News Release

Rolls-Royce

Trusted to deliver excellence

28 July 2016

ROLLS-ROYCE HOLDINGS PLC
2016 HALF YEAR RESULTS

Commenting on the results, Warren East, Chief Executive, said: "In the first half of 2016 Rolls-Royce performed broadly in line with expectations, delivering a result a little better than breakeven; and the outlook for the rest of the year remains unchanged. Order intake has been good and, although known headwinds constrained revenue and profit in the first half, the business remains well positioned to deliver a solid second half performance supported by growth in engine deliveries, stronger aftermarket revenues and incremental benefits from our ongoing restructuring programmes."

	Reported			Underlying		
Half year to 30 June	**2016**	2015	Change*	**2016**	2015	Change*
Revenue (£m)	**6,462**	6,370	-1%	**6,143**	6,256	- 5%
Profit before tax (£m)	**(2,150)**	310	-	**104**	439	- 80%
Earnings per share (p)	**(96.72)p**	19.51p	-	**4.20p**	18.30p	-81%

	2016	2015	Change**
Net funds (£m)	**(712)**	(643)	-69
Free cash flow (£m)* **	**(399)**	(576)	+177

Underlying: for definition see note 2 on page 32; * translated at constant exchange rates; ** translated at actual exchange rates; *** free cash flow defined as operating cash after capital expenditure, pensions and taxes, before payments to shareholders, foreign exchange and acquisitions & disposals. The derivation of free cash flow from the cash flow statement is shown on page 44.

H1 highlights

- Reported revenue down 1% at constant exchange rates; reported loss reflects a non-cash impact of £2.2bn period-end mark-to-market revaluation of our derivatives
- Underlying revenue down 5% at constant exchange rates, led by Civil Aerospace and Marine
- Underlying profit before tax at £104m, down 80% at constant exchange rates
- As set out in February 2016, interim payment to shareholders reduced to 4.60 pence per share (2015 interim: 9.27 pence)

Transformation programme

- 2016 programme well underway, good progress on actions to date
- £50m benefit expected in 2016
- Over £100m of annualised savings already identified; on track for £150-200m by end 2017

Looking forward

- Trading outlook for 2016 unchanged
- €720m acquisition of outstanding ITP stake announced 11 July; expected completion early 2017
- Greater clarity on principles of IFRS 15; further work required in order to assess likely impacts

Warren East added: "We have taken some positive first steps on the journey that will lead Rolls-Royce to profitable and highly cash generative growth. Our strategic advantages lie in our focus on engineering excellence, operational excellence and capturing value in the aftermarket. In the first six months, we have made progress with our business transformation; introducing the greater pace and simplicity required to make Rolls-Royce a more resilient company."

This announcement has been determined to contain inside information.

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Photographs and broadcast-standard video are available at www.rolls-royce.com.
A PDF copy of this report can be downloaded from www.rolls-royce.com/investors.

This Half Year Results Announcement contains forward-looking statements. Any statements that express forecasts, expectations and projections are not guarantees of future performance and will not be updated. 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 under English law.

Results Presentation

A presentation will be held at 08:45 (GMT) today. Details of how to join the event online are provided below. Downloadable materials will be available on the Rolls-Royce website from the start of the event.

Online webcast registration details for 28 July presentation
To register for the live webcast (including Q&A participation) please visit this link:

http://edge.media-server.com/m/p/u2yh2kw3

Please use this same link to access the webcast replay after the event.

2016 Half Year Business Highlights

Percentage or absolute change figures in this document are on a constant translational currency ('constant currency') basis unless otherwise stated

	*% of Group revenues**	Closing order book £bn	**Underlying revenue** £m H1 2016	% change	**Underlying profit before financing** £m H1 2016	% change
Civil Aerospace	*51%*	70.5	3,171	-5%	31	-91%
Defence Aerospace	*16%*	4.2	1,002	-1%	128	-33%
Power Systems	*18%*	2.0	1,084	-3%	13	-35%
Marine	*9%*	1.0	548	-25%	(13)	n/a
Nuclear	*6%*	2.0	356	+14%	18	-15%
Eliminations/other/central		(0.2)	(18)		(19)	
Total Group		**79.5**	**6,143**	**-5%**	**158**	**-70%**

* *Based on gross revenues prior to intra-group eliminations*

Civil Aerospace

- Underlying revenue down 5% and lower gross margins, principally due to:
  - Original equipment (OE): increased deliveries of newer Trent engines but lower link-accounted Trent 700 and business aviation sales
  - Services: growth from in-production fleet, but declining regional and other large engine fleet aftermarket revenues; increase in technical costs for large engines, including the Trent 1000 but some offsetting foreign exchange benefits
- £3.4bn order book growth; includes over £2bn foreign exchange benefit from long-term US dollar planning rate change
- Good progress on new engine programmes: launch of the Trent XWB-84 EP with Singapore Airlines in February and Trent 1000 TEN receiving EASA certification in early July
- Supply chain modernisation reducing costs and increasing capacity for Trent XWB ramp up
- H2 outlook: increasing deliveries driving OE growth and further targeted lifecycle cost savings on large engine installed base

Defence Aerospace

- Underlying revenue 1% lower; growth in OE revenues offset by reduction in service revenues
- Underlying profit before financing down 33%; reflecting adverse product mix and £31m costs supporting TP400 programme
- Roll-out of further Service Delivery Centres set to enhance aftermarket service offering
- H2 outlook: supported by higher engine deliveries, particularly in transport & patrol; actions underway to mitigate TP400 costs

Power Systems

- Underlying revenue 3% lower; led by weaker OE sales
- Underlying profit before financing 35% lower; reflecting lower volume and changes in mix
- R&D investment focus on higher volume engine applications
- H2 outlook: challenging market environment; healthy closing order book for OE in a number of key market segments; cautious but positive outlook

Marine

- Underlying revenue down 25%; weak offshore markets impacting OE and service revenues
- Underlying profit before financing negative; lower volumes and reduced overhead absorption from weak offshore performance with some offset from non-repeat of contract provision in 2015
- Net restructuring benefits from legacy programmes starting to benefit performance
- H2 outlook: continuing challenging offshore market for OE and services; naval and merchant focus on operational execution and ongoing cost reduction

Nuclear

- Underlying revenue 14% higher; strong revenues led by increased submarine work
- Underlying profit before financing 15% lower, adverse margin mix in submarine projects
- H2 outlook: steady – focus on improving delivery performance

Chief Executive's Review

Introduction

In the first half of 2016, Rolls-Royce performed broadly in line with expectations and the outlook for the rest of the year remains unchanged. Order intake has been good, and although known headwinds constrained revenue and profit in the first half, the business remains well positioned to deliver a solid second half performance supported by growing engine deliveries, underlying growth in aftermarket revenues and incremental benefits from our ongoing restructuring programmes.

Performance in the first six months of 2016

Our performance in H1 2016 was broadly in line with our early expectations, with Trent 700 volume and price reductions, legacy aftermarket reductions and Marine markets causing most of the weakness. At the same time we have continued to invest in products and services to support our customers and reinforce the long-term strength of our order book, valued at £79.5bn including £2.2bn of foreign exchange benefit, up 4% from 2015 year end.

Group underlying revenue reduced 5% on a constant currency basis with reductions in both original equipment and aftermarket services revenues led by the Civil Aerospace and Marine businesses. Previously communicated Trent 700 volume and price reductions, reductions in business jet volumes resulting from softening markets, reduced utilisation and fewer overhauls of some of our more mature widebody large engines and increased technical costs for large engines, including the Trent 1000, were the most significant contributors in Civil Aerospace. This was partly offset by the impact of a change to our long-term US dollar planning rate. Difficult trading conditions in offshore oil and gas markets continue to hamper performance in Marine. Compared to H1 2015, underlying profit before finance charges and tax was 70% lower at £158m.

On an underlying profit before finance charges and tax basis, Civil Aerospace delivered £31m (2015: £248m); Defence Aerospace delivered £128m (2015: £184m); Power Systems delivered £13m (2015: £17m); Marine generated a loss of £(13)m (2015: £4m profit) and Nuclear delivered £18m (2015: £20m excluding the residual Energy business assets now reported in "Other"). More detail on each business is included in the Operational Review.

After underlying financing costs of £54m (2015: £17m including a £24m gain from hedging overseas dividends), underlying profit before tax was £104m (2015: £439m).

Since the EU referendum vote at the end of June, the value of sterling relative to the US dollar fell significantly. As a result, we have recognised a £2.2bn non-cash mark-to-market valuation adjustment for our US dollar hedge book. Reported revenue of £6,462m (2015: £6,370m) was unaffected by this; however the valuation adjustment was the principle reason for reported financing costs being £(2,386)m (2015: £(69)m) and reported loss before tax being £(2,150)m (2015: £310m profit).

After an underlying tax charge of £27m (2015: £102m), underlying profit for the year was £77m (2015: £337m). With an average 1,832m shares in issue, underlying earnings per share were 4.20p (2015: 18.27p).

After a reported tax credit of £378m (2015: £50m), reported loss for the year was £(1,772)m (2015: £360m profit). Reported earnings per share were (96.72)p (2015: 19.51p).

A full reconciliation of underlying to reported profit can be found in note 2 on page 32.

At the same time, the weakness in sterling does present near-term opportunities by providing scope to reduce the average hedge book rate and to benefit from a better conversion of our overseas revenues and costs to marginally enhance our underlying performance. As a result, the weaker pound will enhance underlying full year earnings in future years to the extent our effective hedge rate declines over time.

The free cash outflow for the first half of £399m (2015: outflow of £576m) was lower than expected, reflecting strong cash collections from a number of key customers at the very end of the period and a better

than expected overall working capital performance. Most of this positive variance is a timing impact and likely to reverse early in H2 2016.

A more detailed review of financial performance is included in the Group Trading Summary and the Financial Review.

Positive market developments continue to drive long-term growth in Civil Aerospace

The long-term positive market trends for our leading power and propulsion systems remain unchanged despite some near-term uncertainties in Civil Aerospace that are expected to impact business jet engine production volumes and service activity on older large engines over the next couple of years. The long-term trends driving demand for growth in large passenger aircraft, business jets, power systems and maritime activity remain strong; in particular a growing aspirational and mobile middle-class, particularly in Asia, and globalisation in business, trade and tourism.

While recent political and economic developments have added some uncertainty to near-term utilisation, we continue to expect that strong widebody airframe demand - driven by the need for newer, more fuel efficient aircraft - should provide resilience to manufacturing schedules over the next few years as the industry undergoes a strong replacement cycle.

Transitioning airframes impacting short-term performance

The effects of the transition of the Airbus A330ceo to A330neo models have impacted profitability in line with our early estimates. Once completed, we will benefit from an exclusive position with the new Trent 7000 on the A330neo. In the near-term the profit impact of this transition is negative; the impact of lower pricing and gross margin is exacerbated by the accounting effects of changes within our large engine aerospace product mix as we transition to a portfolio increasingly comprising “unlinked-accounted” engine sales. However, the roll-out of new engines, including the Trent XWB for the highly successful Airbus A350 family, will significantly grow our market share and the installed base of new engines that will deliver strong aftermarket revenues for decades to come.

Good progress in the first six-months of our new transformation programme

The objective of our new transformation programme announced in November 2015 is to simplify the organisation, streamline senior management, reduce fixed costs and add greater pace and accountability to decision making. Our target is to deliver incremental gross cost savings of between £150m and £200m per annum, with the full benefits accruing from the end of 2017 onwards.

A transformation team was set up at the end of 2015 to drive change to simplify processes and activities across the company to deliver sustainable performance improvements, and ensure the other restructuring programmes maintain progress.

In the first half of 2016, these transformation actions resulted in the removal of the divisional structure and a reduction of over 400 in headcount across the management levels of the business. As a result, the initial savings achieved are primarily in indirect costs, particularly at corporate and divisional level.

The management simplification has also enabled early improvements to a number of business processes through clearer delegated authorities and reporting lines together with more efficient management reporting and oversight. As a result, the changes enable management to better direct their efforts onto our core areas of focus and continuous improvement. These encompass engineering excellence, operational excellence and capturing more aftermarket value through leveraging our installed base and improving customer facing activities. Examples include: improving cost-awareness and lead times within product development; reducing production cycle times; and encouragement of local initiatives enhancing customer responsiveness and inventory management across our aftermarket activities.

Good early progress on this programme has meant that the business is well on track towards delivering at the top end of our targeted £30-50m of savings in 2016, which will be second half weighted, with over £100m of annualised savings now identified. As a result we are well on our way to achieving the £150-200m of annualised cost savings by the end of 2017. Exceptional restructuring charges for this

programme were £53m in H1 2016 and we expect to remain within our full year 2016 target range of £75-100m.

Work is also well advanced to deliver the necessary suite of key performance indicators (KPIs) needed to create a high performance culture. Management information and forecasting tools are being rolled out across the business to simplify the tracking of performance. These include both physical drivers, for example, various measures of delivery performance and working capital management, together with a greater emphasis on forward-looking KPIs. When combined with increased accountability and improved speed and accuracy of data, we believe the tools being put in place will help drive the needed behavioural change and embed greater pace and simplicity within the business culture.

Acquisition of outstanding 53.1% stake in Industria de Turbo Propulsores SA (ITP)

We were notified in early July that SENER Grupo de Ingeniería SA ("SENER") had decided to exercise the put option in respect of its 53.1% stake in Industria de Turbo Propulsores SA ("ITP"). This decision provides us with the opportunity to effectively consolidate several key large engine risk and revenue sharing partner (RRSP) arrangements into the business and strengthens our position on a number of important defence engine platforms and will enable us to enjoy greater benefits from future aftermarket growth.

Under the existing shareholder agreement, the consideration will be settled over a two year period following completion in eight equal, evenly spaced instalments. The agreement allows flexibility to settle up to 50% of the consideration in the form of Rolls-Royce shares. Final consideration as to whether the payments will be settled in cash or cash and shares will be determined by Rolls-Royce during the payment period. Completion, which is subject to regulatory clearances and due diligence, is expected in early 2017.

The acquisition strengthens Rolls-Royce's position on its Civil Aerospace large engine growth programmes by capturing significant additional value from its long-term aftermarket revenues, including the high volume Trent 1000 and XWB engines, where ITP has played a key role as an RRSP. It also enhances the group's own manufacturing and services capabilities and adds value to the Defence Aerospace business, particularly on the TP400 and EJ200 programmes.

Update on regulatory investigations

We previously reported that the Serious Fraud Office had begun a formal investigation. The Group is continuing to cooperate with the authorities in the UK, US and elsewhere. As the investigations are still ongoing we are unable to give any further details or a timescale for when they will conclude.

Shareholder payments

In February 2016 we recommended that the payment to shareholders should be halved at both the full year for 2015 and at the 2016 half year. As we discussed at the time, 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. We recognise the importance of a healthy 'dividend' to our shareholders and so over time, and subject to short-term cash needs, we intend to review the payment so that it will be progressively rebuilt 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 interim payment for 2016 is 4.60 pence per share, a halving of the interim payment made for full year 2015. As in past payments, the distribution will be in the form of C Shares. Further details are included on page 41 at the end of this statement.

Outlook for the balance of 2016

Our outlook for 2016 is unchanged from that set out in February 2016. On a constant currency basis Group revenue for 2016 is expected to be marginally lower than that achieved in 2015, partially reflecting pricing and volume effects in Civil Aerospace and the continued weakness in offshore marine markets. Overall, the net profit trading headwinds discussed in previous announcements are unchanged.

Individual outlooks are provided for each business in the operating review.

Looking further ahead - long-term outlook remains strong

We continue to see value in the underlying strengths of our business: the underlying growth of our long-term markets, the quality of our mission-critical technology and services, and strength of customer demand for these which are reflected in our exceptional order book. While we have near-term challenges and some core execution priorities, these constants provide us with confidence in a strong, profitable and cash-generative future.

The successful roll-out of new engines, led in particular by the Trent XWB, 1000 and 7000, together with a growing aftermarket, is expected to drive significant revenue growth over the next ten years as we build toward a 50%-plus share of the installed widebody passenger market. As a result, we remain confident that the important investments we are making to transition our production will create a strong platform to drive customer service and strong cash flows, together with the current investments in new products and the streamlining of our existing product portfolios to ensure we are providing high value, cost-competitive products into our target end markets.

