



**Rolls-Royce**

**2017 Governance Event**

**John Dawson**

Director, Investor Relations



**Rolls-Royce**

# Agenda for today



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Welcome

Strategic review

John Dawson

Warren East

## Governance workshop: 8:45am

Board & Governance

Audit

Remuneration

Ian Davis

Lewis Booth

Ruth Cairnie

## Round table discussions: 9.30am

Board Committees

Committee chairs

## Workshop wrap-up: 11.15am

Plenary Q&A

Committee chairs

# Warren East

## Chief Executive



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# FY16 summary



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Underlying Revenue

**£13.8bn**

↓ 2%

Gross Margin

**£2,823m**

↓ 18%

Underlying PBT

**£813m**

↓ 49%

Operating margin

**6.6%**

↓ 480 bps

Free cash flow

**£100m**

2015: £179m

'Dividend' per share

**11.7p**

2015: 16.4p

**Reported vs underlying**

**Headwinds**  
delivered a better overall result than  
originally expected

\* Percentage changes at constant currency

# FY16 headwinds



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## Civil Aerospace

- Trent 700 volume and price reductions
- Disappointing market outlook for corporate jets and regional aftermarket
- Rolls-Royce particularly impacted by specific exposures
  - 50-70 seat regional jets
  - Large corporate jets
  - Legacy RB211/Trent utilisation

## Marine market

- Weakening offshore markets

## November 2015:

Original expectations:  
~£650m headwinds

## FY16 outturn:

~£550m lower than FY15

# Year of steady progress



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## Performed ahead of expectations

### Significant changes to management

- Strengthened individual accountability
- Greater focus on cash and cost measures across the business

### Over £1.5bn invested to support long term growth

- While maintaining the 'dividend' and resolving legacy issues

### On track to deliver against key commitments

- Ramp-up proceeding well
- Three major new engines on track for EIS in 2017 and 2018
- Delivery improvements in Nuclear and Defence

### Driving transformation to provide long-term benefits

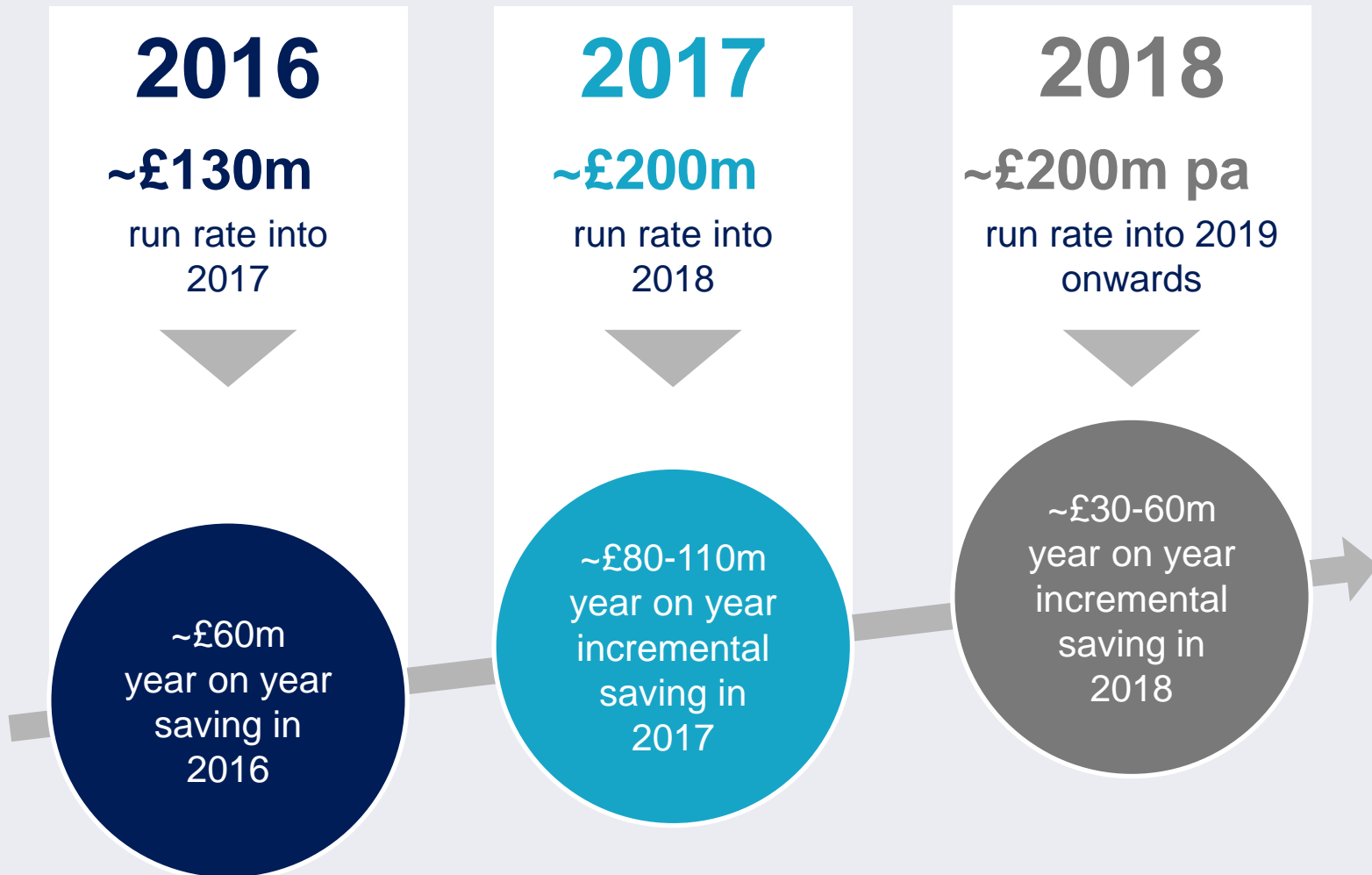
- Help offset some near-term market and performance headwinds

# Transformation programme

ahead of expectations



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# Business outlook for 2017



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## Civil

- Large engine ramp-up; higher OE revenues but adverse mix
- Aftermarket stable overall, but mix changes
- Business aviation OE expected to weaken further
- Further improvement in lifecycle costs
- Trading cash flow steady after better 2016

