



**Rolls-Royce**

**2016 Governance Event**

# Ross Hawley

## Investor Relations



**Rolls-Royce**

# Agenda for today



Rolls-Royce

Welcome

Ian Davis

Strategic review, Q&A

Warren East & David Smith

**Governance workshop: 9am**

Board & governance

Ian Davis

Audit

Lewis Booth

Remuneration

Dame Helen Alexander & Ruth Cairnie

**Round table discussions: 10am**

Board committees

Committee chairs

**Finish: 11am**



Safety

Safe  
Harbour

Mobile  
phones



# Ian Davis

## Chairman



**Rolls-Royce**



1. Company strategy and priorities

2. Board composition and workings

3. Board agenda and focus

# Today's Board attendees



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Ian Davis



Dame Helen Alexander



Lewis Booth



Warren East



Ruth Cairnie



Sir Frank Chapman



Sir Kevin Smith



David Smith

# Warren East

## Chief Executive



**Rolls-Royce**



# Goals for 2015 H2



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Undertake thorough review of operations



Identify the clear areas for business improvement



Keep focus on delivering profitable growth



Improved disclosure and transparency



Set clear priorities for 2016 onwards



# Strategic clarity



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We are a Power Systems business...

## VISION

*“... to be the market leader in high performance power systems where our engineering expertise, global reach and deep industry knowledge deliver outstanding customer relationships and solutions”*

## STRATEGIC FOCUS

*“... focus on differentiated, mission critical power systems markets with high barriers to entry where we can leverage our leading engineering skills and manufacturing excellence to drive growing market shares”*

# Goals for 2016



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With pace and simplicity...

Strengthen our focus on engineering and operational excellence and leveraging our installed base

Deliver a strong start to our transformation programme

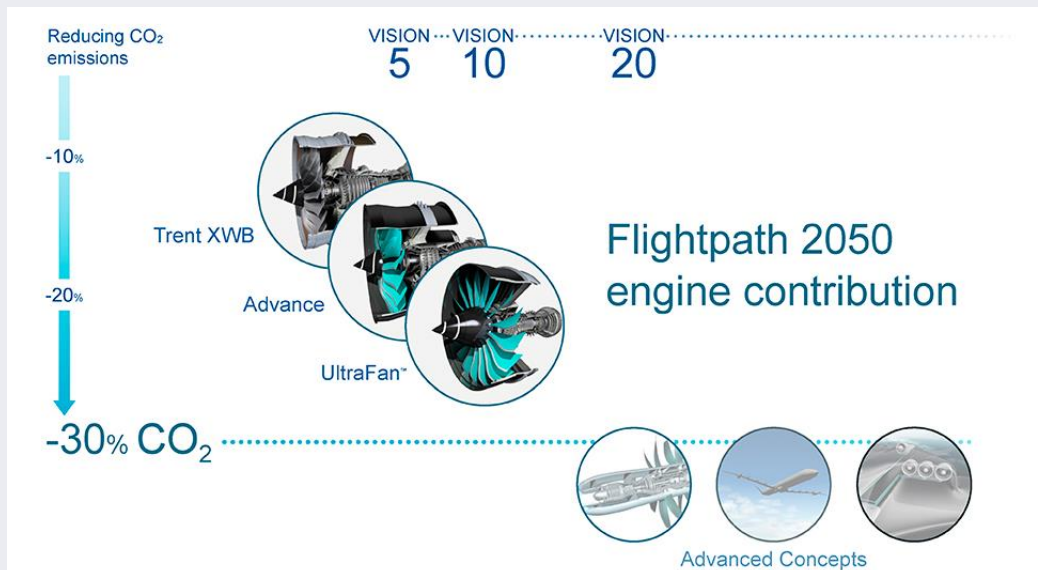
Start rebuilding trust and confidence in our long-term growth prospects

# Engineering excellence

Pace, simplicity and flexibility



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## Advanced Manufacturing Research Centres

- Developed with other companies and key universities

## Advanced Blade Casting Facility in Rotherham

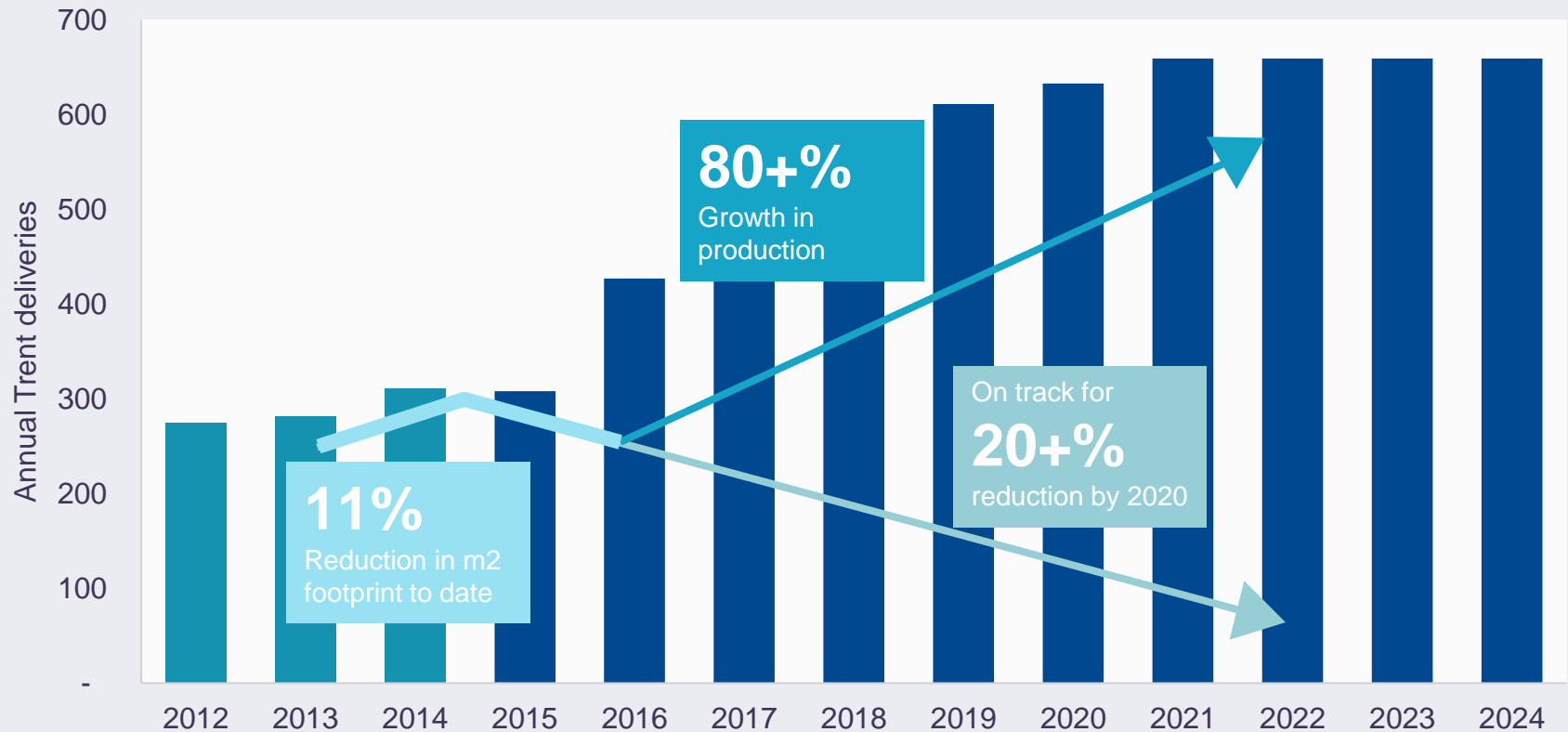
- Opened at the beginning of 2015
- This new facility is co-located with the AMR centre set up with the University of Sheffield