Expected ongoing benefits of all current restructuring programmes will reduce costs by around £300-350m by the end of 2017

Ongoing divisional restructuring programmes together with the new programme announced in November 2015 are expected to reduce costs by around £300m to £350m. This breaks down to incremental legacy Civil and Defence Aerospace restructuring savings of £80m, Marine savings of £65m and new transformation programme savings of between £150m and £200m.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 is a joint standard for IFRS and US GAAP issuers and introduces new accounting principles for revenue recognition for all types of sales of goods or services. For Rolls-Royce, it comes into force from 1 January 2018 and as a result we will adopt IFRS 15 in both our half-year and full-year 2018 accounts. At that time we will restate the 2017 results, with an opening balance sheet adjustment to equity as at 1 January 2017.

It replaces existing revenue recognition standards: IAS 11 *Construction Contracts* and IAS 18 *Revenue*, and moves away from the 'risks and rewards' concept of revenue recognition used by IAS 18 to a concept of 'transfer of control'. Its core principle is that revenue should be recognised when (or as) an entity transfers control of goods or services.

It is important to remember that, while these changes will be significant, there will be no changes to the treatment of cash flows and cash will still be collected in line with the contractual terms.

We have been working to assess the implications and quantify the impact of the new standard. Our work has confirmed our view that our current accounting is in compliance with existing standards and we will continue to make commercial evaluations on a long-term net present value basis.

We are consulting with other companies in the aerospace and defence sector, so that we can take account of other interpretations in our implementation of the new requirements. Before we can fully assess the impact, we still have a considerable amount of work to do to apply the new standard to the large range of different contracts for our original equipment and aftermarket sales across all our businesses. However, the most significant impact will be in Civil Aerospace.

As we described in our 2015 Annual Report, based on our provisional assessment, IFRS 15 will have a significant impact on the timing and profile of revenue recognition over the life of individual long-term contracts (without changing the total amount of revenue recognised), although this will be somewhat mitigated when the portfolio of contracts is combined, and in the way we allocate revenue between original equipment and aftermarket sales.

We have now reached **tentative** conclusions on several key areas of judgement, as follows:

- We will likely no longer recognise contractual aftermarket rights (CARs)
- We will likely no longer link OE and TotalCare agreements, including where we are currently doing so, and these would then be accounted for separately
- Revenues will likely be recognised as and when we deliver OE and then when we carry out aftermarket services activities

The main impacts of applying these principles to civil large engines are expected to be as follows:

Change	Consequence on underlying profit before financing
Unlinked accounting – creation of CARs would cease	• Any OE cash deficits would now be expensed on delivery • Note: the CARs balance would be subject to a transition adjustment • There would be no amortisation expense of OE CARs recognised in prior periods
Linked accounting – would no longer be applied, OE and TotalCare agreements will be accounted for separately and concessions agreed with operators that relate to the aircraft delivery will be set against the OE sales price to the airframer	• Any in-year OE deficits on currently linked engines would now be recognised on delivery • Any OE price concessions would no longer be deferred to the linked aftermarket contract • Note: the TotalCare debtor balance would be subject to a transition adjustment • The unwinding of previous OE deficits and deferred price concessions would no longer reduce TotalCare service margins
TotalCare revenues – would be recognised on an event basis, with the majority being recognised as shop-visits occur	• The profile of revenue recognised on TotalCare contracts over their lives would change, with limited revenue recognition until the first shop visits

Further work is required to fully evaluate the impact and to prepare for adoption in 2018 including:
- finalise our methodology for recognition of revenue on TotalCare contracts including, for example, the impact on risk and revenue sharing agreements and the impact of acquiring ITP
- modelling the detailed impact on our historical results and to determine the actual transition adjustments at 1 January 2017
- finalise the procedures required to operate under the new requirements
- complete the evaluation and implementation for all businesses (note: our initial evaluations indicate these will be less significant than for the Civil Aerospace large engine business)

The adoption of IFRS15 will enhance the focus on cash efficiency measures. This will be particularly important as we invest in building the installed thrust and manage the transition to being the larger aftermarket business that will provide sustainable long-term cash flows. In parallel to our review of KPIs and future remuneration frameworks, we are working to ensure that future measures work within IFRS15 to provide the right focus on cash efficiency, cash conversion and overall free cash flow performance.

We expect to be in a position to give more detail and an indication of potential impact in Q4.

Board update

During the first six months of the year there have been a number of important changes to the Board. In March we appointed Brad Singer to the Board, at which time he also joined the Science and Technology Committee. In May, following the AGM, Dame Helen Alexander stepped down from the Board having reached the end of her term and was succeeded as Chair of the Remuneration Committee by Ruth Cairnie.

In addition, alongside chairing the Science and Technology Committee, Sir Kevin Smith took over the role of Senior Independent Director from Lewis Booth, who continues as Chair of the Audit Committee. Finally, Alan Davies will join the Safety and Ethics Committee with effect from the start of September 2016.

Group Trading Summary

The commentary in this section relates to the Group's operating segments and so, consistent with the requirements of accounting standards, is provided on an underlying basis which is the measurement basis used by the Group in its segment reporting.

£m	H1 2015	Underlying Change***	Acquisitions & disposals	Foreign Exchange*	H1 2016
Order book **	**76,399**	3,028	–	94	**79,521**
Underlying revenue	**6,256**	(296)	–	183	**6,143**
Change		*-5%*		*+3%*	*-2%*
Underlying OE revenue	3,062	(146)	–	102	3,018
Change		*-5%*		*+3%*	*-1%*
Underlying services revenue	3,194	(150)	–	81	3,125
Change		*-5%*		*+3%*	*-2%*
Underlying gross margin	**1,332**	(348)	–	49	**1,033**
Gross margin %	***21.3%***	*-480bps*			***16.8%***
Commercial and administrative costs	(496)	(22)	–	(20)	(538)
Restructuring	(45)	39	–	–	(6)
Research and development costs	(378)	12	–	(12)	(378)
Joint ventures and associates	43	2	–	2	47
Underlying profit before financing	**456**	(317)	–	19	**158**
Change		*-70%*		*+4%*	*-65%*
Underlying operating margin	***7.3%***	*-500bps*			***2.6%***

**Translational foreign exchange impact ** 2015 year end comparative ***Order book change includes £2.1bn increase from change to Long Term US dollar planning rate*

As noted in the 2015 Annual Report, the methodology basis for the allocation of Civil Aerospace revenues on linked TotalCare contracts between original equipment and aftermarket was reviewed and amendments made to reflect better the commercial substance of the combined contracts. Historically, the allocation resulted in original equipment revenue and aftermarket revenue reflecting the contractual terms rather than the commercial substance of the contracts. The H1 2015 figures have been restated on the same basis; the impact was an increase in original equipment revenue of £66m and an equal decrease in aftermarket revenue

Order book and order intake

During the year our order book increased by £3.1bn to £79.5bn, led by Civil Aerospace. Key orders included a $2.7bn order from Norwegian for Trent 1000 engines and the selection by China Eastern of 20 Trent XWB powered Airbus A350 aircraft. The order book also benefitted by a £2.1bn uplift from a 5 cent decrease to our long term US dollar planning rate which is used to convert foreign currency orders. Order intake in our Marine business has been low as a result of the continuing weak offshore market. Overall orders were also lower in Defence Aerospace and Power Systems, although we view the prospects for these businesses as unchanged, reflecting long-term orders won in previous years. Order intake in our Nuclear business was higher as a result of submarine programme activity.

Underlying trading

Underlying group revenue declined 5% in H1 2016 compared to 2015 on a constant currency basis, reflecting declines in both original equipment revenue (down 5%) and services (down 5%) and led by Civil Aerospace and Marine. By business on a constant currency basis, Civil Aerospace revenue reduced 5%, Defence Aerospace revenue decreased 1%, Power Systems revenue decreased 3%, Marine revenue decreased 25% and Nuclear revenue increased 14%.

Underlying profit before financing of £158m (2015: £456m) was 70% lower on a constant currency basis, led by a significant reduction in Civil Aerospace profit reflecting previously communicated volume and margin reductions on link accounted Trent 700 engines, reduced business jet original equipment volumes, reduced large engine aftermarket utilisation and increased technical costs for large engines, including the Trent 1000. Profit in Defence Aerospace was £61m lower resulting from a reduction in sales volumes and

£31m of costs in support of the TP400 programme. Power Systems was down £6m year-on-year due to lower sales and a product mix effect. Marine profit was £18m lower led by continuing weakness in the off-shore markets. Nuclear profit in H1 2016 was £3m lower than 2015 due to a lower margin mix in submarine projects

The R&D charge reduced by 3% over 2015 on a constant currency basis, reflecting an increase in the level of capitalisation within Civil Aerospace in H1 2016 and reduced spend in Power Systems.

Underlying restructuring has reduced to £6m (2015: £45m). Charges relating to the transformation activity launched in November 2015 are treated as exceptional in light of the scale of the programme. An exceptional charge of £53m for this programme has been taken in H1 2016. The benefits of cost savings arising from this programme in 2016 are expected to have a second half weighting.

Commercial and administrative costs include accruals for performance incentive schemes in line with our current policies. Given the current state of performance relative to plan, these are currently higher than in the prior year.

Free cash flow

Cash capital expenditure in the first half of 2016 was £307m (2015: £257m), £50m higher, largely reflecting phasing of payments for aerospace footprint and capacity investments. Cash taxes were £62m (2015: £79m). The cash cost of defined benefit pension schemes in excess of the operating profit charge was £10m (2015: £25m).

Overall, the free cash outflow for the first half year was £(399)m (2015: £(576m). The decline in profit, which included a significant non-cash element, was offset by better than expected favourable working capital movements. The TotalCare net asset movement from 2015 year end of £149m reflects the price pressure on the Trent 700 and associated cash deficits. The net asset is now expected to peak between £2.5-2.7bn in the next twelve months reflecting benefits of the changes to our long term US dollar planning rate, further targeted life cycle cost improvements and other timing differences between cost and cash.

Net debt and foreign currency

The Group is committed to maintaining a robust balance sheet with a strong, investment-grade credit rating. We believe this is important when selling high-performance products and support packages which will be operation for decades. Standard & Poor’s updated its rating in May 2016 to A-/negative outlook and Moody’s maintained a rating of A3/stable.

During H1 2016, the Group’s net debt position increased from £111m to £712m, reflecting the £399m free cash outflow, shareholder payments of £168m and £154m for the increased investment in our approved maintenance centre joint ventures following receipt of regulatory approval for the changes to the joint venture agreements in June 2016. In April, we increased our revolving credit facilities by £500m to £2bn to provide additional standby liquidity.

The Group hedges the transactional foreign exchange exposures to reduce volatility to revenues, costs and resulting margins. The hedging policy sets maximum and minimum cover ratios of hedging for net transactional foreign exchange exposure. It allows us to take advantage of attractive FX rates, whilst remaining within the cover ratios. A level of flexibility is built into the hedging instruments to manage changes in exposure from one period to the next and to reduce volatility by smoothing the achieved rates over time.

The most significant exposure is the net US dollar income of approximately $5bn per year which is converted into GBP. Following the fall in the value of sterling which resulted from the outcome of the UK referendum, additional cover has been taken out to benefit from the favourable rates. This has resulted in an increase in the nominal value of the hedge book to approximately $35bn at the end of June (December 2015: $29bn) together with a reduction in the average rate in the hedge book to £/$1.57 (December 2015: £/$1.59). Whilst the majority of the benefit of the favourable exchange rates is likely to impact revenues in the longer term, the flexibility to reduce volatility built into our hedging arrangements should result in a modest benefit to current year results.

Group technical factors for 2016

All figures are at constant translational currencies unless otherwise stated.

Should **foreign exchange** rates for the full year remain unchanged from those at the end of June 2016, the movements from 2015 rates would improve full year underlying revenues by around £600m and improve underlying profit before tax by around £60m.

There is no change in our guidance on finance charges. Overall underlying **finance charges** in 2016 are expected to be in the region of £90-110m, partly reflecting the higher level of gross and net debt. The increase also reflects the fact that the underlying financing gain of £34m taken in 2015, on realised foreign exchange contracts settled to convert significant overseas dividends from group companies, is not expected to recur.

There is no change in our guidance on our underlying effective tax rate. The underlying **effective tax rate** for 2016 is expected to be around 26% reflecting the greater proportion of taxable profit expected to be generated in higher tax rate regions in 2016 compared to 2015.

There is no change in our guidance on capital expenditure. **Capital expenditure** for 2016 is expected to be around £500-550m (2015: £494m).

Net R&D spend is now expected to be in the region of £900m in 2016, largely reflecting expenses related to the completion of important new product launches in Civil Aerospace.

There is no change to our full year **free cash flow** guidance. Despite a better than expected first half free cash flow performance our guidance for the full year is unchanged. As a result, free cash flow in 2016 is likely to be in line with previous expectations for a modest overall out flow of between £100-300m.

Operational Review : Civil Aerospace

£m	H1 2015	Underlying Change***	Acquisitions & disposals	Foreign Exchange*	H1 2016
Order book **	**67,029**	3,437	–	2	**70,468**
Engine deliveries	326	(14)	–	–	312
Underlying revenue	**3,285**	(159)	–	45	**3,171**
Change		*-5%*		*+1%*	*-3%*
Underlying OE revenue	1,516	(79)	–	24	1,461
Change		*-5%*		*+2%*	*-4%*
Underlying services revenue	1,769	(80)	–	21	1,710
Change		*-5%*		*+1%*	*-3%*
Underlying gross margin	**628**	(243)	–	14	**399**
Gross margin %	**19.1%**	-680bps			**12.6%**
Commercial and administrative costs	(140)	(12)	–	(2)	(154)
Restructuring	(23)	21	–	–	(2)
Research and development costs	(255)	10	–	(5)	(250)
Joint ventures and associates	38	(2)	–	2	38
Underlying profit before financing	**248**	(226)	–	9	**31**
Change		*-91%*		*+4%*	*-88%*
Underlying operating margin	***7.5%***	*-680bps*			***1.0%***

**Translational foreign exchange impact ** 2015 year end comparative ***Order book change includes £2.1bn increase from change to Long Term US dollar planning rate*

As noted in the 2015 Annual Report, the methodology basis for the allocation of Civil Aerospace revenues on linked TotalCare contracts between original equipment and aftermarket was reviewed and amendments made to reflect better the commercial substance of the combined contracts. Historically, the allocation resulted in original equipment revenue and aftermarket revenue reflecting the contractual terms rather than the commercial substance of the contracts. The H1 2015 figures have been restated on the same basis; the impact was an increase in original equipment revenue of £66m and an equal decrease in aftermarket revenue

Financial overview

Overall, **underlying revenue** for Civil Aerospace was 5% lower (down 3% at actual exchange rates) with similar reductions in both original equipment and services.

£m	H1 2015	% of whole	Underlying change	Underlying Change %	Foreign exchange	H1 2016	% of whole
OE	**1,516**	**46%**	**(79)**	**-5%**	**24**	**1,461**	**46%**
Large Engine: linked and other	637	19%	19	+3%	1	657	21%
Large Engine: unlinked installed	298	9%	13	+4%	1	312	10%
Business aviation	413	13%	(75)	-18%	22	360	11%
V2500	168	5%	(36)	-21%	0	132	4%
AM	**1,769**	**54%**	**(80)**	**-5%**	**21**	**1,710**	**54%**
Large Engine	1,094	33%	(66)	-6%	3	1,031	33%
Business aviation	219	7%	(2)	-1%	10	227	7%
Regional	191	6%	(32)	-17%	8	167	5%
V2500	265	8%	20	+8%	0	285	9%

Original equipment revenues from large engines: linked and other increased 3% reflecting increased sales of Trent 900s which included initial deliveries for Emirates A380s as part of our record $9.2bn order announced last year together with more Trent 1000s for the Boeing 787 Dreamliner. These were partly offset by the slow-down in linked Trent 700 deliveries for the Airbus A330 and associated price pressure ahead of the introduction of the Trent 7000 for the Airbus A330neo. Sales of spare engines to joint ventures generated revenue of £35m (2015 H1: £13m).