## Power Systems

- Steady to positive overall
- Good order book in attractive segments while some markets remain mixed
- Modest growth in revenue and profit in 2017

## Nuclear

- Long term positive outlook through gov't contracts
- 2017 profit impacted by minimal R&D credit and Small Modular Reactor spend

## Defence

- Steady revenue
- Margin pressure from investments and lower contract performance incentives

## Marine

- Outlook remains cautious
- Oil price still impacting activity/over-capacity
- Ongoing cost reduction programme focused on manufacturing, supply chain, overheads

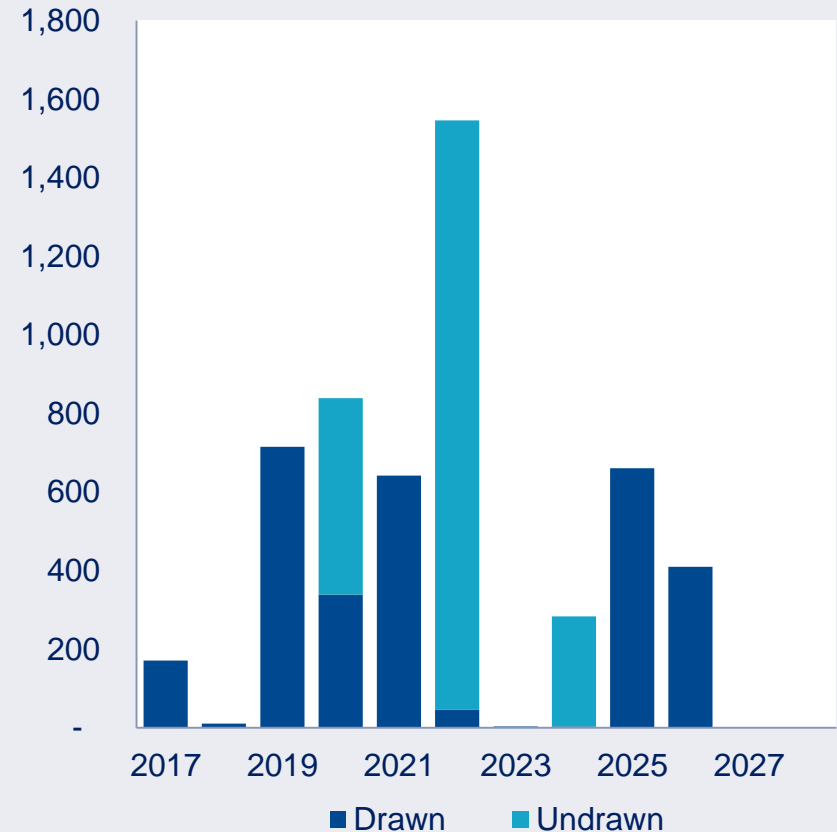
# Group financial strength



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<b>Credit rating</b>	S&P: BBB+/Stable Moody's: A3/Negative Maintain investment-grade rating
<b>Strong liquidity</b>	Total liquidity £5 billion
<b>Debt maturities</b>	2016 YE net debt £225m Spread to 2026 Maturities: <ul style="list-style-type: none"> <li>• 2017 – €75m EIB loan; \$120m loan</li> <li>• 2018 – minimal repayments (&lt;£10m)</li> </ul>
<b>Risk management</b>	Foreign exchange and commodity hedging

## Maturity profile (£ million)



# Investigating Authorities



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- Investigations concluded
  - Deferred Prosecution Agreements (DPA) with UK's Serious Fraud Office (SFO) and US Department of Justice and a Leniency Agreement in Brazil
- No corporate monitors appointed
- SFO requested Lord Gold to make four further recommendations
- Lord Gold continues to assist
  - publish final report in 2019, in accordance with the SFO DPA
- Ethics & Compliance key pillars of Company's culture with continued investment

# Making a sustainable culture



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- High performance culture programme: 80% of organisation undertaken training
- Continuing focus and effort on embedding ethical behaviours & language
- Clear role-modelling and purposeful leadership for the right culture
- Linkage to 'individual' element of annual bonus looking at 'how we do things'
- Greater tracking of outcomes through employee engagement programme

## Core message

“ We now conduct ourselves in a fundamentally different way. We have zero tolerance of business misconduct of any sort. ”

# Senior team appointments



Chief Operating  
Officer  
**Simon Kirby**  
(Sep '16)



Chief Financial  
Officer  
**Stephen Daintith**  
(Sep '16)



Strategic Marketing  
Director  
**Ben Story**  
(Oct '16)



President:  
Power Systems  
**Andreas Schell**  
(Nov '16)

