We are one of the world’s leading producers of aero engines for large civil aircraft and corporate jets. We are the second largest provider of defence aero engines and services in the world. For land and sea markets, reciprocating engines and systems from Rolls-Royce are in marine, distributed energy, oil & gas, rail and off-highway vehicle applications. In nuclear, we have a strong instrumentation, product and service capability in both civil power and submarine propulsion.

Rolls-Royce designs, develops, manufactures and services integrated power systems for use in the air, on land and at sea.
What’s inside...

STRATEGIC REPORT

Our business model and how we performed
- Group at a glance: 2
- Better power: 4
- Chairman’s review: 10
- Chief Executive’s review: 14
- Innovation and technology: 20
- Market outlook: 22
- Strategy: 23
- Business model: 24
- Chief Financial Officer’s review: 26
- Financial review: 28
- Business reviews:
  - Aerospace: 32
  - Land & Sea: 36
  - Our people: 42
  - Sustainability: 44
  - Key performance indicators: 48
  - Principal risks: 50

DIRECTORS’ REPORT

How we manage our business
- Board of directors: 54
- Chairman’s introduction: 56
- Corporate governance: 59
- Committee reports:
  - Nominations and governance: 64
  - Safety and ethics: 66
  - Audit: 69
  - Remuneration: 74
  - Directors’ remuneration: 76
  - Directors’ remuneration policy: 86
  - Responsibility statements: 93
  - Other statutory information: 162

FINANCIAL STATEMENTS

The financial statements of the Group
- Financial statements contents: 94
- Group financial statements: 95
- Company financial statements: 149

OTHER INFORMATION

Auditor’s report and shareholder information
- Subsidiaries, jointly controlled entities and associates: 152
- Independent auditor’s report: 154
- Additional financial information: 160
- Shareholder information: 166
- Glossary: 168

FINANCIAL HIGHLIGHTS

How did we perform in 2014?

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Order book £m</td>
<td>73,674</td>
<td>71,612</td>
<td>+3%</td>
</tr>
<tr>
<td>Underlying* revenue £m</td>
<td>14,588</td>
<td>15,505</td>
<td>-6%</td>
</tr>
<tr>
<td>Underlying* profit before tax £m</td>
<td>1,617</td>
<td>1,759</td>
<td>-8%</td>
</tr>
<tr>
<td>Underlying* earnings per share</td>
<td>65.3p</td>
<td>65.6p</td>
<td>-0.3p</td>
</tr>
<tr>
<td>Full year payment to shareholders (excluding buyback)</td>
<td>23.1p</td>
<td>22.0p</td>
<td>+5%</td>
</tr>
<tr>
<td>Reported revenue £m†</td>
<td>13,736</td>
<td>14,642</td>
<td>-6%</td>
</tr>
<tr>
<td>Reported profit before tax £m†</td>
<td>67</td>
<td>1,700</td>
<td>-96%</td>
</tr>
<tr>
<td>Reported earnings per share†</td>
<td>3.7p</td>
<td>73.3p</td>
<td>-69.6p</td>
</tr>
<tr>
<td>Net cash £m</td>
<td>666</td>
<td>1,939</td>
<td>-66%</td>
</tr>
<tr>
<td>Free cash flow £m</td>
<td>254</td>
<td>781</td>
<td>-67%</td>
</tr>
</tbody>
</table>

* 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.

FORWARD-LOOKING STATEMENTS

This Annual Report contains forward-looking statements. Any statements that express forecasts, expectations and projections are not guarantees of future performance and guidance may be updated from time to time. Latest information will be made available on the Group’s website. By their nature, these statements involve risk and uncertainty, and a number of factors could cause material differences to the actual results or developments. This report is intended to provide information to shareholders, is not designed to be relied upon by any other party or for any other purpose, and the Company and its directors accept no liability to any other person other than that required under English law.
The Group is organised into two Divisions: Aerospace and Land & Sea.
Our vision is to create better power for a changing world.
We do this by developing world-leading technology, producing highly efficient products and providing through-life services in each of our chosen markets.
### AEROSPACE

The Aerospace Division is a leading producer of aero engines for large civil aircraft and corporate jets. We are the second largest provider of defence aero engines and services in the world.

We power more than 50 types of aircraft across civil and defence markets and have over 29,000 engines in service.

**CIVIL AEROSPACE**

- **Underlying Revenue Mix**
  - OE revenue 48%
  - Services revenue 52%
- **Underlying Revenue** £6,837m
- **Underlying Profit** £942m

**DEFENCE AEROSPACE**

- **Underlying Revenue Mix**
  - OE revenue 39%
  - Services revenue 61%
- **Underlying Revenue** £2,069m
- **Underlying Profit** £366m

### LAND & SEA

The Land & Sea Division comprises Power Systems, Marine and Nuclear.

Our Power Systems business includes the world-renowned MTU range of reciprocating engines. Marine has equipment installed on over 25,000 vessels.

We have a growing civil nuclear business and have 55 years of experience in nuclear submarine propulsion.

**POWER SYSTEMS**

- **Underlying Revenue Mix**
  - OE revenue 70%
  - Services revenue 30%
- **Underlying Revenue** £2,720m
- **Underlying Profit** £253m

**MARINE**

- **Underlying Revenue** £1,709m
- **Underlying Profit** £138m

**NUCLEAR**

- **Underlying Revenue** £684m
- **Underlying Profit** £48m

**ENERGY**

- **Underlying Revenue** £724m
- **Underlying Profit** £(3)m

---

For more information, please refer to pages 32 to 35.

For more information, please refer to pages 36 to 41.
BETTER POWER FOR A CHANGING WORLD
Our world is changing, the climate is altering and populations are increasing. We need more power but not at any cost to society. The world needs better power.

Rolls-Royce is committed to research and technology in order to develop innovative and advanced power systems that can help.

Our vision is to deliver better power for a changing world. The following pages illustrate how we are doing this in the air, on land and at sea.
WORLD'S MOST EFFICIENT LARGE AERO ENGINE
Launch customer Qatar Airways took delivery of the first Trent XWB-powered Airbus A350 XWB at the end of 2014. The Trent XWB is the world’s most efficient large aero engine and is 10% more fuel efficient than the legacy engines it is designed to replace.

This first delivery signifies the start of a major engine production programme for the Group. Customers have ordered over 1,500 Trent XWB engines, representing 49% of the Civil aerospace order book.
LEADING IN LATEST TRANSPORTER POWER
Rolls-Royce is the market leader in powering military transport aircraft with 8,000 engines in service. The new Airbus A400M transporter continued to enter service successfully during 2014, further cementing our position in this important market sector. The A400M is powered by the TP400 turboprop engine in which Rolls-Royce is a major partner. We also secured a landmark agreement during the year with Lockheed Martin for up to 600 engines to power its C-130J transporter.

Our fleet of T56 engines has accumulated over 200 million operating hours having first entered service in 1954. We recently introduced an upgrade for the T56 that a US Air Force study predicts could deliver US$240 million in fuel savings for its fleet through to 2040.

FURTHER AND FASTER ON LESS FUEL
Rolls-Royce continues to be a market leader in powering large corporate jets. The latest version of Cessna's flagship aircraft, the Citation X+ entered service in June 2014, further cementing our position in this important market sector. The improved version of our AE 3007 engines on the Citation X+ delivers an increase in thrust at take-off, coupled with a reduction in fuel burn – helping people to fly further and faster but using less fuel to do it.

In addition, we strengthened our long-standing relationship with Gulfstream when we were selected in 2014 to power its new G650ER corporate jet.
LOCAL ENERGY – NATURALLY

Efficient, low-emission power systems are in demand across the world for effective solutions to local energy needs. Through MTU Onsite Energy, Rolls-Royce is providing reliable power for applications such as healthcare, data centres, airports, farms and independent power stations.

In Chile for example, two MTU Onsite Energy units powered by Series 4000 engines are now generating 6,400 MWh of electricity a year from biogas produced by a local pig farm. These units are the first in the country to generate electricity from a biogas plant. For our customer they provide eco-friendly and profitable power to 2,500 families in the area.

POWERPACKED ON THE RAILWAYS

Power Systems is a major player in engines for the rail industry. To date, over 20,000 MTU engines have been sold for use in drive systems and electrical generation in this global market. 2014 marked the 90th year of MTU engines being supplied for rail traction.

