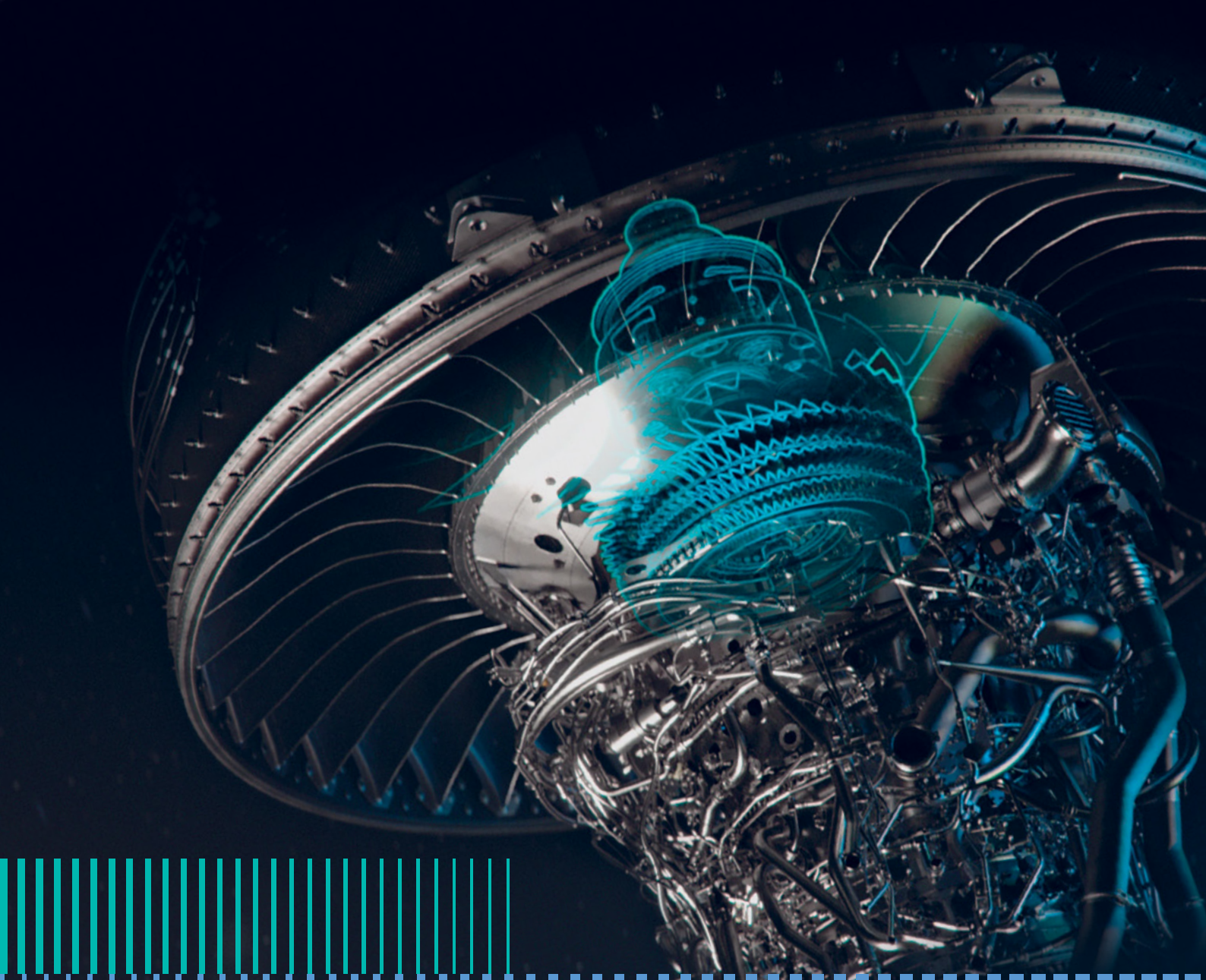

ANNUAL REPORT 2023

Rolls-Royce Holdings plc

We have set out a bold and achievable plan that will take us to the next level: a step change in our performance that will create a high-performing, competitive, resilient and growing business. Our performance in 2023 gives us confidence that we can deliver on our transformation.

Tufan Erginbilgic
Chief Executive

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Use of underlying performance measures in the Annual Report
All figures in the narrative of the Strategic Report are underlying from continuing businesses unless otherwise stated. We believe this is the most appropriate basis to measure our in-year performance as this reflects the substance of trading activity, including the impact of the Group's foreign exchange forward contracts, which lock in transactions at predetermined exchange rates. In addition, underlying results exclude the accounting impact of business acquisitions and disposals, certain impairment charges and exceptional items. A full definition of underlying and the reconciliation to the statutory figures can be found on pages 213 to 214 and 217. All references to organic change are at constant translational currency.

Forward-looking statements
This Annual Report contains forward-looking statements. Any statements that express forecasts, expectations and projections are not guarantees of future performance and guidance may be updated from time to time. This report is intended to provide information to shareholders, and is not designed to be relied upon by any other party or for any other purpose, and the Company and its Directors accept no liability to any other person other than that required under English law. Latest information will be made available on the Group's website. By their nature, these statements involve risk and uncertainty and a number of factors could cause material differences to the actual results or developments.

Group at a glance

UNDERLYING REVENUE [1, 2]

£15,409m

2022: £12,691m

STATUTORY REVENUE [1]

£16,486m

2022: £13,520m

FREE CASH FLOW [1, 2]

£1,285m

2022: £505m

STATUTORY CASH FLOWS FROM OPERATING ACTIVITIES [3]

£2,485m

2022: £1,524m

UNDERLYING OPERATING PROFIT [1, 2]

£1,590m

2022: £652m

STATUTORY OPERATING PROFIT [1]

£1,944m

2022: £837m

UNDERLYING OPERATING MARGIN

10.3%

2022: 5.1%

STATUTORY OPERATING MARGIN

11.8%

2022: 6.2%

UNDERLYING PROFIT BEFORE TAX [1, 2]

£1,262m

2022: £206m

STATUTORY PROFIT/(LOSS) BEFORE TAX [1]

£2,427m

2022: £(1,502)m

TOTAL UNDERLYING CASH COSTS AS A PROPORTION OF UNDERLYING GROSS MARGIN [1, 2, 4]

0.59

2022: 0.80

RETURN ON CAPITAL [1, 2, 5]

11.3%

2022: 4.9%

UNDERLYING EARNINGS PER SHARE [1, 2]

13.75p

2022: 1.95p

STATUTORY EARNINGS/(LOSS) PER SHARE [1]

28.85p

2022: (14.24)p

NET DEBT

£(1,952)m

2022: £(3,251)m

LIQUIDITY [6]

£7.2bn

2022: £8.1bn

ORDER BACKLOG [1, 7]

£68.5bn

2022: £60.2bn

GROSS R&D EXPENDITURE [1, 2, 8]

£1.4bn

2022: £1.3bn

COUNTRIES WITH ROLLS-ROYCE PRESENCE

48

2022: 48

EMPLOYEES (MONTHLY AVERAGE)

41,400

2022: 41,800

See note 2 on page 142 for a reconciliation between underlying and statutory results

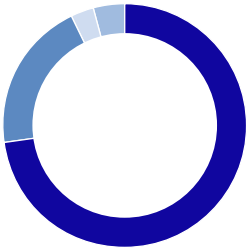
1 2023 and 2022 figures represent the results of continuing operations
2 A reconciliation of alternative performance measures to their statutory equivalent is provided on pages 213 to 217
3 2022 statutory cash flows from operating activities has been represented as described on page 125
4 Total underlying cash costs as a proportion of underlying gross margin is defined on page 217 and is abbreviated to TCC/GM
5 Adjusted return on capital is defined on page 217 and is abbreviated to return on capital
6 Liquidity is defined as cash and cash equivalents plus any undrawn facilities, as listed on page 58
7 See note 2 on page 141
8 See note 3 on page 144 for a reconciliation of gross R&D expenditure to total R&D expenditure

OUR DIVISIONS IN 2023

CIVIL AEROSPACE

Civil Aerospace is a major manufacturer of aero engines for the large commercial aircraft, regional jets and business aviation markets. The business uses its engineering expertise, in-depth knowledge and capabilities to provide through-life service solutions for its customers.

Underlying revenue



- Large engines – 73%
- Business aviation – 20%
- Regional – 3%
- V2500 – 4%

UNDERLYING REVENUE

£7,348m

2022: £5,686m

UNDERLYING OPERATING PROFIT

£850m

2022: £143m

UNDERLYING OPERATING MARGIN

11.6%

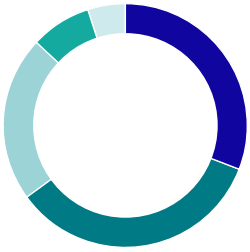
2022: 2.5%

See page 24

DEFENCE

Defence is a market leader in aero engines for military transport and patrol aircraft with strong positions in combat applications. It has significant scale in naval and designs, supplies and supports the nuclear propulsion plant for all of the UK Royal Navy's nuclear submarines.

Underlying revenue



- Transport – 31%
- Combat – 34%
- Submarines – 22%
- Naval – 8%
- Helicopters – 5%

UNDERLYING REVENUE

£4,077m

2022: £3,660m

UNDERLYING OPERATING PROFIT

£562m

2022: £432m

UNDERLYING OPERATING MARGIN

13.8%

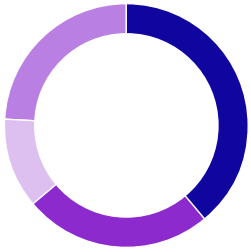
2022: 11.8%

See page 26

POWER SYSTEMS

Power Systems, with its product and solutions brand *mtu*, is a world-leading provider of integrated solutions for onsite power and propulsion, developing sustainable solutions to meet the needs of its customers.

Underlying revenue *



- Power generation – 39%
- Governmental – 25%
- Marine – 12%
- Industrial – 24%

UNDERLYING REVENUE

£3,968m

2022: £3,347m

UNDERLYING OPERATING PROFIT

£413m

2022: £281m

UNDERLYING OPERATING MARGIN

10.4%

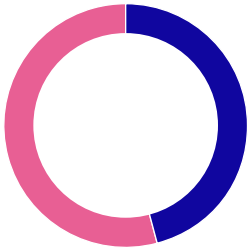
2022: 8.4%

See page 28

NEW MARKETS

New Markets are early-stage businesses. They leverage our existing, in-depth engineering expertise and capabilities to develop sustainable products for new markets, focused on the transition to net zero.

R&D expenditure



- Rolls-Royce SMR – 46%
- Rolls-Royce Electrical – 54%

UNDERLYING REVENUE

£4m

2022: £3m

UNDERLYING OPERATING LOSS

£(160)m

2022: £(132)m

UNDERLYING OPERATING MARGIN

n/a

2022: n/a

See page 30

* In 2023, the naval business of Power Systems was moved from marine to governmental to better reflect the products and customer mix of this business

Chair's statement

The ongoing transformation of our business, the strategy we have laid out and the new mindset being developed throughout the organisation, will create a Rolls-Royce that can be a stronger partner for all our stakeholders. Our progress in 2023 is a significant step in the right direction.

Dame Anita Frew
Chair

Change is a constant in business and the rate of change has been dramatic in 2023. For Rolls-Royce, our annual results represent positive change. Our record performance is testament to the hard work and contributions of all of our people at every level. I would like to thank everyone for the pace and rigour with which they have embraced our transformation programme. We are creating a high-performing, competitive, resilient and growing Rolls-Royce which will ultimately benefit all stakeholders.

The change brought about within our business in 2023 has been driven by the clear transformation programme which our Chief Executive, Tufan Erginbilgic, set out in last year's Annual Report. As part of that process, a thorough strategic review was then carried out involving senior leaders and experts from across the Group. The Board experienced the sheer scale and rigour of that process first hand during 2023. We presented the outcome at our capital markets day (CMD) in November. Our new strategic framework (see page 8) is owned by leadership and is now being cascaded through the organisation as the backbone of both performance management and people engagement. The financial targets that we have laid out for the mid-term (see page 12) are ambitious but achievable, representing a step-change in performance. At the same time, we are continuing to invest in our engineering excellence and technology as well as the safety of our products and people.

Outside of Rolls-Royce, change has been just as dramatic but by no means as positive and underlines the importance of Rolls-Royce becoming a more resilient business through its transformation. The geopolitical outlook, which was already unsettled as a result of the Russia-Ukraine conflict, worsened as 2023 progressed with the deeply distressing events in Israel and Gaza heightening regional tensions and threatening important trade routes. In 2024, there is likely to be further geopolitical uncertainty as countries that account for more than half the world's population hold elections. The macro-economic environment, meanwhile, has been characterised by persistent inflationary pressure, driven in part by the global bounce back from the pandemic, coupled with supply chain challenges and fears of recession in some markets. Against this backdrop, it is imperative that we build a financially stronger Rolls-Royce that will be more resistant to external shocks. It is also vital that, as we do so, we create a Rolls-Royce which can generate sustainable long-term growth built on great technology and engineering, with safety and integrity at its core and which delivers outstanding results for our customers and people.

Listening at a time of change

During a period of transformation, it is important for the Board to monitor the impact of change on the organisation, especially its effect on our people, and ensure that the right values and behaviours are in evidence. In last year's report, I said that the Board would maintain a focus on employee sentiment and culture during 2023, recognising their critical role in delivering a successful transformation programme. In May 2023, we made a series of changes to the Board Committee structure to support this (see page 67). These included a refocusing of the Nominations & Governance Committee, now renamed as the Nominations, Culture & Governance Committee, to assess and monitor culture across the organisation. This was assisted by our Employee Champions, Bev Goulet and Wendy Mars, who continued to represent the voice of our people in the boardroom. Our Employee Champions form an important connection between the Board and our people at all levels of the organisation, providing feedback from their regular interactions, including through the employee stakeholder engagement committee. The whole Board, meanwhile, was able to hear

first-hand accounts of how the transformation programme is coming to life at our annual Meet the Board event which followed the 2023 Annual General Meeting (see page 60) and in our programme of site visits where we meet regularly with our people.

When significant change is being made at pace, it is also crucial that the focus on fundamentals is not lessened and the Board must provide oversight. The transformation programme sees Rolls-Royce place an increased focus on commercial outcomes. This is to be welcomed but must be accompanied by continued vigilance on issues of ethics and integrity. We remain committed to zero tolerance of business misconduct and that is always non-negotiable. The Nominations, Culture & Governance Committee now has oversight of our ethics assurance processes, including reporting of calls into our speak up line.

Tufan has made it clear from his very first day that safety is the number one priority of his leadership team, from the safety of our mission-critical products through to the safety and wellbeing of our people. In the latter half of 2023, a new engineering, technology and safety (ET&S) capability was created within the Group, led by a new Group Director of Engineering, Technology & Safety with a place on the Executive Team. This new capability mirrors a change made to the Board Committee structure earlier in the year with the formation of the Safety, Energy Transition & Tech Committee, which is focused upon safety as well as the energy transition agenda. The strategic framework set out at the CMD makes clear the fundamental role of lower carbon solutions to the long-term success of Rolls-Royce. We are committed to becoming a net zero company by 2050 and we support our customers to do the same. This Committee will provide oversight of our plans (see page 67).

Board developments result in gender parity

To deliver on the strategy that Tufan and his leadership team set out in November 2023 requires a Board with the relevant experience and expertise, who can assist and support as necessary and provide appropriate oversight. We already have significant bench strength in areas vital to the success of our ongoing transformation; nevertheless, during the year we further strengthened the Board's strategic, commercial and operational expertise and brought in additional experience in forging successful international partnerships. Our new appointments in the year also saw us exceed our ambitions to increase the diversity of the Board as we reached gender parity for the first time in the history of Rolls-Royce. The achievement of this milestone should not be taken lightly. It is an historic moment. When I took up the post of Chair, I set a target to have, as a minimum, 40% female representation on the Board and stated that our longer-term ambition was to reach gender parity. The fact that we have reached this target is testament to our hard work and targeted recruitment. It is a clear signal of the importance which the Board places on gender diversity, as well as aligning with the wider ambition to increase representation and opportunity for progression across the Group.

During 2023, the Nominations, Culture & Governance Committee led the process for recruiting and appointing Helen McCabe as Chief Financial Officer. She joined the Board in August, bringing more than 25 years of experience in senior finance and performance management within complex, multinational engineering organisations. She has run multi-billion dollar customer-focused businesses and has extensive experience of delivering transformation programmes that generate substantial returns. She has already made a significant impact on Rolls-Royce, providing robust oversight of our process which led to our mid-term financial targets and played a key role in the presentation of our ambitions for the future at the CMD. She is also bringing renewed rigour and a strong focus to the way Rolls-Royce conducts performance management.

In May 2023, Birgit Behrendt joined as a Non-Executive Director. Birgit brings a combination of deep experience across global procurement and supply chain management with extensive expertise gained from leading large, complex projects across multiple geographies. She spent much of her executive career at Ford Motor Company, latterly as vice president of global purchasing and oversaw the company's European joint ventures and alliances. Her non-executive appointments are across industrial groups beyond automotive, all with a focus on sustainability and transformation.

Stuart Bradie also joined us as a Non-Executive Director in May 2023, bringing with him an outstanding track record in driving strategic transformation and cultural change in international engineering businesses. Currently CEO of KBR, the US listed engineering and technical government services company, Stuart has over 25 years of experience leading global, technically oriented businesses and has strong project management credentials. Additionally, Paulo Cesar Silva joined us as a Non-Executive Director in September. Paulo has an outstanding track record in the global aerospace industry with over 25 years of experience at Embraer, the world's third largest commercial jet manufacturer. As president & CEO, he led Embraer through major strategic change, successful innovation in product development and programmes, significant improvement in operational efficiency and supply chain optimisation and successful industry partnerships.

During 2023, we also saw a number of departures from the Board. Mike Manley stepped down at the Annual General Meeting while Paul Adams stepped down in September. I would like to thank both of them, on behalf of the whole Board, for their hard work during their tenures. We also said farewell to Sir Kevin Smith after serving almost eight years. He made an outstanding contribution during his time and I would like to thank him personally for his work as Senior Independent Director until 2022 and for the way he led the Chair succession process. He was instrumental in the Chief Executive transition. Finally, Panos Kakoullis stepped down as Chief Financial Officer in August, having ensured the successful delivery and reporting of the Group's half-year performance.

Shareholder payments

As set out in further detail elsewhere (see page 19), our capital framework is focused on three clear priorities: a strong balance sheet with an investment grade profile; a commitment to reinstating and growing shareholder returns; and a disciplined approach to investments. Strengthening the balance sheet is a clear priority. We are positioning Rolls-Royce to better withstand volatility and external shocks and to give us financial flexibility for the future. When the Board is confident that the strength of the balance sheet is assured and we are comfortably within an investment grade profile, we are committed to reinstating and growing shareholder distributions.

Looking forward

I have written to you before about my immense pride in being part of Rolls-Royce and that I want to see the Group thrive and remain in control of its own destiny. To achieve this we must become more resilient and the plan laid out by Tufan and his leadership team, which is firmly endorsed by the Board, will achieve this aim. Our mid-term financial targets are ambitious but based on rigorous analysis and will result in a resilient and profitable Rolls-Royce that will deliver outstanding performance for our people and all our stakeholders.

The pride I feel in working for Rolls-Royce is shared by the Board and the whole leadership team. I know for a fact that it is also felt by everyone within the business. I know this because every time I visit one of our facilities our people tell me. There is a special quality to Rolls-Royce and it comes from them. The other members of the Board and I would like to thank all our colleagues in the Group for their incredible hard work in 2023. Together we have already delivered significant progress and I am confident that even better is still to come.

Dame Anita Frew
Chair

Chief Executive's review

Our transformation must be carried out at pace, with rigour and intensity. That is exactly what we have done in 2023 and the proof is in our performance. We now have a clear and granular strategy that will create a high-performing, competitive, resilient and growing Rolls-Royce with the strength to control and shape its own destiny.

Tufan Erginbilgic
Chief Executive

Rolls-Royce is a great company, with a rich heritage and so much potential. This year, we have taken very significant steps towards realising that potential through our transformation programme. The pace at which we are delivering, achieved by managing the Group very differently, enabled us to raise our full-year financial guidance in July 2023 and our transformation has delivered a record performance. At our CMD in November 2023, we set out the scale of that potential over the mid-term (see page 20). Our targets for the mid-term represent a step change in financial performance: quadrupling operating profit compared with 2022; operating margins representing an equal or better competitive performance benchmarked against our peers; sustainable cash flows delivering a more than 100% conversion of improved profits; and an increase in return on capital that will create a truly compelling investment proposition.

In addition to transforming our financial performance, we are also transforming our business. We are creating a simpler, more efficient, more effective and more capable organisation with the winning mindset and performance culture we need to succeed. Our strong progress in 2023 gives us good reason to be confident of achieving further growth in 2024 and unlocking our potential in the mid-term.

In last year's report, I set out my experience of partnering engineering expertise with a granular strategy, business acumen and intense performance management to create an organisation that thrives on strategic progress. This transformation has four key elements. The first is to put a mirror up to the organisation. This is not about giving an opinion, it is about presenting the data honestly about where the business is. During the latter half of 2022, we conducted extensive benchmarking of our Group performance and that of our businesses against our peers. That work showed there was significant scope for us to deliver materially higher profit, cash flows and returns in the mid-term, unlocking our potential and performing as well or better than our best competitors. The conversations this sparked within the organisation were incredibly energising because, at the same time, we presented a vision of what a winning Rolls-Royce will look like. This was evident when we conducted our main employee survey (see page 46) with record turnout and our highest ever engagement score.

The second principle is to set out a clear and granular strategy with well defined strategic initiatives cascaded down through the organisation so that everyone knows their role in the transformation. This is what we set out at the CMD and I will go into further detail shortly.

Thirdly, the success of transformation relies on rigorous performance management driving year-on-year improvement. Our focus is on the strategic progress of Rolls-Royce. We are now creating the performance management framework which will ensure we manage closely against our goals. Performance management also means understanding the markets in which we operate and taking proactive action when the external environment changes. That requires robust management information provided in a timely manner in order to manage the future rather than merely reporting on the past.

Fourthly, transformation must be carried out through a systematic approach, with pace, rigour and intensity. Our performance in 2023 is not only about what we have done, but how we did it. Our people are energised and our strategy is being led by a strengthened Executive Team who are managing the business very differently within a new organisational structure that aligns with that strategy.

Record performance driven by every division

Our performance in 2023 was driven by the actions we took to improve efficiency, reduce costs and enhance our pricing position and commercial outcomes. This step-change has been achieved across all our divisions, despite a volatile environment with geopolitical uncertainty, supply chain challenges and inflationary pressures.

In Civil Aerospace (see page 24), we delivered improved operating profit and a four-fold margin increase despite engine flying hours only 88% of pre-pandemic levels. This was driven by increased aftermarket profit, in both large engines and business aviation, reflecting commercial optimisation and cost efficiencies, as well as volume growth. Defence (see page 26) delivered an improved operating margin of 13.8% (2022: 11.8%), which primarily reflected improved pricing and cost efficiencies. In Power Systems (see page 28), which reported an operating margin of 10.4% (2022: 8.4%), pricing and cost efficiency actions in the first half of the year resulted in a significantly improved operating profit and margin in the second half and in the full year.

As a result of our actions and our new ways of working, Group underlying operating profit rose by £0.9bn to £1.6bn supported by our transformation programme and strategic initiatives, with commercial optimisation and cost efficiency benefits across the Group. This means that we have already delivered more than half of the increase required to achieve the lower end of our mid-term target. Underlying operating margin more than doubled to 10.3%. Civil Aerospace, Defence and Power Systems all delivered materially higher margins compared to last year. This represents a huge step towards our mid-term target of 13%-15% as we narrow the competitive gap. Free cash flow from continuing operations grew by approximately 150% to a best on record £1.3bn, principally due to higher operating profit. Civil Aerospace net long term service agreement (LTSA) creditor growth, net of risk and revenue sharing agreements (RRSAs), was £1.1bn (2022: £0.8bn). Continued LTSA balance growth reflects higher engine flying hours and the benefit of commercial optimisation, with LTSA invoiced flying hour receipts of £4.6bn (2022: £3.6bn). Our focus on working capital resulted in a release in the second half despite ongoing supply chain challenges. For the full year there was a net working capital outflow of £0.4bn (2022: £0.5bn). Inventory and debtor days both improved year-on-year, building further confidence in the actions we are taking to improve the quality of cash delivery. Finally, return on capital more than doubled to 11.3% reflecting improved operating profit, disciplined capital allocation and working capital management.

During 2023, our teams continued to build momentum for the future with strong sales performance across all divisions. Civil Aerospace sealed fantastic customer wins, including orders with Air India, Turkish Airlines, Emirates, new customer EVA Air and, in early 2024, Delta Airlines. It was our best year for large aero-engine orders since 2007. This success is important in maintaining our momentum in the widebody market where our in-service fleet is growing faster than the market. While we currently power about a third of the widebody aircraft in service, in 2023 over half of new aircraft delivered were powered by Rolls-Royce engines, meaning we are growing share. The Defence team achieved generational wins, confirming the engine contract for the US Army's Future Long-Range Assault Aircraft (FLRAA) while our nuclear reactors are set to power submarines for the Royal Australian Navy under the trilateral AUKUS agreement. The multi-national next generation Global Combat Air Programme (GCAP) continued its positive momentum with the signing of the Convention of the Establishment of the GCAP programme by the Italian, Japanese and UK governments. Power Systems delivered an excellent sales performance with major wins from data centres and governmental customers, the latter including a deal to provide more than 50 Puma tank engines for the German Bundeswehr, ensuring that the pipeline for 2024 is largely full.

This performance was achieved despite ongoing macro-economic and supply chain challenges, which we continued to mitigate. The macro outlook remains uncertain and whilst we have advantaged businesses in attractive markets which provide a degree of resilience to the external environment, we have to remain very focused on increasing our resilience to external events, whether that be mitigating inflationary pressure and volatile commodity pricing through cost control measures, strengthening our balance sheet to insulate ourselves from sustained higher interest rates or robust supply chain management in an environment of enhanced geopolitical tensions globally.

Outcome of our strategic review: a granular strategy

Early in 2023, I set out our transformation programme including a rigorous and detailed strategic review across every division and sub-division in the Group. At our CMD, we set out the results of this extensive work and how we will unlock the potential of our business.

Our strategy will enable us to deliver on our proposition to our shareholders, which is to: build a high-performing, competitive and resilient business with profitable growth; grow sustainable free cash flow; and build a strong balance sheet and growing shareholder returns. This will transform Rolls-Royce into a more resilient and efficient business with higher quality of earnings and a focus on cash expansion and more sustainable cash flows. We will be a One Rolls-Royce team, with different ways of working and mindset, underpinned by a differentiated performance culture. This will be delivered through a new organisation that delivers efficiency, simplification and improved capabilities. Our strategic clarity ensures that the organisation will be focused, aligned and energised in the delivery of our strategy. Many of our leaders took part in the strategic review process. At the beginning of 2024, we started the process of cascading it to our people. Not only will everyone appreciate what the strategy means for them and the area of the business in which they work but also the role they play in delivering it. This is an alignment and engagement tool as well as serving as a performance management tool.

Portfolio choices and partnerships

In line with our strategy, we are making choices and executing on them. This allows us to allocate resources more effectively and drive profitable growth. We have segmented our portfolio into three categories: key investment areas for performance improvement and growth; areas where partnerships can create truly winning positions; and businesses and activities we will exit, though only at the right time and at the right price. Our strategic choices will drive value creation.

In Civil Aerospace, our focus will be on the widebody commercial airline market and business aviation, leveraging the value from our Trent and Pearl engine families and investing for the future with UltraFan. In Defence, we have opportunities to continue to improve pricing and performance with new programmes in transport, combat and submarines. We can also use our expertise in adjacent fields such as nuclear micro-reactors. In Power Systems, we will focus on governmental, marine and power generation end markets, where we see the strongest demand and an opportunity for better returns from our power-dense and reliable solutions.

In some cases we will grow in partnership to strengthen our market position. This can bring new skills, build capability and scale, as well as de-risk and reduce capital investment. In Civil Aerospace, we believe we are well positioned to re-enter the narrowbody market by choosing a partnership approach for the next programme. Our UltraFan technology is a vital step towards this. At the right time, with the right partner, we will decide the next steps. In Power Systems, our focused strategy on power generation will make this business more efficient and competitive and drive faster profitable growth. We are also considering potential partnerships to further grow our market position. Battery storage systems are a logical complement to our stationary power generation business, as we have transferable capability. We are already developing a good position in Europe. A partnership with access to additional markets could strengthen our position. Finally, for small modular reactors (SMRs), a broad set of partners will strengthen our position to deliver the overall solution and reduce any future capital call.

OUR STRATEGIC FRAMEWORK

Portfolio choices and partnerships
The markets we have chosen to operate in, businesses we want to invest in and the partnerships that will help create truly winning positions.

Advantaged businesses and strategic initiatives
How we will create a competitive business, expand our earnings potential and sustainably improve our performance.

Efficiency and simplification
The importance of a company-wide focus to drive synergies that will enable us to be more competitive and simplify the way we operate.

Lower carbon and digitally enabled businesses
Our commitment to the energy transition and capturing the benefits of becoming digitally enabled.

In addition, we identified areas that are not strategic for Rolls-Royce. In total, we expect to generate between £1bn and £1.5bn from gross divestment proceeds, which would be in addition to our mid-term cash flow target.

Advantaged businesses and strategic initiatives

Our businesses are advantaged by enjoying strong positions in attractive markets. Across the areas in which we will focus, we have a series of strategic initiatives which underpin the profitable growth we see in the mid-term.

In Civil Aerospace, we have detailed plans to improve large engine margins by targeting both reduced costs and increased revenues. This cost and commercial discipline applies across original equipment (OE), aftermarket, spare engines and our time and materials activities. There are six levers we are pulling, three related to cost and three to revenues. We are extending time-on-wing with better product durability and greater use of digital tools; lowering shop visit costs with better working practices; and reducing product costs through better buying and engineering. On the revenue side, we intend to keep engines earning for longer with contract extensions and conversions, while implementing a new value-driven pricing strategy focused on creating win-win solutions with our customers and addressing onerous and low-margin contracts. Finally, we are driving rigour on contractual terms and conditions. In business aviation, we have established a great platform with our Pearl engines which positions us well to optimise commercial outcomes and grow margins.

Defence was already performing well but there is still an opportunity to improve through strong performance management, commercial optimisation initiatives and greater efficiency. Across transport, combat and submarines we are also seeing a benefit from volume and mix factors as we move from legacy programmes to new funded programmes. We have the same focus on commercial optimisation and value-pricing behaviours as we have across the Group and we are prioritising investment in areas that benefit from increased customer funding.

In Power Systems, our profit growth is being delivered through our power generation, governmental and marine end markets. In power generation, we are optimising our cost structure and focusing on key accounts to drive margin growth. We are also expanding our microgrid solutions and extending our services offering in battery energy storage systems, which is moving to a profitable business in the short term. In governmental, we are capturing near-term growth with scope expansion and investment. Lastly, in marine, we are developing alternative fuel solutions to strengthen our synthetic fuel-ready portfolio.

Efficiency and simplification

We are driving efficiency and simplification across the business. We had a TCC/GM ratio of 0.80 times in 2022 and before that, 0.88 times in 2019. That is around two times higher than the best-in-class level for a business like ours. It is an important metric because it is a measure of the operating leverage of our business and, therefore, of our resilience. We plan to approximately halve our TCC/GM by the mid-term. Across the Group, we have efficiency initiatives underway that will deliver sustainable annualised savings of £400m to £500m, making us more competitively advantaged and fit for the future. This is supported by improved cost reporting capability and fundamentally shifting mindset on efficiencies, embedding them as a sustainable and strategic lever to underpin performance.

Lower carbon and digitally enabled businesses

Our strategic framework acknowledges the fundamental role of lower carbon solutions and digital technologies in the success of Rolls-Royce. We are committed to becoming a net zero company by 2050 (see page 32) and we support our customers to do the same. We are making good progress towards making our own operations net zero (see page 33) but there is a lot more to do to decarbonise the sectors in which we operate. Our technological expertise has a crucial role to play.

New lower carbon fuels will be central to achieving net zero in the medium term across many of our markets. In commercial aerospace, for instance, sustainable aviation fuel (SAF) is the answer for large aircraft. That is why we are very pleased to have successfully reached our target of testing all our in-service Trent and business jet engines with 100% SAF in 2023. We have also been working with our armed forces customers to achieve the same for the engines they use from our Defence division. We also believe the internal combustion engine can be made compatible with net zero, through the use of sustainable fuels. This is vital as many of our customers, such as data centre and governmental clients, will continue to use combustion engines well into the future. At the end of 2023, variants of all our major Power Systems engine platforms can run on sustainable fuels, such as hydrotreated vegetable oil. In marine, we are developing methanol-based solutions and for power generation we see hydrogen as a future solution. All these developments are based on existing engines. In some markets, such as yachts, hybrid solutions will be key and solutions are being developed. We are also prepared for the gradual transition to battery-based solutions, with the required capabilities and products in place.

We are also making increased use of new digital technologies across four areas: enhancing the customer experience; accelerating product design; improving manufacturing; and empowering our people. We are well known for our skill in collecting engine data in order to improve the performance of our engines while in service and, with digital twin capabilities, we can forecast the time an engine stays on wing. This is improving dispatch reliability and reducing disruption for customers. Our future vision is raising the bar to 100% availability, where everything is planned and predictable, further improving the service we offer customers. Digital tools are also helping us design products more efficiently. Powerful virtual simulations and use of artificial intelligence (AI) can reduce the time it takes to develop and test a new engine. In manufacturing, we are using digital tools, such as AI machine learning, to improve our inspection regimes. We also intend to make increasing use of AI to remove repetitive tasks, freeing our people to focus on high-value activity.

One Rolls-Royce focused on strategic delivery

The delivery of our ambitious strategy is through a new organisation structure. We now operate as One Rolls-Royce. This is a major shift away from the previous decentralised model and creates an aligned organisation benefiting from the ability to dynamically deploy resources to strategic priorities; common measures that enable us to assess our progress against our strategic priorities; improved performance through clear decisions and accountability; and finally, a simpler and more efficient operating model. This leaner and lower cost model reduces siloed working and eliminates the waste of duplicated tasks and capabilities in each division.

During 2023, we announced the new organisational design with a simplified leadership structure and plans to reduce the number of roles across the Group by 2,000 to 2,500 by the end of 2025 (see page 48). It simplifies our business, reducing layers and creating a clearer system of controls and alignment. It is not only about structural change, it is also about changing how we run our business. For instance, across Rolls-Royce we are taking a zero-based budgeting approach and have set a 10% to 15% reduction in targeted areas and we are controlling investment centrally to ensure we fund projects in line with strategy.

We have brought together key areas crucial to our success, through a new engineering, technology and safety (ET&S) capability and an enterprise-wide procurement and supplier management organisation. ET&S is a significant change right at the heart of Rolls-Royce. Focused on programme delivery, ET&S will build and strengthen our competence and has responsibility for the delivery of some programmes, engineering standards, processes, methods and tools. This structure provides significant benefits to efficiency levels, capability and retention by ensuring we can move our engineering teams to the highest priority activities across all of our divisions, in-line with our strategy. By benefiting from the learning, tools, resources and capabilities that are common across projects we are better able to execute new product introduction. There are significant synergies across the Group that we will be able to exploit. For example, our GCAP project in Defence can benefit from the certification, design and system engineering that our business aviation team has built from the introduction of three new Pearl engines. Our SMR team can benefit from the manufacturing engineering capability that our Civil Aerospace business has built, while there are common engineering challenges in areas such as thermal management or controls that equally apply to Power Systems as to our Civil Aerospace and Defence divisions. This allows for better retention of talent in key skill areas, as work is balanced across all of the divisions, while also increasing capability by pulling best practice and experience from the whole Group.

Our Group-wide procurement and supplier management organisation, meanwhile, has a critical role to play in our success as we harness the scale of Rolls-Royce. It will support the consolidation of Group spend, leverage scale, develop consistent best-in-class standards and build people capability. We will leverage opportunities across the organisation to deliver approximately £1bn of gross third party cost savings in the mid-term.

Within this new One Rolls-Royce organisation, we have added new talent and strengthened our leadership, with almost half of the immediate direct reports to my leadership team either new to the role or in an expanded role. The Executive Team has also been strengthened, bringing new experience, capabilities and energy. During the year, Helen McCabe joined Rolls-Royce as Chief Financial Officer and Nicola Grady-Smith as Chief Transformation Officer. In 2022, Jörg Stratmann joined as President of Power Systems and I was closely involved in his appointment. During 2023, Rob Watson moved to President of Civil Aerospace, Adam Riddle became President of Defence and Chris Cholerton became Group President, with executive responsibility for the Group's nuclear operations, including Rolls-Royce Submarines and Rolls-Royce SMR. Simon Burr also took up the newly created post of Group Director of Engineering, Technology & Safety (ET&S) in 2023. Keeping our employees and customers safe is our number one priority. Nothing is more important than that. Always, every time. So, we have put product safety at the heart of this new organisation to strengthen our approach to technical safety and assurance. While Simon has leadership accountability for safety across the Group, every single person within Rolls-Royce has a responsibility to prioritise safety above all other considerations.

Looking forward

While we have a strong focus on delivering our short and mid-term targets, we are also investing heavily in product improvements, new product introductions and product cost improvement. All of these are long-term investments. This is in addition to the significant customer wins we have had that drive long-term growth. The result of this combination is a group being set up for enhanced financial performance. It means we are laying down foundations that will benefit us in the period long after our mid-term targets.

For example, in Civil Aerospace, we are spending £1bn on time-on-wing improvements in a multi-year programme. This will double the time-on-wing of our Trent 1000 engine and, in non-benign environments, double the time-on-wing of the Trent XWB-97 as well as generating a 50% improvement in benign environments. We are investing in reducing shop visit costs, creating a more efficient and more resilient aftermarket operation; and in decreasing product costs so we can capture more of the value from the order book. Our win-win approach to contracting means we are better placed to be rewarded for our innovation, while our investment in new digital technologies will ensure a better experience for our customers, as well as make us more efficient. We are also expecting to invest further in UltraFan, having achieved the very important milestone of successful full power testing during 2023. UltraFan also provides us with opportunities to introduce technologies from the demonstrator into our existing fleet. Our Pearl and Trent engine families will benefit from these actions as they power the in-service fleet well into the 2040s.

In Power Systems, we see long-term potential for our competitive portfolio of products and are investing in making those products compatible with sustainable fuels and creating engines capable of using new fuels such as methanol. We are also developing the first new *mtu* engine for many years, an investment that will pay off beyond the mid-term. In Defence, our recent successes in securing a place on the US Air Force's B-52 and US Army's FLRAA will not start to deliver significantly until well after the mid-term. GCAP is expected to deliver a next generation combat aircraft in 2035, building on the progress we have already made with our Team Tempest partners in the UK. All these Defence programmes will result in engines and systems that will remain in service for 30 or 40 years after they are delivered. AUKUS, meanwhile, will see our submarines business delivering and servicing nuclear propulsion systems well into the second half of this century. Finally, of course, our SMR business has a compelling long-term growth story, with power stations expected to be in service for 60 years. As a result, 2024 and even the mid-term targets are merely milestones. They are not the final destination. Rolls-Royce will continue to grow with enhanced margins and cash flow well into the long term as a result of our strategy and the choices we are making today.

Building a track record of delivery

This is a pivotal moment in the history of Rolls-Royce. We have set out a bold and achievable plan to create a high-performing, competitive, resilient and growing business. Our strategy is granular and owned throughout our business. The choices we have made in our strategic review are clear. Our mid-term targets are compelling. We are building a track record of delivery, while investing in the future. Our success will benefit not just our shareholders but all our stakeholders, including our customers as they meet the challenges and opportunities that define the future. We will also create more opportunities for our people, so everyone can be a part of an energising, rewarding and world-leading group. I would like to thank all of our people for their effort and hard work in 2023. Together, we are building One Rolls-Royce. A Group that can fully realise its potential, ensuring the excellence and innovation that has helped shape the modern world, endures long into the future.

Tufan Erginbilgic
Chief Executive

Strategy

In 2023, we developed a clear strategy to help Rolls-Royce perform to its full potential. We have already made good progress towards building a strong, competitive, resilient and growing business. This success is thanks to transformation and performance management.

Rolls-Royce has been at the forefront of innovation for over a century. We set the standard for engineering excellence, providing mission-critical products and services to customers across the globe.

We have built a world-class product portfolio and deep customer relationships. Our focus now is to translate our technical and market success into strong financial returns. We have the potential to achieve so much more.

The progress made in 2023 gives us confidence in the delivery of our strategic plans. We are accelerating financial delivery and have set new, ambitious yet achievable mid-term targets.

The Rolls-Royce proposition

1. Build a high-performing, competitive and resilient business with profitable growth.
2. Grow sustainable free cash flow.
3. Build a strong balance sheet and grow shareholder returns.

Delivering the proposition will make us a stronger partner to our customers as they face future challenges and opportunities. We will unlock our full potential by turning engineering excellence into strong financial performance.

To implement our strategy, we will be disciplined, agile and systematic. We will continue to have a tight focus on priorities, improve commercial discipline and seek efficiency in every step, whilst never compromising on integrity or safety. We will put the business on a stronger financial footing by delivering a sustainable reduction in working capital, higher operating margins and improved operational performance.

Improving profitability will give us options to grow the business and enhance shareholder returns. This performance shift is also crucial to creating more opportunities for our people to be part of an energising, rewarding and world-leading team.

OUR TRANSFORMATION

STRATEGIC FRAMEWORK

- Portfolio choices and partnerships
- Advantaged businesses and strategic initiatives
- Efficiency and simplification
- Lower carbon and digitally enabled businesses

DELIVER AS ONE ROLLS-ROYCE

- Embrace new ways of working and mindset
- Establish a differentiated performance culture
- Execute with strategic clarity
- Externally focused and benchmarking
- Simplified organisation and strengthened capabilities

A HIGH-PERFORMING, COMPETITIVE AND RESILIENT BUSINESS WITH PROFITABLE GROWTH

GROWING SUSTAINABLE FREE CASH FLOWS

STRONG BALANCE SHEET AND GROWING SHAREHOLDER RETURNS

DELIVERING SUSTAINABLE GROWTH THROUGH TRANSFORMATION

Our strategic framework to deliver the proposition

Portfolio choices

We will make decisions on where to operate and where to invest based on clear criteria:

- is the market attractive and growing?
- do we have a differentiated position?
- can we generate attractive returns?

We are making choices and executing on them. We are only investing where the market is attractive and growing, where we can build an advantaged position differentiated through strong customer relationships and competitive technology and where there are high barriers to entry. This allows us to allocate resources more effectively and drive profitable growth.

We have segmented our portfolio into three categories:

- areas where we will invest to drive performance improvement and growth;
- areas where we can create truly winning positions through partnership; and
- business activities which we intend to exit.

Strategic initiatives

We have launched a number of focused strategic initiatives to drive change across the Group, delivering improved value through top and bottom-line actions. These initiatives will enhance competitiveness, expand our earnings potential and sustainably improve our performance.

Efficiency and simplification

We have launched a Group-wide focus to drive synergies, make us more competitive and simplify the way we operate, enabling us to deliver our priorities as One Rolls-Royce. We are optimising our footprint and leveraging our scale to reduce third party costs; strengthening supply chain management to reduce inventory and working capital; and changing the way we work through a refreshed organisational design to reduce duplication and overheads, creating a more efficient organisation.

Commitment to the energy transition

We are committed to becoming a net zero company by 2050 and we are supporting our customers to do the same. We focus on areas where we have the greatest leverage, improving the efficiency of our products, enabling our customers to operate in the most efficient way and decarbonising our own operations and our supply chain.

Capturing the benefits of becoming digitally enabled

Digital technology will play an increasingly important role throughout our value chain. We already use data from products in service to create value for ourselves and for our customers. Future advances in digital, particularly AI, will further enhance operational performance and reduce costs across our industries and markets.

We focus on four areas: enhancing the customer experience; accelerating product design; improving manufacturing; and empowering our people.

CAPTURING PERFORMANCE IMPROVEMENT OPPORTUNITIES

Group mid-term targets

During our strategic review in 2023, we developed a new set of targets that represent a step change in ambition and performance. They are underpinned by our strategy and demonstrate we are creating a new Company, taking Rolls-Royce significantly beyond any previous financial results.

We will build on our world-class engineering heritage to deliver a world-class investment proposition, significantly expanding our earnings and cash potential.

The high, but achievable, bar that we have set is reflective of our winning mindset:

— we will quadruple operating profit from the 2022 baseline to between £2.5bn-£2.8bn;

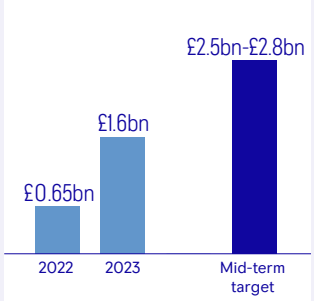
— we will expand operating margins to between 13% and 15% to be at least as competitive as our peers;

— we will grow sustainable cash flows to between £2.8bn and £3.1bn; and

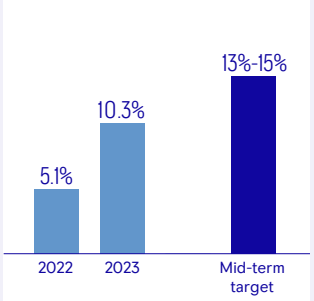
— we are targeting 16% to 18% return on capital, an improvement of more than ten percentage points over our performance in 2022.

We define the mid-term as a 2027 timeframe. Delivering these targets will mean we have created a financially and operationally resilient Group with an expanded earnings potential. They are milestones on our journey, not the destination, and we will continue to grow beyond them into the long term.

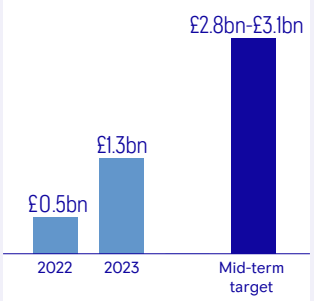
Operating profit



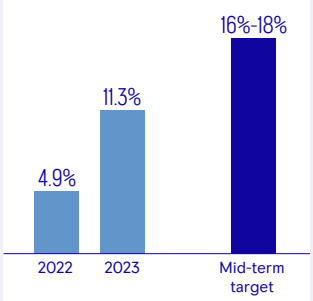
Operating margin



Free cash flow



Return on capital



External environment

Geopolitical tensions

The ongoing Russia-Ukraine conflict and the more recent escalation of violence in the Middle East have destabilised international relations. Policy makers are strengthening their focus on national security in terms of defence, access to energy, critical commodities and key technologies, the latter through re-shoring critical industries and the use of sanctions and subsidies. These policies and actions are disrupting the competitive environment and, together with recent geopolitical risks to international trade, are contributing to price volatility and supply chain issues.

Rolls-Royce response

We see opportunity and risk from the changing security situation. On the opportunity side, we are extending production in our Power Systems division to meet a strong increase in demand from our governmental customers; this will drive longer-term benefits from higher sales of spares and services. We also see increased potential for Rolls-Royce SMR, as customers, particularly in Europe, seek to reduce their dependence on imported oil and gas and Russian nuclear technology. On the risk side, recognising the price and disruption risk in our supply chains, we are taking steps to build resilience, including dual sourcing where appropriate.

Economic slowdown

In 2023, we saw a further slowdown in global activity. The main reasons were the phasing out of post-pandemic effects and high interest rates designed to contain inflationary pressures. The slowdown is expected to continue through 2024 with advanced economies and China being most affected. The US economy, despite proving resilient in 2023, is expected to feel the effects of tighter financial conditions. Europe's growth remains contained by energy uncertainty and slowing external demand. China continues to struggle with its real estate crisis. Business demand is slowing in the manufacturing sector although supply chain problems are easing. A tight labour market may start to open but possibly not for specialised skills. Inflation is expected to normalise above central banks' target of 2% and so forecasters and financial market analysts do not expect interest rates to return to their previous low levels in the short term.

Rolls-Royce response

Across the Group, the diversity in our product portfolio helps to absorb short-term economic impacts and our high level of order backlog acts as a cushion for our business. On the demand side, we have advantaged businesses in markets that are set to grow ahead of GDP. For example, in the widebody market, mid-term growth is forecast to be in the region of 5% to 7% per annum driven by post pandemic recovery and new demand from a growing middle class in countries such as India and China. On the cost side, in addition to the existing inflation-linked pricing clauses in our Civil Aerospace division, we have taken measures to protect margins in our Power Systems division by reacting to price changes in energy, materials and wages. The steps we are taking to strengthen our financial performance will improve the Group's credit rating and contain the impact of high interest rates on our financing costs.

Supply chain uncertainties

As industries recovered from the pandemic, efforts to scale up production exposed underlying supply chain issues which had been exacerbated by cuts in capacity made during the crisis. Skills and experience had been lost and labour availability became a key growth constraint, significantly impacting lead times. With every industry increasing demand at the same time, even relative commodity materials such as steel became difficult and expensive to source. High interest rates also became a drag on recovery by constraining investment in production scale up. The situation is improving but shortages remain for some commodities, parts and components and we expect to experience challenges for at least another 18 to 24 months.

Rolls-Royce response

We are taking steps to improve supply chain efficiency and resilience. We are improving forecasting and planning and collaborating closely with suppliers to drive tighter management of lead times to ensure we have the inventory we need when we need it. Additional supply chain resilience benefits will come from our efforts to reduce cost and enhance commercial discipline. Operationally, we are simplifying product designs to improve sourcing options and we are improving manufacturing processes to reduce scrap and waste. Commercially, we are pushing for stronger contractual protection against inflationary impacts and supplier underperformance.

Long-term issues

Other significant long-term issues for our business include demographic trends, climate change and the intent to move towards a net zero economy.

According to UN data, the expected growth in global population from eight to ten billion people by 2050 will be concentrated in urban areas, driving higher demand for energy and mobility solutions. The development in emerging economies of a stronger middle-class population, especially in India and China, will support growth in commercial aviation. Resource constraints are likely to increase geopolitical risk and Defence budgets will continue to rise in response.

The global effort to decouple economic development from greenhouse gas emissions presents both a challenge and a generational business opportunity.

Rolls-Royce response

Thanks to our strong positions in Civil Aerospace and Power Systems we will benefit directly from the growing demand for global mobility.

Our Defence division will grow within its core transport and combat segments and our unique capabilities will open other opportunities. Rolls-Royce SMR is seeking to enhance the economics of modular nuclear power generation to deliver a scalable, cost-effective source of low-carbon electricity, helping societies meet their development and sustainability goals.

Across the Group we are working to ensure that all our products, in the air, at sea, and on land, can be used sustainably through ensuring compatibility with sustainable fuels and by developing technologies to enable the next generation of high efficiency solutions.

Business model

OUR COMMON DRIVERS FOR SUCCESS

Advantaged businesses with strong positions in attractive and growing markets

OUR CORE DIVISIONS

CIVIL AEROSPACE

OUR ROLE IN SOCIETY

Link to risk
1 3 6 9 11

Connect

We make it possible for people to move safely, efficiently and affordably across the globe.

We provide social and economic value through enabling unique experiences and in-person relationships; connecting people and cultures, businesses and families.

PASSENGERS WHO FLEW ON A ROLLS-ROYCE POWERED AIRCRAFT IN 2023

>250m

OUR BUSINESS MODEL DRIVERS

Link to risk
1 2 3 4 5 6
7 8 9 10 11

Differentiated services

We design, develop, manufacture and support high performance gas turbines for commercial aviation.

We pioneered the industry's adoption of long-term service agreements, a model that aligns our interests with those of our customers and rewards us for improving reliability, availability and reducing costs.

We provide value to airlines through data driven insights and we set the standard for customer service in business aviation.

CUSTOMERS ON LONG-TERM SERVICE AGREEMENTS

2/3

OUR UNIQUENESS

Link to risk
1 3 6 7 10 11

Trusted partner

We partner with customers to develop a close understanding of their needs, co-creating solutions and capabilities. We have partnered for decades with aircraft manufacturers and airlines, including joint MRO facilities.

We partner with our supply chain to access capability and capacity, to maximise market cover, minimise collective investment and share risk and reward.

NEW GENERATION WIDEBODY AIRCRAFT POWERED BY ROLLS-ROYCE

4 out of 5

WHAT WE WILL ACHIEVE

A HIGH-PERFORMING, COMPETITIVE, RESILIENT AND GROWING BUSINESS

Link to risk

1 Safety
2 Compliance
3 Strategy
4 Execution
5 Business interruption
6 Climate change
7 Information & data
8 Market & financial shock
9 Political
10 Talent & capability
11 Technology

ONE ROLLS-ROYCE

Differentiated by deep customer relationships; market leading products and technology; engineering and commercial excellence

DEFENCE

Protect

We provide mission critical power and propulsion in the air, at sea and on land.