# Updating our strategic priorities



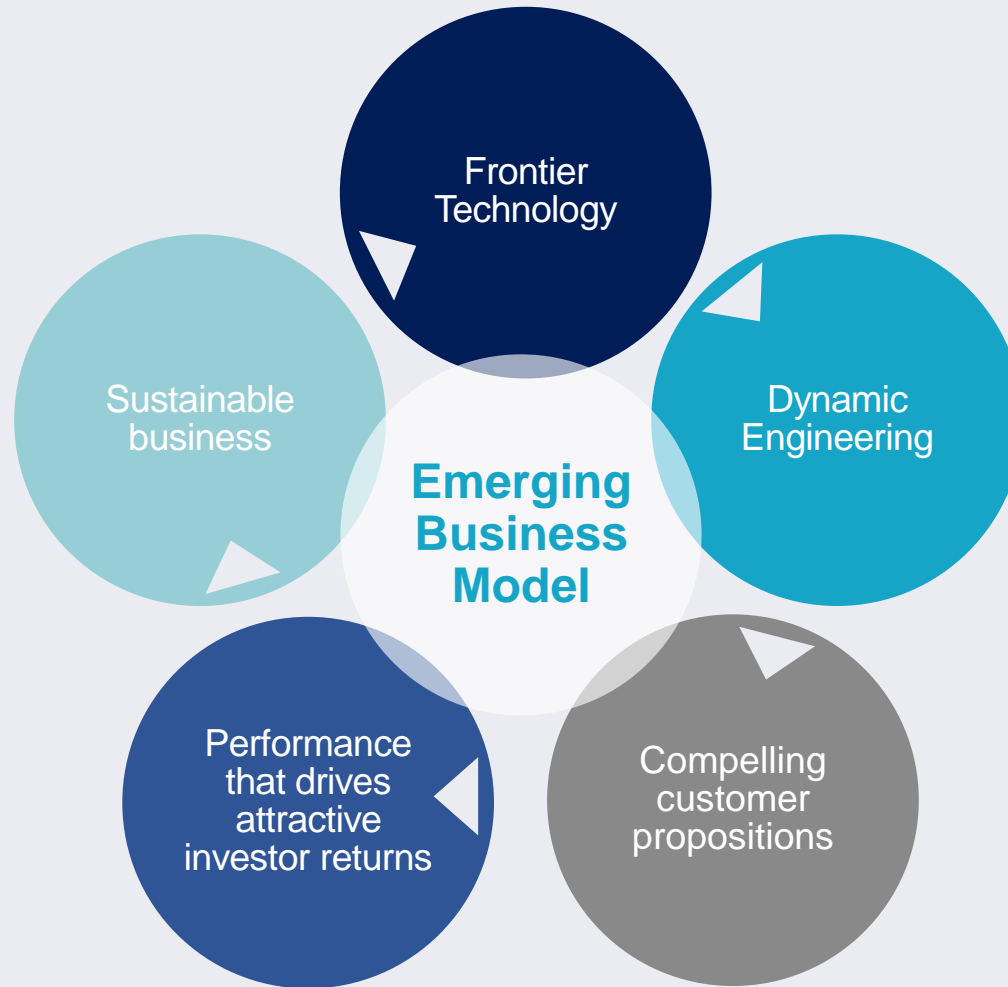
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# Emerging business model



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# Rebuilding trust & confidence



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## 2016

<b>February</b>	Full year results incorporating extra disclosure
<b>April</b>	Corporate governance event
<b>August</b>	Interim results: IFRS 15 principles
<b>November</b>	Capital Markets Event: IFRS 15 workshop

Over 600 management/IR meetings

c20 roadshows/conferences

**Publications**      5x IR Update newsletters





## 2017

- Operational focus on ramp-up, delivery performance, new product introductions and embedding transformation
- Modest performance improvements overall; cash flow similar to 2016

## Clear priorities for the team

- Focus on excellence continues
- Transformation momentum building
- Committed to rebuilding trust in the long-term prospects of the business

## Growth expectations remain positive

- Long-term market demand in Aerospace, Defence and Power Systems remain positive
- Civil Aerospace order book reinforces strong market share gains

**John Dawson**

Director, Investor Relations



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# Ian Davis

## Chairman

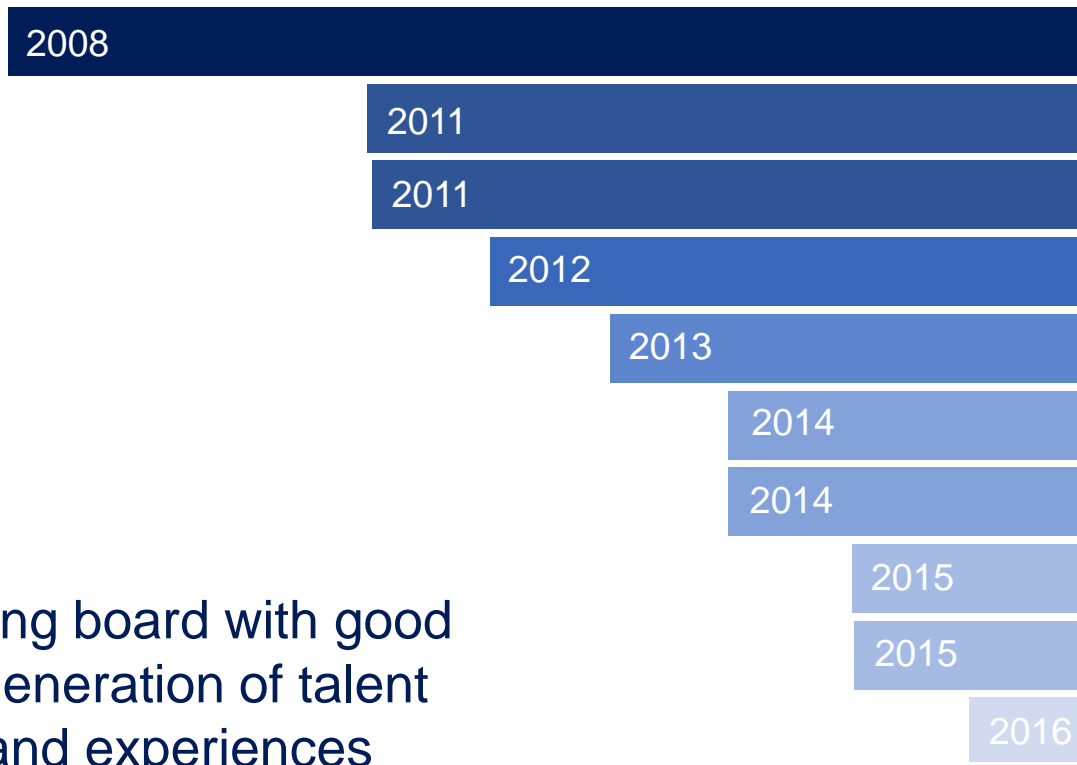


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# Board Composition: Non-executives



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- John McAdam\*
- Lewis Booth
- Sir Frank Chapman
- Jasmin Staiblin
- Ian Davis
- Lee Hsien Yang
- Ruth Cairnie
- Irene Dorner
- Sir Kevin Smith
- Bradley Singer

Strong board with good regeneration of talent and experiences

\* John McAdam will step down from the Board after the AGM in May 2017

# Board skills and experience

Skills and experiences of Non-executive Directors



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## Board skills and experience



- New appointments to refresh the board experience and skill base

- New Senior Independent Director
- New RemCo chairman
- Refresh of Committee composition

- 2017: Non-executive Director searches focused on financial experience and complementary aerospace background

# 2016 key Board topics



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Progress with transformation and operational improvements

