CHAIRMAN'S REVIEW

After a decade of strong performance and growth, 2014 was a year of mixed fortunes for our Company.

"We are totally focused on returning the Company to its long-term trajectory of profitable growth and of superior shareholder returns."

IAN DAVIS
Chairman

There have been some real pluses and achievements alongside a number of challenges that held back the Company's financial performance.

During the course of the year, our order book reached its highest ever level. We also celebrated the delivery of the first Airbus A350 XWB to our launch customer Qatar Airways, powered by Rolls-Royce Trent XWB engines. Our record of customer service continues to improve, in Civil aerospace for example, we have maintained a record of 100% on-time delivery to Airbus for the past two years. In the same period our Marine business improved original equipment on-time delivery by 11%, while spares delivery improved across the Group. We still have more to do here and we are totally committed to enhancing customer satisfaction with our products and services. However, progress is encouraging and bodes well for the future. Happy customers are a precondition for a successful, long-term business.

Set against these achievements, 2014 was the first year in a decade in which revenue and underlying profits, on a like-for-like basis, did not grow. The Defence business was hit hard by constraints in government expenditure. In our Land & Sea Division, we faced tough market conditions, characterised by pricing pressure and deferred or cancelled orders by customers, particularly in the oil & gas, construction and mining industries.

In addition to some difficult trading conditions, we did not make as much progress as planned on improving our cost and cash performance. We fully recognise this is a priority if we are to provide attractive returns to shareholders as well as to fund the investment requirements that will underpin long-term growth. Ours is a business that requires significant up-front cash investment to generate long-term cash flow.

SHAREHOLDER DISTRIBUTIONS

Despite the short-term challenges, the fundamentals of the business remain strong. Rolls-Royce is a growth company, well positioned in long-term growth markets that offer the prospect of attractive returns.

We know that shareholders do not invest in growth alone, they invest for growth that's profitable. Our payment to shareholders of 23.1p reflects the confidence the Board has in the Company's profitability and cash generation prospects. At the same time we are committed to retaining a strong balance sheet. Civil aerospace in particular, although an attractive long-term business, can still be prone to external market shocks. Our customers, who depend on our service support for periods of up to 25 years, both expect and demand a financially resilient supplier.

STRATEGY

Rolls-Royce is intrinsically a long-term business and has to be directed and managed as such. In Civil aerospace for example, products take many years to develop, test and bring to market, and are quite rightly subject to strict regulatory process. Revenue from the sale of original equipment and subsequent aftermarket services generate cash flows for decades.

The Board reviewed the Group's product portfolio and corporate structure in light of these financial and investment characteristics. This review led to the decision to divest our Energy business and we completed its sale to Siemens in December. At the same time we strengthened our position in the core division of Land & Sea by completing the acquisition of the shares held by Daimler in Power Systems. We are focused on the twin pillars of Aerospace and Land & Sea because of their technology and service model synergies and their combined ability to create shared competitive advantage.

Our strong belief is that shareholders, as well as customers and employees, will be best served if the Company continues to focus on expanding its position in the highly attractive global markets for power and propulsion. We have long-established and

FINANCIAL HIGHLIGHTS

PAYMENT TO SHAREHOLDERS

23.1p (2013: 22.0p)

UNDERLYING EPS

65.3p (2013: 65.6p)

ORDER BOOK

£74bn (2013: £72bn)

RETURN ON SALES

11.5% (2013: 11.8%)

MORE FINANCIAL INFORMATION ON PAGES 26 TO 31

"The fundamentals of the business remain strong."

CHAIRMAN'S REVIEW
CONTINUED

PEOPLE AND TALENT
We are exploring ways of accelerating and broadening career paths for our highest potential talent across the world and for further increasing diversity as an important element of changing and strengthening our culture.

MORE INFORMATION ON PAGES 42 TO 43

"We are committed to being a leader in environmental and social responsibility and to being regarded as a good corporate citizen."

competitive technology platforms, as well as customer relationships, in gas turbines, reciprocating engines, nuclear services and controls. We see substantial long-term value creation and growth potential from these products, not least from aftermarket services where Rolls-Royce has been a pioneer. There will be cyclicality and volatility – external and internal risks are not insignificant – however, our long-term aspiration is to build on our position as a leading global provider of complex integrated power systems for use in the air, on land and at sea.