As well as the anniversary, this year also saw an agreement reached with Polish rail vehicle manufacturer PESA for the supply of up to 940 MTU PowerPacks® to be used in railcars operated by Deutsche Bahn. These PowerPacks are among the most advanced in the industry, meeting all the latest European Union requirements on emissions.
40 YEARS OF OFFSHORE FLAGSHIPS

The UT-Design series from Rolls-Royce is recognised worldwide as the benchmark for the offshore industry. Today’s vessels employ our wave-piercing hull which improves efficiency and reduces fuel consumption. All major propulsion systems are fully integrated with the hull design to give optimum performance.

Rolls-Royce UT-Design vessels have been helping pioneer oil & gas exploration and providing offshore support for 40 years. So far, more than 800 have been built or are currently under construction.
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
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 require 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
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.”
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.

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.
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.
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 CO₂ 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.

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
INNOVATION AND TECHNOLOGY

Technology and innovation are at the heart of Rolls-Royce. We anticipate technology then create products and services that our customers need ahead of market requirements. In 2014, we spent £1.2 billion gross in R&D and filed for 600 patents.
ENGINEERING STRENGTH

Our 15,500* engineers, along with our supply chain, commercialise and deploy the continuous stream of science developed by our university partners into technology then products. Competitive technology comes from combining great people, tools and processes. These fundamental building blocks are used across our two Divisions, Aerospace and Land & Sea. We also continually invest in new talent and in 2014 we recruited 354 graduates (254 of which went into engineering) and 357 apprentices. Technical people are the lifeblood of the Company. Our investment in technical and leadership training allows us to continuously develop world-class professionals.

INNOVATION

We have a track record over many years of creating new products and services and we continue to strive to be leading edge in everything we do. Innovation cannot be left to chance. It needs to be encouraged, managed, selected and pulled through into products and services. Harnessing the total intellectual power of our people takes enthusiasm and effort. Our new Innovation Portal, Big Ideas Forums and Open Innovation challenge have been successful and each year we reward the most innovative ideas at our Sir Henry Royce Technology Awards. We look at innovation in terms of technology and services and also in the way we conduct engineering and manufacturing. This ensures that we continuously simplify and improve processes in order to be efficient and remove waste.

RESEARCH AND DEVELOPMENT

The strength of our current product portfolio results from consistent and long-term investment in R&D and our ability to bring technology to industrial applications. In addition to our extensive in-house technology capability, we have partnerships with world-leading universities in order to create new technology. We continuously invest in our global network of 31 world-class University Technology Centres (UTCs) where we build the foundation for the next generation of products. These technologies feed into our demonstration programmes, where robust validation takes place before proceeding in a structured and controlled way into new production.

£1.2bn R&D INVESTMENT

DEMONSTRATOR PROGRAMMES

During 2014, progress was made on our many new technologies, for example, the carbon titanium fan has flown for the first time this year in the advanced low-pressure systems (ALPS) demonstrator, a modified Trent. The composite fan system has been developed with the help of four UTCs and five AMRCs and will offer over 750lbs of weight saving on our future large engines. We have demonstrated a new mobile MTU gas engine which has been in development for some years and offers a 60% reduction in the pollutant NOx, and particulate matter (smoke) compared to year 2000 levels. It will reach flight test in 2015 and is supported by the European Clean Sky Programme.

VISION 10

Vision 10 describes leading-edge, validated technologies for application in the ‘medium term’. Most of these are at demonstration level today and will feature in the next generation of products. For example, the lean burn combustion system for aero gas turbines has been in development for some years and offers a 60% reduction in the pollutant NOx, and particulate matter (smoke) compared to year 2000 levels. It will reach flight test in 2015 and is supported by the European Clean Sky Programme.

VISION 20

Vision 20 describes emerging, or as yet unproven, technologies which may be applied across our product range in both Aerospace and Land & Sea. For example, we are developing concepts for autonomous ships to reduce operating costs and radically simplify onboard facilities.
The Group has identified markets where our skills and technology add value for our customers and deliver value for shareholders. As a long-term business we assess the market potential over a 20-year horizon.

Through the customer-facing businesses that make up our two Divisions, we are delivering better power in the air, on land and at sea.

Our technology, skills and customer insight position us to have the right products and services today and for the future.

### Aerospace Division

**Civil Aerospace**
We estimate that the global civil engine market will be worth approximately US$1,900 billion over the next 20 years, with US$1,250 billion being for original equipment (OE) and US$650 billion for aftermarket services. Over half of this value comprises engines for twin-aisle airliners and large business jets.

**Defence Aerospace**
The defence market opportunity over the next 20 years is US$125-150 billion in OE and US$650 billion in services.

### Land & Sea Division

**Power Systems**
We estimate the off-highway reciprocating engine markets we address offer an opportunity of £500 billion over the next 20 years for OE. The total service-related market will offer a potential of around a third of that OE value, or £150 billion.

**Marine**
We forecast a business opportunity (excluding reciprocating engines) across the offshore, merchant and naval market segments over the next 20 years of £170 billion for OE and £80 billion for associated services.

**Nuclear**
The demand for mission-critical equipment, systems and engineering services for civil nuclear could reach £220 billion over the next 20 years, while the demand for associated reactor support services could amount to £140 billion over the same period.

† Rounded to the nearest 100bn
We are a power systems company competing globally. We win in our chosen markets by focusing on, and connecting, three powerful themes: customer, innovation and profitable growth.

**CUSTOMER**
Placing the customer at the heart of our organisation is key. We listen to our customers, share ideas, really understand their needs and then relentlessly focus on delivering our promises.

**INNOVATION**
This is our lifeblood. We continually innovate to remain competitive. To drive innovation, we create the right environment — curious, challenging, unafraid of failure, disciplined, open-minded and able to change with pace. Most importantly, we ensure our innovation is relevant to our customers’ needs.

**PROFITABLE GROWTH**
By focusing on our customers and offering them a competitive portfolio of products and services, we create the opportunity to grow our market share. We have to make sure that we are not just growing, but growing profitably. That means ensuring our costs are competitive. We look after our cash and we win right.

**PEOPLE**
Our people are the key enabler of our strategy. We are committed to recruiting, developing and retaining the best and to creating a climate for success. We are building a business-orientated, innovative and cost-conscious culture, where our people feel connected to the needs of our customers, the needs of our shareholders and the needs of our broader communities.

See pages 44 to 47 for more information on how sustainability plays a pivotal role in the delivery of our strategy.
We bring advanced technology to market through integrated power and propulsion systems and services for use in the air, on land and at sea.

Engineering excellence is a fundamental source of competitive advantage across the Group. Our methods, processes and experience enable us to deliver complex, high-value programmes. Our ability to optimise and integrate entire systems is a core competence informed by a close understanding of customer needs and decades of domain knowledge.

Addressing complementary markets from a shared capability and technology base brings breadth and scale, diversity and balance, enabling us to invest efficiently, and providing the resilience required to offset new project risk. Our manufacturing model is consistent across the Group; we only produce parts ourselves where we can create and sustain a competitive advantage.

The balance of our supply chain is built around close and long-standing relationships with key partners and suppliers, a model that provides flexibility of capacity and secures access to world-class capability. Some partners, as well as supplying parts, share in the risks and rewards of the whole programme from research and development to manufacture, through risk and revenue sharing arrangements.

Services are an essential part of our business, building customer relationships and providing revenue stability by moderating the effects of new equipment order cycles. Services offer strong growth potential and the opportunity to align incentives through long-term service contracts, providing visibility of costs to our customers and helping us secure future revenues. This is particularly the case in Civil aerospace where contractual and air safety considerations mean that we have rights that secure a large part of the aftermarket spare parts business even where we do not have a TotalCare® agreement.

The operation of our business model over decades has resulted in a substantial and growing installed base of engines at all stages of the product life cycle. Cash flows today from investments made, in some cases many years ago, support investment for the future. We are focused on making this proven business model more effective through relentless focus on costs to generate the funds to sustain the investment necessary to remain competitive.
**INVEST IN R&D AND SKILLED PEOPLE**
Developing and protecting leading-edge technology and deploying it across our businesses allows us to compete on a global basis and creates high barriers to entry.