Progress with investigating authorities

Board and Executive Leadership Team composition

Review of strategic priorities

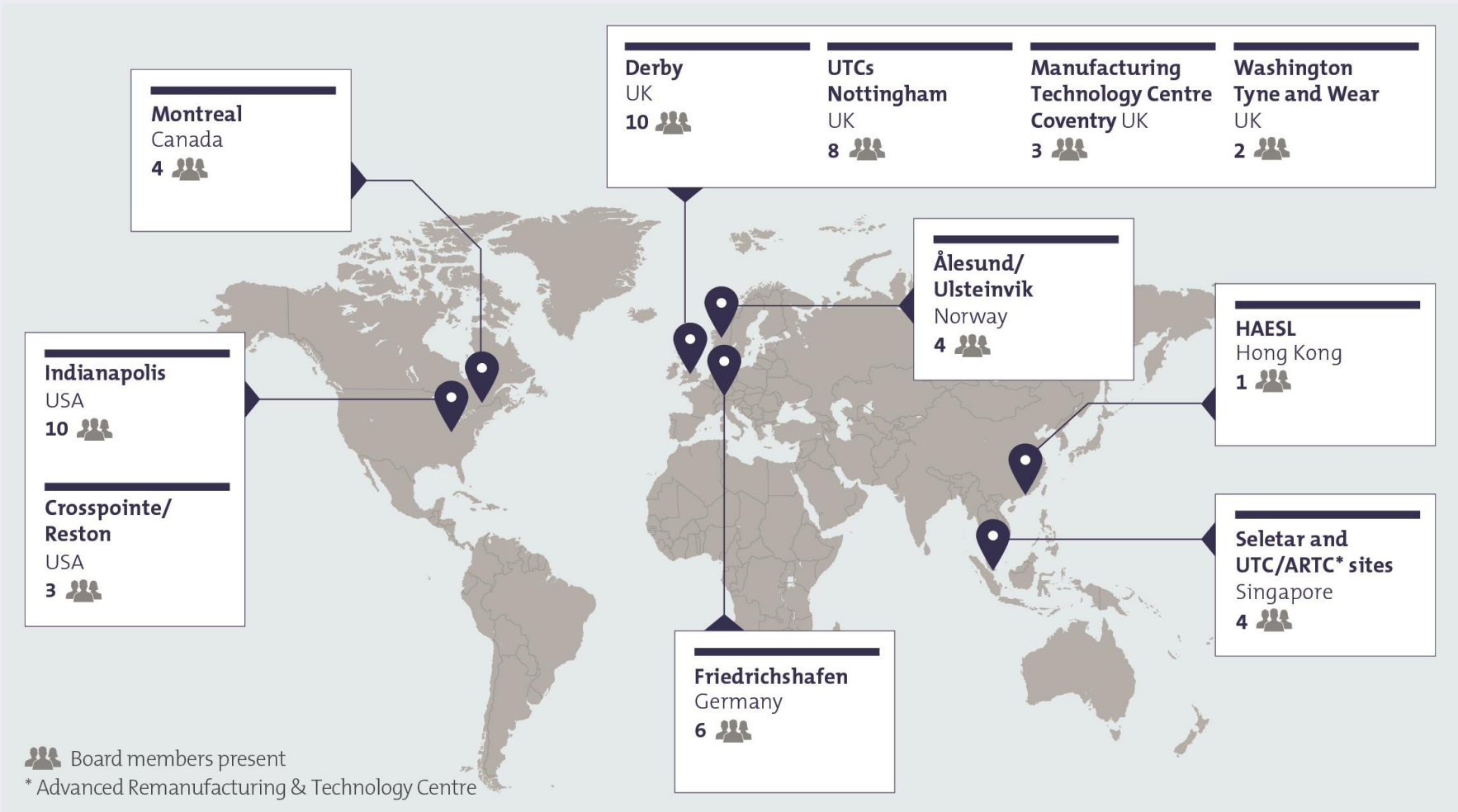
Appointment of PwC as Auditors from 2018 AGM

Stakeholder engagement and Remuneration policy changes

# 2016 Board member activities



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“ Behaviour uncovered...is completely unacceptable and we apologise unreservedly... unworthy of everything which Rolls-Royce stands for. ”

Warren East, CEO

## Since 2013: significant actions to improve ethics/ABC culture & processes

“ Rolls-Royce is no longer the company that once it was; its new Board and executive team has embraced the need to make essential change and has deliberately sought to clear out all the disreputable practices that have gone before, creating new policies, practices and cultures. ”

Sir Brian Leveson  
17 January 2017



# Ethics & compliance

Board focus / monitoring



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Significant investment in E&C staff including 80 Local Ethics Advisers

E&C policies and code of conduct updated and simplified

Enhanced training including mandated annual face-to-face manager-led sessions

All advisers and any payments reviewed to enhanced compliance standards with Panel approval

Strengthened oversight and assurance including compliance verification visits

# 2017 Board priorities



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Execution of  
operational priorities

Principal Risks;  
in-depth reviews

Succession and  
organisational  
strengthening

Development of  
long-term vision and  
strategy

# Board committees



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Nominations &  
Governance  
Committee

Science &  
Technology  
Committee

Safety & Ethics  
Committee

Audit  
Committee

Remuneration  
Committee



Governance framework: review and further embedding

Engagement with stakeholders – meeting with employees after AGM

Non-executive Director search

Further development of succession plans

Transparency

# Other committees: 2017 priorities



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## Science & Technology

- Support management in overseeing Group's technology strategy and its response to emerging technology risks and opportunities
- Oversee and examine in detail the new principal risk: disruptive technologies and business models
- Review the impact of transformation on our R&T strategy