# Operational excellence

Significant productivity improvements



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# Leveraging our installed base

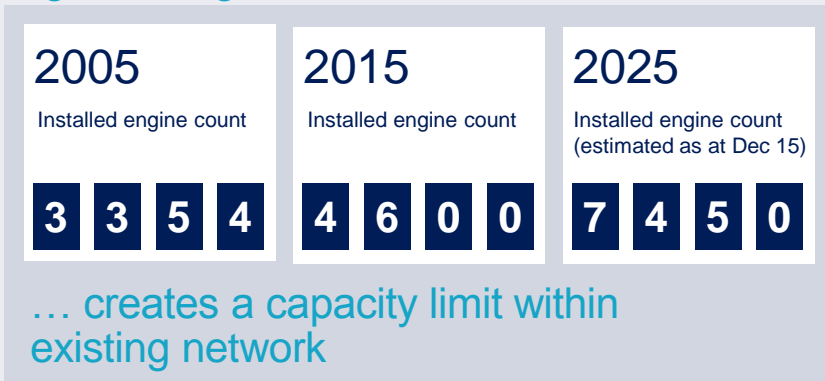
Aerospace initiatives to drive long-term value



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Changing dynamics as we mature ...

Significant growth in installed base...

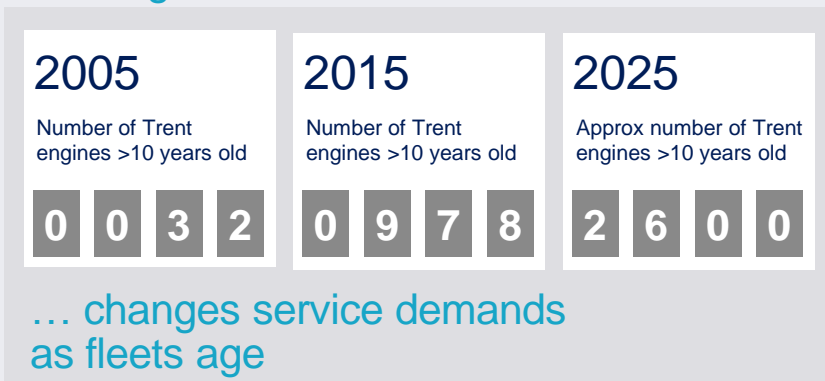


Response... reorganising

New structure focused on flexibility and competition...

- Investing ~\$200m to rebalance MRO network – HAESL, SAESL & N3
- Closing TAESL
- New facility at Delta TechOps

Maturing installed base...



Response ... new TotalCare offerings... designed around the customer

TotalCare	
<p><b>TotalCare Flex</b></p> <ul style="list-style-type: none"> <li>• Pay-as-you-go</li> <li>• Guaranteed power</li> <li>• RR choice to own engines</li> <li>• Owner receives asset value</li> </ul> <p> CATHAY PACIFIC</p>	<p><b>SelectCare</b></p> <ul style="list-style-type: none"> <li>• Service choice</li> <li>• Event based pricing</li> <li>• Fixed price overhauls</li> <li>• Engine exchanges</li> <li>• Customisable</li> </ul> <p>American Airlines </p>

# Transformation

Strong project management and governance



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## Transformation team...

Strong governance over all programmes – old and new

Enduring process simplification and cost reductions

Updating and strengthening key performance indicators

# Transformation

Legacy programmes proceeding well



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Incremental changes (as previously announced)\*

## Aerospace

2015

2016

2017

Net improvement

£0m

£80m

£0m

Headcount reduction

2,200\*

400

—

## Marine

2015

2016

2017

Net improvement

£(10)m

£35m

£40m

Headcount reduction

600

400

—

\* Overall benefits expected to be broadly in line with previously announced estimates

\*\* includes 545 who left the business in 2014



# Transformation

£150-200m cost saving programme



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Senior management headcount reduction 20% of top two layers

Further management headcount reductions to be announced in H1

## Initial benefits identified

- Identified cost savings of £75-100m
  - ~£35-50m benefit in 2016
  - full run rate by end 2017
- 2016 exceptional restructuring charge of £75-100m

## Additional benefits

- Further cost savings targeted for 2017
  - £75-100m driven by a focus on 'organisational software'

Update at end Q2 on progress

## Focus on organisational software



# Rebuilding trust

Delivering on our commitment to transform and grow



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Clear programme of milestones for 2016



# Long-term growth

Fuelling long-term growth critical to our success



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## Successful product innovation

- Address emerging customer needs
- Drive growth in installed base which in turn drives profitability and cash
- Scale efficiencies in the aftermarket help drive higher achieved returns on sales

## Order book reflects significant future value

- Widebody order book is strong
- Pricing robust
  - future performance is about driving cost savings on new engine programmes as we have on older ones – continuous improvement
- But visibility strong for only certain elements of the business
  - limited foresight on balance in volatile market conditions – e.g. oil prices, Asia growth and short-term changes in aircraft utilisation

# Portfolio to drive long-term growth

Opportunities exist across the portfolio



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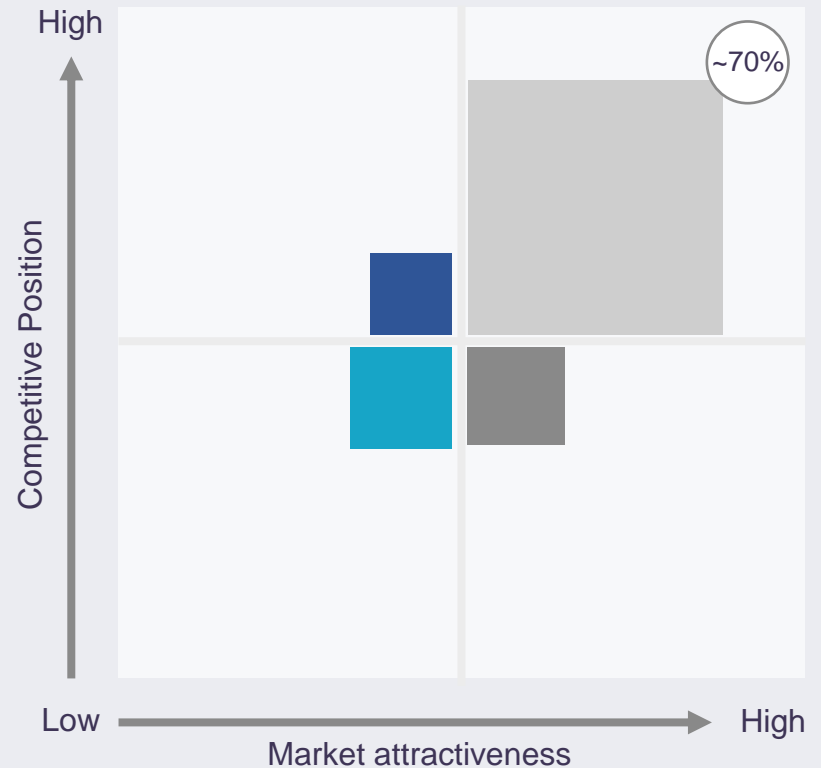
## Strong mix of business