Original equipment revenues from large engines: unlinked installed increased 4%, led by higher volumes of Trent XWBs with some reductions of unlinked engine sales from other Trent engine programmes.

Large engine service revenue reduced 6% despite double digit growth in revenues from new engines. The growth was offset by a significant reduction in revenues from our out-of-production engines. The decline included the expected reduced flying hour revenues from lower utilisation of Trent 500 and Trent 800 engines, and reduced time and material sales from fewer overhauls, particularly on older RB211 engines approaching the end of their long-service lives.

Revenues from business jet engine sales were, as expected, lower, particularly for the BR710 engines, reflecting general market weakness and a transition to newer non-Rolls-Royce powered platforms. Volumes of our newer BR725 engine, which powers the Gulfstream G650 and G650ER, remained good. Overall, business jet original equipment revenues declined 18%. Aftermarket revenues for business jets were broadly unchanged.

Services revenues from our regional jet engines declined 17%, reflecting retirements and reduced utilisation of relevant fleets by North American operators.

On the V2500 programme, revenues from original equipment modules declined 21%, as expected, ahead of the end of production of the V2500 engine. Overall V2500 service revenues were 8% higher, reflecting strong flying hour performance as well as a good level of repair and overhaul activity.

Overall **gross margins** for Civil Aerospace were 12.6% (2015: 19.1%). The main driver of the year-on-year reduction in margin of £243m was the change in mix of large engine sales with fewer link accounted Trent 700 engine sales and price reductions on these engines. Other factors contributing to the reduction were the drop in business jet engine sales, reduced utilisation and less time and material overhauls of our out-of-production Trent 500 and 800 and RB211 engines and a declining regional aftermarket.

In respect of long-term contract accounting adjustments, in the first half of 2016 these totalled a net reduction of £(23)m (2015: total benefit of £48m, including a £66m one-off benefit associated with the refinement of our methodology for risk assessment of future revenue). The £(23)m net reduction included a

£35m benefit (2015: benefit of £25m) from life-cycle cost improvements. In addition, we recognised in this period a £35m benefit from a 5 cent change (2015: £nil) to our estimated long-term US dollar to sterling exchange rate to bring our own planning rate within updated external benchmark long-term forecast data. These benefits were more than offset by technical costs of £(55)m (2015: £9m benefit) for large engines including the Trent 1000 and a retrospective charge of £(38)m (2015: £(52)m), reflecting other operational changes. The gross margin in H1 2015 included a charge of £17m reflecting losses on Trent 1000 engines which was subsequently capitalised in H2 2015 as contractual aftermarket rights. In H1 2016 all "unlinked" Trent 1000 engines were capitalised as contractual aftermarket rights.

Costs below gross margin were £17m lower than the previous year. Within this, R&D charges of £250m were £10m lower, reflecting increased R&D capitalisation on the Trent 1000 TEN partially offset by higher spend on key programmes, particularly in respect of the Trent 7000 and the Trent XWB-97 which are being expensed ahead of capitalisation and reduced development cost contributions from risk and revenue sharing partners.

Underlying commercial and administrative and other costs were £12m higher than 2015 and included higher accruals for performance incentives. Restructuring costs of £2m were £21m lower, reflecting the significant charges taken in 2015.

As a result, **profit before financing and tax** was 91% down, reflecting a combination of lower overall gross margins and higher commercial and administrative costs with partial offset from reduced R&D and restructuring costs. Taking account of foreign exchange effects, underlying profit before financing and tax was £31m (2015: £248m).

TotalCare net assets and Contractual Aftermarket Rights

TotalCare net assets increased in H1 2016 by £149m (H1 2015: £62m) to £2.36bn and the CARs balance increased by £71m (H1 2015: £47m) to £476m.

Investment and business development

Order intake of £7.9bn in the first half of 2016 for Civil Aerospace was £0.5bn higher than the previous year. The order book closed at £70.5bn, up £3.4bn or 5% from 2015 year end, which included a £2.1bn benefit from the change in the long term planning foreign exchange rate discussed above. Excluding this the order book was up 2%.

Significant orders during the first half included an order worth $2.7bn from Norwegian for Trent 1000 engines and TotalCare service support for 19 new Boeing 787 Dreamliner aircraft and the selection of 20 Airbus A350 aircraft, powered by the Trent XWB engine, by China Eastern.

In May, Rolls-Royce despatched the first 'shipset' of four Trent 900 engines as part of its largest ever order, for Emirates. Rolls-Royce is providing Trent 900 engines and TotalCare service for 50 Emirates A380s, the first of which will enter service later this year.

The first half saw several notable entries into service, including Ethiopian Airlines becoming Africa's first operator of the Trent XWB and Cathay Pacific Airways becoming the first in the Greater China region. Air China became China's first operator of the Boeing 787-9 Dreamliner, powered by the Trent 1000 engine.

Investment is targeted at achieving improvements in our three core areas of focus: engineering excellence, operational excellence and capturing aftermarket value:

Engineering excellence remains the cornerstone of our value to Civil Aerospace customers

The Rolls-Royce Trent 1000 TEN engine took to the skies for the first time in March, starting a series of test flights and received its European Aviation Safety Agency (EASA) certification on 11 July. The Trent 1000 TEN (Thrust, Efficiency and New Technology) will power all variants of the Boeing 787 Dreamliner family and draws on technologies from the Rolls-Royce Trent XWB engine and Advance engine programme, delivering thrust and efficiency improvements.

In February, Rolls-Royce launched an Enhanced Performance (EP) version of the Trent XWB, the world's most efficient large aero engine, powering the Airbus A350 XWB. The first customer is Singapore Airlines. The Trent XWB-84 EP goes beyond the original Trent XWB-84 performance target levels, offering a fuel consumption improvement of 1%. The Trent XWB-84 EP incorporates technologies from the higher thrust Trent XWB-97 engine, the Advance engine programme and other future technology research.

The Advance3 large engine demonstrator started build in our Bristol facility. The demonstrator will test the new core architecture for future engine families and other key technologies such as Lean Burn combustion, Ceramic Matrix Composites, CastBond™ (specialist turbine manufacturing) and additive layer manufacturing or 3D printing.

Rolls-Royce's German joint venture for power gearboxes, a key technology for the UltraFan™ engine, delivered the first gearbox hardware and commissioned its attitude rig.

Investing in new aerospace supply chain capabilities to help drive operational excellence

Rolls-Royce announced plans to invest more than £30m at its site in Washington, Tyne & Wear, UK, creating a new facility to manufacture a range of aerospace discs for in-service engines. The new Fleet Support plant is expected to be fully operational in 2018 and will sit alongside our world-class UK discs manufacturing facility, which officially opened in June 2014. The new facility will have the capacity to manufacture well over 1,500 fan and turbine discs a year for use in a wide-range of existing engines, in both Civil and Defence Aerospace applications.

Strengthening our aerospace aftermarket service offering

Rolls-Royce and its partners have received regulatory approval and met all other closing conditions for its previously announced changes to three Approved Maintenance Centre (AMC) joint ventures. AMCs support Rolls-Royce's strategy to develop a competitive, capable and flexible Trent service network to meet the changing needs of customers across the lifecycle of engines and to support the growing Trent engine fleet. In June, we invested £154m to increase our stake in both Hong Kong Aero Engine Aero Services Limited (HAESL) and Singapore Aero Engine Services Pte Ltd (SAESL) to 50%.

Rolls-Royce also announced that it is further expanding its global network of Authorised Service Centres (ASC) for business aviation aircraft under its CorporateCare service provision for customers. Rolls-Royce now has 62 ASCs in place with key maintenance providers worldwide, meaning that CorporateCare customers will benefit from streamlined administration and reduced maintenance time.

Civil Aerospace outlook

We continue to expect our Civil Aerospace business to underperform 2015 underlying profit before finance and tax by around £550m, excluding foreign exchange benefits. The significant headwind related to Trent 700 volume reductions and the non-recurrence of a number of one-off benefits seen in 2016 remains broadly unchanged.

In the second half we expect the business to benefit from higher large engine deliveries for widebody aircraft, including spare engines to support the growth in our fleets, further life-cycle cost improvements within our TotalCare contracts and the benefits of our restructuring activity. We remain cautious about the weak business jet markets.

We expect the TotalCare net asset to peak in the next twelve to eighteen months at between £2.5bn and £2.7bn, reflecting benefits of the changes to our long-term US dollar planning rate, further targeted life cycle cost improvements and other timing differences between cost and cash.

Operational Review: Defence Aerospace

£m	H1 2015	Underlying change	Acquisitions & disposals	Foreign Exchange*	H1 2016
Order book **	**4,316**	(163)	–	3	**4,156**
Engine deliveries	272	19	–	–	291
Underlying revenue	**973**	(8)	–	37	**1,002**
Change		*-1%*		*+4%*	*+3%*
Underlying OE revenue	368	28	–	16	412
Change		*+8%*		*+4%*	*+12%*
Underlying services revenue	605	(36)	–	21	590
Change		*-6%*		*+3%*	*-2%*
Underlying gross margin	**279**	(76)	–	8	**211**
Gross margin %	**28.7%**	-760bps			**21.1%**
Commercial and administrative costs	(63)	5	–	(2)	(60)
Restructuring	(15)	12	–	–	(3)
Research and development costs	(27)	(1)	–	(1)	(29)
Joint ventures and associates	10	(1)	–	–	9
Underlying profit before financing	**184**	(61)	–	5	**128**
Change		*-33%*		*+3%*	*-30%*
Underlying operating margin	***18.9%***	*-620bps*			***12.8%***

**Translational foreign exchange impact ** 2015 year end comparative*

Financial Overview

Underlying revenue of £1,002m was marginally below the prior year on an underlying basis (up 3% at actual exchange rates). Higher volumes on both LiftSystem™ and TP400 production, together with increased Adour engine deliveries to Saudi Arabia, helped original equipment revenues increase 8%, on an underlying basis. Service revenues were 6% lower than the prior year, mainly due to lower spares sales on a number of legacy programmes, while long-term service contract revenues were broadly in line with the prior year.

Gross margin declined by £76m, reflecting the lower sales of spare parts and an adverse change in OE product mix plus expected additional expenditure of £31m on technical improvements to the TP400 programme. Retrospective margin improvements on existing long-term contracts reflecting cost improvements totalled £44m, similar to the prior year. These improvements are expected to be principally first half weighted.

Overall R&D costs were similar to the prior year as the business continued to invest in future programme development, while restructuring costs were lower due to reduced level of severance costs and lower spend on the closure of the defence facility at Ansty. Underlying commercial and administrative costs and other costs were similar to prior year despite higher accruals for performance incentives in 2016.

Profit before financing of £128m was 33% lower than the prior period.

Investment and business development

Order intake for H1 2016 was £743m (2015: £821m). Overall, the Defence Aerospace order book declined by 4%, in part reflecting the timing of a number of expected orders which should be received in the next few quarters. The first half saw continued interest in our Services portfolio from major customers including the contract renewal from the US Department of Defence to support AE 2100 engines powering its C-130J transport fleet. We also delivered the first T56 3.5 technology insertion kits to the USAF which offer both fuel saving and performance benefits for its legacy C-130 fleet. International interest in this technology upgrade continues to be strong.

We received a follow-on production contract for the LiftSystem for the F-35B and recently signed an memorandum of understanding with Pratt & Whitney to extend our aftermarket support for the UK's new F-35B Lightning fleet beyond the LiftSystem. The opening of the Kingsville Service Delivery Centre (SDC)

in Texas strengthens our local service offering for the US Navy's T-45 Goshawk trainer fleet and provides further opportunities to develop the service relationship. A number of new SDC facilities are due to be rolled out over the next 12 months as we pursue this strategy of closer proximity to our major customers.

We continue to work on positioning ourselves to be competitive for forthcoming indigenous combat programmes, and see further combat opportunities following the UK and French Governments' commitment to the €2bn FCAS unmanned combat air system programme. In addition, we signed agreements with both MD Helicopters and Enstrom which offer new opportunities for our small helicopter engines. Our commitment to development of cutting-edge technology was boosted by the selection of our LibertyWorks development unit to provide the vertical lift propulsion for the new DARPA VTOL X-Plane.

As well as some organisational rationalisation, the transformation programme within the Defence Aerospace business has focused on the upgrading of the Indianapolis operations facilities which will deliver both operational efficiencies and greater development capabilities. Performance against transformation milestones ran to plan in the first half. Defence Aerospace capital expenditure rose modestly as the investment activity in Indianapolis increased.

Defence Aerospace outlook

The business continues to invest in important product development and manufacturing transformation initiatives as it looks capitalise on its strong positions, particularly in Combat and Transport & Patrol. As a result, margins are expected to soften from the highs seen in 2014 and 2015.

Expectations for full year performance are unchanged. Revenues should remain steady, with margins continuing to reflect the investments in long-term growth and additional actions to offset the TP400 expenditure.

Operational Review: Power Systems

£m	H1 2015	Underlying change	Acquisitions & disposals	Foreign Exchange*	H1 2016
Order book **	**1,928**	65	–	–	**1,993**
Underlying revenue	**1,039**	(30)	**–**	75	**1,084**
Change		*-3%*		*+7%*	*+4%*
Underlying OE revenue	684	(22)	–	49	711
Change		*-3%*		*+7%*	*+4%*
Underlying services revenue	355	(8)	–	26	**373**
Change		*-2%*		*+7%*	*+5%*
Underlying gross margin	**245**	(11)	–	20	**254**
Gross margin %	**23.6%**	-40bps			**23.4%**
Commercial and administrative costs	(143)	(3)	**–**	(12)	(158)
Restructuring	(2)	2	**–**	–	–
Research and development costs	(82)	5	**–**	(6)	(83)
Joint ventures and associates	(1)	1	**–**	**–**	–
Underlying profit before financing	**17**	(6)	–	2	**13**
Change		*-35%*		*+12%*	*-24%*
Underlying operating margin	***1.6%***	*-50bps*			***1.2%***

**Translational foreign exchange impact ** 2015 year end comparative*

Financial overview

Underlying revenue of £1,084m was 3% lower (4% higher at actual exchange rates). Original equipment revenue was 3% lower, reflecting a lower level of naval and rail project-related sales compared to 2015 and the impact of the low oil price on marine offshore and fracking activities in particular, with some offset from higher power generation, construction and agriculture sales. Low oil and commodity prices were the most significant contributors to the 2% reduction in underlying service revenues, where industrial markets were most impacted.

Gross margins were marginally lower at 23.4% (2015: 23.6%) reflecting volume reductions leading to higher overhead allocations as well as some changes to the product mix.

Underlying profit declined £6m or 35%. Commercial & administrative costs were £3m higher. The £5m reduction in R&D reflects a more focused approach to future product development activity. Other costs below gross margin were broadly unchanged.

Investment and business development

Our Power Systems business serves a variety of markets ranging from marine, industrial, construction & agriculture to defence and power generation. This diversity has enabled the business to mitigate some of the weak market environment, particularly those linked to oil and commodities.

H1 2016 order intake was £1.2bn (2015: £1.3bn) with the year-on-year reduction mainly from oil and gas and commodity related markets together with lower rail and government project orders. Despite this, the order book closed up from the end of 2015 at £2.0bn (2015: £1.9bn).

We have continued to develop our position in the energy segment. In March, we signed a strategic agreement with VPower Group to strengthen our partnership in power generation markets across China and the rest of Asia. We also established a 50/50 joint venture with China Yuchai International Limited's main operating subsidiary, Yuchai Machinery Company Ltd, for the production under licence of MTU Series 4000 diesel engines in China for the Chinese off-highway market, for power generation and for oil and gas applications.

We have had several good contract wins for our naval and marine products. These include an order for twelve MTU diesel gensets for the UK Royal Navy's Type 26 Global Combat Ship and a contract win for six MTU engines from Istanbul based Bilgin Yachts. We have also been selected to supply MTU-branded engines to crane producer Kato for the first time. Winning Kato as a customer represents our first success in the high-tech Japanese crane market and we expect Kato to source several hundred units per year.