We enable operational independence and strategic and tactical advantage; helping nation states keep their citizens safe at home and protect their interests overseas.

YEARS OF PROVIDING GAS TURBINE POWER FOR DEFENCE CUSTOMERS

80

Customer-funded growth

We design, develop, manufacture and support high performance aero and naval gas turbines and nuclear power and propulsion systems.

We turn technology into differentiated products that provide customers with unique capabilities and stay in-service for decades.

We create broader economic value for the Group by balancing the volatility seen in commercial markets and by enabling synergies across technology, infrastructure, supply chain and product families.

DIFFERENT APPLICATIONS OF THE AE ENGINE FAMILY ACROSS DEFENCE AND CIVIL MARKETS

16

Global access, local presence

We support over 160 armed forces in over 100 countries.

We provide whole engine design, development and manufacturing capability and operational independence in the US, UK and Germany and we work closely with partners in Japan, Italy, Spain, France and Australia.

HOME NATIONS WITH WHOLE ENGINE CAPABILITY

3

POWER SYSTEMS

Power

We provide answers to the challenges posed by the rapidly growing societal demands for energy and mobility.

We deliver high performance, dependable and sustainable power, enabling economic growth and development.

EXPECTED ANNUAL GROWTH RATE ACROSS OUR POWER GENERATION MARKETS

5%-7%

One core solution addressing multiple markets

We design develop, manufacture and support high-performance reciprocating engines and broader system solutions for use at sea and on land.

We invent once and use many times, developing products and product families that can be used in different applications across multiple markets, delivering proven solutions for our customers and maximising the returns on investment to us.

NUMBER OF S4000 ENGINES SOLD ACROSS DIVERSE MARKETS

50k

Structural advantage

We deliver unmatched power, reliability and efficiency in return for premium value.

We are recognised as the engine provider of choice where the mission matters: high integrity back-up power for critical infrastructure such as hospitals, airports and data centres; and high performance propulsion for yachts, military vehicles and naval vessels.

MARKET SHARE IN GOVERNMENTAL BUSINESS

>30%

DRIVEN BY COMMITTED EMPOWERED PEOPLE OPERATING IN A PERFORMANCE CULTURE

WITH TRUST, INTEGRITY AND SAFETY AS OUR CORE VALUES

Read more about our strategy on pages 10 to 12

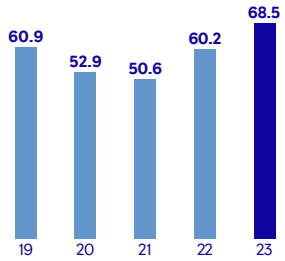
Read more about our KPIs on pages 16 to 18

Read more about our principal risks on pages 50 to 57

Key performance indicators

Financial performance indicators [1,2]

Order backlog (£bn)



HOW WE DEFINE IT

Total value of firm orders placed by customers for delivery of products and services where there is no right to cancel. This KPI is the same as the statutory measure for order backlog. See note 2 on page 141 for more information.

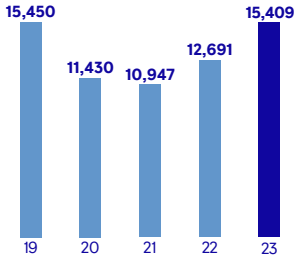
WHY IT IS IMPORTANT

Order backlog provides visibility of future business activity.

LINK TO REMUNERATION

Customer orders drive future revenue growth which, in turn, enables profit and cash flow growth. Profit and free cash flow performance are key financial metrics in the Incentive Plan.

Underlying revenue (£m)



HOW WE DEFINE IT

Revenue generated from operations at the average exchange rate achieved on effective settled derivative contracts in the period that the cash flow occurs. See note 2 on page 138 for more information.

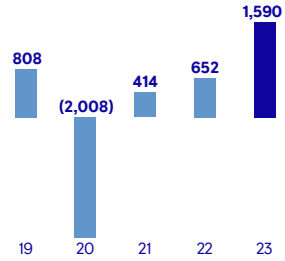
WHY IT IS IMPORTANT

Underlying revenue provides a measure of business growth and activity.

LINK TO REMUNERATION

Underlying revenue growth enables profit and cash flow growth, both of which are key financial metrics in the Incentive Plan.

Underlying operating profit/(loss) (£m)



HOW WE DEFINE IT

Operating profit generated from operations at the average exchange rate achieved on effective settled derivative contracts in the period that the cash flow occurs. It excludes M&A, exceptional items and certain other items outside of normal operating activities. See note 2 on page 138 for more information.

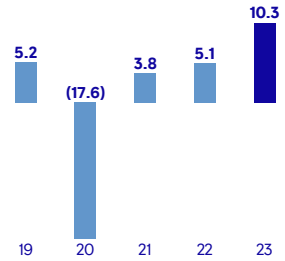
WHY IT IS IMPORTANT

Underlying operating profit indicates how the effect of growing revenue and control of our costs delivers value for our shareholders.

LINK TO REMUNERATION

Profit is a key financial performance measure for our Incentive Plan.

Underlying operating margin (%)



HOW WE DEFINE IT

Underlying operating profit (as defined above) as a percentage of underlying revenue (as defined above). It indicates how much profit the business makes for every one pound sterling of revenue generated.

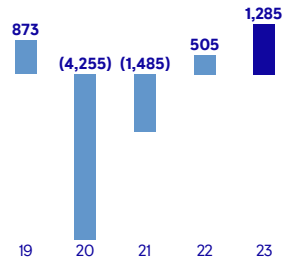
WHY IT IS IMPORTANT

Underlying operating margin indicates how effective the business is at converting revenue to profit. A higher margin is an indicator of increased value for our shareholders, as it demonstrates a higher conversion of revenue to profit.

LINK TO REMUNERATION

Profit is a key financial performance measure for our Incentive Plan.

Free cash flow from continuing operations (£m)



HOW WE DEFINE IT

Free cash flow is cash flows from operating activities, adjusted to include capital expenditure and movements in investments, capital elements of lease payments, interest paid and to exclude amounts spent or received on business acquisitions or disposals, financial penalties paid and exceptional restructuring payments. Cash flow from operating activities is our statutory equivalent. See note 28 on page 184.

WHY IT IS IMPORTANT

Free cash flow is a key metric used to measure the performance of our business and how effectively we are creating value for our shareholders. It enables the business to fund growth, reduce debt and make shareholder payments.

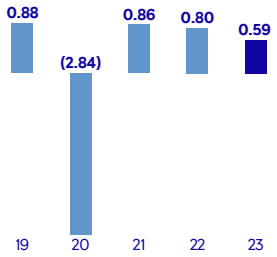
LINK TO REMUNERATION

Free cash flow is a key financial metric in the Incentive Plan.

1 The adoption of IFRS 16 Leases in 2019 had no material impact on our financial KPIs
2 2023, 2022 and 2021 figures represent the results of continuing operations. 2020 figures have been restated, where relevant, to show ITP Aero as a discontinued operation in line with 2021 reporting. 2019 figures have not been restated

A reconciliation from the alternative performance measure to its statutory equivalent can be found on pages 213 to 217

TCC/GM (ratio)



HOW WE DEFINE IT

TCC is defined as total underlying cash costs during the period (represented by underlying R&D and underlying C&A) as a proportion of underlying gross profit.

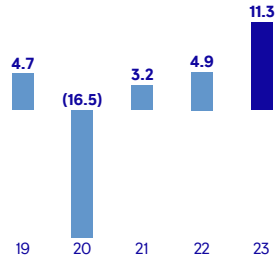
WHY IT IS IMPORTANT

This measure provides an indicator of total cash costs relative to gross profit (the percentage of the Group's overheads that are covered by gross profit). A reduction in total cash costs relative to gross profit indicates how effective the business is at managing and/or reducing its costs.

LINK TO REMUNERATION

Profit is a key financial performance measure for our Incentive Plan.

Return on capital (%)



HOW WE DEFINE IT

Return on capital is defined as net operating profit after tax (NOPAT) as a percentage of average invested capital.

NOPAT is defined as underlying net profit excluding net finance costs and the tax shield on net finance costs. Invested capital is defined as current and non-current assets less current liabilities. It excludes pension assets, cash and cash equivalents and debt. See page 217 for more detail on how we calculate return on capital.

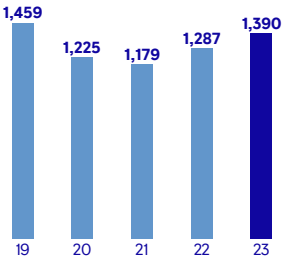
WHY IT IS IMPORTANT

Return on capital assesses our efficiency in allocating capital to profitable investments. The more efficient we are as a business in allocating capital to profitable investments, the more profitable we will be.

LINK TO REMUNERATION

Profit is a key financial performance measure for our Incentive Plan.

Gross R&D expenditure [3] (£m)



HOW WE DEFINE IT

In-year gross cash expenditure on R&D excluding the impact of contributions and fees, amortisation and impairment of capitalised costs and amounts capitalised during the year.

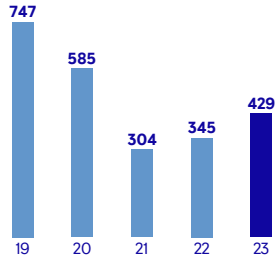
WHY IT IS IMPORTANT

This measure demonstrates the balance between long-term strategic investments and delivering short-term shareholder returns.

LINK TO REMUNERATION

Disciplined control and allocation of R&D expenditure optimises in-year profit and cash flow performance without compromising long-term growth through innovation. There is a balance of long-term metrics which reward strong financial performance and also relative returns to our shareholders through total shareholder return (TSR) in the Incentive Plan.

Gross capital expenditure [4] (£m)



HOW WE DEFINE IT

In-year gross cash expenditure on capital excluding capital expenditure from discontinued operations.

WHY IT IS IMPORTANT

This measure demonstrates the balance between long-term strategic investments and delivering short-term shareholder returns.

LINK TO REMUNERATION

Disciplined control and allocation of capital expenditure optimises in-year profit and cash flow performance without compromising long-term capital requirements. There is a balance of long-term metrics which reward strong financial performance and also relative returns to our shareholders through total shareholder return (TSR) in the Incentive Plan.

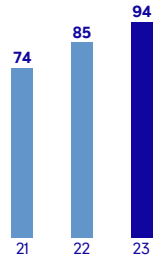
3 This is a new KPI added in 2023 to provide information on gross R&D expenditure as this provides a more meaningful view of total R&D. The previous KPI presented was self-funded R&D as a proportion of underlying revenue

4 This is a new KPI added in 2023 to provide information on gross capital expenditure as this provides a more meaningful view of total capital expenditure. The previous KPI presented was capital expenditure as a proportion of underlying revenue

A reconciliation from the alternative performance measure to its statutory equivalent can be found on pages 213 to 217

Non-financial performance indicators

Safety index (%)



HOW WE DEFINE IT

In 2023, we changed our people metric to incorporate a 50% weighting to an internal safety index. The safety index is the leading measure of our safety culture, which was introduced across the Group in 2021. The index consists of a composite score of five leading indicators, with each indicator measuring a key element of our safety culture. See page 44 for more information.

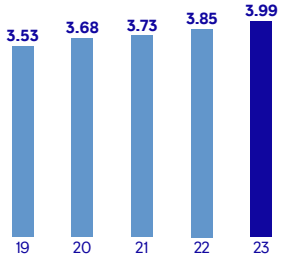
WHY IT IS IMPORTANT

The measure is strongly aligned to our strategy of safety being the number one priority, with an emphasis on proactive measures.

LINK TO REMUNERATION

This metric accounts for 5% of the Incentive Plan.

Employee engagement (scored 1 to 5) [5]



HOW WE DEFINE IT

Since 2019, we have been on a journey targeting upper quartile status versus Gallup's manufacturing organisations peer group. Responses to the engagement survey are scored on a scale of one to five. The employee engagement score averages the responses to all 12 questions in the survey. Our target for 2023 was to score a grand mean of 3.97. See page 46 for more information.

WHY IT IS IMPORTANT

Our people are crucial to delivering future business success. This is an objective way to assess how engaged our employees are with the business and its leaders.

LINK TO REMUNERATION

Employee engagement performance against our target accounts for up to 5% of the Incentive Plan.

Sustainability

The metrics for the Incentive Plan combine short-term measures which focus on in-year performance with longer-term strategic measures. The metric for sustainability is a longer-term measure with targets set at the start of 2021.

HOW WE DEFINE IT

At the start of 2021, each division was set sustainability targets for the three-year performance period ended 31 December 2023. See pages 41 and 42.

WHY IT IS IMPORTANT

We are committed to becoming a net zero company by 2050 and we support our customers to do the same. New fuels will be crucial to achieving net zero in the medium term across many of our markets.

LINK TO REMUNERATION

This metric accounts for up to 5% of the Incentive Plan for 2023.

5 External assurance over the employee engagement score is provided by Bureau Veritas. See page 209 for their assurance statement

Financial review

We have ambitious, bold and achievable plans. We are driving sustainable and higher quality growth in earnings and cash flows and improved return on capital. We have a clear capital framework and detailed plans to deliver our financial targets.

Helen McCabe
Chief Financial Officer

I joined Rolls-Royce in August 2023, excited by the opportunity to help shape the future of this iconic company. We have advantaged positions in attractive and growing end markets with world-leading capabilities and committed and motivated people. We have so much to be proud of and so much potential. I am delighted to be part of the Rolls-Royce team.

We are transforming Rolls-Royce into a high-performing, competitive, resilient and growing business. We have started on a journey that will take the Group to a place where we have the financial strength to invest in projects that will enable us to win, where we have strengthened our balance sheet to withstand external shocks and to enable us to reward our shareholders. We have made good progress in 2023 but there is still more work to do.

I have identified four key priorities which I will be focusing on.

1. Integrated performance management

Our strategic review highlighted the need for improved processes and a stronger culture of integrated performance management. We have already started to improve this and will strengthen it further. Strategic plans will be linked to annual budgets which in turn will be linked to in-year performance management. We will rigorously track performance and make interventions proactively. Targets will be underpinned and owned across the whole organisation.

2. Commercial and cost optimisation

We are developing sharper commercial acumen and a more cost-conscious culture across the organisation. This is underpinned by the philosophy that everyone must act like an owner, treating every pound spent as their own to deliver the most value for all our stakeholders. We are already transforming the way we work with new frameworks and higher quality training in place to build skills and capabilities.

3. Working capital optimisation

Working capital is a key focus as we look to strengthen our balance sheet and improve our return on capital. Our initiatives underpin a sustainable release of working capital benefit across the mid-term, which we define as a 2027 timeframe. The largest opportunity relates to inventory, where we are targeting a meaningful reduction in inventory days. Actions we will take include improving our demand planning and supply chain management. We also see an opportunity to improve receivables, with teams in place to drive down unbilled debt and review customer payment terms, as well as improving our payables performance. We have granular plans to underpin our targets. There are a number of working capital headwinds over the mid-term but the result of our actions offset these headwinds which result in a net working capital release.

4. Capital framework

Our capital framework is focused on three clear priorities.

- First, to obtain a strong balance sheet with an investment grade profile. A strong balance sheet will position us well to withstand volatility and external shocks and will allow us the financial flexibility for further investment for growth.
- Second, once the strength of our balance sheet is assured we are committed to reinstating and growing shareholder distributions. For further details see page 5.

— Third, a disciplined approach to investments. All investments must be aligned to the Group's strategy. Investments are prioritised on a Group-wide basis, focusing on those that drive the greatest shareholder value. We have strict financial and sustainability criteria and hurdle rates in place.

2023 financial performance

In 2023, we have made good progress against our strategic priorities and delivered a step change in financial performance which included some early benefits from our transformation efforts.

— **Driving growth in attractive markets:** Large engine flying hours (EFH) in Civil Aerospace recovered to 88% of 2019 levels, up from 65% in 2022. Large engine orders were the highest in more than 15 years, with major orders from Air India and Turkish Airlines. In Defence, the AUKUS submarine agreement was announced, which will be supported by the expansion of our submarines site in Raynesway, and work on our future programmes in the UK and US progressed well. In Power Systems, we are capturing strong demand for power generation solutions and services in the rapidly expanding data centre market.

— **Significantly improved profit and margins:** Underlying operating profit rose by £0.9bn to £1.6bn supported by our transformation programme and strategic initiatives, with commercial optimisation and cost efficiency benefits across the Group. Underlying operating margin more than doubled to 10.3%. Civil Aerospace, Defence and Power Systems all delivered materially higher margins compared to last year. The largest improvement was in Civil Aerospace, which delivered an operating margin of 11.6% compared to 2.5% in the previous year. This was driven by increased aftermarket profit, in both the large engines and business aviation segments, reflecting commercial optimisation and cost efficiencies, as well as volume growth. Defence delivered an improved operating margin of 13.8% (2022: 11.8%), which primarily reflected improved pricing and cost efficiencies. In Power Systems, which reported an operating margin of 10.4% (2022: 8.4%), pricing and cost efficiency actions in the first half of the year resulted in a significantly improved operating profit and margin in the second half and in the full year.

— **Record cash generation:** Free cash flow from continuing operations grew by approximately 150% to £1.3bn, principally due to higher operating profit. Civil net LTSA creditor growth net of risk and revenue sharing agreements (RRSAs) was £1.1bn (2022: £0.8bn). Continued LTSA balance growth reflects higher EFHs and the benefit of commercial optimisation, with LTSA invoiced flying hour receipts of £4.6bn (2022: £3.6bn). Our focus on working capital resulted in a release in the second half despite ongoing supply chain challenges. For the full year there was a net working capital outflow of £0.4bn (2022: £0.5bn). Inventory and debtor days both improved year on year building further confidence in the actions we are taking to improve the quality of cash delivery.

— **Building financial resilience:** Total underlying cash costs as a proportion of underlying gross margin (TCC/GM) ratio improved to 0.59x in 2023 from 0.80x in 2022. Net debt improved to £2.0bn (2022: £3.3bn). We have £4.1bn of drawn debt, of which £0.5bn matures in 2024, £0.8bn in 2025 and £2.8bn in 2026-2028, and £1.7bn of lease liabilities. We have £3.7bn in cash and cash equivalents and £3.5bn undrawn facilities, totalling £7.2bn of liquidity, and expect to repay the 2024 and 2025 bonds from cash. We cancelled a £1.0bn undrawn UK Export Finance (UKEF) backed facility in the year, and a £1.0bn undrawn bank loan facility reflecting our higher cash balance and more resilient financial position.

2024 outlook

As we continue to deliver our strategy, we expect further improvements towards all our mid-term targets. This is despite the impact of continued supply chain challenges, which we expect to persist for 18 to 24 months, geopolitical uncertainty and inflationary pressures. Our forecast for 2024 underlying operating profit is £1.7bn-£2.0bn and free cash flow between £1.7bn-£1.9bn.

Mid-term outlook: growing profit and competitive margins

Our underlying operating profit and margins in 2023 represent a step change in financial performance, but there is still more to deliver. As detailed at our CMD, our key mid-term targets included operating profit of £2.5bn-£2.8bn with an operating margin between 13%-15%. This is a quadrupling of operating profit from the 2022 baseline, making margins equal to or better than our peers on a competitive basis. These targets are underpinned by the rigour of our extensive benchmarking, the findings of our strategic review and by our commercial optimisation, efficiency and simplification actions across the Group.

In Civil Aerospace, we expect the most material improvement in margins from 2.5% in 2022 to 15%-17% by the mid-term. We are driving higher widebody profit using the six levers of improvement: extending time-on-wing, lowering shop visit costs, reducing product costs, keeping engines earning for longer, implementing a new value-driven pricing strategy and driving rigour on contractual terms and conditions. We are also driving profitable improvement through our aftermarket business, time and material, OE and spare engines. In the business aviation market, we will increase profitability and market share due to the success of the Pearl engine family.

In Defence, we are targeting a 14%-16% operating margin by the mid-term. Our strategic focus is on growing our transport, combat and submarines activities. Operating profit growth and margin improvements will be driven by growth from volume and mix as we move from legacy programmes to new funded programmes and from prioritising investment as we focus our spend and benefit from an increase in customer funded programmes. Margins will also benefit from our efforts on commercial optimisation, including value-driven pricing, and from efficiency and simplification.

In Power Systems, where we are targeting a 12%-14% margin by the mid-term, profit growth will be delivered by strategic initiatives focused on power generation, governmental and marine end markets. In power generation, we are optimising our cost structure and focusing on key accounts to drive margin growth. We are also expanding our microgrid solutions and extending our service offering in battery energy storage systems which will become a profitable business in the short term. In governmental, we are capturing near-term growth with scope expansion and focused investment and in marine we are developing alternative fuel solutions to strengthen our synthetic-fuel-ready portfolio.

Mid-term outlook: sustainable and growing free cash flow

We expect mid-term free cash flow of £2.8bn-£3.1bn; an improvement of £2.3bn-£2.6bn compared to 2022. This free cash flow growth will primarily be driven by operating profit growth of between £1.8bn-£2.1bn as we ensure that all divisions are delivering to their full potential.

In addition to our expectation of higher operating profit, our mid-term free cash flow targets also reflect continued net growth in the Civil Aerospace long term service agreement (LTSA) balance of between £0.8bn-£1.2bn per annum. This is driven by: our young and growing widebody fleet, business aviation growth, benefits from currency as we consume our legacy hedges and the impact of strategic initiatives such as time-on-wing. Our cash flow target also reflects our more disciplined investment approach targeted at strategic growth and working capital improvements.

As we pay down debt, our financing costs will reduce and the cash costs of closing out our over-hedged position, which has been a drag in recent years, will abate. Offsetting these cash flow benefits will be increased tax cash payments which will naturally increase as our profit grows.

Mid-term outlook: efficiency and simplification and total cash cost to gross margin ratio

Across all parts of the Group we are focused on efficiency and simplification. We are targeting to improve our TCC/GM ratio, approximately halving it by the mid-term, taking it to a market leading level (see page 8).

We are leveraging the power of One Rolls-Royce to simplify our organisation and drive efficiencies that will enable us to be more competitive and simplify the way we operate. We are right-sizing the organisation and ensuring it is structured to support strategy implementation, including plans to reduce 2,000 to 2,500 roles across the Group by the end of 2025. We expect severance costs to be between £200m-£250m, which will be taken as an exceptional charge. The reduction in roles will create an annualised sustainable benefit of around £200m once completed. This benefit is part of a collection of initiatives which, across the Group, will deliver a sustainable annualised saving of £400m-£500m. We plan to deliver around £1bn of gross third party cost savings over the mid-term which will help offset the impact of inflationary and product cost increases. We are also more tightly aligning R&D spend to strategy. Finally, we have set a 10%-15% reduction in spend in targeted areas through zero-based budgeting.

Mid-term outlook: return on capital

By the mid-term we are targeting a 16%-18% return on capital. We view return on capital as an important metric for the Group, as it measures both our profitability and capital efficiency.

Helen McCabe
Chief Financial Officer

Statutory and underlying Group financial performance from continuing operations

	2023					2022
£ million	Statutory	Impact of hedge book [1]	Impact of acquisition accounting	Impact of other non-underlying items	Underlying	Underlying
Revenue	16,486	(1,077)	–	–	15,409	12,691
Gross profit	3,620	(461)	46	26	3,231	2,477
Operating profit	1,944	(475)	50	71	1,590	652
Gain arising on disposal of businesses	1	–	–	(1)	–	–
Profit before financing and taxation	1,945	(475)	50	70	1,590	652
Net financing income/(costs)	482	(915)	–	105	(328)	(446)
Profit before taxation	2,427	(1,390)	50	175	1,262	206
Taxation [2]	(23)	285	(12)	(370)	(120)	(48)
Profit for the year from continuing operations	2,404	(1,105)	38	(195)	1,142	158
Basic earnings per share (pence)	28.85				13.75	1.95

1 Reflecting the impact of measuring revenue and costs at the average exchange rate during the year and the valuation of assets and liabilities using the year end exchange rate rather than the rate achieved on settled foreign exchange contracts in the year or the rate expected to be achieved by the use of the hedge book
2 Taxation includes the recognition of a deferred tax asset on UK tax losses of £328m in other non-underlying items

Revenue: Underlying revenue of £15.4bn was up 21%, with double-digit growth in all three core divisions and particularly strong growth in Civil Aerospace. Statutory revenue of £16.5bn was 22% higher compared with 2022. The difference between statutory and underlying revenue is driven by statutory revenue being measured at average prevailing exchange rates (2023: GBP:USD 1.24; 2022: GBP:USD 1.24) and underlying revenue being measured at the hedge book achieved rate during the year (2023 GBP:USD 1.50; 2022: 1.50).

Operating profit: Underlying operating profit of £1,590m (10.3% margin) versus £652m (5.1% margin) in the prior year. This was due primarily to strong aftermarket growth in Civil Aerospace and commercial optimisation and cost efficiencies across the Group. The largest year on year improvement in margin was in Civil Aerospace, but Defence and Power Systems margins also rose materially. Statutory operating profit was £1,944m, higher than the £1,590m underlying operating profit largely due to the £475m negative impact from currency hedges in the underlying results. Net charges of £71m were excluded from the underlying results as these related to non-underlying items comprising net transformation and restructuring charges of £102m; partly offset by net impairment reversals of £8m, the write back of exceptional Trent 1000 programme charges of £21m; and a £2m pension past service credit.

Profit before taxation: Underlying profit before taxation of £1,262m included £(328)m net financing costs comprising £164m interest receivable, £(275)m interest payable and £(217)m of other financing charges and costs of undrawn facilities. Statutory profit before tax of £2,427m included £515m net fair value gains on derivative contracts, £(205)m net interest payable and net foreign exchange gains of £394m.

Taxation: Underlying tax charge of £(120)m (2022: £(48)m) reflects a tax charge on profits of £(198)m net of a tax credit arising on the recognition of a £78m deferred tax asset on previously unrecognised UK tax losses. The 2022 underlying tax charge relates to tax on overseas profits of £(175)m net of a tax credit on the increase in certain UK deferred tax assets of £127m. The statutory tax charge of £(23)m is lower than the underlying charge due to an additional £328m recognition of a deferred tax asset on UK tax losses. This is partially offset by a net tax charge of £(231)m on non-underlying items.

Free cash flow

£ million	2023 Cash flow	Impact of hedge book	Impact of acquisition accounting	Impact of other non-underlying items	Funds flow	2022 Funds flow
Operating profit	1,944	(475)	50	71	1,590	652
Operating profit from discontinued operations	–	–	–	–	–	86
Depreciation, amortisation and impairment	1,019	–	(50)	9	978	953
Movement in provisions	(325)	46	–	21	(258)	(23)
Movement in Civil LTSA balance	1,708	(377)	–	–	1,331	792
Movement in prepayments to RRSAs for LTSA parts	(315)	63	–	–	(252)	(8)
Settlement of excess derivatives [1]	(389)	–	–	–	(389)	(326)
Interest received	159	–	–	–	159	36
Other operating cash flows [2]	(63)	(8)	–	3	(68)	5
Operating cash flow before working capital and income tax	3,738	(751)	–	104	3,091	2,167
Working capital (excluding Civil LTSA balance and prepayment to RRSAs) [3]	(236)	(123)	–	(37)	(396)	(524)
Cash flows on other financial assets and liabilities held for operating purposes	(845)	853	–	–	8	77
Income tax	(172)	–	–	–	(172)	(174)
Cash from operating activities	2,485	(21)	–	67	2,531	1,546
Capital element of lease payments	(291)	21	–	–	(270)	(198)
Capital expenditure	(699)	–	–	4	(695)	(504)
Investment	69	–	–	–	69	28
Interest paid	(333)	–	–	–	(333)	(352)
Other	54	–	–	(71)	(17)	(29)
Free cash flow	1,285	–	–	–	1,285	491
– of which is continuing operations	1,285				1,285	505

1 The funds flow to 31 December 2022 has been represented to disclose cash flows on settlement of excess derivative contracts as cash flows from operating activities. As a result, operating cash flows before working capital and income tax during the year to 31 December 2022 have reduced by £(326)m to £2,167m. Cash flows on settlement of excess derivative contracts were previously shown after cash from operating activities in arriving at free cash flow. There is no impact to free cash flow
2 Other operating cash flows includes profit/(loss) on disposal, share of results and dividends received from joint ventures and associates, flows relating to our defined benefit post-retirement schemes, and share based payments
3 Working capital includes inventory, trade and other receivables and payables, and contract assets and liabilities (excluding Civil LTSA balances and prepayment to RRSAs). Working capital was previously defined as inventory, trade and other receivables and payables, and contract assets and liabilities, excluding Civil LTSA

Free cash flow in the year was £1.3bn, an improvement of £0.8bn compared with the prior year driven by:

Operating cash flow before working capital and income tax of £3.1bn, £0.9bn higher than the prior year. The improvement at the Group level was principally due to our actions on commercial optimisation and cost discipline. The movement in Civil LTSA balance was £1,331m (2022: £792m) driven by higher EFH receipts. RRSA prepayments were £252m (2022: £8m). The movement in provisions of £(258)m largely related to utilisation of the Trent 1000 provision, contract loss provisions and the settlement of a legal claim. The settlement of excess derivative contracts of £(389)m was in line with expectations, with a further cash outflow of £146m expected to be incurred in 2024, £148m in 2025 and £27m in 2026. Interest received was £159m, up from £36m in 2022 due to higher cash balances and higher interest rates in the year.

Working capital £(396)m, compared to £(524)m in the prior year. Inventory increased by £(0.2)bn in the year primarily driven by Civil Aerospace as a result of continued supply chain disruption. There was a net £(0.2)bn outflow from receivables, payables and contract liabilities reflecting the net of volume growth in receivables and an increase in advance payments from customers.

Income tax of £(172)m, net cash tax payments in 2023 were marginally lower than the prior year of £(174)m, mainly due to the receipt of refunds in respect of prior periods in the US and timing of payments in Germany.

The capital element of lease payments was £(270)m, £(72)m higher than the prior year as a result of timing of lease payments.

Capital expenditure of £(695)m, mainly £(429)m property, plant and equipment additions and £(284)m intangibles additions. The combined additions were higher than last year as a result of investment in site improvements across the Group.

Interest paid of £(333)m, including lease interest payments, has reduced by £19m as a result of the settlement of the UKEF £2bn loan facility in September 2022 slightly offset by higher interest on gross overdrafts.

Balance sheet

£ million	2023	2022	Change
Intangible assets	**4,009**	4,098	(89)
Property, plant and equipment	**3,728**	3,936	(208)
Right of use assets	**905**	1,061	(156)
Joint ventures and associates	**479**	422	57
Civil LTSA [1]	**(9,080)**	(7,372)	(1,708)
RRSA prepayments for LTSA parts [1]	**1,320**	1,005	315
Working capital [1]	**(1,386)**	(2,017)	631
Provisions	**(2,029)**	(2,333)	304
Net debt [2]	**(1,952)**	(3,251)	1,299
Net financial assets and liabilities [2]	**(2,060)**	(3,649)	1,589
Net post-retirement scheme deficits	**(253)**	(420)	167
Taxation	**2,605**	2,468	137
Held for sale [3]	**54**	–	54
Other net assets and liabilities	**31**	36	(5)
Net liabilities	**(3,629)**	(6,016)	2,387
Other items			
US$ hedge book (US$bn)	**15**	19	

1 The total of these lines represents inventory, trade receivables and payables, contract assets and liabilities and other assets and liabilities in the statutory balance sheet
2 Net debt includes £23m (2022: £86m) of the fair value of derivatives included in fair value hedges and the element of fair value relating to exchange differences on the underlying principal of derivatives in cash flow hedges
3 Held for sale assets relate to the sale of the off-highway engines business in the lower power range based in Power Systems

Key drivers of balance sheet movements were:

Civil LTSA: The £(1.7)bn movement in the net liability balance was mainly driven by an increase in invoiced LTSA receipts exceeding revenue recognised in the year, this is especially prevalent on new contracts where shop visits are not immediately scheduled.

RRSA prepayments for LTSA parts: The £0.3bn increase corresponds to the increase seen in the civil LTSA balance above. RRSA prepayments typically move in line with the civil LTSA as the RRSA prepayment represents amounts that we have paid to Risk and Revenue Share Partners for the parts that they will ultimately provide in support of our contracts.

Working capital: The £(1.4)bn net working capital position decreased by £0.6bn compared to the prior year. The movement comprised £0.1bn increase in inventory, mainly in Civil Aerospace due to supply chain disruption, £0.9bn increase in receivables due to higher trading volumes and prepayments from customers, £0.5bn reduction in payables due to changes in operational volumes and timing of supplier payments, partly offset by an increase in contract liabilities of £(0.9)bn driven by advanced payments received across the divisions.

Provisions: The £0.3bn net reduction was primarily driven by the settlement of a legal claim, utilisation of the Trent 1000 provision, and a net £0.1bn reduction in contract loss provisions due to provision utilisation, renegotiations and extensions of some major contracts resulting in improved margins, partly offset by increased cost estimates from supply chain issues.

Net debt: Decreased from £(3.3)bn to £(2.0)bn driven by free cash inflow of £1.3bn. Our liquidity position is strong with £7.2bn of liquidity including cash and cash equivalents of £3.7bn and undrawn facilities of £3.5bn. Two undrawn facilities, totalling £2.0bn, were cancelled in 2023 reflecting our higher cash balance and more resilient financial position. Net debt included £(1.7)bn of lease liabilities (2022: £(1.8)bn).

Net financial assets and liabilities: A £1.6bn reduction in the net financial liabilities driven by contracts maturing in the year and a change in fair value of derivative contracts largely due to the impact of the movement in GBP:USD exchange rates.

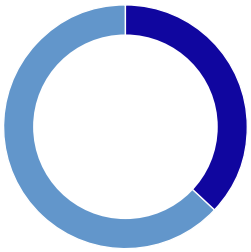
Taxation: The net tax asset has increased by £137m. This includes an overall increase in the deferred tax asset of £267m, due to increases in the deferred tax asset recognised on UK tax losses of £422m and other deferred tax assets of £101m, partly offset by a reduction of £256m on the deferred tax on foreign exchange derivative contracts. Other tax balance movements include increases in the deferred tax liability of £44m and net current tax liabilities of £86m.

Our divisions

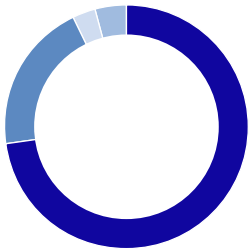
CIVIL AEROSPACE

Civil Aerospace is a major manufacturer of aero engines for the large commercial aircraft, regional jets and business aviation markets. The business uses its engineering expertise, in-depth knowledge and capabilities to provide through-life service solutions for its customers.

Underlying revenue mix



Underlying revenue mix by sector



UNDERLYING REVENUE	UNDERLYING OPERATING PROFIT	UNDERLYING OPERATING MARGIN	ORDER BACKLOG
£7,348m	£850m	11.6%	£55.2bn
2022: £5,686m	2022: £143m	2022: 2.5%	2022: £47.7bn

Market overview

Our Civil Aerospace division comprises four categories: large engines, business aviation, regional and V2500.

Our large installed product base of more than 4,860 engines powers 4 out of 5 of the new generation widebody aircraft. We have a 33% market share of the large engines in service globally and 41% of the engines on order. Large engine deliveries increased in 2023 to 262 (2022: 190) as we grow our market share.

We have a high-quality order book with 1,632 large engines (2022: 1,282). We have seen substantial new orders in 2023, including orders with Air India, Turkish Airlines, Emirates, EVA Air and in early 2024, Delta Airlines. 2023 was our best year for large engine orders since 2007. We are also seeing growth in the new Airbus A350 freighter market where there is clear demand for our products and services. During 2023, we took new orders of 678 large engines (2022: 150). Of the 262 large engine deliveries in 2023, 53 were spare engines (2022: 44). Spare engines are important to our customers as they support fleet health and aircraft availability.

In 2023, business aviation engine deliveries increased to 196 (2022: 165). There are currently over 6,500 in-service Rolls-Royce business aviation engines across our Tay, BR710 and AE 3007 platforms which provide power to a range of aircraft, including Gulfstream and Bombardier aircraft. There are over 1,200 BR725 and Pearl 15 engines in service which power the Gulfstream 650/G650ER and Bombardier 5500/6500. The Pearl 700, which is going through in-flight testing and already has a strong order book, will power the Gulfstream G700/G800. The Pearl 10X, which is in development and has had a positive reaction from the market, will power the Dassault Falcon 10X. This will be the first time a Rolls-Royce engine powers a Dassault aircraft. Within the market, we have won the last three major campaigns, with the Pearl engine firmly established as the engine of choice.

The civil aerospace market further recovered from the effects of the pandemic in 2023. Large engine flying hours were 88% of 2019 levels (2022: 65%). The easing of global pandemic management measures, specifically in China, paired with fleet expansion are the main contributors to engine flying hour improvement. Industry forecasts predict a return to 2019 large engine flying levels in 2024 and we expect this to grow to 120%-130% by 2027. Business aviation engine flying hours continue to be above 2019 levels, as they were in 2022, having recovered more quickly from post-pandemic measures.

Total shop visits in 2023 were 1,227 (2022: 1,044) carried out to maintain and repair the engines in our fleet. Of these, 368 were large engine major shop visits (2022: 248). The increase was driven by higher utilisation levels and growth in the fleet.

Supply chain pressures remain a hurdle across the industry. We are proactively managing the risks, including consolidating spend with our high performing supplier group for cost, quality and reliability, improving our sourcing, renegotiating contracts and supporting our most important suppliers. We expect supply chain challenges to persist for the next 18 to 24 months. We are not experiencing any ongoing impact from the two supplier fires which we reported in our 2022 Annual Report.

Financial performance

Underlying revenue of £7.3bn increased 29% year on year, driven by higher shop visits and OE engine deliveries and commercial optimisation. Underlying OE revenues grew by 36% in the year to £2.7bn and services revenues grew by 25% to £4.6bn. LTSA revenue catch-ups were £(104)m (2022: £360m).

Underlying operating profit was £850m (11.6% margin) versus £143m in 2022 (2.5% margin). The year on year improvement was driven by higher large engine LTSA shop visit volumes and profitability, increased time and materials profits from life limited parts sales for large engines, and higher business aviation profits, again driven by aftermarket profit growth. In each case, our commercial optimisation actions helped drive margin improvements. This was complemented by cost efficiencies, with lower indirect costs net of inflation.

Financial overview

£ million	2023	Organic change[1]	FX	2022	Change	Organic change[1]
Underlying revenue	**7,348**	1,645	17	5,686	1,662	29%
Underlying OE revenue	**2,703**	706	15	1,982	721	36%
Underlying services revenue	**4,645**	939	2	3,704	941	25%
Underlying gross profit	**1,394**	540	1	853	541	63%
Gross margin %	**19.0%**			15.0%	+4.0pt	+4.0pt
Commercial and administrative costs	**(354)**	18	(1)	(371)	17	(5)%
Research and development costs	**(343)**	112	(3)	(452)	109	(25)%
Joint ventures and associates	**153**	40	–	113	40	35%
Underlying operating profit	**850**	710	(3)	143	707	nm
Underlying operating margin %	**11.6%**			2.5%	+9.1pt	+9.1pt

	2023	2022	Change
Trading cash flow	**626**	226	400

Key operational metrics

	2023	2022	Change
Large engine deliveries	**262**	190	72
Business aviation engine deliveries	**196**	165	31
Total engine deliveries	**458**	355	103
Large engine LTSA flying hours (million)	**13.5**	10.0	3.5
Large engine LTSA major refurbs	**368**	248	120
Large engine LTSA check & repair	**471**	455	16
Total large engine LTSA shop visits	**839**	703	136

1 Organic change is the measure of change at constant translational currency applying full year 2022 average rates to 2023. All underlying income statement commentary is provided on an organic basis unless otherwise stated

Contract catch-ups were £(29)m (2022: £319m). The prior year benefitted from material positive contract catch-ups mostly associated with inflation assumption changes in 2022. Net onerous provisions/releases were £(25)m (2022: £51m). We made good progress on onerous contracts in the year, releasing £385m of provisions taken in prior periods. However, this was more than offset by £410m new provisions taken in 2023 mostly related to industry wide supply chain constraints.

Trading cash flow was £626m versus £226m in 2022. Improved cash flows were driven by higher operating profit, continued strong growth in the LTSA balance, partly offset by net working capital movements and increased investments in the year including improving time on wing for our Trent engines, investment in the Pearl business aviation engines and the UltraFan demonstrator engine test. LTSA invoiced flying hour receipts increased to £4.6bn (2022: £3.6bn).

Operational and strategic progress

As we outlined at our CMD, we are focused on the following six key levers to unlock value in the Civil Aerospace aftermarket business: extend time-on-wing; lower shop visit costs; reduce product costs; keep engines earning for longer; implement value-based pricing; and drive contractual rigour. We are making excellent progress against these initiatives. In addition, the same commercial and cost disciplines are being applied to other areas of our business too, where we are targeting profitable improvements in time and material, original equipment and spare engines.

We are improving engine performance whilst maintaining excellent safety and operational availability. For example, extending time-on-wing means our engines stay in service for longer periods between shop visits, reducing the lifetime maintenance cost. We aim to improve the average time-on-wing for modern Trent engines by at least 40% over the medium term. This means that relative to today's engine standard we will extend time to overhaul by almost two years. We are spending £1bn on time-on-wing improvements as part of a multi-year programme. This will double the time-on-wing of our Trent 1000 engine and in non-benign environments double the time-on-wing on the Trent XWB-97 as well as generating a 50% improvement in benign environments.

At the right time we believe we are well positioned to re-enter the narrowbody market by choosing a partnership approach for the next engine programme. Our UltraFan technology is a vital step towards this. The UltraFan demonstrator, our next generation of engine architecture and suite of technologies, achieved a significant milestone by running to maximum power in tests. These tests also showed the power gearbox handled accelerations and decelerations 20 times faster than we have previously achieved. We expect to continue to invest in the UltraFan following these significant milestones. UltraFan technologies can also be fitted to our existing Trent engines to increase time-on-wing, reduce cost and increase efficiency.

We remain focused on the transition to lower carbon and in reducing emissions in our markets. Our actions start with maximising the efficiency of our current fleet, as many of these engines will remain in service for decades to come. We have already demonstrated that all our production engines are 100% SAF compatible, and this year our Trent 1000 engines powered the world's first commercial transatlantic 100% SAF flight on a Virgin Atlantic Boeing 787 Dreamliner.

Outlook

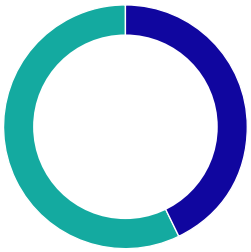
Executing on our strategic initiatives, which include the six key levers previously mentioned, will mean that we are less exposed to fluctuations in engine flying hours. Industry forecasts do predict a continued recovery in international travel and in 2024 we expect large engine flying hours to be in the range of 100%-110% of 2019 levels. Business and regional markets are expected to continue to perform above 2019 levels with growth year-on-year.

We expect operating profit to improve to 15%-17% in the mid-term as a result of the actions we are taking.

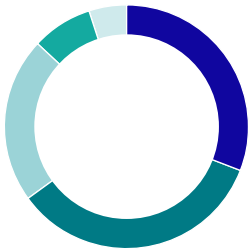
DEFENCE

Defence is a market leader in aero engines for military transport and patrol aircraft with strong positions in combat applications. It has significant scale in naval and designs, supplies and supports the nuclear propulsion plant for all of the UK Royal Navy's nuclear submarines.

Underlying revenue mix



Underlying revenue mix by sector



UNDERLYING REVENUE	UNDERLYING OPERATING PROFIT	UNDERLYING OPERATING MARGIN	ORDER BACKLOG
£4,077m	**£562m**	**13.8%**	**£9.2bn**
2022: £3,660m	2022: £432m	2022: 11.8%	2022: £8.5bn

Market overview

Our Defence business supports five distinct end markets: transport, where we are the market leader; combat, where we have full engine capability; submarines, where we have unique nuclear propulsion capability; naval, where our high power density engines bring real advantage; and helicopters, where we have accumulated huge experience in military and civil programmes. Our order book is strong at £9.2bn (2022: £8.5bn) and our order coverage is 90% (2022: 86%).

We maintained our customer and shareholder commitments throughout the pandemic. Since then, the global security situation has led to governments increasing their commitment to defence. We continue to be selected as long-term partners in the development, manufacture and maintenance of defence power for critical military missions to deter threats, preserve life and maintain order. Rolls-Royce does not provide or manufacture weapons for our customers.

We are a trusted and key supplier to many countries across the globe for the provision of defence power for the protection of society, preservation of peace and economic stability. We are chosen for our unrivalled engineering and technological capabilities as we push the boundaries of what is possible and provide our customers with cutting-edge solutions.

Recent substantial wins underpin our long-term growth as we have been chosen to participate on the FLRAA programme, B-52 re-engining, Tempest and the GCAP. In 2023, it was also announced that Rolls-Royce will provide reactors for Australia's nuclear-powered submarines under the AUKUS trilateral agreement. These contracts come along once in a generation and will provide substantial economic benefit.

The Defence market has demonstrated its resilience in recent years and our customers continue to invest in capability in our core markets. £45bn of new programmes will come online by 2050 within the transport and patrol market, creating a substantial opportunity for us, and we are very well positioned to capture a significant portion of these emerging opportunities. We continue to see strong momentum in this market demonstrated by the US Army selecting us for the FLRAA programme. Partnered with Bell and the US Army, we are excited to power FLRAA with our AE 1107F engine, providing a low risk, ready-now propulsion solution with best-in-class capabilities. The FLRAA platform will provide twice the range and speed for the US Army when compared with the existing Black Hawk helicopter capabilities.

Financial performance

Revenues increased by 12% in 2023 to £4.1bn, with year-on-year growth in all major end markets, notably double-digit revenue growth in combat and submarines. Combat growth was driven by the GCAP programme in the UK and the ramp-up of the F130 programme for the B-52 in the US. Total OE revenues grew by 8% in the year to £1.8bn and services revenues grew by 14% to £2.3bn.

Operating profit was £562m (13.8% margin) versus £432m (11.8% margin) in the prior year, reflecting commercial optimisation, cost efficiencies, and growth in submarines. A lower R&D charge reflected increased customer funding and our strategic focus on the most attractive future programmes.

Trading cash flow of £511m improved versus £426m last year, driven by higher underlying operating profit and our working capital initiatives which resulted in inventory reductions, and increased customer deposits.

Operational and strategic progress

One outcome of the Group strategic review in 2023 is to concentrate on areas where we leverage our differentiation. In Defence, we are focusing on growing sectors where we are strategically advantaged. These are combat, transport and submarines. There are opportunities to improve our position in the defence market through strong performance management, commercial optimisation and efficiency savings.

Financial overview

£ million	2023	Organic change[1]	FX	2022	Change	Organic change[1]
Underlying revenue	**4,077**	428	(11)	3,660	417	12%
Underlying OE revenue	**1,766**	136	(4)	1,634	132	8%
Underlying services revenue	**2,311**	292	(7)	2,026	285	14%
Underlying gross profit/(loss)	**804**	78	–	726	78	11%
Gross margin %	**19.7%**			19.8%	(0.1)pt	(0.1)pt
Commercial and administrative costs	**(173)**	2	(1)	(174)	1	(1)%
Research and development costs	**(72)**	49	1	(122)	50	(40)%
Joint ventures and associates	**3**	1	–	2	1	50%
Underlying operating profit	**562**	130	–	432	130	30%
Underlying operating margin %	**13.8%**			11.8%	+2.0pt	+1.9pt

	2023	2022	Change
Trading cash flow	**511**	426	85

1 Organic change is the measure of change at constant translational currency applying full year 2022 average rates to 2023. All underlying income statement commentary is provided on an organic basis unless otherwise stated

We have been designing and producing combat jet engines for 80 years and we currently support customers in 22 countries. In 2023, we produced 39 new engines, up from 20 to 30 per year in the 2018 to 2020 period. This increase was driven by the maturity of the F-35 programme which has moved to full-rate production. This drove an increased demand for our LiftSystem as well as increased demand for Typhoon and EJ200 in Germany, Spain and Qatar.

In 2021, we secured the contract to re-engine the B-52 for the US Air Force. With the ramp-up of B-52, we expect to increase production of our combat portfolio to 100 engines per year before the end of the decade and peak at over 130 engines per year by the early 2030s. In 2023, we completed the initial F130 engine testing for the B-52 aircraft. Continued testing at NASA Stennis Space Center in Mississippi accomplished our testing goals and allowed for the gathering of large amounts of data early in the programme. This will de-risk the integration of the F130 engine onto the B-52.

Rolls-Royce powered submarines have played a critical role in the UK's naval defence for over 60 years. This is a growing market with a recent increase in demand from the UK Ministry of Defence which includes providing all of the new reactor plants for the UK and Australia as part of the AUKUS trilateral agreement. This will ensure we are supporting naval propulsion with our nuclear expertise for another 60 years and beyond. To meet the enhanced demands from both the UK Royal Navy and AUKUS we are already on the journey to double the size of our site at Raynesway in the UK, developing cutting-edge manufacturing facilities and inspiring the nuclear experts of tomorrow to maintain our talent pool. AUKUS has given us enhanced surety of work that will take us well into the second half of this century.

At our CMD, we demonstrated how we are capturing performance improvement opportunities to grow our business. We outlined the key drivers for operating profit improvement as volume and mix, commercial optimisation, investment prioritisation and cost management.

Under volume and mix, the overall transport fleet is growing, generating higher flying hours and more shop visits. In combat, changes to the product mix yield higher profits due to the scale of newer programmes with similar themes in submarines which will see an increase in volume, funded development and infrastructure.

Under commercial optimisation, in the mid-term, all our major contracts will be renewed, providing us the opportunity to work with our customers to find win-win solutions that capture the fair value of our products and services.

Under investment priorities, the strategic review enabled us to take a more focused view on where and how to invest. We remain aligned with the Group investment priorities framework which will result in capital being allocated to the best projects. Our major customers strongly support our core differentiated strengths in transport, combat and submarines and, as a result, our customer-funded R&D is due to increase by 150% over the medium term.

Our financial results demonstrate that we are making progress on cost management as we embrace the Group-wide transformation activities and strive for a sustainably reduced cost base in the medium term and beyond.

We are committed to becoming a net zero company by 2050 and we support our customers to do the same. The best solution for the defence markets which we operate in to decarbonise is via synthetic fuels, which can deliver a reduction in lifecycle carbon emissions compared to fossil fuels. Our micro-reactors can also play a big part in helping energy security and resilience as part of the energy transition.

Outlook

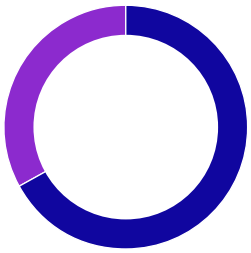
As we outlined at our CMD, we expect the defence market to grow. We expect our margins to improve to between 14%-16% in the mid-term, which we define as 2027, as long-term contracts underpin security for our Defence business for decades to come.

Current geopolitical uncertainties do not immediately benefit our financial performance, however, they provide the backdrop which will support growth in defence budgets in the years to come.

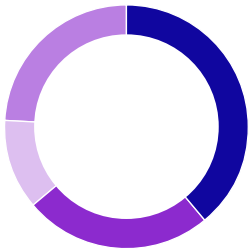
POWER SYSTEMS

Power Systems, with its product and solutions brand *mtu*, is a world-leading provider of integrated solutions for onsite power and propulsion, developing sustainable solutions to meet the needs of its customers.

Underlying revenue mix



Underlying revenue mix by sector *



* In 2023, the naval business of Power Systems was moved from marine to governmental to better reflect the products and customer mix of this business

UNDERLYING REVENUE	UNDERLYING OPERATING PROFIT	UNDERLYING OPERATING MARGIN	ORDER BACKLOG
£3,968m	**£413m**	**10.4%**	**£4.1bn**
2022: £3,347m	2022: £281m	2022: 8.4%	2022: £4.0bn

Market overview

Our Power Systems business serves four distinct end markets where we are a leading player with double-digit market shares. The outlook for our markets is positive with annual growth rates often greater than GDP growth. Our broad positioning in different industries further makes us resilient to market volatility in individual sectors. Based on this, we have created a highly resilient business model which will drive profitable growth.

In power generation, we have a market share of 15%-20% and our key markets are data centres, industrial manufacturing and utilities. We offer dependable diesel and gas power solutions as well as battery energy storage systems for mission-critical to everyday backup and continuous power needs.

In governmental, we have a market share of greater than 30% and our two key markets are land defence and naval. We provide peak-performance diesel engines and propulsion systems with outstanding power density and power-to-weight ratios.

In marine, we have a market share of 15%-20% and our two key markets are commercial marine and yacht. We deliver integrated diesel, gas and hybrid propulsion systems, including automation and control systems, which are renowned for reliability and performance.

In industrial, we have a market share of 10%-15% and our key markets are rail, construction, agriculture and mining. We offer a broad range of highly reliable industrial diesel and hybrid solutions for a diverse range of requirements.