**DESIGN AND MAKE WORLD-CLASS PRODUCTS**
We differentiate on performance. We win and retain customers by developing and delivering products that provide more capability and offer better through-life value than those of our competitors.

**SECURE AND MAXIMISE SERVICE OPPORTUNITY**
Our equipment is in service for decades. Our deep design knowledge and in-service experience ensures that we are best placed to optimise product performance and availability.

**GROW MARKET SHARE AND INSTALLED BASE**
Our substantial order book for both original equipment and services provides good visibility of future revenues and provides a firm foundation to invest with confidence.

### LAND & SEA

<table>
<thead>
<tr>
<th>POWER SOURCE</th>
<th>Reciprocating engines</th>
<th>Nuclear</th>
</tr>
</thead>
<tbody>
<tr>
<td>CUSTOMER BASE</td>
<td>Large &amp; global</td>
<td>Global</td>
</tr>
<tr>
<td>BARRIERS TO ENTRY</td>
<td>Medium/high</td>
<td>High</td>
</tr>
<tr>
<td>INVESTMENT REQUIRED</td>
<td>Low/medium</td>
<td>Low/medium</td>
</tr>
<tr>
<td>DEVELOPMENT TIME</td>
<td>2-8 years</td>
<td>20 years</td>
</tr>
<tr>
<td>PRODUCT LIFE</td>
<td>20+ years</td>
<td>40+ years</td>
</tr>
<tr>
<td>SERVICE OPPORTUNITY</td>
<td>Growing</td>
<td>Growing</td>
</tr>
</tbody>
</table>
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.
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.

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

* 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.
2014 has been a mixed year during which underlying revenue fell for the first time in a decade, reflecting reduced spending by our defence customers, macro economic uncertainty and falling commodity prices.

**GROUP UNDERLYING INCOME STATEMENT**

<table>
<thead>
<tr>
<th>£ million</th>
<th>2014</th>
<th>2013</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>14,588</td>
<td>15,505</td>
<td>(917)</td>
</tr>
<tr>
<td>Profit before financing</td>
<td>1,678</td>
<td>1,831</td>
<td>(153)</td>
</tr>
<tr>
<td>Net financing</td>
<td>(61)</td>
<td>(72)</td>
<td>11</td>
</tr>
<tr>
<td>Profit before taxation</td>
<td>1,617</td>
<td>1,759</td>
<td>(142)</td>
</tr>
<tr>
<td>Taxation</td>
<td>(387)</td>
<td>(434)</td>
<td>47</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>1,230</td>
<td>1,325</td>
<td>(95)</td>
</tr>
<tr>
<td>Earnings per share (EPS)</td>
<td>65.31p</td>
<td>65.59p</td>
<td>(0.28)</td>
</tr>
<tr>
<td>Payments to shareholders</td>
<td>23.1p</td>
<td>22.0p</td>
<td>1.1p</td>
</tr>
<tr>
<td>Gross R&amp;D investment</td>
<td>1,249</td>
<td>1,118</td>
<td>131</td>
</tr>
<tr>
<td>Net R&amp;D charge</td>
<td>755</td>
<td>624</td>
<td>131</td>
</tr>
</tbody>
</table>

**SEGMENTAL ANALYSIS**

<table>
<thead>
<tr>
<th>£ million</th>
<th>Revenue</th>
<th>Profit before financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Civil</td>
<td>6,837</td>
<td>942</td>
</tr>
<tr>
<td>Defence</td>
<td>2,069</td>
<td>366</td>
</tr>
<tr>
<td>Aerospace Division</td>
<td>8,906</td>
<td>1,308</td>
</tr>
<tr>
<td>Power Systems</td>
<td>2,720</td>
<td>2,831</td>
</tr>
<tr>
<td>Marine</td>
<td>1,709</td>
<td>138</td>
</tr>
<tr>
<td>Nuclear</td>
<td>684</td>
<td>48</td>
</tr>
<tr>
<td>Intra-segment</td>
<td>(155)</td>
<td>(13)</td>
</tr>
<tr>
<td>Land &amp; Sea Division (excluding Energy)</td>
<td>4,958</td>
<td>426</td>
</tr>
<tr>
<td>Energy</td>
<td>724</td>
<td>64</td>
</tr>
<tr>
<td>Land &amp; Sea Division</td>
<td>5,682</td>
<td>423</td>
</tr>
<tr>
<td>Central costs</td>
<td>(53)</td>
<td>(3)</td>
</tr>
<tr>
<td>Group (excluding Energy)</td>
<td>13,864</td>
<td>1,681</td>
</tr>
<tr>
<td>Group</td>
<td>14,588</td>
<td>1,678</td>
</tr>
</tbody>
</table>

**GROUP UNDERLYING REVENUE**  
£14,588m

**GROUP UNDERLYING PROFIT BEFORE TAXATION**  
£1,617m

**Underlying revenue** reduced £0.9 billion to £14.6 billion, a reduction of 6%, of which 3% is due to adverse year-on-year foreign exchange (FX) rate movements. The remaining reduction reflects a 5% decline in original equipment (OE) revenue and a 1% decline in services revenue. Underlying services revenue continues to represent around half (48%) of the Group’s underlying revenue. Group services revenue included increases in Defence aerospace and Power Systems partially offset by reductions in our Marine, Nuclear and Energy businesses.

**Underlying profit before financing and taxation** reduced 8% to £1.7 billion. We saw a negative impact from lower volumes, especially in Defence and Land & Sea, increased R&D investment (£140 million) and higher restructuring charges (£100 million), a one-off Marine charge (£30 million), and adverse FX (£49 million). These factors were offset by an improved trading margin which included approximately £150 million benefit from improved retrospective TotalCare contract profitability (£110 million deterioration in 2013), reflecting lower cost, changing operating patterns and reduced contract risk. Trading margins in Defence also
improved, driven by both cost reduction action and an improved mix. In Land & Sea we incurred a loss at our Bergen subsidiary (£33 million), reflecting weaker trading performance. Lower bonus and share incentive costs resulted in a saving of £178 million.

Underlying financing costs reduced by 15% to £61 million reflecting reduced financial risk and revenue sharing arrangements (RRSAs) liabilities and other improvements.

Underlying taxation of £387 million represents an underlying tax rate of 23.9%, compared with 24.7% in 2013.

At the Annual General Meeting on 8 May 2015, the directors will recommend an issue of 141 C Shares with a total nominal value of 14.1 pence for each ordinary share. Together with the interim issue on 2 January 2015 of 90 C Shares for each ordinary share with a total nominal value of 9.0 pence, this is the equivalent of a total annual payment to ordinary shareholders of 23.1 pence for each ordinary share. Further details are on page 162.

Net underlying R&D charged to the income statement increased by 21% to £755 million, reflecting a combination of increased net investment of £98 million and lower net capitalisation of £21 million (due to the phasing of major new programmes, in particular the certification of the Trent XWB-84) and £12 million lower net deferral of RRSAs entry fees — see page 115. The net investment spend represents 5.8% of Group underlying revenue, although it is expected that this will reduce slightly in the future towards the longer-term target of around 5%. Our gross R&D expenditure of £1.2 billion includes funded programmes.

Underlying financing costs reduced by 15% to £61 million reflecting reduced financial risk and revenue sharing arrangements (RRSAs) liabilities and other improvements.

Underlying EPS was marginally lower at 65.31p, with the impact of the lower underlying profit after tax largely offset by the improvement in the underlying tax rate and a lower non-controlling interest in Power Systems, following Daimler’s exercise of the put option in April 2014.

At the Annual General Meeting on 8 May 2015, the directors will recommend an issue of 141 C Shares with a total nominal value of 14.1 pence for each ordinary share. Together with the interim issue on 2 January 2015 of 90 C Shares for each ordinary share with a total nominal value of 9.0 pence, this is the equivalent of a total annual payment to ordinary shareholders of 23.1 pence for each ordinary share. Further details are on page 162.