Power Systems outlook

The Power Systems outlook is cautiously positive. The business finished the first half with a solid order book and good order coverage in several key longer cycle markets including power generation and governmental, broadly consistent with the prior year. Markets continue to be mixed, with some industrial markets remaining soft, as demonstrated by comments from some of our customers and competitors. While there is much to do in the second half, we expect our diverse end market mix to help mitigate this.

Operational Review: Marine

£m	H1 2015	Underlying change	Acquisitions & disposals	Foreign Exchange*	H1 2016
Order book **	**1,164**	(259)	–	87	**992**
Underlying revenue	**695**	(171)	–	24	**548**
Change		*-25%*		*+3%*	*-21%*
Underlying OE revenue	415	(124)	–	12	303
Change		*-30%*		*+3%*	*-27%*
Underlying services revenue	280	(47)	–	12	245
Change		*-17%*		*+4%*	*-13%*
Underlying gross margin	**121**	(18)	–	5	**108**
Gross margin %	**17.4%**	+220bps			**19.7%**
Commercial and administrative costs	(100)	–	–	(4)	(104)
Restructuring	(4)	3	–	–	(1)
Research and development costs	(13)	(3)	–	–	(16)
Underlying profit before financing	**4**	(18)	–	1	**(13)**
Change		*-450%*		*+25%*	*-425%*
Underlying operating margin	***0.6%***	*-320bps*			***-2.4%***

**Translational foreign exchange impact ** 2015 year end comparative*

Financial overview

Underlying revenue of £548m was 25% lower (down 21% at actual rates). Within this, original equipment revenues were down 30% and service revenues declined 17%, primarily due to the downturn in the offshore market.

Gross margins increased 220 basis points to just under 20% and overall gross margin was £108m, £18m lower than in 2015. Despite the sharply lower revenues, gross margins were largely held as a result of the non-repeat of last year's £30m contract provision which impacted the first half of 2015. As a result, the business reported an underlying loss of £(13)m, compared to a profit of £4m in H1 2015

Investment and business development

The order book declined 22% during the first half of this year, with order intake of £362m, 36% down on H1 2015. In particular, the offshore market has remained very weak, with the low level of OE revenues reflecting the impact of the continued low oil price and reduced investment by oil majors. Service revenues have been more resilient, although also at subdued activity levels.

We have continued to look for opportunities to extend our differentiated technology into non–oil related adjacent markets including for other support, fishing and research vessels. These applications place a similar value on the high-performance characteristics of our Marine products. One of the most interesting contract wins will be to design and equip the UK's new polar research ship, the RRS Sir David Attenborough. In addition, there have been a number of opportunities within the cruise ship sector, including a £25m order to design and equip up to four new Hurtigruten polar cruise vessels to operate off the coast of Norway, announced in July (and therefore not in the closing order book).

The Naval business has continued to perform well, having a strong first half compared to the prior year. This included delivery of the first MT30 gas turbine for the UK's new Type 26 Global Combat Ship, and the successful sea trials of the USS Zumwalt. The MT30 was also selected by a new customer, the Italian Navy.

Product development work within the business included increasing our R&D focus on ship intelligence to develop a range of products that can monitor equipment performance in real time, and help facilitate full ship automation in the long-term.

We have also recently announced plans for a significant investment in our azimuth thruster production facility in Rauma, Finland. The £44m project will create a state-of-the-art production facility for one of our most important product groups.

The marine restructuring programme remains on track, following last year's proposals to reduce our workforce by 1,000. By the end of this year, we will have reduced our Marine workforce by around 20% since 2014. We continue to assess further cost restructuring opportunities.

Marine outlook

With the continued decline with offshore oil & gas markets impacting revenues the Marine business is becoming more balanced across its different end markets. As a result, business performance is starting to more visibly reflect the benefits of restructuring and its strong positions in Naval and Merchant, positive features as the business looks to the next few years.

However, in the near-term, expectations for the second half 2016 remain challenging. While the stronger Naval and Merchant order book at the end of H1 provides some comfort for achieving expectations for the full year, when combined with the ongoing focus on cost reduction, there are continued weaknesses in offshore oil & gas and potential order cancellations. As a result, we continue to expect revenues and profits to be lower than those seen in the second half of 2015.

Operational Review: Nuclear

£m	H1 2015	Underlying change	Acquisitions & disposals	Foreign Exchange*	H1 2016
Order book **	**2,168**	(210)	–	2	**1,960**
Underlying revenue	**309**	44	–	3	**356**
Change		*+14%*		*+1%*	*+15%*
Underlying OE revenue	110	30	–	1	141
Change		*+27%*		*+1%*	*+28%*
Underlying services revenue	199	14	–	2	215
Change		*+7%*		*+1%*	*+8%*
Underlying gross margin	**49**	1	–	1	**51**
Gross margin %	**15.9%**	-170bps			**14.3%**
Commercial and administrative costs	(25)	(8)	–	–	(33)
Restructuring	(1)	1	–	–	–
Research and development costs	(3)	3	–	–	–
Underlying profit before financing	**20**	(3)	–	1	**18**
Change		*-15%*		*+5%*	*-10%*
Underlying operating margin	***6.5%***	*-170bps*			***5.1%***

**Translational foreign exchange impact ** 2015 year end comparative*

Financial overview

Underlying revenue increased 14%, led by growth particularly in original equipment activities in the submarines business. This reflects the phasing of programmes across next generation and refuelling projects as well as acceleration of the Vulcan test facility decommissioning.

Gross margin was lower at 14.3%, reflecting the product mix favouring lower margin government-led submarine projects. Below gross margin, the change in treatment of R&D tax credits, which significantly impacted the full year in 2015, produced an R&D credit of £3m in the first half (H1 2015: nil), offset by increased costs to support the increased volumes and higher performance incentives within commercial and administrative costs. As a result, underlying profit before financing was £3m lower than the prior year, at £18m.

Investment and business developments

While order intake of £144m was £49m higher than the prior period, the order book was £210m lower at £2.0bn, reflecting the phasing of MoD order releases and both delays and contract phasing within civil nuclear programmes in the UK, North America and Europe.

Our civil nuclear business, which focuses on multi-year engineering projects and specialist technical services, concentrated its first half activities on its long-term instrumentation & controls retrofit contracts in France and Finland, together with the integration of the US R.O.V. Technologies business (a provider of complementary remote visual inspection services) acquired last year. In March, Nuclear also announced the strengthening of the strategic collaboration started in 2014 with the China National Nuclear Corporation, CNNC. This includes specific engineering, consultancy and training services to be provided by Rolls-Royce in a market expected to continue to grow strongly and where we have a strong technology presence.

Our submarine activities focused on performance improvement initiatives to support its long-term contracts for the UK Royal Navy's nuclear submarine fleet, including delivery of the nuclear propulsion system to power the Astute class submarines. Development work on the new PWR3 power plant for Successor (the next generation of Trident submarines) continues with contract extensions agreed in preparation ahead of the government final investment decision. Work on the older Vanguard-class Trident submarines included implementing a refuelling programme. In addition, progress continues on the decommissioning of the Naval Reactor Test Establishment, HMS Vulcan, in Scotland.

An R&D programme was initiated together with a number of partners to scope out the initial design phase for Small Modular Reactors. These smaller, more flexible units offer the potential for lower cost/lower scale and more flexible power generation in future decades and directly build on the knowledge and specialist skills of our Rolls-Royce Nuclear business.

Transformation projects within the Nuclear business have focused on operational improvements and on people and culture. The organisational design and management reduction is on track to deliver against committed cost saving targets.

Nuclear outlook

The long-term outlook for Nuclear remains positive, with both the civil and submarine businesses focused on delivering cost-effective and value-added products and services with on time deliveries to their core customers under long-term secure aftermarket contracts. Confirmation by the UK Government of the ongoing investment in the Successor submarine programme to replace Trident, together with renewed activities in the civil market, particularly in China, provide encouraging growth opportunities.

In the near term, our focus is on sustaining the recent operational improvements at our key UK facility to improve delivery performance. At the same time we will be making the modest investments set out above to explore the technical and market opportunities for Small Modular Reactors. As a result, while revenues and gross margins are expected to be largely unchanged year on year, full year profit is expected to be lower.

Financial review

Underlying income statement

Six months to June £m	2016	2015	Change
Revenue at 2015 exchange rates	**5,960**	6,256	-296
Translation to 2016 exchange rates	**183**	–	
Revenue	**6,143**	6,256	-113
Gross profit	**984**	1,332	-348
Commercial and administrative costs	**(518)**	(496)	-22
Restructuring	**(6)**	(45)	+39
Research and development costs	**(366)**	(378)	+12
Share of results of joint ventures and associates	**45**	43	+2
Profit before financing at 2015 exchange rates	**139**	456	-317
Translation to 2016 exchange rates	**19**	–	
Profit before financing	**158**	456	-298
Net financing	**(54)**	(17)	-37
Profit before tax	**104**	439	-335
Tax	**(27)**	(102)	+75
Profit for the year	**77**	337	-260
Earnings per share (EPS)	**4.20p**	18.27p	-14.07p
Payments to shareholders	**4.60p**	9.27p	-4.67p
Gross R&D investment	**638**	580	+58
Net R&D charge	**380**	378	+2

Segmental analysis

Six months to June £m	Revenue 2016	Revenue 2015	Revenue Change	Gross profit 2016	Gross profit 2015	Gross profit Change	Profit before financing 2016	Profit before financing 2015	Profit before financing Change
Civil	**3,126**	3,285	-159	**385**	628	-243	**22**	248	-226
Defence	**965**	973	-8	**203**	279	-76	**123**	184	-61
Power Systems	**1,009**	1,039	-30	**234**	245	-11	**11**	17	-6
Marine	**524**	695	-171	**103**	121	-18	**(14)**	4	-18
Nuclear	**353**	309	+44	**50**	49	+1	**17**	20	-3
Other	**20**	27	-7	**11**	7	+4	**11**	5	+6
Intra-segment	**(37)**	(72)	+35	**(2)**	3	-5	**(2)**	3	-5
Central costs							**(29)**	(25)	-4
Group at 2015 exchange rates	**5,960**	6,256	-296	**984**	1,332	-348	**139**	456	-317
Translation to 2016 exchange rates	**183**			**49**			**19**		
Group	**6,143**	6,256	-113	**1,033**	1,332	-299	**158**	456	-298

Underlying revenue and **underlying profit before financing** are discussed in the Business Highlights (page 3), the Group Trading Summary (page 9) and the Operational Reviews (page11).

Underlying financing costs increased by £37m to £54m. Net interest payable increased by £7m to £35m due to the issue of $1.5bn of debt in the second half of 2015 and other underlying financing costs increased by £6m to £19m. In addition, an underlying gain of £24m in 2015 on realised foreign exchange contracts which were settled to convert overseas dividends into sterling did not recur.

Underlying taxation was £27m, an underlying tax rate of 26% compared with 23% in 2015.

Underlying EPS decreased 77% to 4.20p, in line with profit for the period.

Payments to shareholders are made in the form of C Shares, details of which are set out on page 41. An interim payment of 4.6p per share will be made.

Reported income statement

Six months to June £m	**2016**	2015
Revenue	**6,462**	6,370
Gross profit	**1,193**	1,269
Other operating income	**2**	5
Commercial and administrative costs	**(605)**	(522)
Research and development costs	**(404)**	(404)
Share of results of joint ventures and associates	**51**	31
Operating profit	**237**	379
Loss on disposal of businesses	**(1)**	–
Profit before financing	**236**	379
Net financing	**(2,386)**	(69)
Profit before tax	**(2,150)**	310
Tax	**378**	50
Profit for the year	**(1,772)**	360
Earnings per share (EPS)	**(96.72p)**	19.51p

The changes in 2016 resulting from underlying trading are described in the previous sections.

Consistent with past practice and IFRS, the Group provides both reported and underlying figures. We believe underlying figures are more representative of the trading performance, by excluding the impact of period-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 below and in more detail in note 2 to the Condensed Financial Statements. This basis of presentation has been applied consistently.

Reconciliation between underlying and reported results

Six months to 30 June £m	**2016**	2015
Underlying revenue	**6,143**	6,256
Recognise revenue at exchange rate on date of transaction	**319**	114
Reported revenue	**6,462**	6,370

	Profit before financing		**Financing**		**Profit before tax**	
Six months to 30 June £m	**2016**	2015	**2016**	2015	**2016**	2015
Underlying	**158**	456	**(54)**	(17)	**104**	439
Mark-to-market adjustments on derivatives	**4**	(12)	**(2,155)**	(89)	**(2,151)**	(101)
Related foreign exchange adjustments	**203**	87	**(171)**	27	**32**	114
Movements on other financial instruments	**–**	–	**(8)**	(3)	**(8)**	(3)
Effects of acquisition accounting	**(62)**	(63)	**–**	–	**(62)**	(63)
Impairment of goodwill	**–**	(69)	**–**	–	**–**	(69)
Exceptional restructuring	**(68)**	(11)	**–**	–	**(68)**	(11)
Acquisitions and disposals	**(1)**	(3)	**–**	–	**(1)**	(3)
Post-retirement schemes	**–**	–	**3**	13	**3**	13
Other	**2**	(6)	**(1)**	–	**1**	(6)
Reported	**236**	379	**(2,386)**	(69)	**(2,150)**	310

The **mark to market adjustments** are principally driven by movements in the GBP:USD and EUR:USD exchange rates which moved from 1.48 to 1.34 and from 1.09 to 1.11 respectively during the period 1 January 2016 to 30 June 2016. At each reporting date our foreign exchange hedge book is included in the balance sheet at fair value (‘mark-to-market’). The movement in this valuation during the period, after taking account of contracts settled, is included in the reported profit. As the Group has a large hedge book ($35bn), the movements can be significant, depending on changes in exchange rate. In H1 2016 this resulted in a charge of £2,155m.

The hedge book is held to manage the impact of changes in exchange rates on future foreign currency income. Accordingly, non-cash changes in its value are excluded from the underlying results as they do not relate to the trading in the period.

Movements on other financial instruments relate to exchange differences on risk and revenue sharing arrangements.

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. In addition, the impairment charge in Marine of £69m was excluded in 2015.

Costs associated with the substantial closure or exit of a site, facility or activity and significant organisation transformation are classified as **exceptional restructuring** and excluded. In 2016, these increased by £57m primarily representing costs of the transformation programme.

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

Net financing on **post-retirement schemes** is excluded from underlying profit.

Appropriate tax rates are applied to these adjustments, depending on the relevant tax jurisdiction, the net effect of which was a reduction of £405m to the underlying tax charge (2015 £152m reduction). In 2016, the most significant tax adjustment was £377m in relation to mark-to-market adjustments of £2,155m. These are predominantly held in the UK.

Summary balance sheet

£m	**30 June 2016**	31 December 2015
Intangible assets	**4,990**	4,645
Property, plant and equipment	**3,718**	3,490
Net working capital [1]	**(125)**	(501)
Net funds [2]	**(712)**	(111)
Provisions	**(777)**	(640)
Net post-retirement scheme surplus/(deficit)	**141**	(77)
Net financial assets and liabilities [2]	**(3,954)**	(1,883)
Joint ventures and associates	**765**	576
Other net assets and liabilities [3]	**(204)**	(483)
Net assets	**3,842**	5,016
Other items		
US$ hedge book (US$bn)	**34.6**	28.8
TotalCare assets	**3,275**	2,994
TotalCare liabilities	**(915)**	(783)
Net TotalCare assets	**2,360**	2,211
Gross customer finance commitments	**253**	269
Net customer finance commitments	**62**	54

1 Net working capital includes inventories, trade and other receivables, trade and other payables and tax assets and liabilities (other than deferred).
2 Net funds includes an asset of £332m (2015 asset £13m) of the fair value of financial instruments which are held to hedge the fair value of borrowings.
3 Other includes other investments and deferred tax assets and liabilities.

Intangible assets (note 8) increased by £345m mainly due to exchange differences of £314m. Additions of £232m (including £39m of certification and participation fees, £54m of development costs and £90m of contractual aftermarket rights) were largely offset by amortisation of £199m.

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.

Property, plant and equipment (note 9) increased by £228m. Additions of £191m were largely offset by depreciation of £195m. Exchange differences were £206m and £41m was added from the reclassification of joint ventures to joint operations.