The short cycle nature of these markets and global supply chain disruptions over the last three years led to increased industry-wide inventory build. The supply chain stabilised in 2023 and as a result we were able to unwind some of the inventory build we were holding.

Financial performance

Underlying revenue was £4.0bn, an increase of 16% year on year with 34% growth in the power generation end market driven by data centre growth, where we have a leading position. Underlying OE revenues grew by 19% to £2.7bn. Underlying Services revenues grew by 10% to £1.3bn.

Operating profit was £413m, a 44% year on year increase. This was driven by commercial optimisation and cost efficiencies. In power generation, profitability tripled in 2023 as we took steps to ensure we are appropriately remunerated for our products and services through value-based pricing. The year on year improvement in operating margin to 10.4% in 2023 versus 8.4% in 2022 was achieved despite a slight product mix headwind in the year.

Trading cash flow was £461m with a conversion ratio of 112% versus £158m and 56% last year. The increase in trading cash flow was due to increased operating profit and working capital initiatives including a benefit from increased customer advance payments and reduced inventories in the year.

Operational and strategic progress

Based on the findings of our recent strategic review, which we presented at our CMD, we are confident that we will deliver strong profitable growth through focusing on the power generation, including battery energy storage systems, governmental and marine markets. In all these markets we are targeting to strengthen the highly attractive service business through additional offerings such as upgrade and retrofit kits or digital services. We are also developing the first new *mtu* Series 4000 engine for many years, an investment that will pay off beyond the mid-term. In addition, we will drive efficiency and simplification measures across the business, including streamlining our organisation and creating additional synergies across the Group.

Financial overview

£ million	2023	Organic change[1]	FX	2022	Change	Organic change[1]
Underlying revenue	**3,968**	539	82	3,347	621	16%
Underlying OE revenue	**2,661**	419	55	2,187	474	19%
Underlying services revenue	**1,307**	120	27	1,160	147	10%
Underlying gross profit	**1,050**	111	21	918	132	12%
Gross margin %	**26.5%**			27.4%	(0.9)pt	(0.9)pt
Commercial and administrative costs	**(456)**	(7)	(8)	(441)	(15)	2%
Research and development costs	**(187)**	21	(4)	(204)	17	(10)%
Joint ventures and associates	**6**	(2)	–	8	(2)	(25)%
Underlying operating profit	**413**	123	9	281	132	44%
Underlying operating margin %	**10.4%**			8.4%	+2.0pt	+2.0pt

	2023	2022	Change
Trading cash flow	**461**	158	303

1 Organic change is the measure of change at constant translational currency applying full year 2022 average rates to 2023. All underlying income statement commentary is provided on an organic basis unless otherwise stated

In power generation, we are focusing on optimising our cost structure and further scaling the business. We are targeting a benefit from our strong position in mission-critical applications such as data centres and capturing significant growth as the market is growing rapidly, driven by global trends for data processing and AI. Battery energy storage systems (BESS) are a logical complement to our power generation business and expand our markets towards new applications such as utility-scale storage. Here we can leverage existing system capabilities and market access to create a profitable BESS business in the medium term.

In governmental, we have a leading position today and are well positioned to capture the strong market growth and even outgrow the market as our propulsion systems are well placed for the current investment cycle into military vehicles and naval vessels. Furthermore, we will drive additional growth by expanding our offering towards more integrated solutions such as ship automation products. Through disciplined investments in technologies, we are also strengthening our longer-term opportunities and underpinning our leading market position.

In marine, we have a market leading position in the highly profitable yacht market and a strong position in commercial marine. Our target is to strengthen our leading position in yachts and further improve our position in commercial marine through various strategic measures. Part of this is our bridge-to-propeller strategy which creates profitable upsell potential and differentiation by providing our customers with fully integrated solutions from bridge automation to the propulsion system. Furthermore, we are securing our leading portfolio position by offering alternative-fuel ready engines to support our customers' transition towards sustainability.

As a result of our strategy to focus on power generation, governmental and marine end-markets and a detailed product portfolio analysis, we will be concentrating largely on higher-powered systems in the off-highway engines sector primarily from our in-house production. We have therefore decided to transfer our successful lower-power-range engines business, using Daimler technology and focused on the industrial construction and agriculture markets, to a partner. We have reached an agreement-in-principle with an industrial buyer to take over the lower-power-range engines business.

In all the above-mentioned markets, we have already made significant progress towards offering lower carbon solutions. However, the speed of transition and customer demand strongly varies between our market segments. Combustion engines will remain highly relevant for many years, increasingly powered by sustainable fuels. The use of sustainable diesel substitute hydrotreated vegetable oil (HVO) can reduce full lifecycle emissions by up to 90%. Nearly all our major engine platforms are already able to run on HVO and some of our customers are using this fuel to cut their emissions.

In marine, we are developing methanol-based solutions and for power generation we see hydrogen-based engines as a future solution. These developments are based on existing engines and given the progress already made we are well-positioned to deliver this transition. In addition, we are investing into electrification by offering hybrid solutions, for example, for the yacht or rail market and transitioning our power generation business gradually to complement battery-based solutions. By taking these steps we are participating in the energy transition and support our customers in various industries to achieve their growth and sustainability goals at the same time.

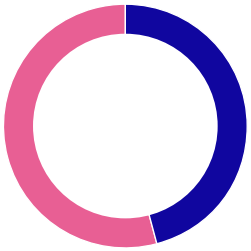
Outlook

We have a resilient business model with strong market positions and opportunities in growing markets to unlock the full potential of our business. Based on a clear focus on profitable growth markets as well as efficiency and simplification measures, we target to achieve an operating margin of 12%-14% in the mid-term.

NEW MARKETS

New Markets are early-stage businesses. They leverage our existing, in-depth engineering expertise and capabilities to develop sustainable products for new markets, focused on the transition to net zero.

Value R&D spend £(137)m



UNDERLYING REVENUE

£4m

2022: £3m

UNDERLYING OPERATING LOSS

£(160)m

2022: £(132)m

UNDERLYING OPERATING MARGIN

n/a

2022: n/a

Market overview

The market for small modular reactors (SMRs) is very attractive with real momentum behind the nuclear power ambitions in many countries, driven by energy security and decarbonisation targets. The role of SMRs is of particularly high interest and we see a large export opportunity in addition to the UK fleet potential.

We took the decision in 2023 to exit our Rolls-Royce Electrical business. We are looking at options to exit our advanced air mobility activities in the short term or reduce our position to a minority share with the intention to exit fully in the mid-term.

Financial performance

Planned cost increases in both Electrical and SMR to meet development milestones resulted in an increased operating loss of £(160)m a 20% increase from £(132)m in the prior year.

Trading cash flow was an outflow of £(63)m compared to £(57)m in the prior year, with SMR costs covered by third party funding.

Rolls-Royce SMR is backed by world-class investors, including an international nuclear operator, and has received grants from the UK Government. Our current shareholding in the SMR business is more than 70% and in 2024 we will continue to explore partnerships that will strengthen our position to deliver the overall solution. Where agreements are reached, equity from these partnerships will likely be received in late 2024 or early 2025. Rolls-Royce has contributed approximately 10% of the total cash costs.

Operational and strategic progress

Rolls-Royce SMR is the UK's first domestic nuclear offering in more than 20 years. Our SMRs are designed to produce stable, affordable and emission-free electricity to power a million homes for at least 60 years.

The modular build approach is the fastest and cheapest way to get nuclear on-grid solutions to help meet global net zero ambitions. We are controlling the integrated design of the powerplant and enabling a very high level of modularisation. This moves work from onsite construction into a standardised, controlled, factory build with modules then assembled on site. This reduces cost, risk and time to construct and results in a highly competitive cost of electricity.

Rolls-Royce SMR has been successfully shortlisted in the first stage of the Great British nuclear SMR technology selection process, marking a significant step towards the first plants being built in the UK. We welcome our shortlisting and are eager to build on this progress as we move quickly towards the next stage where we can work to agree a contract for fleet deployment. This should be as soon as possible, as the earlier this is achieved the more likely it is that our SMR fleet will be able to help the UK Government reach its ambition to deliver up to 24GW of nuclear power by 2050.

Rolls-Royce SMR is making very good progress through the generic design assessment (GDA) by the UK nuclear industry's independent regulators. We entered the UK regulatory process in April 2022 and continue to successfully move through the steps to secure design certification, putting us around two years ahead of rival technologies in Europe.

In Rolls-Royce Electrical we have made significant strides in developing electric and hybrid-electric power and propulsion technology. In 2023, we continued to further develop and test the products and power generation solutions we have been working on. Our electrical capabilities continued to provide electrical solutions to our core businesses and this includes leading on the EU-funded HE-ART programme that is focusing on demonstrating enabling technologies for regional aircraft hybridisation. Our engineers are also developing the embedded electrical technology for the global combat air programme.

Financial overview

£ million	2023	Organic change[1]	FX	2022	Change	Organic change[1]
Underlying revenue	**4**	1	–	3	1	33%
Underlying OE revenue	2	1	–	1	1	100%
Underlying services revenue	2	–	–	2	–	–
Underlying gross profit/(loss)	**1**	2	–	(1)	2	nm
Gross margin %	**25.0%**			(33.3)%	+58.3pt	+58.3pt
Commercial and administrative costs	(24)	(1)	–	(23)	(1)	4%
Research and development costs	(137)	(27)	(2)	(108)	(29)	25%
Joint ventures and associates	–	–	–	–	–	–
Underlying operating loss	**(160)**	(26)	(2)	(132)	(28)	20%

	2023	2022	Change
Trading cash flow	**(63)**	(57)	(6)

1 Organic change is the measure of change at constant translational currency applying full year 2022 average rates to 2023. All underlying income statement commentary is provided on an organic basis unless otherwise stated

Outlook

In Rolls-Royce SMR regulatory activities such as the GDA, factory development and siting plans will continue simultaneously as the work to secure firm domestic and export commitments continues.

In addition to the UK, we are deeply engaged with governments, developers and potential industrial customers in the Czech Republic, Finland, Sweden, USA, Poland, the Netherlands and more. Selection processes in several countries are in progress.

We will need a broad set of partners to deliver our overall solution. Our partnership approach de-risks our profitable growth and reduces the future capital call on Rolls-Royce. It also brings additional expertise to help reduce delivery risk. Risk will also be mitigated by our commercial constructs, for example funding mechanisms such as the regulated asset base model in the UK. There is a credible path to be under contract for multiple units domestically and overseas by 2030, creating significant value.

In Rolls-Royce Electrical we will exit the advanced air mobility part of the business while retaining key electrical capabilities in the Group to support activities in Civil Aerospace, Defence and Power Systems.

Sustainability

Our sustainability approach aims to ensure we are a responsible and resilient business through identifying, assessing and managing our environmental and social impacts.

2023 HIGHLIGHTS

Achieved our 2023 target to test all in-production and in-development Civil Aerospace engines on 100% unblended SAF

Retained our second place position in the Dow Jones Sustainability Index for the Aerospace & Defence industry

Enhanced and updated governance of sustainability at Board and Executive-level committees

We seek to operate and act in an ethically, environmentally and socially responsible manner that creates shared value for us and our key stakeholders on a long-term basis. We are a technology company that operates in markets that face great technical challenges to abate carbon emissions. We know that the biggest contribution we can make to a sustainable future for the climate is by actively collaborating with partners, customers and suppliers to help enable the energy transition. We firmly believe in the role of technology in helping to meet global energy demands whilst mitigating the impacts of climate change. Our products and services will have a critical role to play in enabling the global energy transition to a low carbon economy through the provision of power, transport and energy that can be compatible with net zero carbon emissions.

To be successful it is critical that we appropriately understand and manage our impact on society and the environment and that we continue to maintain the highest standards of ethics and compliance. We use the UN Sustainable Development Goals to refine our areas of focus on Responsible Consumption and Production, Climate Action, Decent Work and Economic Growth and Peace Justice and Strong Institutions. We routinely benchmark our performance in ESG assessments such as the Dow Jones Sustainability Index and the CDP.

Our sustainability approach

We look to operate and act in an ethically, environmentally and socially responsible manner by:

Managing and minimising environmental impacts across our value chain	Creating a positive social impact for our people, our partners and communities	Maintaining the highest standards of ethics and compliance
12 RESPONSIBLE CONSUMPTION AND PRODUCTION; 13 CLIMATE ACTION	8 DECENT WORK AND ECONOMIC GROWTH	16 PEACE, JUSTICE AND STRONG INSTITUTIONS
See pages 33 to 43	See pages 44 to 48	See page 49

Underpinned by our values and behaviours

Our sustainability and ESG strategy is embedded within our global governance framework, enterprise risk management approach and operating model. We deploy our approach through our global policies, including Our Code and related policies, such as our health and safety, anti-bribery and corruption and human rights policies.

During 2023, we continued to focus on two primary areas of our sustainability approach, in particular by strengthening our strategic resilience to climate change and the energy transition (see pages 33 to 43) and continuing to embed our Group-wide human rights programme (see page 49). In 2023, we completed a granular strategic review of the business resulting in us setting our strategic framework for the future. In 2024, using this framework we will be reviewing and refreshing our sustainability and ESG objectives including updating our Group climate-related targets. This work will enable us to further progress and create a more granular transition plan to support the energy transition.

NON-FINANCIAL AND SUSTAINABILITY INFORMATION STATEMENT

The following summarises where you can find further information on each of the key areas of disclosure required by sections 414CA and 414CB of the Companies Act. The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 amend these sections of the Companies Act 2006, placing requirements on the Group to incorporate climate disclosures in the annual report. We believe these have been addressed within this year's climate-related disclosures on page 41 and as such we have referenced the location of these within our statement on TCFD on page 35.

	RELATED GROUP POLICIES & GUIDANCE	RELEVANT PRINCIPAL RISKS	PAGE
Environmental matters	– Health, safety & environment	– Safety – Climate change	52 and 55
Employees	– Our Code – Security – People – Speak up – Our life-saving rules	– Safety – Talent & capability	52 and 57
Social matters	– Charitable contributions and social sponsorships	– Political	56
Human rights	– People – Diversity & inclusion – Human rights – Data privacy – Modern slavery statement	– Compliance	53
Anti-bribery and corruption	– Anti-bribery and corruption	– Compliance	53

For a description of our business model, see pages 14 and 15; Non-financial key performance indicators, see page 18; Full details of the Group's principal risks, see pages 50 to 57; Further information on Group policies can be found on www.rolls-royce.com

CLIMATE AND THE ENERGY TRANSITION

OUR PROGRESS IN 2023

UltraFan technology demonstrator engine ran for the first time using 100% SAF and world's first commercial transatlantic 100% SAF flight

Released 80% of our Power Systems portfolio for use on sustainable fuels

Rolls-Royce SMR design shortlisted within the Great British Nuclear selection process by UK Government

The following pages outline the progress we have made in advancing our climate strategy and progress against our short-term targets in 2023. It also outlines our approach to assessing strategic resilience in the face of climate change through alignment with our Task Force on Climate-related Financial Disclosures (TCFD) reporting. See page 35 for our explanation.

Our role in the energy transition

We have an important role to play in the global energy transition. We firmly believe in the role of technology in helping to meet increasing global energy demands whilst mitigating the impacts of climate change. Our products and services will have a critical role to play in supporting the global energy transition to a low carbon economy through the provision of power, transport and energy that can be compatible with net zero carbon emissions.

We are committed to reaching net zero carbon emissions from our operations and facilities and that our products are compatible with net zero operations by 2050, in line with the consensus of the global scientific community. Our climate strategy is designed to ensure that we play an active role in the energy transition and that we are strategically resilient in the face of climate change. In line with our strategic review we are still committed to short and medium-term targets. The specifics of these are to be confirmed as part of our 2024 strategic review of sustainability.

Our climate strategy has four key pillars starting with our own operations, extending to the support we can provide our customers and ultimately focusing on the contribution we can make to the global energy transition, whilst recognising the enabling landscape that must be in place for this to be realised:

- decarbonising our operations, facilities and business activities;
- enabling our customers to operate their products in a way that is compatible with low or net zero carbon emissions;
- delivering new products and solutions that can accelerate the global energy transition; and
- creating the necessary enabling environment, with public and policy support, to achieve our collective climate goals.

The majority of our impact occurs in the use phase of our product lifecycle (Scope 3, category 11, use of sold products emissions).

Decarbonising our operations

Our total annual Scope 1 + 2 emissions, those associated with our operations, facilities, business activities (excluding product testing activities), comprised 148 $ktCO_2e$ in 2023, a 18% decrease compared to 2022 (see page 41 for further detail).

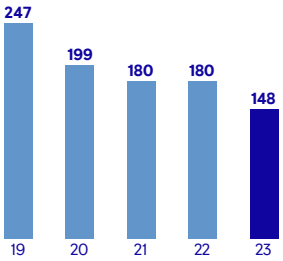
We have continued to make progress in decarbonising our global operations, as well as in reducing our overall energy consumption by approximately 10% in 2023. Both these activities will help ensure our facilities and internal supply chains are more resilient. To continue our progress we are: deploying energy efficiency and low-cost electrification; maximising on-site renewable energy generation and storage, utilising Rolls-Royce technologies where appropriate; procuring certified green energy via Power Purchase Agreement (PPA), Virtual Power Purchase Agreement (VPPA), or Renewable Energy Guarantees of Origin (REGO); and procuring high quality removals to mitigate residual emissions.

In 2023, we entered into an agreement to install more than 2,300 solar panels on the roofs of our Tukang, Singapore facility, as part of a PPA with a total capacity of 1,425 kWh. Once fully operational, the installation will meet approximately a third of the site's total energy needs. This project builds upon our experience of existing solar facilities at our manufacturing sites in Germany, UK, US and elsewhere in Singapore.

We also opened our new *mtu* Series 2000 engine production building in Kluftern near Friedrichshafen, Germany which has been equipped with a 1.2 MW-peak photovoltaic system which provides green electricity to power the site, e-charging columns and an intelligent building control system to enable energy-efficient operation.

Emissions from product testing activities, a critical part of our product safety assurance and engine certification programmes, contributed 42% of our Scope 1 + 2 emissions during the year. We use a blend of 10% sustainable aviation fuel (SAF) across our Civil Aerospace and Defence UK testing activities to help mitigate some of these emissions.

Operations and facility emissions (excluding product testing activities) ($ktCO_2e$) [1,2]



1 External assurance over Scope 1 + 2 GHG data is provided by Bureau Veritas. See page 209 for their sustainability assurance statement
2 Data has been reported in accordance with our basis of reporting, available at www.rolls-royce.com/sustainability

Enabling our customers

The biggest contribution that we can make to global energy transition is to ensure the sectors we operate in, transport, energy and power generation, are compatible with net zero carbon emissions. Scope 3, category 11 emissions, those associated with the use of our sold products by our customers, dominate our emissions footprint. We will further advance the efficiency and environmental performance of our engine and technology portfolio and ensuring compatibility with sustainable fuels.

During 2023, we completed the build stage of our UltraFan technology demonstrator programme, a large Civil Aerospace engine programme that brings together a suite of new technologies, such as a powered gearbox and lean burn combustion system, to deliver an anticipated 10% efficiency improvement over the Trent XWB, which is already the

world's most efficient large aero engine in service. The first run of the UltraFan demonstrator was completed on our test beds in Derby, UK on 100% SAF.

Sustainable fuels, such as SAF in aviation, will play a critical role in energy transition. To accelerate their scale up we have been carrying out a series of ground and in-flight tests to demonstrate there is no technology barrier to their increased usage. In November 2023, we announced the successful achievement of our target to test all in-production Civil Aerospace engines on 100% unblended SAF.

Our Trent 1000 engines powered the world's first commercial transatlantic flight carried out on 100% SAF aircraft in November 2023, a UK Government funded project in partnership with our customer Virgin Atlantic. This builds on our experience working with the UK Royal Air Force (RAF) to power the Voyager aircraft on 100% SAF in 2022 and successful in-flight refuelling SAF test carried out with the Voyager and Typhoon and Hercules aircraft in April 2023.

In Power Systems, we have continued to release our engine portfolio for use on sustainable fuels. In September 2023, we announced the release of the *mtu* series 2000 and 4000 engines for use with bio and synthetic based diesel fuels and have completed the successful testing of an *mtu* 4000 gas engine for power generation on 100% hydrogen fuel.

At the end of 2023, 80% of our portfolio in Power Systems had been released for use on sustainable fuels. This enables our customers to utilise synthetic diesel type fuels; these are e-fuels that are created from captured CO_2 using renewable or zero carbon electricity.

Delivering new products and solutions

Beyond mitigating emissions associated with our existing products and the markets we serve, our technologies can play a role in accelerating the energy transition in new markets and sectors for Rolls-Royce. Through the provision of low carbon and net zero technologies, we can abate emissions outside of our current emissions footprint in support of national and international climate policy goals.

A key part of our strategy is the development and deployment of SMRs, that can play a vital role in decarbonising the global energy mix and in meeting increasing demand for clean electricity. During 2023, the Rolls-Royce SMR design was shortlisted in the first stage of the Great British Nuclear SMR technology selection process and we successfully progressed to the second stage of the design assessment process. SMRs also have a potential role to play in the production of sustainable fuels as a clean power source. During 2023, we entered research agreements on the use of Rolls-Royce SMR to support production of low-carbon hydrogen.

In Power Systems, we see battery energy storage solutions as a potential growth area which complements our existing expertise in stationary power generation. Energy storage will play a critical role in stabilising intermittent renewables as part of the global energy transition.

At the end of 2023, we successfully installed our *mtu* EnergyPack QG battery systems for SemperPower in the Netherlands. With a power rating of 30.7 MW and a 62.6 MWh of energy storage capacity, this project is one of the largest battery projects in the EU.

Creating the necessary enabling environment

Our ability to deliver our decarbonisation approach, in addition to supporting our customers and government partners to meet their own climate goals, is highly dependent upon a supportive external environment. We continue to actively engage policy makers, regulators and others to advocate for the necessary policy and economic support we have identified.

During 2023, this included:

- active participation at COP28 in Dubai, UAE;
- founding signatory of the Defence Aviation Net Zero Charter with the UK RAF;
- engagement at the UN ICAO CAAF/3 meeting on creating a global framework for sustainable aviation fuels;
- senior representation on the UK's Jet Zero Council;
- taking over the VP role of decarbonisation on the CIMAC (International Council on Combustion Engines) board; and
- active participation on the BDI Climate & Energy Policy board.

STATEMENT ON TCFD

We continue to progress in building our understanding of climate-related risks and opportunities to ensure we are strategically prepared for a climate-impacted future and able to seize commercial opportunities that arise from the energy transition. These activities in turn help to support our TCFD reporting.

In our 2022 Annual Report, we confirmed a position of consistency with nine of the 11 recommendations under the TCFD framework. The areas of non-consistency, against Strategy B and C requirements, were in recognition of the announcement of the strategic review of our business model, strategy and financial plans.

The strategic review was undertaken and completed in 2023. We can therefore confirm our consistency with Strategy B requirements. To achieve this, we have considered a number a climate-related scenarios and the potential impacts against on our operating profit (see climate risk summary on page 40).

As the strategic review concluded in 2023, we will need to further assess the impact of the review conclusions against our longer-term sustainability and climate strategy and update our associated targets during 2024. This review will also consider the Group's target for net zero for Scope 1 + 2 excluding product testing by 2030.

As a result, we can confirm full consistency to nine of the 11 recommendations of the TCFD framework. We can confirm we are only partially consistent with Strategy C and Metrics & Targets C requirements. Our partial consistency results from us having not fully reviewed and confirmed our medium-term decarbonisation targets to align with the 2023 strategic review, and further work is required to confirm our resilience on our long-term financial planning. A comprehensive review of our sustainability and climate-related strategy and targets will be completed in 2024.

Through our climate programme we have made considerable progress across the spectrum of TCFD recommendations this year. This progress includes strengthening Board and executive-level governance; reviewing and refining our climate scenarios; and assessing the impact of changes in our strategy and portfolio on climate-related targets. We have concentrated on ensuring we have robust foundations in place, such as the further integration of climate considerations into existing strategy and financial planning processes, to ensure this is a routine factor in our business planning activities.

Strategy C – resilience of the organisation's strategy

As we carried out our strategic review, our business planning processes have necessarily focused on the short and medium term. Our financial planning has looked out five years to 2028 and our strategic planning ten years to 2033. Our assessment of climate risks and opportunities and the exploration of the potential impacts of climate scenarios has been completed on the same timescales. Whilst there has been some consideration of longer-term impacts carried out within the divisions this has not yet been robustly tested and reviewed at Group level.

We know from previous assessments that the majority of our identified climate-related risks and opportunities manifest themselves over the medium to longer term, largely beyond 2035. For that reason we have previously completed our impact assessments on timescales out as far as 2050. Based on previous analysis, we do not believe that any of the changes resulting from the strategy review will have a negative impact on our long-term financial resilience. However, until we complete our testing, as part of our comprehensive review of our sustainability and climate-related strategy, we have considered that our approach is not yet fully consistent with the expectations of Strategy C.

TCFD recommendations

		RECOMMENDATION	CONSISTENCY	PAGE	CA 414CB *
Governance	A	Board oversight of climate-related risks and opportunities	✓	36	CA s414CB(a)
	B	Management's role in assessing and managing climate-related risks and opportunities	✓	36	CA s414CB(a)
Strategy	A	The organisation's identification of climate risks and opportunities it faces over the short, medium and long term	✓	37	CA s414CB(d)
	B	Consideration of the impact of climate risks and opportunities on the organisation's business, strategy and financial planning	✓	38	CA s414CB(e)
	C	Resilience of the organisation's strategy, taking into consideration different climate-related scenarios	✓	40	CA s414CB(f)
Risk management	A	Presence of the organisation's processes for identifying and assessing climate-related risks	✓	37	CA s414CB(b)
	B	Processes for managing climate-related risks including prioritisation methods	✓	37	CA s414CB(b)
	C	Processes for identifying, assessing and managing climate-related risks are integrated into overall risk management	✓	37	CA s414CB(c)
Metrics and targets	A	Disclosure of metrics used to assess climate risks and opportunities in line with strategy and risk management processes	✓	41	CA s414CB(h)
	B	Disclosure of material greenhouse gas emissions and the associated risks	✓	41	–
	C	Presence of targets used to manage climate-related risks and opportunities and performance against such targets	✓	41	CA s414CB(g)

Key: ✖ Not consistent ✓ Partially consistent ✓ Consistent

* Companies Act 2006, s414CB(2a)-(2h)

Metrics & Targets C – presence of targets used to manage climate-related risks

We concluded our strategic review in November 2023, announcing changes to our business strategy, technology portfolio and financial targets that have an impact on our previously stated decarbonisation strategy and related targets. We had previously disclosed proposed Group-level targets for Scope 1 + 2 and Scope 3, category 11 emissions that had been submitted to the Science-Based Targets Initiative (SBTi) for validation; we paused this validation process in April 2023 whilst we completed the strategic review and have since withdrawn those proposed targets in line with the SBTi policy on validation completion timescales. As a result, we do not currently have Group-level targets in place for our material emissions sources, namely Scope 3, category 11, and therefore recognise that we are only partially consistent with Metrics & Targets C, presence of climate related targets.

Governance

Sustainability and climate are embedded within our Group governance framework, risk management system and operating model. The Board has oversight of climate-related risks and opportunities impacting the Group and all Board Committees have an aspect of climate within their remit. The Executive Team is responsible for the delivery of our climate strategy, including associated targets and transition plan and for ensuring the assessment and appropriate response to climate-related risks and opportunities throughout our business model and activities.

In 2023, we revised our governance structure at both Board and Executive level to reflect the changes in our business model and wider strategy (see corporate governance on page 67). These changes have strengthened the focus on technologies and solutions that can play an active role in the energy transition.

After each Committee meeting, the chair reports back to the Board formally on topics discussed. During 2023, the Board discussed specific aspects relating to climate, including the consideration of climate and energy transition within our strategic review and the impact upon our climate-related disclosures. The strategic review and later consideration of the annual and five-year plan included consideration of climate issues in relation to capital expenditure and potential strategic partnerships and disposals. Climate is also embedded in the approach to risk management.

The Safety, Energy Transition & Tech Committee oversees the Group's sustainability strategy, priorities and progress and has delegated responsibility to review the principal risk relating to climate change. It monitors our sustainability and climate-related performance and progress against our associated strategy and targets. It receives reports from the head of sustainability and the Committee is updated on the discussions of the Executive-level energy transition & technology committee.

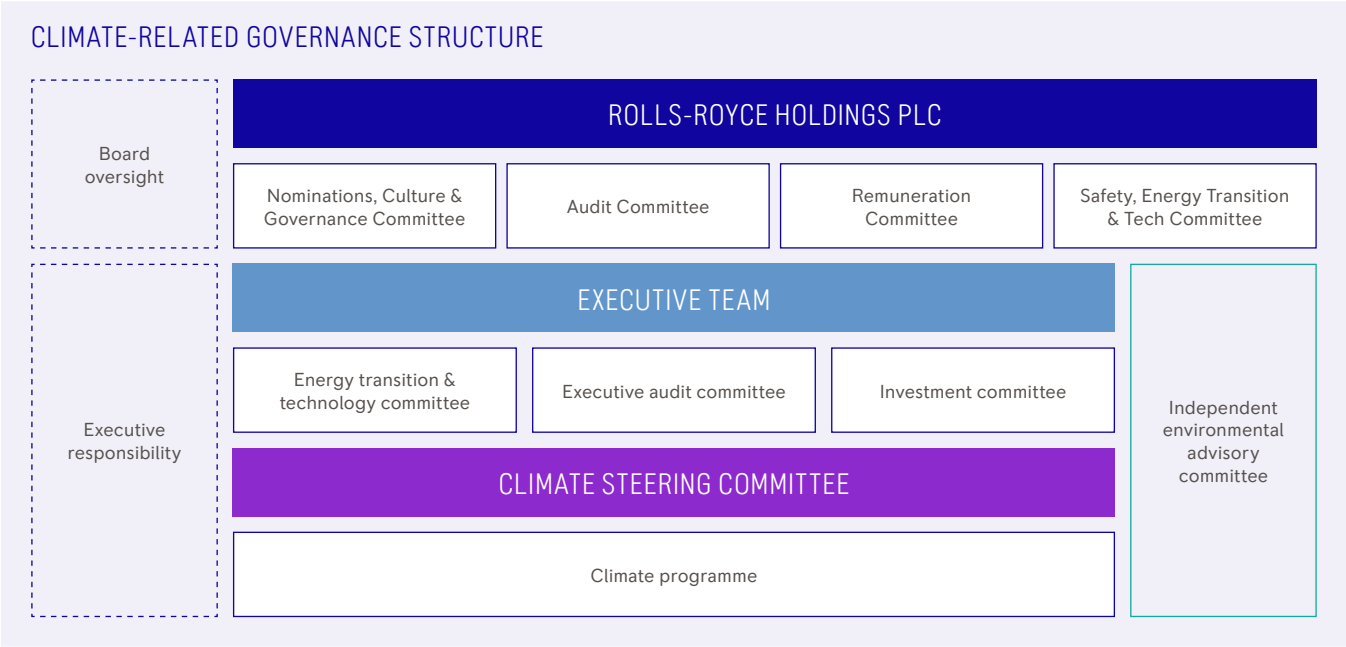
The Audit Committee is responsible for reviewing and approving the content of our TCFD recommendations and noted progress as preparations were being made for the disclosures in this report. The Committee also ensures that, where material, the impact of climate change is reflected in the financial statements and disclosed appropriately.

The Remuneration Committee determines our remuneration policy, which includes sustainability metrics.

The Nominations, Culture & Governance Committee reviews the Board's skills and oversees membership of each of the Board's committees and terms of reference, ensuring, as part of its overall remit, that the Board's governance and oversight of ESG matters, including climate, is appropriate.

The Executive Team is responsible for managing climate-related risks and opportunities on a day-to-day basis and for delivering the programmes and plans to achieve our sustainability and decarbonisation goals.

The energy transition & technology committee, which meets four times a year, is a sub-committee of the Executive Team that is responsible for formulating and overseeing the Group's response to climate change and the energy transition and its technology portfolio. The committee also reviews investment decisions and projects with the value between £0.5m and £25m where they relate to the energy transition or have an



impact on mitigating Scope 1 + 2 or Scope 3 emissions. The committee is chaired by the Chief Executive and all members of the Executive Team are invited to participate. The committee receives regular updates from our climate steering committee and itself reports regularly to the Safety, Energy Transition & Tech Committee.

This committee is supported by a climate steering committee to specifically oversee progress against our climate programme. It comprises core functional and business representatives, including the head of strategy, head of sustainability, head of risk and group financial controller. The committee meets on a monthly basis. This provides regular oversight of progress made against our decarbonisation goals.

Internal expertise is complemented by an independent environmental advisory committee which comprises external experts and academics who are leaders in relevant fields, including climate science, materials science and environmental policy. One member is a lead author of the Intergovernmental Panel on Climate Change (IPCC). The committee provides input and independent challenge of our sustainability and environment policy and strategy and is commissioned to undertake or review scientific research on behalf of the Group. During 2023, the committee oversaw research into the non-CO_2 impacts of aviation.

Assessing strategic resilience

We seek to assess our resilience over three time horizons: short term (less than five years), medium term (five to ten years) and longer term (ten years plus). This year we have focused on short and medium-term assessments.

We use climate scenarios to test our strategic planning. We test against our business planning baseline to assess potential risks to our financial performance and to identify ways to mitigate our exposure to these risks. The outputs of these assessments help inform our wider business planning and decision making, including our technology portfolio and investment decisions, as well as our related engagement activities.

A baseline and three scenarios have been considered, (see page 39), based on independent external climate scenarios that present plausible levels of global temperature rise and associated policy responses. These scenarios are not predictions or forecasts but future possibilities which enable us to explore the physical and transition risks and opportunities associated with climate change that may manifest over short, medium and longer-term horizons.

Our scenarios analysis asks to what extent do the climate scenarios manifest as risks to the Group. This included assessment of potential impacts on market dynamics and demand, cost exposure, for instance carbon pricing, and physical impact of climate change on operations, including site based impacts.

From this primary question, focal questions assessed under each scenario include:

- how does the scenario impact the life or risk exposure of assets (e.g. product competitiveness, facilities)?
- how does the scenario impact future revenue projections (e.g. demand for products and services)?
- how does the scenario impact future profitability projections (e.g. operational disruption, supply chain)?
- what additional costs may occur under each scenario (R&D, commodity pricing, cost of capital)?

The outputs of this exercise inform our climate-related risk management process.

In 2023, we have followed a three-step process:

1. review and confirm key risks and opportunities;
2. confirm key scenarios and assumptions, including the addition of a third scenario based on a delayed disruptive transition; and
3. model the potential impact of each risk.

Our analysis, explained below, has not identified any material risks to the Group.

Climate-related risks and opportunities

The identification, assessment and management of climate-related risks and opportunities is undertaken as part of our enterprise risk management framework, in line with the TCFD Technical Supplement (see page 50). The TCFD Technical Supplement helped us understand our risk exposure and to consider steps we could take to mitigate it. One of the ways climate-related risks and opportunities are identified is through the emerging risk process where one of the categories is environmental risk (see page 51).

Once a risk is identified, the framework includes a requirement for risk owners to decide on and document their response to an identified risk. Although there are some examples where the risk can be transferred, in most cases risks are accepted and require mitigation, such as effective controls and/or a plan of action. These are monitored through our risk management effectiveness reviews, as described on page 50, with a focus on control effectiveness. The determination of risk materiality is based on gross and current (i.e. net) risk assessments, using Group-wide scoring criteria for impact and likelihood. These criteria are used for divisional and functional key risks as well as principal risks, with the expectation that the basis of the estimate is clear, consistent and with key assumptions documented.

Key climate-related risks and opportunities

Transition risks and opportunities	Changing customer demand	Financial impact from changes to revenue and/or cost due to customers responding to changing market conditions, e.g. customer sentiment or cost increases affecting passenger demand in Civil Aerospace, opportunity for zero emissions solutions in our Power Systems markets, customer priorities in Defence
	Changes in costs due to carbon pricing	Changes to our costs due to the assumed application of carbon pricing measures on our Scope 1 + 2 activities and the application of carbon pricing to the activities of our suppliers that are passed through to us in the form of higher part costs
	Changes in costs due to commodity price changes	Changes to our costs due to variation in market supply and demand and/or cost passed through from suppliers
	Change in investment requirement	Changes to investment required (R&D, capital expenditure etc.) due to a need to respond to changing customer demand
Physical risks	Facility disruption (acute risk)	Financial exposure resulting from a temporary (up to 12 months) disruption to a Rolls-Royce facility due to a climate-related event (e.g. flood or fire)
	Supply chain disruption (acute risk)	Financial exposure resulting from a temporary (up to 12 months) disruption to supply chain due to climate-related event (e.g. flood or fire)
	Impact on product performance (chronic risk)	Financial exposure resulting in a deviation in expected product performance (e.g. power, efficiency and/or life etc.) due to changes in environmental conditions

Aligning with our overarching framework and using common assessment criteria for all risk categories ensures that risks can be compared across the Group, supporting prioritisation and providing a mechanism for monitoring how effectively we are managing these risks.

We have identified seven key climate-related risks and opportunities that are relevant to our business. Of these, four are transition risks and opportunities resulting from the shift towards a low-carbon future and three are physical risks relating to the physical impact of climatic events.

We have a climate change principal risk that specifically refers to the potential impacts on future revenues as a result of a potential failure to transition to an inherently lower carbon product portfolio. Following a principal risk refresh carried out in 2023, this risk has been re-classified as a principal risk driver (see page 51), recognising the fact that the consequences of this risk materialising are then causes of other principal risks. For example, extreme weather events can disrupt our supply chain (resilience to shocks) or carbon taxes could enhance or reduce the competitiveness of our products (competitive environment).

There are a number of climate-related opportunities that have been explored. These include the demand for high base load, low carbon energy sources provided by products like SMR. These also include high demand for sustainable fuel compatible products across our sectors to reduce the carbon emissions and potential emission penalties.

These key climate-related risks and opportunities have been explored in our scenarios assessments. As part of our climate-related risk assessment process we consider the potential physical impact of climate change on our operating locations. During 2022, we conducted a physical risk impact assessment of 50 Rolls-Royce sites and selected key suppliers and joint ventures. In 2023, we continued to build on this work with further detailed analysis at eight key sites considered most at risk. This work quantified the potential impact and likelihood of eight key climate perils that may impact each site, including flooding, water stress, extreme heat and wildfire, with ongoing analysis of extreme wind events such as cyclones. The results have fed into our wider climate scenarios assessments and are now being communicated to divisions and locations, for inclusion in business continuity and property risk assessments. These discussions will inform future sustainability strategy decisions and decisions on further analysis required in 2024.

Climate scenarios assessment

We use scenario planning to help assess our strategic resilience to climate change. These scenarios are intended to act not as predications or projections but as explorations of potential plausible futures. In 2021 and 2022, we used two scenarios that acted as bookends of our assumed base case. These scenarios are reviewed annually to ensure they remain viable, plausible and appropriately challenging; as part of this review we decided to introduce a third scenario for our 2023 assessments. This additional scenario explores a delayed and disruptive transition; our original scenario scoping activity in 2021 had identified that a delayed transition may present additional challenges for aspects of our business model, particularly in relation to the long-term nature of our business.

The scenarios we use are based on independent external climate scenarios (see page 39) and representative concentration pathways (RCPs). We utilise additional supplementary data for third party sources, such as carbon pricing and GDP, to support our modelling and financial impact assessments.

Modelling the potential impact

Cross-functional teams within each division, including representatives from strategy, finance and risk, collectively assess the potential impact of each key risk on the business under each of these three scenarios. This includes calculating a revenue, cost or profit impact for each scenario across the timescales defined. As part of our 2023 activity, we have quantified short and medium-term risks, consistent with our wider financial and strategic planning. In addition, each business has considered, but not quantified, the potential implications of each scenario on a longer-term outlook to 2050. At this time we have not identified any impact on demand, cost or competitive position that we would not be able to detect and respond to.

Climate scenarios: summary and key assumptions

	DESCRIPTION	KEY DATA POINTS * 2030	KEY DATA POINTS * 2050
Baseline	The world follows a path in which social, economic and technological trends do not shift markedly from historical patterns. Global and national institutions work toward achieving sustainability goals but make slow progress. Environmental systems experience further degradation, despite gradual improvement in energy and resource intensity. Global population growth is moderate and levels off in the second half of this century. Economic development proceeds unevenly. Income inequality persists or improves only slowly and challenges to reducing vulnerability to societal and environmental changes remain.	CO_2 price ($/tonne) – advanced economies $60/t – developing economies $30/t GDP growth rate (global five-year average) 2.7% Global emissions rise 36Gt CO_2 Global temperature rise 1.5°C	CO_2 price ($/tonne) – advanced economies $100/t – developing economies $30/t GDP growth rate (global five-year average) 1.7% Global emissions rise 32Gt CO_2 Global temperature rise 2.0°C
Accelerated transition scenario (< 1.5°C by 2100)	The world shifts gradually, but pervasively, toward a more sustainable path, emphasising more inclusive development that respects perceived environmental boundaries. Resulting global temperature rise plateaus at 1.5°C. Educational and health investments accelerate the demographic transition and the emphasis on economic growth shifts toward a broader emphasis on human wellbeing. Driven by an increasing commitment to achieving development goals, inequality is reduced both across and within countries. Consumption is oriented towards low material growth and lower resource and energy intensity.	CO_2 price ($/tonne) – advanced economies $140/t – developing economies $90/t GDP growth rate (global five-year average) 2.4% Global emissions rise 23Gt CO_2 Global temperature rise 1.5°C	CO_2 price ($/tonne) – advanced economies $250/t – developing economies $200/t GDP growth rate (global five-year average) 1.9% Global emissions rise none Global temperature rise 1.5°C
Accelerated physical scenario (3.5°C by 2100)	Expanding fossil fuel demand and government failure to meet stated commitments leads to higher emissions. The expected expansion towards renewables is cut short causing global emissions to rise significantly. Global warming rises to 2.1°C by 2050, on track to hit 3.5°C of global temperature rise by 2100. This causes significant physical disruption and damage that accelerates as the scenario progresses. Fossil fuel supply is slower to adjust than demand as existing resources are strained and further exploration is needed. This causes spot prices to rise contributing to inflationary pressure in both energy and consumer sectors.	CO_2 price ($/tonne) – advanced economies $24/t – developing economies $12/t GDP growth rate (global five-year average) 2.6% Global emissions rise 46Gt CO_2 Global temperature rise 1.5°C	CO_2 price ($/tonne) – advanced economies $31/t – developing economies $17/t GDP growth rate (global five-year average) 1.3% Global emissions rise 54Gt CO_2 Global temperature rise 2.1°C
Delayed disruption scenario (1.7°C by 2100)	Increasing fossil fuel demand and delay of climate policies until 2030 leads to higher emissions. Stronger policy actions are necessary to compensate for time lost. Global warming can be contained to 1.7°C but the sudden shift in the energy mix causes more economic and environmental damage than in the baseline. Aggressive and uncertain carbon taxation policies cause substantial inflationary pressures, stranded assets and financial instability. Frictions in the shift towards renewables and more limited carbon capture availability than in the accelerated transition scenario require vast gains in energy efficiency to bring down emissions and therefore global warming by 2050.	CO_2 price ($/tonne) – advanced economies $24/t – developing economies $12/t GDP growth rate (global five-year average) 2.7% Global emissions rise 41Gt CO_2 Global temperature rise 1.5°C	CO_2 price ($/tonne) – advanced economies $379/t – developing economies $209/t GDP growth rate (global five-year average) 1.7% Global emissions rise 2Gt CO_2 Global temperature rise 1.7°C

* Key data points are taken from external sources, including Oxford Economics, Global Climate Service and Databank (data extract May 2023) and the International Energy Agency, Net Zero by 2050 – A Roadmap for the Global Energy Sector, May 2021 and World Energy Outlook 2022, October 2022. These data points are then used to model Group specific assumptions such as demand for aviation and maritime transport

CLIMATE RISK SUMMARY

The following table summarises the potential impact assessments post mitigations of each of our identified climate-related risks under the three scenarios (see page 39). These are presented as potential ranges that depict an estimated financial impact and timeframe. We have concluded that these risks have no impact in 2023 and no material financial impact in the short term, as reflected in our financial accounting, see note 1 of the Financial Statements on pages 122 to 124.

We do anticipate that the majority of the identified risks will materialise over the medium to longer-term horizon. As described on page 35, our strategic and financial planning for 2023 has largely focused on the short to medium term, out to 2033, and we have more work to do to fully reconcile and quantify potential financial impacts beyond this time horizon.

	PERCENTAGE IMPACT ON OPERATING PROFIT BY SCENARIO AFTER MITIGATION (CUMULATIVE 2024 TO 2033)												
	NET ZERO <1.5°C				HIGH TEMP 3.5°C				DISRUPTIVE 1.7°C				TIMING OF HIGHEST EXPOSURE
	CA	D	PS	NM	CA	D	PS	NM	CA	D	PS	NM	
Changing customer demand	(1.2)	(0.4)	0.4	4.0	(0.3)	0.9	(0.1)	0	(0.1)	0	0.4	4.0	10yrs+
Change in costs due to carbon pricing	(2.7)	0.4	(2.8)	0	(0.8)	(0.3)	1.2	0	(0.7)	(0.1)	0.8	0	5-10yrs
Change in costs due to commodity pricing	0.9	0	0.1	0	(4.8)	0.2	(1.9)	(0.2)	2.0	(0.1)	0.4	0	5-10yrs
Changing investment requirement	0	0	(0.3)	0	0	0	0.3	0	0	0	(0.3)	0	5-10yrs
Facility disruption	(0.4)	(0.4)	(0.4)	0	(0.4)	(0.4)	(0.4)	0	(0.4)	(0.4)	(0.4)	0	10yrs+
Supply chain disruption	(1.4)	(0.3)	(0.3)	0	(1.4)	(0.3)	(0.3)	0	(1.4)	(0.3)	(0.3)	0	10yrs+
Impact on product performance	0	0	0	0	(0.5)	0	0	0	(0.5)	0	0	0	10yrs+
Total	(4.8)	(0.7)	(3.3)	4.0	(8.2)	0.1	(1.2)	(0.2)	(1.1)	(0.9)	0.6	4.0	

	EXPLANATION/MITIGATION
Changing customer demand	In the markets we serve, overall demand is expected to be robust in each scenario although product mix may change with customer requirements, particularly in Power Systems where we would see a stronger market for zero emissions solutions. We expect demand in Civil Aerospace to be strong, driven by clear demographic trends; enabled by a continued focus on efficiency and the introduction of sustainable fuels. We would expect climate stress to create opportunities in Defence; both in security and humanitarian response. We see significant opportunity to accelerate the growth of SMR in the medium term in the <1.5°C and 1.7°C cases.
Change in costs due to carbon pricing	We are taking steps to reduce our exposure to carbon pricing by decarbonising our own operations and encouraging our suppliers to do the same. Moves to improve energy efficiency and switch to low-carbon sources improve resilience and have short payback times.
Change in costs due to commodity pricing	Our markets can sustain the commodity price changes assumed in each scenario. There is medium-term risk in the 3.5°C scenario in Civil Aerospace and Power Systems where existing contracts may limit our ability to pass through higher then expected costs, negatively impacting profits. Future contracts with both suppliers and customers need to minimise and mitigate our potential exposure.
Changing investment requirement	In both Civil and Defence aerospace markets, new products are expected in the mid-2030's. High carbon pricing could increase the level of technology required but would also delay new programme launch, allowing resources to be reallocated and presenting an upside opportunity for current products lines. In Power Systems the <1.5°C and 1.7°C scenarios would require an acceleration of investment in new technologies.
Facility disruption	Quantification of potential impact is based on site assessment work carried out by Marsh Advisory and business continuity analysis performed by each division. Future site strategy, investment in existing facilities and development of new footprint options, needs to consider climate risk.
Supply chain disruption	Quantification of potential impact is based on site assessment work carried out by Marsh Advisory and business continuity analysis performed by each division. Future supply chain decisions, including the potential need for dual sourcing, need to consider climate risk.
Impact on product performance	Over the next decade the temperature differences to the baseline in all scenarios are relatively limited. The risk is highest in Civil Aerospace where we see a potential modest increase in shop visit frequency and cost in the 3.5°C scenario.

Key: Opportunity Risk CA = Civil Aerospace D = Defence PS = Power Systems NM = New Markets

Metrics and targets

Emissions are calculated in accordance with the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard and Corporate Value Chain (Scope 3) Accounting and Reporting Standard (GHG Protocol). See our basis of reporting at www.rolls-royce.com for further detail. We calculate and disclose our Scope 1 + 2 and our Scope 3, category 11 emissions.

For further detail on our calculation methodologies, and the assumptions and judgements applied, see our basis of reporting document at www.rolls-royce.com

Scope 1 + 2 emissions

EMISSION SOURCE [1]	2020	2021	2022	2023
Scope 1 + 2: emissions from office, manufacturing and production facilities	199 $ktCO_2e$	180 $ktCO_2e$	180 $ktCO_2e$	148 $ktCO_2e$
Scope 1 + 2: emissions from product testing activities	126 $ktCO_2e$	133 $ktCO_2e$	136 $ktCO_2e$	109 $ktCO_2e$
Total Scope 1 + 2 emissions	326 $ktCO_2e$	313 $ktCO_2e$	316 $ktCO_2e$	257 $ktCO_2e$
Total Scope 1 + 2 emissions normalised by revenue ($ktCO_2e$/£m)	0.0283 $ktCO_2e$/ £m revenue	0.0279 $ktCO_2e$/ £m revenue	0.0234 $ktCO_2e$/ £m revenue	0.0156 $ktCO_2e$/ £m revenue

1 Statutory GHG emissions disclosures are detailed in our SECR statement on page 210

SCOPE 3, CATEGORY 11 EMISSIONS	2022 [2]	2023
Use of sold products on a fossil fuel based pathway (with weight based adjustment)	85.7 $MtCO_2e$	97.3 $MtCO_2e$
Use of sold products on a fossil fuel based pathway (without weight based adjustment)	247.4 $MtCO_2e$	315.5 $MtCO_2e$
Use of sold products of a sustainable fuel based pathway (with weight based adjustment)	70.0 $MtCO_2e$	77.0 $MtCO_2e$
Use of sold products of a sustainable fuel based pathway (without weight based adjustment)	185.1 $MtCO_2e$	229.1 $MtCO_2e$

2 Defence emission adjustments have been updated for partnerships to align to the approach taken in Civil Aerospace. Historical data has been restated to reflect this

Scope 3, category 11 emissions

Emissions associated with use of sold products by our customers, or end-use customers, comprise the majority of our emissions footprint. We completed an emissions inventory exercise in 2019 that demonstrated these represent >90% of our total footprint and it is on this basis that we do not disclose the other 14 categories. We do not anticipate there has been any material change in this composition since then.

We calculate emissions associated with the use of sold products in accordance with the GHG Protocol. Scope 3, category 11 emissions is a complex calculation that requires us to take a forward-looking projection of lifetime emissions of products sold within the reporting year. This requires us to make a number of assumptions about the operation of the product throughout its lifetime, including assumptions on hours of operation, anticipated length of service and fuel choice which may be up to 30 years plus for some of our portfolio. As a result, we have opted to report four emissions metrics representing two differing fuels scenarios; one is based on an assumed pathway of 100% fossil fuel based operation out to 2050 and the other assumes a 100% sustainable fuel uptake by 2050, both with and without a weight-based adjustment applied. For further detail on these assumptions, and other judgements taken, see our basis of reporting document available at www.rolls-royce.com/sustainability/performance/reporting-approach

The majority of our portfolio is recognised by the GHG Protocol as an intermediate product which requires us to take an allocation of emissions based on a proportion of the total emissions of the final platform. We do so as a weight-based adjustment, as advised within the GHG Protocol. At present this adjustment is only applied to the relevant Civil Aerospace and Defence portfolio; our Power Systems portfolio is inherently more complex and varied and for this business we do not yet have the same level of visibility of the emissions performance of our products in the final product application, nor would a weight-based adjustment be appropriate for parts of the portfolio, such as stationary power generation. We will seek to progress visibility of this data in 2024.

There have been increases in our Scope 3, category 11 emissions. This has been driven mostly out of Civil Aerospace due to ~100 extra engines being delivered. Power Systems has had increased sales volumes as well as a change in product mix with more products with higher operational hours. Defence have seen a slight reduction in emissions driven by lower OE sales in 2023 compared with 2022.

Climate-related targets

We are committed to reaching net zero carbon emissions by 2050. As part of the commitments we made under the UN Race to Zero campaign in 2021, we announced short-term targets to help accelerate progress against this goal within our core business activities. These targets formed part of our remuneration policy (see page 100). We have met significant targets demonstrating product compatibility with sustainable fuels across all our divisions, as well advancing the use of these fuels in our own testing activities. For the new remuneration policy to be considered by shareholders at the AGM in May 2024, see page 88.