- Over 80% in attractive growth markets
- Over 75% with strong competitive advantages

## Competitive advantage strengthened by investments

- 2/3rds of group will benefit from transformation programme

2020



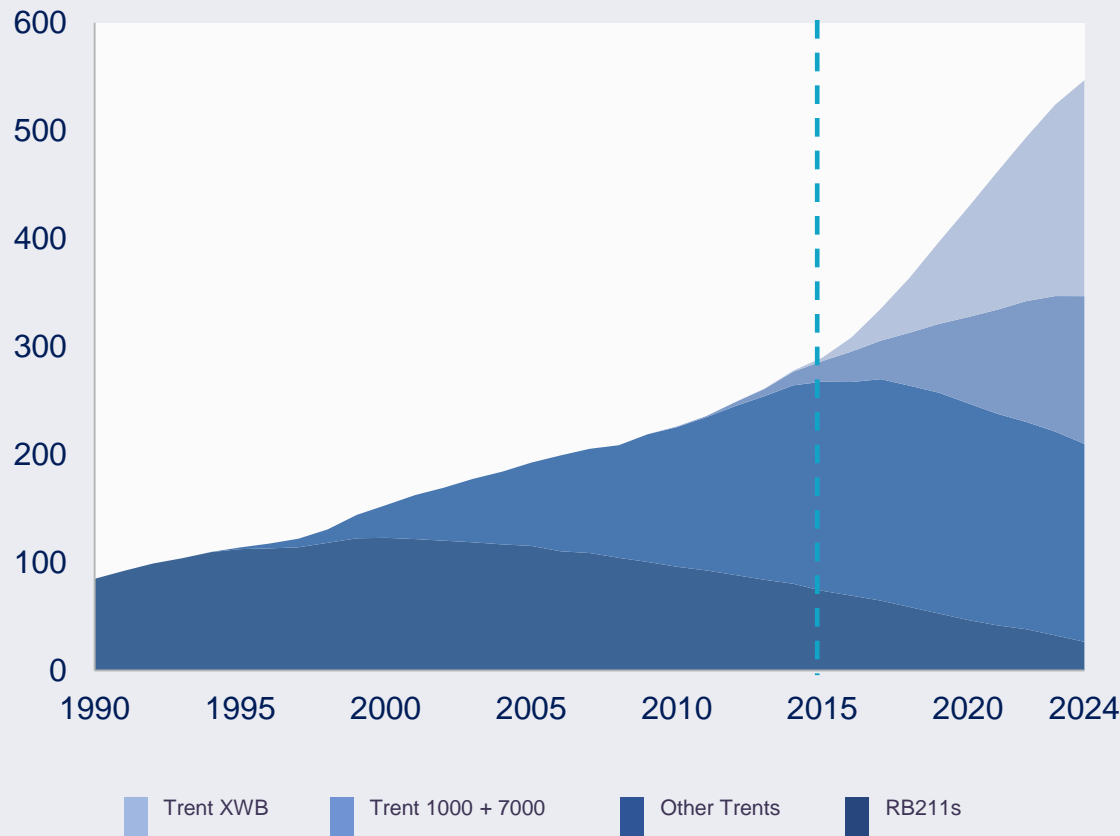
# Long-term growth

Civil Aerospace: widebody installed thrust growth

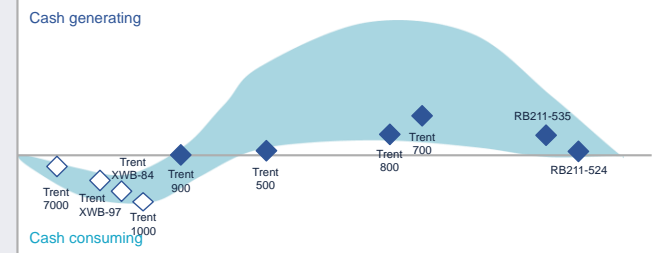


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## Installed thrust drives aftermarket revenue growth