The **net post-retirement scheme deficit surplus/(deficit)** (note 11) has increased by £218m largely due to movements on discount rates in the period. In the UK, the discount rate reduced from 3.6% to 2.7%, which was the main component of an increase in pension liabilities of £1.7bn. As the pension assets are managed to hedge changes in the valuation of the liabilities, these increased by £2.2bn, a net movement in

the UK of £0.5bn. The deficit on overseas schemes increased by £0.3bn (including £0.1bn of foreign exchange) as many of these (most significantly in Germany and US healthcare schemes) are unfunded and consequently the reduction in the discount rate increases the post-retirement liabilities with no off-setting change in assets.

Movements in **net funds** are shown overleaf.

Investments in joint ventures and associates increased by £189m largely due to a £154m increase in the Group's share of Approved Maintenance Centre joint ventures. The reclassification of joint ventures to joint operations (£57m, see page31), was broadly offset by exchange gains of £47m.

Provisions largely relate to warranties and guarantees provided to secure the sale of OE and services. The increase of £137m includes reclassifications from accruals of £92m, following a review of accounting consistency during the period. The remaining increase of £45m includes additional charges of £132m, principally for warranty and guarantees and restructuring, and foreign exchange movements of £50m, offset by utilisation of £100m.

Net financial assets and liabilities relate to the fair value of foreign exchange, commodity and interest rate contracts, financial RRSAs, set out in detail in note 10. All contracts continue to be held for hedging purposes. The fair value of foreign exchange derivatives is a financial liability of £3.7bn, an increase of £2.1bn in the period, mainly a result of the strengthening of the US dollar.

The US$ hedge book increased by 20% to US$35bn. This represents around 5½ years of net exposure and has an average book rate of £1 to US$1.57.

Net TotalCare assets relate to Long-Term Service Agreement (LTSA) contracts 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.

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 generally 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 12. 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.

The reduction in gross exposures is a result of guarantees expiring.

Summary funds flow statement

Six months to 30 June £m	**2016**	2015	Change
Underlying profit before tax	**104**	439	-335
Depreciation and amortisation	**335**	317	+18
Movement in net working capital	**(235)**	(747)	+512
Expenditure on property, plant and equipment and intangible assets	**(539)**	(391)	-148
Other	**8**	(90)	+98
Trading cash flow	**(327)**	(472)	+145
Contributions to defined benefit pensions in excess of PBT charge	**(10)**	(25)	+15
Taxation paid	**(62)**	(79)	+17
Free cash flow	**(399)**	(576)	+177
Exceptional restructuring expenditure	**(15)**	–	-15
Shareholder payments	**(168)**	(165)	-3
Share buyback	**–**	(433)	+433
Increase in share of joint ventures	**(154)**	–	-154
Other acquisitions/disposals	**7**	(104)	+111
Foreign exchange	**128**	(31)	+159
Change in net funds	**(601)**	(1,309)	
Opening net funds	**(111)**	666	
Closing net funds	**(712)**	(643)	

Movement in working capital – the £235m increase includes higher levels of inventory due to a forecast increase in deliveries in the second half of the year, partly offset by an increase in deposits and advance payments. The increase is lower than the previous year, reflecting the increase in deposits and a reversal of the payables reduction experienced in 2015 due to the timing of sales and purchases.

Expenditure on property, plant and equipment and intangibles – the increase largely reflects higher capital spend (£50m), certification costs (£23m), capitalised development costs (£45m) and contractual aftermarket rights (£16m).

Pensions – the reduction in pension contributions in excess of the income statement charge arose principally in the UK due to a reduction of deficit reduction payments and the non-recurrence of a past-service credit in 2015.

Shareholder payments – the change in shareholder payments reflects the difference between the 2014 and 2015 interim payments, which are paid in the following January. The reduction in shareholder payments announced in February 2016 will be reflected in cash from the second half of 2016.

The derivation of the summary funds flow statement above from the reported cash flow statement is included in the appendix.

Condensed consolidated income statement

For the half-year ended 30 June 2016

	Notes	**Half-year to 30 June 2016 £m**	Half-year to 30 June 2015 £m	Year to 31 December 2015 £m
Revenue	2	**6,462**	6,370	13,725
Cost of sales		**(5,269)**	(5,101)	(10,459)
Gross profit		**1,193**	1,269	3,266
Other operating income		**2**	5	10
Commercial and administrative costs		**(605)**	(522)	(1,059)
Research and development costs	3	**(404)**	(404)	(818)
Share of results of joint ventures and associates		**51**	31	100
Operating profit		**237**	379	1,499
(Loss)/profit on disposal of businesses		**(1)**	–	2
Profit before financing and taxation		**236**	379	1,501
Financing income	4	**36**	86	115
Financing costs	4	**(2,422)**	(155)	(1,456)
Net financing		**(2,386)**	(69)	(1,341)
Profit before taxation [1]		**(2,150)**	310	160
Taxation	5	**378**	50	(76)
Profit for the period		**(1,772)**	360	84
Attributable to:				
Ordinary shareholders		**(1,772)**	360	83
Non-controlling interests		**–**	–	1
Profit for the period		**(1,772)**	360	84
Earnings per ordinary share attributable to shareholders	6			
Basic		**(96.72p)**	19.51p	4.51p
Diluted		**(96.72p)**	19.35p	4.48p
Underlying earnings per ordinary share are shown in note 6.				
Payments to ordinary shareholders in respect of the period	7			
Pence per share		**4.60p**	9.27p	16.37p
Total		**85**	170	301
[1] Underlying profit before taxation	2	**104**	439	1,432

All activities comprise continuing operations.

Condensed consolidated statement of comprehensive income

For the half-year ended 30 June 2016

	Notes	**Half-year to 30 June 2016 £m**	Half-year to 30 June 2015 £m	Year to 31 December 2015 £m
Profit/(loss) for the period		**(1,772)**	360	84
Other comprehensive income (OCI)				
Items that will not be reclassified to profit or loss				
Movements in post-retirement schemes	11	**346**	(722)	(722)
Share of OCI of joint ventures and associates		**(2)**	–	–
Related tax movements		**(123)**	250	257
		221	(472)	(465)
Items that may be reclassified to profit or loss				
Foreign exchange translation differences on foreign operations		**557**	(280)	(129)
Reclassification to income statement on disposal of businesses		**–**	–	1
Share of OCI of joint ventures and associates		**(6)**	(12)	(19)
Related tax movements		**3**	(3)	(2)
		554	(295)	(149)
Total comprehensive income for the period		**(997)**	(407)	(530)
Attributable to:				
Ordinary shareholders		**(997)**	(407)	(530)
Non-controlling interests		**–**	–	–
Total comprehensive expense for the period		**(997)**	(407)	(530)

Condensed consolidated balance sheet

At 30 June 2016

	Notes	**30 June 2016 £m**	30 June 2015 £m	31 December 2015 £m
ASSETS				
Non-current assets				
Intangible assets	8	**4,990**	4,476	4,645
Property, plant and equipment	9	**3,718**	3,312	3,490
Investments – joint ventures and associates		**765**	532	576
Investments – other		**37**	29	33
Other financial assets	10	**351**	185	83
Deferred tax assets		**617**	419	318
Post-retirement scheme surpluses	11	**1,545**	1,016	1,063
		12,023	9,969	10,208
Current assets				
Inventories		**3,165**	2,930	2,637
Trade and other receivables		**7,145**	5,624	6,244
Taxation recoverable		**16**	16	23
Other financial assets	10	**45**	47	29
Short-term investments		**1**	7	2
Cash and cash equivalents		**2,287**	1,581	3,176
Assets held for sale		**5**	3	5
		12,664	10,208	12,116
Total assets		**24,687**	20,177	22,324
LIABILITIES				
Current liabilities				
Borrowings		**(120)**	(269)	(419)
Other financial liabilities	10	**(521)**	(218)	(331)
Trade and other payables		**(7,524)**	(6,555)	(6,923)
Tax liabilities		**(119)**	(159)	(164)
Provisions for liabilities and charges		**(408)**	(418)	(336)
		(8,692)	(7,619)	(8,173)
Non-current liabilities				
Borrowings		**(3,212)**	(1,937)	(2,883)
Other financial liabilities	10	**(3,497)**	(895)	(1,651)
Trade and other payables		**(2,807)**	(2,002)	(2,317)
Tax liabilities		**(1)**	(10)	(1)
Deferred tax liabilities		**(863)**	(906)	(839)
Provisions for liabilities and charges		**(369)**	(314)	(304)
Post-retirement scheme deficits	11	**(1,404)**	(1,084)	(1,140)
		(12,153)	(7,148)	(9,135)
Total liabilities		**(20,845)**	(14,767)	(17,308)
Net assets		**3,842**	5,410	5,016
EQUITY				
Attributable to ordinary shareholders				
Called-up share capital		**367**	367	367
Share premium account		**180**	180	180
Capital redemption reserve		**159**	164	161
Cash flow hedging reserve		**(105)**	(93)	(100)
Other reserves		**508**	(205)	(51)
Retained earnings		**2,731**	4,992	4,457
		3,840	5,405	5,014
Non-controlling interests		**2**	5	2
Total equity		**3,842**	5,410	5,016

Condensed consolidated cash flow statement

For the half-year ended 30 June 2016

	Notes	**Half-year to 30 June 2016 £m**	Half-year to 30 June 2015 £m	Year to 31 December 2015 £m
Reconciliation of cash flows from operating activities				
Operating profit		**237**	379	1,499
Loss on disposal of property, plant and equipment		**2**	–	8
Share of results of joint ventures and associates		**(51)**	(31)	(100)
Dividends received from joint ventures and associates		**14**	16	63
Amortisation of intangible assets	8	**201**	268	432
Depreciation of property, plant and equipment	9	**196**	181	378
Impairment of investments		**–**	–	2
Increase/(decrease) in provisions		**86**	(44)	(151)
(Increase)/decrease in inventories		**(339)**	(260)	63
Increase in trade and other receivables		**(459)**	(234)	(836)
Increase/(decrease) in trade and other payables		**514**	(227)	242
Cash flows on other financial assets and liabilities		**(139)**	(122)	(305)
Net defined benefit post-retirement cost recognised in operating profit	11	**118**	102	213
Cash funding of defined benefit post-retirement schemes	11	**(128)**	(127)	(259)
Share-based payments		**14**	5	5
Net cash inflow/(outflow) from operating activities before taxation		**266**	(94)	1,254
Taxation paid		**(62)**	(79)	(160)
Net cash inflow /(outflow) from operating activities		**204**	(173)	1,094
Cash flows from investing activities				
Additions of unlisted investments		**–**	–	(6)
Additions of intangible assets	8	**(232)**	(134)	(408)
Disposals of intangible assets		**–**	–	4
Purchases of property, plant and equipment		**(307)**	(258)	(487)
Government grants received		**–**	1	8
Disposals of property, plant and equipment		**10**	6	33
Acquisitions of businesses		**–**	(5)	(5)
Disposal of discontinued operations		**–**	(99)	(121)
Disposals of businesses		**1**	–	2
Increase in share in joint ventures		**(154)**	–	–
Other investments in joint ventures and associates		**(11)**	(5)	(15)
Cash and cash equivalents in joint ventures reclassified as joint operations		**5**	–	–
Net cash outflow from investing activities		**(688)**	(494)	(995)
Cash flows from financing activities				
Repayment of loans	10	**(325)**	(1)	(54)
Proceeds from increase in loans		**–**	47	1,150
Capital element of finance lease payments		**–**	–	(1)
Net cash flow from (decrease)/increase in borrowings		**(325)**	46	1,095
Interest received		**7**	5	5
Interest paid		**(54)**	(48)	(58)
Interest element of finance lease payments		**(1)**	–	(2)
Increase in short-term investments		**1**	–	5
Issue of ordinary shares and cash received on share-based payments vesting		**–**	31	32
Purchase of ordinary shares – share buyback		**–**	(433)	(433)
Purchase of ordinary shares for share schemes		**(20)**	(1)	(2)
Redemption of C Shares		**(168)**	(165)	(421)
Net cash (outflow)/inflow from financing activities		**(560)**	(565)	221
Net (decrease)/increase in cash and cash equivalents		**(1,044)**	(1,232)	320
Cash and cash equivalents at 1 January		**3,176**	2,862	2,862
Exchange gains/(losses) on cash and cash equivalents		**155**	(49)	(6)
Cash and cash equivalents at period end		**2,287**	1,581	3,176

	Half-year to 30 June 2016 £m	Half-year to 30 June 2015 £m	Year to 31 December 2015 £m
Reconciliation of movements in cash and cash equivalents to movements in net funds			
Net (decrease)/increase in cash and cash equivalents	**(1,044)**	(1,232)	320
Net cash flow from decrease/(increase) in borrowings	**325**	(46)	(1,095)
Net cash flow from decrease in short-term investments	**(1)**	–	(5)
Change in net funds resulting from cash flows	**(720)**	(1,278)	(780)
Net funds joint ventures reclassified to joint operations	**(9)**	–	–
Exchange gains/(losses) on net funds	**128**	(31)	3
Fair value adjustments	**(319)**	83	45
Movement in net funds	**(920)**	(1,226)	(732)
Net funds at 1 January excluding the fair value of swaps	**(124)**	608	608
Net funds at period end excluding the fair value of swaps	**(1,044)**	(618)	(124)
Fair value of swaps hedging fixed rate borrowings	**332**	(25)	13
Net funds at period end	**(712)**	(643)	(111)

The movement in net funds (defined by the Group as including the items shown below) is as follows:

					Reclassifications		
	At 1 January 2016 £m	**Funds flow £m**	**Exchange differences £m**	**Fair value adjustments £m**	**Joint ventures to joint operations £m**	**Other £m**	**At 30 June 2016 £m**
Cash at bank and in hand	**662**	**161**	**65**	**–**	**5**	**–**	**893**
Money market funds	**783**	**(258)**	**13**	**–**	**–**	**–**	**538**
Short-term deposits	**1,731**	**(952)**	**77**	**–**	**–**	**–**	**856**
Cash and cash equivalents	**3,176**	**(1,049)**	**155**	**–**	**5**	**–**	**2,287**
Investments	**2**	**(1)**	**–**	**–**	**–**	**–**	**1**
Current borrowings (excluding overdrafts)	**(417)**	**325**	**(12)**	**–**	**(9)**	**(4)**	**(117)**
Non-current borrowings	**(2,833)**	**–**	**(10)**	**(319)**	**–**	**4**	**(3,158)**
Finance leases	**(52)**	**–**	**(5)**	**–**	**–**	**–**	**(57)**
Net funds excluding the fair value of swaps	**(124)**	**(725)**	**128**	**(319)**	**(4)**	**–**	**(1,044)**
Fair value of swaps hedging fixed rate borrowings	**13**			**319**			**332**
Net funds	**(111)**	**(725)**	**128**	**–**	**(4)**	**–**	**(712)**

Condensed consolidated statement of changes in equity

For the half-year ended 30 June 30, 2016

	Attributable to ordinary shareholders								
	Share capital	Share premium	Capital redemption reserve	Cash flow hedging reserve	Other reserves [1]	Retained earnings [2]	Total	Non-controlling interests	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2015	**376**	**179**	**159**	**(81)**	**78**	**5,671**	**6,382**	**5**	**6,387**
Total comprehensive income for the period	**–**	**–**	**–**	**(12)**	**(283)**	**(112)**	**(407)**	**–**	**(407)**
Arising on issues of ordinary shares	–	1	–	–	–	–	1	–	1
Issue of C Shares	–	–	(170)	–	–	1	(169)	–	(169)
Redemption of C Shares	–	–	166	–	–	(166)	–	–	–
Ordinary shares purchased – buyback [4]	–	–	–	–	–	(433)	(433)	–	(433)
Ordinary shares cancelled [4]	(9)	–	9	–	–	–	–	–	–
Ordinary shares purchased – other	–	–	–	–	–	(1)	(1)	–	(1)
Share-based payments – direct to equity [3]	–	–	–	–	–	35	35	–	35
Related tax movements	–	–	–	–	–	(3)	(3)	–	(3)
Other changes in equity in the period	**(9)**	**1**	**5**	**–**	**–**	**(567)**	**(570)**	**–**	**(570)**
At June 30, 2015	**367**	**180**	**164**	**(93)**	**(205)**	**4,992**	**5,405**	**5**	**5,410**
Total comprehensive income for the period	**–**	**–**	**–**	**(7)**	**154**	**(270)**	**(123)**	**–**	**(123)**
Issue of C Shares	–	–	(260)	–	–	1	(259)	–	(259)
Redemption of C Shares	–	–	257	–	–	(257)	–	–	–
Ordinary shares purchased	–	–	–	–	–	(1)	(1)	–	(1)
Share-based payments – direct to equity [3]	–	–	–	–	–	(5)	(5)	–	(5)
Disposal of business	–	–	–	–	–	–	–	(3)	(3)
Related tax movements	–	–	–	–	–	(3)	(3)	–	(3)
Other changes in equity in the period	**–**	**–**	**(3)**	**–**	**–**	**(265)**	**(268)**	**(3)**	**(271)**
At 31 December 2015	**367**	**180**	**161**	**(100)**	**(51)**	**4,457**	**5,014**	**2**	**5,016**
Total comprehensive income for the period	**–**	**–**	**–**	**(5)**	**559**	**(1,551)**	**(997)**	**–**	**(997)**
Issue of C Shares	–	–	(171)	–	–	1	(170)	–	(170)
Redemption of C Shares	–	–	169	–	–	(169)	–	–	–
Ordinary shares purchased	–	–	–	–	–	(20)	(20)	–	(20)
Share-based payments – direct to equity [3]	–	–	–	–	–	14	14	–	14
Related tax movements	–	–	–	–	–	(1)	(1)	–	(1)
Other changes in equity in the period	**–**	**–**	**(2)**	**–**	**–**	**(175)**	**(177)**	**–**	**(177)**
At 30 June 2016	**367**	**180**	**159**	**(105)**	**508**	**2,731**	**3,840**	**2**	**3,842**

1 Other reserves include a merger reserve of £3m and a translation reserve of £505m.

2 At 30 June 2016, 6,821,060 ordinary shares with a book value of £56m were held for the purposes of share-based payment plans and included in retained earnings. During the period, the Company acquired 2,847,750 ordinary shares through purchases on the London Stock Exchange for use in share-based payment plans.