## Safety & Ethics

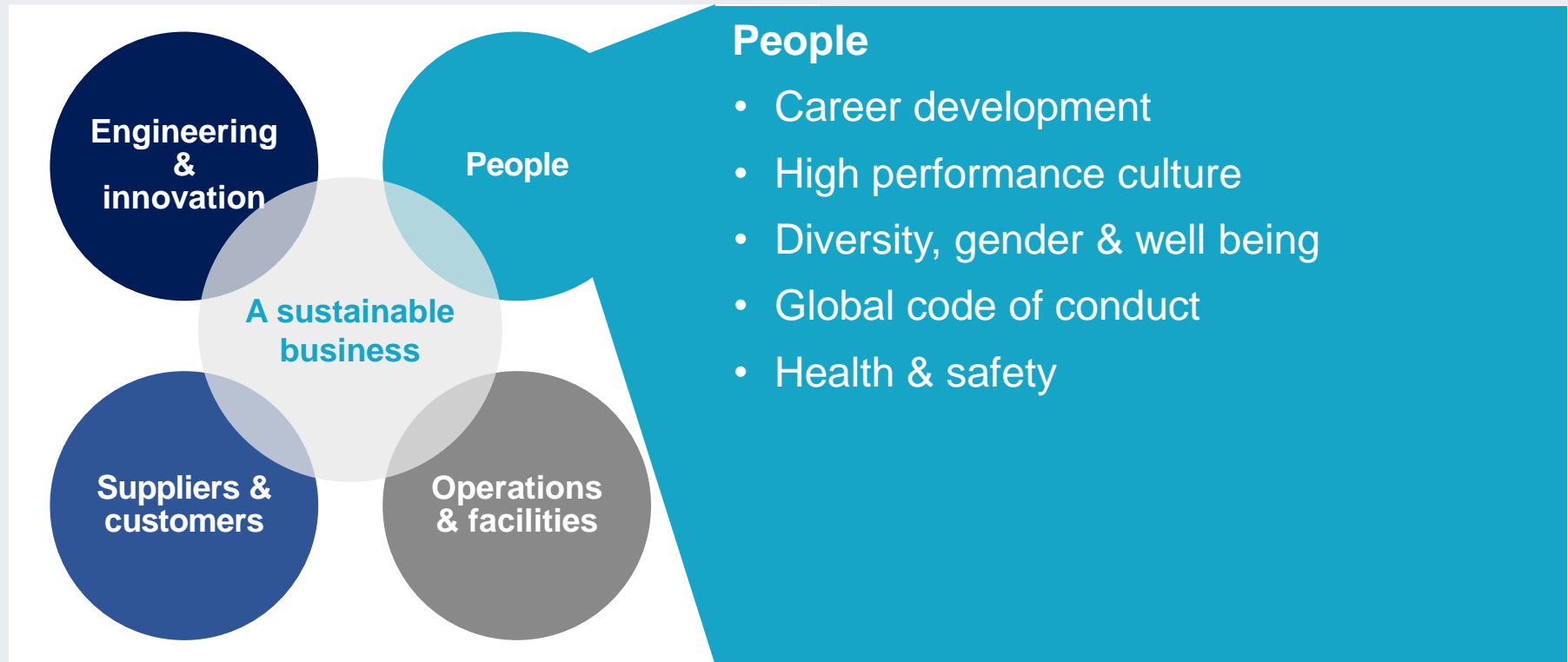
- Oversee the implementation of outstanding recommendations made by Lord Gold
- Monitor compliance with the Group's obligations under the DPAs
- Management of product safety
- Management of employee health and safety

# A sustainable business



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We continue to invest in the resources and capabilities which underpin our future success as we transform the business

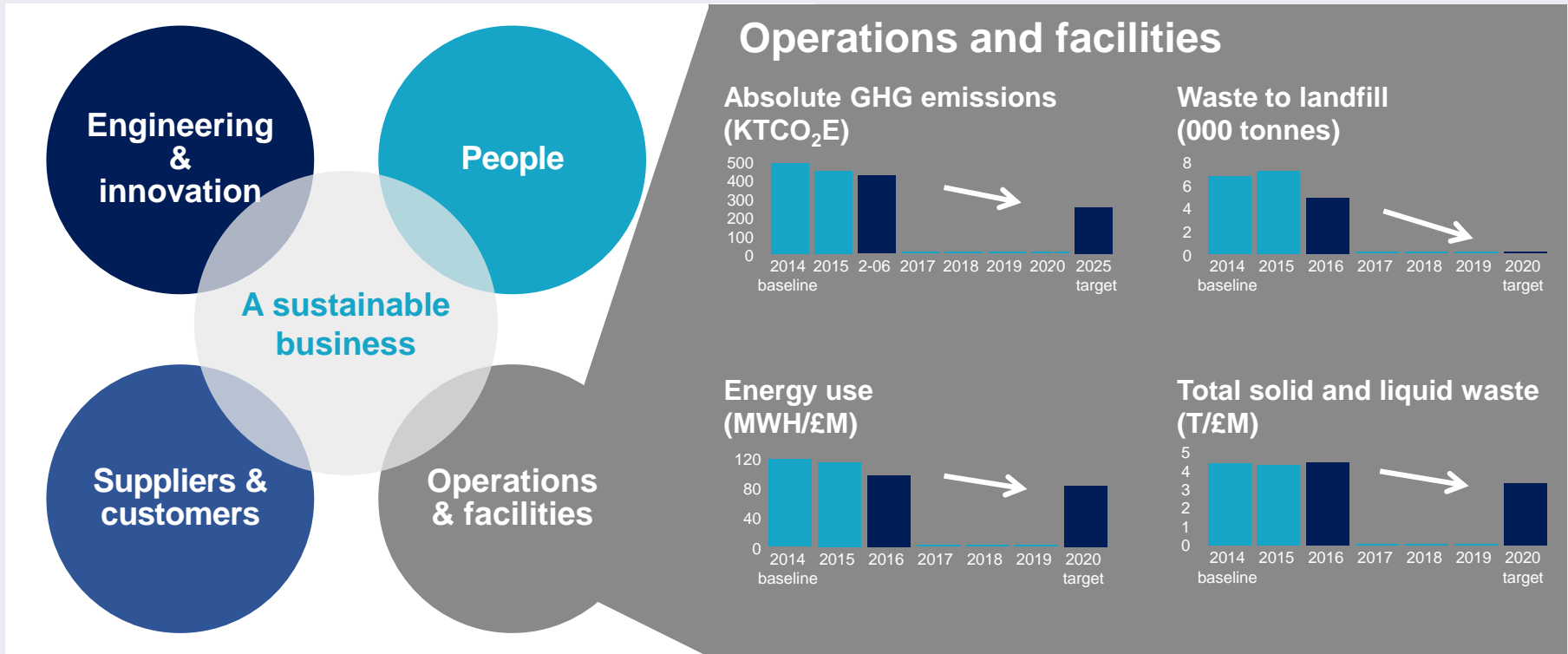


# A sustainable business



Rolls-Royce

We continue to invest in the resources and capabilities which underpin our future success as we transform the business



Energy use target: reduce energy use in our operations and facilities by 30%, normalised by revenue (excluding product test and development)  
 Solid & liquid waste target: reduce total solid and liquid waste in our operations and facilities by 25%, normalised by revenue.