INNOVATION
Innovation has been, and is, critical to the long-term success of Rolls-Royce. We cannot depend on size and scale alone for competitive advantage. We invest more than £1 billion a year in research and development (R&D) to ensure that we conceive, design and deliver world-class technology that meets our customers' current and future requirements.

Innovation is not just about R&D numbers and not just about product technology. An increasing focus, for example, is on data analytics and on control systems to reflect our customers' increasing requirements for integrated solutions. Rolls-Royce has long been an innovator in services and we will be looking to build on this. I am especially proud of our collaborative approach to innovation, particularly our work with leading universities across the world on designated topics and technologies. We are quite clear that we must improve our capital efficiency, our cost competitiveness and our cash generation. However this will not be at the expense of our strategic commitment to innovation and development. These will be the drivers of long-term profitable growth and value creation.

TALENT AND CAPABILITIES
I would like to touch on some of the key enablers that will be required to deliver our strategy and our operational plans. In particular, we need to attract, develop and retain outstanding talent everywhere we operate, commercial and functional talent as much as engineering talent. In the past year we recruited 354 graduates from 112 universities in 11 countries and we recruited 357 apprentices across the world. I am pleased that 26% of our graduate recruits and 10% of our UK apprentices are female – not good enough but progress. Our community programmes remain directed towards encouraging young people, particularly females, to choose science, technology, engineering and maths (STEM) subjects. We are in the process of reviewing our training and leadership development programmes, particularly for middle managers. We are also exploring ways of accelerating and broadening career paths for our highest potential talent across the world and for further increasing diversity as an important element of changing and strengthening our culture.

CORPORATE GOVERNANCE
The Board recognises that strong governance is a hallmark of excellent companies. We remain committed to being a leader in ethical behaviour and in environmental and social responsibility. We are updating and upgrading our governance structures and controls, with a particular focus on risk and compliance procedures. The concerns about bribery and corruption involving intermediaries in overseas markets, and the subsequent SFO enquiry, together with wider speculation, have been a body blow to the Company and we have responded accordingly. We have expanded significantly our compliance team, invested heavily in training and awareness building across the Group and strengthened our internal controls. Our staff have received a new Global Code of Conduct, together with mandatory training. We have established or expanded our own offices in many international markets and reduced dramatically the number of external intermediaries. Further details are contained in the Safety and Ethics Committee Report on page 66. We are grateful to Lord Gold who continues to advise us on compliance and ethics best practice.

BOARD APPOINTMENTS AND CHANGES
Ruth Cairnie, formerly an executive vice president with Royal Dutch Shell, joined the Board in September. In addition, Pamela Coles, previously at Centrica, has joined Rolls-Royce as Company Secretary. We are lucky to have both of them.

I was also very pleased to welcome David Smith to the Board. David was appointed Chief Financial Officer (CFO) in November, replacing Mark Morris who left the Company. David joined Rolls-Royce at the beginning of 2014 as the CFO of the Aerospace Division. Prior to that, he had extensive international experience in engineering and technology companies. A particular focus for David will be to strengthen further our financial controls and management information systems as well as improving our communications with the investment community.

I would like to thank Mark Morris for his years of service and contributions to the Company and to the Board. I would also like to thank Iain Conn who stood down from the Board after nine years of dedicated and exemplary service. He was succeeded as Senior Independent Director by Lewis Booth.

After a successful career spanning 17 years with Rolls-Royce, James Guyette will step down from the Board at the conclusion of the 2015 Annual General Meeting (AGM) and retire from his role as President and Chief Executive Officer of Rolls-Royce North America on 31 May 2015. James has made a tremendous contribution to the Company over many years. He has helped guide the business through a period of significant expansion, especially in the North American market. His energy, good humour and commitment to our customers will be missed by us all.