3 Share-based payments- direct to equity is the net of the credit to equity in respect of the share-based charge to the income statement and the actual cost of shares vesting in the period, excluding those vesting from shares already held.

4 Following the completion of the sale of the Energy business to Siemens on 1 December 2014 and further to the announcement on 19 June 2014 of a £1bn share buyback, the Company put in place a programme to enable the purchase of its ordinary shares. The aim of the buyback was to reduce the issued share capital of the Company, helping enhance returns for shareholders. In the period to 31 December 2014, 8,215,000 shares were purchased at an average price of 840p. These shares were cancelled. In the period to 30 June 2015, 46,016,303 shares were purchased at an average price of 937p. 44,016,303 of these shares were cancelled and 2,000,000 were retained for use in share-based payment plans.

1 Basis of preparation and accounting policies

Reporting entity

Rolls-Royce Holdings plc is a company domiciled in the UK. These condensed consolidated half-year financial statements of the Company as at and for the six months ended 30 June 2016 comprise the Company and its subsidiaries (together referred to as the "Group") and the Group's interests in joint arrangements and associates.

The consolidated financial statements of the Group as at and for the year ended 31 December 2015 (2015 Annual Report) are available upon request from the Company Secretary, Rolls-Royce Holdings plc, 62 Buckingham Gate, London SW1E 6AT.

Statement of compliance

These condensed consolidated half-year financial statements have been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the European Union. They do not include all of the information required for full annual statements, and should be read in conjunction with the 2015 Annual Report.

The comparative figures for the financial year 31 December 2015 are not the Group's statutory accounts for that financial year. Those accounts have been reported on by the Group's auditors and delivered to the registrar of companies. The report of the auditors was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report, and (iii) did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

The Board of directors approved the condensed consolidated half-year financial statements on 27 July 2016.

Significant accounting policies

The accounting policies applied by the Group in these condensed consolidated half-year financial statements are the same as those that applied to the consolidated financial statements of the Group for the year ended 31 December 2015 (International Financial Reporting Standards issued by the International Accounting Standards Board (IASB), as adopted for use in the EU effective at 31 December 2015).

During the period, the Group has reassessed the categorisation of joint arrangements. As a result of this review, certain entities, previously classified as joint ventures, have been reclassified as joint operations from 1 January 2016. This reclassification does not affect profit before tax or net assets, but the Group's share of the individual income statement and balance sheet categories are included on a proportional basis, rather than as a single figure. The adjustment to the opening balance was to reclassify £57m of investments in joint ventures to: property, plant and equipment (£41m), inventory (£19m), receivables (£18m), cash (£5m), payables (£17m) and borrowings (£9m). In addition, following a review of consistency, £92m of accruals have been reclassified as provisions. Prior figures have not been restated.

Key sources of estimation uncertainty

In applying the accounting policies, management has made appropriate estimates in many areas, and the actual outcome may differ from those calculated. The key sources of estimation uncertainty at the balance sheet date were the same as those that applied to the consolidated financial statements of the Group for the year ended 31 December 2015.

2 Analysis by business segment

The analysis by Divisions (business segment) is presented in accordance with IFRS 8 *Operating segments*, on the basis of those segments whose operating results are regularly reviewed by the Board (the Chief Operating Decision Maker as defined by IFRS 8).

Civil	development, manufacture, marketing and sales of commercial aero engines and aftermarket services.
Defence	development, manufacture, marketing and sales of military aero engines and aftermarket services.
Power Systems	development, manufacture, marketing and sales of reciprocating engines and power systems.
Marine	development, manufacture, marketing and sales of marine-power propulsion systems and aftermarket services.
Nuclear	development, manufacture, marketing and sales of nuclear systems for civil power generation and naval propulsion systems.

The operating results are prepared on an underlying basis, which the Board considers reflects better the economic substance of the Group's trading during the year. The principles adopted to determine the underlying results are:

Underlying revenues – Where revenues are denominated in a currency other than the functional currency of the Group undertaking, these reflect the achieved exchange rates arising on settled derivative contracts.

Underlying profit before financing – Where transactions are denominated in a currency other than the functional currency of the Group undertaking, this reflects the transactions at the achieved exchange rates on settled derivative contracts. In addition, adjustments have been made to exclude one-off past-service credits on post-retirement schemes, exceptional restructuring, profits or losses on acquisitions and disposals and eliminating charges recognised as a result of recognising assets in acquired businesses at fair value.

Underlying profit before taxation – In addition to those adjustments in underlying profit before financing:

- Include amounts realised from settled derivative contracts and revaluation of relevant assets and liabilities to exchange rates forecast to be achieved from future settlement of derivative contracts.
- Exclude unrealised amounts arising from revaluations required by IAS 39 *Financial Instruments: Recognition and Measurement*, changes in value of financial RRSA contracts arising from changes in forecast payments, and the net impact of financing costs related to post-retirement scheme benefits.

Taxation – the tax effect of the adjustments above are excluded from the underlying tax charge. In addition changes in the amount of recoverable advance corporation tax recognised that arises from the above adjustments are also excluded.

This analysis also includes a reconciliation of the underlying results to those reported in the consolidated income statement.

The 2016 underlying results below are shown at 2015 exchange rates, with the adjustment to 2016 exchange rates shown separately.

	Civil £m	Defence £m	Power Systems £m	Marine £m	Nuclear £m	Inter-segment £m	Total reportable segments £m
For the half-year ended 30 June 2016							
Underlying revenue from original equipment	**1,437**	**396**	**662**	**291**	**140**	**(18)**	**2,908**
Underlying revenue from aftermarket services	**1,689**	**569**	**347**	**233**	**213**	**(19)**	**3,032**
Total underlying revenue at 2015 exchange rates	**3,126**	**965**	**1,009**	**524**	**353**	**(37)**	**5,940**
Translation to 2016 exchange rates	**45**	**37**	**75**	**24**	**3**	**(2)**	**182**
Total underlying revenue	**3,171**	**1,002**	**1,084**	**548**	**356**	**(39)**	**6,122**
Gross profit	**385**	**203**	**234**	**103**	**50**	**(2)**	**973**
Commercial and administrative costs	**(152)**	**(58)**	**(146)**	**(100)**	**(33)**	**–**	**(489)**
Restructuring	**(2)**	**(3)**	**–**	**(1)**	**–**	**–**	**(6)**
Research and development costs	**(245)**	**(28)**	**(77)**	**(16)**	**–**	**–**	**(366)**
Share of results of joint ventures and associates	**36**	**9**	**–**	**–**	**–**	**–**	**45**
Underlying profit before financing and taxation at 2015 exchange rates	**22**	**123**	**11**	**(14)**	**17**	**(2)**	**157**
Translation to 2016 exchange rates	**9**	**5**	**2**	**1**	**1**	**–**	**18**
Underlying profit before financing and taxation	**31**	**128**	**13**	**(13)**	**18**	**(2)**	**175**
For the half-year ended 30 June 2015 *							
Underlying revenue from original equipment	1,516	368	684	415	110	(41)	3,052
Underlying revenue from aftermarket services	1,769	605	355	280	199	(31)	3,177
Total underlying revenue	3,285	973	1,039	695	309	(72)	6,229
Gross profit	628	279	245	121	49	3	1,325
Commercial and administrative costs	(140)	(63)	(143)	(100)	(25)	–	(471)
Restructuring	(23)	(15)	(2)	(4)	(1)	–	(45)
Research and development costs	(255)	(27)	(82)	(13)	(3)	–	(380)
Share of results of joint ventures and associates	38	10	(1)	–	–	–	47
Underlying profit before financing and taxation	248	184	17	4	20	3	476

* As reported in the 2015 Annual Report, the basis for the allocation of Civil revenues on linked TotalCare contracts between OE and aftermarket was reviewed and amendments made to reflect better the commercial substance of the combined contracts. Historically, the allocation has resulted in original equipment revenue and aftermarket revenue reflecting the contractual terms rather than the commercial substance of the contracts. The 2015 half-year figures have been restated on the same basis

	Civil £m	Defence £m	Power Systems £m	Marine £m	Nuclear £m	Inter-segment £m	Total reportable segments £m
For the year ended 31 December 2015							
Underlying revenue from original equipment	3,258	801	1,618	773	251	(53)	6,648
Underlying revenue from aftermarket services	3,675	1,234	767	551	436	(53)	6,610
Total underlying revenue	6,933	2,035	2,385	1,324	687	(106)	13,258
Gross profit	1,526	579	635	260	111	7	3,118
Commercial and administrative costs	(296)	(124)	(275)	(201)	(53)	–	(949)
Restructuring	(7)	(8)	(4)	(16)	(2)	–	(37)
Research and development costs	(515)	(73)	(162)	(28)	14	–	(764)
Share of results of joint ventures and associates	104	19	–	–	–	–	123
Underlying profit before financing and taxation	812	393	194	15	70	7	1,491

Reconciliation to reported results

	Total reportable segments £m	Other businesses* and corporate £m	Total underlying £m	Underlying adjustments £m	Reported results £m
For the half-year ended 30 June 2016					
Revenue from original equipment	**2,908**	**8**	**2,916**	**258**	**3,174**
Revenue from aftermarket services	**3,032**	**12**	**3,044**	**244**	**3,288**
Total underlying revenue at 2015 exchange rates	**5,940**	**20**	**5,960**	**502**	**6,462**
Translation to 2016 exchange rates	**182**	**1**	**183**	**(183)**	**–**
Total revenue	**6,122**	**21**	**6,143**	**319**	**6,462**
Gross profit	**973**	**11**	**984**	**209**	**1,193**
Other operating income	**–**	**–**	**–**	**2**	**2**
Commercial and administrative costs	**(489)**	**(29)**	**(518)**	**(87)**	**(605)**
Restructuring	**(6)**	**–**	**(6)**	**6**	**–**
Research and development costs	**(366)**	**–**	**(366)**	**(38)**	**(404)**
Share of results of joint ventures and associates	**45**	**–**	**45**	**6**	**51**
Profit before financing and taxation at 2015 exchange rates	**157**	**(18)**	**139**	**98**	**237**
Translation to 2016 exchange rates	**18**	**1**	**19**	**(19)**	**–**
Loss on disposal of businesses	**–**	**–**	**–**	**(1)**	**(1)**
Profit before financing and taxation	**175**	**(17)**	**158**	**78**	**236**
Net financing		**(54)**	**(54)**	**(2,332)**	**(2,386)**
Profit before taxation		**(71)**	**104**	**(2,254)**	**(2,150)**
Taxation		**(27)**	**(27)**	**405**	**378**
Profit for the period		**(98)**	**77**	**(1,849)**	**(1,772)**
Attributable to:					
Ordinary shareholders			**77**	**(1,849)**	**(1,772)**
Non-controlling interests			**–**	**–**	**–**
For the half-year ended 30 June 2015					
Revenue from original equipment	3,052	10	3,062	50	3,112
Revenue from aftermarket services	3,177	17	3,194	64	3,258
Total revenue	6,229	27	6,256	114	6,370
Gross profit	1,325	7	1,332	(63)	1,269
Other operating income	–	–	–	5	5
Commercial and administrative costs	(471)	(25)	(496)	(26)	(522)
Restructuring	(45)	–	(45)	45	–
Research and development costs	(380)	2	(378)	(26)	(404)
Share of results of joint ventures and associates	47	(4)	43	(12)	31
Profit before financing and taxation	476	(20)	456	(77)	379
Net financing		(17)	(17)	(52)	(69)
Profit before taxation		(37)	439	(129)	310
Taxation		(102)	(102)	152	50
Profit for the period		(139)	337	23	360
Attributable to:					
Ordinary shareholders			337	23	360
Non-controlling interests			–	–	–
For the year ended 31 December 2015					
Revenue from original equipment	6,648	76	6,724	215	6,939
Revenue from aftermarket services	6,610	20	6,630	156	6,786
Total revenue	13,258	96	13,354	371	13,725
Gross profit	3,118	64	3,182	84	3,266
Other operating income	–	–	–	10	10
Commercial and administrative costs	(949)	(55)	(1,004)	(55)	(1,059)
Restructuring	(37)	(2)	(39)	39	–
Research and development costs	(764)	(1)	(765)	(53)	(818)
Share of results of joint ventures and associates	123	(5)	118	(18)	100
Profit on disposal of businesses	–	–	–	2	2
Profit before financing and taxation	1,491	1	1,492	9	1,501
Net financing		(60)	(60)	(1,281)	(1,341)
Profit before taxation		(59)	1,432	(1,272)	160
Taxation		(351)	(351)	275	(76)
Profit for the period		(410)	1,081	(997)	84
Attributable to:					
Ordinary shareholders			1,080	(997)	83
Non-controlling interests			1	–	1

* Other businesses comprise former Energy businesses not included in the disposal to Siemens in 2014.

	Total assets			Total liabilities			Net assets/(liabilities)		
	30 June 2016 £m	30 June 2015 £m	31 December 2015 £m	**30 June 2016 £m**	30 June 2015 £m	31 December 2015 £m	**30 June 2016 £m**	30 June 2015 £m	31 December 2015 £m
Civil	**13,261**	11,210	11,774	**(11,671)**	(7,073)	(8,709)	**1,590**	4,137	3,065
Defence	**1,535**	1,389	1,449	**(1,643)**	(1,668)	(1,698)	**(108)**	(279)	(249)
Power Systems	**3,680**	3,228	3,384	**(1,084)**	(975)	(1,017)	**2,596**	2,253	2,367
Marine	**1,528**	1,515	1,488	**(816)**	(877)	(783)	**712**	638	705
Nuclear	**289**	351	303	**(304)**	(337)	(324)	**(15)**	14	(21)
Inter-segment	**(452)**	(731)	(850)	**435**	712	850	**(17)**	(19)	–
Reportable segments	**19,841**	16,962	17,548	**(15,083)**	(10,218)	(11,681)	**4,758**	6,744	5,867
Other businesses	**48**	118	120	**(43)**	(101)	(120)	**5**	17	–
Net funds	**2,620**	1,646	3,252	**(3,332)**	(2,289)	(3,363)	**(712)**	(643)	(111)
Tax assets/(liabilities)	**633**	435	341	**(983)**	(1,075)	(1,004)	**(350)**	(640)	(663)
Post-retirement scheme surpluses/(deficits)	**1,545**	1,016	1,063	**(1,404)**	(1,084)	(1,140)	**141**	(68)	(77)
	24,687	20,177	22,324	**(20,845)**	(14,767)	(17,308)	**3,842**	5,410	5,016

Group employees at period end	**30 June 2016 ***	30 June 2015	31 December 2015
Civil	**23,600**	23,100	23,100
Defence	**6,200**	6,400	6,400
Power Systems	**10,300**	10,700	10,400
Marine	**5,300**	6,100	5,600
Nuclear	**4,300**	4,100	4,200
Other	**–**	200	100
	49,700	50,600	49,800

* As described in Note 1, the Group has reclassified certain joint ventures to joint operations from 1 January 2016. This has had the effect of increasing the reported Group employees at 30 June 2016 by 800.

