerate our cost reduction focus on our footprint, our supply chain, and our overhead costs in order to drive a more competitive business while also adapting to volume risks. Our guidance is based on 2014 average exchange rates.

OUR YEAR

2014 saw continuing challenges in the global maritime market, and there is a mixed picture across the market segments in which we operate. In the offshore support sector, demand was encouraging for sophisticated anchor handling vessels, including our own UT ship designs, which incorporate a wide range of Rolls-Royce technology. However, the rapid decline in the price of oil in the second half of the year dented confidence in the oil & gas industry, slowed demand and order intake as we approached year end, a trend we expect to continue into 2015.

In merchant shipping, many owners continued to delay investment in new ships and equipment, or are extending maintenance intervals.

Improving competitiveness remains a key priority for the Marine business and we took important steps in the year, including the announcements of facility restructuring or closures in South Korea, US, UK, Norway and Sweden to consolidate our manufacturing activities at fewer locations. We made strong progress in improving the external supply chain management and reducing our indirect headcount.

We are narrowing our product portfolio by focusing on the products that provide the most return to the business and add most value to our customers. We have exited non-core product lines such as well intervention equipment used for extracting oil from mature wells.

We continue to focus on efficiency and cost reduction, addressing areas including our supply chain, operational footprint and indirect headcount. We have reduced the number of suppliers to Marine by almost 40% in the last four years (half of that in 2014) and reduced indirect headcount by more than 500 people over the past two years.

**“A ship fit for a queen”**

was how First Sea Lord, Sir George Zambellas, described the new aircraft carrier for the Royal Navy at its naming ceremony held at Rosyth, UK, in July 2014.

HMS Queen Elizabeth has two Rolls-Royce MT30 gas turbines as main power units and they drive Rolls-Royce propellers that each weigh 33 tonnes and measure seven metres in diameter.



BUSINESS REVIEW – LAND & SEA

CONTINUED

We are streamlining our global footprint and have consolidated manufacturing of some key products either into fewer locations or into the external supply chain.

Our programmes to improve competitiveness will continue throughout 2015 and beyond, as we aim to manage the impact of a slowdown in the oil & gas sector. Further changes to the structure of the business are planned.

In the commercial market, our UT-Design celebrated its 40th successful year – it is the benchmark ship design for the offshore oil & gas industry, with almost 800 now in service or on order. We continue to lead ship innovation in this sector and this year we contracted to supply the largest ever vessel, the UT 777 for Island Offshore. This vessel is being built in Japan to a high specification and will be deployed on drilling operations in the Arctic.

AT SEA

For 55 years we have been designing and manufacturing the reactors that power the Royal Navy's fleet of nuclear submarines. In 2014, we submitted designs to our customer for the next generation of propulsion plant.

ON LAND

Our Nuclear business currently provides components, systems and services to over half the world's 435 operating civil nuclear reactors.



Naval continued to perform well. We are contracted to a number of key international programmes which to date have been largely unaffected by defence budget cuts. These include the UK Type 26 frigates and the US Navy's Littoral Combat Ship and ship-to-shore-connector hovercraft programmes. We also delivered the first MT30 to the Republic of Korea Navy for the first of its eight new frigates. Other highlights were the naming of the US Navy's sophisticated multi-mission destroyer USS Zumwalt and launch of the Royal Navy's aircraft carrier HMS Queen Elizabeth, both of which are powered by our MT30 gas turbine.

Our services business continues to adapt to support our customers' needs and this year we expanded our global workshop network with a new facility in Bergen, Norway.

LOOKING AHEAD

Ship efficiency, and ship intelligence, where the smart use of data in more complex ships will improve efficiency, will be key market drivers in the future, as will the demand for more environmentally-friendly power and propulsion systems to drive down the costs of operating ships.

We are strongly positioned to provide efficient solutions and have the necessary integration capability as ships become more complex in the future.

Our unified bridge, which entered service recently, is one example of the type of intelligent control system that we believe will become commonplace on new vessels over the next five years.

In the near term, we expect the market to remain challenging especially in the Offshore sector where we may see project deferrals and temporary lay-ups of vessels as they come off-charter.

We have begun to transform our business to improve our competitiveness in all areas and this programme will continue, again focusing on consolidation of manufacturing, our external supply chain and reducing our overhead costs. We will adapt to the market conditions in our biggest market sector,

Offshore, which accounts for around two-thirds of our business, responding to the uncertainties caused by the significant decrease in oil prices over recent months.