John Neill has also indicated that he will step down from the Board after just over six years as a Non-Executive Director and will not therefore put himself forward for re-election at the 2015 AGM. I would like to thank John for his tremendous contribution to the Board and his exemplary commitment to Rolls-Royce over the last six years. He will be missed and we wish him well for the future.

I am pleased to announce that Irene Dorner will be joining the Board as a Non-Executive Director with effect from 27 July 2015. She will also become a member of the Nominations and Governance Committee and the Safety and Ethics Committee from the date of her appointment. She brings a wealth of experience from international banking along with a passion for driving culture change in large organisations.

Irene was CEO and president of HSBC USA until December 2014 where she was responsible for all of HSBC's operations in the US and played a key role in strengthening their risk processes. During her 29-year career at HSBC, she held a number of international roles. She was the first woman to lead HSBC in Malaysia and launched its Islamic banking unit. She is a passionate advocate of diversity and inclusion.

There have been some adjustments to the committee structure of the Board, explained in more detail in my introduction to the Directors' Report on page 56. Safety and Ethics have been combined into one committee under the chairmanship of Sir Frank Chapman, formerly CEO of BG Group. I have also established a Science and Technology Committee, under the chairmanship of Warren East, formerly CEO of ARM Holdings. Science and technology are critical to the Company's success and warrant the attention of a focused committee, in addition to general board oversight.

We have benefited again from the insight and experience of our International Advisory Board (IAB) the composition of which is described on page 57. The role of the IAB is to provide contextual understanding of international economic and political developments, and to help management and the Board better understand long-term geographical opportunities and risks. Members of the IAB are also available to our senior management on specific issues and areas of expertise. We are fortunate to have such a wealth of experience and knowledge at our disposal. I am very grateful to them and in particular to Lord Powell for his exemplary chairmanship of the IAB.

I would like to thank my fellow board members for their diligence and outstanding commitment to Rolls-Royce.

I would also like to thank John Rishton, his management team and all our employees for their hard work and exceptional dedication in a demanding year.

I hope this review demonstrates our understanding of the concerns about Rolls-Royce's financial performance in 2014 and the 2015 outlook. We are totally focused on returning the Company to its long-term trajectory of profitable growth and of superior shareholder returns. We will continue to focus on the 4Cs of Customer, Concentration, Cost and Cash to improve performance, and we will strengthen our financial controls and communications. We will sustain our commitment to innovation and development.

The fundamentals of the business remain strong. They are underpinned by our record order book and our expanding installed equipment base that will generate value for years ahead. This is a sound business with continued growth potential.

IAN DAVIS
Chairman
12 February 2015

CHIEF EXECUTIVE'S REVIEW

Rolls-Royce is in business to deliver better power for a changing world. The integrated power systems that we develop, build and maintain, address the increasing global demand for transport and energy.

"We continually seek to reduce cost to remain competitive and to generate the funds we need to invest in future growth."

JOHN RISHTON
Chief Executive

As society becomes more integrated, population expands and the world becomes more affluent, the requirement for the type of advanced engineering solutions we provide will grow. These are long-term trends that require long-term investment and present us with the opportunity for long-term profitable growth.

The path to growth will not always be smooth. For Rolls-Royce, 2014 has proved a challenging year for reasons that I will explain in some detail. During 2014, Group underlying revenue was 6% lower than in 2013 and underlying profit before tax declined by 8%. However, the Group order book grew to a new record of £73.7 billion, demonstrating the confidence our customers continue to place in our technology and the growth that lies ahead. It is encouraging that the Defence aerospace order book increased for the first time since 2010, with continued growth in the order books of Civil aerospace and Power Systems.

In this review I will explain why we believe our business model is robust, I will describe the transformation we are driving through the Group and the reasons for our confidence in the future. I will also outline the challenges we face and the decisive action we are taking to accelerate a return to our long-term trend of profitable growth.

So let me start with our business model. We invest in technology in order to meet our customers' current and future needs. Through constant innovation we create the opportunity to grow sales and expand our market share. We earn revenue both from the sale of original equipment and from servicing the power systems we produce. We continually seek to reduce cost to remain competitive and to generate the funds we need to invest in future growth.