Underlying revenue adjustments	**Half-year to 30 June 2016 £m**	Half-year to 30 June 2015 £m	Year to 31 December 2015 £m
Underlying revenue	**6,143**	6,256	13,354
Recognise revenue at exchange rate on date of transaction	**319**	114	371
Revenue per consolidated income statement	**6,462**	6,370	13,725

Underlying profit adjustments	**Half-year to 30 June 2016**			Half-year to 30 June 2015			Year to 31 December 2015		
	Profit before financing £m	**Net financing £m**	**Taxation £m**	Profit before financing £m	Net financing £m	Taxation £m	Profit before financing £m	Net financing £m	Taxation £m
Underlying performance re-presented	**158**	**(54)**	**(27)**	456	(17)	(102)	1,492	(60)	(351)
Realised losses/(gains) on settled derivative contracts [1]	**131**	**5**	**(25)**	145	(28)	(24)	287	(35)	(51)
Net unrealised fair value changes to derivative contracts [2]	**4**	**(2,155)**	**377**	(12)	(89)	19	(9)	(1,306)	270
Effect of currency on contract accounting	**32**	**–**	**(6)**	(32)	–	6	(9)	–	2
Revaluation of trading assets and liabilities	**40**	**(176)**	**26**	(26)	55	(7)	(13)	20	(6)
Financial RRSAs – exchange differences and changes in forecast payments	**–**	**(8)**	**1**	–	(3)	1	–	8	(1)
Effect of acquisition accounting	**(62)**	**–**	**17**	(63)	–	19	(124)	–	31
Impairment of goodwill	**–**	**–**	**–**	(69)	–	–	(75)	–	–
Net post-retirement scheme financing	**–**	**3**	**(1)**	–	13	(5)	–	32	(12)
Disposal of business	**(1)**	**–**	**–**	(3)	–	15	2	–	15
Exceptional restructuring [3]	**(68)**	**–**	**13**	(11)	–	2	(49)	–	11
Other	**2**	**(1)**	**3**	(6)	–	4	(1)	–	(2)
Recognition of advance corporation tax	**–**	**–**	**–**	–	–	122	–	–	–
Reduction in rate of UK corporation tax	**–**	**–**	**–**	–	–	–	–	–	18
Total underlying adjustments	**78**	**(2,332)**	**405**	(77)	(52)	152	9	(1,281)	275
Reported per consolidated income statement	**236**	**(2,386)**	**378**	379	(69)	50	1,501	(1,341)	(76)

[1] The adjustments for realised losses/(gains) on settled derivative contracts include adjustments to reflect the losses/(gains) in the same period as the related trading cash flows.
[2] The adjustments for unrealised fair value changes to derivative contracts include those included in equity accounted joint ventures and exclude those for which the related trading contracts have been cancelled when the fair value changes are recognised immediately in underlying profit.
[3] Restructuring is excluded from underlying performance when it concerns the closure of a significant business or site or a fundamental reorganisation of the business.

3 Research and development

	Half-year to 30 June 2016 £m	Half-year to 30 June 2015 £m	Year to 31 December 2015 £m
Expenditure in the period	**(433)**	(405)	(831)
Capitalised as intangible assets	**54**	9	51
Amortisation of capitalised costs	**(71)**	(66)	(136)
Net cost	**(450)**	(462)	(916)
Entry fees received	**59**	57	83
Entry fees deferred in respect of charges in future periods	**(27)**	(22)	(28)
Recognition of previously deferred entry fees	**14**	23	43
Net cost recognised in the income statement	**(404)**	(404)	(818)
Underlying adjustments relating to the effects of acquisition accounting and foreign exchange	**24**	26	53
Net underlying cost recognised in the income statement	**(380)**	(378)	(765)

4 Net financing

	Half-year to 30 June 2016		Half-year to 30 June 2015		Year to 31 December 2015	
	Per consolidated income statement £m	***Underlying financing £m***	Per consolidated income statement £m	*Underlying financing £m*	Per consolidated income statement £m	*Underlying financing £m*
Financing income						
Interest receivable	**7**	***7***	4	*4*	12	*12*
Net fair value gains on foreign currency contracts	**1**	**–**	–	–	–	–
Financial RRSAs – foreign exchange differences and changes in forecast payments	**–**	**–**	–	–	21	–
Net fair value gains on commodity contracts	**6**	**–**	–	–	–	–
Financing on post-retirement scheme surpluses	**22**	**–**	31	–	65	–
Net foreign exchange gains	**–**	**–**	51	*24*	17	*32*
	36	***7***	86	*28*	115	*44*
Financing costs						
Interest payable	**(42)**	***(42)***	(32)	*(32)*	(71)	*(71)*
Net fair value losses on foreign currency contracts	**(2,162)**	**–**	(61)	–	(1,217)	–
Financial RRSAs – foreign exchange differences and changes in forecast payments	**(8)**	**–**	(3)	–	(13)	–
Financial charge relating to financial RRSAs	**(2)**	***(2)***	(2)	*(2)*	(8)	*(8)*
Net fair value losses on commodity contracts	**–**	**–**	(28)	–	(89)	–
Financing on post-retirement scheme deficits	**(19)**	**–**	(18)	–	(33)	–
Net foreign exchange losses	**(171)**	**–**	–	–	–	–
Other financing charges	**(18)**	***(17)***	(11)	*(11)*	(25)	*(25)*
	(2,422)	***(61)***	(155)	*(45)*	(1,456)	*(104)*
Net financing	**(2,386)**	***(54)***	(69)	*(17)*	(1,341)	*(60)*
Analysed as:						
Net interest payable	**(35)**	***(35)***	(28)	*(28)*	(59)	*(59)*
Net fair value (losses)/gains on derivative contracts	**(2,155)**	**–**	(89)	*24*	(1,306)	–
Net post-retirement scheme financing	**3**	**–**	13	–	32	–
Net other financing	**(199)**	***(19)***	35	*(13)*	(8)	*(1)*
Net financing	**(2,386)**	***(54)***	(69)	*(17)*	(1,341)	*(60)*

5 Taxation

The effective tax rate for the half year is 17.6% (2015 half-year (16.1)%, full year 47.5%).

The Summer Budget 2015 announced that the UK corporation tax rate will reduce to 19% from 1 April 2017 and 18% from 1 April 2020; these reductions were substantively enacted on 26 October 2015. As the reductions were substantively enacted prior to the year end, the 2015 closing deferred tax balances were calculated at 18%.

A subsequent reduction in the rate to 17%, effective from 1 April 2020, was announced in the 2016 Budget. The proposed further reduction in the rate to 17% will be reflected when the relevant legislation is substantively enacted.

6 Earnings per ordinary share (EPS)

Basic EPS are calculated by dividing the profit attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period, excluding ordinary shares held under trust, which have been treated as if they had been cancelled. Diluted EPS are calculated by adjusting the weighted average number of ordinary shares in issue during the period for the bonus element of share options.

	Half-year to 30 June 2016			Half-year to 30 June 2015			Year to 31 December 2015		
	Basic	**Potentially dilutive share options [1]**	**Diluted**	Basic	Potentially dilutive share options	Diluted	Basic	Potentially dilutive share options	Diluted
Profit attributable to ordinary shareholders (£m)	**(1,772)**	**–**	**(1,772)**	360	–	360	83	–	83
Weighted average shares (millions)	**1,832**	**9**	**1,841**	1,845	15	1,860	1,839	12	1,851
EPS (pence)	**(96.72p)**	**–**	**(96.72p)**	19.51p	(0.16p)	19.35p	4.51p	(0.03p)	4.48p

[1] As there is a loss on continuing operations, the effect of potentially dilutive ordinary shares is anti-dilutive and consequently diluted EPS is the same as basic EPS.

The reconciliation between underlying EPS and basic EPS is as follows:

	Half-year to 30 June 2016		Half-year to 30 June 2015		Year to 31 December 2015	
	Pence	**£m**	Pence	£m	Pence	£m
Underlying EPS / Underlying profit attributable to ordinary shareholders re-presented	**4.20**	**77**	18.27	337	58.73	1,080
Total underlying adjustments to profit before tax (note 2)	**(123.03)**	**(2,254)**	(7.00)	(129)	(69.17)	(1,272)
Related tax effects	**22.11**	**405**	8.24	152	14.95	275
EPS / Profit attributable to ordinary shareholders	**(96.72)**	**(1,772)**	19.51	360	4.51	83
Diluted underlying EPS	**4.18**		18.12		58.35	

7 Payments to shareholders in respect of the period

Payments to shareholders in respect of the period represent the value of C Shares to be issued in respect of the results for the period. Issues of C Shares were declared as follows:

	Half-year to 30 June 2016		Year to 31 December 2015	
	Pence per share	**£m**	Pence per share	£m
Interim (issued in January)	**4.6**	**85**	9.27	170
Final (issued in July)			7.10	131
	4.6	**85**	16.37	301

8 Intangible assets

	Goodwill £m	**Certification costs and participation fees £m**	**Development expenditure £m**	**Contractual aftermarket rights £m**	**Customer relationships £m**	**Software £m**	**Other £m**	**Total £m**
Cost:								
At 1 January 2016	**1,589**	**1,145**	**1,730**	**799**	**456**	**616**	**543**	**6,878**
Exchange differences	**195**	**19**	**84**	**–**	**56**	**10**	**46**	**410**
Additions	**–**	**39**	**54**	**90**	**–**	**25**	**24**	**232**
At 30 June 2016	**1,784**	**1,203**	**1,868**	**889**	**512**	**651**	**613**	**7,520**
Accumulated amortisation:								
At 1 January 2016	**86**	**373**	**691**	**394**	**139**	**325**	**225**	**2,233**
Exchange differences	**12**	**3**	**33**	**–**	**19**	**5**	**24**	**96**
Charge for the period	**–**	**32**	**71**	**19**	**23**	**36**	**18**	**199**
Impairment	**–**	**–**	**2**	**–**	**–**	**–**	**–**	**2**
At 30 June 2016	**98**	**408**	**797**	**413**	**181**	**366**	**267**	**2,530**
Net book value at:								
30 June 2016	**1,686**	**795**	**1,071**	**476**	**331**	**285**	**346**	**4,990**
31 December 2015	1,503	772	1,039	405	317	291	318	4,645

Certification costs and participation fees, development expenditure and contractual aftermarket rights have been reviewed for impairment in accordance with the requirements of IAS 36 *Impairment of Assets*. Where an impairment test was considered necessary, it has been performed on the following basis:

- The carrying values have been assessed by reference to value in use. These have been estimated using cash flows from the most recent forecasts prepared by management, which are consistent with past experience and external sources of information on market conditions over the lives of the respective programmes.

- The key assumptions underlying cash flow projections are assumed market share, programme timings, unit cost assumptions, discount rates, and foreign exchange rates.
- The pre-tax cash flow projections have been discounted at 9-11% (2015 full year 9-11%), based on the Group's weighted average cost of capital.
- No impairment is required on this basis. However, a combination of changes in assumptions and adverse movements in variables that are outside the Company's control (discount rate, exchange rate and airframe delays), could result in impairment in future periods.

9 Property, plant and equipment

	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m	In course of construction £m	Total £m
Cost:					
At 1 January 2016	**1,375**	**3,894**	**339**	**708**	**6,316**
Exchange differences	**91**	**222**	**5**	**34**	**352**
Reclassification of joint ventures to joint operations	**7**	**87**	**–**	**–**	**94**
Additions	**6**	**47**	**21**	**117**	**191**
On disposal of businesses	**–**	**(3)**	**–**	**–**	**(3)**
Reclassifications	**15**	**75**	**29**	**(119)**	**–**
Disposals	**(4)**	**(29)**	**(41)**	**(1)**	**(75)**
At 30 June 2016	**1,490**	**4,293**	**353**	**739**	**6,875**
Accumulated amortisation:					
At 1 January 2016	**416**	**2,284**	**125**	**1**	**2,826**
Exchange differences	**27**	**117**	**2**	**–**	**146**
Reclassification of joint ventures to joint operations	**1**	**52**	**–**	**–**	**53**
On disposal of businesses	**–**	**(1)**	**–**	**–**	**(1)**
Charge for the period	**28**	**154**	**13**	**–**	**195**
Impairment	**–**	**–**	**–**	**1**	**1**
Disposals	**(4)**	**(22)**	**(37)**	**–**	**(63)**
At 30 June 2016	**468**	**2,584**	**103**	**2**	**3,157**
Net book value at:					
30 June 2016	**1,022**	**1,709**	**250**	**737**	**3,718**
31 December 2015	959	1,610	214	707	3,490

10 Financial assets and liabilities

Other financial assets and liabilities comprise:

	Derivatives							
	Foreign exchange contracts £m	Commodity contracts £m	Interest rate contracts £m	Total £m	Financial RRSAs £m	Other £m	C Shares £m	Total £m
At 30 June 2016								
Non-current assets	**8**	**2**	**341**	**351**	**–**	**–**	**–**	**351**
Current assets	**44**	**1**	**–**	**45**	**–**	**–**	**–**	**45**
Current liabilities	**(443)**	**(30)**	**–**	**(473)**	**(17)**	**–**	**(31)**	**(521)**
Non-current liabilities	**(3,324)**	**(53)**	**(9)**	**(3,386)**	**(97)**	**(14)**	**–**	**(3,497)**
	(3,715)	**(80)**	**332**	**(3,463)**	**(114)**	**(14)**	**(31)**	**(3,622)**
At 30 June 2015								
Non-current assets	129	–	56	185	–	–	–	185
Current assets	46	–	1	47	–	–	–	47
Current liabilities	(157)	(22)	–	(179)	(13)	–	(26)	(218)
Non-current liabilities	(629)	(37)	(88)	(754)	(141)	–	–	(895)
	(611)	(59)	(31)	(701)	(154)	–	(26)	(881)
At 31 December 2015								
Non-current assets	3	–	80	83	–	–	–	83
Current assets	29	–	–	29	–	–	–	29
Current liabilities	(244)	(39)	–	(283)	(19)	–	(29)	(331)
Non-current liabilities	(1,428)	(65)	(67)	(1,560)	(91)	–	–	(1,651)
	(1,640)	(104)	13	(1,731)	(110)	–	(29)	(1,870)

Derivative financial instruments

	Half-year to 30 June 2016				Half-year to 30 June 2015	Year to 31 December 2015
	Foreign exchange £m	**Commodity £m**	**Interest rate £m**	**Total £m**	Total £m	Total £m
At January 1	(1,640)	(104)	13	**(1,731)**	(630)	(630)
Currency options at inception [1]	(33)	–	–	**(33)**	(20)	(20)
Movements in fair value hedges	–	–	319	**319**	(83)	(35)
Movements in other derivative contracts	(2,161)	6	–	**(2,155)**	(89)	(1,306)
Contracts settled	119	18	–	**137**	121	260
At period end	**(3,715)**	**(80)**	**332**	**(3,463)**	(701)	(1,731)

[1] The Group wrote currency options to sell USD and buy GBP as part of a commercial agreement. The fair value of this option on inception was treated as a discount to the customer.