**PROFIT BEFORE TAXATION**

<table>
<thead>
<tr>
<th></th>
<th>£ million</th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Underlying</td>
<td></td>
<td>1,617</td>
<td>1,759</td>
</tr>
<tr>
<td>Mark-to-market adjustments on derivatives</td>
<td>(1,254)</td>
<td>217</td>
<td></td>
</tr>
<tr>
<td>Movements on other financial instruments</td>
<td>(87)</td>
<td>(251)</td>
<td></td>
</tr>
<tr>
<td>Effect of acquisition accounting</td>
<td>(142)</td>
<td>(265)</td>
<td></td>
</tr>
<tr>
<td>Exceptional restructuring</td>
<td>(39)</td>
<td>–</td>
<td></td>
</tr>
<tr>
<td>Acquisitions and disposals</td>
<td>8</td>
<td>335</td>
<td></td>
</tr>
<tr>
<td>Post-retirement schemes</td>
<td>(29)</td>
<td>(90)</td>
<td></td>
</tr>
<tr>
<td>Other (including discontinued operations)</td>
<td>(7)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reported (2013 restated to exclude discontinued operations)</td>
<td>67</td>
<td>1,700</td>
<td></td>
</tr>
</tbody>
</table>

**REPORTED PROFIT BEFORE TAX**

Consistent with IFRS and past practice, the Group provides both reported and underlying figures. We believe underlying figures are more representative of the trading performance, by excluding the impact of year-end mark-to-market adjustments, principally the GBP:USD hedge book. In addition, post-retirement financing and the effects of acquisition accounting are excluded. The adjustments between the underlying income statement and the reported income statement are set out in more detail in note 2 to the Financial Statements. This basis of presentation has been applied consistently.

The mark-to-market adjustments are principally driven by movements in the GBP:USD exchange rate which moved from 1.65 to 1.56 during 2014.

**Net underlying R&D charged to the income statement** increased by 21% to £755 million, reflecting a combination of increased net investment of £98 million and lower net capitalisation of £21 million (due to the phasing of major new programmes, in particular the certification of the Trent XWB-84) and £12 million lower net deferral of RRSAs entry fees — see page 115. The net investment spend represents 5.8% of Group underlying revenue, although it is expected that this will reduce slightly in the future towards the longer-term target of around 5%. Our gross R&D expenditure of £1.2 billion includes funded programmes.

**Reported profit before tax**

Consistent with IFRS and past practice, the Group provides both reported and underlying figures. We believe underlying figures are more representative of the trading performance, by excluding the impact of year-end mark-to-market adjustments, principally the GBP:USD hedge book. In addition, post-retirement financing and the effects of acquisition accounting are excluded. The adjustments between the underlying income statement and the reported income statement are set out in more detail in note 2 to the Financial Statements. This basis of presentation has been applied consistently.

The mark-to-market adjustments are principally driven by movements in the GBP:USD exchange rate which moved from 1.65 to 1.56 during 2014.

**Costs associated with the substantial closure or exit of a site, facility or activity** are classified as exceptional restructuring and excluded.

**Profits and losses arising on acquisitions and disposals** during the year are excluded.

**Net financing on post-retirement schemes** is excluded from underlying profit so that all businesses are measured on an equivalent basis.

**Appropriate tax rates** are applied to these adjustments, the net effect of which was

**23.1p** payment to shareholders

**Movement on other financial instruments** primarily relate to the change in value of the put option on the Power Systems non-controlling interest, which has now been exercised.

**The effects of acquisition accounting** in accordance with IFRS 3 are excluded from underlying profit so that all businesses are measured on an equivalent basis.

**Costs associated with the substantial closure or exit of a site, facility or activity** are classified as exceptional restructuring and excluded.

**Profits and losses arising on acquisitions and disposals** during the year are excluded.

**Net financing on post-retirement schemes** is excluded from underlying profit so that all businesses are measured on an equivalent basis.

**Appropriate tax rates** are applied to these adjustments, the net effect of which was
The Group continues to maintain a strong balance sheet, providing reassurance to our customers.”

FINANCIAL REVIEW
CONTINUED

The Group
continues to maintain a strong balance sheet, providing reassurance to our customers.”

a £239 million reduction in the reported tax charge (2013 £54 million reduction). The adjustment includes a £64 million reduction in the value of recoverable advance corporation tax recognised. A reconciliation of the tax charge is included in note 5.

BALANCE SHEET

Intangible assets (note 9) represent long-term assets of the Group. These assets decreased by £77 million with additional development, contractual aftermarket rights, certification and software costs being more than offset by annual amortisation charges.

The carrying values of the intangible assets are assessed for impairment against the present value of forecast cash flows generated by the intangible asset. The principal risks remain: reductions in assumed market share; programme timings; increases in unit cost assumptions; and adverse movements in discount rates. There have been no significant impairments in 2014.

Property, plant and equipment (note 10) increased by £241 million due to the ongoing development and refreshment of facilities and tooling as the Group prepares for increased production volumes.

Investments in joint ventures and associates (note 11) remain stable as the share of retained profit was offset by dividends received.

Provisions (note 18) largely relate to warranties and guarantees provided to secure the sale of OE and services. The increase is largely a result of the recognition of restructuring costs.

Net post-retirement scheme surpluses/(deficits) (note 19) increased by £1,348 million, principally due to relative movements in the yield curves used to value the underlying assets and liabilities in accordance with IAS 19. In addition, the scheme rules on the largest UK scheme were amended during the year, resulting in the surplus being recognised (£544 million impact).

The Group’s principal pension schemes adopt a low risk investment strategy that reduces volatility going forward and enables the funding position to remain stable: interest rate and inflation risks are largely hedged and the exposure to equities is around 8% of scheme assets.

Net financial assets and liabilities (note 17) include the fair value of derivatives, financial RRASs, the put option on the non-controlling interest of Power Systems and C Shares. The reduction primarily reflects the settlement of the put option (£1,937 million) offset by a reduction in value of the foreign exchange derivatives (£1,137 million) due to the strengthening of the US dollar.

The USD hedge book increased by 4% to US$25.6 billion. This represents around four and a half years of net exposure and has an average book rate of £1 to US$1.61.

Net TotalCare assets relate to long-term service agreement (LTSA) contracts (and where appropriate the linked OE contract) in the Civil aerospace business, including the flagship services product TotalCare. These assets represent the timing difference between the recognition of income and costs in the income statement and cash receipts and payments. The increase largely reflects high levels of linked Trent 700 and increasing Trent 1000 engine sales in the year.
Customer financing facilitates the sale of OE and services by providing financing support to certain customers. Where such support is provided by the Group, it is almost exclusively to customers of the Civil aerospace business and takes the form of various types of credit and asset value guarantees. These exposures produce contingent liabilities that are outlined in note 18. The contingent liabilities represent the maximum aggregate discounted gross and net exposure in respect of delivered aircraft, regardless of the point in time at which such exposures may arise.

During 2014, the Group’s gross exposure on delivered aircraft increased by £32 million, due largely to the strengthening of the US dollar. On a net basis, exposures remained unchanged with a small reduction being offset by the exchange rate movement.

FUNDS FLOW

Movement in working capital – the increase reflects the growth of the net TotalCare asset offset by a reduction in the amount of customer deposits. This increase compares to a modest decrease in the previous year which is primarily a result of the phasing of customer deposit utilisation.

Expenditure on property, plant and equipment and intangibles – the decrease reflects a reduction in additions to property, plant and equipment (£32 million), participation fees and certification costs (£26 million) and software and other intangible assets (£41 million), offset by increased expenditure on contractual aftermarket rights (£41 million).

Pensions – contributions to defined benefit pension schemes in 2014 included £33 million to UK schemes to fund the discretionary increases agreed in 2013. The service cost included a past-service credit of £31 million – largely relating to restructuring (2013 past-service cost £71 million – largely relating to the discretionary increases above), which is the main reason for the £116 million increase in the cash contributions in excess of the PBT charge.

The Group’s funding of its defined benefit schemes is expected to reduce by around 30% in 2015, as a result of deficit funding requirements ending and the non-reoccurrence of the payment for discretionary increases.

Shareholder payments – the increase reflects the C Share issues in 2014 (£1 million increase) and the Power Systems dividend to Daimler (£14 million increase).

Acquisitions and disposals include the payment of £2,013 million (including the fair value of derivatives held to hedge the cost) for the additional 50% of Power Systems offset by £1,027 million of net proceeds from the disposal of the Energy business.