We recognise the role of interim emissions reduction targets in helping us and our stakeholders monitor progress against our long-term goal. In our 2022 Annual Report, we disclosed draft Group targets for Scope 1 + 2 and Scope 3, category 11 emissions that had been submitted to the SBTi for validation. As a result of the strategic review in 2023 (see page 10), we have since withdrawn these targets from the validation process. As a result, we do not currently have Group-level targets in place to address our material emissions sources.

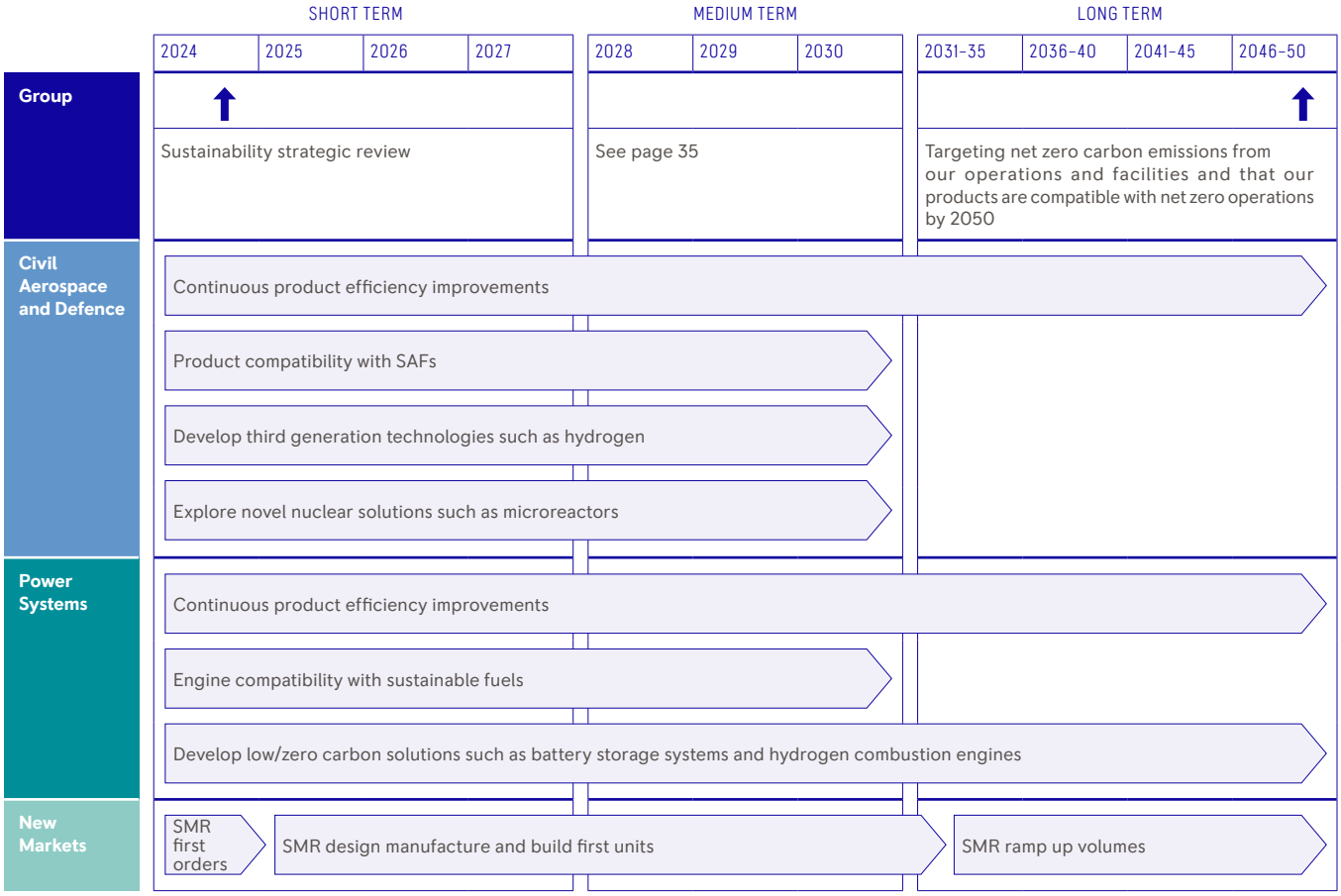
In 2024, it is our intent to complete a comprehensive review of our sustainability and climate-related strategy and approach to align and integrate with the outcomes of the strategic review. This will include redefining Group climate-related and emissions reduction targets.

2023 TARGETS	PERFORMANCE
Utilise a 10% blend of SAF across our product testing activities for Civil Aerospace operations	**Target met** We utilise a contribution of over 10% SAF in our Civil Aerospace engine testing, primarily at our largest test sites in the UK and Germany. Of the 18.6m litres of fuel consumed by our global testing activities in 2023, 1.9m litres of this was SAF.
Prove all in-production commercial Civil Aerospace engine types are compatible with 100% SAFs	**Target met** We completed a successful series of one-off ground and in-flight tests across our Civil Aerospace portfolio on 100% SAFs. Engines tested during 2023 include the Trent 7000, BR710, Pearl 10X and the first run of our UltraFan demonstrator. We are the only aerospace original engine manufacturer to test our entire portfolio on 100% SAFs.
Prove compatibility of major Defence engines in production for 100% SAF	**Target met** We successfully tested the AE, Trent 700, Model 250 and Advance 1 on 100% SAF in 2023.
Release 80% of our Power Systems portfolio for use on sustainable fuels	**Target met** The *mtu* Series 2000 and 4000 engines, the most popular reciprocating engines which make up 80% of our Power Systems portfolio, have been successfully tested and released for use on 100% unblended synthetic diesels.

Transition plan

We recognise the increasing expectation for companies to develop and disclose a detailed transition plan outlining the steps they are taking to align with a low and net zero global economy. Throughout 2023, we were actively participating in the development of the Transition Plan Taskforce guidelines as one of a small number of companies involved.

For 2023, we are disclosing a high level transition plan. We continue to work towards our target of net zero carbon emissions by 2050 and, in 2024, we will conduct a full strategic review of sustainability, delivering a more granular transition plan with defined metrics and targets that will allow us to measure progress and deliver net zero goals.



Responsible consumption

Understanding and minimising our environmental impacts across our operations and value chain helps ensure we are a responsible and resilient business. We particularly focus on minimising energy consumption and waste generation and on maximising resource efficiency and recycling.

OUR PROGRESS IN 2023

- Achieved 2025 normalised energy reduction target two years early
- Completed Group-wide Scope 1 + 2 net zero carbon roadmaps
- 100% of active suppliers in tier 1 supply chain completed first stage of sustainability due diligence

We are committed to behaving in a way that minimises impact on the environment. This means taking personal and collective responsibility with our business partners to prevent or minimise any adverse environmental impact from our activities, products and services. As set out in our health, safety and environment policy, we do this by striving for resource efficiency and supporting the sustainable handling, collection, storage, use and disposal of resources. Increasing our operational resilience in this way is fundamental to the success of our business and is an integral part of how we work every day.

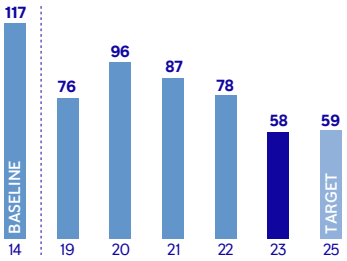
We focus on our material impacts by optimising energy use; reducing GHG emissions; reducing waste and optimising material efficiency. For each of these focus areas we implement measures to mitigate, prevent or minimise impacts and drive progress against our environmental targets. Our Group-wide targets are supported by individual business-level targets as well as specific local targets to respond to particular risks or opportunities. For example, our recycling and recovery target is broken down into different sub-targets for our individual divisions depending on the types of wastes they generate and the opportunity to recycle them whilst remaining compliant with relevant local legislation.

During 2023, we completed Scope 1 + 2 net zero carbon roadmaps for each of our major sites; delivered a detailed physical climate risk site assessment (see page 38); and continued to grow our understanding of our impact on biodiversity and nature. This year, we achieved our normalised energy consumption target two years early, having reduced absolute energy consumption by 429,697 MWh (31.2%) since the baseline in 2014.

The incentive for circularity is deeply embedded in our business model given the significant aftermarket and maintenance requirements of our products. We focus on the remanufacturing and reuse of components and pay particular attention to the responsible use of chemicals, waste and water. At our Magdeburg site in Germany, we have improved the remanufacturing process for railway PowerPacks, including for their complex drive motors. We provide the users of our products with a comprehensive programme for spare parts and service solutions to maximise the performance and value of our products in use.

Our supply chain plays an important role in our ability to reduce environmental impacts, build operational resilience and improve performance against our targets. In 2023, all active suppliers were screened and risk rated using recognised commodity and country risk indices to understand the inherent sustainability risks in our supply chain. Prioritised suppliers are requested to complete comprehensive environmental performance assessments and, where appropriate, offered support and resources to instigate improvement plans. These assessments will also provide greater visibility of Scope 3, category 1 purchased goods and services emissions and broader climate impacts on our supply chain.

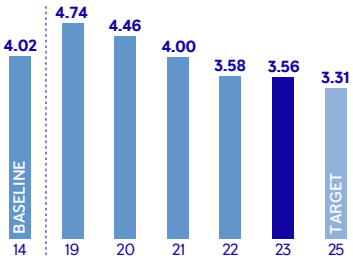
Energy consumption (MWh/£m)



Target
Reduce total energy consumption, normalised by revenue, by 50% by 2025 [1, 2, 3]

Reducing our energy demand is integral to our success in delivering our decarbonisation goals and reducing our exposure to energy-related risk. Our normalised energy consumption in 2023 was 58 MWh/£m. This represents a reduction of 429,697 MWh (31.2%) since 2014. The total amount of energy consumed in the year was 947,955 MWh, of which 34% came from renewable energy sources, including 1.5% generated from our own on-site clean energy installations.

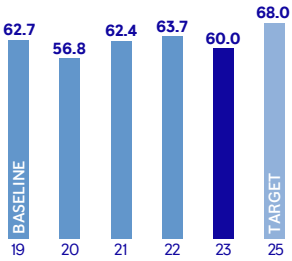
Total solid and liquid waste (t/£m)



Target
Reduce total solid and liquid waste production, normalised by revenue, by 25% by 2025 [1, 2, 3, 4]

By focusing on the waste hierarchy and introducing new technology, we continually improve our management and reduction of waste. In 2023, our total normalised solid and liquid waste was 3.56 kilotonnes/£m, an 11% reduction since 2014. The total amount of solid and liquid waste generated in operations was 58.8 kilotonnes, compared to 48.3 in 2022. This includes 21 kilotonnes of hazardous, primarily chemical, waste. The overall increase in the volume of waste produced has been driven by an increase in liquid wastewater that would normally be treated on site. We continue to pursue opportunities to prevent or reduce waste.

Recycling and recovery rate (%)



Target
Increase the recycling and recovery rate to 68% by 2025 [1, 2, 4]

Our recycling and recovery rate for 2023 was 60.0%. This represents a 2.7% reduction against the 2019 baseline, driven by an increase in production resulting in more non-recycled foundry sand and chemical process waste. Our Power Systems business has a recycling and recovery rate above 80%. During the year, 6.1 kilotonnes of waste were sent to landfill, a 24% increase since 2014, primarily due to the increase in waste foundry sand. We continue to work to identify appropriate alternatives to landfill disposal for complex waste streams, such as foundry sand.

1 External assurance over selected sustainability data, detailed on page 209, is provided by Bureau Veritas. See page 209 for their sustainability assurance statement
2 Data has been calculated in accordance with our basis of reporting. This and further data is available at www.rolls-royce.com
3 Energy and waste data are normalised by Group revenue (£m)
4 Historical data has been updated with actual rather than predicted data

People and culture

Our 2023 people priorities focused on the areas required to step change our culture and performance, enabling our transformation.

OUR PROGRESS IN 2023

Implemented a new differentiated performance management framework to enable high performance

Exceeded our 2023 engagement target with a grand mean score of 3.99 and our greatest ever participation rate

Took significant steps to embed our enterprise approach to skills and capabilities to drive synergies and simplify the way we operate

Enabling colleagues to thrive, grow and co-create our future is critical to building a high-performing, competitive, resilient and growing company. Our colleagues dedication to engineering excellence, safety and integrity has enabled our rich heritage and history of innovation. We continue to be a Company that makes a difference with our people at the heart of everything we do. Our 2023 people priorities focused on the areas required to make a step change in our culture and performance, enabling our transformation. These were all underpinned by our values of trust, integrity and a rigorous focus on safety in everything we do.

Our 2023 people priorities were:

- safety, health and wellbeing;
- performance management: enabling high performance; rewarding and recognising our people;
- leading with purpose – driving a growth agenda: empowering our leaders; learning, skills and capabilities;
- culture and behaviours: inclusion, equity, diversity and belonging; engagement and listening; and
- colleague experience: wellbeing; community investment and STEM outreach; change and transformation.

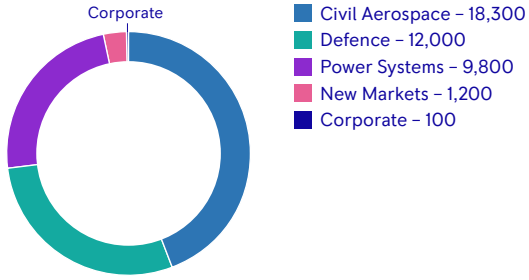
Safety, health and wellbeing

The safety of our people and our customers is a core value and our top priority. We consider all incidents to be preventable and focus on proactive safety behaviour as the foundation of our safety culture and journey to zero harm. We believe that safety is everyone's responsibility and continue to embed it into everything we do. Visible, engaged leadership is critical to driving this culture. Through our habitual safety moments focus is given to safety at the start of leadership meetings. We raise awareness of important topics, safety roles and responsibilities and incorporate real life examples in these moments to ground relevant messages.

Safety risks are actively monitored to minimise risk, identify improvement opportunities and continue to create a safe and healthy working environment that is free from harm. Our safety index, introduced in 2021, is the core measure of our safety culture. It consists of five leading indicators that measure a key element of our safety culture: senior leadership safety walks; safety case improvement activity; HSE alert response; close-out of HSE non-conformances; and accountable person engagement. These measurements, alongside more traditional measures such as injury rates, enable an evaluation of our safety culture and we use this information to drive action and enhance proactive safety behaviours and interventions.

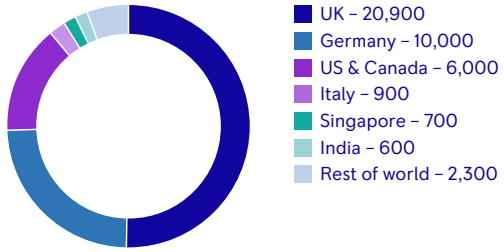
In 2023, we achieved a target safety index score of 94% representing an improvement of 9% percentage points on the previous year (2022: 85%). We achieved this through a stronger focus on safety leadership and the management of our high consequence hazards. This included significant improvements in the number of safety leadership walks at 97% in 2023 (2022: 83%) and accountable person engagement at 94% (2022: 72%).

41,400 employees total (monthly average) *



* Segments are defined in note 2 on page 137

Employees in 48 countries (monthly average) *



* Employee headcount data represents permanent employees and excludes contractors

We work to identify and control preventable incidents and we believe that motivating colleagues to lead healthy lifestyles and maintain good wellbeing is critical in creating safe and healthy working environments. Our industry-leading LiveWell programme encourages colleagues to take personal responsibility for their health and wellbeing and support others to do the same. Our wellbeing site provides tools and resources including practical guides and learning materials to support people with their mental, physical and financial wellbeing.

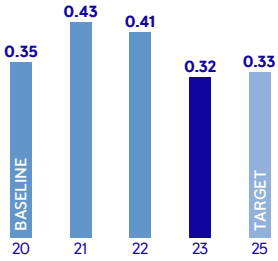
LiveWell is a global, evidence-based accreditation scheme through which sites, facilities and teams assess their workplace on supporting three key areas: healthy bodies, healthy minds and healthy workplaces. It empowers teams and individuals to set data-based goals and focused actions on removing barriers to health and wellbeing. Our LiveWell programme is current in 21 countries and covers 84 workplaces globally.

In addition to LiveWell, we continue to engage colleagues and raise awareness of the importance of workplace safety. Forty-five health and wellbeing events took place across the enterprise in 2023, representing a total of 75,530 engagements. In April and May, we held global world safety day events in all three divisions, re-emphasising the importance of health and safety as our top priority. We also introduced new safety toolkits on monthly risk themes aimed at reducing incidents and empowering teams to reflect, think and plan how they can work more safely.

Our total reportable injuries (TRI) rate has continued to fall this year through our continued efforts to prevent harm and injuries. In 2023, our TRI rate was 0.32 per 100 employees representing a 20% reduction

(2022: 0.41). There was a total of 139 TRIs with 17 incidents resulting in major injuries (including six contractors). There were no fatalities. In 2023, we exceeded our target TRI rate, which was set in 2019, and plan to review this in 2024 on our journey to zero harm. When incidents do occur, we have systems in place to share learning across the Group and improve our controls to prevent similar incidents occurring in the future. Sharing knowledge to learn, grow and minimise risk is a key element of our transformation programme and continued focus on safety as our number one priority.

TRI rate (per 100 employees)*



* Our TRI rate shows the Group TRI performance (absolute and rate). External assurance over the TRI data is provided by Bureau Veritas (see page 209)

Performance management

Enabling high performance

We believe a differentiated performance culture, where performance expectations are clearly defined and results tightly monitored, will drive the step change necessary to become a high-performing, competitive, resilient and growing company. In 2023, we launched a new Group-wide performance management framework to embed this approach.

Our reward and recognition programmes were also adjusted to support greater differentiation of individual outcomes. Our core programme for leaders and colleagues includes regular on-going check-ins, annual performance reviews and disciplined calibration. Our approach encourages an agile mindset that is outcome focused and acknowledges that high performance is a relative concept.

We provide accessible support through digital tools to enable our people to grow and achieve their full potential. In 2023, we launched new interactive learning resources for leaders to support the performance of their teams. The new resources focus on ensuring that high quality performance conversations take place and help leaders take account of how people achieve their results as well as measure the impact of what was achieved. As we continue to build our high performance culture and enable transformation, our leaders are critical to this shift and we are already seeing a step change in their approach, which is evidenced in our financial results. Our 2023 employee engagement survey results (see page 46) also highlight positive change in leadership, with a significant increase on the continuous feedback to improve question which shows that our leaders are providing actionable feedback to their people to drive improvement and enhance performance.

Rewarding and recognising our people

Our pay philosophy is directly connected to our performance management framework and we take a Group approach for all people leaders globally. Where possible, we align individual goals to strategic priorities and connect reward and recognition to business success with differentiated outcomes recognising performance that delivers the greatest impact.

Our global incentive arrangements are aligned to the delivery of our business strategy through direct cascade from Executive Director incentive metrics (see page 18). Cascade of goals aligned to transformation has been a key priority for us in 2023. From 2024, all senior leaders have new clear performance contracts setting out their priorities.

Steps are being taken to enable all colleagues to understand how their accountabilities and deliverables support business strategy and their role within it. We believe this will drive performance and enhance colleagues pay and benefit opportunities. As an example, during 2023, we implemented a new compensation system in Germany that enables performance differentiation and simplification of base pay arrangements for the vast majority of our people covered by tariff arrangements.

In 2024, we aim to enable more colleagues to share in our success through enhanced affordable share ownership options. We currently offer tax approved ShareSave and SharePurchase plans in the UK and non-tax qualified cash settled phantom ShareSave plan for colleagues outside of the UK. We also plan to expand our work on global living wage standards in line with our continued focus on pay and benefits.

We are committed to fair and appropriate levels of pay and conform to all national pay laws globally. In the UK, we pay all colleagues above the standards outlined by the Living Wage Foundation and we require all our suppliers to meet minimum/fair wage standards by signing up to our global supplier code of conduct.

Leading with purpose – driving a growth agenda

Empowering our leaders

Our leaders play a critical role in transformation and in 2023 have been challenged to think and act differently. We have encouraged leaders to ruthlessly prioritise what they do to enable a tighter focus on priorities and to work smarter and achieve better outcomes together. We are making good progress and have already accelerated our financial delivery (see page 20) which gives us confidence in the ability of our leaders to make the step change in performance required to deliver our strategic priorities.

We have undertaken different ways of engaging leaders as part of this approach through new learning methods and tools. In 2023, we developed resources on change, performance management and communication as well as introducing experiential peer-to-peer leadership learning workshops. Many of our leaders took part in our new winning together performance management learning series, including showing care through consistency, embracing the relativity of performance and psychological safety. We received great feedback and the events are now available digitally for all leaders to use. We have continued to expand our formal leadership learning programmes and leadership fundamentals that provide critical leadership skills for first and second-line leaders, and in 2023 we launched a new strategic development programme for senior leaders. Alongside our formal leadership development programmes, we also continue to update our digital leadership toolkit with new resources and communication guides focused on engaging teams during times of change. In 2023, utilisation of this award-winning resource was just over 166,000 learning engagements, (2022: 138,500).

Learning, skills and capabilities

In 2023, we have taken significant steps to embed a Group-wide approach to skills and capabilities to drive synergies that will enable us to be more competitive and simplify the way we operate. Capabilities and skill development are a core element of our learning agenda. They also enable us to share expertise, specialist capability and resources more effectively to align with our strategic priorities. Our business capabilities are engineering, technology, safety, procurement and manufacturing operations.

We have significant engineering expertise, and in 2023 we brought together ET&S as a key element in our new organisation design, right at the heart of our Group (see page 9). We believe this will enable enhanced mobility and growth for our engineers and create better efficiency and agility. This is supported by our #alwayslearning culture, self-led, continuous learning and supporting tools and resources. Our continued investment in digital tools provides enhanced experiential learning opportunities and fosters a digital, agile learning culture to keep up with the pace of change and to support future growth.

We continually refresh and update our learning resources in line with our strategic priorities and track development on critical skills and capabilities at Group level. Leatro Collections, our curated learning, provides learning on capabilities required to deliver our transformation. As a key priority, safety is one of our core offerings and we built on this in 2023 to include business acumen and commerciality, health and wellbeing, engagement and change as well as inclusion, equity diversity and belonging. Learning week, held in September, showcased our learning resources with internal and external leaders including our Chief Executive and three senior leaders talking through their personal approach to learning and experience and adapting through change.

Aligned with Our Code and our Group policy framework, we also deliver an annual Group-wide mandatory learning programme centred on our values and behaviours and our safety, security and legal obligations. In 2023, 96% of colleagues completed all mandatory learning (2022: 94%). Our continued investment in learning and development in 2023 was £20.8m (2022: £17.8m), delivering 757,629 hours of formal learning (2022: 581,505 hours).

Enhancing development using skills and gigs

In 2023, we continued our work on skills development using gigs to both enhance learning and embed new agile ways of working. Introduced in 2022, gigs use digital systems and artificial intelligence to create an internal marketplace of bite-sized tasks to enable colleagues to drive their own learning and skill development creating their own career experiences as a result.

Our early pilots were successful and experiences reported by participants were positive. Colleagues involved in gigs are 1.5 times more likely to respond highly to our engagement survey questions on learning and growth. We expanded gigs to the full enterprise in October 2023 and around 11,000 people had signed up by the end of the year.

It is driving growth in discretionary effort and productivity as well as motivating colleagues to seek new opportunities to learn and grow in skills areas anticipated to be required and valued in the future. This is supporting our self-led learning culture, putting people at the heart of their own development. It provides rich, cross-enterprise experience, both increasing people's breadth and enabling agility within the organisation and enhancing delivery of key projects through increased access to resources and diversity of thought.

Culture and behaviours

Engagement and listening

Engagement is an outcome of our employee experience with a focus driven through our people leadership practices, purpose and performance culture. We believe that highly engaged colleagues fuel improved business outcomes. Engagement is one of our Group KPIs with continued links to leadership incentive plans (see page 18). Listening, understanding and acting on colleagues questions and concerns is a critical aspect of our transformation journey. In 2023, our engagement grand mean was 3.99. We surpassed our Group target of 3.97, set in 2019 with our partner Gallup, and achieved a meaningful, consecutive increase of 0.14 since 2022 (0.47 since 2019). We also secured our highest participation rate of 80% with 32,544 colleagues completing the survey.

We take a people first approach to listening, engagement and communication and believe our leaders play a vital role given the direct impact of their behaviour and actions on the people they lead. We provide data and insights to leaders through Gallup to enable them to work together with their teams on action plans and improvements. In 2023, we introduced new governance to monitor engagement across the Group. It enables better sharing of best practice where teams have made significant improvement as well as the ability to provide targeted learning to support the teams that need it most.

Our inclusion goals

We drive inclusion to unleash the power of our people

Lead
We drive inclusive leadership behaviours and capabilities to create high performing teams

Attract
We promote our inclusive values to enable us to hire the best talent

Engage
We create an inclusive culture in which everyone is actively engaged, belongs and can be at their best

Develop
We support the growth of our learning culture to empower everyone to reach their full potential

In addition to our survey, we provide a variety of channels for colleague engagement and listening, including interactive learning sessions, newsletters and team briefings as well as digital communication channels such as Viva Engage. Through our transformation programme we are introducing new ways to engage with colleagues and amplify employee voice. In 2023, we have held regular live town halls with Q&As hosted by our Chief Executive and Executive Team. Our global inclusion networks (see page 47) also play a key role in engagement and listening. Members of our networks have been invited to various leadership sessions this year and our Employee Champions have attended some of the network sessions to listen to what colleagues think about key topics (see page 60). In May 2023, we held another Meet the Board event continuing to foster engagement with our Board members as well as encourage all colleagues to contribute and help co-create our transformation (see page 60). Engaging colleagues to shape our future helps us to build a better and stronger business that everyone is proud of. We made CMD accessible for all colleagues to attend virtually and we held multiple local sessions to flow down key messages as well as creating new digital tools and resources to ensure that everyone had access to information on our new strategy and business plan.

Culture underpins everything we do, and in 2023, through our culture and purpose transformation workstream (see page 66), we started work to evolve our culture and behaviours to align with our strategic priorities and foster a new winning mindset. We invited all colleagues to help shape our new purpose and culture ambition through 16 global focus groups and an all-employee crowdsourcing opportunity. We are working to better understand our current culture and establish new ways of monitoring and measuring culture to track progress against our future ambitions. In 2023, we introduced a new Group-wide horizon scanning capability using organisational uncertainty metrics. This enables us to identify and mitigate people risk across the organisation quarterly and is reviewed at our people committee (see page 69). This committee and the Nominations, Culture & Governance Committee will oversee our continued work on culture and purpose.

Inclusion is everyone's business

Our ambition is for all colleagues to feel psychologically safe and able to be at their best, thereby driving not only our colleague experience but also individual and business performance. We believe that being inclusive will enhance our ability to attract, retain and grow the critical diverse talent we need to succeed now and in the future. Whilst we continue to report against our established diversity and inclusion (D&I) 2025 targets, we have matured our approach to focus more on building a culture of inclusion and belonging. Throughout 2023, the global inclusion team have focused on embedding inclusion throughout the Group.

Our inclusion goals (see above) provide the framework to enable our ambition. Our 2023 mandatory learning on behaviours focused on psychological safety. It consisted of interactive learning on

microaggressions, exclusion and health and safety and included real-life case studies to bring the subject to life. Ninety-five percent of all colleagues completed this training in 2023. Mandatory learning is a key element in our approach to embed dignity and respect throughout the Group.

Our global inclusion networks also play a critical role in driving our strategy and allowing the voices of all our people to be heard. They are groups of colleagues, organised primarily around a specific characteristic or life experience, who provide personal and professional support to each other, run events and help everyone to focus on inclusion. In 2023, our D&I councils were refreshed as business inclusion forums operating under the umbrella global inclusion forum. In 2023, the forum met quarterly with the global inclusion network chairs to ensure two-way communication at all levels.

In September, we launched our Rolls-Royce inclusion week, led by the global inclusion team and supported by a group of volunteers. The week included enterprise-wide sessions covering a range of topics such as inclusive language, allyship and neurodiversity led by external and internal speakers. During the week, 2,976 colleagues attended at least one of the virtual sessions.

Accelerating diversity and attracting future talent

As outlined above, we believe that to enhance diversity our primary focus should be on creating a safe, inclusive and equitable working environment where everyone feels valued and belongs. We also continue to focus action on improving our diversity. Increased awareness and an intentional focus on diversity in hiring and succession planning has resulted in an increase in the representation of women at all leadership levels in 2023 (see diversity metrics opposite). We focus action on diversity in succession planning and support diverse colleagues to thrive and grow through targeted learning programmes and support initiatives.

Following a successful implementation in 2022, we further embedded our Thrive programme during 2023. The programme focuses on enabling women and includes internal mentoring, coaching and skill development workshops. Eighty-nine women across the Group participated in Thrive this year with 88% of participants sharing feedback that they would recommend the programme. Forty-six percent of participants were promoted, moved role or had their responsibilities expanded. We will also continue to accelerate diverse talent through transformation where inclusion and diversity principles have been built into our restructuring approach and Group-wide people system.

In 2023, we significantly reduced external recruitment as part of our effort to mitigate job losses that could result from the transformation programme but we continued to recruit into critical roles and skill gaps and sustained our focus on future pipeline through early career programmes. Across our recruitment programmes, we continued to enhance the inclusivity of our processes. This included introducing additional support through the process for any candidate declaring a disability at application stage and continuing our recruitment bias learning for all assessors and interviewers. We give full and fair consideration to all employment applications from people with disabilities. If an employee becomes disabled whilst working for us we take steps to support their continued working including, wherever possible, making adjustments to ways of working.

Within early careers and education outreach we continue to focus on diversity and inclusion (see page 48). Our aim is to engage and inspire more females and ethnically-diverse talent into STEM, supporting our future talent pool, as well as more broadly within the communities in which we operate and our supply chain. In 2023, through targeted campaigns to attract more ethnically diverse candidates, we hired 34% ethnically diverse graduates (2022: 17%) and 19% ethnically diverse apprentices (2022: 31%).

Twenty-two percent of our apprentice hires were female in 2023 (2022: 22%). Our female graduate hire rate was lower in 2023 at 32% (2022: 40%).

We continue to expand our partnership approach and have introduced new initiatives in 2023. These include working with UpReach a partnership aimed at undergraduates from less-advantaged backgrounds supporting access to top graduate employers, the National Coding Challenge and sponsoring the wellbeing student roadshow. Through Undergraduate of The Year (UGOTY), we sponsored three undergraduate awards and converted 30% of the finalists into internship offers across our female, social mobility and neurodiversity categories (100% female conversion and 54% ethnicity conversion). Our i-Accelerator insights programme supports 30 ethnically diverse students across both STEM and business programmes.

We still have much work to do and our focus remains on inclusion, equity and belonging. Moving forward, we plan to adopt a more holistic approach to driving systemic change. We are determined to increase the diversity of our workforce and work together to create a company where every person can belong. We have been recognised in our efforts and placed 42nd in the top 50 Inclusive Companies Award 2023 and we progressed from 336 to 47 in the Financial Times Diversity Leaders 2024 ranking.

Our diversity metrics at 31 December 2023 [1]

Female diversity percentage tracking and 2025 targets

	2022	2023	2025 target
The Board [2]	33%	50%	50%
Executive Team	18%	30%	33%
ELG	22%	23%	35%
Senior leaders [3]	22%	24%	30%
All employees	18%	18%	25%

Ethnic diversity percentage tracking and 2025 targets for UK and US [4]

	2022	2023	2025 target
UK ethnicity	11%	11%	14%
US ethnicity	16%	17%	20%

Gender diversity

	Female	Male	Total	Female (%)
The Board	6	6	12	50%
Executive Team (ET)	3	7	10	30%
ET, Chief Governance Officer and direct reports	23	49	72	32%
ELG	17	56	73	23%
Senior leaders [3]	20	63	83	24%
All employees	**7,662**	**34,148**	**41,810**	**18%**

1 The data for diversity information is showing permanent employee year-end actuals
2 The Board diversity policy aims for gender parity
3 Senior leaders are defined in the Companies Act 2006 (those who have responsibility for planning and directing or controlling the activities of the entity or a strategically significant part of it). We do not include all subsidiary directors in the definition of senior leaders as this would not accurately reflect the leadership pipeline. We have a large number of small and dormant subsidiaries and the composition of these Boards reflects their level of activity. Accordingly, senior leaders refers to the Executive Team and the ELG
4 For ethnicity information we are only able to monitor and track this in the UK and US and therefore this only includes businesses in these locations. The population is only those who have chosen to disclose this information

In October, we launched our global self-identification project, 'count me in' which aims to increase diversity data disclosure from our global workforce. Through this project, colleagues can self-disclose their nationality, gender identity, armed forces service, social mobility, carers and parents status, sexual orientation, neurodiversity, religion, and disability (where not restricted legally). We have made good progress with the project in the first three months since launch with 46% of our people self-disclosing. We plan to review our 2025 ambitions, including D&I targets, once we have greater participations because we believe this will enable a review of our ambitions in a more meaningful way. In 2023, we submitted diversity data to the FTSE Women Leaders and Parker Review and explained our decision not to set new

targets this year. As a multinational organisation we operate consistently across the Group and vary our approach accordingly to local legislative frameworks and D&I requirements. We plan to take a One Rolls-Royce approach to diversity metrics and tracking progress and this will be part of a broader, more holistic review of our equity, inclusion, diversity and belonging ambitions moving forwards.

Colleague experience

Supporting wellbeing

We recognise the uncertainty and challenge associated with transformation. We believe in creating a working environment where all colleagues can be at their best and, in 2023, we increased the support provided. We developed a new virtual wellbeing site containing tools and resources to help support our colleague's wellbeing. Our new wellbeing resources form a key element in our LiveWell programme (see page 44). We have received 22,570 visits to our new LiveWell microsite since its launch in February 2023.

We have continued to embed existing wellbeing tools and resources, developing over 100 new resources for people leaders to engage their teams on mental health and wellbeing topics. An example, in 2023 there was a new leadership workshop titled 'resilience during times of change'. Our programme on mental health included promotion on World Mental Health Day with a focus on managing anxiety through uncertainty and change and included interactive workshops by internal and external leaders. The day was a great success, with 21,352 colleagues attending our events and significant engagement on our internal media and communication channels. We continue to engage in national events to highlight important topics and focus conversations and we work hard to ensure that mental health and wellbeing remain talking points all year round.

Our global mental health champion network, a group of volunteers trained to guide colleagues and provide support, has increased 33% in 2023 to over 728 champions globally in 13 countries. We have worked to expand the network and enhanced learning through the sharing of best practice and new toolkits for our champions and leaders to use, to connect and signpost colleagues to our support sites, tools and resources.

During 2023, we also maintained our focus on menopause, and our monthly cafe community now has over 300 members who meet regularly to share information and host discussions on important relevant issues. We launched a new training programme in the UK for leaders supporting team members going through the menopause and our aim is to launch this globally in 2024.

Community and STEM outreach

Our ambition is to contribute to a more equitable and inclusive society by enabling our people to make a positive social impact and investing in education and skills. Our priority is to support young people, particularly those underrepresented in our industry, to achieve their aspirations and overcome barriers to success.

We understand the interdependencies between business and society and invest in our communities to address social needs in a way that makes sense for our business. We engage with local partners to help focus our action on activities that provide the greatest positive impact for all of our stakeholders.

We deliver high quality STEM learning experiences that encourage children from an early age to explore and be inspired by the role of science, technology, engineering and maths in finding solutions to the challenges facing society and our planet. During 2023, our STEM ambassadors supported programmes and partnerships across the globe to raise aspirations and encourage young people to continue STEM studies to achieve the qualifications needed to pursue a career in STEM. We reached 1.01 million people through our STEM programmes in 2023 and are now 41% towards our target to inspire 25 million of tomorrow's pioneers by 2030.

Inspiring future generations with STEM

Encouraging young people to explore how things work and find ways to do things better is fundamental to our STEM outreach programmes. We work with Girlguiding and the Scouts in the UK to sponsor STEM badges and provide practical STEM activity resources for 7 to 18 year olds, estimated to have engaged approximately 137,000 young people during 2023.

Addressing inequalities in STEM

Our programmes help to enable future success in communities challenged by barriers to participation. We have partnered with Glyph in Singapore to design highly-participative STEM workshops for children from less-privileged backgrounds and engaged 688 students in 2023. The sessions took place both in the community and on our Seletar site, supported by our STEM ambassador team.

Enabling excellence and innovation in STEM teaching

Our UK schools prize for science and technology provided £200,000 in bursaries through the National STEM Learning Centre to support continuous professional development for STEM teachers, estimated to enhance the learning of approximately 42,500 students during 2023. We invested an additional £60,000 during 2023 in awards to schools to develop innovative teaching projects and will be announcing the winners in 2024.

Our people remain at the heart of all our programmes and contributed 37,680 hours (2022: 48,347) to community investment and education outreach programmes in 2023. In addition, at least 106 teams across the Group completed practical projects in their local communities ranging from improving community facilities to maintaining natural environments. We embed community investment and education outreach opportunities into our strategic learning programmes, including early career training, skills development gigs, as well as being a fundamental element of our wellbeing strategy and LiveWell accreditation programme (see page 44).

Our global charitable contributions and community investment for 2023 is valued at £4.3m (2022: £5.1m) with £3.0m in cash donations which included £520,000 of funds received as a result of a share forfeiture programme carried out in earlier years. £250,000 was provided to support communities impacted by the earthquake in Turkey and Syria in February.

Change and transformation

We have made good progress in our transformation in 2023 (see page 6) but there remains a lot more to do. We have confidence in our ability to be a better and stronger business than we are today. To do so, one of our transformation building blocks is to create a simpler and more efficient organisation, a truly customer-centric business where multi-disciplinary working enables us to unlock our potential and move at pace, as one team, One Rolls-Royce.

Bringing together ET&S (see page 9) is a significant change right at the heart of our Group. They will also have responsibility for our engineering standards process, methods and tools and operate with a flexible resourcing model to deliver the programmes in the divisions. The same approach was taken to strengthen our procurement capability and organisation. This will see us capitalise on economies of scale for our key commodities and provide a stronger service to our customers.

Group-wide synergies have been identified to enable us to manage our costs more tightly. This work has allowed us to minimise the resulting headcount reduction announced in October 2023 of between 2,000 to 2,500 roles worldwide by the end of 2025. In 2024, we will continue to embed our transformation principles, including redeployment and other levers available whilst maintaining continuous dialogue with our people and their employee representatives.

Ethics and compliance

We are committed to conducting business with integrity and creating a working environment where everyone can be at their best.

OUR PROGRESS IN 2023

- Delivered a global engagement campaign on ethics and compliance
- Developed a Group human rights reporting tool
- Appointed division-level human rights committees

We are committed to upholding high ethical standards underpinned by our values and behaviours to create a working environment where everyone at Rolls-Royce and those we work with can be at their best. Our code of conduct (Our Code) and associated Group policies guide our actions and decisions to ensure we can be proud of the way we behave and the way we do business.

In 2023, a global 'win right' campaign was deployed across the Group to engage our employees on the important role they play in maintaining our high standards of ethics and compliance. In addition, as part of our 2023 annual mandatory learning programme, our core compliance learnings included handling confidential information, data privacy and complying with export control requirements. We ask all our employees to annually certify their understanding of Our Code, which is mandatory for our leaders.

We strive to create an environment where everyone feels valued and actively encouraged to speak up about questions or concerns without fear of negative consequences. This is a vital part of enhancing our culture of inclusion and belonging. Everyone can use our speak up channels, whether or not they are an employee. We provide multiple ways to raise a concern, including the Rolls-Royce speak up line which enables concerns to be raised anonymously and confidentially in multiple languages. A speak up report highlighting key statistics is made available to employees at regular intervals to remind them of the importance of speaking up and our annual speak up report video is published on our website.

We have a zero tolerance approach to misconduct of any kind and will take disciplinary action, where appropriate, up to and including dismissal in the event of a breach of Our Code. In 2023, 132 employees (2022: 76) left the business for reasons related to breaches of Our Code. The increase in numbers of dismissals is due to a range of factors, including enhanced consistency of tools across the Group which record and classify dismissals and our commitment to continuous improvement.

Supply chain sustainability

Our global supplier code of conduct sets out the ethical principles we expect from our suppliers. All suppliers are required contractually to adhere to this or a mutually agreed alternative. We work closely with our partners to continually improve the environmental and ethical performance of our supply chain. Partnering with a leading third-party provider, we conduct sustainability screening and assessments to understand the inherent sustainability risks within our supply chain and take appropriate mitigating actions where required.

In 2023, all active suppliers were screened and risk rated using recognised commodity and country risk indices across environmental, ethics, labour and human rights topics. Prioritised suppliers are requested to complete a comprehensive assessment of their sustainability risk management. Where risks are identified, suppliers are asked to put in place improvement plans and offered support and resources to help with this via our third party partner. To enhance the effectiveness of our due diligence controls, we also updated our partner contracts with specific sustainability clauses.

Anti-bribery and corruption

We do not tolerate bribery and corruption in any form, as set out in Our Code and associated anti-bribery and corruption policy. We routinely check and test the effectiveness of our anti-bribery and corruption programme to manage proactively the associated risks (see page 53). In 2023, we continued to monitor our controls through compliance specific assurance activities through site visits and reviews of financial and operational data. These activities are overseen by the Nominations, Culture & Governance Committee (see page 78).

In October 2021, we entered into a leniency agreement with the Brazilian offices of the comptroller general and attorney general in relation to historic bribery allegations. As part of this, we agreed to implement improvements to our integrity programme in Brazil and to provide three reports to the Brazilian comptroller general setting out all steps taken. The first report was submitted in August 2022, the second in February 2023 and the final report in November 2023. In the final report, we confirmed all required enhancements had been successfully completed. The official response from the office of the comptroller general will be received in 2024.

Human rights and anti-slavery

We are committed to protecting and preserving all internationally-recognised human rights of everyone who may be impacted by our business activities along our value chain. This includes upholding the principles set out in our global policies and processes to fulfil our legal obligations and avoid any potential complicity in human rights violations.

In 2023, we have enhanced our human rights risk management framework to ensure that we take appropriate action to prevent, minimise, mitigate and, where necessary, remedy human rights related risks. Our framework includes processes, methods and tools to regularly conduct a risk analysis of our own operations and our suppliers using an expert external platform provider and using established and accepted indices on human rights globally. The risk analysis includes continuous external screening services, internal checks on contracts, certifications of the subsidiary or supplier, and specific examinations based on questionnaires for prioritised risks. Results of these assessments are considered in the human rights governance structure and compliance framework, where further tailored preventative, corrective or remedial measures may be assigned as appropriate in a systematic and proportionate manner. These activities are overseen by the human rights steering group and the Nominations, Culture & Governance Committee (see page 78).

In 2023, we have focused on implementing a consistent approach across the Group through the development of a human rights reporting tool, deploying targeted human rights training, and identifying human rights committees in each division chaired by the newly-appointed human rights officers.

Find more information on our anti-slavery and human trafficking statement, see the Group policies and global supply chain page at www.rolls-royce.com

For more information on our ethics approach see the Nominations, Culture & Governance Committee report on page 78 or view 'Sustaining our culture of integrity' document available at www.rolls-royce.com

Principal risks

The Rolls-Royce risk management and internal control system

Effective risk management helps Rolls-Royce to identify anything that could hinder or support the effective implementation of its strategy and business model. In order to achieve this, we have an established risk management and internal controls system, with the Board overseeing its effectiveness (see pages 65 to 75).

As well as including procedures to monitor the nature and extent of the principal risks the Group is willing to take in order to optimise its commercial opportunities and achieve its long-term strategic objectives, it also covers the monitoring of emerging risks.

At least once a year, the Board, supported by the Audit Committee, assesses how effectively we manage principal risks and, where we are not, reviews plans in place to address these. In 2023, there was an additional internal review on risk maturity which was incorporated into the effectiveness review.

For key principal risks, particularly compliance and safety, we have mandatory training and policies in place, linked to performance management and remuneration, which all our people are required to complete and comply with (see pages 46 and 49 for details).

The Audit Committee also reviews the Group's internal financial controls with financial reporting controls being subject to periodic review by the Group's internal controls team.

The Board confirms that it has monitored the effectiveness of risk management and internal controls throughout the year, in accordance with the 2018 UK Corporate Governance Code.

Risk management
Risks facing the business are identified and assessed on a regular basis.

Internal control
Internal controls are designed and deployed to mitigate these risks to an accepted level.

Assurance
Assurance activities assess whether the controls are effective and risks are mitigated to an acceptable level in practice.

How Rolls-Royce manages risk

We use a framework which aligns with international standards for managing risk. This sets out requirements across the organisation for all categories of risk, including climate, finance, legal and operations, as well as providing guidance and tools. Everyone at Rolls-Royce has a role to play in identifying and managing risks, but the Board (aided by its Committees) is ultimately accountable. An independent, central enterprise risk management team supports the divisions and functions in their effective management of risk.

Define	Risks are identified by individuals across all divisions and functions and at different layers of the organisation by considering what could stop us achieving our strategic, operational or compliance objectives or impact the sustainability of our business model (described on pages 14 and 15).
Quantify	Risk owners assess the likelihood of a risk materialising and the impact if it does, taking into account current mitigating control activities.
Control and assure	Risk owners consider the effectiveness of current mitigating control activities, supported by different assurance providers (detailed in the principal risk tables from pages 52 to 57).
Respond	Risk owners identify where additional activities may be needed to bring the risk within appetite. A judgement is made by assessing the Group's ability to reduce the impact of risks that do materialise and ensure the costs of operating particular controls are proportionate to the benefit provided.
Monitor, review and report	Risk owners report their assessment of the current risk status and action plans to divisions, functions and other review forums (including the Executive Team, Board and Board Committee meetings) as needed depending on the nature of the risk, for support, challenge and oversight.

Continuous improvement

We regularly benchmark the risk framework through active participation in industry groups and against best practice risk standards. Progress made in 2023 includes further embedding risk considerations in the investment committee decision-making process and five-year planning process.

We also made improvements to how we define, document and operate controls (e.g. for the safety and compliance principal risks). This is a key part of how we mitigate risk and keep within appetite, alongside assurance so we know the mitigation is effective. A risk and its mitigation is continually evaluated in response to external or internal factors changing the nature of the risk and how we manage it.

Emerging risks

In a fast-changing world, it is getting harder to predict the future in time to make decisions and act early enough to deal with unexpected, disruptive events. Rolls-Royce has processes in place to identify emerging risks, including:

- divisional risk identification;
- regulatory and compliance horizon scanning, including requirements relating to climate change;
- geopolitical horizon scanning and risk identification;
- new technologies horizon scanning;
- analysis of external emerging risk information; and
- strategic risk identification.

Outputs are assessed to identify any potential new impacts on Rolls-Royce. Where we do identify items, these are captured by either recording a new risk or amending an existing risk and managing this in accordance with the framework described on page 50, or added to an emerging risk watch list to monitor and/or investigate further.

The Board consider an annual summary of emerging risks and management's response. In 2023, we concluded that known significant risk trends are deteriorating simultaneously; in particular the effects of climate change, geopolitical conflict and tensions, the pace of technological advancements, and global economic constraints and their knock-on effect on society. This evolution has been reflected in the revised approach to principal risk interdependencies, shown in the diagram below.

We added two risks to the emerging risk watch list this year arising from external geopolitical tensions: the possibility of national power outages and an attack on physical infrastructure. Technology risk has also now been split out from the previously reported competitive environment risk, expanding it into a separate opportunity risk driver (see the table on page 57 for details).

Read more about our strategy on pages 10 to 12

Principal risks

The Board confirms that it has assessed and monitored the Group's principal risks throughout the year, in accordance with the 2018 UK Corporate Governance Code.

Changes to the principal risks profile in 2023

We continue to review our principal risks, their evolving nature and how well they are managed. In November 2023, the principal risk profile was refreshed to ensure it reflects where risks could impact the organisation in light of the strategic review. This resulted in a number of changes to our principal risks.

- Transformation has been replaced with a strategy risk, which incorporates the old transformation risk as well as elements of the previous competitive environment risk.
- Execution replaces elements of the previous competitive environment risk.
- Technology is now a separate principal risk, whereas previously it was captured under the competitive environment risk.
- Information & data risk includes the previous cyber risk but has been expanded to include physical as well as digital data.
- Business continuity risk is now called business interruption.

As part of this, we also looked at risk interdependencies, categorising principal risks as either a 'pillar' or a 'driver', with drivers being those risks that could cause one or more risk pillars to happen and/or make them worse if they do. The diagram below shows how the risks interconnect, with the crosses showing the interdependencies which will be a focus as part of our risk management and oversight in 2024. More information on each of the risks can be found in the tables starting on page 52.

Principal risks are owned by one or more members of the Executive Team and subject to a review at an Executive Team meeting at least once each year, before a review by the Board or a Board Committee. Risks are managed against risk appetite (i.e. how much risk we are prepared to accept or be exposed to) as a mechanism for making decisions for how risks are managed and the actions needed to mitigate them.

Principal risk interdependencies – pillars and drivers

Principal risk drivers	Principal risk pillars: Safety Product & people	Compliance With law & regulations	Strategy	Execution	Business interruption
Climate change			✖		✖
Information & data	✖	✖	✖		✖
Market shock			✖	✖	✖
Financial shock				✖	✖
Political			✖		✖
Talent & capability			✖	✖	
Technology			✖	✖	

Changes in overall risk levels

The overall risk profile has remained broadly stable. Where we have developed our strategy (as described on pages 10 to 12) and associated short to medium-term plans, the related risks have reduced accordingly. Successfully managing these risks will help us to achieve our goal of being a high-performing, competitive, resilient and growing business.

The following tables detail the current principal risk pillars and drivers, together with how we manage them, how we assure them (in addition to internal audit), the oversight provided by the Board and/or its Committees and how the risk levels have changed over the course of the year.

PRINCIPAL RISKS – PILLARS

Change in risk level: Increased Static Decreased

Safety

PRINCIPAL RISK DESCRIPTION

Product: Failure to provide safe products

People: Failure to create a place to work which minimises the risk of harm to our people, those who work with us, and the environment, would adversely affect our reputation and long-term sustainability

CONTROLS AND MITIGATING ACTIONS

Product:
- Our product safety management system includes controls designed to reduce our safety risks as far as is reasonably practicable and to meet or exceed relevant company, legal, regulatory and industry requirements
- We verify and approve product design
- We test adherence to quality standards during manufacturing
- We validate conformance to specification for our own products and those of our suppliers
- We mandate safety awareness training
- We use engine health monitoring to provide early warning of product issues
- We take out relevant and appropriate insurance

People:
- Our HSE management system includes activities and controls designed to reduce our safety risks as far as is reasonably practicable and to meet or exceed relevant company, legal, regulatory and industry requirements
- We reinforce our journey to zero harm
- We use our crisis management framework

ASSURANCE ACTIVITIES AND PROVIDERS

Product
- Product safety assurance team
- Product safety board
- Technical product lifecycle audits

People
- Safety case interventions
- HSE audit team

OVERSIGHT FORUM(S)

- Safety, Energy Transition & Tech Committee

BUSINESS MODEL

- Our role in society
- Our business model drivers
- Our uniqueness

WHAT HAS CHANGED IN 2023?

No overall change in risk status.

As part of transformation, we are bringing together engineering technology and safety into one organisation, ET&S, with product safety at its heart (see page 9).

People safety related metrics can be found on pages 44 to 45.

PRINCIPAL RISKS – PILLARS CONTINUED

Change in risk level: Increased Static Decreased

Compliance

PRINCIPAL RISK DESCRIPTION	CONTROLS AND MITIGATING ACTIONS
Non-compliance by the Group with legislation or other regulatory requirements in the heavily regulated environment in which we operate (e.g. export controls; data privacy; use of controlled chemicals and substances; anti-bribery and corruption; human rights; and tax and customs legislation). This could affect our ability to conduct business in certain jurisdictions and would potentially expose us to: reputational damage; financial penalties; debarment from government contracts for a period of time; and suspension of export privileges (including export credit financing), each of which could have a material adverse effect.	— We continuously develop and communicate a comprehensive suite of mandatory policies and processes and controls throughout the Group — We undertake third-party due diligence — We encourage, facilitate and investigate speak up cases — We investigate potential regulatory matters — Our financial control framework activities are designed to reduce financial reporting and fraud risks — We classify data to meet internal and external requirements and standards

ASSURANCE ACTIVITIES AND PROVIDERS	OVERSIGHT FORUM(S)	BUSINESS MODEL
— Compliance teams — Financial controls team	— Board — Nominations, Culture & Governance Committee — Audit Committee	— Our business model drivers

WHAT HAS CHANGED IN 2023?

No overall change in risk status. Read more about ethics and compliance on page 49.

