

FOCUS



Underlying EPS

58.73p

Payment to shareholders

16.37p



OTHER STATUTORY INFORMATION P178

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We have made some important changes to our management in 2015 and laid the groundwork for further performance improvements as we tackle some near-term challenges.”

Ian Davis
Chairman

Rolls-Royce is a business in transition. The next few years are going to be very important as we capitalise on our outstanding portfolio of products and services and the £76.4bn order book that supports them. Underpinning this journey will be significant changes to our business. Warren East, our new Chief Executive, will talk more about these in the Strategic Report.

During this period of transition we should not forget the core strengths of the business. Our products, technologies and customer relationships have been further strengthened as a result of focused investment and the continued hard work of our teams. The sustained strong growth in our order book shows that our customers recognise the value Rolls-Royce delivers.

The fundamentals of our business are unchanged. We are investing today, as we have for many years, in building a strong installed base of mission-critical industrial, marine and aerospace power systems. Our market share, particularly in powering large civil airliners, will grow significantly over the next ten years providing a cash generative, sustainable platform from which to further develop the business. Investing today to secure that future is essential.



CORPORATE GOVERNANCE P63

In summary...

- Fundamental strengths of the business unchanged
- Continue to invest in market-leading products, technologies and customer services
- Lay stronger foundations to rebuild trust and confidence in a world-class engineering business

At the same time, we are facing some challenges in key markets, particularly in Marine, and are managing a major change in product mix within Civil Aerospace, which has a direct impact on how we recognise revenues and profits. This meant we took the decision to undertake a major restructuring of the business. Warren's recent review of operations, unanimously supported by the Board, highlighted a number of areas where, over time, costs have grown in an unsustainable way. This clearly needs to change. We have approved a plan to reduce our fixed cost base by £150m to £200m per annum and simplify the way we manage the business.

Shareholder payments

The pace of investment required to transform the business creates near-term pressure on free cash flow. At the same time, we need to sustain a healthy balance sheet to ensure we have the financial flexibility to maintain a strong investment-grade credit rating. As a result, the Board is recommending that the payment to shareholders is halved in cash terms at the full year and the next half year. We recognise the importance of a healthy 'dividend' to our shareholders. Subject to short-term cash needs, we intend to review the payment so that it will be rebuilt over time to an appropriate level. This reflects the Board's long-standing confidence in the strong future cash generation of the business.

As a result, the proposed final payment for 2015 is 7.1p per share, 50% of the final payment made for full year 2014. It is further proposed that the interim payment for 2016 will also be reduced to 50% of the prior year.

Corporate governance

2015 has proven to be a strong test of our governance processes and, while we will

take away several important learnings from different events, I have been impressed by how your Board and senior management at Rolls-Royce have performed at a difficult time. This has not been an easy year for the Company, its employees, investors or other stakeholders. We have had to communicate some challenging messages both internally and externally about our market outlook, our performance and, very importantly, the essential changes we will be making to cut waste and restore confidence in the business.

We have not taken our eye off some of the historic issues that have undermined confidence in the business in the past. Concerns about bribery and corruption involving intermediaries in overseas markets remain subject to examination by the Serious Fraud Office and other authorities and these investigations are not yet complete. We have done much to address the root of these problems and this work is being continually reinforced to ensure we all meet the high standards expected of us.

Board developments

During the year there have been a number of important changes to the Board. On 22 April we announced that John Rishton had decided to retire as Chief Executive on 2 July, to be succeeded by Warren East. At the AGM on 8 May James Guyette, President and Chief Executive Officer of Rolls-Royce North America, retired and stepped down from the Board. John Neill also stood down at the AGM after six years as a Non-executive Director.

Irene Dörner, formerly CEO and President of HSBC USA, joined the Board in July. Alan Davies, Chief Executive of Rio Tinto's Diamonds and Minerals division, and Sir Kevin Smith, the former Chief Executive of GKN, the multinational automotive and aerospace business, both joined the Board from 1 November. In February 2016, Sir Kevin assumed Chairmanship of the Science & Technology Committee.

Irene brings a wealth of international expertise, particularly in risk management and operational performance. Alan, as well as having a strong financial background, brings relevant experience in transforming operational performance and driving cultural change through a complex global organisation, together with a deep knowledge of China and other key emerging markets. Sir Kevin also brings recent Asian experience together with significant aerospace industry knowledge, with

engineering and manufacturing experience, after a long career at GKN and BAE Systems.

Lewis Booth, a US resident and an independent Non-executive Director since 2011 has indicated his intention to relinquish his responsibility as Senior Independent Director once a successor has been appointed. He will continue as Chairman of the Audit Committee.

Dame Helen Alexander, an independent Non-executive Director since 2007, will be stepping down from the Board after the AGM in May 2016 having completed her nine-year term. At that time she will be succeeded as Chairman of the Remuneration Committee by Ruth Cairnie, who joined the Board in September 2014. On behalf of the Board I would like to thank Dame Helen for her dedicated service to the Company. She has been a wise and insightful member of the Board and her well-judged advice and leadership of our Remuneration Committee have been highly valued by her colleagues.

Rebuilding trust and confidence

In the first months since his appointment last July, Warren has made an enormous impact on the business with a clear, well-structured review. This has examined the strengths and weaknesses of our businesses and highlighted the critical investment priorities required to develop our competitive advantages and market position. I have also been pleased by the steps he and his team have taken to improve communication to our investors. While it is early days, I believe his approach has been well received and has laid good foundations from which we can rebuild trust and confidence in the business.

Looking forward

2016 will be another challenging year for Rolls-Royce. As Warren sets out in his review, we are doing a great deal within the business to ensure we successfully transition over the next few years to a more strongly profitable and cash-generative future. The Group is well positioned to grow strongly on the back of innovative, market-leading technology. We do have some near-term challenges but the fundamentals of the business remain strong, underpinned by a record order book and some great people across the organisation.

Ian Davis

Chairman

11 February 2016