We have evolved and simplified our strategy to focus on the core areas of: **customer**, **innovation** and **profitable growth.**

Customer: we put customers at the heart of the organisation. We understand their needs and then focus relentlessly on delivery.

Innovation: is at the core of Rolls-Royce and drives a culture of continuous improvement. Delivering relevant innovation is critical to meeting our customers' current and future needs.

Profitable growth: by focusing on our customers and presenting them with a competitive portfolio of innovative products and services, we create the opportunity for long-term profitable growth.

This sharper focus enables us to drive our business model harder and will, over time, deliver improving financial returns.

From its earliest days Rolls-Royce has addressed a range of markets where demand exists for advanced engineering solutions. Our 1906 articles of association describe the business as producing technology for use in the air, on land and at sea. More than a century later this approach remains relevant and we run our business through the two Divisions of Aerospace and Land & Sea that you will see described in the pages of this Annual Report.

There is an industrial, commercial and strategic logic that ties these two Divisions together and generates value for the Group.

Industrially, our knowledge of advanced engineering applies across both our Divisions. World-class technology is required by all of our customers and as the power systems we produce become more sophisticated, a deep understanding of materials science, electronics, data management and aftermarket services are increasingly important in every part of the Group.

BETTER POWER
Our Land & Sea Division is well positioned to meet the requirements for cleaner power that will be driven by future growth in world trade.

£74bn Our order book increased in 2014 to a record level

Commercially, we and our competitors recognise the requirement of a broad portfolio and exposure to differing business and investment cycles. It is not a coincidence that there is no pure aerospace power system company in the world.

The scale represented by our two Divisions is important in maintaining a strong balance sheet and protecting our investment grade rating. Scale has also enabled us to maintain a global R&D network comprising 31 University Technology Centres and seven Advanced Manufacturing Research Centres. These facilities envisage, develop and test emerging technologies that have applications across our portfolio. Our breadth increases market access and generates opportunity. For example, our Nuclear business is relatively small but extends our influence and gives us access to the highest levels of government internationally.

CHIEF EXECUTIVE'S REVIEW
CONTINUED

INNOVATION

We invest in technology in order to meet our customers' current and future needs. Through constant innovation we create the opportunity to grow sales and expand our market share.

MORE INFORMATION ON PAGES 20 TO 21

"We continue to make good progress improving quality, delivery, reliability and responsiveness."

Strategically, our two Divisions address markets where long-term growth is assured and where increasingly sophisticated engineering solutions will be required. We believe both aerospace and land & sea markets offer attractive returns and play to our strengths.

The future growth of air travel is widely understood and reflected in our £63 billion Civil aerospace order book. To give this some perspective, in the past decade we have delivered 1,600 Trent engines. In the decade ahead we expect to deliver 4,000. All of the engines in this expanding fleet will produce service revenues that will extend for decades to come. Our Land & Sea Division is well positioned to meet the requirements for cleaner power that will be driven by future growth in world trade (90% of which is carried by sea), urbanisation, population growth and tighter environmental regulations.

Across the Group, we invest in technology that is continually setting new standards in power efficiency and environmental performance. The complexity of what we do creates barriers to entry and generates new market opportunities. Put simply, there will be significant long-term growth in demand for the complex integrated power systems we deliver, and there are not many companies with the ability to do what we can do.

Despite these fundamental strengths, in 2014 our short-term performance has been negatively affected by a number of factors. In Aerospace our Defence revenues fell by 20%, reflecting reduced government defence spending in our main markets of North America and Europe. In Land & Sea, slowing growth in a number of our major markets including Continental Europe, South America and China has caused some customers to delay or cancel orders. At the same time, sharp declines in the price of oil and other commodities have led customers to reduce or defer expenditure, especially in the oil & gas, mining and construction industries.

In response to these adverse conditions, we have accelerated progress on the **4Cs** of **Customer**, **Concentration**, **Cost** and **Cash** – with a particular emphasis on cost. This decisive action is driving a transformation of the business that will, in time, make us a stronger Group and hasten our return to profitable growth.