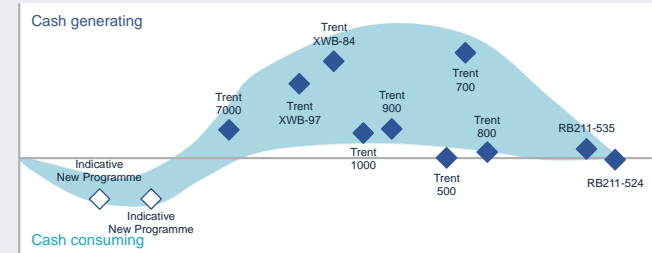


### Portfolio today...



66

### In 10 years...



68

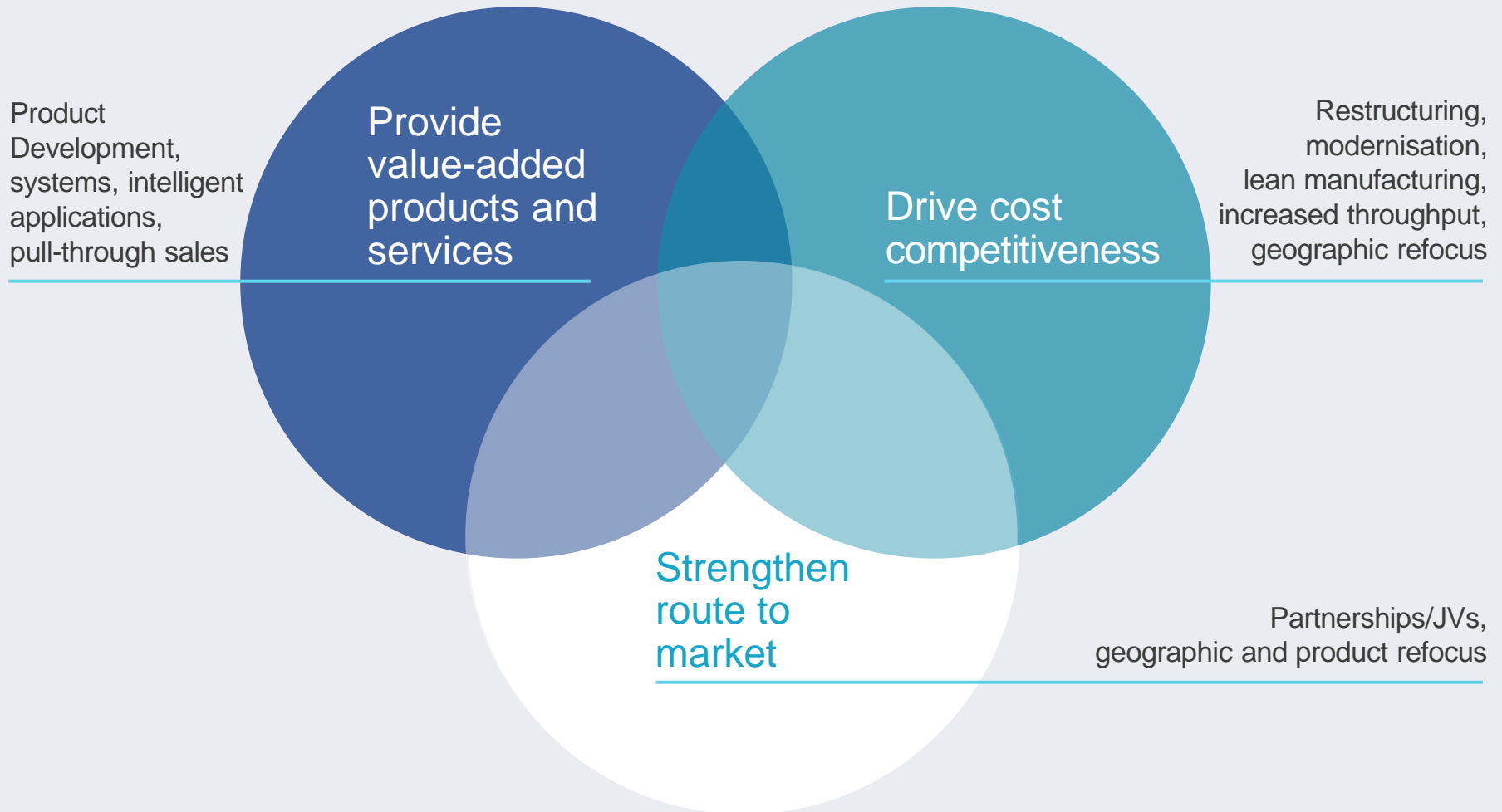
\* Installed thrust is shown net of retirements - includes parked and stored engines

# Long-term growth

Power Systems & Marine focused on driving profitable growth



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# Conclusions



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## Period of unprecedented change

- In our mix of business and how we account for it
- In our industrial footprint as we invest in a wide-ranging transformation
- As we double production of our widebody engines
- As we invest in technology for post-Trent product family

## Review underpins confidence about the future

- Outlook remains very positive
- Industrial transformation proceeding well
- Set to gain significant market share and build a strong cash generative platform

## Laying the foundations for long-term profitable growth

- Financially stronger, more resilient business
- Restructure organisation to drive material cost and process improvements

**David Smith**

**Chief Financial Officer**



**Rolls-Royce**



# Headline results



Rolls-Royce

Underlying Revenue

**£13.4bn**

↓ 1%

Gross Margin

**£3,182m**

↓ 10%

Underlying Profit

**£1,432m**

↓ 12%

Operating margin

**11.2%**

↓ 130 bps

Free cash flow

**£179m**

2014: £447m

'Dividend' per share

**7.1p**

2014: 14.1p

# Group financial strength



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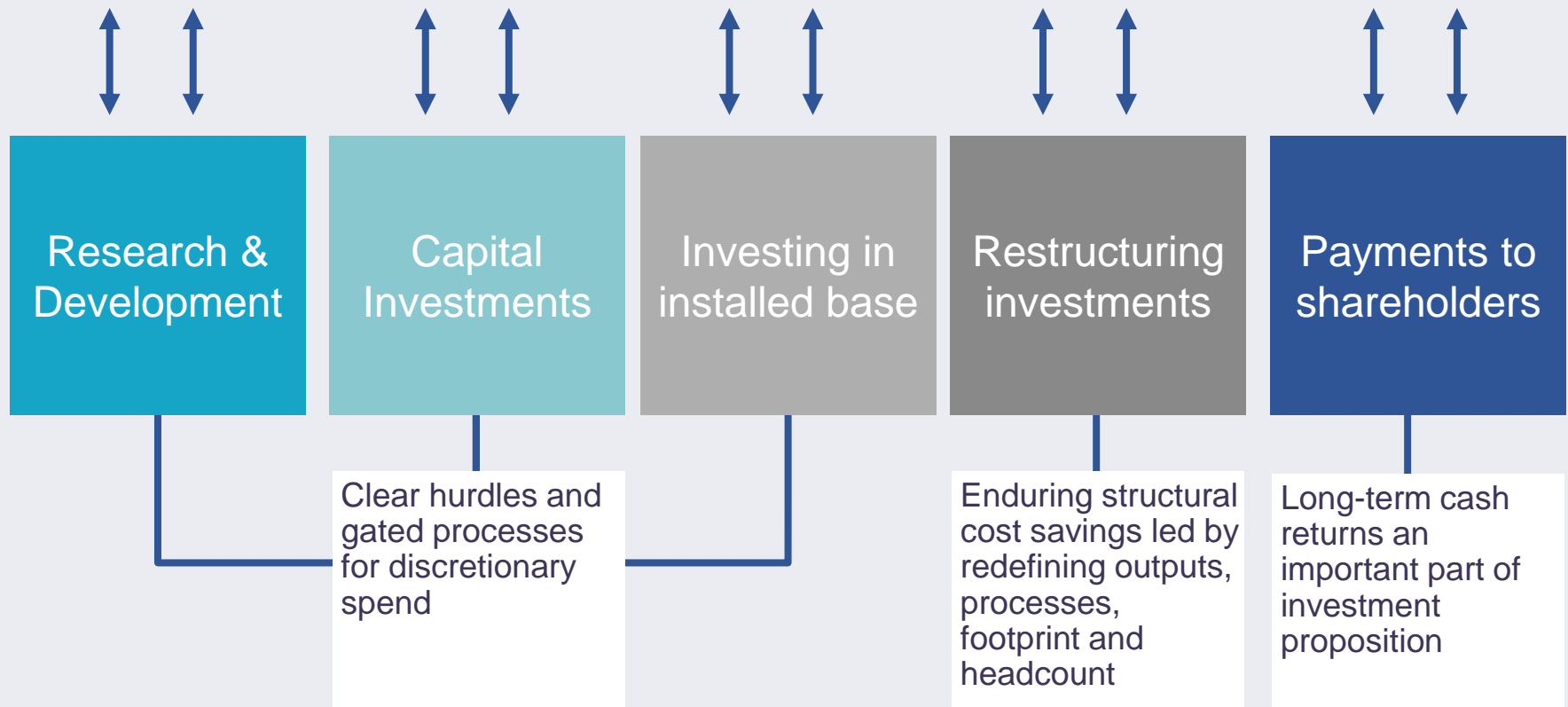
Credit rating	S&P: A/Negative Moody's: A3/Stable Maintain investment-grade rating
Strong liquidity	Total liquidity £5 billion
Debt maturities	Spread to 2026 Maturities: <ul style="list-style-type: none"><li>• 2016 - £200m bond &amp; €125m EIB loan</li><li>• 2017 – €75m EIB loan</li></ul>
Risk management	Foreign exchange and commodity hedging