Strategy

PRINCIPAL RISK DESCRIPTION	CONTROLS AND MITIGATING ACTIONS
Failure to develop an optimal strategy and continuously evolve it, investing in key areas for performance improvement and growth (taking into account risk reward), making difficult decisions for competitive advantage and the right portfolio and partnership choices, could result in us underperforming against our competitors and significantly reduce our ability to build a high-performing, competitive, resilient and growing company.	— We run a rigorous strategic review process — We benchmark our capabilities and performance against our competitors, the market and other external metrics — We align our R&D spend to our strategy, with a smaller, more focused portfolio — We make investment choices to improve the quality, delivery and durability of our existing products and services — We scan the horizon for competitive threats and opportunities, including patent searches — We invest in R&D opportunities to support the development of new products or services to protect and sustain our future market

ASSURANCE ACTIVITIES AND PROVIDERS	OVERSIGHT FORUM(S)	BUSINESS MODEL
— Group strategy team — Challenge from external advisers	— Board	— Our business model drivers

WHAT HAS CHANGED IN 2023?

This risk replaces transformation as well as part of the previous competitive environment risk and covers the development of the Group's strategy. It has reduced following completion of our strategic review which included a robust assessment of the competitive environment, agreement on priorities and changing how the organisation operates to enable execution.

PRINCIPAL RISKS – PILLARS CONTINUED

Change in risk level: Increased Static Decreased

Execution

PRINCIPAL RISK DESCRIPTION

Failure to deliver as One Rolls-Royce on short to medium-term financial plans, including efficient and effective delivery of quality products, services and programmes, or falling significantly short of customer expectations, would reduce our resilience and 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.

CONTROLS AND MITIGATING ACTIONS

- We robustly performance manage our operational execution and monitor performance against plans
- We keep control of costs with rigorous budgeting
- We review product lifecycles
- We protect our intellectual property (e.g. through patents)
- We include inflation clauses in our contracts to manage cost increases
- We work closely with our suppliers, driving tighter management of lead times

ASSURANCE ACTIVITIES AND PROVIDERS

- Executive Team monitoring of execution

OVERSIGHT FORUM(S)

- Board
- Investment committee

BUSINESS MODEL

- Our business model drivers

WHAT HAS CHANGED IN 2023?

This risk replaces part of the previous competitive environment risks and covers delivery of strategic initiatives, including existing product delivery and improving performance, together with the associated financial plans.

Although progress has been made (as we have articulated how we plan to monitor strategy execution from 2024 and introduced more robust monitoring of in-flight projects and programmes) we have held the risk level unchanged as we have yet to commence execution and monitoring.

We are in the process of identifying and describing any new and changed risks arising from strategy development and execution, in addition to introducing new mitigations including zero-based budgeting.

Business interruption

PRINCIPAL RISK DESCRIPTION

A major disruption of our operations and ability to deliver our products, services and programmes could have an adverse impact on our people, internal facilities or external supply chain which could result in failure to meet agreed customer commitments and damage our prospects of winning future orders.

Disruption could be caused by a range of events such as extreme weather or natural hazards (e.g. earthquakes or floods) which could increase in severity or frequency given the impact of climate change; political events; financial insolvency of a critical supplier; scarcity of materials; loss of data; fire; or infectious disease.

CONTROLS AND MITIGATING ACTIONS

- We invest in capacity, equipment and facilities, dual sources of supply and in researching alternative materials
- We provide supplier finance in partnership with banks to enable our suppliers to access funds at low interest rates
- We hold buffer stock
- We plan and practice IT disaster recovery, business continuity and crisis management exercises
- We undertake supplier due diligence
- We take out relevant and appropriate insurance

ASSURANCE ACTIVITIES AND PROVIDERS

- Investment reviews
- Supplier strategy and sourcing reviews
- Group security and resilience team

OVERSIGHT FORUM(S)

- Audit Committee

BUSINESS MODEL

- Our business model drivers

WHAT HAS CHANGED IN 2023?

This risk replaces business continuity and remains high due to the external threat landscape, such as geopolitical instability disrupting supply or demand. A description of how we manage supply chain disruption risk can be found on page 13.

PRINCIPAL RISKS – DRIVERS

Change in risk level: Increased Static Decreased

Climate change

PRINCIPAL RISK DESCRIPTION

Failure to become a net zero company by 2050, leveraging technology to transition from carbon intensive products and services at pace could impact our ability to win future business; achieve operating results; attract and retain talent; secure access to funding; realise future growth opportunities; or force government intervention to limit emissions.

In addition, physical risks from extreme weather events (and/or natural hazards) could potentially materialise, which may result in disruption.

See pages 38 to 40 for more detail on key climate change risks and their impact.

CONTROLS AND MITIGATING ACTIONS

- We invest in reducing carbon impact of existing products and zero carbon technologies to replace our existing products
- Performance of climate scenario modelling and physical risk impact assessments
- We balance our portfolio of products, customers and revenue streams to reduce our dependence on any one product, customer or carbon emitting fuel source
- Communication of the actions we are taking to manage this risk, in order to demonstrate our alignment to societal expectations and global climate goals

ASSURANCE ACTIVITIES AND PROVIDERS

- Strategy reviews
- Technology reviews
- Investment reviews
- Group sustainability team
- Climate steering committee

OVERSIGHT FORUM(S)

- Board and its Committees
- Executive Team and its committees

BUSINESS MODEL

- Our role in society
- Our business model drivers
- Our uniqueness

WHAT HAS CHANGED IN 2023?

This risk currently remains unchanged. Our intention is to complete a comprehensive review of our sustainability, energy transition and climate related strategy, including redefining group level targets in 2024. See page 32 for details.

Information & data

PRINCIPAL RISK DESCRIPTION

Failure to protect the integrity and availability of data, both physical and digital, from attempts to cause us harm, such as through a cyber attack. Potential impacts include hindering data driven decision making, disrupting internal business operations and services for customers, or a data breach, all of which could damage our reputation, reduce resilience, and cause financial loss.

Causes include ransomware threats, unauthorised access to property or systems for the extraction, corruption, destruction of data, or availability of access to critical data and intellectual property.

CONTROLS AND MITIGATING ACTIONS

- We deploy web gateways, filtering, firewalls, intrusion, advanced persistent threat detectors and integrated reporting
- We test software
- Application of our crisis management framework to govern our response to potential cyber security incidents and significant IT disruption
- We restrict access to our systems and locations

ASSURANCE ACTIVITIES AND PROVIDERS

- Group cyber security team and security operations centre

OVERSIGHT FORUM(S)

- Audit Committee

BUSINESS MODEL

- Our business model drivers
- Our uniqueness

WHAT HAS CHANGED IN 2023?

This risk replaces the previous cyber threat risk and now includes physical data as well as digital. The risk remains high due to factors including the ongoing evolution of data security threats as well as increasing demands for additional data (e.g. to meet compliance requirements).

PRINCIPAL RISKS – DRIVERS CONTINUED

Change in risk level: Increased Static Decreased

Market & financial shock

PRINCIPAL RISK DESCRIPTION

The Group is exposed to market and financial risks, some of which are of a macro-economic nature (e.g. economic growth rates, foreign currency, oil price and interest rates) and some of which are more specific to us (e.g. reduction in air travel or defence spending, disruption to other customer operations, liquidity and credit risks).

Significant extraneous market events could also materially damage our competitiveness and/or creditworthiness and our ability to access funding. This would affect operational results or the outcomes of financial transactions.

Demand for our products and services could be adversely affected by factors such as current and predicted air traffic, fuel prices and age/replacement rates of customer fleets. A large proportion of our business is reliant on the civil aviation industry, which is cyclical in nature.

CONTROLS AND MITIGATING ACTIONS

- We monitor trends, market demand and future market forecasts and make investment choices to maximise the related opportunities
- We incorporate trends, demand and other dependencies in our financial forecasts
- We balance our portfolio with the sale of OE and aftermarket services, providing a broad product range and addressing diverse markets that have differing business cycles
- We execute our short, medium and long-term plans
- Our financial control framework activities are designed to reduce financial reporting risks
- We analyse currency and credit exposures and include in-sourcing and funding decisions
- We develop, review and communicate treasury policies that are designed to hedge residual risks using financial derivatives (covering foreign exchange, interest rates and commodity price risk)
- We raise finance through debt and equity programmes
- We hedge with reference to volatility in external financial markets

ASSURANCE ACTIVITIES AND PROVIDERS

- Five-year and strategic planning process
- Strategy reviews
- Technology reviews

OVERSIGHT FORUM(S)

- Board
- Audit Committee

BUSINESS MODEL

- Our business model drivers

WHAT HAS CHANGED IN 2023?

Overall, this risk has remained the same. The external environment is increasingly uncertain, with ongoing inflation and high interest, the possibility of a recession in the short term across one of more countries and market volatility following elections (see political risk above). However, improvements made across the Group and strategic plans in place means that we are in a good position to manage this volatility, as described more on page 13.

Political

PRINCIPAL RISK DESCRIPTION

Geopolitical factors leading to an unfavourable business climate and significant tensions between major trading parties or blocs could impact our strategy, execution, resilience, safety and compliance. Examples include changes in key political relationships explicit trade protectionism, differing tax or regulatory regimes, potential for conflict or broader political issues and heightened political tensions.

CONTROLS AND MITIGATING ACTIONS

- We develop Group and country strategies and consider associated dependencies
- We horizon scan for political implications and dependencies
- We include diversification considerations in our investment and procurement choices

ASSURANCE ACTIVITIES AND PROVIDERS

- Strategy reviews
- Technology reviews
- Supplier sourcing teams
- Government relations teams

OVERSIGHT FORUM(S)

- Board

BUSINESS MODEL

- Our role in society
- Our business model drivers

WHAT HAS CHANGED IN 2023?

This risk has increased throughout the year, due to external factors including (but not limited to) the recent instability in the Middle East, plus upcoming elections that could increase geopolitical tensions, depending on the outcome.

PRINCIPAL RISKS – DRIVERS CONTINUED

Change in risk level: Increased Static Decreased

Talent & capability

PRINCIPAL RISK DESCRIPTION

Failure to create a company where our people can build a successful career with better choices for development and personal growth will hinder our ability to identify, attract, retain and apply the critical capabilities and skills needed in appropriate numbers for the successful execution of our business strategy.

CONTROLS AND MITIGATING ACTIONS

- We have implemented a new performance management framework to manage and reward our staff
- We undertake succession planning and monitor the talent pipeline
- We survey employee opinion
- We develop, implement and review strategic resourcing plans
- We are investing in our learning culture and people's development

ASSURANCE ACTIVITIES AND PROVIDERS

- People leadership team

OVERSIGHT FORUM(S)

- Nominations, Culture & Governance Committee

BUSINESS MODEL

- Our business model drivers
- Our uniqueness

WHAT HAS CHANGED IN 2023?

This risk was high in 2022 due to the ongoing impacts of the pandemic and has remained high this year due to our current transformation programme. There have been some year-on-year improvements in agreed key measures and improvement plans in place for others. As part of our new strategy, we are investing in our learning and skills culture, challenging the way leaders lead whilst managing and rewarding performance and dealing with poor performance.

People related metrics, including on retention and learning and development, can be found on pages 44 to 48.

Technology

PRINCIPAL RISK DESCRIPTION

Failure to become a digitally enabled business using tools including AI could hinder our ability to enhance the customer experience, drive the transition to lower carbon, accelerate product design, improve manufacturing and empower our people with new tools to improve productivity, as well as preventing us from creating new growth opportunities.

CONTROLS AND MITIGATING ACTIONS

- Investment in R&D opportunities
- We scan the horizon for emerging technology threats and opportunities

ASSURANCE ACTIVITIES AND PROVIDERS

- Disruptive technology horizon scanning process
- Strategy reviews
- Investment reviews
- Technology reviews

OVERSIGHT FORUM(S)

- Safety, Energy Transition & Tech Committee

BUSINESS MODEL

- Our role in society
- Our business model drivers
- Our uniqueness

WHAT HAS CHANGED IN 2023?

Disruptive technology, as a threat (previously part of the competitive environment risk), was one of the primary considerations in setting strategy and is now a key element of the strategic initiatives. This has been reframed following both the strategy reviews and outputs of the horizon scanning exercise described on page 51. We will continue to develop and evaluate this newly expanded risk.

Going concern and viability statements

Going concern statement

Overview

In accordance with the requirements of the 2018 UK Corporate Governance Code, the Directors have assessed the prospects of the Group, taking into account its current position, the Group's principal risks which are described on pages 50 to 57, and the Group's mid-term forecasts that considered a range of internal and external factors as part of the strategic review to support setting the Group's new mid-term targets which are set out on pages 8 to 12.

The Strategic Report on pages 3 to 15 sets out the activities of the Group and the factors likely to impact its future development, performance and position. The Group's updated mid-term targets are set out on page 12.

The Financial Review on pages 19 to 31 sets out the financial position of the Group, its cash flows, liquidity position and the Group's capital framework. The notes to the accounts include the objectives, policies and procedures over financial risk management including financial instruments and hedging activities, exposure to credit risk, liquidity risk, interest rate risk and commodity price risk.

In adopting the going concern basis for preparing the consolidated and Company financial statements, the Directors have undertaken a review of the Group's cash flow forecasts and available liquidity, along with consideration of possible risks and uncertainties over an 18-month period from the date of this report to August 2025. The Directors have determined that an 18-month period is an appropriate timeframe over which to assess going concern as it considers the Group's short to medium-term cash flow forecasts and available liquidity.

Forecasts

Recognising the challenges of reliably estimating and forecasting the impact of external factors on the Group, the Directors have considered two forecasts in their assessment of going concern, along with a likelihood assessment of these forecasts. The base case forecast reflects the Directors current expectations of future trading. A stressed downside forecast has also been modelled which envisages a 'stressed' or 'downside' situation that is considered severe but plausible. Both forecasts have been modelled over an 18-month period.

Industry forecasts predict a return to 2019 large engine flying levels in 2024, which is reflected in the Group's base case forecast. Macro-economic assumptions have been modelled using externally available data based on the most likely forecasts with general inflation at around 2%-3%, wage inflation at an average of 3%-5%, interest rates at around 3%-4% and GDP growth at around 2%-3%.

The stressed downside forecast assumes Civil Aerospace large engine flying hours remain at average fourth quarter 2023 levels throughout the 18-month period to August 2025, reflecting slower GDP growth in this forecast when compared with the base case. It also assumes a more pessimistic view of general inflation at around 1%-2% higher than the base case covering a broad range of costs including energy, commodities and jet fuel. Wage inflation in the stressed downside is 1%-5% higher than the base case and interest rates in the stressed downside are 1%-2% higher than the base case. These macro-economic pressures have been modelled across the whole going concern period. The stressed downside also considers lower demand as a result of slower market growth, and potential output risks associated with increasing volumes and possible ongoing supply chain challenges.

The future impact of climate change on the Group has been considered through climate scenarios. The climate scenarios modelled do not have a material impact on either the base case or stressed downside forecast over the 18-month period to August 2025. Further detail on these climate scenarios is set out on page 39.

Liquidity and borrowings

During 2023, the Group cancelled a £1bn undrawn UKEF-supported loan facility that was due to mature in March 2026 and a £1bn undrawn bank loan facility due to mature in January 2024. The £2.5bn undrawn revolving credit facility that was due to mature in April 2025 was refinanced in November 2023 with the new facility having a term of three years with the banks having the option to extend with two one-year extension options (3+1+1).

At 31 December 2023, the Group had liquidity of £7.2bn including cash and cash equivalents of £3.7bn and undrawn facilities of £3.5bn. The 18-month going concern period includes the maturity of a €550m bond repayable in May 2024 which we do not intend to refinance given the Group's cash and liquidity position, our assessment of the Group's cash flow forecasts and available liquidity over the 18-month period.

Based on borrowing facilities available at the date of this report the Group's committed borrowing facilities at 31 December 2023 and 31 August 2025 are set out below. None of the facilities are subject to any financial covenants or rating triggers which could accelerate repayment.

(£m)	31 December 2023	31 August 2025
Issued bond notes [1]	3,995	3,511
UKEF £1bn loan (undrawn) [2]	1,000	1,000
Revolving credit facility (undrawn) [3]	2,500	2,500
Total committed borrowing facilities	**7,495**	**7,011**

1 The value of Issued bond notes reflects the impact of derivatives on repayments of the principal amount of debt. The bonds mature by May 2028
2 The £1bn UKEF sustainability-linked loan matures in September 2027 (currently undrawn)
3 The refinanced £2.5bn revolving credit facility matures in November 2026 (currently undrawn)

Taking into account the maturity of these borrowing facilities, the Group has committed facilities of at least £7bn available throughout the period to 31 August 2025. The next debt maturity is a $1bn bond that is due to be repaid in October 2025, which is outside the 18-month going concern period.

Conclusion

After reviewing the current liquidity position and the cash flow forecasts modelled under both the base case and stressed downside, the Directors consider that the Group has sufficient liquidity to continue in operational existence for a period of at least 18 months from the date of this report and are therefore satisfied that it is appropriate to adopt the going concern basis of accounting in preparing the consolidated and company financial statements.

Viability statement

The viability assessment considers liquidity over a longer period than the going concern assessment. The downside forecast uses the same assumptions as the going concern assessment for the first 18 months and in 2026 to 2028 assumes a slower recovery than assumed in the base case.

Consistent with previous years, the Directors have assessed viability over a five-year period which is in line with the Group's five-year planning process. The Directors continue to believe that this is the most appropriate time period to consider as, inevitably, the degree of certainty reduces over any longer period.

Severe but plausible scenarios have been modelled that estimate the potential impact of the Group's principal risks arising over the assessment period (descriptions of the principal risks and the controls in place to mitigate them can be found on pages 50 to 57). The risks chosen and scenarios used are as shown in the table on page 59.

The cash flow impacts of these scenarios were overlaid on the five-year forecast to assess how the Group's liquidity would be affected.

The scenarios assume an appropriate management response to the specific event which could be undertaken and also consider specific activities to improve liquidity such as raising additional funds, reducing expenditure and divesting parts of our business.

Reverse stress testing has also been performed to assess the severity of scenarios that would have to occur to exceed liquidity headroom. The assumptions used in these stress tests were not considered plausible, as shown in the table below.

On the basis described above, the Directors confirm that there is a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the next five years.

In making this statement, the Directors have made the following key assumptions:

1. the Group continues to have access to its current undrawn facilities or the ability to obtain equivalent alternative sources of finance;
2. that implausible scenarios do not occur. Implausible scenarios include either multiple risks impacting at the same time or where management actions do not mitigate an individual risk to the degree assumed; and
3. that in the event of one or more risks occurring (which has a particularly severe effect on the Group) all potential actions (such as but not limited to restricting capital and other expenditure to only committed and essential levels, reducing or eliminating discretionary spend, reinstating pay deferrals, raising additional funds through debt or equity raises, executing disposals and undertaking further restructuring) would be taken on a timely basis.

This assessment is based on debt maturities over the assessment period as follows:

a. €550m bond maturing in 2024
b. $1bn bond maturing in 2025
c. £2.5bn revolving credit facility maturing in 2026 *
d. €750m bond maturing in 2026
e. £375m bond maturing in 2026
f. £1bn UKEF loan maturing in 2027 *
g. $1bn bond maturing in 2027
h. £545m bond maturing in 2027
i. €550m bond maturing in 2028

The Group believes it has the early warning mechanisms to identify the need for such actions and, as demonstrated by our decisive actions over the course of the pandemic, has the ability to implement them on a timely basis if necessary.

* Currently undrawn facilities

PRINCIPAL RISK	SCENARIO ASSUMPTIONS AND IMPACTS
Safety (product)	Civil Aerospace product safety event resulting in aircraft being grounded, lower engine flying hour revenues, commercial penalties and additional costs (e.g. unplanned shop visits). The grounding time and number of shop visits required to exceed headroom are considered remote.
Compliance	A compliance breach resulting in fines (greater than those agreed as part of our DPAs) and loss of new business with governments and state-owned companies. The probability of triggering the size of fine required to exceed headroom is considered remote.
Execution (previously competitive environment)	A programme issue on a major programme of the same (proportionate) scale as Trent 1000. The extent to which engine life would need to be impacted to breach headroom is considered remote.
Business interruption (previously business continuity)	The loss of a key element of our supply chain resulting in an inability to fulfil Civil Aerospace large engine orders for 12 months. Reverse stress testing would require the time over which orders could not be fulfilled to be extended beyond what is considered plausible.
Climate change	Transition risk from our 1.5c TCFD scenario where we receive lower revenues from existing Civil Aerospace and Power Systems products coupled with a business interruption at one of our facilities. The extent of time to over which orders cannot be fulfilled in order to breach headroom is considered not plausible.
Information & data (previously cyber)	A cyber-attack resulting in loss and corruption of data and resulting in business disruption, loss of EFHs, compliance concerns due to disclosure of data and potentially trigger debarment from government contracts. The time period over which EFHs would need to be affected to breach headroom is not considered plausible.
Market & financial shock	Civil Aerospace EFH remain flat at 2023 levels across the first 18 months, reduction in GDP impacts Defence and Power Systems fail to secure new business opportunities. The extent of additional EFH reductions necessary to breach headroom was considered not plausible, given this would require EFHs to drop to a quarter of the planned levels, being significantly below the levels seen in the pandemic.
Political	Sanctions imposed between major trading blocs resulting in supply chain disruption and a loss of sales in impacted markets. Reverse stress testing showed that sanctions would need to persist over a period of time beyond what is considered plausible.

Stakeholder engagement

Consistent communication with stakeholders is a priority for the Group leadership. The Board and Executive Team maintain regular touchpoints with stakeholders to remain updated on their views and interests. The points identified through this engagement influence Board decision making and long-term strategy.

STAKEHOLDER	ENGAGEMENT	REFERENCE
People	The Directors recognise that the success of our business depends on attracting, retaining and motivating talented people. The Directors consider and assess the implications of decisions on our people, where relevant and feasible. During 2023, our Employee Champions, Bev Goulet and Wendy Mars, continued to represent the voice of our people in the boardroom. The activities of the Employee Champions during 2023 and opportunities for further engagement in 2024 were discussed at the Nominations, Culture & Governance Committee, which itself was changed from the Nominations & Governance Committee to provide a forum for the Board's oversight of the Group's culture. The Employee Champions provide regular feedback to Board members on topics of interest and/or concern. This provides a valuable link between our people and the Board. The Employee Champions continue to meet regularly with the employee stakeholder engagement committee, which provides support for their activities. In 2023, the Employee Champions had an engagement schedule of on-site and hybrid engagement activities which included virtual sessions with the global inclusion network chairs, inclusion champions and the people leadership team. Site visits included Bristol, UK and Washington, US. Our Meet the Board event enabled around 60 colleagues to talk to the Board in an informal setting. Questions this year related to the transformation programme, workplace inclusivity and the Board's personal experiences. The Board was taken through the refreshed flagship employee wellbeing initiative LiveWell which was relaunched in 2023 to provide more tailored and extensive support to our people and to embed this within the culture of the Group. Our 2023 employee engagement survey had a record participation rate, identifying our strengths in progress and commitment to care and quality and our crowdsourcing activity invited employee views on our purpose and culture. We believe that these methods of engagement with our people are effective in building and maintaining trust and communication whilst providing our people with a forum to influence change in relation to matters that affect them. Many of our people are also our shareholders and we encourage their participation in a variety of share plans. During 2023, the Remuneration Committee has discussed and supported the launch of a new global all-employee share plan, better aligned with the all-employee share plan strategy, focused on business performance and supporting the transformation programme.	See page 44 People and Culture See page 78 Nominations, Culture & Governance Committee report
Customers	The Board recognises that the quality of the Group's customer relationships is based on mutual trust as well as our engineering expertise. We recognise that we must retain and strengthen our focus on the transition to a net zero carbon global economy by creating the sustainable power that our customers require. We continue to focus on helping our customers deliver their own sustainability agendas. During 2023, the Chief Executive and members of the Executive Team engaged with customers at the Paris and Dubai airshows and communicated our achievements regarding UltraFan and the compatibility of our products with 100% SAF. The Board regularly receives operational updates, including customer metrics and feedback, across all the divisions. This greatly influences the Board's deliberations and its support for the Executive Team when considering our strategy. The Chair and Chief Executive continued to meet with key customers during 2023.	See page 3 Our divisions
Suppliers and partners	The interests of both our suppliers and partners are regularly considered as part of the Board's discussions on manufacturing strategy and when reviewing specific projects. The Board supports our Executive Team who work collaboratively with our suppliers and partners to continue to improve operational performance through various means. The Board continued to receive updates from the businesses on supplier performance and supply chain disruption. One of our Non-Executive Directors attended a global aviation industry event in 2023 and the Chief Executive engaged with leaders from across the industry, including attending an event with the Aerospace, Security and Defence Industries Association of Europe.	See page 6 Chief Executive's Review

STAKEHOLDER	ENGAGEMENT	REFERENCE
Communities	The Board recognises the importance of our communities and understands that everything we do can have an impact on our local and global communities. The Group's charitable contributions and sponsorships committee continued to identify causes for donation and partnership. During 2023, this included emergency financial support in response to the earthquake in Turkey and funding the Unnati Scholarships which support 50 girls annually to pursue engineering degrees in India. The Group supports education and skills development through STEM outreach programmes. This included sponsorship of the UK's 2023 Big Bang Fair and projects with expert partners in South East Asia, China, Germany, India and Japan. Additionally, the Group entered into the Defence Aviation Charter with the UK RAF and the Board received updates on the Group's engagement during COP28 in the UAE.	See page 44 People and Culture
Governing bodies and regulators	The Board recognises the importance of governments and regulators as stakeholders. Not only are governments across the world customers but they also support the Group's investment in infrastructure and technology. During 2023, the Chair and Chief Executive held meetings with ministers and senior officials on topics including the Atlantic Declaration, AUKUS and the SMR programme. Following the division of the BEIS Department, the Board engaged with and briefed the new post-holders on the Group's strategy and performance. The Board is updated on engagement with tax authorities and the related regulatory landscape. The General Counsel provides regular updates to the Board on compliance with regulation.	See page 3 Our divisions
Investors	The investor relations team is the key interface between the investment community and the Board, providing frequent dialogue and feedback. The Chair and members of the Board make themselves available to meet with institutional investors and seek to understand and prioritise the issues that matter most. In addition, the Chief Executive and Chief Financial Officer, supported by members of the Executive Team and investor relations, interact regularly with investors, most notably after our financial results, capital markets events, site visits and at conferences. In November 2023, the Group held its first CMD since the pandemic, at which the Chief Executive set out the progress of the transformation programme so far and shared with investors the results of the rigorous and detailed strategic review that had been carried out during 2023. The CMD was attended by more than 150 guests in person and broadcast live. The event included Executive Team presentations, investor Q&As and expo sessions highlighting the capabilities of the Group. Investor interest with the transformation programme has resulted in greater engagement with the Group during 2023. Throughout 2023, the Remuneration Committee Chair and Governance Team engaged with shareholders and proxy advisers on remuneration proposals ahead of the 2024 AGM at which shareholders will consider our revised remuneration policy.	See page 10 Strategy See page 84 Remuneration Committee report

Section 172 and our transformation programme

With the transformation programme guiding decision making in 2023, our section 172 (s172) statement below sets out how the Directors have discharged their s172 duty alongside Group-wide reform.

The transformation programme seeks to realign the Group's values and purpose to create long-term business success and the Board recognises that effective engagement with our stakeholders is essential to create value for them. The Board acknowledges its responsibility to all the Group's different but interrelated stakeholder groups and wider society and recognises their role in shaping and supporting our transformation programme for the long term.

This section should be read in conjunction with our stakeholder engagement section, see pages 60 and 61 and the Board's focus which contains information on the principal decisions made by the Board over the year, see pages 75 and 76.

All of our Directors are briefed on their Companies Act 2006 duties during their induction. The Directors have ensured their duties under s172 noted below have been considered with regards to the transformation programme:

a. the likely consequences of any decision in the long term;

b. the interests of the Company's employees;

c. the need to foster the Company's business relationships with suppliers, customers and others;

d. the impact of the Company's operations on the community and the environment;

e. the desirability of the Company maintaining a reputation for high standards of business conduct; and

f. the need to act fairly between members of the Company.

STRATEGIC REVIEW

Applicable s172 factors (a)-(f)

In considering the strategic review, the Board prioritised the long-term interests of all stakeholders. The Group's revised investment priority is to focus on profitable opportunities in new technologies where the Group is differentiated, where the market size is sufficiently large and where there is a good fit and synergy with the Group's existing activities. The decisions made will create enduring value for all stakeholders. Nonetheless, our people's safety together with product and customer safety remains the Group's core priority.

Customers

The Group's customers are seeking a solution integrated into a larger system more than just a product. The Group's advantaged manufacturing expertise allows for the production of complex parts to exceptionally high specifications with high performance and reliability.

The Group is refocusing its portfolio choices into growing markets where the Group has a differentiated position, strong customer recognition and excellent technology.

This allows us to effectively leverage our expertise into next generation technologies, including UltraFan and nuclear micro-reactors.

Environment

The Group is committed to becoming a net zero company by 2050 through pursuing lower carbon opportunities. We support our customers to do the same.

Within our Civil Aerospace and Defence divisions, integrating sustainable fuels can deliver 80% reduction in carbon emissions compared to fossil fuels. Powering Virgin Atlantic's commercial transatlantic 100% SAF flight is evidence of this ambition.

Variants of our major Power Systems engine platforms can run on sustainable fuels such as HVO. We see hydrogen as a future solution for power generation.

SMRs and micro-reactors will be needed to decarbonise the grid.

Partners

In certain cases, the Group will pursue growth through partnerships to strengthen existing market positions and enter new markets. The Board evaluates opportunities which will allow for a mutual exchange of new skills and capability, as well as a reduction in capital investment.

Such partnerships could assist with a re-entry into the narrowbody market or development of battery energy storage systems, where we have transferable capabilities.

Regarding Rolls-Royce SMR, the Group values its existing partners and welcomes new ones to assist in delivering the overall solution.

EFFICIENCY AND SIMPLIFICATION

Applicable s172 factors (a)(b)(c)(e)

A detailed review of the organisational design of the Group has identified synergies that can be harnessed from the One Rolls-Royce approach. The opportunity is being taken to right-size its cost base to deliver sustainable cost efficiencies across the whole Group. As part of this drive for simplification, the Group has brought its core technological expertise together with the introduction of the Group-wide ET&S business capability which will ensure alignment of standards and compliance.

Employees

The Board and Executive Team significantly increased Group-wide employee engagement during 2023. This included specific engagement following the decisions to reduce the number of roles across the Group by between 2,000 to 2,500 by the end of 2025 and an intention to exit Rolls-Royce Electrical.

The Chief Executive held town halls throughout 2023. These were broadcast Group-wide and included live Q&A sessions allowing for direct conversations with the Chief Executive and members of the Executive Team. More tailored sessions were held with individual members of the Executive Team, including inviting business groups across Germany to a One Rolls-Royce event in Berlin.

The Board has considered the interests of the Group's employees as part of the transformation programme. Pursuing One Rolls-Royce seeks to ensure a Group-wide winning culture which empowers our people. The revised organisational design will limit duplication of tasks and encourage employee upskilling.

Suppliers

The Group will significantly streamline how it works with suppliers.

A Group-wide reorganisation of procurement processes and supplier management was initiated as part of the transformation programme. This seeks to consolidate Group spend, leverage scale and develop consistent best-in-class standards.

COMMERCIAL OPTIMISATION AND WORKING CAPITAL

Applicable s172 factors (a)(c)(e)(f)

The Group is bringing sharper commercial acumen and a more cost conscious culture to everything it does. Working capital is also a key focus in order to strengthen our balance sheet and improve returns on invested capital. By conducting a deep-dive into the operational value chain and addressing working capital in its component parts, the Board believes that there are sustainable improvements available. Building a profitable and sustainable business with a strong balance sheet will drive organisation-wide benefits, generate strong financial performance and create opportunities for all stakeholders.

Investors

Strengthening the balance sheet and achieving an investment grade credit profile through optimising working capital will deliver long-term benefits for our shareholders.

Achieving this will enable the Group to better withstand volatility and external shocks and will provide greater financial flexibility in the future.

Once the Group is confident this has been achieved, it is committed to reinstating and growing shareholder distributions.

The transformation programme's focus on the most profitable growth activities will drive shareholder value.

Customers

Pursuing commercial optimisation means being rewarded by our customers for the value our products bring and the risks we take.

Within Civil Aerospace, the Group is implementing a new value-driven pricing strategy and addressing onerous and low margin contracts. The Group is also driving rigour on contractual terms and conditions.

In Defence, we have a focus on commercial optimisation and value-pricing behaviours as we have in Civil Aerospace and we are prioritising investment in areas that benefit from increased customer funding.

Strategic Report signed on behalf of the Board

Tufan Erginbilgic
Chief Executive
22 February 2024

GOVERNANCE REPORT

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Compliance with the Code

COMPLIANCE WITH THE 2018 UK CORPORATE GOVERNANCE CODE

The Company is subject to the principles and provisions of the 2018 UK Corporate Governance Code (the Code), a copy of which is available at www.frc.org.uk. For the year ended 31 December 2023, the Board considers that it has applied the principles and complied in full with the provisions of the Code.

Board leadership and company purpose	– Our Governance Report provides examples of our leadership and our Strategic Report sets out how we have engaged with our key stakeholders – Throughout the year, the Board has provided oversight of the Group-wide transformation programme – Following a review of its Board and Committee structure, the Safety, Energy Transition & Tech Committee was introduced and the remit of the Nominations, Culture & Governance Committee was refocused to include ethics and culture – The Safety, Ethics & Sustainability Committee and Science & Technology Committee held their last meetings in February 2023	See page 60 Stakeholder engagement See page 111 Safety, Energy Transition & Tech Committee report
Division of responsibilities	– We clearly define the roles of the Chair and the Chief Executive and fully support the separation of the two roles – The Board believes it operates effectively with the appropriate balance of independent Non-Executive Directors and Executive Directors – The Board regularly considers the time commitments of our Non-Executive Directors. Prior Board approval is required for any external appointments to ensure there is no conflict or compromise on their time – The quality of information and resources available to the Board has enabled us to operate effectively and efficiently throughout the year	See page 70 Board of Directors See page 78 Nominations, Culture & Governance Committee report
Composition, succession and evaluation	– The appointment process for our new Chief Financial Officer and new Non-Executive Directors was led by the Nominations, Culture & Governance Committee. Further information on the appointments can be found on page 78 – Our Board comprises a combination of broad skills, experience and knowledge – We have a clear process when considering appointments to the Board and operate effective succession planning – In 2023, Manchester Square Partners carried out an external evaluation of the Board. The methodology and outcomes can be found on page 77	See page 70 Board of Directors See page 73 Board Composition
Audit, risk and internal control	– We recognise the importance and benefits of ensuring the internal audit function and the external auditors remain independent – The Board presents a fair, balanced and understandable assessment of the Group's position and its prospects – Our risk and control environment is reviewed by the Audit Committee. The Board considered both emerging and principal risks during the year and held deep dive sessions where relevant – The Audit Committee also considers the information and data principal risk, including cyber risk, which forms part of the Committee's review of business interruption	See page 80 Audit Committee report
Remuneration	– The Remuneration Committee, comprising only Non-Executive Directors, is responsible for developing the policy and determining executive and senior management remuneration – During 2023, the Committee also considered the remuneration package for the new Chief Financial Officer, Helen McCabe, and leaver treatment for Panos Kakoullis – No Director is involved when deciding their own remuneration outcome – The Remuneration Committee engaged with investors on the remuneration policy which is being proposed to shareholders for approval at the 2024 Annual General Meeting	See page 84 Remuneration Committee report

Chair's introduction

As you will see from the Strategic Report, the focus of the Board in 2023 was on a range of aspects of the transformation programme.

Leadership and succession planning

There were a number of changes on the Board this year. Panos Kakoullis stepped down and Helen McCabe was appointed as Chief Financial Officer on 4 August 2023. Helen has a track record of promoting rigorous financial discipline and delivering effective performance management within complex multinational engineering organisations. Further information on Helen's experience can be found in her biography on page 70. Information on her appointment process is set out in the Nominations, Culture & Governance Committee Report on page 78.

There were also a number of Non-Executive Director changes during the year. As a result of the changes, the gender diversity of our Board is now at parity and, with the appointment of Helen as Chief Financial Officer, two senior Board members are now women. This is clear recognition of the importance we place as a Board on diversity. There have also been changes to the Executive Team over the year with gender diversity also improving across this team, increasing to 30% female.

I would like to thank Sir Kevin Smith, Mike Manley and Paul Adams, all of whom stepped down from the Board in 2023.

Details of the Board changes and our Board diversity policy can be found in the Nominations, Culture & Governance Committee Report on page 78.

Effectiveness

In 2023, Manchester Square Partners were appointed to facilitate an external evaluation of the Board and Committees. A full report on this review is set out on page 77.

For 2021 and 2022 we worked with Lintstock who supported us with internal board effectiveness reviews.

Culture

Leadership behaviours, purpose and culture is an important part of our transformation programme and will be a continuing workstream in 2024. This was an important pillar of the work of our organisational design that was announced in October.

The Board has continued to engage with our people. Following the 2023 Annual General Meeting, we held an in-person Meet the Board event where approximately 60 employees from across Rolls-Royce were able to interact with Board members and share experiences, discuss concerns and swap insights. Topics discussed included transformation, workplace inclusivity and the Board's personal experiences. The event was a great success and provided the Board with a valuable insight into the culture within Rolls-Royce and areas where improvements can be made.

Bev Goulet and Wendy Mars continued to act as Employee Champions and reported back to the Board regularly on discussions they had held with employee groups. Their focus this year was on how people were feeling during the transformation.

Governance

The Board reviewed and approved changes to the Board committee structure – as shown on page 67 and explained in the Nominations, Culture & Governance Report on page 78. The Board committees are closely aligned to the revised Executive Team's governance structures which were introduced at the beginning of the year (see page 69). Our new Safety, Energy Transition & Tech Committee, which is chaired by Wendy Mars, focuses on people and product safety, our sustainability agenda and our technology roadmap.

During 2023, the Board and Audit Committee were kept appraised of the developments relating to the proposed UK corporate governance reform. We will continue to keep this under review in 2024.

In May 2023, our Board apprentice programme concluded. The purpose of the programme was to provide coaching and board experience to a diverse group of emerging leaders selected from the Group's talent pool, whilst also demonstrating our commitment to participants' career progression and development as leaders.

Annual General Meeting

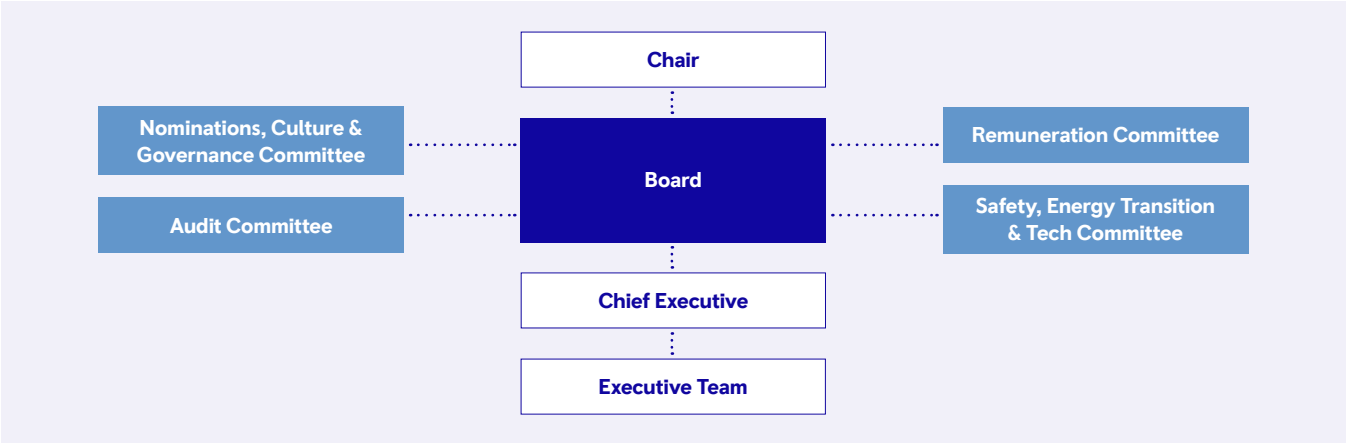
I look forward to engaging with shareholders at the Annual General Meeting on 23 May 2024, which will again be held as a hybrid meeting. Shareholders are encouraged to join, participate and vote virtually and we will answer any questions that you may have. We will propose our revised remuneration policy for approval by shareholders at that meeting.

Looking forward

Our priority for 2024 is the execution of our agreed strategy, particularly in relation to the culture of the Group and progress with our sustainability agenda.

Dame Anita Frew
Chair

Corporate governance



THE ROLE OF THE BOARD

The Board is ultimately responsible to shareholders for the direction, management, performance and long-term sustainable success of the Group. It sets the Group's strategy and objectives and oversees and monitors internal controls, risk management, principal risks, governance and viability of the Group. In doing so, the Directors comply with their duties under s172 of the Companies Act 2006 (see pages 62 to 63).

The Board has established certain principal committees to assist it in fulfilling its oversight responsibilities, providing dedicated focus on particular areas, as set out below. The chair of each committee reports to the Board on the Committee's activities after each meeting.

In addition to the Board's principal committees, it has established a sub-committee of Directors who each hold an appropriate level of UK national security clearance for the purpose of receiving and considering, on behalf of the Board, any UK classified information relating to the Group's programmes and activities.

Bev Goulet, a US national and independent Non-Executive Director, also sits on the board of Rolls-Royce North America Holdings, Inc. to create a link between the Board and the Group's North American governance structure.

Roles and responsibilities

The roles of the Chair and Chief Executive are clearly defined and the Board supports the separation of the two roles. The Chair is responsible for the leadership and effectiveness of the Board. The Chief Executive is responsible for the running of the Group's business and leads the Executive Team which comes together to review, agree and communicate issues and actions of Group-wide significance.

Non-Executive Directors support the Chair and provide objective and constructive challenge to management. The Senior Independent Director (SID) provides a sounding board for the Chair and serves as an intermediary for the Chief Executive, other Directors and shareholders when required.

The Chief Governance Officer ensures that appropriate and timely information is provided to the Board and its committees and is responsible for advising and supporting the Chair and the Board on all governance matters. All Directors have access to the Chief Governance Officer and may take independent professional advice at the Group's expense in conducting their duties.

Directors' independence

We continue to monitor and note potential conflicts of interest that each Director may have and recommend to the Board whether these should be authorised and if any conditions should be attached to such authorisations. The Directors are regularly reminded of their continuing obligations in relation to conflicts and are required to review and confirm their external interests at least annually. This helps us to consider whether each of them continues to be independent.

Following due consideration, the Board determined that all Non-Executive Directors continued to be independent in both character and judgement. Furthermore, it was determined that the Chair was independent on her appointment.

KEY MATTERS RESERVED FOR THE BOARD

- The Group's long-term objectives, strategy and risk appetite
- The Group's organisation and capability
- Stakeholder engagement
- Overall corporate governance arrangements, including Board and Committee composition, committee terms of reference, Directors' independence and conflicts of interest
- Internal controls, governance and risk management frameworks
- Changes to the corporate or capital structure of the Company
- Annual Report and financial and regulatory announcements
- Significant changes in accounting policies or practices
- Annual plan and financial expenditure and commitments above levels set by the Board
- Overview of the speak up programme and cases reported through the speak up line

THE ROLE OF EACH COMMITTEE

Nominations, Culture & Governance

Lead the process for appointments to the Rolls-Royce Board

Ensure plans are in place for orderly succession for the Board and senior executive positions

Oversee the development of a diverse pipeline for succession

Ensure the composition of the Board is appropriate and relevant so that the Board is in the best position to oversee operational performance and drive the Group's strategy

Assess and monitor culture to ensure alignment with the Group's policies, practices and behaviours

Oversee the Group's global diversity and inclusion strategy and its implementation

Keep the Board's corporate governance arrangements under review. Ensure these are consistent with best corporate governance standards

Principal risks: compliance; talent and capability

See page 78

Audit

Assist the Board in monitoring the integrity of the Company's financial statements and any formal announcements relating to financial performance

Oversight of climate change reporting

Review the internal financial controls and the risk management and internal control systems and review any concerns of financial fraud

Recommend to the Board the financial reporting, focusing on accounting policies, judgements and estimates; disclosures; compliance with regulations; and that the Annual Report is fair, balanced and understandable

Monitor and review the effectiveness of the internal audit function and oversee the Company's relations with the external auditor and approve their terms of engagement and fees

Principal risks: business interruption; compliance; information and data; market and financial shock

See page 80

Remuneration

Determine a policy for executive director remuneration capable of attracting and retaining individuals necessary for business success

Set remuneration for the Chair of the Board, Executive Directors and senior executives

Determine the design, conditions and coverage of incentives for senior executives and approve total and individual payments under the plans

Determine targets for any performance-related pay plans and the issue and terms of all-employee share plans

Oversee any major changes in remuneration

Review workforce remuneration and related policy and the alignment of incentives and rewards with culture, taking these into account when setting the policy for executive director remuneration

See page 84

Safety, Energy Transition & Tech

Provide oversight in respect of:
- product safety
- HS&E (occupational health and safety, process safety, maintenance of facilities, asset integrity and personnel security)
- environment and energy transition, including progress and delivery against agreed metrics, targets and objectives

Monitor the operation of the Group's product safety governance frameworks, scrutinising the development and implementation of changes in process and practice

Review, challenge and support the Group's energy transition strategy, track progress and review the environmental impacts of products and operations. Provide oversight and assurance of the Company's scientific and technological strategy, processes and investments

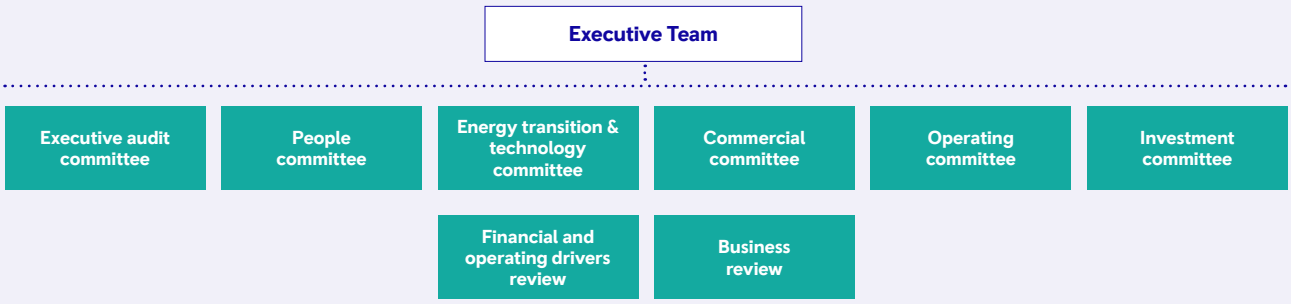
Principal risks: climate change; safety (people); safety (product); technology

See page 111

Committee membership

	Nominations, Culture & Governance	Audit	Remuneration	Safety, Energy Transition & Tech
Dame Anita Frew	■			
Birgit Behrendt	▒			▒
Stuart Bradie	▒			▒
Paulo Cesar Silva	▒			▒
George Culmer	▒	▒	▒	
Lord Jitesh Gadhia	▒	▒	■	
Beverly Goulet	▒	▒	▒	
Nick Luff	▒	■		
Wendy Mars	▒			■
Dame Angela Strank	▒			▒
Female representation	50%	25%	33%	60%

■ Chair of the Committee ▒ Member of the Committee □ Not a member of the Committee



The Chief Executive is responsible for the running of the Group. He leads the Executive Team which comes together to review, agree and communicate issues and actions of Group-wide significance and is supported by the governance framework introduced in 2023 shown above in the delivery of its remit. A summary of responsibilities is set out below:

Executive audit committee

- to consider principal risks
- to review delivery of in-year internal audit plan and to finalise internal audit plan for forthcoming year ahead of Group Audit Committee approval

Operating committee

- to improve Group-wide operational performance
- to review supply chain performance
- to oversee critical enablers of operational performance

People committee

- to ensure that Rolls-Royce has a winning team to deliver our strategic priorities
- to keep under review talent and succession, performance and leadership, reward, purpose and experience

Investment committee

- to make capital allocation decisions for all investments, acquisitions and divestments in line with our strategy
- to review performance of in-flight investments

Energy transition & technology committee

- to ensure the Group is playing a winning role in energy transition and future technologies
- to consider rationale for and progress of investments in energy transition; make capital allocation decisions on technologies that support energy transition
- assess strategic opportunity for future technology investments

Financial and operating drivers review

- to review in-year financial performance and operational drivers against plan
- to agree interventions where required

Commercial committee

- to develop Group-wide pricing strategy and commercial capability
- to identify and deliver pricing actions and capability improvements to enable a step change in performance

Business review

- to review performance by division, focusing on in-year and five-year horizon
- includes financial and operational performance, people and talent, strategic initiatives, principal risks and engagement with our people

Board of Directors

	Position	Board skills and competencies	Key external appointments
	DAME ANITA FREW **Chair of the Board** Chair, Nominations, Culture & Governance Committee Appointed to the Board on 1 July 2021 and as Chair on 1 October 2021	Dame Anita brings a wealth of extensive leadership and global experience from more than two decades of board appointments, both in the UK and internationally. Together, with her skills and reputation with investors and government institutions, her broad knowledge of strategic management across a range of sectors is invaluable to the Board and the Group as a whole.	**Current** — Croda International plc, chair
	TUFAN ERGINBILGIC **Chief Executive** Appointed to the Board on 1 January 2023	Tufan is a proven leader of winning teams within complex multinational organisations, with over six years as CEO of BP's downstream business. He drives a high-performance culture and delivers results for investors. He has extensive strategic and operational experience and a firm understanding of safety critical industries as well as the challenges and commercial opportunities presented by the drive for low carbon technologies. He has a strong track record for execution, delivery and the creation of significant value and an ambition to deliver the full potential of Rolls-Royce's market positions.	**Current** — Iveco Group NC, NED — Global Infrastructure Partners (GIP), senior adviser — UK PM's 2024 Business Council **Past** — GIP, partner — BP p.l.c., various executive roles — DCC plc, NED — Turkiye Petrol Rafinerileri A.S, NED — GKN plc, NED
	HELEN MCCABE **Chief Financial Officer** Appointed to the Board on 4 August 2023	Helen has a track record of promoting rigorous financial discipline and her experience of delivering effective performance management within complex multi-national engineering organisations will be invaluable as the Group moves, at pace, to transform Rolls-Royce. Her skillset complements the existing capabilities of the Executive Team, contributing to Rolls-Royce delivering on its significant potential.	**Past** — BP p.l.c., various leadership roles
	BIRGIT BEHRENDT **Independent Non-Executive Director** Appointed to the Board on 11 May 2023	Birgit brings deep experience across global procurement and supply chain management to the Board. Alongside this, she has significant insights into the development and management of international joint ventures (JV), having led Ford's key European JV's. She also has a strong track record and an ongoing interest in developing, mentoring and coaching key talent and encouraging women in particular to consider a career in STEM. She has worked in the US and Germany and brings profound experience of working with unions and works councils.	**Current** — Umicore SA, NED — Thyssenkrupp AG, NED — KION Group AG, NED **Past** — Ford, various executive roles — Ford-Werke GmbH, NED
	STUART BRADIE **Independent Non-Executive Director** Appointed to the Board on 11 May 2023	Stuart brings to the Board a reputation for building strong relationships and successfully driving comprehensive organisational transformation. Over the past nine years, Stuart has guided KBR's evolution, prioritising a focus on people alongside strong commercial discipline. KBR delivers disruptive technologies and digital solutions that address areas of global importance. Stuart has used a safety and ESG focus to deliver cultural change and helped make KBR the number one in its peer group in delivering against its ESG agenda.	**Current** — KBR, President & Chief Executive
	PAULO CESAR SILVA **Independent Non-Executive Director** Appointed to the Board on 1 September 2023	Paulo brings deep expertise in the aerospace industry, a broad international mindset and an appetite for growth, change and innovation. Alongside this, he brings a wealth of strategic, commercial and operational experience to the Board's discussions. He also brings considerable finance experience having spent his early career in senior finance roles.	**Current** — Cemig, NED — Electra.Aero, advisor **Past** — Embraer S.A., president & CEO
	GEORGE CULMER **Senior Independent Director** Appointed to the Board on 2 January 2020	George has a strong track record as a senior finance professional with significant experience gained in large, international, highly regulated groups with high cyber threat profiles and has proven business leadership credentials. With this experience, together with his strengths in change leadership and transformation gained from within complex groups, George makes a significant contribution to the Board.	**Current** — Aviva plc, chairman **Past** — Lloyds Banking Group plc, CFO — RSA Insurance Group plc, group financial officer

	Position	Board skills and competencies	Key external appointments
	LORD JITESH GADHIA **Independent Non-Executive Director** Chair, Remuneration Committee Appointed to the Board on 1 April 2022	Jitesh brings a wealth of complex advisory and transactional experience to the Board, having spent nearly 25 years in the banking and private equity sector. He has extensive remuneration experience, earned from both listed companies and UK Government Investments and UK Financial Investments, where he played a key role in compensation discussions about the Government's investments in some of the UK's biggest companies. This, together with his broad industry experience, is an asset to the Board and the Remuneration Committee.	**Current** — Taylor Wimpey plc, NED — Compare the Market Limited, NED — Accord Healthcare Limited, NED — Court of Directors of the Bank of England, NED **Past** — UK Government Investments, NED — Blackstone Group, senior MD
	BEVERLY GOULET **Independent Non-Executive Director** Rolls-Royce North America Holdings, Inc., board member. Lead Employee Champion Appointed to the Board on 3 July 2017	Having spent a considerable amount of her career in the airline industry, Bev brings valuable knowledge and operational experience to the Board. She has significant expertise in finance, treasury, strategy, legal and governance matters. She has the expertise and experience to be able to confidently contribute to decision-making and actively take part in developing and strengthening our businesses.	**Current** — Xenia Hotels & Resorts, Inc., NED — Answer ALS Foundation, foundation board chair **Past** — American Airlines, Inc., various executive roles — American Airlines Federal Credit Union, chair — Atlas Air Worldwide Holdings, Inc., NED
	NICK LUFF **Independent Non-Executive Director** Chair, Audit Committee Appointed to the Board on 3 May 2018	Nick is an experienced finance executive having been chief financial officer of a number of listed companies across a variety of industries. He has broad financial skills and a track record of driving business performance. His extensive non-executive and audit committee experience, together with both financial and accounting expertise and a passion for engineering, is crucial in his role as Chair of the Audit Committee and is invaluable to the Board.	**Current** — RELX plc, CFO **Past** — Centrica plc, CFO — Lloyds Banking Group plc, NED — QuinetiQ Group plc, NED
	WENDY MARS **Independent Non-Executive Director** Chair, Safety, Energy Transition & Tech Committee Employee Champion Appointed to the Board on 8 December 2021	As a leader, Wendy has overseen diverse teams across sales, engineering and innovation in 123 countries. She brings experience and insight across hardware, software and services with technological transformation of complex global organisations at her core. Wendy's knowledge of both the technical steps needed to foster innovation in a technology company as well as the challenging realities of its implementation in organisations at different stages of their transformation journey is invaluable to the Board and the Group as a whole. Technology can play a significant role in helping businesses to achieve their sustainability objectives; Wendy brings this experience to the Board.	**Past** — Cisco Systems, Inc., president Europe, Middle East and Africa region (EMEA) — ThruPoint, Inc., various executive roles
	DAME ANGELA STRANK **Independent Non-Executive Director** Appointed to the Board on 1 May 2020	Dame Angela brings a wealth of corporate experience to the Board and a proven track record in managing engineering operations and driving technology, science and engineering programmes. Having actively worked in climate research and pioneering women in STEM careers, sustainability and corporate ethics are key areas of interest. As a member of the Safety, Energy Transition & Tech Committee, Dame Angela draws on her experience as a member of two other listed companies' sustainability committees which is invaluable to the Group as it develops its sustainability strategy.	**Current** — Mondi plc, NED — SSE plc, NED — Rio Tinto Innovation Advisory Committee, member **Past** — Severn Trent plc, NED — BP p.l.c., various executive roles
	PAMELA COLES **Chief Governance Officer** Appointed on 1 October 2014	Pamela is widely considered an expert in corporate governance and company law. She has a passion for engineering and a pragmatic approach to how the governance team supports the business. Pamela is instrumental in supporting the Chair and the Non-Executive Directors to build strong relationships with the Executive Team and has been able to offer advice and guidance on a wide range of topics.	**Current** — E-Act, NED — GC100, executive committee member — University of Greenwich, governor and chair of the audit committee

Executive Team

1. DR JÖRG STRATMANN
CEO – Rolls-Royce Power Systems AG

2. NICOLA GRADY-SMITH
Chief Transformation Officer

3. DR ROB WATSON
President – Civil Aerospace

4. HELEN MCCABE
Chief Financial Officer

5. CHRIS CHOLERTON
Group President

6. TUFAN ERGINBILGIC
Chief Executive

7. SARAH ARMSTRONG
Chief People Officer

8. MARK GREGORY
General Counsel

9. ADAM RIDDLE
President – Defence;
Chairman & CEO – Rolls-Royce North America

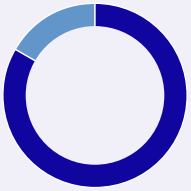
10. SIMON BURR MBE
Group Director of Engineering, Technology & Safety

Appointment details and career highlights of the members of the Executive Team are available at www.rolls-royce.com

COMPOSITION OF THE BOARD AT 22 FEBRUARY 2024

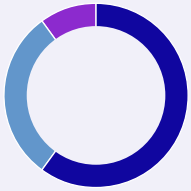
The Board brings a wide range of experience, skills and backgrounds which complement the Group's strategy.