On Customer: we continue to make good progress improving quality, delivery, reliability and responsiveness; the characteristics our customers tell us they value most. The results can be seen across a wide range of programmes. At Group level there has been a further improvement in delivery times – particularly for spare parts. In Aerospace, the Trent 1000 that powers the Boeing 787 Dreamliner has achieved an industry-leading 99.9% engine dispatch reliability after completing over 500,000 flying hours in service. Since launch, we have doubled the time on wing for both our Trent 700 and Trent 800 fleets. In our Civil Small and Medium Engines business, we achieved a 57 percentage points improvement in restoring operational availability for business jets in the past year.

Recognising the progress we have made, Airbus has presented us with its Supply Chain and Quality Improvement Award. The US Government's Defense Logistics Agency recognised Rolls-Royce as a 'first tier supplier' from among 153 companies and we were awarded joint first place by Aviation International News for the quality of our business aircraft support.

In Land & Sea, our delivery on time to Marine customers has improved by 33 percentage points since 2012. Marine also signed its first commercial long-term service agreement. As the power systems we deliver in Land & Sea become more complex, we see further opportunities to expand our aftermarket activities, building on the data and service capabilities we have developed in Aerospace. In Power Systems, we opened an additional logistics centre in Singapore, enabling a 5% improvement in the availability of spare parts and setting a new standard for customer service.

Improving performance in this way strengthens the relationship we have with our customers, and generates opportunities for us to secure additional business.

Concentration: means deciding where we want to invest and where not to.

In August, we were pleased to acquire Daimler's 50% shareholding in Rolls-Royce Power Systems for £1.94 billion. Power Systems adds scale and capability to our reciprocating engines portfolio. It has outstanding technology, operates in long-term growth markets and has proved a valuable addition to our Land & Sea Division.

We also divested a significant business in December, completing the sale of our Energy gas turbines and compressor business to Siemens. This is a business that has excellent technology and a talented workforce, but it lacks the scale required to prosper as part of Rolls-Royce. Siemens has a far bigger power generation business and is a more suitable owner. The sale generated proceeds of around £1 billion. We are returning this to shareholders by way of a share buyback that started in December 2014.

Turning to Cost: we have taken action to improve cost performance in every part of the business and in every cost category. We have made good progress in some areas and as a result, Group gross margins improved by 1.7 percentage points in 2014. In Defence, we have improved margins despite declining revenue. In Land & Sea, we closed five plants and are rationalising other parts of the business. For example, we are consolidating production of steering gear in Norway and waterjets into Finland. We are driving down cost by improving quality, simplifying logistics, reducing waste, and adopting processes that allow us to make things better and faster.

In November, we announced a restructuring programme in our Aerospace Division and central functions, which is expected to reduce headcount by 2,600. By the end of 2014, 545 people had left the business, with the majority of the reductions expected in 2015. This programme is expected to result in restructuring charges of around £120 million, of which £56 million was recognised in our 2014 results.

We anticipate annualised cost benefits of around £80 million from 2016 onwards, with £50 million in benefits expected in 2015. Our total Aerospace 2014 restructuring activities cost £164 million (of which £139 million was underlying).

However, in a complex and highly-regulated business, we recognise that it will take some time for the full benefit of our cost programmes to feed through. There are also a number of headwinds in our Civil aerospace business associated with our future growth. For example, we have invested in the capacity required to deliver our record order book, but delay in a number of our customers' major programmes has meant some of this new capacity has come on stream before it is needed, leaving us with under-utilised production facilities. We have also constructed a number of new world-class facilities to replace older, less productive plants. For a period of transition we are carrying the cost of both the old and new facilities.

Group restructuring costs in 2014 were £188 million, of which £149 million was underlying. Over the past two years, the Group has reduced indirect headcount by 18%. We expect Group underlying restructuring costs to be between £90 and £100 million in 2015.

Cost performance will continue to be a major focus, and as we rationalise and transform the Group, we have targeted a 20% reduction in our footprint and a doubling of our lower-cost country sourcing by 2020. We are now accelerating progress towards these targets.

Cash: we continue to focus on improving our free cash flow, particularly in the face of near-term headwinds. Our programmes to reduce product and aftermarket costs, lower our headcount and to reduce our footprint all require upfront investment but will deliver cost and cash benefits in the medium term. As revenue increases, we expect to reduce our capital expenditure and R&D as a percentage of sales. The customer progress highlighted earlier is improving our operational performance.