# Disciplined capital allocation will be critical to our success



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## Investment Grade



# Finance team priorities



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Restore investor confidence

Improve forecasting and Management Information

Continue to build the Finance function

Continue to support the 4Cs – Cost transparency

Continue to support the 4Cs – Cash and funding

Develop our controls culture

# Improving our financial framework



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- Financial analysis and reporting remains work-in-progress
- Pricing and investment decisions good
- Inconsistent strengths in forecasting, analysis and systems support
- Improve disclosure of in year and near-term performance
- Strengthen controls

## Current disclosure

### Revenue

- By business
  - OE
  - AM

### Profit before FCT

- By business

### Group Finance charges

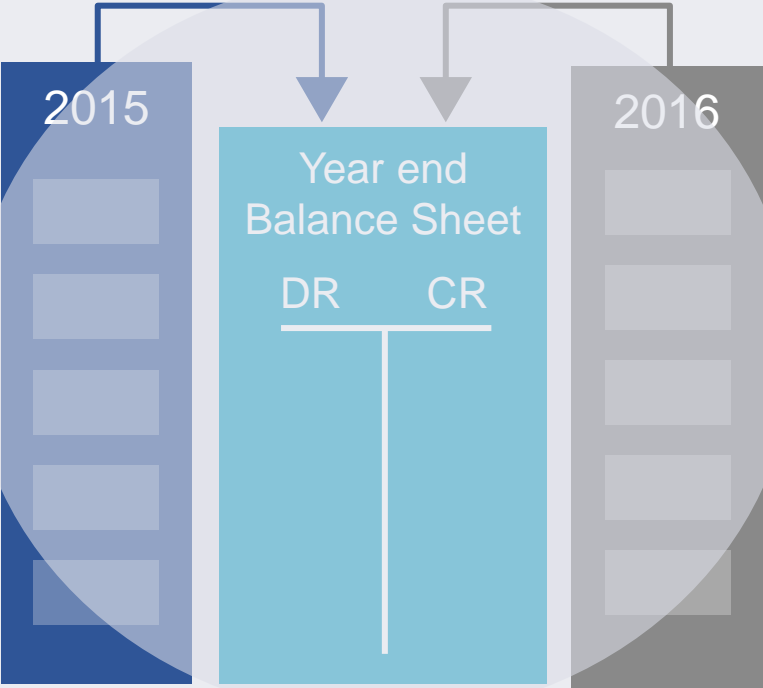
### Group PBT

# Improving focus on operational measures which drive financial performance



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Clearer focus around financial performance



Clearer operational measures of success... helping drive change in behaviour

Productivity measures

Unit cost measures

Working capital efficiency

Innovation efficiency

Process waste

# Improved disclosure



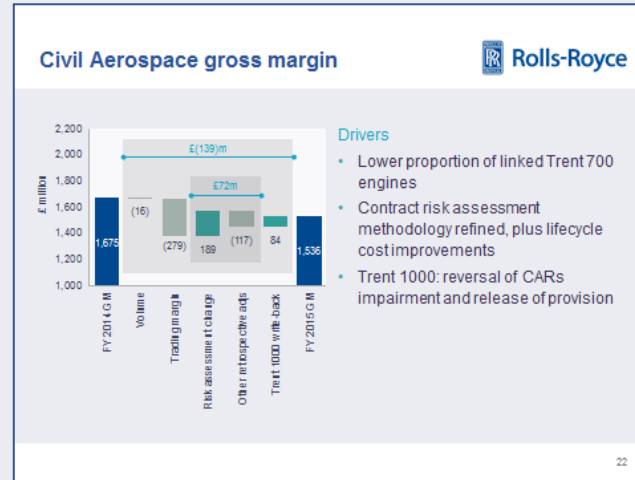
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## Enhancing disclosure and transparency

### Civil Aerospace revenue outlook

£m	2015	2016
Original Equipment	3,258	→
Large engine: linked and other	1,570	→
Large engine: unlinked installed	504	→
Corporate	903	→
V2500	281	→
Aftermarket*	3,486	→
Large engine*	2,182	→
Corporate	425	→
Regional	360	→
V2500	519	→
<b>Total Revenue*</b>	<b>6,744</b>	

\* Adjusted for £189m methodology change



### Civil Aerospace trading cash flow outlook

£m	2015	2016
Underlying profit before financing	812	→
Depreciation, amortisation and impairment	410	→
Sub-total	1,222	→
CARs additions	(181)	↔ I.A. adverse variance to PT
Property, plant, equipment and other intangibles	(502)	→
Other timing differences*	(75)	→
Trading cash flow pre-working capital movements	484	→
Net long-term contract debtor movements	(406)	→
Other working capital movements	(78)	↔ I.A. favourable variance to PT
Trading cash flow**	0	

\* Includes timing differences based on the recognition of non-current assets acquired with cash in advance of the cash payments for underlying cash and working capital movements (including reworking and financial lease) and business assets.  
 \*\* Trading cash flow is cash flow before debt contributions to the parent and dividend payments to shareholders for exchange on cash balances and acquisitions and disposals.