Balance of the Board



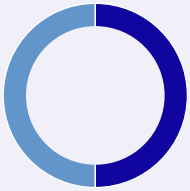
- Non-Executive Directors – 10
- Executive Directors – 2

Non-Executive Directors' tenure



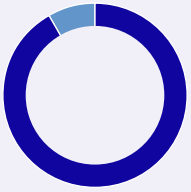
- 0–3 years – 6
- 3–6 years – 3
- 6–9 years – 1

Board members by gender



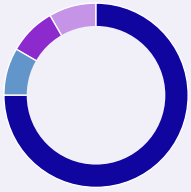
- Male – 6
- Female – 6

Board members by ethnicity



- White – 11
- British-Asian – 1

Board members by nationality *



- British – 9
- American – 1
- European – 1
- Brazilian – 1

* According to the Company's Articles, at least 50% of our Directors must be British citizens

Non-Executive Directors' skills and experience at 22 February 2024

Non-Executive Director	Business experience												Global experience		
	People and product safety	Cyber & digital	Climate change & sustainability	Engineering, science & technology	Company leadership	Finance	Audit & risk management	Remuneration	Transformation	Legal & regulation	Sector specific	Geopolitics	Europe	Americas	Asia & Middle East
Dame Anita Frew	▪		▪	▪	▪	▪	▪	▪	▪	▪		▪			
Birgit Behrendt	▪		▪	▪					▪			▪	▪	▪	▪
Stuart Bradie	▪	▪			▪				▪				▪	▪	
Paulo Cesar Silva				▪	▪	▪	▪		▪		▪		▪	▪	▪
George Culmer		▪			▪	▪	▪	▪	▪	▪			▪		
Lord Jitesh Gadhia						▪	▪	▪	▪	▪		▪			▪
Beverly Goulet						▪	▪	▪	▪	▪	▪			▪	
Nick Luff			▪		▪	▪	▪		▪	▪			▪	▪	
Wendy Mars		▪	▪	▪					▪				▪		▪
Dame Angela Strank	▪		▪	▪				▪	▪				▪	▪	▪

Board and Committee attendance in 2023

	Board	Nominations, Culture & Governance	Audit	Remuneration	Safety, Energy Transition & Tech
	8 meetings	6 meetings	9 meetings	8 meetings	2 meetings
Dame Anita Frew	8/8	6/6			
Tufan Erginbilgic	8/8				
Helen McCabe	3/3				
Birgit Behrendt	4/4	2/3			2/2
Stuart Bradie	3/4	2/3			2/2
Paulo Cesar Silva	3/3	2/2			1/1
George Culmer	8/8	6/6	9/9	8/8	
Lord Jitesh Gadhia	8/8	6/6	8/9	8/8	
Beverly Goulet	8/8	6/6	9/9	8/8	
Nick Luff	8/8	6/6	9/9		
Wendy Mars	8/8	6/6			2/2
Dame Angela Strank	8/8	5/6			1/2
Panos Kakoullis	5/5				
Paul Adams	5/5	4/4			
Mike Manley	4/4	3/3			
Sir Kevin Smith	4/4	3/3		4/4	

The table above sets out the Directors' attendance at Board and Committee meetings throughout 2023. During the year, we made changes to the committees' memberships with the introduction of the Safety, Energy Transition & Tech Committee in May 2023. Furthermore, the Nominations, Culture & Governance Committee was renamed in May 2023 to include the Board's focus on culture. Further information on the Board committee realignment can be found on page 67.

Most scheduled meetings end with a private discussion of the Non-Executive Directors led by the Chair of the Board or Committee, without the Executive Directors or members of the Executive Team or management present.

Additional meetings and sub-committee meetings

The Board held one sub-committee meeting in March 2023 to approve the appointment of Helen McCabe as Chief Financial Officer.

In support of the Board and committees' work, where there is a requirement for greater, in-depth discussion, we hold deep dives into specific areas of focus outside the meeting schedule.

- In July 2023, the Board held a strategy workshop with the Executive Team to consider in depth the strategic plans for each of the divisions (see page 75).
- The Safety, Energy Transition & Tech Committee combined a visit to the Civil Aerospace facilities in Derby, UK in October 2023 with a deep dive on both product and people safety. More information can be found on page 111).

Safety, Ethics & Sustainability Committee and Science & Technology Committee

The Safety, Ethics & Sustainability Committee (SES) and the Science & Technology Committee (S&T) held their last meetings in February 2023. These were the only meetings held by these committees in 2023 and Anita Frew (SES), Wendy Mars (S&T) and Angela Strank (SES and S&T) were in attendance.

Non-attendance

Board members' attendance was once again high in 2023. However, Directors are sometimes unable to participate in certain Board and Committee meetings due to other business commitments. In this situation, they communicate their responses to the matters for consideration to the Chair of the Board and the Committees' chairs, where relevant.

BOARD FOCUS THROUGH 2023

IN-YEAR PRIORITIES

Transformation

In February 2023, a multi-year transformation programme was launched to deliver sustainable earnings growth and cash generation. Progress was reviewed regularly by the Board with particular focus on the strategic review, commercial optimisation, working capital and organisational design.

Strategy

The Board held a strategy workshop with the Executive Team in July 2023. The Board considered the strategic plans for each of our divisions in light of the transformation programme. The Board also considered the messaging ahead of the CMD at which the future strategy for the Group was communicated to investors.

Capital markets day

In September 2023, the Board received a comprehensive review of the proposed organisational design and, in November 2023, the Board reviewed the content and disclosure to be made at the CMD and agreed mid-term targets and the capital framework.

FINANCIAL

Group budget and five-year plan

The Board approved the 2023 budget and five-year plan in February 2023 and regularly reviewed progress against both. See page 19 for further information.

Viability statement

The Board agreed the viability statement period to be reported in the Annual Report. The Audit Committee assessed the Group's viability, with scenarios created based on the principal risks and modelled by the businesses as part of the five-year forecasts. Read more on page 58.

Reports and regulatory reporting

On the recommendation of the Audit Committee, the Board reviewed and approved the half year and full year results announcements, the trading updates issued during the year and Annual Report and Accounts.

RISK MANAGEMENT

Review of effectiveness of risk management and internal controls

The Audit Committee and Board assessed the effectiveness of the risk management and internal controls in place across the Group. The Board confirms that, where weaknesses in the Group's internal control environment were identified, plans for remediation were implemented and aligned to an appropriate timeframe. Read more on page 81.

Product and people safety risk

In October 2023, members of the Safety, Energy Transition & Tech Committee visited a number of our Civil Aerospace operational sites in Derby, UK. As part of the visit, safety in relation to our products and people were considered. Further details can be found on page 11.

Principal risk review

To discharge their responsibilities under the 2018 UK Corporate Governance Code, throughout the year the Board reviewed the principal risks. The Audit Committee reported to the Board that a robust assessment of the principal risks and emerging risks facing the Group had been undertaken.

Key stakeholders

People | Customers | Suppliers and partners | Communities | Governing bodies and regulators | Investors

BOARD FOCUS THROUGH 2023 – CONTINUED

SUSTAINABILITY AND ENVIRONMENTAL

TCFD and climate change

The Audit Committee and Safety, Energy Transition & Tech Committee both considered the TCFD recommendations and the Scope 3 emissions calculations. During the year, the Audit Committee also reviewed the controls in relation to the data to gain greater oversight of the metrics used in relation to Scope 3 emissions.

Climate commitments

The Safety, Energy Transition & Tech Committee considered the Group's climate programme including updates of the activities of the Executive-level energy transition & technology committee.

CULTURE

People and culture

The Nominations, Culture & Governance Committee received an update from the Chief People Officer on people and culture, including on the progress against our People strategy.

Diversity & inclusion

The Nominations, Culture & Governance Committee continued to review progress against the strategic pillars of our inclusion strategy: leadership and governance; attract and recruit; engage; and develop. The Committee continued to review performance against the 2025 diversity targets (see page 44).

GOVERNANCE, LEGAL AND REGULATORY

Committee structure

The Board conducted a review of its Committees and introduced the Safety, Energy Transition & Tech Committee with effect from May 2023 to focus on safety, the energy transition agenda and to provide oversight and assurance of the Group's scientific and technological strategy, processes and investments. In addition, the remit of the Nominations & Governance Committee was refocused to include ethics and culture and the Committee was renamed the Nominations, Culture & Governance Committee.

Board succession planning

In line with the Board succession plans, and on the recommendation of the Nominations, Culture & Governance Committee, the Board approved the appointments of Helen McCabe as Chief Financial Officer and Birgit Behrendt, Stuart Bradie and Paulo Cesar Silva as Non-Executive Directors. Their biographies can be found on pages 70 and 71.

Board effectiveness evaluation

An external evaluation of the effectiveness of the Board and its Committees was conducted by Manchester Square Partners. Further information on the process and findings from the evaluation can be found on page 77.

Key stakeholders

People | Customers | Suppliers and partners | Communities | Governing bodies and regulators | Investors

BOARD EFFECTIVENESS

Review of the Board and Committees

Manchester Square Partners (MSP) were appointed in September to carry out an independent review of the Board's effectiveness for 2023. MSP were appointed following a desk top review and benchmarking exercise, conducted by the Chief Governance Officer, on the basis of cultural fit, overall approach and fee level. A review of the Board's Committees was undertaken at the same time. MSP have not provided any other service to the Company during the year and have agreed this disclosure.

The review took the form of confidential one-to-one discussions with each of the Directors and the Chief Governance Officer; attendance at a Board meeting and at meetings of the Committees; and a review of Board papers and agendas over the year. The scope of the review was agreed with the Chair in advance and included: strategy, including challenges, risks, values and culture; the role of the Board, Board dynamics and engagement; structure, including composition and succession; and governance, including execution and leadership.

MSP reported back their findings to the Nominations, Culture & Governance Committee, which all Board members attended, at the Committee's meeting in February 2024.

In addition to this review, during a private meeting of the Non-Executive Directors, the Senior Independent Director led a review of the Chair's performance without the Chair present. The Nominations, Culture & Governance Committee has an item at the end of each agenda without any management present and, during these sessions, regularly discussed the performance of the Chief Executive throughout his first year; the Chair also conducted the Chief Executive's annual performance review having sought feedback on his performance from the Board. These meetings concluded that both the Chair and the Chief Executive were effective and feedback was shared with each of them.

Each Committee chair considers feedback for the Committees for which they are responsible.

AREAS OF FOCUS

2023 FOCUS IDENTIFIED IN 2022	PROGRESS IN 2023	FOCUS IN 2024
Board structure, composition and dynamics Board to review executive governance and its own committee structure. Continue to work towards our diversity and inclusion ambitions.	Changes were made to both the Executive Team's governance structures early in the year (and as reported in 2022) and the structure of the Committees (see pages 69 and 78). The Board reached gender parity and two senior Board members are women (Chair and Chief Financial Officer) (see page 79).	Review Board inductions and ongoing training.
The Board's role Focus on strategic choices.	The Group's strategy was reviewed and communicated to shareholders at the CMD in November.	Continued focus on strategic progress, ambitions and options. Oversight of the continuing transformation particularly around culture, people and succession. Focus on risk management as the enterprise continues to change and respond to the external environment.
The Board at work Continued focus on stakeholder engagement, ensuring Board sponsorship of the transformation programme.	Stakeholders were a key part of the discussions throughout the year on the transformation programme (see pages 60 to 63).	Board site visits and deep-dives to continue to build on Directors' induction, training and development.

STAGES OF THE BOARD EFFECTIVENESS REVIEW

SEPTEMBER 2023	SEPTEMBER	NOVEMBER/DECEMBER	JANUARY	FEBRUARY 2024
Decision reached to undertake an externally facilitated Board effectiveness review and tender exercise carried out	MSP appointed to carry out the effectiveness review	Interviews undertaken with individual Directors, Board papers reviewed and attendance at Board and Committee meetings	Report reviewed by Chair and Chief Governance Officer	Report presented to the Board by MSP and action plan for 2024 agreed

Nominations, Culture & Governance Committee report

KEY AREAS OF FOCUS IN 2023

- Revised Board committee structure
- Board composition and diversity
- Organisational design

Board and committees' composition

The Committee is responsible for keeping the structure, size and composition of the Board and its Committees under review. During 2023, the Committee oversaw the search and appointment of a new Chief Financial Officer, Helen McCabe. Helen succeeded Panos Kakoullis as Chief Financial Officer on 4 August 2023.

The Committee oversaw a number of changes to the Non-Executive Directors. As reported in our 2022 Annual Report, Birgit Behrendt joined and Mike Manley stepped down from the Board at the 2023 AGM in May. In addition, Sir Kevin Smith stepped down from the Board in May and Paul Adams stepped down in September. Stuart Bradie was appointed in May and Paulo Cesar Silva joined the Board in September.

Furthermore, during the year, the Committee considered the re-appointment terms of Dame Angela Strank, for a second three-year term, and Bev Goulet. Bev was appointed for an annual term as all Non-Executive Directors are appointed annually once they have served six years on the Board.

Prior to making any new appointments to the Board, the Committee considers the skills and attributes required and agrees a profile. The Committee also provides input into a shortlist of candidates and is involved in the interview process for all appointments. The Committee recommends the appointments to the Board for approval. All Non-Executive Directors are appointed to the Nominations, Culture & Governance Committee and to other Board committees, depending on the skills they bring. The Company used MWM Consulting for all appointments to the Board in 2023. MWM Consulting has no connection with individual directors.

The Chief Governance Officer ensures that new Directors have a thorough and appropriate induction programme. Each programme is tailored for the individual depending on the role they will be taking up or the Board Committees they will join.

Summary biographies for the Directors can be found on pages 70 to 71. Full biographies can be found at www.rolls-royce.com

Board Committee re-alignment

In March 2023, the Committee considered a revised Board Committee structure, which was subsequently put in place from May 2023. This action followed from the 2022 Board evaluation and also brought the Board and Executive Team's governance structures, which were also reviewed in the year, into closer alignment.

The work of the Safety, Ethics & Sustainability Committee and the Science & Technology Committee was reviewed and those committees were stepped down. A new committee, the Safety, Energy Transition & Tech Committee was formed to focus on safety and the energy transition agenda as well as to provide oversight of the Company's scientific and technology strategy, processes and investments. Wendy Mars became chair of the Safety, Energy Transition & Tech Committee from its inception.

The Nominations & Governance Committee was renamed the Nominations, Culture & Governance Committee and leads the Board's focus on culture, which was identified as a priority in 2022. Specific areas now additionally come under the remit of this Committee including human rights, speak up line reporting and feedback from the employee champions. These, in addition to its existing focus on diversity and inclusion; talent and succession; Group policies and the Code will enable the Committee to develop metrics and build a dashboard to provide better oversight of the Group's culture and behaviours. The Executive Directors join the Committee meetings for discussion on these topics so that there is dedicated Board time for these important areas. This will be an area of focus in 2024 as work continues on the purpose and culture workstream as part of the transformation programme.

The role of each committee is on page 68. The full terms of reference and terms of reference applicable to all Committees can be found at www.rolls-royce.com

See page 68 for our current Board committee membership.

Board appointment, induction and development

The Committee, led by the Chair, oversaw the search and appointment of the new Chief Financial Officer. An internal and external search and benchmarking exercise was followed by an interview process. Helen brings more than 25 years of experience in senior finance and performance management roles within complex multinational organisations.

The Chair and Chief Governance Officer arrange a comprehensive, tailored induction programme for newly-appointed Non-Executive Directors, which includes dedicated time with the Executive Team and senior management and scheduled trips to business operations. The programme is tailored based on experience and background of the individual and the requirements of the role. All Directors visit the Group's main operating sites as part of their induction and are encouraged to make at least one visit to other sites every year. Site visits are an important part of the induction process, as well as for continuing education. They help Directors understand the Group's activities through the direct experience of seeing our facilities and operations and by having discussions with a diverse group of our people.

It is important that the Directors continue to develop and refresh their understanding of the Group's activities. The Board's engagement with its stakeholders is set out on pages 60 to 63. It is also important that the Directors regularly refresh and update their skills and knowledge and receive relevant training when necessary. Members of the Board also attend relevant seminars, conferences and training events to keep up-to-date on developments in key areas.

Culture

During 2023, the Committee started to pull together its agenda to look at the culture of the organisation. Reports were received from the speak up line and Employee Champion directors and a presentation on the enterprise-wide human rights programme was received in December.

In August 2023, there was a discussion on the behavioural expectations of senior leadership, following events in the wider UK corporate environment. As well as updates on diversity and inclusion, talent and succession, the Committee received a detailed briefing in September 2023 on the organisation design work that was undertaken as part of the wider transformation programme. This included presentations and discussion on enterprise skills and capabilities and purpose and culture enablement.

Diversity and inclusion

In 2023, the Committee continued its work to maintain a balance on the Board of individuals representing a wide cross-section of experience, cultural backgrounds and specialisms. The Board diversity policy aims for gender parity and we are delighted to report that during 2023 we met the Board's ambition. We have also exceeded the Board's intention that at least one senior Board member will be a woman. With the appointment of Helen McCabe, both the Chair of the Board and the Chief Financial Officer are women. One of our Board members is from a non-white ethnic minority background. The Board diversity policy is available at www.rolls-royce.com

The Committee continued to receive regular updates on progress with our diversity and inclusion strategy across the Group and received updates on progress against key metrics and targets in February and September 2023.

Diversity in our Executive Team has improved and now stands at 30%, increased from 18% at the end of 2022. The Committee continues to support and monitor Group activities to increase the percentage of women and other under-represented groups in the senior management population (see page 69). We recognise that there is still more to do. Improvements in ethnicity balance are beginning to be seen, particularly in the US leadership group as well as in the wider Group across the graduate and high potential populations.

Improving diversity and inclusion remains a priority and we continue to track progress. More on our progress against our targets can be found on page 47. Disclosures under Listing Rule 9.8.6 can be found on page 220.

Succession planning

The Committee considers the current skills, experience and tenure of the Directors and assesses future needs against the longer-term strategy of the Group. The skills and experience criteria for incoming directors is discussed and agreed before the recruitment process is commenced.

The Committee plays a vital role in promoting effective Board and leadership succession, making sure it is fully aligned to the Group's strategy. In 2023, the Committee appointed Helen McCabe as Chief Financial Officer and had full discussions with Tufan Erginbilgic on the changes to the Executive Team throughout the year. The Committee also considered succession planning for the Chief Executive. The Committee were fully briefed on the changes to the organisational design before they were announced in October.

Principal risk review

The Committee considers the principal risk of talent and capability as part of the regular discussion on succession planning and, in 2023, in light of the discussions on transformation and the organisational design for the Group. The development of our leaders is critical to ensuring the right culture and behaviours are embedded enterprise wide and to ensure we maintain the right skills and capability to meet our strategic plan. In addition, the Board met as a whole to receive an update from the chief people officer on overall enterprise capabilities, including a deep dive on engineering.

Members	All Non-Executive Directors
	Biographies are on pages 70 and 71
Remit	See page 68

Directors' conflicts of interest

As required under the Code, any additional external appointments taken up by Directors during the year are considered by the Committee and approved by the Board prior to the Directors accepting such appointments. The Committee considers any conflicts that may arise as a result of any external appointments taken up by the Directors and the Board monitors the extent of those interests and the time commitment required to fulfil them to ensure that effectiveness is not compromised. As part of the Committee's discussions, external appointments are considered against the parameters set by ISS. The Committee has found this to be a useful gauge when discussing whether there is potentially any impact on Directors' time commitments when taking on additional external appointments.

In 2023, the Directors demonstrated a strong commitment to the Company, as shown by their high levels of attendance at all our meetings (see page 74). During the year, the Board considered two external appointments for directors who subsequently stepped down from the Board. One of the appointments was with a company which Rolls-Royce has a joint venture relationship with, although not material in nature. The Board agreed appropriate mechanisms to recuse the director from any discussions that may arise concerning that relationship. The Board concluded that neither of these external appointments were considered time restrictive.

Engagement with shareholders

For information on how the Board has engaged with stakeholders during the year, see pages 60 to 63.

Corporate governance

Throughout 2023, we have continued to watch the evolving agenda in the UK on audit and corporate governance reform. We will continue to keep good governance at the core of all we do and are pleased to report another full year of compliance with the 2018 UK Corporate Governance Code, as reported on page 65. During 2024, we will be working on our internal governance arrangements to ensure they are aligned with our organisational design.

The extracts from the Group's governance framework, which is also applied to our subsidiary companies and is our response to the Wates principles, are available at www.rolls-royce.com

Dame Anita Frew
Chair of the Nominations, Culture & Governance Committee

Audit Committee report

KEY AREAS OF FOCUS IN 2023

- Ensured our business performance is fairly presented with equal prominence of statutory and alternative performance measures
- Reporting of climate change and environmental data and the interaction with accounting assumptions and financial reporting, including in relation to TCFD recommendations
- Implications for our financial reporting of the recovery in air travel globally and of our Group-wide transformation programme
- Continued oversight of internal controls improvement programmes and of effectiveness of risk management with a focus on cyber security and on business continuity, including supply chain dependencies

I am pleased to present the 2023 report of the Audit Committee which provides an overview of the areas of focus for the Committee during the year, as well as its key activities and the framework within which it operates.

The composition of the Committee has not changed during 2023 and the membership is set out on page 83. George Culmer, Bev Goulet and I have recent and relevant financial experience. The Board remains confident that the Committee members have the appropriate knowledge, skills and experience to fulfil the duties delegated to the Committee and that the Committee as a whole has the competence relevant to the Company's sector.

In 2023, we were pleased to have the opportunity to meet with several shareholders in person as well as hear from shareholders virtually at our 2023 AGM, where we were able to answer questions both in person and via the live stream of the meeting. Members of the Committee attended the capital markets day in November 2023, either in person or virtually.

This report sets out the work of the Committee in 2023 with a focus on the issues relevant to the Group's financial reporting, considering how business performance is reflected in financial reporting, assessing key accounting judgements and ensuring ongoing quality of the related disclosures. In our meetings, we have robust conversations to ensure management are challenged, to satisfy ourselves that the judgements taken and the disclosures made are appropriate for the Group.

We continue to support the Board in its considerations of climate change risks and opportunities. The Committee has reviewed and approved the TCFD recommendations (see page 35) and noted the progress during the year as the disclosures were being prepared for the 2023 Annual Report. We have continued to ensure that the impact of climate change, where material, is reflected in the financial statements and disclosed accordingly, including the assumptions used in the forecasts for the assessment of going concern and viability, long-term contract accounting, impairment testing and deferred tax asset recognition.

We undertook deep dives of the principal risks we oversee. We met with each of the divisions' presidents during the year to discuss their business governance, including the risks and internal control frameworks, and to consider their business continuity risks. While previously data and cyber security had been the remit of the Data Security sub-committee of the Audit Committee, throughout 2023 the Audit Committee has addressed data security as part of its review of business continuity with each division. The Committee also receives regular reports from the director of cyber security as part of the Committee's consideration of the cyber threat.

We also meet regularly with the head of tax to review the management of tax and customs risks. The Committee approves annually our tax policy to ensure it remains appropriate for the Group and we receive updates on its application as well as changes to relevant laws and regulations. We have discussed the changing external reporting requirements.

The Committee continues to oversee the assurance activity conducted by internal audit. The Committee monitored delivery of their 2023 internal audit plan, considered the findings from internal audit reports and ensured that actions identified were implemented. We also approved their 2024 plan, confirming the focus on key risks and adequate cover of all material operations and appropriate geographical coverage. We have scheduled an independent effectiveness assessment of internal audit for 2024.

During 2023, we have engaged with the Financial Reporting Council (FRC) following their evaluation of the 2022 Annual Report and Accounts. This review was part of a regular assessment of the quality of corporate reporting in the UK undertaken by the FRC. We welcome the FRC's engagement and, as a result of our communications, we have enhanced several existing disclosures, including a change in accounting policy following a reassessment of a judgement previously taken which resulted in a change in the classification within the cash flow statement. Additional disclosures are included in our 2023 reporting in relation to this (see note 1 of the Consolidated Financial Statements on page 188).

Financial reporting

The Group has complex long-term contract accounting and every year the Committee spends much of its time reviewing the accounting policies and judgements implicit in the Group's financial results. In 2023, we have considered the implications on our assumptions and key accounting judgements of the recovery in air travel globally, the improved financial performance of the Group and the Group-wide transformation programme, as well as changes in the global macro-economic and political environment. We have ensured that the disclosures in respect of all key areas of judgement are appropriate and balanced. We assess and consider the sensitivity of the estimates to changes in key assumptions which are summarised in note 1 of the Consolidated Financial Statements on page 188.

Fair, balanced and understandable

As part of its review of the 2023 Annual Report, the Committee considered whether the report, taken as a whole, was fair, balanced and understandable and that it provided the information necessary for shareholders to assess the Group's position, performance, business model and strategy. In so doing, the Committee considers the financial reporting procedures and internal controls in place in preparing the report. There is a robust governance framework with well documented planning and procedures for the preparation of the report and a collaborative approach across all those who contribute to the report. The Committee concluded that the basis of preparation was consistent with financial reporting throughout the year and that all significant issues had been considered. The Committee was satisfied that the process was effective and that the messaging was consistent, particularly the narrative reflecting the financials, and confirmed to the Board that, when taken as a whole, the Annual Report is fair, balanced and understandable.

Significant issues relating to the 2023 financial statements:
A summary of the principal matters we considered in respect of the 2023 Consolidated Financial Statements is set out below.

AREA OF FOCUS	CONSIDERATIONS
Alternative Performance Measures (APMs)	As in previous years, the Committee reviewed the clarity of the definitions and the reconciliation of each APM to its statutory equivalent. The Committee concluded that there was no undue prominence of the APMs in the Annual Report. See page 213 for a reconciliation of APMs to their statutory equivalents. New KPIs were introduced during 2023, following the strategic review. The Committee challenged the calculation underpinning these KPIs to ensure the conclusions reached resulted in appropriate additional KPIs being disclosed.
Long-term contract accounting	The Committee considered the assessment of estimates of future revenue and costs on the Group's long-term contractual arrangements. This has continued to be a particular focus for the Committee due to the complex nature of long-term contract accounting, the recovery in air travel globally, the changing macro-economic conditions and the Group-wide transformation programme. As part of our considerations, we reviewed onerous contracts given their sensitivity to changes in revenue and cost assumptions. We also reviewed catch-ups to understand the changes to revenue and cost assumptions driving them and looked at accounting for risk and revenue sharing arrangements. We reviewed the disclosures and concluded these, together with the assessments, were appropriate. See note 1 in the Consolidated Financial Statements.
Deferred tax assets	The Committee discussed the recoverability of deferred tax assets and the forecasts, assumptions and sensitivities applied in order to ascertain the recognition and recoverability of the deferred tax assets. The Committee discussed the basis for the recognition of the UK deferred tax assets and considered the judgements and estimates necessary to assess the recoverability of the UK deferred tax assets. This was particularly important during 2023 due to the strategic review, the improved financial performance and the higher mid-term targets that have been communicated. We considered this in light of the requirements set out in IAS 12 *Income Taxes* to assess probable profits when considering the recognition of the UK deferred tax assets. We confirmed the approach, which remained consistent with that taken in 2022, together with the disclosures set out in note 1 to the Consolidated Financial Statements.
Impact of climate change	The approach taken by management to assess the impact of climate change, the conclusions reached and the disclosures presented have been reviewed by the Committee, including considering the related TCFD recommendations. We have received updates on the improving internal controls in relation to process and data and considered progress made with the Group's reporting. The Committee has ensured it understands and has continued to challenge the assumptions in the climate scenarios used by management to sensitise forecasts in respect of viability, long-term contract accounting, impairment assessments and deferred tax asset recognition. See note 1 in the Consolidated Financial Statements.
Accounting for complex treasury instruments	The Committee continued to consider numerous topics in relation to the Group's complex treasury instruments including the GBP:USD hedge book and associated hedge book rates and the long term planning rate used by management beyond the hedge book period. This included understanding and challenging management on the assumptions, the approach, the accounting and reporting.
Transformation programme: organisational design	The Committee considered the impact of the transformation programme, including the organisational design, on the assumptions and accounting judgements, and monitored whether the criteria required for a restructuring and transformation provision had been met.

Risk management and the internal control environment

Our risk management and internal control framework is described in the Principal Risks section on page 50. During the year, we focused on the effectiveness of risk controls and their assurance, ensuring actions to mitigate where needed and to manage risks in relation to our appetite for taking risk as described on page 50. We will continue to focus on embedding risk mitigation controls and risk appetite in 2024, embedding these more firmly as part of our routine processes and decision making, including in relation to strategic planning.

We also satisfied ourselves that the processes for identifying and managing risks are appropriate and that all principal risks and mitigating actions had been subject, during the year, to a detailed review by the Board or an appropriate Board Committee. Based on this and on our other activities, including consideration of the work of internal and external audit and attendance at the Committee meetings by divisional and functional risk owners, the Board confirmed that a robust assessment of the principal risks and emerging risks facing the Group had been undertaken. Details of our principal risks are set out on pages 50 to 57. The Board allocated certain principal risks to the Committee and we considered these in detail throughout the year, as described below. From our discussions, we are satisfied that the principal risks that we oversee have received appropriate management attention during 2023:

- **Business continuity:** the Committee received updates on the status of the continuity risk management of each business, including the risks to internal facilities and in the external supply chain, as well as an assessment of risk management effectiveness.
- **Cyber:** the Committee received updates on the status of cyber security risk, including lessons learnt from incidents and an assessment of risk management effectiveness. The cyber security strategy was kept under review during the year.
- **Financial shock:** the Committee has reviewed the Group's policies, procedures and controls for identifying, managing and mitigating financial shock. The Group is exposed to a number of financial risks, some of which are of a macro-economic nature (for example, foreign currency, oil price and interest rates) and some of which are more specific to the Group (for example, liquidity and credit risks).

Internal financial control

The Committee specifically reviews the Group's internal financial controls (see page 50). During 2023, we reviewed the results of self-attestation and testing performed by the internal control and internal audit teams to confirm the effective operation of key financial controls across the Group. We monitored progress against the 2023 financial controls programme to strengthen the financial reporting and compliance controls. We confirmed completion of identified key activities. We also considered the external auditor's observations on the financial control environment.

Effectiveness of risk management and internal control systems

The Committee has conducted a review of the effectiveness of the Group's risk management and internal control systems, including those relating to the financial reporting process. We consider that our review of the risk management and internal control systems, in place throughout 2023 and up to the date of this report, satisfies the requirements of the Code, the DTR and the FRC's guidance on risk management. To support this:

- we monitor changes to regulatory requirements with respect to risk management on an ongoing basis;
- we review relevant policies and procedures and update where necessary, in line with regulatory changes and our perspective on effective approaches to risk management;
- our risk management team and relevant assurance functions, such as internal audit, review key business processes, including long-term contract pack reviews and the budgeting process with periodic reforecasting, identifying key risks and opportunities;
- we assess and monitor management responses to key audit findings, including the design of mitigations and developments to existing controls;
- a defined anti-bribery and corruption policy has been implemented; and
- where necessary, we report to the Board and its Committees on key risk and regulatory matters.

During the course of the financial year, any control weaknesses identified through the operation of our risk management and internal control processes were subject to monitoring and resolution in line with our normal business operations. In 2023, no significant weaknesses were identified.

To further support the enhancement of the existing internal control environment:

- risk management specialists have been assigned to review and monitor the implementation of actions, to ensure these remain appropriate and aligned to the risks to which they relate;
- policies and procedures are subject to review and are updated to align to changes in the underlying control environment; and
- risk owners remain informed of the risks they are accountable for, and their key responsibilities with regards to managing these risks.

In addition, and on an ongoing basis, the Board reviews the effectiveness of the Group's risk management and internal control system and continues to:

- monitor reports from the Executive Team, relating to their assessment of risks and internal control systems;
- monitor assurance received from the Executive Team regarding compliance to relevant policies;
- monitor assurance received on the effectiveness of the Company's internal control environment;
- review reports from this Committee, the Internal Audit function and the external auditor;
- review the Company's response to incidents and threats, including those related to cyber security and safety; and
- review information gathered from the Company's formal whistleblowing process where issues relate to financial misconduct.

Where opportunities for improvement were identified, action plans have been put in place and progress is monitored by the Audit Committee.

Going concern and viability statements

Having regard to the net liabilities of £3,629m on the Group's 2023 balance sheet, we paid particular attention to these assessments. With consideration to the available information, the Audit Committee confirms it maintains a reasonable expectation that the Group is able to continue to meet its liabilities as these fall due, over the five-year period to 31 December 2028.

We reviewed the processes and assumptions underlying the going concern and viability statements set out on pages 58 and 59, considering in particular:

- the Group's forecast funding position over the next five years;
- the forecasts for material subsidiaries making up this position;
- an analysis of impacts of severe but plausible risk scenarios, ensuring that these included relevant principal risks;
- the impact of multiple risks occurring simultaneously;
- additional mitigating actions that could be taken in extreme circumstances; and
- the current borrowing facilities in place and the availability of future facilities.

As a result, we are satisfied that the going concern and viability statements have been prepared on an appropriate basis.

Internal audit

The director of risk and internal audit regularly attends and reports to the Committee on risk and internal audit matters including:

- identifying key trends and headline findings from internal audit reports issued in the period;
- details of any specific significant findings raised by internal audit that warrant the Committee's attention;
- status of agreed actions arising from internal audit work;
- the plan of internal audit work for the following year; and
- progress against the current year's internal audit plan and any changes to the plan.

I meet the director of risk and internal audit regularly throughout the year to discuss risk matters and the nature of internal audit findings in more depth. We continue to focus on the nature of issues raised by internal audit and the timescales to complete the related actions. The future work plan is risk-based, including risks to both short and longer-term objectives and balancing focus on principal risk areas and on business-as-usual transactional activity where controls are understood to be mature and established. Internal audit also considers the activities of our second line assurance functions in their approach. We reviewed the effectiveness of the Group's internal audit function, including resources, plans and performance as well as the function's interaction with management. Based on the reports and discussion, we are satisfied that the scope, extent and effectiveness of internal audit work are appropriate for the Group and that there is an appropriate plan in place to sustain this. We are also planning an independent review of the effectiveness of internal audit in 2024.

External audit

PwC were appointed as the Group's external auditor for the financial year, commencing on 1 January 2018, following a formal tender process in 2016. As required by auditor rotation rules, Ian Morrison took over as lead audit partner for the 2023 audit, replacing Ian Chambers who was required to rotate after five years. Other key audit partners are also required to rotate every five years.

The external audit contract will be put out to tender at least every ten years. Any future audit tenders will be carried out in line with the FRC's practice aid for audit committees. The Committee currently expects to undertake an audit tender during 2026, with a view to a new audit firm, if there is a change from PwC, being appointed as external auditor for the financial year commencing 1 January 2028. We believe that this timing for the audit tender strikes an appropriate balance between continuity for the current audit firm and consideration of alternative firms.

Other than the services detailed below, PwC have no other connection with the Company or its Directors.

During 2023, the Company complied with the relevant provisions of The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

2023 audit

The Committee reviewed the quality of the external audit throughout the year and considered the performance of PwC. This year, to support this, the Committee members and senior finance personnel have undertaken an internal evaluation, focusing on a range of factors we consider relevant to audit quality. The findings from this evaluation and agreed actions were reviewed and approved by the Committee in February 2024. Feedback was also received from the auditors on their performance against their own objectives.

Based on these reviews, the Committee concluded that there had been appropriate focus and challenge by PwC on the primary areas of the audit and that they had applied robust challenge and scepticism throughout the audit. Consequently, the Committee has recommended to the Board that they be reappointed at the 2024 AGM.

In November 2023, PwC presented its formal audit plan, which identified its assessment of the key audit risks and the proposed scope of audit work. Reflecting on findings from the half-year review and the developments in the Group, we agreed the approach and scope to be undertaken. Key risks and the audit approach to these risks are discussed in the Independent Auditor's Report (pages 196 to 208), which also highlights the other risks that PwC drew to our attention.

As part of the reporting of the half-year and full-year results, in August 2023 and February 2024 PwC reported to the Committee on its assessment of the Group's judgements and estimates in respect of these risks and the adequacy of the reporting. Where effective to do so, PwC also reported on its assessment of the Group's controls.

I meet with the lead partner regularly throughout the year and the whole Committee has a private meeting with PwC at least once a year.

Non-audit services

To safeguard the auditor's independence and objectivity, and in accordance with the FRC's ethical standard, we do not engage PwC for any non-audit services, except where it is work that they must, or are clearly best-suited to, perform. Accordingly, our policy for the engagement of the auditor to undertake non-audit services broadly limit these to audit-related services such as reporting to lenders and grant providers, where there is a requirement by law or regulation to perform the work. All other non-audit services are considered on a case-by-case basis in light of the requirements of the ethical standards and in compliance with our own policy.

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Fees paid to PwC are set out in note 7 to the Consolidated Financial Statements on page 149. All proposed services must be pre-approved in accordance with the policy which is reviewed and approved annually. Above defined levels, my approval is also required before PwC is engaged. We also review the non-audit fees charged by PwC on a quarterly basis. Our non-audit services policy can be found at www.rolls-royce.com

Non-audit related fees paid to the auditor during the year were £0.9m (2022: £1.5m), representing 7% (2022: 11%) of the audit fee. This included £0.7m (2022: £0.7m) relating to the review of the half-year results. Our annual review of the external auditor takes into account the nature and level of all services provided.

Based on our review of the services provided by PwC and discussion with the lead audit partner, we concluded that neither the nature nor the scale of the non-audit services gave any concerns regarding the objectivity or independence of PwC.

Nick Luff
Chair of the Audit Committee

Remuneration Committee report

KEY AREAS OF FOCUS IN 2023

Development of a revised remuneration policy proposal and the cascade to the wider workforce in support of the Group's transformation

Support for changes to the Executive Team as part of the Group-wide transformation programme

Determining remuneration for 2023, taking into account the experience of key stakeholders

I am pleased to present my second report as Chair of the Committee and would like to thank my fellow Committee members for their support during a busy year. I would like to acknowledge the support provided by Sir Kevin Smith who served on the Committee for seven years prior to his retirement in May 2023.

This letter outlines the key decisions taken by the Committee during 2023, both in relation to the implementation and review of policy and to the changes in leadership, with the appointment of Helen McCabe as Chief Financial Offer and changes across the Executive Team.

Business context for 2023

2023 has witnessed a material improvement in performance levels with very strong progress made on the Group's transformation. At the CMD, Tufan Erginbilgic and the Executive Team presented a clear vision for Rolls-Royce to become a high performing, competitive, resilient and growing business. Our ambitious mid-term targets will take Rolls-Royce significantly beyond any previously achieved level of financial performance. Achieving our ambition will require intense focus and rigour from the management team to drive the transformation and deliver a cultural shift in performance management.

Review of the remuneration policy

To drive focus on urgent restructuring requirements and to navigate the challenges of setting long-term incentive targets during the pandemic, in 2021 we implemented a market atypical single incentive plan that was primarily focused around in-year annual targets with some trailing long-term targets included for 2022 and 2023. This bespoke solution, which was supported by our shareholders, was developed to respond to the specific challenges the Group faced at that time with the aim of placing more of an emphasis on short-term performance whilst also motivating and retaining key talent through a phase of stabilisation and recovery. The structure was specific to the circumstances at the time and we signalled an intent to review the arrangements as our circumstances changed.

Return to a market-typical incentive structure

Given the Group has now returned to a more normal operating environment and we have articulated medium-term commitments, the Committee believes it is appropriate to return to a more conventional remuneration structure that will include a separate annual bonus with mandatory deferral, combined with a market-standard performance share plan with a three-year performance period plus two year holding period. We strongly believe that clear, forward-looking, stretching targets aligned with our medium-term ambition will motivate and align participants to the Group's strategy for the benefit of our stakeholders.

We have consulted with our largest shareholders, proxy advisors and employee groups and are grateful for the feedback and support provided during this process. The feedback received has consistently confirmed support for a return to a more conventional incentive structure, with a focus on stretching long term performance targets aligned to our transformation, with quantum aligned to typical FTSE 50 levels.

Alignment with mid-term targets

Performance measures in both the annual bonus and the LTIP place emphasis on cash flow and profit, reinforcing the Group's stated ambition to return to investment grade, which in turn will enable the Group to make appropriate portfolio choices and reintroduce shareholder payments.

ESG

The Committee is extremely mindful of the Group's responsibilities in reducing global carbon emissions. In 2024, there will be a full strategic review of sustainability, delivering a granular net zero emissions plan with defined metrics and targets. The Committee envisages introducing a climate-related performance measure aligned to the strategic review within the life of the new policy, focusing on a reduction in Scope 1 + 2 emissions. The 2024 annual bonus scorecard will continue to be partly assessed against safety, our number one priority, in addition to employee engagement.

Cascade of remuneration policy

To create alignment between the Executive Directors and senior management, the revised incentive structure will be cascaded across the top three management levels of the Group. In doing so, remuneration will be rebalanced towards the long-term and the clear three-year financial targets will help foster a high-performance culture aligned to the objectives of the transformation.

New appointments

During 2023, we were delighted to welcome Helen McCabe as our new Chief Financial Officer and new appointments across the Executive Team. The Committee oversaw and approved the remuneration arrangements for all appointments as well as the exit terms for Panos Kakoullis and other members of the Executive Team. In the case of Helen McCabe, the Committee also carefully reviewed the buyout of share awards forfeited as a result of her resignation from her previous employment. The incentive plans forfeited included a mix of performance shares, restricted stock and stock options. The details of Helen's buyout are disclosed on page 103. We have also included additional context for the buyout disclosed last year for Tufan Erginbilgic on pages 102 and 103.

The selection processes for the appointments provided clear insight to the level of compensation required to recruit experienced talent in international markets. There has been a lot of external coverage of the need to ensure that the UK remains a competitive market for executive recruitment and we would echo the sentiments and issues highlighted by the capital markets industry taskforce. It is important that UK packages are globally competitive to allow us to attract and retain talent within the markets in which we operate.

Remuneration decisions related to 2023

The current remuneration policy was agreed by shareholders at the AGM in 2021 and was in place for 2023. Key features of the policy can be found on page 86 and how it operated during 2023 on pages 86 and 87.

Incentive outturn in respect of 2023

The Incentive Plan measures for 2023 were weighted 80% towards Group performance and 20% towards personal performance. The Group performance metrics for 2023 originally were intended to represent an evolution of the policy, transitioning from a 100% focus on short-term performance in 2021 to a 50:50 split of annual metrics and cumulative three-year metrics in 2023. The arrangements for Tufan Erginbilgic and Helen McCabe were structured to ensure that their outturns only relate to performance in 2023, thus ensuring that they were rewarded for business performance during their tenure only. The outturn applicable for Panos Kakoullis' pro-rated incentive reflects the blend of annual and three-year cumulative performance metrics.

At Group level, both free cash flow of £1,285m and underlying operating profit of £1,590m were significantly ahead of the original

target and maximum threshold for performance. This is exceptional performance relative to target and to prior years and rightly reflects maximum outturns for these elements of the scorecard. New for 2023 was the inclusion of two new strategic measures to incentivise quality of financial performance. Underlying operating margin performance of 10.3% was ahead of the level required to trigger maximum payout, reflecting very significant year-on-year improvement. Operating cost performance was ahead of target, with this portion vesting at 91% of maximum.

Non-financial performance metrics for 2023 were also ahead of target. Our people engagement, measured by our annual engagement survey delivered by Gallup, showed another year of improvement to achieve upper quartile status relative to manufacturing peers. We achieved a 5% improvement in participation to reach 80% and an overall score of 3.99, which was marginally above target with 63% of maximum vesting. Colleague safety performance relative to target was also strong with this portion vesting at 91% of maximum.

In reviewing incentive outturns, the Committee did consider the experience of internal and external stakeholder groups, in particular our employees and shareholders. Our global incentive arrangements will ensure that our wider workforce benefit from the excellent progress in 2023 and there has been an extremely positive experience for our shareholders given the market reactions to our 2023 performance, strategic review and medium-term guidance. In this context, the Committee is very pleased to be able to recognise this excellent performance in an overall outturn of 97% of maximum for Tufan and 90% of maximum for Helen. As referenced above, the measures applicable for Panos' pro-rated incentive include cumulative performance metrics covering the period 2021-2023. For this reason, Panos' outturn is 89% of maximum.

All of these awards will be delivered in shares which will be granted in March 2024, using the share price at that time. As per the approved remuneration policy, 40% of the shares will be required to be held until 2027 and 60% held until 2028.

Wider workforce context

Global inflationary pressures have continued for our colleagues across many of our locations worldwide. We also continue to see extremely competitive talent markets. These factors have required specific reward interventions to continue in 2023. Since 1 January 2022, we have delivered base pay increases of 13.4% plus one-off lump sums of £2,000 to the majority of our UK employees (including all of our lowest paid employees). In 2023, the median base pay increase in the UK was 6.5%, with an average increase across the UK workforce of 5.8%. In Germany, a tariff deal covering the period from October 2022 to September 2024 provided an increase of 5.2% from June 2023 and 3.3% from May 2024, plus two one-off payments of €1,500 each, paid over two years.

In parallel with the remuneration policy review, we have reviewed our all-employee share plan offering to the wider workforce. We currently offer tax approved sharesave and sharepurchase plans in the UK and a cash settled phantom sharesave plan for colleagues outside the UK. As our multi-year transformation programme delivers improvements in our business performance, we will invest in a new plan which will allow more colleagues to share in our success, enabled by affordable share ownership. Subject to shareholder approval being granted for the new share plan, we intend to launch this for our people in the second half of 2024.

Looking ahead – summary implementation of the remuneration policy in 2024

Salary

The Committee has reviewed the salaries for the Chief Executive and Chief Financial Officer and has concluded to make an award of 4.5% for both Tufan Erginbilgic and Helen McCabe effective 1 March 2024. This is in line with the average increase for the broader UK management population and reflects prevailing wage inflation for executive roles.

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Base pay increases for the wider UK workforce are subject to negotiation and increases for 2024 have not yet been agreed.

Incentives

As outlined earlier in my letter, subject to shareholder approval, the Group will be returning to a market-typical annual bonus and a separate long-term incentive plan (LTIP).

Annual bonus

Subject to approval of the remuneration policy, the maximum annual bonus for Executive Directors in 2024 will be 200% of salary with 50% of any payment delivered in shares which will be deferred for three years.

The 2024 annual bonus measures and weightings will be the same as operated in the 2023 combined incentive plan. These measures include: free cash flow (40%); operating profit (20%); and strategic objectives which are split equally between operating cost (15%); operating profit margin (15%); and people (10%), which includes health and safety and employee engagement.

Long-term incentive

Subject to approval of the remuneration policy, the LTIP award will be 375% of salary for the Chief Executive and 275% for the Chief Financial Officer. Following the three-year performance period, any vest will be subject to a mandatory two-year holding period. The proposed LTIP measures include free cash flow (30%), operating profit margin (30%), return on capital (10%) and relative TSR (30%) assessed in equal parts against the FTSE 100 and the S&P Global Industrials index constituents.

Remuneration Committee advisers

During 2023, the Committee had access to advice from WTW. Total fees for the advice provided to the Committee during the year by WTW were £174,500 (2022: £108,200). Fees are based on a time and materials basis. WTW also provided human capital and benefits services to the Group. No Directors have a connection to WTW.

The Committee requests that WTW attend meetings periodically during the year. The Committee is exclusively responsible for reviewing, selecting and appointing its advisers and is satisfied that the advice it has received has been objective and independent and that there is no conflict of interest associated with any advice provided. WTW is a member of the remuneration consulting group and, as such, voluntarily operates under the code of conduct in relation to executive remuneration consulting in the UK.

Summary

I have been delighted with the progress that is being made on the transformation programme and am excited about the role that the Committee has to reinforce the performance culture that we are striving for.

I would like to reiterate my appreciation to those shareholders who provided feedback to our policy proposals and I look forward to your support at the forthcoming AGM.