# Summary



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Strong board, relevant experience

Highly engaged, on top of key issues

Embracing necessary change and innovative responses

Zero tolerance on unethical behaviour

Very supportive of executive team focus: all about delivery



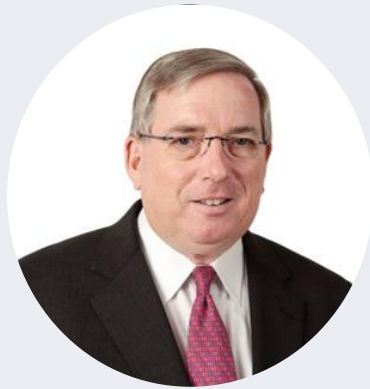
**Lewis Booth**

**Audit Committee Chair**



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# Audit Committee members



**Lewis Booth**



**Irene Dorner**



**Lee Hsien Yang**

# Agenda



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Financial reporting

Risk management and controls

Internal audit and external audit

Management information and forecasting

Areas of focus for 2017

Review of appropriateness of accounting policies and key accounting judgements and estimates including:

Review of long term contract accounting estimates and judgements  
- Methodologies and consequential financial impacts

Review of market condition-driven impairment of goodwill in Marine

Review of goodwill at Rolls-Royce Power Systems

Post-retirement benefits and impact of restructuring of UK defined benefit schemes

High level review of requirements and judgements necessary for implementation of IFRS 15

Recognition of Deferred Tax Assets

FRC review of 2015 Annual Report

- No questions or queries raised
- Suggestions for improvement incorporated into 2016 ARA

# Accounting under IFRS 15 – background



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- Introduces new accounting principles for revenue recognition
- Consulting with other companies in the aerospace and defence sector
- Adoption of IFRS 15 does not change cash flow profiles
- Effective from 2018, with 2017 comparator. Opening 2017 balance sheet transition adjustment

- No longer recognise contractual aftermarket rights (CARs)

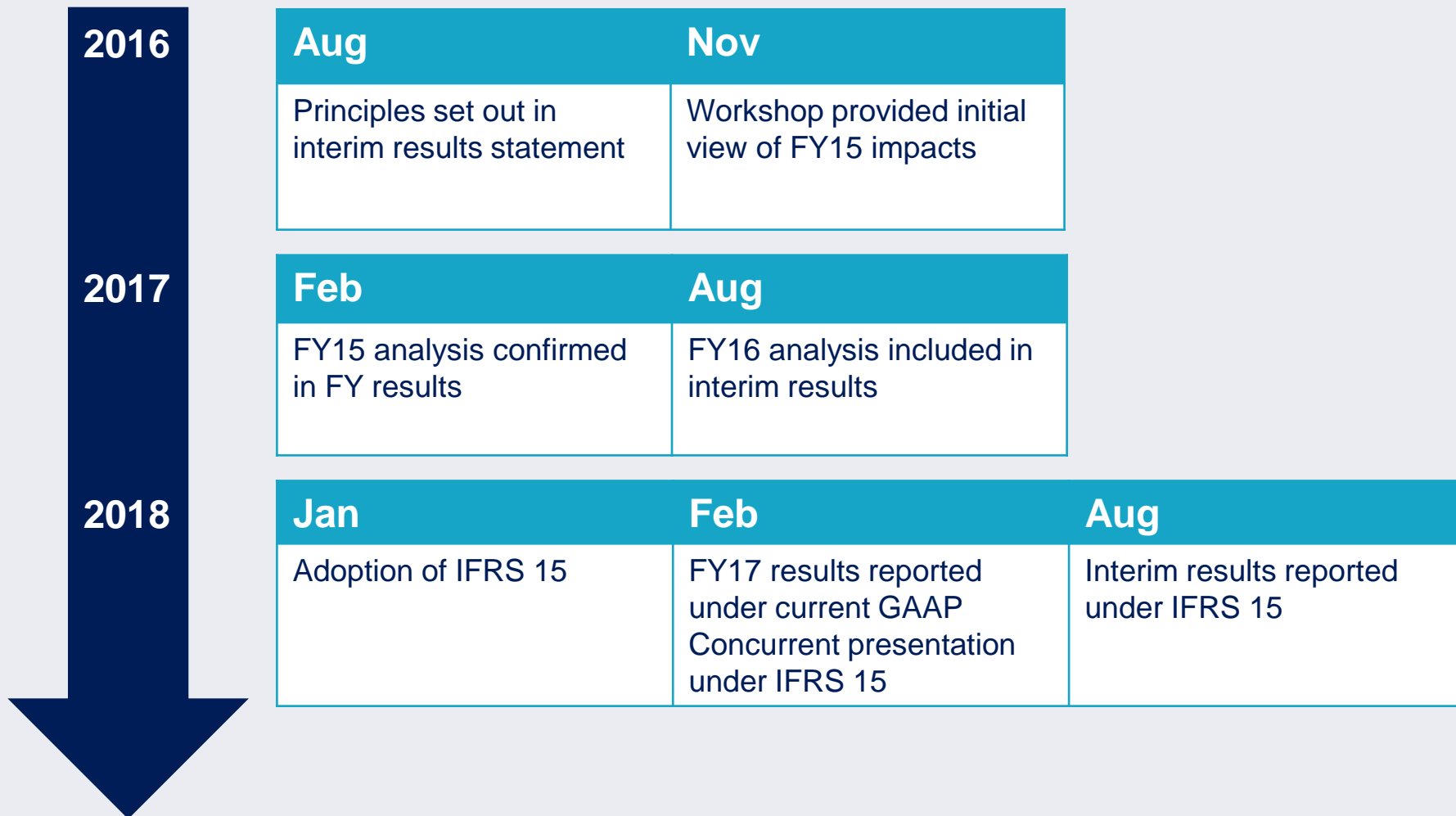
- Linked accounting will no longer be applied