**Q&A**

**Warren East & David Smith**



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# Ian Davis

## Chairman

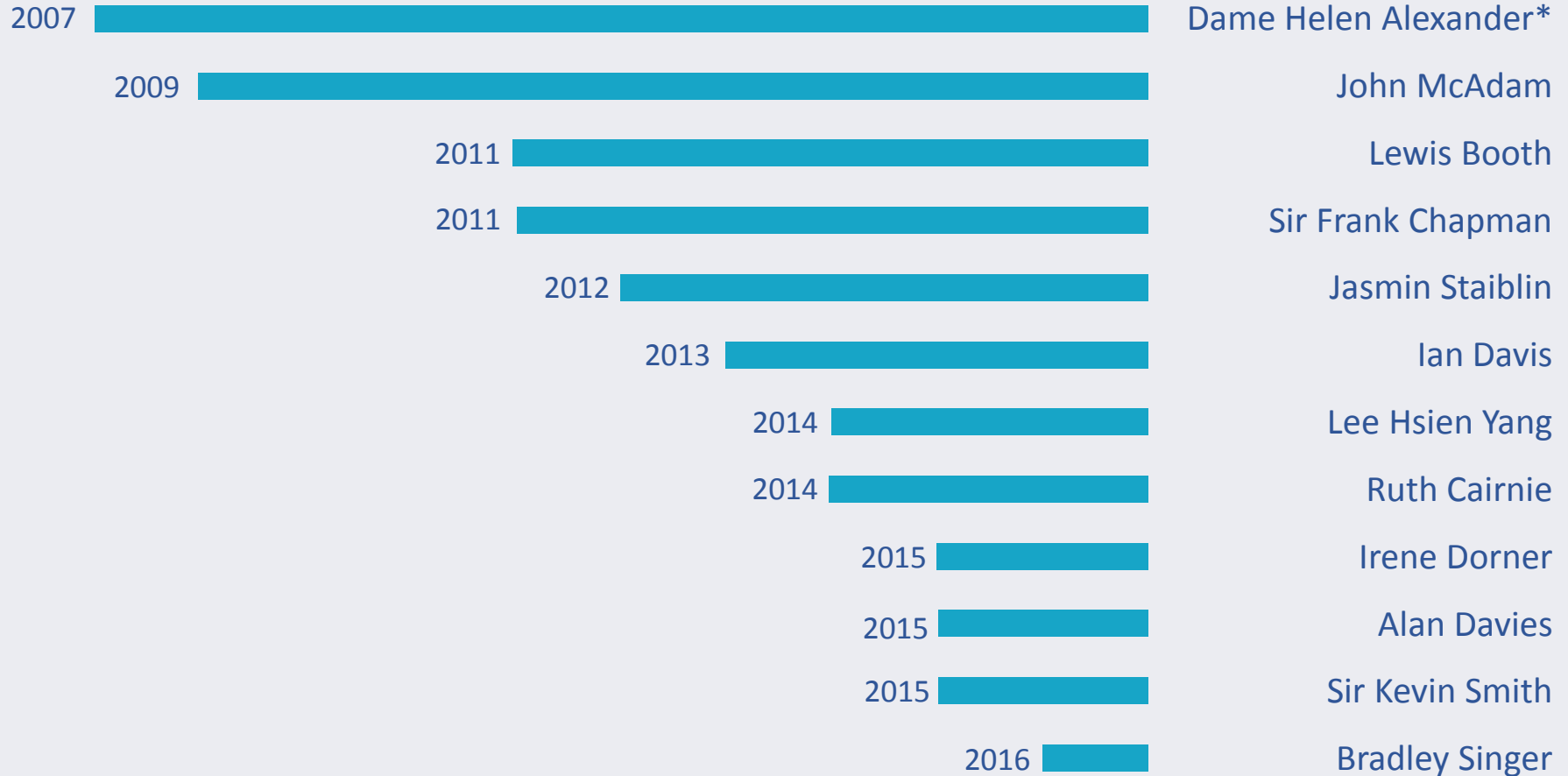


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# Board composition: Non-executives



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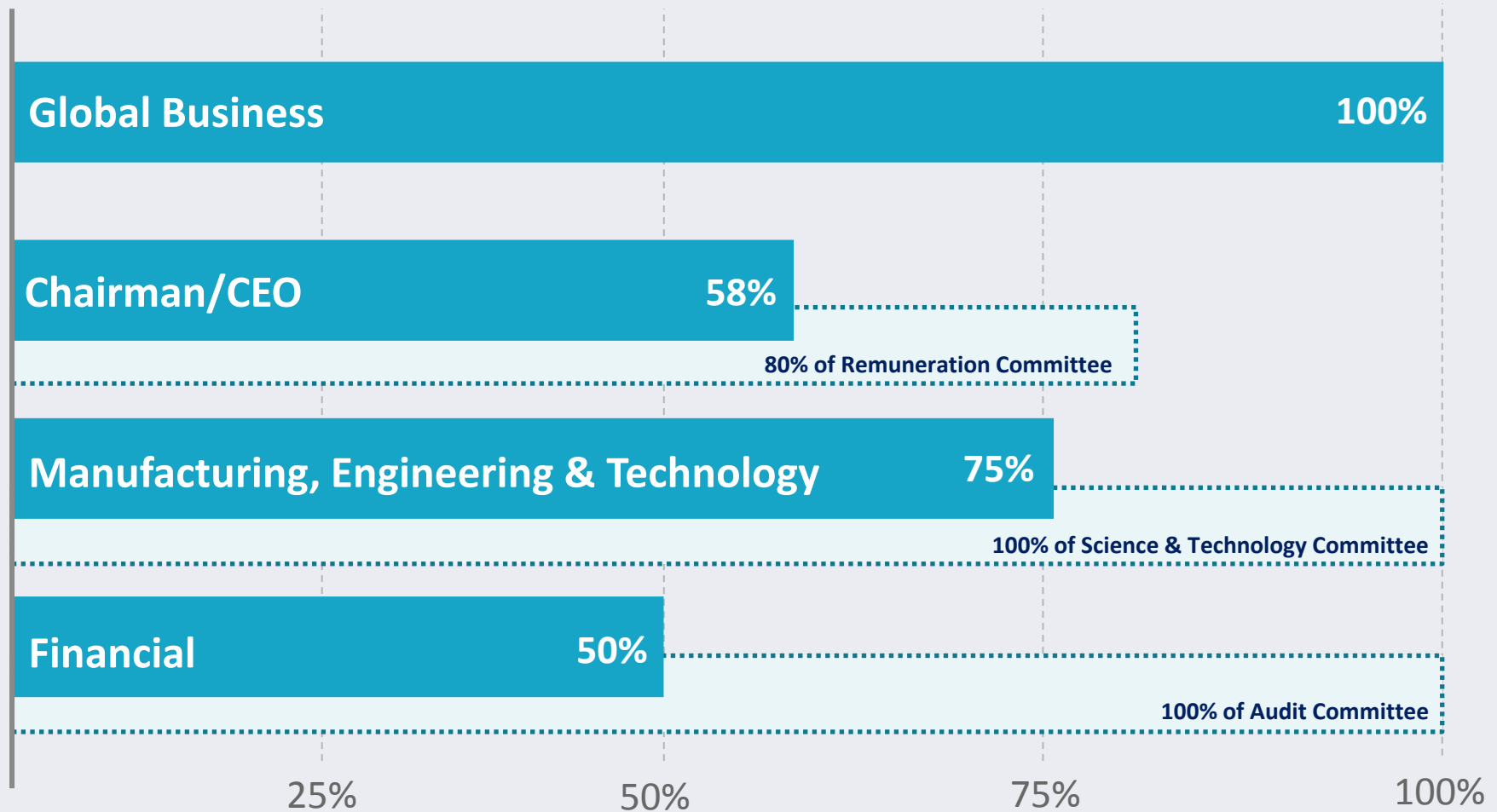
\* Dame Helen Alexander will step down from the Board after the AGM in May 2016

# Board skills and experience

Skills and experiences of Non-executive Directors



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# ValueAct relationship agreement



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<b>Standstill Duration</b>	Post 2018 AGM
<b>Standstill Ownership range</b>	Maintain shareholding of 10% - 12.5%*
<b>Standstill Restrictions</b>	No public proposing of corporate actions or negative public statements
<b>Voting Agreement</b>	Vote to support all 'customary resolutions'
<b>Committee Membership</b>	Science & Technology only
<b>Confidential Information</b>	Strong confidentiality obligations on both ValueAct and board nominee

\* In all normal circumstances; can go down to 7.5% if holding otherwise above 20% of ValueAct total assets

# 2015 Key Board topics



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Forecasting, control systems and risk assessments

Capital allocation

CEO and board appointments

Operational review and strategic priorities

Transformation planning

Response to ValueAct

Stakeholder communication and engagement

# 2016 Board priorities



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Operational  
performance oversight

Forecasting risk  
and controls

Succession and  
organisational  
strengthening

Transformation  
programme

# Key governance actions



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New governance framework and documentation

Enhanced focus on sustainability and diversity along with safety and ethics

Creation of Science & Technology committee

Enhanced board evaluation

Increased board training and benchmarking

# Sustainability



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## Understanding and prioritising the issues that matter most to the Group and our stakeholders

