CHIEF FINANCIAL OFFICER'S REVIEW

As I reflect on my new role as Chief Financial Officer at Rolls-Royce, I would like to underline the progress we've made in 2014 and outline my priorities for 2015 and beyond.

This has clearly not been an easy year. However, the Group is fundamentally strong. We are in the enviable position of having a £74 billion order book of products and services that will deliver revenue for decades to come. We operate in markets with excellent long-term growth dynamics and high barriers to entry. We are valued by our customers. Our innovative team is creating products at the forefront of technology. We have set out firmly on the path to transform our industrial structure. Our objective now is to translate these product successes, growth markets and internal transformation into attractive returns and cash flow in the medium term.

In 2014, we made good progress on our business transformation, delivering both in-year improvements on our 4Cs such as customer delivery performance and creating the medium-term platform for improving margins and cash flow.

For example, in Aerospace we have reduced our aftermarket costs for our volume engine, the Trent 700, and also made good progress on our corporate jet and defence contracts. Over the past two years, the Group has reduced indirect headcount by 18%. We also sold our Energy gas turbines and compressor business to Siemens on 1 December 2014.

DAVID SMITH
Chief Financial Officer

SUMMARY

	2014	2013	Change
Order book £m	**73,674**	71,612	+3%
Underlying* revenue £m	**14,588**	15,505	-6%
Underlying* profit before tax £m	**1,617**	1,759	-8%
Return on sales	**11.5%**	11.8%	-0.3pp
Underlying* earnings per share	**65.3p**	65.6p	-0.3p
Full year payment to shareholders	**23.1p**	22.0p	+5%
Reported revenue†	**13,736**	14,642	-6%
Reported profit before tax†	**67**	1,700	-96%
Reported earnings per share†	**3.7p**	73.3p	-69.6p
Net cash	**666**	1,939	-66%
Free cash flow £m	**254**	781	-67%

* Underlying explanation is in note 2 on page 110.
† 2013 re-presented to reflect Energy as a discontinued operation.
All figures in the narrative of the Strategic Report are underlying unless otherwise stated.

We know we need to accelerate our efforts on cost and cash. In November, we announced a restructuring and cost reduction plan that will deliver £80 million in annualised savings and we will make further announcements at the appropriate time. We will also look to reduce our facilities' footprint, increase our activities in lower-cost countries, pursue further aftermarket cost reductions and continue to make progress on inventory, investment efficiency and cash management.

A personal priority is strengthening and streamlining our financial controls and business information. We have excellent accounting and technical skills, which are critical in our complex business. I will be working to deliver financial and non-financial KPIs that are more forward-looking and have a greater focus on the business fundamentals which are driving our cash and profit performance.

I will also be working to ensure that our communications with shareholders are clear, consistent and helpful. As part of this, we have started to provide a medium-term outlook and will continue to look at additional ways to communicate more clearly. Our share buyback programme is already underway and will return to shareholders £1 billion in proceeds from the sale of our Energy gas turbines and compressor business.

Amid these changes there are certain fundamentals that we will continue to support. These include:
- maintaining a strong balance sheet that gives confidence to our customers and enables our business to invest in future programmes;
- continuing to refine our capital allocation processes and invest in R&D to develop the next generation of products; and
- managing risk prudently including hedging our foreign currency exposures to reduce volatility.

There's no doubt that the recent changes in oil and commodity prices, currencies and geopolitical strains have increased uncertainty. We therefore need to plan cautiously while accelerating our business improvement activity. In 2015, we expect underlying revenue to be flat overall and underlying profit before tax to be down somewhat, reflecting the present phase of our business transformation. We also expect free cash flow to be lower given our restructuring spend.

Looking ahead, our product portfolio transition will see rising deliveries of new civil engines that will significantly increase our installed base. We will also continue to grow our Land & Sea businesses. This and our investment in new technology and industrial transformation will constrain near-term margins and cash generation. However, as we move towards the medium term and this growth and investment phase moderates, we expect both margins and cash conversion to improve in line with our medium-term guidance.

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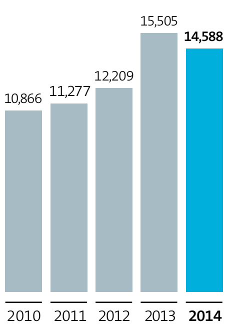
CONSOLIDATED FINANCIAL STATEMENTS

GROUP UNDERLYING REVENUE (£m)



RETURN ON SALES (%)

GROUP UNDERLYING PROFIT BEFORE TAXATION (£m)