### SUMMARY FUNDS FLOW

<table>
<thead>
<tr>
<th>£ million</th>
<th>2014</th>
<th>2013</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening net funds</td>
<td>1,939</td>
<td>1,317</td>
<td>(122)</td>
</tr>
<tr>
<td>Closing net funds</td>
<td>666</td>
<td>1,939</td>
<td>(1,273)</td>
</tr>
<tr>
<td>Change in net funds</td>
<td>(1,273)</td>
<td>622</td>
<td>(1,273)</td>
</tr>
<tr>
<td>Underlying profit before tax</td>
<td>1,617</td>
<td>1,759</td>
<td>(142)</td>
</tr>
<tr>
<td>Depreciation and amortisation</td>
<td>600</td>
<td>608</td>
<td>(8)</td>
</tr>
<tr>
<td>Movement in net working capital</td>
<td>(509)</td>
<td>91</td>
<td>(600)</td>
</tr>
<tr>
<td>Expenditure on property, plant and equipment and intangible assets</td>
<td>(1,114)</td>
<td>(1,172)</td>
<td>58</td>
</tr>
<tr>
<td>Other</td>
<td>88</td>
<td>(231)</td>
<td>319</td>
</tr>
<tr>
<td>Trading cash flow</td>
<td>682</td>
<td>1,055</td>
<td>(373)</td>
</tr>
<tr>
<td>Contributions to defined benefit post-retirement schemes in excess of PBT charge</td>
<td>(152)</td>
<td>(36)</td>
<td>(116)</td>
</tr>
<tr>
<td>Tax</td>
<td>(276)</td>
<td>(238)</td>
<td>(38)</td>
</tr>
<tr>
<td>Free cash flow</td>
<td>254</td>
<td>781</td>
<td>(527)</td>
</tr>
<tr>
<td>Shareholder payments</td>
<td>(482)</td>
<td>(417)</td>
<td>(65)</td>
</tr>
<tr>
<td>Share buyback</td>
<td>(69)</td>
<td>–</td>
<td>(69)</td>
</tr>
<tr>
<td>Acquisitions and disposals</td>
<td>(965)</td>
<td>265</td>
<td>(1,230)</td>
</tr>
<tr>
<td>Net funds of businesses acquired</td>
<td>(30)</td>
<td>36</td>
<td>(66)</td>
</tr>
<tr>
<td>Foreign exchange</td>
<td>19</td>
<td>(43)</td>
<td>62</td>
</tr>
<tr>
<td>Change in net funds</td>
<td>(1,273)</td>
<td>622</td>
<td>(1,273)</td>
</tr>
<tr>
<td>Average net funds</td>
<td>(38)</td>
<td>350</td>
<td>(388)</td>
</tr>
</tbody>
</table>
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

With 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 engines.

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 engines.
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.
BUSINESS REVIEW – AEROSPACE

CIVIL AEROSPACE – KEY FINANCIAL DATA

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

* 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.

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% £1.64 billion in 2013. intake increased 55% to £2.54 billion, from 12% 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, 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.

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 MRRT 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.

DEFENCE – KEY FINANCIAL DATA

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

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

---

**LAND & SEA LOCATIONS**

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

**Multiple Land & Sea locations:**
- Finland 2
- France 2
- Germany 10
- Italy 2
- Netherlands 2
- Norway 8
- Poland 2
- Spain 2
- United Kingdom 4
BUSINESS REVIEW – LAND & SEA
CONTINUED

POWER SYSTEMS – KEY FINANCIAL DATA

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Order book £m</td>
<td>1,927</td>
<td>1,971</td>
<td>2%</td>
</tr>
<tr>
<td>Underlying revenue £m</td>
<td>2,831</td>
<td>2,720</td>
<td>-4%</td>
</tr>
<tr>
<td>Underlying OE revenue £m</td>
<td>2,004</td>
<td>1,893</td>
<td>-6%</td>
</tr>
<tr>
<td>Underlying services revenue £m</td>
<td>827</td>
<td>827</td>
<td>-</td>
</tr>
<tr>
<td>Underlying profit before financing £m</td>
<td>294</td>
<td>253</td>
<td>-14%</td>
</tr>
</tbody>
</table>

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 on-board power generators for two platform supply vessels for Chinese shipbuilder COSCO; and, in Brazil, MTU engines were specified for Rolls-Royce UT S35E 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.
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.

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.

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.
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.

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.
**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.
The engagement of our people is essential to the success of our strategy.

In 2014 we launched the Trusted to Deliver Excellence Awards. Over 500 submissions were received, each of which demonstrates the talent, innovation, commitment and ambition of Rolls-Royce men and women.

The achievements of all the entries that resulted in the final award winners showcased here, prove what’s possible when we put ourselves in customers’ shoes.

CELEBRATING SUCCESS:
AWARD WINNERS’ STORIES

SIMPLE TOUCH SCREEN TO HELP MARINE CUSTOMERS

MARINE
ÅLESUND, NORWAY

On the bridge of a marine customer’s ship, the team from Ålesund saw the array of different panels, uncoordinated operating systems and audible alerts that face our customers every day. They saw first-hand what could be a source of frustration, fatigue and a trigger for human error. The team redesigned an overlay to the operating system. This coordinated, both functionally and visually, the range of essential controls via a simplified touch screen to provide a unified bridge design.

100% RIGHT-FIRST-TIME DISC PRODUCTION

SUPPLY CHAIN
WASHINGTON, UK

The £100 million investment in the High-Performance Disc Manufacturing facility in Washington set the record for the fastest new Rolls-Royce facility build in the Group’s history. A combination of state-of-the-art equipment, training and up-skilling programmes has established a culture of continuous improvement. This has resulted in 100% right-first-time production and it means that the discs, which are integral to gas turbine engines, can be delivered in half the time.

The delighted right-first-time team from Washington, UK.

image: our advanced new unified bridge design for an offshore support vessel.
We need to work with people who make the whole production process smarter and more cost effective. People like these award winners.”

Nicole Piasecki, VP and General Manager, Propulsion Systems Division of Boeing Commercial Airplanes, presented the awards to the winners.

We need to work with people who make the whole production process smarter and more cost effective. People like these award winners.”

Nicole Piasecki, VP and General Manager, Propulsion Systems Division of Boeing Commercial Airplanes, presented the awards to the winners.

The winners from Montreal get the red carpet treatment themselves as they pick up their award.

The winners from Montreal get the red carpet treatment themselves as they pick up their award.

The winners from Montreal get the red carpet treatment themselves as they pick up their award.

The winners from Montreal get the red carpet treatment themselves as they pick up their award.

The winners from Montreal get the red carpet treatment themselves as they pick up their award.

The winners from Montreal get the red carpet treatment themselves as they pick up their award.

The winners from Montreal get the red carpet treatment themselves as they pick up their award.

The winners from Montreal get the red carpet treatment themselves as they pick up their award.

The winners from Montreal get the red carpet treatment themselves as they pick up their award.

The winners from Montreal get the red carpet treatment themselves as they pick up their award.

The winners from Montreal get the red carpet treatment themselves as they pick up their award.

The winners from Montreal get the red carpet treatment themselves as they pick up their award.

The winners from Montreal get the red carpet treatment themselves as they pick up their award.

The winners from Montreal get the red carpet treatment themselves as they pick up their award.
Our strategy focuses on customer, innovation and profitable growth to ensure a sustainable business.

OUR APPROACH

Sustainability is inherent to our strategy. For Rolls-Royce that means driving profitable growth whilst achieving a positive economic, social and environmental impact.

BETTER POWER

HELPING OUR CUSTOMERS DO MORE, USING LESS

We use our engineering expertise to develop and deliver integrated power systems for our customers, helping them to do more using less. Our commitment is to continuously improve the environmental performance of our products and services.

IMPROVING ENVIRONMENTAL PERFORMANCE

Our environmental strategy reflects the main focus of our investment and effort, concentrating on three areas: supporting our customers by further reducing the environmental impact of our products and services; developing new technology for future low-emission products; and maintaining our drive to reduce the environmental impact of our business activities.

PRODUCT SAFETY

Our products are often deployed in mission critical environments. We are committed to delivering products and services that achieve the highest standards of product safety. We have a consistent approach to safety across the Group and systematically pursue proactive opportunities for improvement. More details can be found in the Safety and Ethics Committee report on page 66.