- Governance is a core part of business sustainability
- Employee engagement critical through period of transformation
- Social & Environmental impacts:
  - KPIs & report in Annual Report
  - Welcome engagement from SRI community
- A&D 'Industry Leader' status: Dow Jones Sustainability index



See 2015 Annual Report page 48, and [www.rolls-royce.com/sustainability](http://www.rolls-royce.com/sustainability)



# Board committees



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Nominations & Governance Committee

Science & Technology Committee

Safety & Ethics Committee

Audit Committee

Remuneration Committee

- Technology acquisition & development priorities
- IP & data analytics
- Commercial applications
- R&D investments & risks

- Robustness of safety programme
- Safety governance framework
- Regulatory investigations
- Ethics & Code of Conduct
- ABC programme

**Lewis Booth**

**Audit Committee Chair**



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# Audit committee



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Lewis Booth



Alan Davies



Irene Dorner



Lee Hsien Yang

# Agenda



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Financial reporting

Risk and control environment

Internal audit and external audit

Management information and forecasting

Areas of focus for 2016

# Financial reporting



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Review of appropriateness of accounting policies and key accounting judgements and estimates included in 2015

Reversal of impairment on contractual aftermarket rights

Review of long term contract accounting estimates and judgements

Review of impairment of goodwill and adequacy of warranty provisions in Marine

Review of goodwill at Rolls-Royce Power Systems  
Completion of Energy disposal

Increased disclosure of retrospective contract accounting adjustments  
Increased financial disclosures for 2015 results

High level review of requirements and judgements necessary for implementation of IFRS 15 (revenue recognition)



## Strong risk management system

- Meets new UK Governance Code
- Enhanced processes
- Strengthened Board oversight
- Enables continuous monitoring of risk

## Output reflected in

- Principal risks
- Going concern
- Viability statement

# Internal control process

Risk and control environment



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## Comprehensive improvement programme

Prioritised review of key controls at entity level

Concluded that key controls were operating effectively for 2015

Implemented increased scrutiny on core financial controls

Instigated plan to align financial controls with revised MI system upgrade

## Internal control framework

### Clearly defined internal controls

- Strong and consistent
- Financial and non-financial
- Increased awareness of key controls
- Regular monitoring and reporting

### Enhanced view of control environment

- Controls at all levels
- Better visibility for Board

# Principal risks

Reviewed in audit committee



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Overall risk  
management  
process

Business continuity

Market and  
financial shock

IT vulnerability



# Viability statement



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## Incorporated into risk and control programme

- First publication of a viability statement
- Provides confidence around risk mitigation

## Five year review

- Longer than standard 3 year review period; consistent with business and financing medium-term planning horizon

## Consideration includes

- Consistency of risk analysis within strategic discussions
- Impact of risks on the business / sensitivity analysis
- Quality and robustness of financing in place and availability of future funding



## Internal

- Provides key input to Board oversight of group's processes and controls
- Quarterly review of dashboard
- Detailed internal audit review twice per year
- All 2014 identified actions resolved in 2014/15

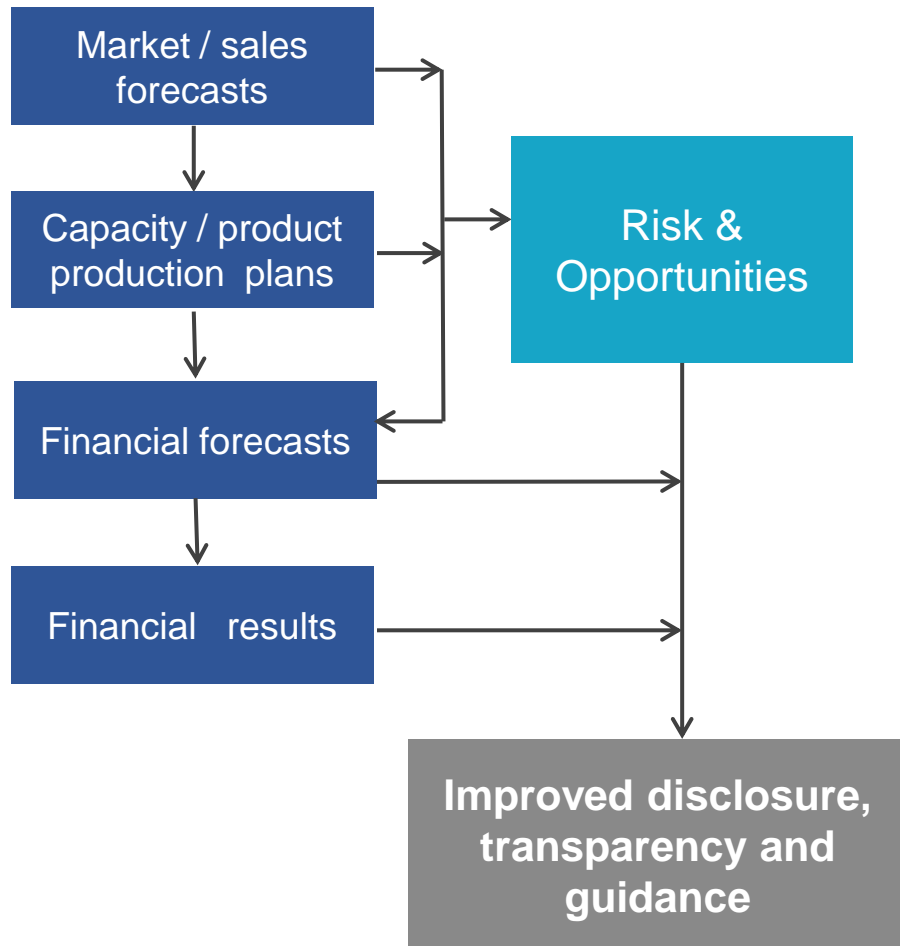
## External

- Extended auditor's report goes beyond minimum requirements, enhance transparency
- Clear signposting of key changes and key risks
- Underpins the robustness and transparency of reported financial results

# Management information and forecasting



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## Main elements include

- Improved project control / analysis
- Data quality
- Consistent KPIs
- Linking physical factors to financials
- Revised planning / forecasting
- Improved cost systems

# Areas of focus for 2016



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Continued assessment of accounting principles and judgements; added focus on implementation of enhanced risk management process

Audit tender process

Reviewing the development of IFRS 15 introduction plans and new leasing standards

Monitoring effectiveness of new management information and forecasting systems

# Dame Helen Alexander

## Remuneration Committee Chair



**Rolls-Royce**

# Remuneration committee



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Dame Helen Alexander



Ruth Cairnie



Sir Frank Chapman



John McAdam



Sir Kevin Smith

# Terms of reference



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Set policy for the remuneration of the Executive Directors and other Senior Executives reporting to Chief Executive

Approve the design, targets and payouts for annual and long-term incentive plans

Approve the design and payouts for all share-based plans, including all employee plans