- Aftermarket revenue will be recognised on a cost input basis

# IFRS 15 – programme



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# IFRS 15: civil aerospace scope



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## Civil Aerospace OE revenue

Large Engine OE

Business jet and V2500

Installed OE

Spare Engines



Around 50% of OE revenues generate positive cash margin

- Typical range of cash losses on installed large engines £1-2m
- Targeting cash break even on XWB-84 by 2020
- Cost reduction activity underway to reduce the average installed engine cash loss over the next few years

## Civil Aerospace AM revenue

Large Engine AM

Business/Regional

V2500

TotalCare® & CorporateCare®

Time & Materials



Around 1/3 of AM revenues accounted for on a 'time & materials' basis

- Around 2/3 of aftermarket revenues affected by IFRS 15
- Over 80% of long term contracts are pay as you go style contracts
- Pay at shop visit not materially impacted by IFRS 15



## Risk management

- Increasing robustness
- Cyber-security threat vigilance
- Ongoing work on forward-looking views

## Internal controls

- Governance framework issued
  - solid framework for entity-level controls
- Targeting greater consistency across group
- Robust review of control effectiveness

## Principal risks

- Building on 2015 work
- Risk processes reflected in judgements
- Added risk of '*Impact of disruptive technologies and business models*'

## Viability statement

- Five-year view for long term business
- Incorporated risk management outputs
- Added review of mitigating actions responding to extreme situations
- Satisfied prepared on appropriate basis





## Internal

- Effectiveness key to monitoring of Group's processes
- Time to complete audit actions reduced; root cause analysis initiative
- Sector Audit Committees driving operational management engagement
- Continuous improvement programme: e.g. data analytics

## External

- Extended auditor's report goes beyond minimum requirements, enhances transparency
- Clear signposting of key changes and key risks
- FRC's Audit Quality Review team commended KPMG on their report



## Timetable

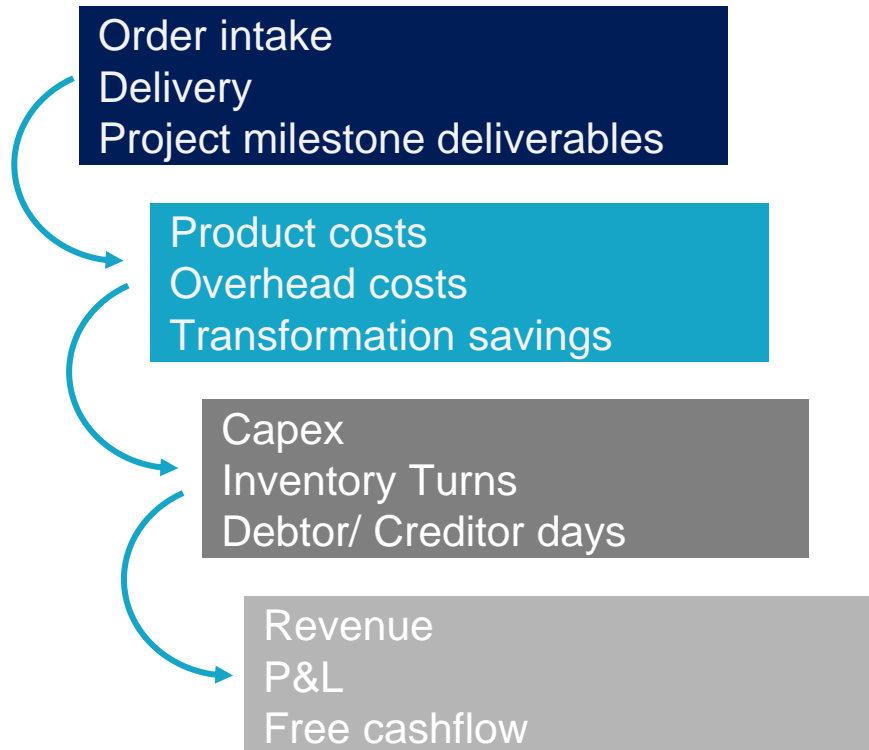
- Aligned with rotation of lead KPMG audit partner in 2018
- Led by steering group: AuditCo; CFO; Director of Internal Audit
- PwC selected in Dec 2016
- Approval sought at 2018 AGM
- New firm will be compliant with EU rules on non-audit services

## Process

- Overall – 8 month process
- Very engaged tenders from other Big 4 firms
- Written and interview stages
- Key criterion: audit quality



## Civil – real business drivers



## Current focus includes

- Stronger cascade of metrics and business drivers
- Clear accountabilities and strengthened business appraisals
- Linking physical factors to financials – P&L and cash
- Improving cost transparency
- Improving project control / analysis
- Revised planning / in-year forecasting

# Areas of focus for 2017



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Development of supporting processes & controls for IFRS 15 introduction

Effectiveness of improving MI systems and organisational changes

Activities to support auditor transition to PwC

Group approach to managing new standard: IFRS 16 Leases

Monitoring relevant issues arising from Lord Gold's recommendations & agreements with investigating authorities

**Ruth Cairnie**

**Remuneration Committee Chair**



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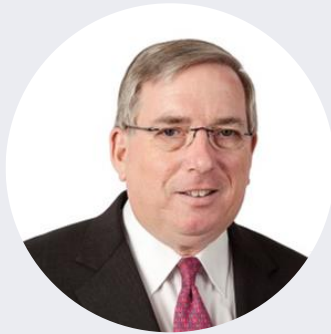
# Remuneration Committee



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**Ruth Cairnie**



**Lewis Booth**



**Sir Frank  
Chapman**



**John McAdam**



**Sir Kevin Smith**

# Terms of Reference



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Remuneration policy for Executive Directors and other senior executives reporting to CEO

Approve design, targets and pay-outs for annual and long-term incentive plans

Approve design and pay-outs for all share-based plans, including all employee plans

Determine total individual remuneration packages and T&Cs for Executive Directors

Oversee any major changes in remuneration throughout the group



## Leadership changes

- Agreeing terms for new CFO, Stephen Daintith
- Approving terms for departures of two Executive Directors