Lord Jitesh Gadhia
Chair of the Remuneration Committee

Remuneration at a glance

This section provides a summary of the current remuneration policy and its implementation that was approved by a binding shareholder vote at the 2021 AGM (see page 110). The full policy can be found at www.rolls-royce.com

Details of a revised policy, which will be taken to the AGM in May 2024 for a binding shareholder vote, can be found on pages 88 to 98.

Summary of our current remuneration policy

Fixed pay

- Base salary
- Benefits
- Pension

Variable pay

Incentive Plan

80% Group performance			20% personal performance
Annual financial metrics 2023 – profit, cash, operating cost, operating profit margin	Long-term metrics set in 2021 – cumulative cash (three-year), TSR, CO_2 sustainability	Annual non-financial metric: people – engagement and safety	Goals and leadership behaviours

All awards to be made at the end of the performance period in shares, 40% settled after three years and 60% after four years

Malus and clawback – incentive awards are subject to malus and clawback provisions where there has been a material misstatement of audited results; serious financial irregularity; material financial downturn or an event causing a material negative impact on the value of the Group; material failure of risk management; a serious breach of Our Code; individual misconduct or actions that materially damage the Group; a breach of or inadequate response to a significant HSE or other environmental issue; failure to adequately manage/supervise others which in turn led to one of the above triggers; and/or materially incorrect calculation of an award. For awards issued under the Incentive Plan these provisions apply from the start of the performance period to three years after date of grant or the settlement date, if later.

Shareholding requirement – in line with the Rolls-Royce shareholding requirements policy, Executive Directors are required to establish and maintain a level of share ownership in proportion to a percentage of base salary. The shareholding requirement is 400% for the Chief Executive and 300% for the Chief Financial Officer. Executive Directors are also required to retain the lower of their shareholding requirement or their actual shareholding at the date of leaving for 12 months after leaving and then half of that amount for the following 12 months.

Executive Directors summary policy and implementation table 2023

Base salary	
Purpose and link to strategy	To attract and retain individuals of the right calibre to develop and execute the business strategy.
Key features of current policy	Salaries are reviewed annually but not necessarily increased. Decisions on salary are informed but not led by reference to companies of a similar size, complexity and international reach. 30% of salary for the Chief Executive and 20% for the Chief Financial Officer is delivered in deferred shares.
Implementation in 2023	The Chief Executive joined the Group on 1 January 2023, with a base salary of £1.25m, and the Chief Financial Officer joined the Group on 1 August 2023, with a base salary of £725,000. Salaries for both remained unchanged throughout 2023. A salary increase of 4% was awarded to Panos Kakoullis effective 1 March 2023. This increase was in line with the average increase for the UK management population and lower than the average increase for wider workforce. Throughout 2023, 30% of salary for the Chief Executive and 20% for the Chief Financial Officers who served during the year was deferred into shares for two years.

Benefits	
Purpose and link to strategy	To attract and retain individuals of the right calibre to develop and execute the business strategy.
Key features of current policy	Benefits may include car allowance and related costs, financial planning assistance, private medical insurance, life assurance and other appropriate benefits at the discretion of the Committee.
Implementation in 2023	No changes to benefits.

Executive Directors summary policy and implementation table 2023 continued

Retirement allowance	
Purpose and link to strategy	To attract and retain individuals of the right calibre to develop and execute the business strategy.
Key features of current policy	Executive Directors are offered membership of a defined contribution plan. A cash allowance may be payable in lieu of pension contributions. The maximum contribution is 12% of base salary only, in line with the rate offered to the wider UK workforce.
Implementation in 2023	Contribution/allowance of 12%, in line with the rate for the wider UK workforce.

Incentive plan	
Purpose and link to strategy	To incentivise the execution of the business strategy, delivery of financial targets and the achievement of personal objectives.
Key features of current policy	Maximum opportunity is 385% (220% target) for the Chief Executive and 333% (190% target) for the Chief Financial Officer. Targets are set based on Group financial performance and individual performance and may include both annual and long-term metrics. Non-financial metrics may also be included. All of the incentive is deferred into shares, 40% for three years and 60% for four years. The Committee may apply discretion to any formulaic outturn. The Incentive Plan is subject to malus and clawback.
Implementation in 2023	For 2023, the Incentive Plan metrics were based on in-year performance only for Tufan Erginbilgic and Helen McCabe, ensuring that they were measured on business performance during their tenure. The Incentive Plan metrics for Panos Kakoullis and the wider leadership team were based on a combination of annual and longer-term targets. An outturn of 170% of target, 97% of maximum for Tufan Erginbilgic; 157% of target, 90% of maximum for Helen McCabe, and 156% of target, 89% of maximum for Panos Kakoullis. All deferred into shares, 40% held for three years and 60% for four years. The award for Panos Kakoullis was pro-rated to reflect his employment during the performance period. Further details of the exit arrangements for Panos can be found on page 103.

Shareholding requirement	
Purpose and link to strategy	To align the interests of Executive Directors to those of shareholders by requiring Executive Directors to build a high level of personal shareholding in the Company during their employment and for a specified post-employment holding period.
Key features of current policy	Under the 2021 policy, the shareholding requirement for the Chief Executive was 250% and for the Chief Financial Officer was 200%. Upon appointment, the shareholding requirement was increased to 400% for Tufan Erginbilgic and 300% for Helen McCabe. Executive Directors are required to retain the lower of their actual shareholding at the date of leaving for 12 months after leaving and then half of that amount for the following 12 months.
Planned implementation in 2023	Shareholdings as a % of salary as at 31 December 2023: Chief Executive – 877% Chief Financial Officer – 285%

Alignment with shareholders

The current policy was designed to ensure alignment with shareholders through a significant part of the overall reward package being delivered in shares with long holding periods.

Under the current policy, 30% of salary for the Chief Executive and 20% for the Chief Financial Officer is deferred into shares for two years. All incentive awards are delivered in shares in the March following the performance year, 40% held for three years and 60% for four years.

Remuneration policy

Introduction

The policy will take effect from immediately after the AGM to be held on 23 May 2024, subject to shareholder approval.

Key policy themes

At the 2021 Annual General Meeting, shareholders approved a new remuneration policy which was put in place as a direct response to the impact that the pandemic had on the aerospace sector, which in turn had a profound impact on the Group. The 2021 policy reflected the urgency of the challenges faced at the time and was designed to incentivise restoration of the balance sheet and the reduction of net debt. The main features of the policy were a combined incentive plan which focused initially on short-term financial metrics, with longer-term metrics added in year two and three of the policy. Given the rights issue in 2020, the policy was also designed to heavily align the interests of the Executive Directors with the interests of shareholders, with all of the incentive plan awards delivered in deferred shares and 30% of salary for the Chief Executive and 20% for the Chief Financial Officer also delivered in deferred shares. The existing policy was considered by the Committee to be a temporary intervention and always considered that a return to a more market-standard arrangement would happen when the Group returned to a more normal operating environment.

Since 2021, both the external and internal environment have changed significantly, with engine flying hours recovering and Rolls-Royce delivering a strong financial performance in 2023. The 2023 strategic review has culminated in a granular strategy which Tufan Erginbilgic set out at the CMD with a clear proposition to shareholders (see page 10).

The proposed remuneration policy has been developed by the Committee with the shareholder proposition central to decision making.

The Committee have also focused on the following key themes:

- **Talent attraction and retention** – Ensure we have the right talent in our organisation to deliver the strategic priorities. We are proposing to transition from the bespoke single incentive which is heavily weighted to annual targets to a more market-standard annual bonus and LTIP structure, with a market-aligned maximum opportunity and market standard delivery of cash versus shares. This plan will cascade to the Executive Team and senior management. The simplicity of the plan, combined with competitive quantum and metrics which are directly aligned to our mid-term targets, will help with talent attraction and retention.
- **Behaviours and cultural change** – The Committee has considered the need for the remuneration policy to align with the Group's values and behaviours, as well as to support the creation of a performance culture. In relation to performance culture, the Committee focused on: enterprise thinking; driving both cost and growth; commercial optimisation; and a culture where year-on-year improvement is normalised. The Committee has ensured that the structure of the incentive scheme, in addition to the metrics used, reinforces the strategic priorities and the cultural change required to deliver this and, in particular, enables a cascade through to individual objectives throughout the organisation.
- **Alignment with the mid-term targets** – Metrics in both the annual bonus and the LTIP place emphasis on cash flow and profit, reinforcing the Group's stated ambition to return to investment grade, which in turn will enable the Group to make appropriate portfolio choices and to reintroduce shareholder payments.
- **ESG** – A full strategic review of sustainability will be carried out in 2024, delivering a granular net zero emissions plans with defined metrics and targets. The Committee envisage introducing a climate related performance measure aligned to the strategic review within the life of the new policy, focusing on a reduction in Scope 1 + 2 emissions. The annual bonus will continue to have metrics aligned to safety, which is our number one priority, as well as employee engagement.
- **Ensuring alignment between Executive Directors and the wider organisation** – Our policy will cascade throughout the organisation and all employees are rewarded for delivery and execution of our strategy.

Changes to policy design

When considering how we transition away from the previous bespoke policy the Committee explored various incentive structure designs, including value creation/absolute return structures, as well as the more market standard structures. There was a strong consensus among the Committee that moving to a market conventional structure with a separate annual bonus and market typical LTIP for the next policy period would be the preferred option.

The Committee unanimously agreed that given the proposal to move to a market-standard annual bonus and LTIP structure, we should also align to a market standard quantum. The selection and appointment process undertaken in 2023 in respect of the various changes to the Executive Team gave the Committee a good insight into the competitive level of reward for our key talent markets. A benchmarking review was commissioned against several peer groups, including the FTSE 100 and the FTSE 50, both excluding financial services; a European Industrials Index; and a US Industrials bespoke group. Although Rolls-Royce competes in an international industrial talent market, the Committee believes that having a primary benchmarking perspective around the UK market is important given the UK headquarters and listing. Given this perspective and also that Rolls-Royce is firmly positioned in the FTSE 50, the Committee propose to align incentives for Executive Directors to the FTSE 50 market median.

The Committee believes that the proposed policy supports alignment with shareholder interests and enables metrics to be set that are strategically aligned and linked directly to the financial commitments set out at the CMD. A description and explanation of all significant changes from the policy approved in 2021 are set out below.

No Executive Director or Executive Team member was present during discussion of his or her own remuneration package and they were not involved in the final approval of the new remuneration policy design.

Annual bonus

The bonus may be based on a combination of financial, operational and individual metrics which the Committee will review on an annual basis, with the weightings and allocation between financial and non-financial depending on the strategic focus of the Group from year-to-year. At least 50% of the annual bonus targets will be financial.

In 2024, the metrics will remain the same as the annual metrics used in the 2023 single incentive plan, free cash flow (40%); operating profit (20%); strategic objectives, split equally between operating cost and operating profit margin (30%); and people (10%).

The target annual bonus for Executive Directors is proposed to be 100% of salary, with a maximum of 200% of salary. 50% of any payment will be delivered in shares which will be deferred for three years. This is in contrast to the previous policy where the entire combined incentive was delivered in shares, with 40% held for three years and 60% for four years.

LTIP

The Committee determines performance targets each year to ensure that the targets are stretching and support value creation for shareholders while remaining motivational for management. The precise metrics and weightings will be determined by the Committee on an annual basis and will depend on the strategic focus of the Group year-to-year. The LTIP performance period will be three-years, followed by a two-year holding period.

Measures for the 2024 award include free cash flow (30%); profit margin (30%); relative total shareholder return (30%); and return on capital (10%).

The maximum potential award under the LTIP will be 375% of salary for the Chief Executive and 275% of salary for the Chief Financial Officer.

Increase in incentive opportunity

The maximum incentive opportunity when the annual bonus and LTIP plans are combined will be 575% of salary for the Chief Executive and 475% of salary for the Chief Financial Officer. This compares to a maximum opportunity under the previous policy of 385% of base salary for the Chief Executive and 333% of base salary for the Chief Financial Officer. This is a significant increase in quantum when compared to the previous policy but the Committee is comfortable that, given the peer group review and the significant change in the internal and external landscape since 2021, that the maximum opportunity is proportionate and fair.

Minimum shareholding requirement

The minimum shareholding requirement under the previous policy was 250% for the Chief Executive and 200% for the Chief Financial Officer. On appointment, the minimum shareholding requirement changed to 400% of salary for the Chief Executive and 300% of salary for the Chief Financial Officer and it is proposed that this continues into the new policy period.

Removal of deferral of salary into shares

Under the previous policy 30% of the Chief Executive's salary and 20% of other Executive Directors' salary was delivered in shares which were then deferred for two years. Under the proposed policy, salary will be delivered entirely in cash.

Consideration of shareholder feedback

During the policy review, we have consulted with our largest shareholders and the proxy agencies to provide context for the proposed new policy and gain feedback on how it could be improved. We have been pleased that the feedback that we have received has been positive, with shareholders understanding the rationale to return to more market-standard incentives and quantum broadly aligned to FTSE 50 levels. The overall feedback from this consultation was:

- support for transitioning to a market standard incentive structure;
- the increase in quantum was noted but was not called out as a concern so long as incentive metrics were stretching, aligned to strategy and reward true business performance;
- mixed views on the inclusion of relative TSR in the LTIP metrics, with some investors preferring the use of absolute rather than relative TSR;
- the use of profit and cashflow in both the annual bonus and the LTIP was noted but not highlighted as a concern due to these being central to the shareholder proposition outlined on page 10; and
- support for the measured approach proposed in relation to the introduction of a CO_2 metric, with investors expressing views that strategic alignment of metrics is of upmost importance.

These views have been considered in the final policy design for 2024.

Remuneration policy table

The table below sets out each element of Executive Directors' remuneration.

Base salary	
Purpose and link to strategy	We provide competitive salaries to attract and retain individuals of the highest calibre to develop and execute the business strategy.
Operation	Salaries are reviewed annually but not necessarily increased. Decisions on salary are informed but not led by reference to: — companies of a similar size, complexity and international reach; — size and scope of the role; — skills and experience of the individual; — market competitiveness of the broader remuneration package; — performance of the Group and individual; — wider market and economic conditions; and — increases made across the Group. The Committee has the flexibility to set the salary of a new hire at a discount to the market and to realign it in subsequent years as the individual gains experience in the role. In exceptional circumstances, the Committee may agree to pay above market levels to secure or retain an individual who is considered by the Committee to possess significant and relevant experience that is critical to the delivery of the Group's strategy. No recovery or withholding applies.
Maximum opportunity	There is no formal maximum. Any salary increases will be assessed annually and will not normally exceed average increases for employees in other appropriate parts of the Group. Where the Committee considers it necessary or appropriate, larger increases may be awarded in individual circumstances, including but not limited to: where there is a significant change in the scale, scope or responsibility of a role; where the organisation has undergone significant change; development within a role; and/or significant market movement.
Performance measures	Not applicable, although overall individual and business performance is considered when setting and reviewing base salary.

Benefits	
Purpose and link to strategy	We provide competitive benefits suitable to attract and retain individuals of the right calibre to develop and execute the business strategy and support wellbeing.
Operation	A range of benefits may be provided including, but not limited to, provision of a company car or car allowance, financial planning and tax assistance, private medical insurance, life assurance and other appropriate benefits at the discretion of the Committee. Relocation support or support for accommodation and travel may be offered to executives where necessary. Executive Directors may participate in all-employee share plans including ShareSave and the Share Incentive Plan. No recovery or withholding applies.
Maximum opportunity	There is no formal maximum. The cost of benefits is not pre-determined reflecting the need to allow for increases associated with the provision of benefits. Benefit costs are reviewed regularly to ensure they remain cost-effective. Participation in any tax advantaged share schemes is capped at the same level as other participants which is determined by the Group within the bounds of any applicable legislation which may change from time to time.
Performance measures	Not applicable.

Retirement	
Purpose and link to strategy	We provide a competitive retirement savings plan suitable to attract and retain individuals of the right calibre to develop and execute the business strategy.
Operation	Executive Directors are offered membership of a retirement savings plan. A cash allowance may be payable in lieu of contributions to the plan. In certain jurisdictions it may be more appropriate to offer more bespoke pension arrangements. The Committee will give due consideration to local employment legislation, market practices and the cost of the plan.
Maximum opportunity	The maximum employer contribution for the Executive Directors is aligned with that made available to the wider workforce, being 12% of base salary.
Performance measures	Not applicable.

Remuneration policy table continued

Annual bonus	
Purpose and link to strategy	We reward annual performance against stretching financial, strategic and individual targets aligned to delivery of the Group's strategy. Mandatory deferral reinforces retention and enhances alignment with shareholders by encouraging longer-term focus and sustainable performance.
Operation	The Group operates an annual bonus scheme which may be based on a combination of financial, operational or individual performance measures aligned to the Group's strategy. At least half the bonus awarded in any year will be deferred into shares, normally for a period of three years. The Committee has discretion to permit a dividend equivalent amount to accrue on shares delivered under the deferred bonus arrangement. Vesting of deferred shares is dependent on continued employment or good leaver status, as described in the notes to the policy table on page 93. The Committee retains the discretion, acting fairly and reasonably, to alter the bonus outcome in light of the underlying performance of the Group, taking account of any factors it considers relevant. Clawback will apply to cash bonuses paid and to any deferred shares within the three-year deferral period.
Maximum opportunity	The maximum annual bonus opportunity for the Executive Directors is 200% of base salary.
Performance measures	The bonus may be based on a combination of financial, operational and individual measures which the Committee will review on an annual basis. The precise allocation between financial and non-financial measures, as well as weightings within these metrics, will depend on the strategic focus of the Group from year-to-year. At least 50% of the performance measures will be financial. Up to 25% of the maximum bonus opportunity is paid for achieving a threshold level of performance and the maximum bonus is paid for delivering stretching levels of business performance and outstanding personal performance. No bonus is payable if threshold levels of performance are not achieved.

Long-term incentive plan	
Purpose and link to strategy	We incentivise the execution of strategy, drives long-term value creation and alignment with long term returns to shareholders.
Operation	Awards under the LTIP are conditional rights to receive shares subject to continued employment or good leaver status and the achievement of any relevant performance conditions. Awards are subject to performance targets normally assessed over three year financial years. The number of shares will be adjusted to reflect performance on the third anniversary of the grant, and the shares will vest on the five year anniversary of the grant, after a two year holding period. The Committee has discretion to set different performance periods if it considers it appropriate. The Committee shall determine the extent to which the performance measures have been met. The Committee may make adjustments to performance targets if an event occurs or circumstances arise which causes the Committee to determine that performance conditions are no longer appropriate. The performance targets will be at least as challenging as the ones originally set. The Committee has discretion to permit a dividend equivalent amount to accrue on shares during the holding period under the LTIP. Awards under the LTIP are subject to the malus and clawback policy which takes account of exceptional and adverse circumstances as described in the notes to the policy table. The Committee has the ability to exercise discretion in adjusting the formulaic outcome of incentives to ensure the outcome is reflective of the performance of the Group and the individual over the performance period.
Maximum opportunity	The maximum long-term incentive award for Executive Directors is 375% of base salary.
Performance measures	The Committee determines performance measures each year and will ensure that the targets are stretching and support value creation for shareholders whilst remaining motivational for management. The precise measures and weightings will be determined by the Committee on an annual basis and will depend on the strategic focus of the Group year-to-year. A minimum of 90% of measures will be financial. Measures for the 2024 award include free cash flow (30%); operating margin % (30%); relative total shareholder return (30%); and return on capital % (10%). For each performance element, achievement of the threshold performance level will result in no more than 20% of the maximum award paying out. For achievement of the maximum performance level, 100% of the maximum pays out. Normally, there is straight-line vesting between these points. No amount is payable if threshold levels of performance are not achieved

Remuneration policy table continued

Share ownership	
Purpose and link to strategy	Ensures alignment with shareholders' interests.
Operation	Executive Directors are required to build a holding of beneficially-owned shares equivalent in value to a percentage of their base salary. For the Chief Executive this requirement is 400% of salary and for the Chief Financial Officer and any other Executive Directors this requirement is 300% of base salary. Where requirements are not met, Executive Directors must retain at least one half of after-tax shares released from the legacy single Incentive Plan, the deferred bonus arrangements and the LTIP until this requirement is met. Post-cessation, Executive Directors are normally required to retain the lower of: the shareholding requirement or their actual shareholding at leaving date for 12 months and then 50% of that amount for the following 12 months.
Maximum opportunity	Not applicable.
Performance measures	Not applicable.

The table below sets out the main elements of Non-Executive Directors' remuneration.

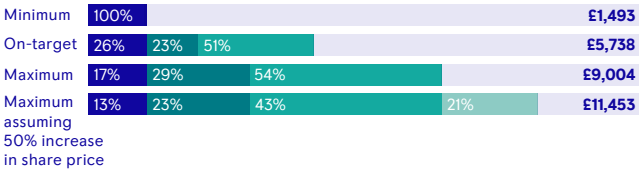
Fees	
Purpose and link to strategy	To reward individuals for fulfilling their role and attract individuals of the skills and calibre required.
Operation	The Committee makes recommendations to the Board on the Chair's remuneration. The Chair and the Executive Directors determine the remuneration of the Non-Executive Directors. The fees for Non-Executive Directors are set at a level which is considered appropriate to attract individuals with the necessary skills and experience. Fees are periodically reviewed to ensure they remain appropriate in the context of: the role scope; company size, complexity and global breadth; and wider market conditions. The Chair is normally paid a single fee which reflects the commitment, demands and responsibility of the role and may be paid in either or cash, shares, or a combination of both. Other Non-Executive Directors are normally paid a base fee and additional fees for Board Committee chairmanship and membership responsibilities. The Senior Independent Director and Employee Champion receive an additional fee for these additional duties. Non-Executive Director fees may be paid in either or cash, shares or a combination of both. Non-Executive Directors are not eligible to participate in the annual bonus or LTIP.
Maximum opportunity	The current limit on the aggregate fees is set out in the Articles of Association which may be amended by a shareholder vote.
Performance measures	Not applicable.

Benefits	
Purpose and link to strategy	To reimburse Non-Executive Directors for reasonable expenses incurred fulfilling the duties of their role.
Operation	Reimbursement for expenses that may include but not limited to: travel, hotel and subsistence incurred when attending meetings. The Group may provide support with tax matters for Non-Executive Directors based outside the UK. The Chair may have occasional use of chauffeur services. The Group may pay tax on benefits provided to Non-Executive Directors.
Maximum opportunity	Not applicable.
Performance measures	Not applicable.

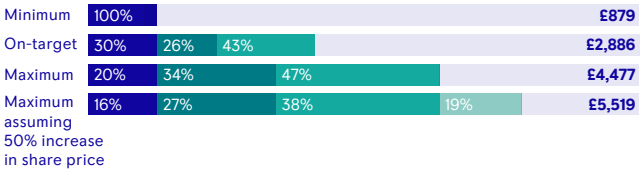
Remuneration policy – worked examples for 2024

The tables below provide an illustration of what could be received by each Executive Director for the 2024 performance year, assuming minimum, on-target, and maximum levels of performance. The maximum with share price increase scenario shows the impact of a 50% share price growth on the LTIP shares.

Tufan Erginbilgic
Chief Executive £000



Helen McCabe
Chief Financial Officer £000

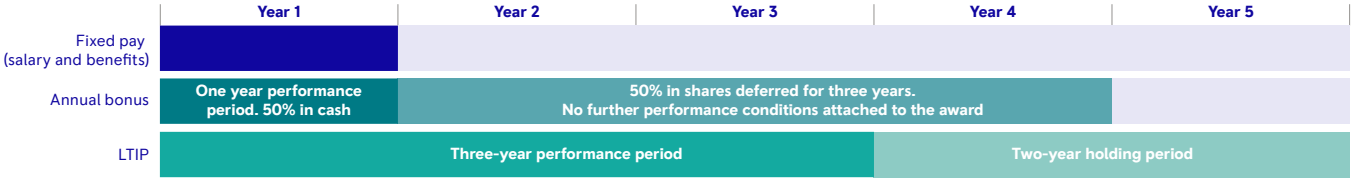


■ Fixed pay ■ Annual bonus ■ LTIP ■ Share price increase

Minimum	Fixed remuneration (salary, retirement, benefits)
On-target	Fixed remuneration, on-target annual bonus (equivalent to 100% of salary for both the Chief Executive and Chief Financial Officer) and 60% vesting of the LTIP (equivalent to 225% for the Chief Executive and 165% for the Chief Financial Officer)
Maximum	Fixed remuneration, maximum annual bonus (equivalent to 200% of salary for both the Chief Executive and Chief Financial Officer) and 100% vesting of the LTIP (equivalent to 375% for the Chief Executive and 275% for the Chief Financial Officer)
Maximum assuming 50% increase in share price	All elements the same as the maximum but assumes a 50% increase in the share price from the date that the shares are granted

Alignment with shareholders

The table below illustrates how the policy aligns the interests of Executive Directors with the long-term interests of shareholders. A significant portion of the total compensation package will be delivered in shares. 50% of the annual bonus will be deferred into shares for a period of three-years and the long-term incentive plan will have a three-year performance period followed by a two-year holding period.



Notes to the policy table

Performance measure selection and setting

The annual bonus measures are determined annually to reflect matters which the Committee considers to be areas of specific focus for the Executive Directors over the short term. The Committee believes that using a number of measures provides a balanced incentive. The measures themselves are aligned to, and are designed to support the delivery of, the Group's strategic objectives.

The Committee sets performance conditions relating to the LTIP awards which are designed to align the interests of management and shareholders, incentivise management to deliver the Group's strategic objectives and reward performance over the longer term.

Targets for the annual bonus and performance measures for the LTIP awards are reviewed before the awards are made, based on a number of internal and external reference points, including strategic plans and analyst consensus, to reflect market expectations, where available. The Committee intends that the targets will be stretching and will align management's interests with those of shareholders. The measurement of performance is at the Committee's discretion, which may include appropriate adjustments to financial or non-financial elements and/or consideration of overall performance in the round. Adjustments may be either upwards or downwards.

In exceptional circumstances, performance conditions may also be replaced or varied if an event occurs or circumstances arise which cause the Committee to determine that the performance conditions have ceased to be appropriate.

Malus and clawback provisions

A malus provision applies to awards granted under the LTIP and to unvested awards under the Incentive Plan which were granted under the previous policy, to new awards granted under the proposed policy, and the mandatory bonus deferral arrangements. This would allow the Committee, in its absolute discretion, to determine, at any time prior to the vesting of an award, to reduce or cancel the award in certain circumstances, including:

— a material misstatement of audited results;

— serious financial irregularity;

— material financial downturn or an event causing a material negative impact on the value of the Group;

— material failure of risk management;

— a serious breach of Our Code;

— individual misconduct or actions that materially damage the Group;

— acting in a way which has materially damaged the reputation of the Group or any member of the Group;

— a breach of or inadequate response to a significant HSE or other environmental issue;

— materially incorrect calculation of an award; and/or

— failure to adequately manage/supervise others which in turn led to one of the above triggers and/or materially incorrect calculation of an award.

A clawback provision applies to vested awards granted under the LTIP, the mandatory bonus deferral arrangements and deferred shares granted under the Incentive Plan, as well as annual bonuses paid previously. This would allow the Committee, in its absolute discretion, to claw back from individuals some or all of the vested awards or paid bonus in the circumstances described above.

These provisions apply from the start of the performance period to three years after date of grant or the settlement date, if later.

Policy on new appointments

The Committee will appoint new Executive Directors with a package that is in line with the remuneration policy. Base salary may be set at a higher or lower level than the previous incumbent. The maximum incentive opportunity on appointment will be no higher than the maximum of the shareholder approved remuneration policy, which is 200% of the annual bonus and 375% for the LTIP.

Remuneration forfeited on resignation from a previous employer may be compensated. This will be considered on a case-by-case basis and may comprise cash or shares. In general:

— if such remuneration was in the form of shares, compensation will be in the Company's shares;

— if remuneration was subject to achievement of performance conditions, compensation will, where possible, be subject to performance (either Rolls-Royce performance conditions or actual/forecast performance outturns from the previous company); and

— the timing of any compensation will, where practicable, match the vesting schedule of the remuneration forfeited.

Legacy terms for internal appointments may be honoured, including any outstanding incentive awards. If an Executive Director is appointed following a merger or an acquisition of a company by Rolls-Royce, legacy terms and conditions may be honoured.

Where an Executive Director is required to relocate from their home location to take up their role, the Committee may provide reasonable relocation assistance and other allowances including expatriate assistance. Global relocation support and any associated costs or benefits (including but not limited to housing, school fees, tax preparation and filing assistance and flights back to the home country) may also be provided if business needs require it. Should the Executive's employment be terminated without cause by the Group, repatriation costs may be met by the Group.

The Company may agree to pay the reasonable legal fees incurred by a new appointee for advice received in relation to his/her contract of employment or service agreement.

Wider workforce considerations

The Committee has responsibility for overseeing pay arrangements of all our people and reviews broader workforce policies and practices in order to support decisions on executive pay. When setting remuneration for Executive Directors and senior management, the Committee carefully considers wider remuneration across the Group, including salary increases, bonus awards, share plan participation and pay ratios between Executive Directors and employees.

Paying our people fairly relative to their role, skills, experience and contribution is central to our approach to remuneration. The Group's reward framework and policies fundamentally support this. The remuneration policy for senior executives and other employees is determined based on similar principles to Executive Directors. For roles below the Board, the exact structure and balance are tailored based on various factors including the scale, scope or responsibility of the role, development within the role and local market practice.

We drive alignment through the organisation with our incentives and our all-employee share plans. The annual bonus plan metrics cascade from Executive Directors to the vast majority of our wider workforce and our LTIP plan cascades to a large proportion of our global management population as well as our key talent groups (c. 12% of the global workforce). This drives alignment of organisational and individual objectives, ensuring that the wider workforce is driving the key metrics which will help us to continue to deliver a step change in our performance and enable future strategy.

The Committee is supportive of providing all employees with the opportunity to become shareholders, again aligning the interests of the wider workforce, the Executive Directors and our shareholders. In 2024, we are implementing a new all-employee share plan, moving from a ShareSave plan which is cash settled outside of the UK, to a global purchase plan where the Company has the opportunity to match personal investment up to a certain value each month. Our new plan will enable share ownership from the outset, driving engagement with business and share price performance and reinforcing the message that we all benefit if the business succeeds.

Input on the new remuneration policy was sought from employee groups at all levels within the organisation, including the European works council and representatives of our global management population. Input was received by both face-to-face and virtual meetings. We shared how reward packages for Executive Directors are typically structured and received input on appropriate performance measures to determine pay outcomes and how incentive structures should cascade to the wider organisation.

Share plans

The Committee retains a number of discretions consistent with the relevant share plan rules. For example, in the event of any variation in the share capital of the Company, a demerger, special dividend, distribution or any other transaction which will materially affect the value of shares, the Committee may make an adjustment to the number or class of shares subject to awards.

The treatment of leavers in our ShareSave and Share Incentive Plan is covered by the respective plan rules. Change of control provisions in respect of employee share plans are set out below.

Service contracts

A summary of the key elements of the Executive Directors' service agreements as they relate to remuneration are as follows:

Contract duration	No fixed term.
Notice period	12 months' notice (both to and from the Executive Director).
Payment in lieu of notice (PILON)	Employment can be terminated with immediate effect by undertaking to make a PILON comprising base salary, pension contributions or allowance, car allowance and a sum representing the cost of private medical insurance. The Company may elect to provide private medical insurance and/or to allow an Executive Director to retain his or her company car through the notice period (or the balance of it) as an alternative to making cash payments. The Company is entitled to make the PILON on a phased basis, subject to mitigation, so that any outstanding payment(s) would be reduced or stopped if alternative employment is obtained.
Change of control	If there is a change of control of the Company (or other specified Company events), the relevant plan rules contain details on the impact for awards. In most cases, this is likely to result in the awards vesting early but subject to still meeting any applicable performance conditions (as decided by the Committee, who may have regard to projected performance over the whole period) and applying time pro-rating. Alternatively, awards may be exchanged for new awards over shares in the acquiring company in some circumstances.
Other entitlements on termination	There is no contractual entitlement to notice or any other payments in respect of the period after cessation of employment if the individual is summarily dismissed. Please see payments for loss of office below for a summary of other entitlements which may be due upon termination (and which relate to remuneration).

Payments for loss of office

The Company's policy on payments for loss of office is as follows:

The relevant share plan rules govern the treatment of in-flight share awards when an Executive Director leaves. The table below summarises leaver provisions for good leavers.

Good leavers are those who have left the Group due to death; ill-health, injury or disability; redundancy; retirement with the agreement of the Group; the sale or transfer of the business in which the Executive Director is employed to a Company which is not a member of the Group; the participant's employing company ceasing to be a member of the Group; and other such circumstances approved by the Committee.

All awards will normally lapse if an individual leaves the Company for any reason other than a good leaver reason.

The Committee will not exercise discretion where a participant is dismissed for gross misconduct.

Component	Approach
Annual bonus	Individuals who are determined by the Committee to be good leavers may be considered for an annual bonus in relation to the year in which their active employment ceases. When deciding whether to exercise its discretion to allow a payment in respect of an annual bonus (and, if so, its amount and the terms on which it may be paid), the Committee will consider such factors as it considers to be appropriate, including performance against bonus targets, the performance of the individual and the Group in general and the circumstances in which the individual is leaving office. Any payment to a good leaver in respect of an annual bonus will typically be made at the same time as annual bonuses are paid to other employees. Clawback will continue to apply to the cash element of any payment made in respect of an annual bonus. The Committee will determine if it is appropriate in the particular circumstances to apply bonus deferral. Deferred shares allocated in part satisfaction of annual bonuses shall vest in full on the vesting date if an individual is determined by the Committee to be a good leaver unless the Committee, in its absolute discretion, determines that an award will vest on such earlier date on or following the date of such cessation as it may specify. Otherwise, they will lapse on exit.
LTIP	If an individual is determined by the Committee to be a good leaver, LTIP awards will normally continue to vest on the original vesting date and any holding period will normally still apply (subject to the satisfaction of performance conditions and unless the Committee exercised its discretion to waive time pro-rating, time-pro-rating which will apply to reflect the period worked). If an individual leaves during the holding period for any reason (except summary dismissal) the award will not lapse or be pro-rated for time but the holding period will normally remain in force.

Component	Approach
SIP and SAYE schemes	The Executive Directors are subject to the same leaver provisions as all other participants, as prescribed by the rules of the relevant scheme or plan.

Legacy commitments

Any remuneration payments and/or payments for loss of office made under legacy arrangements prior to the approval of the remuneration policy may be paid out subject to the terms of the remuneration policy in place at the time they were agreed. For these purposes, payments include satisfying awards of variable remuneration and, in relation to an award over shares, the terms of the payment will be agreed at the time the award is granted. Unvested incentive plan awards issued under the previous policy, along with any salary that was deferred into shares, will vest on the usual vesting dates, consistent with the terms of that policy. LTIPs granted under previous policies remain in place, consistent with the terms of that policy.

Minor amendments

The Committee may make minor amendments to the policy (for regulatory, exchange control, tax or administrative purposes or to take account of a change in legislation) without obtaining shareholder approval.

Provision 40, section 41 disclosures

When developing the proposed remuneration policy and considering its implementation, the Committee was mindful of the Code and considers that the executive remuneration framework appropriately addresses the following factors:

Clarity	We provide open and transparent disclosures regarding our Executive remuneration arrangements. We have explained the changes to our proposed remuneration policy in a way that highlights alignment to both our vision and strategy as well as the provisions of the Code.
Simplicity	Remuneration arrangements for our Executive Directors and our wider workforce are simple in nature and well understood by both participants and shareholders.
Predictability	Our remuneration policy contains details of maximum opportunity levels for each component of pay, with actual incentive outcomes varying depending on the level of performance achieved against specific measures.
Proportionality, risk and alignment to culture	The metrics used to measure performance for incentive awards drive behaviours that are closely aligned to our vision and strategy. In particular, our variable pay arrangements continue to focus on delivering an unprecedented level of transformation. The Committee considers that our variable pay structures do not encourage inappropriate risk-taking. The incentives are subject to the achievement of stretching performance targets and the Committee's holistic assessment of performance that can result in the application of discretion. The use of holding periods, the payment of fixed salary in shares with holding periods and our shareholding requirements (including after leaving employment with the Group) provide a clear link to the ongoing performance of the business and, therefore, alignment with shareholders. Malus and clawback provisions also apply to the Incentive Plans.

Implementation of proposed remuneration policy for 2024 (subject to shareholder approval)

Base salary

A salary increase of 4.5% for the Chief Executive and 4.5% for the Chief Financial Officer is proposed. This is in line with the average increase for the broader UK management population and reflects prevailing wage inflation for executive roles. Base pay increases for the wider UK workforce are subject to negotiation and increases for 2024 have not yet been agreed.

Until a new policy is approved, 30% of Tufan Erginbilgic's salary and 20% of Helen McCabe's salary will continue to be deferred into shares for two years. We expect that, from 1 June 2024, all base salaries will be paid as cash.

Benefits

There will be no change to our approach to benefits in 2024, which includes car allowance, financial planning assistance, insurances and other benefits.

Retirement

The cash allowance for Tufan Erginbilgic and Helen McCabe is 12% of salary, in line with the rate made available to the wider UK workforce.

Annual incentive

In line with the proposed policy, the annual incentive for 2024 will be based on 80% Group performance and 20% individual performance, with a maximum opportunity for both Tufan Erginbilgic and Helen McCabe of 200% of salary. Fifty percent of any incentive payable will be delivered in shares which will vest after three years. If shareholding requirements are not met at the point of vesting, Executive Directors may only dispose of up to 50% of shares vesting.

As we transition from the combined Incentive Plan to a more conventional STIP and LTIP structure, the Committee considered whether the three-year targets set at the start of 2022 should form part of the annual incentive for 2024, so that long-term business performance continues to be measured and rewarded. Business performance for 2023 has exceeded expectations and ambitious targets have been set for future performance. Because of this, the 2024 metrics which are set out in the 2023 remuneration report will not be reflected in the 2024 incentives for any of the workforce. Instead, the metrics associated with both the long and short-term incentive plans reflect the ambitious targets that were laid out at the CMD.

The metrics and associated weightings will be:

Metric	Weighting	Link to strategy
Free cash flow	40%	A fundamental KPI which helps to measure the level of value we are creating for our shareholders. It enables the business to fund growth, reduce debt and make shareholder distributions.
Operating profit	20%	Indicates how the effect of growing revenue and control of our costs delivers value for shareholders.
Strategic objectives (split equally between operating cost and operating profit margin)	30%	Incentivises the delivery of key annual objectives linked to the transformation. Cost and margin controls are critical to increasing the quality of financial returns.
People (split equally between engagement and safety index)	10%	Safety is the Group's licence to operate and sits at the heart of everything we do. Employee engagement is an objective way of assessing how engaged our employees are with the business and its leaders.

Where targets are set with a one-year performance period, these are considered to be commercially sensitive and will be disclosed following the end of the performance period, along with performance against targets and the details and context for the assessment of performance.

The Committee may make appropriate adjustments and use judgement in assessing performance outcomes. It retains its overriding ability to apply discretion to adjust any formulaic outcome to ensure that the final outcome is fair and justified in the context of the overall performance of the business.

Implementation of proposed remuneration policy for 2024 (subject to shareholder approval) continued

Long-term incentive

The proposed long-term incentive will have a three-year performance period and a two-year holding period, with a maximum opportunity of 375% of salary for Tufan Erginbilgic and 275% for Helen McCabe.

The metrics for the 2024 long-term incentive covering the performance period from 1 January 2024 to 31 December 2026 are set out on page 91.

Metrics	Weighting	Threshold [1] (20% vesting)	Maximum [1] (100% vesting)	Link to strategy
Free cash flow (three-year cumulative)	30%	£5,600m	£7,300m	A fundamental KPI which helps to measure the level of value we are creating for our shareholders. It enables the business to fund growth, reduce debt and make shareholder distributions.
Operating margin % (average over three-year performance period)	30%	10.9%	12.7%	Reflects the quality of performance and will encourage continued cost focus across the Group.
Relative TSR (50% versus the FTSE 100 constituents and 50% versus the S&P global industrials index constituents)	30%	Median	Upper quartile	Closely aligns executive pay outcomes with the shareholder experience, a measure favoured by a large proportion of our shareholder base.
Return on capital % (average over three-year performance period)	10%	11.3%	13.8%	Reflects the Group's ability to generate returns on our investments for the benefit of our shareholders.

1 Outturn between threshold and maximum will be calculated on a sliding scale

The Committee may make appropriate adjustments and use judgement in assessing performance outcomes. It retains its overriding ability to apply discretion to adjust any formulaic outcome to ensure that the final outcome is fair and justified in the context of the overall performance of the business.

The long-term incentive opportunities and time horizons will operate as per the remuneration policy.

2023 remuneration report

Executive Directors' remuneration

The following pages show how we have applied our remuneration policy during 2023 and disclose all elements of remuneration received by our Executive Directors.

Executive Directors' single figure of remuneration (audited)

	Tufan Erginbilgic		Helen McCabe		Panos Kakoullis	
	2023 £000	2022 £000	2023 £000	2022 £000	2023 £000	2022 £000
Salary (a)	875		242		395	555
Salary as deferred shares	375		60		84	139
Benefits (b)	29		13		16	26
Incentive Plan (c)	4,680		908		1,430	1,705
Long-Term Incentive Plan	–		–		–	–
Pension (d)	150		36		57	83
Previous employer buy-outs (e)	7,500		2,537			
Total remuneration	13,609		3,796		1,982	2,508
Total fixed remuneration	1,429		465		552	803
Total variable remuneration	12,180		3,331		1,430	1,705

* Helen McCabe was appointed on 1 August 2023. Panos Kakoullis stepped down from the Board on 4 August 2023

a) Salary (audited)

The Company provides suitable competitive salaries to attract and retain individuals of the right calibre to develop and execute the business strategy.

Discrepancies between single figure of remuneration salary and base salary:

— from the date of their appointments, 30% of Tufan Erginbilgic's salary and 20% of Helen McCabe's salary is deferred into shares for two years. From June 2021 and 20% of Panos Kakoullis' salary was deferred into shares for two years. The shares are not subject to performance conditions nor conditional on continued employment. However, if the Executive Director is summarily dismissed as a result of their actions or the result of actions of others acting under their instruction, the shares will immediately lapse.

In February 2024, the Committee reviewed the base salaries of Tufan Erginbilgic and Helen McCabe and agreed an increase of 4.5%. This is in line with the average increase for the broader UK management population and reflects prevailing wage inflation for executive roles.

	Base salary as at 1 March 2024	Base salary as at 1 March 2023
Tufan Erginbilgic	£1,306,250	£1,250,000
Helen McCabe	£757,625	£725,000 *
Panos Kakoullis	n/a	£724,880

* Helen McCabe was appointed on 1 August 2023

b) Benefits (audited)

Benefits are provided to ensure that remuneration packages remain sufficiently competitive to attract and retain individuals of the right calibre to develop and execute the business strategy and to enable them to devote themselves fully to their roles. The taxable value of all benefits paid to Executive Directors is shown below.

	Car or car allowance £000		Medical insurance £000		Travel and subsistence £000		Tax benefit £000		Total £000	
	2023	2022	2023	2022	2023	2022	2023	2022	2023	2022
Tufan Erginbilgic	15		–		14		–	–	29	–
Helen McCabe	6		1		6		–	–	13	–
Panos Kakoullis	10	15	1	1	4	8	1	2	16	26

c) Incentive Plan (audited)

The Incentive Plan is designed to incentivise the execution of the business strategy, delivery of financial targets and the achievement of personal objectives. Incentive Plan awards are made in March each year, following the performance period. All of the incentive is deferred into shares, 40% for three years and 60% for four years, and include the right to receive an amount equal in value to any shareholder distributions issued during the deferral period. The shares are conditional on continued employment but do not have further performance conditions. The annual maximum for the Chief Executive is 385% of salary and 333% for the Chief Financial Officer.

— 80% of the award is based on Group performance; and

— 20% of the award is based on individual performance.

For 2023, the Incentive Plan metrics were based on in-year performance only for Tufan Erginbilgic and Helen McCabe, ensuring that they are only rewarded for business performance during their tenure. The Incentive Plan metrics for Panos Kakoullis and the senior leadership team were based on a combination of annual and longer-term targets.

The Committee reviewed the 2023 outturn against the performance measures.

2023 Incentive Plan performance outturn

	Weighting for prior Chief Financial Officer and wider leadership	Weighting for Chief Executive and Chief Financial Officer	Threshold (50% outturn) [1]	Target (100%)	Maximum (175%) [1]	Performance pre-adjustments	Performance post-adjustments	% of target	% of maximum
Annual targets:									
Free cash flow [2]	20%	40%	£525m	£750m	£975m	£1,285m	£1,275m	175%	100%
			Actual £1,275m						
Operating profit [3]	10%	20%	£850m	£1,050m	£1,250m	£1,590m	£1,568m	175%	100%
			Actual £1,568m						
People [4]	5%	10%							
– Gallup Q12	2.5%	5%	3.73	3.97	4.11	3.99	3.99	111%	63%
			Actual 3.99						
– Safety Index score	2.5%	5%	85%	90%	95%	94%	94%	160%	91%
			Actual 94%						
Key strategic objectives [5]	15%	30%							
– Operating cost [6]	7.5%	15%	£(6,088)m	£(5,988)m	£(5,888)m	£(6,062)m	£(5,909)m	159%	91%
			Actual £(5,909)m						
– Operating profit margin [3]	7.5%	15%	6%	7.6%	9.2%	10.3%	10.2%	175%	100%
			Actual 10.2%						
Weighting for 12 month targets	50%	100%							
Outcome for 12 month targets								169%	97%
Longer-term targets:									
Cumulative cash (three year) [7]	20%	n/a	(£1,606m)	(£706m)	£194m	£266m	£266m	175%	100%
			Actual £266m						
Relative TSR (50% versus the FTSE 100 constituents and 50% versus the S&P Global Industrials index constituents)	25%	n/a	Median		Upper Quartile			175%	100%
			Actual (99th percentile against FTSE 100; 96th percentile against S&P)						
CO_2 sustainability [8]	5%		50%	100%	175%	148%	148%	148%	85%
			Actual 148%						
Weighting for three-year targets	50%	n/a							
Outcome for longer-term targets								172%	98%
Total scorecard outcome (combined annual and longer-term)								170%	97%

1 Payout between threshold and target and target and maximum is calculated on a straight line sliding scale
2 Free cash flow has been adjusted to account for FX changes in order to ensure that targets and assessments are measured on a like-for-like basis
3 Operating profit has been adjusted to account for FX changes (see footnote 2) and to reflect consistent target and outturn treatment for transformation costs
4 The people objective was weighted 50% to the Gallup engagement score and 50% to an internal safety measure
5 Key strategic objectives aligned to the broader transformation objectives and were weighted 50% to operating cost and 50% to operating profit margin
6 Operating cost has been adjusted to reflect transformation costs (see footnote 3); FX changes (see footnote 2) and discretion has been applied to neutralise the impact of costs directly linked to fully funded customer business and above target incentive accruals
7 Cumulative cash targets have been re-stated to reflect adjustments made in prior years, including removing the cash and profit contributions associated with business disposals (ITP and Airtanker), and for FX purposes (see footnote 2)
8 CO_2 sustainability was calculated using an average of the divisions' targets, which were a mix of product related milestones including proving compatibility with sustainable fuels across all our core platforms

The Committee considered adjustments to targets resulting from events which were not anticipated at the time the targets were set, to ensure that targets and assessments are measured on a like-for-like basis. The details of the adjustments are included in the footnotes above.

As a result of these adjustments, the incentive plan outturns are:

— combined annual and three-year targets, as applies to Panos Kakoullis and senior management: 170% of target and 97% of maximum.

— in-year targets only, as applies to Tufan Erginbilgic and Helen McCabe: 169% of target; 97% of maximum.

	Panos Kakoullis	Tufan Erginbilgic	Helen McCabe
Group performance (% of maximum) – weighting 80%	97%	97%	97%
Individual performance (% of maximum) – weighting 20%	100%	175%	110%
Actual award – % of maximum	89%	97%	90%
Actual award – % of salary	197%	374%	125%
Actual award – £000	£1,430	£4,680	£908

All of the incentive outturn will be delivered in deferred shares, 40% for three years and 60% for four years, and for Tufan Erginbilgic and Helen McCabe will vest subject to continued employment. No further performance conditions are attached.

Definitions used for performance measures:

Operating profit – adjusted Group underlying operating profit before tax for 2023.

Free cash flow – adjusted Group free cash flow.

Operating cost – adjusted Group operating costs (which exclude direct procurement of parts and components).

Operating profit margin – adjusted Group underlying operating profit margin.

People – weighted 50% to the Gallup engagement survey and 50% to an internal safety measure, the safety index. The Gallup score increased from 3.92 in 2022 to 3.99 in 2023 and participation increased from 75% to 80%. This exceeded our target score of 3.97 which was set in 2019 when the target was set to achieve upper quartile status versus Gallup's manufacturing peer group. This is another meaningful improvement and an extremely positive result. The safety index is an established internal KPI used by all divisions and was included for the first time as an incentive metric for 2023.

CO_2 sustainability – Calculated using an average of the three divisional targets which were mainly based on product compatibility with sustainable fuel.

Individual performance

Subject to achievement of a minimum financial threshold, the Executive Directors have 20% of their incentive based on the achievement of their personal objectives. The financial threshold for 2023 was to deliver a Group free cash flow of a minimum of £300m. Personal performance objectives are set at the beginning of the year and are aligned with the Group's priorities.

Objective	Measure	Assessment against objective
Chief Executive: Tufan Erginbilgic		
Deliver the 2023 plan	Deliver free cash flow of £800m; deliver operating profit of £1,050m; deliver operating cost of no more than £5,988m	Financial targets all exceeded, with maximum incentive targets achieved for free cash flow and operating profit margin. Operating cost was ahead of target but slightly below maximum.
Deliver the transformation programme	Deliver improvement in earning and cash potential through creating credible business improvement plans	The key strategic objectives of operating cost and operating profit margin are key indicators of the success of the transformation programme, and maximum incentive targets were achieved for operating profit, and slightly below maximum for operating cost.
Safety	Ensure focus on safety of our people, measured through progressing the safety index score of 90%, maintaining TRIR below 0.38%, and maintaining world-class performance of product safety	Tufan has been clear that safety is our number one priority and is at the heart of everything we do. The metrics are the safety index, which achieved a score in 2023 of 94% (target 90%), and the total reported injury rate (TRIR) which was 0.31 against a target of 0.38.
People	Deliver effective people strategy which ensures capability and engagement. Impact measured by Gallup score of 3.97, as well as progress against our 2025 D&I commitments	The Group Gallup engagement score was 3.99 against a target of 3.97. The Committee considers this to be a very strong outcome given the amount of change being implemented at pace.
Strategic Review	Complete the strategic review, obtain Board approval and engage with our investors in the second half of the year	The strategic review was completed to plan, and a successful capital markets day was held in November. Investors have been actively engaged in the process, and our share price has responded favourably.
Overall personal performance assessment: 175%		
Chief Financial Officer * Helen McCabe		
Deliver the 2023 plan	Deliver free cash flow of £800m; deliver operating profit of £1,050m; deliver operating cost of no more than £5,988m	Financial targets all exceeded, with maximum incentive targets achieved for free cash flow and operating profit margin. Operating cost was ahead of target but slightly below maximum.
Deliver the transformation programme	Execute a smooth transition of leadership within the finance function and deliver CMD following strategic review	Helen has transitioned seamlessly into the Chief Financial Officer role, and has played a fundamental part in the preparation for and execution of the successful capital markets day.
Risk management	Ensure effective risk management and internal control over business operations	Helen quickly identified the key priority areas and put in place robust transition plans including cyber; delegations; segregation of duties; intercompany activity; and balance sheet assurance
People	Lead delivery of the transformation for Finance, GBS and IT/Digital. Gallup target of 3.97	Organisation design complete and new ways of work being embedded to drive performance culture. Gallup participation increased compared to 2022, and the Finance score increased to 4.1, which was above the Group average of 3.99.
Strategic Review	Ensure robust financial plans in place to deliver five-year plan. Embed cash framework and deploy new investment criteria and investment approach	Robust plan in place for delivery of five year plan. Strategically aligned framework for M&A in place and being executed and risk managed.
Overall personal performance assessment: 110%		

* The objectives for Helen McCabe applied equally to Panos Kakoullis who left the business on 31 August 2023. Panos fulfilled his objectives during this period, delivering the half-year results and also ensuring a smooth and effective handover of responsibilities to Helen. The Committee has determined that Panos' performance was in line with expectations and he was, therefore, awarded 100% for the personal element of his 2023 incentive

d) Pension (audited)

Executive Directors are offered membership of a defined contribution plan with a maximum employer contribution of 12% of salary (or cash allowance of equivalent value). This aligns to the average rate for the UK workforce.