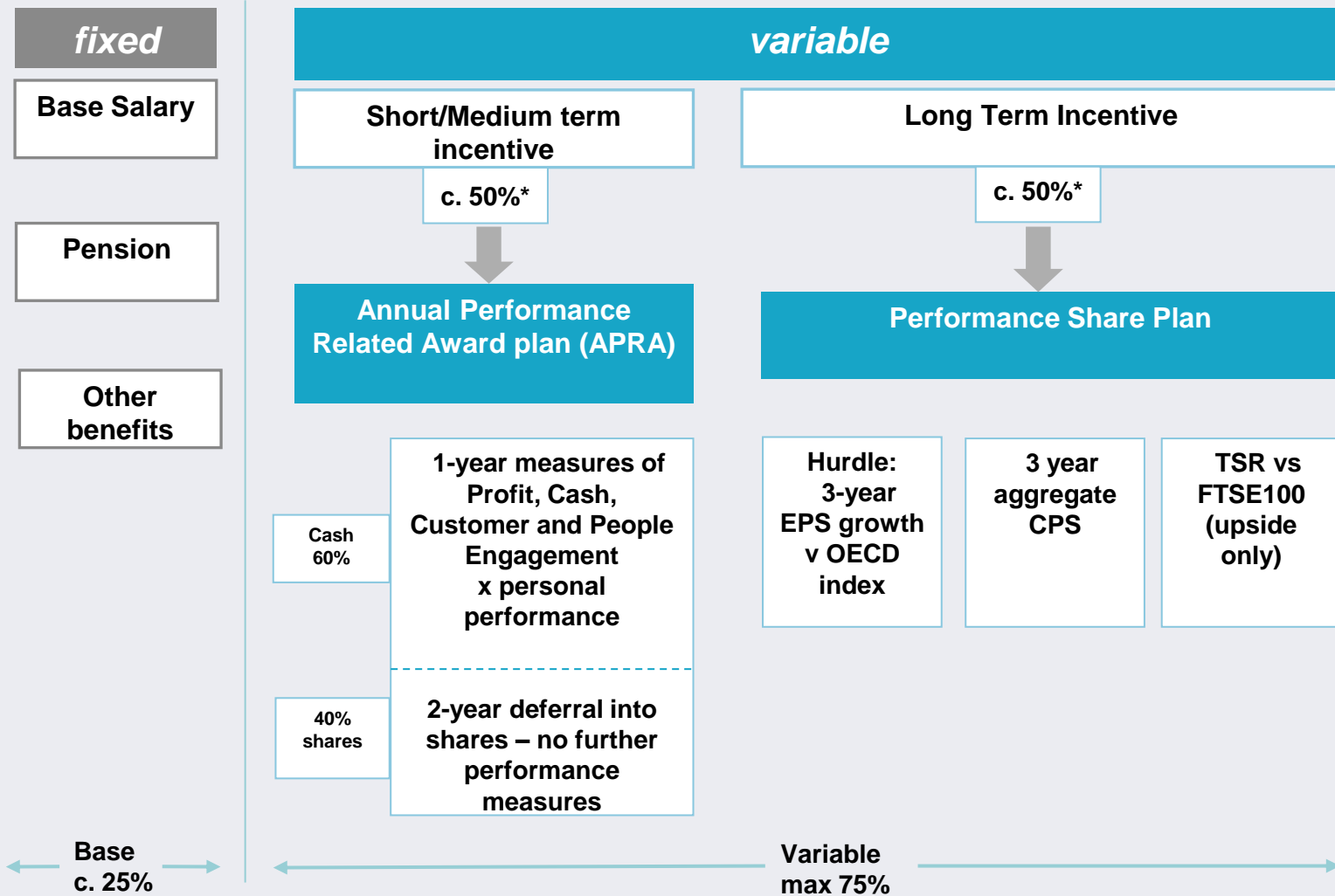
Determine the total individual remuneration packages and terms and conditions for the Executive Directors

Oversee any major changes in remuneration throughout the group

# Current policy



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\* Of total incentive opportunity





## Leadership changes

- Retirement of John Rishton as CEO
- Retirement of Jim Guyette as main board director and US CEO
- Agreeing terms for Warren East as incoming CEO

## Salaries

- Review of executive base salaries as a result of reorganisation

## Variable pay

- 2015 bonus outcome
- 2013 PSP award outcome

## 2016 plans

- Introduction of non-financial KPIs for 2016 bonus
- Adjustment of EPS hurdle for 2016 PSP awards
- Scale back of 2016 PSP maximum award

# Recent outturn of variable pay



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	Annual Bonus Payout	Performance Share Plan	
		Executive	Other
2015	Nil	-	-
2014	Nil	-	-
2013	60% of max	0%	0%
2012	85% of max	67%	61%
2011	90% of max	150%	125%
2010	100% of max	150%	125%

# 2016 Plans



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## Performance share plan

### – EPS

- Adjustments made to EPS hurdle just for 2016
- Moved base year for EPS to 2016 from 2015
- Reduced the maximum award value, e.g. CEO from 180% to 150% of salary

### – CPS

Aggregate CPS over the three-year period

Maximum award released %

Less than 10p	0
10p	30
50p	100

## 2016 bonus plan

- Introduction of non-financial KPIs to support transformation process
  - Employee engagement
  - Customer satisfaction – on time delivery

# Review of remuneration policy



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Current policy is due for re-approval at the 2017 AGM, review will focus on:

1. Changes in remuneration landscape

2. Needs of the business

3. The views of shareholders

4. Alignment of reward structure and metrics with business strategy

# Round Table Discussions Session




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# Round table discussions programme



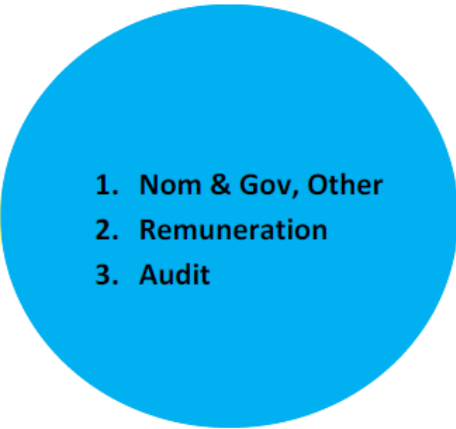
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- 
- A large red circle containing a numbered list of three items.
1. Audit
  2. Nom & Gov, Other
  3. Remuneration

**Red Room**

- 
- A large yellow circle containing a numbered list of three items.
1. Remuneration
  2. Audit
  3. Nom & Gov, Other

**Yellow Room**

- 
- A large blue circle containing a numbered list of three items.
1. Nom & Gov, Other
  2. Remuneration
  3. Audit

**Blue Room**

# Contacts



Rolls-Royce

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# Safe harbour statement



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This presentation contains certain forward-looking statements. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. In particular, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of interest or exchange rates, the availability of financing to the Company, anticipated cost savings or synergies and the completion of the Company's strategic transactions, are forward-looking statements. By their nature, these statements and forecasts involve risk and uncertainty because they relate to events and depend on circumstances that may or may not occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements and forecasts. The forward-looking statements reflect the knowledge and information available at the date of preparation of this announcement, and will not be updated during the year. Nothing in this announcement should be construed as a profit forecast. All figures are on an underlying basis unless otherwise stated. See note 2 of the Financial Review for definition.