BETTER FUTURE

COMMITTED TO INNOVATION, POWERING BETTER, CLEANER ECONOMIC GROWTH

This year, we invested over £1.2 billion in gross R&D. As a result of engineering expertise and our strong tradition of innovation, many of our products are currently market-leaders in terms of environmental performance. Innovation is embedded in all our products and services and is key to our competitive edge.

OUR PEOPLE

The Group employed a total of 54,100* people in 2014. We know that our future depends on the skills, knowledge and passion of all of our people and work to create an environment where all employees can reach their full potential.

We encourage diversity, engagement and development. We give full and fair consideration to all employment applications from people with disabilities, and support disabled employees helping them to make the best use of their skills and potential.

A diverse workforce will help ensure our continued success as a global business and contribute towards a better future. More information on our approach to diversity and gender distribution can be found in the Nominations and Governance Committee report, on page 65.

EMPLOYEE INVOLVEMENT

We use a variety of channels to communicate with our employees, including face-to-face and online communications. We encourage collaboration, employee suggestions and feedback through these systems. In addition we have mechanisms in place for employees to be able to raise concerns both formally and anonymously, including through the Rolls-Royce Ethics Line.

We have established frameworks for managing employee, trade union and representative participation, including formal information and consultations. Our incentive schemes and all-employee share plans enable every employee to have the opportunity to share in our success.

EARLY CAREER DEVELOPMENT PROGRAMMES

We continue to attract large numbers of high quality graduates and apprentices, and have well-established early career programmes in 11 countries worldwide.

In 2014, we introduced non-engineering graduate and apprenticeship programmes in Germany. We continue to focus on expanding...
our offerings beyond the UK, particularly in India and Germany.

We have won a number of awards this year, including TargetJobs Winner of ‘The most popular graduate recruiter – engineering, design and manufacture’ in the UK, for the fifth year running.

HUMAN RIGHTS
Our human rights approach is aligned with our Global Code of Conduct. It draws together relevant internal controls that oversee the range of issues encompassed by human rights. Our policy sets out our commitment to respect the human rights of our employees through core labour standards. This covers employee involvement, diversity and equality, pay and benefits, working hours, forced labour and child labour.

We comply with the local laws of the countries where we operate. In the event that our Human Rights policy imposes higher requirements than local law, we adhere to that higher requirement. We set equivalent standards for our supply chain through our Global Supplier Code of Conduct. This is part of our broader aim to align the standards of our suppliers to those of the Group.

EMPLOYEE WELLBEING
We work to enhance the personal wellbeing of our people to help them reach their full potential. We are committed to empowering and enabling employees to lead a healthy lifestyle at work.

We launched new wellbeing initiatives across our global locations this year. These include physiotherapy and employee assistance programmes in the UK, employee sports days in China and Germany, and a Wellbeing Month across our US facilities. Over 4,000 employees worldwide participated in the Global Corporate Challenge, amassing a combined total of over five billion steps.

COMMUNITIES
Our community investment and education outreach programmes support our Group strategy. We recognise that talented engineers are the key to our future and work actively to increase interest and encourage diversity amongst those taking science, technology, engineering and mathematics (STEM) subjects.

GLOBAL PARTNERSHIPS
We engage in dialogue and partnerships with governments and industry bodies aligned to our business needs. This year we have worked with the UK Government on the implementation of the Aerospace Growth Partnership. In the EU, we have focused on preventing unintended consequences of the inclusion of aviation in the European Union Emissions Trading Scheme. In North America, we continue to engage with a range of political stakeholders on issues including defence appropriations, aviation policy, Federal Aviation Administration approval of our products, and trade proposals.

Our joint venture in India has now reached full production and exports to our other locations around the world. Through our subcontractors TCS and Quest we have over 1,000 engineers serving the Group’s needs globally. In China we are present in more than 30 locations including joint ventures. Our manufacturing and services centres in Singapore are the heart of a multi-business and multi-function regional hub, where our first major Customer Service Centre opened in early 2015.

Better Business

INVESTING IN TECHNOLOGY, PEOPLE AND IDEAS TO IMPROVE ALL ASPECTS OF OUR PERFORMANCE AND TO DRIVE PROFITABLE GROWTH

ETHICS
High ethical standards, supported by good governance, are fundamental to how we run our business. We have a strong focus on ethics that helps ensure we win right every time. 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.

Rolls-Royce does not make any corporate contributions or donations to political parties or causes, as outlined in our Global Code of Conduct.

More information on our approach to ethics can be found in the Safety and Ethics Committee report on page 68.

HEALTH, SAFETY AND ENVIRONMENT
We regard the health and safety of our employees at work as paramount. It is therefore with particular regret that we report the death of four employees in a single drowning incident which occurred in 2014. This tragic incident took place outside work whilst deployed at a customer location. This incident is not reported in our annual data because it occurred outside working hours. We have sought to learn from this incident in terms of managing remote field-service activities.

We continue to monitor safety performance in the workplace and are continuing with the process of integrating our Power Systems business into our HS&E management system. At present, Power Systems does not collect its HS&E data in a manner consistent with the Group and therefore this data has been excluded from our 2013 and 2014 HS&E figures.

In 2014, our total reportable injury (TRI) rate fell by 16% to 0.37 TRIs per 100 employees, compared to 0.44 in 2013*. In the UK we were fined £200,000 and £176,000 in costs for a source radiography event that occurred in 2011. We improve the performance of our operations by reducing energy, greenhouse gas emissions and waste. We support our external suppliers to do the same.

ACCELERATING PROGRESS
Our goal is to be recognised as a leading sustainable business. To achieve this we have established a dashboard of higher stretching targets, showing progress towards improved sustainability performance.

These targets are baselined on our 2014 performance data, with the exception of the ACARE Flightpath 2050 goals.

Our 2014 sustainability performance and targets are detailed overleaf.
2014 PERFORMANCE

Sustainability is inherent to our strategy. To be recognised as a leading sustainable business we will deliver better power for our customers, use innovation to secure a better future, and develop a better business, ready to meet the opportunities ahead.

**CUSTOMER**

**BEFTER POWER**

*In the air*
Our new Trent 7000 engine will deliver a 10% improvement in specific fuel consumption and halve the noise energy output compared to the current engine on the A330. Announced this year, our Advance and UltraFan next generation designs will offer at least 20-25% better fuel burn and CO₂ emissions than first generation Trent engines.

*On land*
Our MTU technology installed on Deutsche Bahn’s diesel Coradia Lint 54 and 81-type trains reduces particulate emissions by 90% and contributes to reducing fuel consumption and CO₂ emissions. Our nuclear technology is installed in over 200 reactors across 20 countries worldwide, making a significant contribution to low-carbon electricity generation.

*At sea*
Our innovative ship design and propulsion systems and pioneering use of new cleaner fuel solutions are reducing emissions for our customers. Our Environship design reduces CO₂ by up to 40% compared to conventional diesel powered vessels and received the Heyerdahl Award this year.

**7,900** customers supported with our product learning solutions

**14,000** visitors at our Customer Training Centres

**INNOVATION**

**BEFTER FUTURE**

Over **1,000** employee STEM ambassadors globally

Supporting a global network of 31 University Technology Centres, engaging over **700 academics** in fundamental research into cutting edge technologies

Recruited **354 graduates** and **357 apprentices**

**£10.6 million invested** in supporting communities, a **31%** increase since 2013

**40,000** employees directly accessed our learning system, completing **250,000 individual courses**

In 2014 we invested **£1.2 billion in gross R&D** and filed for **600 patents**

**PROFITABLE GROWTH**

**BEFTER BUSINESS**

A Global Code of Conduct issued to all employees in **21** different languages

Reduced year-on-year energy consumption normalised by revenue by **16% since 2010**

Invested **£4 million** in energy efficiency improvement projects

**565 ktcO₂e** absolute total GHG emissions from our operations*

Total reportable injury (TRI) rate of **0.37** per 100 employees

Occupational illness occurrence rate of **0.05** per 100 employees

Our health and safety performance continues to improve with a **45% reduction** in TRI rate since 2010

Supported suppliers to complete **2,500** individual courses

---

*Refractory GHG emissions data detailed on page 164.

Limited assurance engagement undertaken by KPMG LLP, using the assurance standards ISAE 3000 and ISAE 3410, over the GHG and TRI data as highlighted. More information detailed on page 164.