NUCLEAR

BUSINESS PERFORMANCE REVIEW

WHO WE ARE

Rolls-Royce manages all aspects of nuclear plant design, safety, manufacture, performance and through-life support for the UK Submarine Programme.

In the civil nuclear market, we provide nuclear reactor vendors and utility operators with integrated, long-term support services and solutions spanning the whole reactor life cycle, from concept design through to obsolescence management and plant-life extension.

We have been a key player in the nuclear industry for over 50 years, with expertise in component manufacturing, licensing, project and supply chain management, as well as world-class engineering.

FINANCIAL REVIEW

The order book for the continuing business declined 4%, reflecting lower order intake following the receipt of a multi-year submarines contract in 2013.

Underlying revenue increased 3%, driven by good growth in the Civil Nuclear services business, which has been the focus of recent acquisitions. Our services capabilities include remote inspection, plant-life extension and obsolescence management and these performed well in 2014.

Underlying profit increased £38 million, including £20 million from better operating performance, lower C&A and bonus costs and a non-repeat of 2013 one-time charges.

In 2015, we expect revenue between £670 and £730 million and profit between £40 and £50 million. This is based on 2014 average exchange rates.

NUCLEAR – KEY FINANCIAL DATA

	2013	2014	Change
Order book £m	2,617	2,499	-4%
Underlying revenue £m	667	684	3%
Underlying OE revenue £m	236	254	8%
Underlying services revenue £m	431	430	0%
Underlying profit before financing £m	10	48	380%

OUR YEAR

In 2014, we made progress on our long-term projects for the UK Submarine Programme. We submitted the design of the new propulsion plant for the Vanguard class replacement submarine for customer approval. Construction of the Core Manufacturing Facility in Derby, UK, has progressed well and we successfully introduced several innovations to the programme which brought cost savings for our customer (as part of the foundation contract designed to deliver savings of £200 million over ten years). Our support to the Royal Navy submarine flotilla is mission critical and contributes to maintaining the UK's continuous at sea deterrent.

During 2014, we performed well against our strategic intent of growing a global civil nuclear business as a technology-independent partner to the industry.

Civil nuclear power is increasingly important to the energy policy of a growing number of countries and regions such as China, India, Middle Eastern countries and Central and Eastern Europe. Increased focus on low-carbon electricity generation and security of energy supply, continued to drive demand for the upgrade, plant-life extension and replacement of nuclear capacity. More countries are considering adopting nuclear power for the first time, with governments seeking to develop a nuclear industrial and supply chain strategy designed to benefit local economies and capability (Turkey and Poland being examples).

For the UK civil nuclear new build programme, we continued to carry out early works to support developers and operators and we continue to recruit and develop capability in line with market growth projections for future years. The UK has one of the largest new build programmes in the western world with 11 reactors expected to

be built by 2030. European Union Commission approval in 2014 of the investment contract for the first new reactor to be built at Hinkley Point C in Somerset was a significant milestone.

During the year we were awarded a contract by Fortum, the owner and operator of the Loviisa nuclear power plant in Finland, to modernise the safety and non-safety instrumentation and control (I&C) systems. We also received US Nuclear Regulatory Commission licensing of Spinline, our safety-critical I&C technology, and this will help us access new markets.

We won a contract to supply and commission pressure transmitter technology for the Flamanville 3 reactor in France and continued to deliver against our customer commitments on the world's largest I&C upgrade of the 20-strong French fleet of reactors. We continued to be

successful in China, as an important supplier to the world's largest nuclear programme.

We introduced equipment obsolescence services and engineering support to new customers in the UK, France, Belgium, and South Africa. We also provided reactor inspection services to EDF Energy's UK operations.

LOOKING AHEAD

Our priorities will be focus on customers, winning new orders and high-quality delivery. A key feature will be continuously improving operational efficiency and performance as we expand our products and services, and the markets in which we operate. We will build on our manufacturing capability, engineering excellence and supply chain relationships to ensure that we contribute positively to new build programmes in the UK and other international markets.

We will focus on further extending the suite of products and services that we offer to operational reactor utilities to enable them to achieve safe, efficient and reliable lifetime operations while enabling us to further grow our nuclear services presence.

ENERGY BUSINESS**PERFORMANCE REVIEW**

On 1 December, we concluded the sale of our Energy gas turbines and compressor business to Siemens for a £785 million cash

consideration, and a further £200 million for a 25-year licensing agreement.

ENERGY – KEY FINANCIAL DATA

	2013	2014
Order book £m	1,226	–
Underlying revenue £m	871	724
Underlying OE revenue £m	329	302
Underlying service revenue £m	542	422
Underlying profit before financing £m	64	(3)