## Pay outcomes

- 2016 bonus
- 2014 PSP award
- 2017 pay increase

## Remuneration policy review

- Alignment of policy to business strategy
- Alternative remuneration models & remuneration landscape
- Simplification of incentive plan design
- Appropriate performance measures
- LTIP: overall quantum of awards
- Consultation exercise with shareholders



# 2016 awards



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## 2016 bonus adjustments

- **Cash & profit metrics**  
Removed gains from unbudgeted FX and cash receipts, and restructuring payments
- **Overall group performance**  
Outturn reduced to 'on-target' – 60% of maximum

## Incentive payout history 2011-16

	Bonus	PSP
2016	60% of Max	–
2015	Nil	–
2014	Nil	0%
2013	60% of max	0%
2012	85% of max	67%
2011	90% of max	150%

**2017 pay increase: deferred to September for managers**

# Priorities for new policy



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Theme	Targeting	Action
<b>Support Transformation</b>	Align reward to key business outcomes, specifically the transformation programme which will deliver the long term investment case	Pay-out linked to delivery of transformation programme  Focus on cash measures
<b>Talent</b>	Strengthen leadership capability	Increase in LTI quantum
<b>Stewardship</b>	Strengthen alignment of executives & shareholders	2-year holding period; reduced vesting at threshold
<b>Simplification</b>	Simplify model, greater transparency	Additive models, aligned to business strategy

# Consultation with shareholders



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3 rounds of consultation with ~25 of largest shareholders,  
Sep '16-Feb '17

## Talent & transformation

Recognition of the level of challenge

## Remuneration structure

Support for simplification

## Non-financial measures

Positive view on inclusion, providing they are objective & quantifiable

## LTI awards

Support for increase in maximum, when linked to clearly stretching targets

## Vesting

Positive view on additional holding period & reduced vesting at threshold level

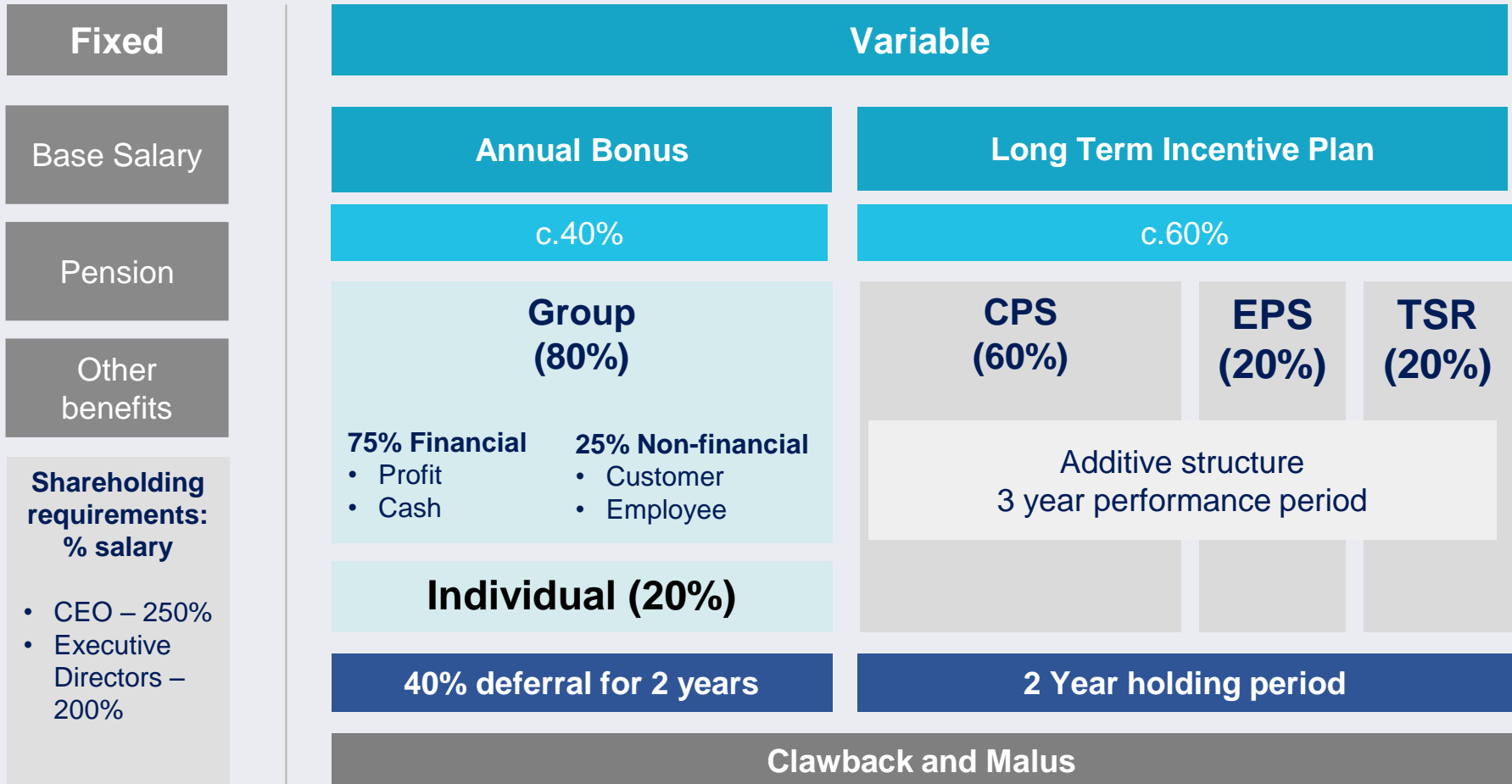
## Performance measures

Strong support for cash as key metric; mixed views on TSR

# Proposed new policy design for 2017-19



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# Setting stretching performance targets

Cumulative 2017-19



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		<b>CPS</b> 60%	<b>EPS</b> 20%	<b>TSR</b> 20%
	vesting			
<b>Threshold*</b>	20%	60p	115p	Median
<b>Mid</b>	50%	80p	135p	-
<b>Maximum</b>	100%	110p	160p	Upper quartile

\*reduced from 30% vesting at threshold  
N.B. 2016 targets 10p threshold, 50p max

**John Dawson**

Director, Investor Relations



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# Plenary Q&A



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# Safe harbour statement



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This announcement 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 in the 2016 Annual Report for definition.