Financial risk and revenue sharing arrangements (RRSAs) and other financial liabilities

	Financial RRSAs			Other
	Half-year to 30 June 2016 £m	Half-year to 30 June 2015 £m	Year to 31 December 2015 £m	**Half-year to 30 June 2016 £m**
At January 1	**(110)**	(145)	(145)	**–**
Exchange adjustments included in OCI	**4**	(5)	–	**–**
Additions	**–**	–	–	**(14)**
Financing charge [1]	**(2)**	(2)	(8)	**–**
Exchange adjustments – excluded from underlying results [1]	**(8)**	(3)	8	**–**
Cash paid to partners	**2**	1	35	**–**
At period end	**(114)**	(154)	(110)	**(14)**

[1] Included in net financing.

Fair values of financial instruments equate to book values with the following exceptions:

	Half-year to 30 June 2016		Half-year to 30 June 2015		Year to 31 December 2015	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m	Book value £m	Fair value £m
Borrowings	**(3,332)**	**(3,320)**	(2,206)	(2,293)	(3,302)	(3,312)

Fair values

The fair value of a financial instrument is the price at which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms-length transaction. Fair values have been determined with reference to available market information at the balance sheet date, using the methodologies described below.

- Unlisted non-current investments primarily comprise bank deposits where the fair value approximates to the book value.
- The fair values of trade receivables and payables, short-term investments and cash and cash equivalents are assumed to approximate to cost either due to the short-term maturity of the instruments or because the interest rate of the investments is reset after periods not exceeding six months.
- Fair values of derivative financial assets and liabilities are estimated by discounting expected future contractual cash flows using prevailing interest rate curves. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. These financial instruments are included on the balance sheet at fair value, derived from observable market prices (Level 2 as defined by IFRS 13 *Fair Value Measurement*).
- Borrowing and financial RRSAs are carried at amortised cost. Fair values are estimated by discounting expected future contractual cash flows using prevailing interest rate curves (Level 2 as defined by IFRS 13). Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. For financial RRSAs, the contractual cash flows are based on future trading activity, which is estimated based on latest forecasts.

Borrowings

During the period, the Group has repaid £325m of short-term borrowings, including the £200m $7^3/_8$% Notes, which matured in June.

11 Pensions and other post-retirement benefits

The net post-retirement scheme deficit as at 30 June 2016 is calculated on a year to date basis, using the latest valuation as at 31 December 2015, updated to 30 June 2016 for the principal schemes.

Movements in the net post-retirement position recognised in the balance sheet were as follows:

	UK schemes £m	**Overseas schemes £m**	**Total £m**
At 1 January 2016	**1,043**	**(1,120)**	**(77)**
Exchange adjustments	–	(139)	(139)
Current service cost	(84)	(26)	(110)
Past service credit/(cost)	2	(10)	(8)
Net financing	21	(18)	3
Contributions by employer	88	40	128
Actuarial gains /(losses)[1]	457	(111)	346
Other	–	(2)	(2)
At 30 June 2016	**1,527**	**(1,386)**	**141**
Analysed as:			
Post-retirement scheme surpluses - included in non-current assets	1,540	5	1,545
Post-retirement scheme deficits - included in non-current liabilities	(13)	(1,391)	(1,404)
	1,527	**(1,386)**	**141**

[1] The net actuarial gains in the UK arose principally due to changes in the yield curves used to value the assets and the liabilities.

12 Contingent liabilities

On 6 December 2012, the Company announced that it had passed information to the Serious Fraud Office (SFO), following a request from the SFO for information about allegations of malpractice in overseas markets. On 23 December 2013, the Company announced that it had been informed by the SFO that it had commenced a formal investigation. Since the initial announcement, the Company has continued its investigations and is engaging with the SFO and other authorities in the UK, the USA and elsewhere in relation to the matters of concern.

The consequence of these disclosures will be decided by the regulatory authorities. It is too early to predict the outcomes, but these could include the prosecution of individuals and of the Group. Accordingly, the potential for fines, penalties or other consequences cannot currently be assessed. As the investigation is ongoing, it is not yet possible to identify the timescale in which these issues might be resolved.

In connection with the sale of its products the Group will, on some occasions, provide financing support for its customers - generally in respect of civil aircraft. The Group's commitments relating to these financing arrangements, which are spread over many years, relate to a number of customers and a broad product portfolio and are generally secured on the asset subject to the financing. These include commitments of US$3.6bn (31 December 2015 $3.1bn) to provide borrowing facilities to enable customers to purchase aircraft (of which approximately US$317m could be called in 2016). These facilities may only be used if the customer is unable to obtain financing elsewhere and are priced at a premium to the market rate. Consequently the directors do not consider that there is a significant exposure arising from the provision of these facilities.

Commitments on delivered aircraft in excess of the amounts provided are shown in the table below. These are reported on a discounted basis at the Group's borrowing rate to reflect better the time span over which these exposures could arise. These amounts do not represent values that are expected to crystallise. The commitments are denominated in US dollars. As the Group does not generally adopt cash flow hedge accounting for future foreign exchange transactions, this amount is reported, together with the sterling equivalent at the reporting date spot rate. The values of aircraft providing security are based on advice from a specialist aircraft appraiser.

	30 June 2016		31 December 2015	
	£m	***$m***	£m	*$m*
Gross contingent liabilities	**253**	***339***	269	*399*
Value of security[1]	**(114)**	***(153)***	(136)	*(201)*
Indemnities	**(77)**	***(103)***	(79)	*(118)*
Net commitments	**62**	***83***	54	*80*
Net commitments with security reduced by 20% [2]	**91**	***122***	78	*115*
[1] Security includes unrestricted cash collateral of:	**35**	***47***	35	*52*

[2] Although sensitivity calculations are complex, the reduction of the relevant security by 20% illustrates the sensitivity of the contingent liability to changes in this assumption.

Contingent liabilities exist in respect of guarantees provided by the Group in the ordinary course of business for product delivery, performance and reliability. The Group has, in the normal course of business, entered into arrangements in respect of export finance, performance bonds, countertrade obligations and minor miscellaneous items. Various Group undertakings are parties to legal actions and claims which arise in the ordinary course of business, some of which are for substantial amounts. As a consequence of the insolvency of an insurer as previously reported, the Group is no longer fully insured against known and potential claims from employees who worked for certain of the Group's UK-based businesses for a period prior to the acquisition of those businesses by the Group. While the outcome of some of these matters cannot precisely be foreseen, the directors do not

expect any of these arrangements, legal actions or claims, after allowing for provisions already made, to result in significant loss to the Group.

13 Related party transactions

Transactions with related parties are shown on page 156 of the 2015 Annual Report. Significant transactions in the current financial period are as follows:

	Half-year to 30 June 2016 £m	Half-year to 30 June 2015 £m	Year to 31 December 2015 £m
Sales of goods and services to joint ventures and associates	**887**	859	1,896
Purchases of goods and services from joint ventures and associates	**(1,072)**	(1,120)	(2,266)

Included in sales of goods and services to joint ventures and associates are sales of spare engines amounting to £35m (2015: half-year £13m, full-year £189m).

Profit recognised in the year on such sales amounted to £21m (2015: half-year £13m, full-year £71m), including profit on current year sales and recognition of profit deferred on similar sales in previous years.

14 Post-balance sheet events

On 11 July 2016, the Group announced that it will purchase the outstanding 53.1% shareholding in Industria de Turbo Propulsores SA ("ITP") owned by SENER Grupo de Ingeniería SA ("SENER"). Rolls-Royce will pay SENER a total consideration of €720m, subject to due diligence, for the outstanding 53.1% of ITP. This follows a decision by SENER to exercise its put option. Under the existing shareholder agreement, consideration will be settled over a two year period following completion in eight equal, evenly spaced instalments. The agreement allows flexibility to settle up to 50% of the consideration in the form of Rolls-Royce shares. Final consideration as to whether the payments will be settled in cash, or cash and shares will be determined by Rolls-Royce during the payment period. Completion, which is subject to regulatory clearances, is expected in early 2017.

Principal risks and uncertainties

Whilst the Group has a consistent strategy and long performance cycles, it continues to be exposed to a number of risks and has an established, structured approach to identifying, assessing and managing those risks.

The principal risks facing the Group for the remaining six months of the financial year are unchanged from those reported on pages 55 and 56 of the Annual Report 2015, as set out below:

Product failure
Product not meeting safety expectations, or causing significant impact to customers or the environment through failure in quality control.

Business continuity
Breakdown of external supply chain or internal facilities that could be caused by destruction of key facilities, natural disaster, regional conflict, 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.

Competitive position
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.

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.

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.

Compliance
Non-compliance by the Group with legislation or other regulatory requirements in the regulated environment in which it operates (eg. export controls; offset; use of controlled chemicals and substances; and anti-bribery and corruption legislation) compromising our 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.

Market and financial shock
The Group is exposed to a number of market risks, some of which are of a macro-economic nature (eg. foreign currency, oil price, exchange rates) and some of which are more specific to the Group (eg. 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.

IT vulnerability
Breach of IT security causing controlled or critical data to be lost, made inaccessible, corrupted or accessed by unauthorised users.

Talent and capability
Inability to attract and retain the critical capabilities and skills needed in sufficient numbers and to effectively organise, deploy and incentivise our people to deliver our strategy, business plan and projects.

Going concern

After making enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. There have been no significant changes to the basis described on page 57 of the Annual Report 2015. For this reason they continue to adopt the going concern basis in preparing the consolidated financial statements.

Payments to shareholders

The Company makes payments to shareholders in the form of redeemable C Shares which shareholders may either choose to retain or redeem for a cash equivalent. On 4 January 2017, 46 C Shares, with a total nominal value of 4.6p, will be allotted for each ordinary share to those shareholders on the register on 21 October 2016. The final day of trading with entitlement to C Shares is 19 October 2016. Our Registrar, Computershare Investor Services PLC, operates a C Share Reinvestment Plan (CRIP), and can, on behalf of shareholders, use the cash proceeds of redemption to purchase ordinary shares from the market. Shareholders wishing to redeem their C Shares, or participate in the CRIP, must lodge instructions with our Registrar to arrive no later than 5.00 pm on 1 December 2016. The payment of C Shares redemption monies will be made on 6 January 2017.

Statement of directors' responsibilities

The directors confirm that, to the best of their knowledge:

- the condensed consolidated half-year financial statements have been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU;
- the interim management report includes a fair review of the information required by:
  - (a) DTR 4.2.7R of the *Disclosure and Transparency Rules*, being an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed consolidated half-year financial statements; and a description of the principal risks and uncertainties for the remaining six months of the year; and
  - (b) DTR 4.2.8R of the *Disclosure and Transparency Rules*, being related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or performance of the entity during that period; and any changes in the related party transactions described in the last Annual Report that could do so.

The directors of Rolls-Royce Holdings plc at 11 February 2016 are listed in its 2015 Annual Report 2015 on pages 58 to 61. Since that date, the following changes have taken place:

- Bradley Singer was appointed as a Non-executive director on 2 March 2016; and
- Helen Alexander retired as a Non-executive director at the conclusion of the AGM on 5 May 2016.

By order of the Board

Warren East
Chief Executive
27 July 2016

David Smith
Chief Financial Officer
27 July 2016

Independent review report to Rolls-Royce Holdings plc

Introduction

We have been engaged by the company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2016 which comprises the condensed consolidated income statement, the condensed consolidated statement of comprehensive income, the condensed consolidated balance sheet, the condensed consolidated cash flow statement, the condensed consolidated statement of changes in equity and the related explanatory notes. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the company in accordance with the terms of our engagement to assist the company in meeting the requirements of the Disclosure and Transparency Rules ("the DTR") of the UK's Financial Conduct Authority ("the UK FCA"). Our review has been undertaken so that we might state to the company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company for our review work, for this report, or for the conclusions we have reached.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the DTR of the UK FCA.

As disclosed in note 1, the annual financial statements of the group are prepared in accordance with IFRSs as adopted by the EU. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU.

Our responsibility

Our responsibility is to express to the company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2016 is not prepared, in all material respects, in accordance with IAS 34 as adopted by the EU and the DTR of the UK FCA.

Jimmy Daboo
for and on behalf of KPMG LLP
Chartered Accountants
15 Canada Square
London E14 5GL
27 July 2016

Appendix: Derivation of summary funds flow statement from reported cash flow statement

	£m	£m	Source
Reported operating profit		**237**	
Realised gains on settled derivatives	(131)		Reported to underlying adjustment (note 2)
Net unrealised fair value to changes to derivatives	(4)		Reported to underlying adjustment (note 2)
Foreign exchange on contract accounting	(32)		Reported to underlying adjustment (note 2)
Revaluation of trading assets and liabilities	(40)		Reported to underlying adjustment (note 2)
Effect of acquisition accounting	62		Reported to underlying adjustment (note 2)
Exceptional restructuring	68		Reported to underlying adjustment (note 2)
Other	(2)		Reported to underlying adjustment (note 2)
Adjustments to reported operating profit		**(79)**	
Underlying profit before financing		**158**	
Underlying financing		**(54)**	Underlying income statement (note 2)
Underlying profit before tax		**104**	
Depreciation of property, plant and equipment	196		Cash flow statement
Amortisation of intangible assets	201		Cash flow statement
Acquisition accounting	(62)		Reversal of underlying adjustment (above)
Depreciation and amortisation		**335**	
Increase in inventories	(339)		Cash flow statement
Increase in trade and other receivables	(465)		Cash flow statement, excluding £6m receipts on the Energy disposal in 2014
Increase in trade and other payables	529		Cash flow statement, excluding £15m exceptional restructuring
Revaluation of trading assets	40		Reversal of underlying adjustment (above)
Movement on net working capital		**(235)**	
Additions of intangible assets	(232)		Cash flow statement
Purchases of property, plant and equipment	(307)		Cash flow statement
Expenditure on property, plant and equipment and intangible assets		**(539)**	
Realised gains	131		Reversal of underlying adjustment (above)
Net unrealised fair value to changes to derivatives	4		Reversal of underlying adjustment (above)
FX on contract accounting	32		Reversal of underlying adjustment (above)
Reported restructuring	(68)		Reversal of underlying adjustment (above)
Other	2		Reversal of underlying adjustment (above)
Underlying financing	54		Reversal of charge in underlying profit before tax (above)
Loss on disposal of property, plant and equipment	2		Cash flow statement
Joint ventures	(37)		Joint venture dividends less share of results – cash flow statement
Increase in provisions	86		Cash flow statement
Cash flows on other financial assets and liabilities	(139)		Cash flow statement
Share based payments	14		Cash flow statement
Disposal of property, plant and equipment	10		Cash flow statement
Other investments in joint ventures and associates	(11)		Cash flow statement
Net interest	(48)		Interest received and paid – cash flow statement
Net funds of JVs reclassified to JOs	(4)		Net cash and borrowings reclassified – cash flow statement
Purchase of ordinary shares for share schemes	(20)		Cash flow statement
Other		**8**	
Trading cash flow		**(327)**	
Net defined benefit plans – operating charge	118		Cash flow statement
Cash funding of defined benefit plans	(128)		Cash flow statement
Contributions to defined benefit schemes in excess of PBT charge		**(10)**	
Tax		**(62)**	Taxation paid – cash flow statement
Free cash flow		**(399)**	
Exceptional restructuring expenditure		**(15)**	Reversal of adjustment (above)
Shareholder payments		**(168)**	Redemption of C Shares – cash flow statement
Increase in share in joint ventures		**(154)**	Cash flow statement
Other acquisitions/disposals		**7**	Disposals of businesses – cash flow statement, and receipts on Energy disposal (above)
Exchange gain on net funds		**128**	Cash flow statement
Change in net funds		**(601)**	

This table shows the derivation free cash flow, an alternative performance measure, to the movement in net funds shown on page 29. The movement in net funds table shows the change in cash and cash equivalents which represents the most directly reconcilable line item shown in the financial statements required by IFRS.

Free cash flow is a measure of financial performance of the business's cash flow to see what is available for distribution among those stakeholders funding the business (including debt holders and shareholders). Free cash flow is calculated as trading cash flow less recurring tax and post-employment benefit expenses, It excludes payments made to shareholders, amounts spent (or received) on business acquisitions, exceptional restructuring costs and foreign exchange changes on net funds. The Board considers that free cash flow reflects cash generated from the Group’s underlying trading.