OUR FIVE PRIORITIES FOR THE GROUP

DURING 2014 WE OUTLINED THE PRIORITIES FOR THE BUSINESS GOING FORWARD.

FIX THE BASICS (THE 4Cs)
This is about improving the bedrock of the organisation: focusing on our customers and their needs; concentrating on what we are good at; attacking cost across the Group and managing our cash position effectively.

CULTURE
We want a business-orientated, innovative and cost-conscious culture, one that understands our customers and delivers on their behalf. We must have a culture where ethical behaviour is fully embedded, so that we don't just win but win right.

CIVIL WIDEBODY
We are building on success. In the last decade we delivered 1,600 Trents and in the next we will deliver 4,000. We power over 50% of new widebody aircraft. Our next generation engines, Advance and UltraFan™, will help maintain our leading market position.

CIVIL NARROWBODY
Narrowbodies represent 70% of the civil aircraft market by volume and 50% by value. We have the requisite skills and technology to return to this market and are determined to do so when the opportunity arises. This is important in the longer term, not just because of the scale this market segment offers but also because of the chance it presents to develop greater customer intimacy.

MEDIUM-SPEED RECIPROCATING ENGINES
Medium-speed reciprocating engines power the vast majority of the marine vessels that we design and equip. We have world-class technology, but it is characteristic of this industry that the engine supplier is particularly well placed to pull through other technologies, so our lack of scale in medium-speed engines confers a disadvantage we need to address.

CHIEF EXECUTIVE'S REVIEW
CONTINUED

TECHNOLOGY

We have continued to invest in our Land & Sea Division, bringing new technology to market across the portfolio. In September, we unveiled the first of a new family of medium-speed reciprocating engines for power on land and at sea. The new Bergen B33:45 offers a 20% increase in power per cylinder, while reducing fuel consumption, emissions and operating costs.

MORE INFORMATION ON PAGE 38

Combined with increasing volumes, this will enable us to reduce our inventory buffers.

While a great deal of attention has been focused, quite rightly, on the financial performance of the Group, it is important to recognise significant achievements in 2014 that will support the Group's future profitable growth.

1,500 Trent XWB engines are on order. The first engines were delivered to Qatar Airways in 2014

In Aerospace in December, we were delighted to celebrate the first delivery of the Trent XWB, powering the new Airbus A350 XWB for launch customer Qatar Airways. The Trent XWB is the most fuel efficient large aero engine operating in the world today. I would like to congratulate everyone at Rolls-Royce who has worked so hard over many years to support the successful delivery of this exceptional aircraft, for which Rolls-Royce is the sole engine provider.

At the Farnborough International Airshow in July, we announced the seventh member of the Trent engine family, the Trent 7000, that will power the new Airbus A330neo. This new engine will incorporate technology from our most recent Trents and will deliver a 10% improvement in specific fuel consumption and halve the noise energy output compared to the current engine on the A330. Rolls-Royce will be the exclusive engine supplier on the A330neo, due to enter service in 2017.

We have continued to bring new world-class facilities on stream in 2014. These include the opening of our new advanced disc manufacturing facility at Washington in the UK and the first production aerofoil from our new Advanced Aerofoil Manufacturing Facility at Crosspointe, Virginia in the US. 2014 saw the inauguration of our new large engine test bed in Dahlewitz, Germany and the opening of a new marine customer training centre outside Rio de Janeiro in Brazil.

We marked a major milestone in the development of carbon titanium (CTi) fan blades with the launch of a test flight programme on board a Boeing 747 flying test bed. CTi technology delivers lighter fan blades that will be incorporated into future aero engines. Combined with a composite fan casing, it forms a system that can reduce weight by up to 1,500lb per aircraft, the equivalent of seven passengers.