We are in the process of integrating our Power Systems business into our HS&E management system. Energy, GHG, TRI and occupational illness data from Power Systems is excluded for 2014. The figures presented have been adjusted to reflect the disposal of our Energy gas turbine and compressor business in December 2014. Entities that were part of the Energy business that were not part of the disposal have been included.

---

Rolls-Royce has been listed in the Dow Jones Sustainability Index for the 13th consecutive year. We achieved an overall score of 66, well above the average of 49 in the Aerospace and Defense sector.

We have improved our CDP score to 89. This and our maintained performance band rating ‘B’ demonstrates our commitment to continually improving our environmental performance.
Our goal is to be recognised as a leading sustainable business. We have established a dashboard of higher stretching targets to accelerate progress.
KEY PERFORMANCE INDICATORS

We continue to build strong foundations for future growth in challenging economic conditions.

Financial performance indicators are shown below. The key objectives of the Board and its committees are described on pages 59 to 75, non-financial performance indicators are shown in the Sustainability section on pages 44 to 47.

<table>
<thead>
<tr>
<th>CUSTOMER</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ORDER BOOK</strong></td>
</tr>
<tr>
<td>+3% +5% excluding Energy</td>
</tr>
<tr>
<td><strong>HOW WE HAVE PERFORMED</strong></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td><strong>£bn</strong></td>
</tr>
<tr>
<td>59.2</td>
</tr>
<tr>
<td><strong>ORDER INTAKE</strong></td>
</tr>
<tr>
<td>Order intake is a measure of new business secured during the year and represents new firm orders, net of the movement in the announced order book between the start and end of the period. Any orders which were recorded in previous periods and which are subsequently cancelled, reducing the order book, are included as a reduction to intake. We measure order intake at constant exchange rates and list prices and, consistent with the order book policy of recording the first seven years’ revenue of long-term aftermarket contracts, include the addition of the following year of revenue on long-term aftermarket contracts.</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td><strong>£bn</strong></td>
</tr>
<tr>
<td>12.3</td>
</tr>
<tr>
<td><strong>UNDERLYING REVENUE</strong></td>
</tr>
<tr>
<td>Monitoring of revenues provides a measure of business growth. Underlying revenue is used as it reflects the impact of our FX hedging policy by valuing foreign currency revenue at the actual exchange rates achieved as a result of settling FX contracts. This provides a clearer measure of the year-on-year trend.</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td><strong>£m</strong></td>
</tr>
<tr>
<td>10,866</td>
</tr>
</tbody>
</table>
INNOVATION

<table>
<thead>
<tr>
<th>NET R&amp;D EXPENDITURE AS A PROPORTION OF UNDERLYING REVENUE</th>
<th>5.8%</th>
</tr>
</thead>
</table>

**WHY WE MEASURE IT**
This measure reflects the need to generate current returns as well as to invest for the future. We measure R&D as the self-funded expenditure before both amounts capitalised in the year and amortisation of previously-capitalised balances. We expect to spend approximately 5% of underlying revenues on R&D although this proportion will fluctuate depending on the stage of development of current programmes. We expect this proportion will reduce modestly over the medium term.

**HOW WE HAVE PERFORMED**
The increase reflects increased investment due to the phasing of major new programmes.

<table>
<thead>
<tr>
<th>%</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>4.7</td>
<td>4.6</td>
<td>4.7</td>
<td>4.8</td>
<td>5.8</td>
</tr>
</tbody>
</table>

CAPITAL EXPENDITURE AS A PROPORTION OF UNDERLYING REVENUE

| 4.6% |

To deliver on its commitments to customers, the Group invests significant amounts in its infrastructure. All proposed investments are subject to rigorous review to ensure that they are consistent with forecast activity and will provide value for money. We measure annual capital expenditure as the cost of property, plant and equipment acquired during the period and, over the medium term, expect a proportion of around 4%.

**HOW WE HAVE PERFORMED**
The level of expenditure reflects the ongoing investment in facilities and tooling as the Group prepares for increased production volumes.

<table>
<thead>
<tr>
<th>%</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>3.3</td>
<td>4.1</td>
<td>4.0</td>
<td>4.4</td>
<td>4.6</td>
</tr>
</tbody>
</table>

PROFITABLE GROWTH

<table>
<thead>
<tr>
<th>UNDERLYING PROFIT BEFORE FINANCING</th>
<th>-8%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-5% excluding FX</td>
</tr>
</tbody>
</table>

**WHY WE MEASURE IT**
We measure underlying profit before financing on a basis that shows the economic substance of the Group’s hedging strategies in respect of the transactional exchange rate and commodity price movements. In particular: (a) revenues and costs denominated in US dollars and euros are presented on the basis of the exchange rates achieved during the year; (b) similar adjustments are made in respect of commodity derivatives; and (c) consequential adjustments are made to reflect the impact of exchange rates on trading assets and liabilities and long-term contracts on a consistent basis.

**HOW WE HAVE PERFORMED**
The reduction reflects FX changes, restructuring costs, a one-off product rectification charge and higher R&D, partially offset by benefits on TotalCare contracts and lower bonus costs.

<table>
<thead>
<tr>
<th>£m</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1,010</td>
<td>1,206</td>
<td>1,495</td>
<td>1,831</td>
<td>1,678</td>
</tr>
</tbody>
</table>

AVERAGE CASH/DEBT

| -£38m |

We measure average cash based on the weekly balance of net funds/debt. These balances are reported at prevailing exchange rates and in recent periods, year-on-year movements in average cash balances reflect the significant acquisitions and disposals which have taken place, most notably RRPS in 2011, IAE restructuring in 2012, the purchase of the remaining 50% of RRPS and the disposal of our Energy gas turbines and compressor business in 2014. The impact on average cash balances will depend on when these transactions took place during the year.

**HOW WE HAVE PERFORMED**
The reduction reflects the impact of the purchase of the remaining 50% of Power Systems in August.

The sale of the Energy business in December had a minimal impact.

<table>
<thead>
<tr>
<th>£m</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>960</td>
<td>320</td>
<td>(145)</td>
<td>350</td>
<td>(38)</td>
</tr>
</tbody>
</table>

FREE CASH FLOW

| £254m |

In a business requiring significant investment, we monitor cash flow to ensure that profitability is converted into cash generation, both for future investment and as a return to shareholders. We measure free cash flow as the movement in net funds/debt during the year, before movements arising from payments to shareholders, acquisitions and disposals and FX.

**HOW WE HAVE PERFORMED**
The reduction mainly reflects lower profits and movements in customer deposits.

<table>
<thead>
<tr>
<th>£m</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>714</td>
<td>581</td>
<td>548</td>
<td>781</td>
<td>254</td>
</tr>
</tbody>
</table>

During 2015, we intend to re-consider the dashboard of financial and non-financial KPIs against which we believe the Group should be measured.
PRINCIPAL RISKS

Managing our risks to deliver better power for a changing world

Rolls-Royce benefits from operating a risk management framework within a risk-conscious organisation. Risk management is built into our day-to-day activities and forms an integral part of how we work. From our engineering design, through to engine production, servicing and how we run our operations, risk management is a key enabler for delivering our brand promise: ‘trusted to deliver excellence’.

Given the rapid growth of the business over the past few years and the changing risk environment that we work in, we have been reviewing how far the risk management framework continues to meet our needs across the Group. This work is now largely complete and we will be rolling out some improvements across the organisation to help ensure greater consistency across the different parts of our operations. Part of this review has looked at risk governance and how the Board assesses our principal risks and satisfies itself that these are being managed appropriately.

RISK GOVERNANCE

The review of our risk management framework has been conducted alongside the governance review described on page 56. The Board has decided that, from January 2015, the principal risks will be reviewed by the Board or the most appropriate board committees to make sure that there is sufficient focus and independent oversight on the risks. During the year, the relevant committees will carry out ‘deep dives’ to review their allocated risks in detail and then report to the Board. This will ensure that we are in a good position to assess how far controls and actions are effective.

The Executive Leadership Team (ELT) assists the Board in determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. During 2014, as part of the full and half-year results process, the ELT reviewed key risks which had been reported by the Divisions and functions. These were cross-checked with the risks that the ELT had identified from its own assessments, from which it developed a list of principal risks.