In Land & Sea we have also continued to strengthen our portfolio, bringing new technology to market across the Division. In September, we unveiled the first of a new family of medium-speed reciprocating engines for use on land and at sea. The new Bergen B33:45 offers a 20% increase in power per cylinder, while reducing fuel consumption, emissions and operating costs. It is our first new product to combine the engineering strengths of our traditional Bergen engines operation and our new Power Systems business. Because of its greater power range, the new engine increases our addressable market in medium-speed engines by 20%.

In the naval market two important new ships powered by our MT30 gas turbines were officially named: the multi-mission destroyer USS Zumwalt and the Royal Navy aircraft carrier Queen Elizabeth.

In the rail sector, Power Systems has developed an MTU hybrid PowerPack that generates additional power through the braking control system. This technology offers a fuel saving of up to 25% with a proportional reduction in emissions.

For off-highway vehicles, MTU's latest Series 4000 engine has improved fuel consumption by 5%. For a typical application this can represent a saving of up to 100,000 litres of fuel and reduction of 350 tonnes of CO_2 emissions each year.

MTU's latest Series 4000 engine has improved fuel consumption by

5%

In our Nuclear business, we were encouraged that, in October, the European Commission approved the construction of the first new commercial nuclear power station to be built for a generation in the UK, at Hinkley Point in Somerset. The Commission concluded that new nuclear power is vital for Britain's energy security and will be key to reducing carbon emissions from the UK's electricity industry. Hinkley Point C is the first of at least 11 new reactors planned for the UK, for which Rolls-Royce is well positioned to supply components, systems and engineering services.

31 University Technology Centres. This research network extends relationships we have with world-leading universities

As the Chairman said, we continued to strengthen the governance of the Group. We expect the highest standards of behaviour from our employees and we have been explicit that we will not tolerate business misconduct of any sort. The Serious Fraud Office investigation into concerns about bribery and corruption involving intermediaries in overseas markets continues and we are cooperating fully with the investigating authorities. Lord Gold is heading a review of our process and procedures regarding compliance and business ethics.

This year our Global Code of Conduct has been ranked by the Red Flag Group as third among those within the FTSE 100 companies that were assessed. Following the roll-out of our Global Code, dilemma-based ethics training has been deployed to all our employees to ensure continuing attention on this important topic. Training in ethics and compliance will continue in 2015. All employees will be required to certify annually that they have completed their training. We will be setting similar standards for our supply chain through the publication of our Supplier Code of Conduct.

Responding to the difficult circumstances of 2014 has required fortitude and resilience from the talented men and women who work for Rolls-Royce. I would like to thank them for their hard work and for the enthusiasm I encounter wherever in the Company I travel. I am grateful to our suppliers and partners who make such an important contribution to Rolls-Royce and share our commitment to continuous improvement. I would like to thank our customers who continue to place their faith in our technology. Meeting their current and future needs is our highest priority.

This year we held our inaugural Trusted to Deliver Excellence Awards to recognise Rolls-Royce teams who have achieved outstanding results for their customers. The imagination, passion and ability to execute demonstrated by all the finalists is inspiring. You can read more about these awards on pages 42 to 43.

Returning our Group to profitable growth will demand firm resolve and commitment and will take some time. However, as I have described in this review, the business fundamentals of Rolls-Royce remain sound, we have the right strategy and we are clear about the action that is required. Everything I know about this great Company makes me confident that the team will rise to the challenge.

JOHN RISHTON
Chief Executive
12 February 2015

"Strategically, our two Divisions address markets where long-term growth is assured and where increasingly sophisticated engineering solutions will be required."

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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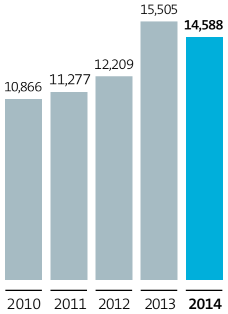
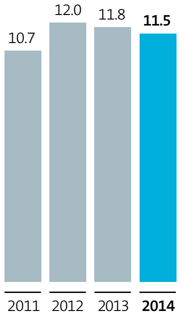
CONSOLIDATED FINANCIAL STATEMENTS

GROUP UNDERLYING REVENUE (£m)



RETURN ON SALES (%)



GROUP UNDERLYING PROFIT BEFORE TAXATION (£m)