When the ELT reviews the principal risks it takes into account changes in external strategic factors such as the competitive environment, technology, cyber security and macro-economic developments as well as potential operational, financial and compliance risks. Changes in our risk profile are highlighted to the Board. The Board can regularly review and challenge whether the Group’s principal risks are the right ones to focus on and have an opportunity to discuss with senior management how they are being managed. The Board is very conscious of the need to both keep the list of principal risks under active review and consider potential risks as an explicit part of its discussions.

OUR RISK MANAGEMENT ACTIVITIES

The Board is responsible for the Group’s system of internal control and for maintaining and reviewing its effectiveness from a financial, operational and compliance perspective. This system of internal control is designed to identify and manage, rather than eliminate, the risk of failure to achieve business objectives and to provide reasonable but not absolute assurance against material misstatement or loss. Our risk management process is a key element of the Group’s internal control system and will develop in line with our activities, and in response to the risks and uncertainties that arise.

Risk management is implemented using a Group-wide framework and software tool and a network of trained experts.

Divisions and their business units and functions are accountable for identifying and managing risk in line with Group requirements and they formally review risks at least twice yearly. Business continuity plans are put in place by the businesses to mitigate continuity risks.

Risk thresholds are set at each level across the Group and any risks identified that meet the agreed threshold are captured in the Group risk software tool and escalated to Group level as part of a well structured reporting and review system.

This framework benefits from overall coordination by the Group’s enterprise risk team, led by the director of risk, which is responsible for disseminating risk policy and processes. To help ensure full coverage and efficiency we are currently conducting a risk, control and assurance mapping exercise to give the Board and committees that have oversight responsibility a clearer picture of how the internal control and risk management framework is working in practice.

Joint ventures constitute an increasingly large part of the Group’s activities. Responsibility for internal control procedures in joint ventures lies with the managers of those operations. We seek to exert influence over such joint ventures through board representation. Management and internal audit regularly review the activities of these joint ventures and the director of internal audit and the Audit Committee have been taking a close look at audit coverage in this area.
The Board is very aware that the effectiveness of risk management is highly dependent on behaviours, as a good process does not automatically lead to a good outcome. Our ethics and compliance improvement programme, aimed at securing compliance with our ethical standards, will help. The launch of the new Global Code of Conduct is reinforcing the values and behaviours required, which in turn will strengthen our risk culture.

**PRINCIPAL RISKS**

During the year, the ELT and Board focused on the principal risks and the actions being taken to manage them. This involved:
- discussing changes to the risk register;
- considering key risk thresholds and agreeing changes to limits; reviewing the risk indicators for principal risks; and, hearing from management how risks that exceed the revised thresholds will be managed.

The following table describes the principal risks facing the Group notwithstanding that there are other risks that may occur and may impact the achievement of the Group’s objectives.

<table>
<thead>
<tr>
<th>RISK OR UNCERTAINTY AND POTENTIAL IMPACT</th>
<th>HOW WE MANAGE IT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PRODUCT FAILURE</strong></td>
<td></td>
</tr>
</tbody>
</table>
| Product not meeting safety expectations, or causing significant impact to customers or the environment through failure in quality control. | • Operating a safety first culture  
  • Applying our engineering design and validation process from initial design, through production and into service  
  • The Safety and Ethics Committee reviewing the scope and effectiveness of the Group’s product safety policies to ensure that they operate to the highest industry standards (see Safety and Ethics Committee on page 66)  
  • Operating a safety management system (SMS), governed by the product safety review board, and subject to continual improvement based on experience and industry best practice. Product safety training is an integral part of our SMS  
  • Improving our supply chain quality  
  • Crisis management team chaired by the Director – Engineering and Technology or General Counsel as appropriate  

**This principal risk is subject to review by the Safety and Ethics Committee** |

| **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. | • Continuing investment in adequate capacity, and modern equipment and facilities (see Aerospace Business review on page 33)  
  • Identifying and assessing points of weakness in our internal and external supply chain, our IT systems and our people skills  
  • Selecting and developing stronger suppliers  
  • Developing dual sources or dual capability  
  • Developing and testing incident management and business continuity plans  
  • Crisis management team chaired by Director – Engineering and Technology or General Counsel as appropriate  
  • Customer excellence centres providing improved response to supply chain disruption  

**This principal risk is subject to review by the Audit Committee** |
### PRINCIPAL RISKS

**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.

**HOW WE MANAGE IT**

- Accessing and developing key technologies and service offerings which differentiate us competitively (see Innovation and Technology on page 21)
- 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 page 17 and Chief Financial Officer’s review on pages 26 and 27)
- Protecting credit lines
- Investing in innovation, manufacturing and production, and continuing governance of technology programmes
- Understanding our competitors

*This principal risk is subject to review by the Board*

### POLITICAL RISK

Geopolitical factors that lead to an unfavourable business climate and 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.

**HOW WE MANAGE IT**

- Where possible, locating our domestic facilities and supply chain in countries with a low level of political risk and/or ensuring that we maintain dual capability
- Diversifying global operations to avoid excessive concentration of risks in particular areas
- The international network of Rolls-Royce and its business units proactively monitoring local situations
- Maintaining a balanced business portfolio with high barriers to entry and a diverse customer base (see Chief Executive’s review on pages 15 and 16 and business model on pages 24 and 25)
- Proactively influencing regulation where it affects us (see Sustainability on page 45)

*This principal risk is subject to review by the Board*

### MAJOR PROGRAMME DELIVERY

Failure to deliver a major programme on time, within budget to specification or technical performance falling significantly short of customer expectations, or not delivering the planned business benefits, 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.

**HOW WE MANAGE IT**

- Major programmes are subject to Board approval (see Additional financial information on page 160)
- Reviewing major programmes at levels and frequencies appropriate to their performance against key financial and non-financial deliverables and potential risks throughout the programme’s life cycle (see Additional financial information on page 160)
- Conducting technical audits at pre-defined points and performed by a team that is independent from the programme
- Requiring programmes to address the actions arising from reviews and audits and monitoring and controlling progress through to closure
- Applying knowledge management principles to provide benefit to current and future programmes

*This principal risk is subject to review by the Board*
### RISK OR UNCERTAINTY AND POTENTIAL IMPACT

#### COMPLIANCE

Non-compliance by the Group with legislation or other regulatory requirements in the heavily regulated environment in which it operates (for example: export controls, use of controlled chemicals and substances, and anti-bribery and corruption legislation) compromising the 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.

- Taking an uncompromising approach to compliance
- Operating an extensive compliance programme. This programme and the Global Code of Conduct are disseminated 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 Safety and Ethics Committee on page 67)
- A legal and compliance team is in place to manage our compliance programme and any ongoing regulatory investigations (see Safety and Ethics Committee on page 68)
- Lord Gold has reviewed the Group’s current compliance procedures and the Group has continued to implement an improvement plan
- Implementing a comprehensive REACH compliance programme. This includes establishing appropriate data systems and processes, working with our suppliers, customers and trade associations and conducting research on alternative materials

**This principal risk is subject to review by the Safety and Ethics Committee**

#### MARKET SHOCK

The Group is exposed to a number of market risks, some of which are of a macro-economic nature. For example, oil price or foreign currency exchange rates, and some which are more specific to the Group, such as 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 creditworthiness. This would affect operational results or the outcomes of financial transactions.

- 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 161)
- Sustaining a balanced portfolio through earning revenue both from the sale of original equipment and aftermarket services, providing a broad product range and addressing diverse markets that have differing business cycles
- Deciding where and what currencies to source in, and where and how much credit risk is extended or taken. The Group has a number of treasury policies that are designed to hedge residual risks using financial derivatives (foreign exchange, interest rate and commodity price risk – see Additional financial information on page 160 and note 17)

**This principal risk is subject to review by the Audit Committee**

#### IT VULNERABILITY

Breach of IT security causing controlled or critical data to be lost, made inaccessible, corrupted or accessed by unauthorised users impacting the Group’s operations or reputation.

- Establishing ‘defence in depth’ through deployment of multiple layers of software protection and processes including web gateways, filtering, firewalls, intrusion, and advanced persistent threat detectors and integrated reporting (see Audit Committee report on pages 71 and 72)
- Running security and network operations centres
- Actively sharing IT Security information through industry, government and security forums

**This principal risk is subject to review by the Audit Committee**