In 2023, Tufan Erginbilgic, Helen McCabe and Panos Kakoullis received a cash allowance in lieu of employer contributions.

e) Compensation for remuneration forfeited from previous employment (audited)

Chief Executive

As disclosed in the 2022 annual report, in line with the remuneration policy Tufan Erginbilgic was compensated for remuneration forfeited from previous employment. Tufan joined Rolls-Royce from private equity where remuneration arrangements are fundamentally different to listed companies. The arrangements are commercially sensitive, confidential and cannot be disclosed in the same way that disclosures are made for a UK listed company. A robust process was undertaken by the Committee to ensure that compensation awarded was fair and prudent considering the compensation forfeited, with the value awarded positioned at the lower end of a fair value range. The vesting period applied to the awards (with 50% vesting after four years and 50% vesting after five years) ensures long-term alignment with the interests of shareholders.

The compensation was in the form of two grants of shares valued at £7.5m. The awards were made in March 2023 and the number of shares subject to the awards was calculated using the average closing share price during the month prior to joining (December 2023). The number of shares awarded and the respective vesting dates are shown below:

— 4,128,138 shares which will vest in March 2027 subject to continued employment

— 4,128,138 shares which will vest in March 2028 subject to continued employment

Chief Financial Officer
Helen McCabe became Chief Financial Officer on 1 August 2023 and, in line with the remuneration policy, has been compensated for remuneration forfeited from previous employment with a total value of £2.54m. Compensation for the loss of equity, both in-flight LTIPs and share options, was issued in the form of a grant of Rolls-Royce Holdings plc shares. Compensation for the loss of cash bonus for the period January to July 2023 will be paid in cash in March 2024.

Long-Term Incentives: In-flight LTIPs valued at £1.58m were converted into Rolls-Royce Holdings plc shares using the average closing BP share price and the average closing share price in the three months prior to Helen joining Rolls-Royce, being May to July 2023. Restricted stock awards were replaced on a like-for-like basis; performance share awards were replaced with Rolls-Royce performance shares, with the vesting schedule aligned to the original BP vesting schedule. The number of shares awarded and the respective vesting dates are shown below:

— 813,292 shares which will vest between February 2024 and March 2026 subject to continued employment

— 118,156 shares which will vest in March 2025 subject to the long-term incentive plan performance conditions set for the wider Group in 2022 being met. The performance conditions include a free cash flow target (45% weighting, threshold target of £874m and maximum target of £2,674m); a cumulative operating profit target (45% weighting, threshold target of £1,705m and maximum target of £2,905m); and a CO_2 sustainability target (10% weighting, calculated as an the average achievement of CO_2 sustainability milestones across the divisions, subject mainly to product compatibility with sustainable fuels)

— 99,212 shares which will vest in March 2026 subject to the long-term incentive plan performance conditions set for the wider Group in November 2023 being met. The performance conditions are equally weighted to operating profit (threshold target of £4.4bn, maximum of £5.4bn) and free cash flow (threshold target of £4bn and maximum of £5.3bn)

Share options: Compensation for the loss of 500,000 share options valued at £844,000. The options had no performance conditions other than requiring continued BP employment and were valued using a Black-Scholes model on the day before Helen joined the Group, 31 July 2023. The value of the options was then converted to Rolls-Royce Holdings plc shares using the average closing Rolls-Royce share price during the month prior to joining, July 2023. As a result, 536,966 shares were granted which will vest in March 2025 subject to continued employment.

Cash bonus: A cash payment of £113,750 will be made to Helen in March 2024. This assumes an on-target award of 65% of base salary.

Malus and clawback
Awards to compensate for remuneration forfeited from previous employment for both Tufan and Helen are subject to the Rolls-Royce malus and clawback policy.

Payments to past directors (audited)
Warren East stepped down from the Board on 31 December 2022. In January 2023, he received a payment of £14,821 for leave not taken during 2022.

Jasmin Staiblin stepped down as a Non-Executive Director from the Board on 13 May 2021. Jasmin was appointed as a member of the supervisory board of Rolls-Royce Power Systems AG on 10 June 2021 and as chair of their supervisory board, executive committee, audit committee and mediation committee on 11 June 2021. Payments of £270,948 have been made to Jasmin in 2023 in relation to her appointment (2022: £300,200). No other payments have been made to past directors during the year.

Payments for loss of office (audited)
It was announced on 31 March 2023 that Panos Kakoullis would be leaving the business. He stepped down from the Board on 4 August 2023 and left the Group on 31 August 2023. The Committee agreed that Panos would receive a payment in lieu of notice for the seven unworked months of his twelve month notice period, reflecting base pay, a cash allowance in lieu of pension plan provision and the cost of providing benefits. A pay in lieu of notice payment of £483,221 was therefore paid to Panos on exit. Panos was deemed a good leaver in respect of his unvested Incentive Plan awards from 2021 and 2022, all of which were delivered in shares in March 2022 and March 2023, and which will vest in accordance with the original vesting schedule between March 2025 and March 2027.

Executive Directors' shareholdings and share interests

Executive Directors' share interests (audited)

The Directors and their connected persons hold the following interests in the ordinary shares of the Company:

	Ordinary shares owned outright		Conditional shares not subject to performance conditions (salary as deferred shares)		Conditional shares not subject to performance conditions (Incentive Plan)		Conditional shares subject to performance conditions (LTIP)	
	22 February 2024	31 December 2023	22 February 2024	31 December 2023	22 February 2024	31 December 2023	22 February 2024	31 December 2023
Tufan Erginbilgic	–	–	227,742	217,547	–	n/a	8,256,276	n/a
Helen McCabe	–	n/a	30,490	n/a	–	n/a	1,567,626	n/a
Panos Kakoullis *	n/a	n/a	258,585	214,858	2,439,039	2,439,039	–	–

* Panos Kakoullis stepped down from the Board on 4 August 2023

Executive Directors' share awards (audited)

The following sets out details of share awards that were granted, outstanding and vested during the year. See pages 102 and 103 for compensation for remuneration forfeited from previous employment in respect of the 2023 LTIP grants made during 2023 for Tufan Erginbilgic and Helen McCabe.

Tufan Erginbilgic	Balance at 31 December 2022	Granted during the year	Vested during the year	Lapsed during the year	Balance at 31 December 2023	Date of grant	Market price at date of grant (p)	Date of vest/ lapse	Market price at date of vest/lapse (p)	Face value of award * (£000)
Salary as deferred shares	–	217,547	–	–	217,547	21/12/2023	Various	21/12/2025	n/a	375
2023 LTIP (buyout)	–	4,128,138	–	–	4,128,138	08/03/2023	90.84	08/03/2027	n/a	3,750
2023 LTIP (buyout)	–	4,128,138	–	–	4,128,138	08/03/2023	90.84	08/03/2028	n/a	3,750

Helen McCabe	Balance at 31 December 2022	Granted during the year	Vested during the year	Lapsed during the year	Balance at 31 December 2023	Date of grant	Market price at date of grant (p)	Date of vest/ lapse	Market price at date of vest/lapse (p)	Face value of award * (£000)
Salary as deferred shares	–	26,548	–	–	26,548	21/12/2023	Various	21/12/2025	n/a	60
2023 LTIP (buyout)	–	1,030,660	–	–	1,030,660	29/11/2023	153.00	29/11/2028	n/a	1,577
2023 LTIP (buyout)	–	536,966	–	–	536,966	29/11/2023	157.00	29/11/2028	n/a	843

Panos Kakoullis	Balance at 31 December 2022	Granted during the year	Vested during the year	Lapsed during the year	Balance at 4 August 2023	Date of grant	Market price at date of grant (p)	Date of vest/ lapse	Market price at date of vest/lapse (p)	Face value of award * (£000)
Salary as deferred shares	223,931	56.827	22,173	–	258,585	28/07/2023	Various	28/07/2025	Various	84
2022 Incentive Plan	1,316,606	1,122,433	–	–	2,439,039	08/03/2023	151.87	08/03/2026	–	1,705

Salary as deferred shares *

30% of Tufan Erginbilgic's salary and 20% of Helen McCabe's and Panos Kakoullis' salary was deferred into shares for two years. During 2023, shares were awarded on a monthly basis from January to December at market price under the rules of the Incentive Plan (the date of grant in the table above is the last grant made in 2023). These shares will vest on a monthly basis from January 2025 (the date of vest/lapse in the table above is the vest date of the last grant made in 2023). The face value has been determined using the market price of each monthly award in 2023 set out below. The shares are not subject to performance conditions nor conditional on continued employment. However, if the Executive Director is summarily dismissed as a result of their actions or the result of actions of others acting under their instruction, the shares will immediately lapse.

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
£1.13	£1.45	£1.44	£1.52	£1.49	£1.55	£1.90	£2.02	£2.19	£2.01	£2.43	£2.99

2021 and 2022 Incentive Plan

Both Warren East and Panos Kakoullis were granted an award of shares under the Incentive Plan in March 2022 in respect of the 2021 financial year, and in March 2023 in respect of the 2022 financial year. The average closing share price in the three days prior to the award was used to calculate the number of shares. 40% of each award was deferred for three years, vesting in March 2025 and March 2026 respectively, and 60% for four years, vesting in March 2026 and March 2027 respectively. The awards are subject to malus and clawback. The performance outturn was assessed before the award was granted.

LTIP 2019 and 2020

Warren East was awarded an LTIP in 2019 and 2020. The performance conditions of both awards were assessed at the end of the 2021 and 2022 respectively and were not met. The performance adjustments were made on the three-year anniversary of the grants and the awards will formally lapse on the five-year anniversary of the grant (March 2024 and March 2025 respectively).

Executive Directors' shareholding requirements (audited)

In line with our shareholding requirements policy, Executive Directors are required to establish and maintain a level of share ownership in proportion to a percentage of base salary. The shareholding requirement is 400% for the Chief Executive and 300% for the Chief Financial Officer. Share interests that are included in the shareholding requirements are as follows: shares vested from Company share plans; shares held in the individual's own name or by a nominee; shares held by a person closely associated (PCA) (as defined by UK Market Abuse Regulation) where the PCA has given express permission; shares held as part of the SharePurchase Plan; and, the estimated net-of-tax shares held in trust as part of unvested awards under the Incentive Plan where the awards are not subject to any performance conditions.

Individuals are expected to meet the shareholding requirement within five years of becoming subject to the policy. Where the shareholding requirements are not met, individuals may only dispose of shares in the following circumstances: to cover taxation; to cover any costs associated with the vesting or exercise of a share award; up to 50% of any shares acquired following the vesting of an award under the Incentive Plan; in connection with the operation of the malus and clawback policy; or where the Committee determines there are exceptional circumstances.

At 31 December 2023, Tufan Erginbilgic's shareholding represented 877% of his base salary and Helen McCabe's shareholding represented 285% of her base salary. They had been subject to the policy since January and August 2023 respectively. These percentages have been calculated by reference to the three-month average share price to 29 December 2023, being the last working day of the year.

Executive Directors are also required to retain the lower of their shareholding requirement or their actual shareholding at the date of leaving for 12 months after leaving and then half of that amount for the following 12 months. Warren East and Panos Kakoullis have agreed to hold shares in accordance with the shareholding requirements policy until January 2025 and August 2025 respectively. Warren East's shareholding represented 1004% of his base salary and Panos Kakoullis' shareholding represented 486% of his base salary at 31 December 2023. Panos had been subject to the policy since May 2021.

These percentages had been calculated by reference to the three-month average share price to 29 December 2023, being the last working day of the year.

Executive Directors' contractual arrangements

Each Executive Director has a service agreement that sets out their contract with the Company.

	Effective date of contract	Notice period from Company	Notice period from individual
Tufan Erginbilgic	1 January 2023	12 months	12 months
Helen McCabe	4 August 2023	12 months	12 months

Pay across the organisation

This section of the report enables our remuneration arrangements to be seen in context by providing:

- a comparison of the percentage change in our Directors' remuneration with the change in our UK employees average remuneration over two years;
- a ten-year history of our Chief Executive's remuneration;
- our TSR performance over the same period;
- an indication of the ratio between our Chief Executive's remuneration and the remuneration of employees;
- gender pay reporting; and
- a year-on-year comparison of the total amount spent on employment costs across the Group and shareholder payments.

Percentage change in Directors' remuneration

The following table compares the percentage change in each of the Director's salary/fees, benefits and incentive to the average percentage change in salary, benefits and incentive for all UK employees for the past three years.

	2022–2023			2021–2022			2020–2021			2019–2020		
	Salary/ fees %	Benefits %	Incentive award %	Salary/ fees %	Benefits %	Incentive award %	Salary/ fees %	Benefits %	Incentive award %	Salary/ fees %	Benefits %	Incentive award %
Dame Anita Frew	**n/a**	**(61.54)**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Panos Kakoullis [1]	**n/a**	**n/a**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Tufan Erginbilgic [1]	**n/a**	**n/a**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Helen McCabe [1]	**n/a**	**n/a**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Paul Adams [1]	**n/a**	**n/a**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Birgit Behrendt [1]	**n/a**	**n/a**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Stuart Bradie [1]	**n/a**	**n/a**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Paulo Cesar Silva [1]	**n/a**	**n/a**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
George Culmer [2]	**n/a**	**6.25**	**n/a**	14.29	150	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Lord Jitesh Gadhia [1]	**38.46**	**(50)**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Beverly Goulet [3]	**6.25**	**28.85**	**n/a**	14.29	1,633.33	n/a	7.69	–	n/a	(7.5)	(72.27)	n/a
Nick Luff [4]	**n/a**	**–**	**n/a**	5.56	–	n/a	38.46	–	n/a	(7.5)	–	n/a
Mike Manley [1]	**n/a**	**n/a**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Wendy Mars [1]	**18.57**	**60**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Sir Kevin Smith [1,5]	**n/a**	**n/a**	**n/a**	(20.95)	50	n/a	8.25	∞ [6]	n/a	(7.5)	(79.32)	n/a
Dame Angela Strank [7]	**(14.44)**	**(50)**	**n/a**	8.43	300	n/a	n/a	n/a	n/a	n/a	n/a	n/a
UK employees average [8,9]	**5.77**	**(1.87)**	**25.42**	5.71	3.8	3	1.03	(9.13)	1,435	1.96	2.23	(89.94)

1 Appointed or stepped down during 2023, 2022 or 2021 and therefore unable to provide percentage change for a full year's remuneration
2 George Culmer was appointed Senior Independent Director (SID) on 12 May 2022 and received an increase in fees
3 Beverly Goulet was appointed Lead Employee Champion on 12 May 2022 and received an increase in fees
4 Nick Luff was appointed Chair of the Audit Committee on 13 May 2021 and received an increase in fees
5 Sir Kevin Smith stepped down as SID and as Chair of the Science & Technology Committee on 12 May 2022 and received a decrease in fees
6 Unable to show percentage change as the increase was from zero
7 Dame Angela Strank was appointed Chair of the Safety, Ethics & Sustainability (SES) Committee on 13 May 2021 and received an increase in fees. She stepped down as Chair of the SES Committee on 11 May 2023
8 UK employees were chosen as a comparator group in order to avoid the impact of exchange rate movements over the year. UK employees including apprentices, graduates and interns make up 50% of the total employee population and are employed by Rolls-Royce plc or its relevant subsidiaries. Rolls-Royce Holdings plc has no employees
9 There was an incentive award for only a very small population in 2020, hence the significant increase in 2021

Chief Executive pay

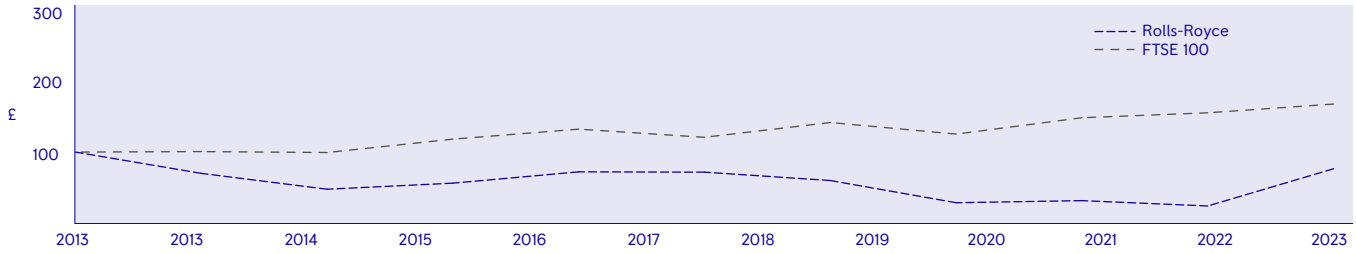
Year	Chief Executive	Single figure of total remuneration £000	Incentive award as a % of maximum	LTIP as a % of maximum
2023	Tufan Erginbilgic	13,610	97%	–
2022	Warren East	3,835	74	–
2021	Warren East	3,950	79.7	–
2020	Warren East	1,110	–	–
2019	Warren East	2,528	52	53
2018	Warren East	4,075	60	100
2017	Warren East	2,331	68	–
2016	Warren East	2,089	55	–
2015	Warren East	543	–	–
	John Rishton	754	–	–
2014	John Rishton	2,596	–	45

John Rishton retired on 2 July 2015 and Warren East was appointed as Chief Executive on 3 July 2015.

Warren East retired on 31 December 2022 and Tufan Erginbilgic was appointed as Chief Executive on 1 January 2023. Tufan received compensation for remuneration forfeited from previous employment in 2023 (see pages 102 and 103).

TSR performance

The Company's TSR performance over the previous ten years compared to a broad equity market index is shown in the graph below. The FTSE 100 has been chosen as the comparator because it contains a broad range of other UK-listed companies. The graph shows the change in value of a hypothetical £100 holding in the Company's ordinary shares over ten years (prior years adjusted for the rights issue), relative to the FTSE 100 index.



Chief Executive pay ratio

The Committee is mindful of the relationship between the remuneration of the Chief Executive and the wider employee population. This is the sixth year that we have published our Chief Executive pay ratio and we have continued to use option A. We believe that this is the most accurate and robust methodology because it relies on calculating actual full time equivalent remuneration for all relevant employees rather than rely on data collected for other purposes. We have used the full time equivalent total remuneration of all UK employees at 31 December 2023.

Year	Method	25th percentile	Median	75th percentile
2023	Option A	254:1	219:1	185:1
2022	Option A	75:1	64:1	55:1
2021	Option A	88.1	76.1	63.1
2020	Option A	26:1	22:1	19:1
2019	Option A	66:1	56:1	48:1
2018	Option A	92:1	77:1	66:1

For 2023, the salary and total remuneration for the three employees identified at the 25th, median and 75th percentiles are as follows:

Year	25th percentile	Median	75th percentile
Salary *	£42,453	£52,104	£60,852
Total remuneration	£53,545	£62,168	£73,618

* Calculated using base pay as at 31 December 2023

The 2023 pay ratio is significantly higher than it has been in previous years driven primarily by the award of shares valued at £7.5m at the time of grant to the Chief Executive as compensation for remuneration forfeited from previous employment. If this value was removed from the calculation the pay ratio would be 98:1. The Chief Executive has a larger proportion of his total reward based on variable elements linked to performance than other UK employees, as well as a significant proportion of his total package delivered in shares ensuring a direct link between his reward and share price performance. The Committee recognises that the pay ratio for 2023 is significantly higher than in recent years, relating primarily to the £7.5m award of shares. The Committee considers this to be appropriate considering the exceptional performance delivered in 2023.

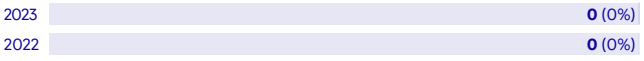
There is good alignment between the reward structure for the Chief Executive and that of the wider workforce, with the majority of employees participating in an incentive plan with aligned financial metrics. We also encourage all eligible employees to join our all-employee share plans, with approximately 50% of our global population enrolling in our most recent ShareSave plan and approximately 35% of the UK population participating in our SharePurchase Plan. In 2024, we will be broadening our all-employee share plan offering, launching a global purchase plan which will be structured to offer matching free shares for every share purchased up to maximum monthly limit. This aligns to our broader strategy to increase employee share ownership and links directly to the transformation programme.

Relative importance of spend on pay

The following chart sets out the percentage change in payments to shareholders and overall expenditure on pay across the Group.

Payment to shareholders (£m)

(Consolidated cash flow statement)



Group employment costs (£m)

(Note 8, employee information – see page 150)

* Excludes ITP employment costs. ITP Aero sale was completed September 2022

Gender pay reporting

The Company is committed to creating a diverse and inclusive place to work where our people can be themselves and be at their best.

More information about this can be found in the People and Culture section, pages 44 and 48. We published our UK gender pay gap in February 2024, which showed:

Median gender pay gap across all employees in the UK

Mean gender pay gap across all employees in the UK

The reducing pay gap in the UK is explained by the changing distribution of our workforce, with proportionately more women than men in higher paid positions. We continue to pursue diverse and under represented talent, including women, at all levels.

Non-Executive Directors' remuneration

Non-Executive Directors' single figure of remuneration (audited)

	Fees (£000)		Benefits (£000)		Total remuneration (£000)	
	2023	2022	2023	2022	2023	2022
Dame Anita Frew	490	490	5	13	495	503
Birgit Behrendt [1]	45	n/a	10	n/a	55	n/a
Stuart Bradie [1]	45	n/a	1	n/a	46	n/a
Paulo Cesar Silva [2]	23	n/a	8	n/a	31	n/a
George Culmer [3]	85	80	5	5	90	85
Lord Jitesh Gadhia [4]	90	65	1	2	91	67
Beverly Goulet [5]	85	80	67	52	152	132
Nick Luff	95	95	–	–	95	95
Wendy Mars [6]	83	70	8	5	91	75
Dame Angela Strank [7]	77	90	2	4	79	94
Paul Adams [8]	54	83	6	10	60	93
Irene Dorner [9]	n/a	39	n/a	–	n/a	39
Lee Hsien Yang [10]	n/a	70	n/a	19	n/a	89
Mike Manley [11]	26	70	3	7	29	77
Sir Kevin Smith [12]	26	83	1	3	27	86
Total	1,224	1,315	117	120	1,341	1,435

1 Birgit Behrendt and Stuart Bradie were appointed as Non-Executive Directors on 11 May 2023
2 Paulo Cesar Silva was appointed as a Non-Executive Director on 1 September 2023
3 George Culmer was appointed Senior Independent Director (SID) on 12 May 2022, when Sir Kevin Smith stepped down as SID
4 Lord Jitesh Gadhia was appointed as a NED on 1 April 2022 and as Chair of the Remuneration Committee on 12 May 2022
5 Beverly Goulet was appointed Lead Employee Champion on 12 May 2022
6 Wendy Mars was appointed Chair of the Safety, Energy Transition & Tech Committee on 11 May 2023
7 Dame Angela Strank stepped down as Chair of the Safety, Ethics & Sustainability Committee on 11 May 2023
8 Paul Adams stepped down from the Board on 1 September 2023 and as Chair of the Science & Technology Committee on 11 May 2023
9 Irene Dorner stepped down from the Board on 12 May 2022
10 Lee Hsien Yang stepped down from the Board on 31 December 2022
11 Mike Manley stepped down from the Board on 11 May 2023
12 Sir Kevin Smith stepped down from the Board on 11 May 2023

Non-Executive Directors' fees

The Chair's fee is reviewed by the Board as a whole on the recommendation of the Committee. The review of the other Non-Executive Directors' base fees is reserved to the Chair and Executive Directors. No individual may be involved in setting his or her own fee. In December 2023, the Chair's fee and those of the other Non-Executive Directors were reviewed and it was agreed to change these with effect from 1 June 2024. No changes had been made to the Non-Executive Directors' fees since 2014. Fees from 1 June 2024 are set out in the table below. The Non-Executive Directors are not eligible to participate in any of the Group's share schemes, incentive arrangements or pension schemes.

A facility is in place which enables Non-Executive Directors (who reside in a permitted dealing territory) to use some or all of their fees, after the appropriate statutory deductions, to make market purchases of shares in the Company on a monthly basis. Wendy Mars and Birgit Behrendt use this facility.

	1 June 2024 £000	2023 £000	2022 £000
Chair	630	490	490
Other Non-Executive Directors base	90	70	70
Chair of the Audit Committee	35	25	25
Chair of the Remuneration Committee	35	20	20
Chair of the Safety, Energy Transition & Tech Committee	35	–	–
Chair of the Safety, Ethics & Sustainability Committee	–	20	20
Chair of the Science & Technology Committee	–	20	20
Committee member	15	–	–
Senior Independent Director	35	15	15
Lead Employee Champion	20	15	15
UK Employee Champion	15	–	–
North American board member	15	–	–

Non-Executive Directors' benefits (audited)

The benefits for Non-Executive Directors relate predominantly to travel, hotel, and subsistence incurred in attending meetings.

For Non-Executive Directors based outside the UK, the Company may also pay towards tax advice and the cost of making tax filings.

Non-Executive Directors' share interests (audited)

The Non-Executive Directors and their connected persons hold the following interests in the ordinary shares of the Company:

	22 February 2024	**31 December 2023**	23 February 2023	31 December 2022
Dame Anita Frew	350,000	**350,000**	350,000	350,000
Birgit Behrendt [1, 2]	1,092	**379**	n/a	n/a
Stuart Bradie [1]	95,437	**95,437**	n/a	n/a
Paulo Cesar Silva [3]	94,546	**94,546**	n/a	n/a
George Culmer	37,960	**37,960**	37,960	37,960
Lord Jitesh Gadhia	50,000	**50,000**	50,000	50,000
Beverly Goulet	40,972	**40,972**	40,972	40,972
Nick Luff	120,000	**120,000**	120,000	120,000
Wendy Mars [2]	34,339	**33,155**	23,026	19,546
Dame Angela Strank	60,583	**60,583**	13,780	13,780
Paul Adams [4]	n/a	**n/a**	10,000	10,000
Irene Dorner [5]	n/a	**n/a**	n/a	n/a
Lee Hsien Yang [6]	n/a	**n/a**	n/a	76,089
Mike Manley [7]	n/a	**n/a**	–	–
Sir Kevin Smith [8]	n/a	**n/a**	116,540	116,540

1 Birgit Behrendt and Stuart Bradie were appointed as Non-Executive Directors on 11 May 2023
2 Both Birgit Behrendt and Wendy Mars have entered into a share purchase agreement allocating a percentage of their net fees for the monthly purchase of shares at market price
3 Paulo Cesar Silva was appointed as a Non-Executive Director on 1 September 2023. He holds a percentage of his share interests as American Depository Receipts
4 Paul Adams stepped down from the Board on 1 September 2023
5 Irene Dorner stepped down from the Board on 12 May 2022
6 Lee Hsien Yang stepped down from the Board on 31 December 2022
7 Mike Manley stepped down from the Board on 11 May 2023
8 Sir Kevin Smith stepped down from the Board on 11 May 2023

Non-Executive Directors' letters of appointment

Our Non-Executive Directors serve two, three-year terms followed by three, one-year terms (nine years in total).

	Original appointment date	Current letter of appointment end date
Dame Anita Frew	1 July 2021	30 June 2024
Birgit Behrendt	11 May 2023	10 May 2026
Stuart Bradie	11 May 2023	10 May 2026
Paulo Cesar Silva	1 September 2023	31 August 2026
George Culmer	2 January 2020	1 January 2026
Lord Jitesh Gadhia	1 April 2022	31 March 2025
Beverly Goulet	3 July 2017	2 July 2024
Nick Luff	3 May 2018	2 May 2024
Wendy Mars	8 December 2021	7 December 2024
Dame Angela Strank	1 May 2020	30 April 2026

Shareholder voting

The remuneration policy was last approved by shareholders at our 2021 AGM held on 13 May 2021 and the remuneration report was last approved by shareholders at our 2023 AGM held on 11 May 2023. Details of voting are shown in the table below.

	For	% For	Against	% Against	Withheld
Approval of the remuneration policy (2021)	5,662,106,630	97.04	172,496,155	2.96	14,886,550
Approval of the remuneration report (2023)	4,894,967,977	88.17	656,792,687	11.83	1,563,614

Withheld votes are not counted towards the total percentage of votes cast.

Statutory requirements

The Committee's composition, responsibilities and operation comply with the principles of good governance, as set out in the Code, the Listing Rules (of the Financial Conduct Authority) and the Companies Act 2006. The Directors' remuneration report has been prepared on the basis prescribed in the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013.

The Remuneration Report, comprising the Remuneration Committee report, the remuneration policy and the 2023 remuneration report, has been approved by the Board and signed on its behalf by:

Lord Jitesh Gadhia
Chair of the Remuneration Committee
22 February 2024

Safety, Energy Transition & Tech Committee report

KEY AREAS OF FOCUS IN 2023

Principal risk reviews and deep dives into product and people safety. Site visit with safety focus to Civil Aerospace facilities in Derby, UK

Review of progress of with the energy transition and climate agendas; review of Sustainability report for recommendation to the Board

Initial discussions on tech strategy and roadmap

Members	Wendy Mars (Chair) Birgit Behrendt Stuart Bradie Paulo Cesar Silva Dame Angela Strank
	Biographies are on pages 70 and 71
Remit	See page 68

I am pleased to present the first report of the Safety, Energy Transition & Tech (SETT) Committee. This Committee was introduced in May 2023 and I became chair from its inception. The SETT Committee focuses on safety and the energy transition agenda and provides oversight and assurance of the Company's scientific and technological strategy, processes and investments. A summary of the SETT Committee's remit can be found on page 68. The Committee members, all Non-Executive Directors, bring deep experience between them in the Committee's areas of focus which they have gained in their various external executive roles. This is invaluable to the Committee in its oversight role and enables appropriate and robust challenge.

The Committee has met twice in 2023 and also visited our Civil Aerospace facilities in Derby, UK with a particular focus on safety, both product and people.

The Committee is supported at executive-level by the newly created appointment of the director of engineering, technology & safety and the chief transformation officer, who has responsibility for the energy transition strategy, and the Executive-level energy transition & technology committee. The Group's chief engineer also attends every meeting of the Committee.

Safety

Both product and people safety are the main priority for the Group.

During 2023, we reviewed the updated product safety policy and considered in detail the product safety principal risk. We have paid close attention to the effectiveness of the product safety management system and the relevant controls as the Group's transformation is progressed, in particular the organisational design. The Committee reviewed reports from the Group's chief engineer detailing the status of product safety issues across the Group and are working with him to develop more granular reporting to support the Committee with greater understanding of the divisional safety management control effectiveness. The Committee also reviewed relevant internal audit reports in relation to product safety.

People safety updates were received at both meetings of the Committee, including a summary of performance in 2023 and the associated action plans for 2024 to ensure continuous improvement in embedding Group-wide standards and policies.

In October 2023, members of the Committee visited Derby, UK to meet different teams across various Civil Aerospace division's facilities and to learn at first hand the management and importance of both product and people safety. We visited the service control centre and the major events centre as well as the Group's newest testbed facility and two separate manufacturing facilities: new engine and turbine blade. We gained insight into the management of in-service fleets and how technologies were being developed to grow the capability. We also learnt how the right response teams would be assembled in the event of a major incident and how this would then be managed. The tour of the new product facility provided an understanding of how product and people safety was managed and we were taken through an assessment of both within the facility. The visit ended with a tour of the turbine blade manufacturing facility and the Committee members were able to see the degree of technology and automation deployed.

As part of the visit, the Committee was taken through an overview of the people safety framework and gained a detailed understanding of the approach and standards across the Group. The people safety risks were defined and the importance of the speak up line for both product and people risks was highlighted. Safety briefings were given to the Committee at each facility and the importance of personal protective equipment stressed.

Energy Transition

The focus of the Committee is to provide oversight of the Group's energy transition strategy and to receive progress reports against policies, strategies, KPIs, plans, capability, process and systems. At our first meeting, the Committee was updated on the focus of the Executive-level energy transition & technology committee (see page 69). At the same meeting, the head of sustainability provided an introduction to the Group's climate programme and its role in ensuring the reporting obligations of the Group are met and aligned with the strategic plan and financial forecasts. At our subsequent meeting, we reviewed progress made in 2023 with Scope 1 + 2 GHG emissions reduction plans and the Scope 3, category 11 (use of sold products) emissions reporting (see page 41). We also discussed the progress with the energy transition and climate agendas. At our meeting in February 2024, as part of the year-end reporting, the Committee reviewed the Sustainability report set out on pages 32 to 43 and recommended it to the Board for approval.

Tech

Following the strategy presentation at the capital markets day in November 2023, the Committee had initial discussions on the technology strategy and roadmap, considering prioritisation of investment, funding and partnership approaches, the roadmapping process and organisation and potential disruptions and threats. The Committee's oversight of the technology strategy will ensure alignment with the climate change strategy.

Wendy Mars
Chair of the Safety, Energy Transition & Tech Committee

Responsibility statements

Statement of Directors' responsibilities in respect of the financial statements

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors have prepared the Group Financial Statements in accordance with UK-adopted international accounting standards and the Company Financial Statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 Reduced Disclosure Framework and applicable law).

Under company law, Directors must not approve the Financial Statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and of the profit or loss of the Group for that period. In preparing the financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable UK-adopted international accounting standards have been followed for the Group financial statements and United Kingdom Accounting Standards, comprising FRS 101 have been followed for the Company financial statements, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Company will continue in business.

The Directors are responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are also responsible for keeping adequate accounting records that are sufficient to show and explain the Group's and the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' confirmations

The Directors consider that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's and the Company's position and performance, business model and strategy.

Each of the Directors, whose names and functions are listed in the Directors' Report confirm that, to the best of their knowledge:

- the Group financial statements, which have been prepared in accordance with UK-adopted international accounting standards, give a true and fair view of the assets, liabilities, financial position and profit of the Group;
- the Company financial statements, which have been prepared in accordance with United Kingdom Accounting Standards, comprising FRS 101, give a true and fair view of the assets, liabilities and financial position of the Company; and
- the Strategic Report includes a fair review of the development and performance of the business and the position of the Group and the Company, together with a description of the principal risks and uncertainties that it faces.

In the case of each Director in office at the date the Directors' Report is approved:

- so far as the Director is aware, there is no relevant audit information of which the Group's and the Company's auditors are unaware; and
- they have taken all the steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Group's and the Company's auditors are aware of that information.

By order of the Board

Pamela Coles
Chief Governance Officer
22 February 2024

FINANCIAL STATEMENTS

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Consolidated income statement

Year ended 31 December 2023

	Notes	2023 £m	2022 £m
Continuing operations			
Revenue	2	**16,486**	13,520
Cost of sales [1]		**(12,866)**	(10,763)
Gross profit	2	**3,620**	2,757
Commercial and administrative costs	2	**(1,110)**	(1,077)
Research and development costs	2, 3	**(739)**	(891)
Share of results of joint ventures and associates	12	**173**	48
Operating profit		**1,944**	837
Gain arising on disposal of businesses	27	**1**	81
Profit before financing and taxation		**1,945**	918
Financing income	4	**1,163**	355
Financing costs	4	**(681)**	(2,775)
Net financing income/(costs) [2]		**482**	(2,420)
Profit/(loss) before taxation		**2,427**	(1,502)
Taxation	5	**(23)**	308
Profit/(loss) for the year from continuing operations		**2,404**	(1,194)
Discontinued operations			
Profit for the year from ordinary activities	27	**–**	68
Loss on disposal of discontinued operations	27	**–**	(148)
Loss for the year from discontinued operations		**–**	(80)
Profit/(loss) for the year		**2,404**	(1,274)
Attributable to:			
Ordinary shareholders		**2,412**	(1,269)
Non-controlling interests (NCI)		**(8)**	(5)
Profit/(loss) for the year		**2,404**	(1,274)
Other comprehensive (expense)/income (OCI)		**(171)**	522
Total comprehensive income/(expense) for the year		**2,233**	(752)
Earnings/(loss) per ordinary share attributable to ordinary shareholders:	6		
From continuing operations:			
Basic		**28.85p**	(14.24)p
Diluted		**28.70p**	(14.24)p
From continuing and discontinued operations:			
Basic		**28.85p**	(15.20)p
Diluted		**28.70p**	(15.20)p

1 Cost of sales includes a net release for expected credit losses (ECLs) of £48m (2022: charge of £73m). Further detail can be found in note 14
2 Included within net financing are fair value changes on derivative contracts. Further details can be found in notes 2, 4 and 20

Consolidated statement of comprehensive income

Year ended 31 December 2023

	Notes	2023 £m	2022 £m
Profit/(loss) for the year		**2,404**	(1,274)
Other comprehensive income/(expense) (OCI)			
Actuarial movements on post-retirement schemes	22	**116**	(156)
Revaluation to fair value of other investments	12	**(4)**	(4)
Share of OCI of joint ventures and associates	12	**1**	2
Related tax movements	5	**(43)**	89
Items that will not be reclassified to profit or loss		**70**	(69)
Foreign exchange translation differences on foreign operations		**(226)**	452
Foreign exchange translation differences reclassified to income statement on disposal of businesses	27	**1**	65
Hedging reserves reclassified to income statement on disposal of businesses		**–**	111
NCI disposed of on disposal of businesses		**–**	1
Movement on fair values charged to cash flow hedge reserve		**(82)**	(7)
Reclassified to income statement from cash flow hedge reserve		**61**	(55)
Costs of hedging		**–**	10
Share of OCI of joint ventures and associates	12	**1**	–
Related tax movements	5	**4**	14
Items that will be reclassified to profit or loss		**(241)**	591
Total other comprehensive (expense)/income		**(171)**	522
Total comprehensive income/(expense) for the year		**2,233**	(752)
Attributable to:			
Ordinary shareholders		**2,241**	(748)
NCI		**(8)**	(4)
Total comprehensive income/(expense) for the year		**2,233**	(752)
Total comprehensive income/(expense) for the year attributable to ordinary shareholders arises from:			
Continuing operations		**2,241**	(673)
Discontinued operations		**–**	(75)
Total comprehensive income/(expense) for the year attributable to ordinary shareholders		**2,241**	(748)

Consolidated balance sheet

At 31 December 2023

	Notes	2023 £m	2022 £m
ASSETS			
Intangible assets	9	**4,009**	4,098
Property, plant and equipment	10	**3,728**	3,936
Right-of-use assets	11	**905**	1,061
Investments – joint ventures and associates	12	**479**	422
Investments – other	12	**31**	36
Other financial assets	20	**360**	542
Deferred tax assets	5	**2,998**	2,731
Post-retirement scheme surpluses	22	**782**	613
Non-current assets		**13,292**	13,439
Inventories	13	**4,848**	4,708
Trade receivables and other assets	14	**8,123**	6,936
Contract assets	15	**1,242**	1,481
Taxation recoverable		**80**	127
Other financial assets	20	**34**	141
Short-term investments	20	**–**	11
Cash and cash equivalents	16	**3,784**	2,607
Current assets		**18,111**	16,011
Assets held for sale	27	**109**	–
TOTAL ASSETS		**31,512**	29,450
LIABILITIES			
Borrowings and lease liabilities	17	**(809)**	(358)
Other financial liabilities	20	**(448)**	(1,016)
Trade payables and other liabilities	19	**(6,896)**	(6,983)
Contract liabilities	15	**(6,098)**	(4,825)
Current tax liabilities		**(143)**	(104)
Provisions for liabilities and charges	21	**(532)**	(632)
Current liabilities		**(14,926)**	(13,918)
Borrowings and lease liabilities	17	**(4,950)**	(5,597)
Other financial liabilities	20	**(1,983)**	(3,230)
Trade payables and other liabilities	19	**(1,927)**	(2,364)
Contract liabilities	15	**(8,438)**	(7,337)
Deferred tax liabilities	5	**(330)**	(286)
Provisions for liabilities and charges	21	**(1,497)**	(1,701)
Post-retirement scheme deficits	22	**(1,035)**	(1,033)
Non-current liabilities		**(20,160)**	(21,548)
Liabilities associated with assets held for sale	27	**(55)**	–
TOTAL LIABILITIES		**(35,141)**	(35,466)
NET LIABILITIES		**(3,629)**	(6,016)
EQUITY			
Called-up share capital	23	**1,684**	1,674
Share premium		**1,012**	1,012
Capital redemption reserve		**167**	166
Cash flow hedge reserve		**12**	26
Translation reserve		**634**	861
Accumulated losses		**(7,190)**	(9,789)
Equity attributable to ordinary shareholders		**(3,681)**	(6,050)
Non-controlling interest (NCI)		**52**	34
TOTAL EQUITY		**(3,629)**	(6,016)

The Financial Statements on pages 114 to 184 were approved by the Board on 22 February 2024 and signed on its behalf by:

Tufan Erginbilgic
Chief Executive

Helen McCabe
Chief Financial Officer

Consolidated cash flow statement

Year ended 31 December 2023

	Notes	2023 £m	Restated [1] 2022 £m
Reconciliation of cash flows from operating activities			
Operating profit from continuing operations		1,944	837
Operating profit from discontinued operations	27	–	86
Operating profit		1,944	923
Loss on disposal of property, plant and equipment		18	18
Share of results of joint ventures and associates	12	(173)	(48)
Dividends received from joint ventures and associates	12	54	73
Amortisation and impairment of intangible assets	9	272	287
Depreciation and impairment of property, plant and equipment	10	423	430
Depreciation and impairment of right-of-use assets	11	334	287
Adjustment of amounts payable under residual value guarantees within lease liabilities	18	(10)	(3)
Impairment of and other movements on investments	12	–	75
Decrease in provisions		(325)	(197)
Increase in inventories		(200)	(887)
Movement in trade receivables/payables and other assets/liabilities		(1,346)	(56)
Movement in contract assets/liabilities		2,703	1,753
Cash flows on other financial assets and liabilities held for operating purposes [2]		(845)	(660)
Cash flows on settlement of excess derivative contracts [1, 3]		(389)	(326)
Interest received		159	36
Net defined benefit post-retirement cost recognised in profit before financing	22	41	27
Cash funding of defined benefit post-retirement schemes	22	(69)	(81)
Share-based payments	24	66	47
Net cash inflow from operating activities before taxation		2,657	1,698
Taxation paid		(172)	(174)
Net cash inflow from operating activities		2,485	1,524
Cash flows from investing activities			
Movement in other investments	12	1	(5)
Additions of intangible assets		(284)	(237)
Disposals of intangible assets	9	4	8
Purchases of property, plant and equipment		(429)	(359)
Disposals of property, plant and equipment		10	48
Acquisition of businesses		(14)	–
Disposal of businesses (including cash flows on disposals in prior periods)	27	(4)	1,398
Movement in investments in joint ventures and associates	12	(9)	(24)
Movement in short-term investments		11	(3)
Cash flows on other financial assets and liabilities held for non-operating purposes		(12)	–
Net cash (outflow)/inflow from investing activities		(726)	826
Cash flows from financing activities			
Repayment of loans		(1)	(2,024)
Proceeds from increase in loans		2	1
Capital element of lease payments		(291)	(218)
Net cash flow from decrease in borrowings and lease liabilities		(290)	(2,241)
Interest paid		(196)	(235)
Interest element of lease payments		(85)	(68)
Fees paid on undrawn facilities		(52)	(49)
Transactions with NCI [4]		77	57
Dividends to NCI		(2)	(3)
Redemption of C Shares		(1)	(1)
Net cash outflow from financing activities		(549)	(2,540)

Consolidated cash flow statement continued

Year ended 31 December 2023

	Notes	2023 £m	Restated [1] 2022 £m
Change in cash and cash equivalents		**1,210**	(190)
Cash and cash equivalents at 1 January		**2,605**	2,639
Exchange (losses)/gains on cash and cash equivalents		**(84)**	156
Cash and cash equivalents at 31 December [5]		**3,731**	2,605

1 The cash flow statement to 31 December 2022 has been represented as a result of a change in accounting policy to disclose cash flows on settlement of excess derivative contracts as cash flows from operating activities. As a result, there has been a decrease in cash flows from operating activities during the year to 31 December 2022 from £1,850m to £1,524m and a decrease in cash outflow from financing activities from £(2,866)m to £(2,540)m. There is no impact to the total change in cash and cash equivalents or to any alternative performance measures. See note 1 for further detail
2 Predominately relates to cash settled on derivative contracts held for operating purposes
3 In 2020, the Group experienced a significant decline in its medium-term outlook and consequently a significant deterioration to its forecast net USD cash inflows. The Group took action to reduce the size of the USD hedge book by $11.8bn across 2020 to 2026 to reflect the fact that at that time, future operating cash flows were no longer forecast to materialise. To achieve the necessary reduction in the hedge book, a separate and distinct set of foreign exchange derivative instruments were entered into to buy $11.8bn. The associated cash outflow of these transactions is £1,674m and occurs over the period 2020 to 2026. This action had the impact of fixing the fair value of the over-hedged position and provided certainty over when the cash flows to settle the position would occur in future periods. During the year, the Group incurred a cash outflow of £389m (2022: £326m) and estimates that future cash outflows of £146m will be incurred in 2024 and £175m spread over 2025 and 2026
4 Relates to NCI investment received in the year, in respect of Rolls-Royce SMR Limited
5 The Group considers overdrafts (repayable on demand) and cash held for sale to be an integral part of its cash management activities and these are included in cash and cash equivalents for the purposes of the cash flow statement

In deriving the consolidated cash flow statement, movement in balance sheet items have been adjusted for non-cash items. The cash flow in the year includes the sale of goods and services to joint ventures and associates – see note 26.

	2023 £m	2022 £m
Reconciliation of movements in cash and cash equivalents to movements in net debt		
Change in cash and cash equivalents	**1,210**	(190)
Cash flow from decrease in borrowings and lease liabilities	**290**	2,241
Cash flow from (decrease)/increase in short-term investments	**(11)**	3
Change in net debt resulting from cash flows	**1,489**	2,054
Lease additions, modifications and other non-cash adjustments on borrowings and lease liabilities	**(191)**	(170)
Exchange gains/(losses) on net debt	**57**	(150)
Fair value adjustments	**7**	70
Debt disposed of on disposal of businesses	**–**	53
Movement in net debt	**1,362**	1,857
Net debt at 1 January	**(3,337)**	(5,194)
Net debt at 31 December excluding the fair value of swaps	**(1,975)**	(3,337)
Fair value of swaps hedging fixed rate borrowings	**23**	86
Net debt at 31 December	**(1,952)**	(3,251)

Consolidated cash flow statement continued

Year ended 31 December 2023

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

	At 1 January £m	Funds flow £m	Net debt on disposal £m	Exchange differences £m	Fair value adjustments £m	Reclassi-fications £m	Other movements £m	At 31 December £m
2023								
Cash at bank and in hand	847	(79)	–	(29)	–	–	–	739
Money market funds	34	1,043	–	–	–	–	–	1,077
Short-term deposits	1,726	297	–	(55)	–	–	–	1,968
Cash and cash equivalents (per balance sheet)	2,607	1,261	–	(84)	–	–	–	3,784
Overdrafts	(2)	(51)	–	–	–	–	–	(53)
Cash and cash equivalents (per cash flow statement)	2,605	1,210	–	(84)	–	–	–	3,731
Short-term investments	11	(11)	–	–	–	–	–	–
Other current borrowings	(1)	(1)	–	–	(13)	(462)	(1)	(478)
Non-current borrowings	(4,105)	–	–	59	20	462	(4)	(3,568)
Lease liabilities	(1,847)	291	–	82	–	–	(186)	(1,660)
Financial liabilities	(5,953)	290	–	141	7	–	(191)	(5,706)
Net debt excluding the fair value of swaps	(3,337)	1,489	–	57	7	–	(191)	(1,975)
Fair value of swaps hedging fixed rate borrowings [1]	86	–	–	(59)	(4)	–	–	23
Net debt	(3,251)	1,489	–	(2)	3	–	(191)	(1,952)
2022								
Cash at bank and in hand	795	17	–	35	–	–	–	847
Money market funds	49	(15)	–	–	–	–	–	34
Short-term deposits	1,777	(171)	–	120	–	–	–	1,726
Cash and cash equivalents (per balance sheet)	2,621	(169)	–	155	–	–	–	2,607
Cash and cash equivalents included within assets held for sale	25	(26)	–	1	–	–	–	–
Overdrafts	(7)	5	–	–	–	–	–	(2)
Cash and cash equivalents (per cash flow statement)	2,639	(190)	–	156	–	–	–	2,605
Short-term investments	8	3	–	–	–	–	–	11
Other current borrowings	(2)	2	–	(1)	–	–	–	(1)
Non-current borrowings	(6,023)	2,000	–	(125)	72	–	(29)	(4,105)
Borrowings included within liabilities held for sale	(59)	21	40	–	(2)	–	–	–
Lease liabilities	(1,744)	217	–	(179)	–	–	(141)	(1,847)
Lease liabilities included within liabilities held for sale	(13)	1	13	(1)	–	–	–	–
Financial liabilities	(7,841)	2,241	53	(306)	70	–	(170)	(5,953)
Net debt excluding the fair value of swaps	(5,194)	2,054	53	(150)	70	–	(170)	(3,337)
Fair value of swaps hedging fixed rate borrowings [1]	37	–	–	125	(76)	–	–	86
Net debt	(5,157)	2,054	53	(25)	(6)	–	(170)	(3,251)

1 Fair value of swaps hedging fixed rate borrowings reflects the impact of derivatives on repayments of the principal amount of debt. Net debt therefore includes the fair value of derivatives included in fair value hedges (2023: £34m, 2022: £38m) and the element of fair value relating to exchange differences on the underlying principal of derivatives in cash flow hedges (2023: £(11)m, 2022: £48m)

Consolidated statement of changes in equity

Year ended 31 December 2023

The following describes the nature and purpose of each reserve within equity:

Share capital – The nominal value of ordinary shares of 20p each in issue.
Share premium – Proceeds received in excess of the nominal value of ordinary shares issued, less the costs of issue.
Capital redemption reserve – Amounts transferred from accumulated losses on the repurchase of ordinary shares or the redemption of C Shares. In Rolls-Royce Holdings plc's own Financial Statements, C Shares are issued from the merger reserve. This reserve was created by a scheme of arrangement in 2011. As this reserve is eliminated on consolidation in the Consolidated Financial Statements, the C Shares are shown as being issued from the capital redemption reserve.
Hedging reserves – Cumulative gains and losses on hedging instruments deemed effective in cash flow hedges and cost of hedging reserve.
Merger reserve – The premium on issuing shares to acquire a business where merger relief in accordance with the Companies Act 2006 applies.
Translation reserve – Gains and losses arising on retranslating the net assets of overseas operations into sterling.
Accumulated losses – All other net gains and losses and transactions with owners not recognised elsewhere and ordinary shares held for the purpose of share-based payment plans.
Non-controlling interests – The share of net assets or liabilities of subsidiaries held by third parties.

		Attributable to ordinary shareholders									
	Notes	Share capital £m	Share premium £m	Capital redemption reserve £m	Cash flow hedging reserve £m	Merger reserve £m	Trans-lation reserve £m	Accum-ulated losses [1] £m	Total £m	NCI £m	Total equity £m
At 1 January 2023		1,674	1,012	166	26	–	861	(9,789)	(6,050)	34	(6,016)
Profit/(loss) for the year		–	–	–	–	–	–	2,412	2,412	(8)	2,404
Foreign exchange translation differences on foreign operations		–	–	–	–	–	(226)	–	(226)	–	(226)
Foreign exchange translation differences reclassified to income statement on disposal of businesses	27	–	–	–	–	–	1	–	1	–	1
Actuarial movements on post-retirement schemes	22	–	–	–	–	–	–	116	116	–	116
Fair value movement on cash flow hedges		–	–	–	(82)	–	–	–	(82)	–	(82)
Reclassified to income statement from cash flow hedge reserve		–	–	–	61	–	–	–	61	–	61
Revaluation to fair value of other investments	12	–	–	–	–	–	–	(4)	(4)	–	(4)
OCI of joint ventures and associates	12	–	–	–	2	–	(1)	1	2	–	2
Related tax movements	5	–	–	–	5	–	(1)	(43)	(39)	–	(39)
Total comprehensive (expense)/ income for the year		–	–	–	(14)	–	(227)	2,482	2,241	(8)	2,233
Issues of ordinary shares		10	–	–	–	–	–	–	10	–	10
Redemption of C Shares	20	–	–	1	–	–	–	(1)	–	–	–
Shares issued to employee share trust		–	–	–	–	–	–	(10)	(10)	–	(10)
Share-based payments – direct to equity [2]		–	–	–	–	–	–	49	49	–	49
Dividends to NCI		–	–	–	–	–	–	–	–	(2)	(2)
Transactions with NCI [3]		–	–	–	–	–	–	57	57	28	85
Related tax movements		–	–	–	–	–	–	22	22	–	22
Other changes in equity in the year		10	–	1	–	–	–	117	128	26	154
At 31 December 2023		1,684	1,012	167	12	–	634	(7,190)	(3,681)	52	(3,629)

Consolidated statement of changes in equity continued

Year ended 31 December 2023

	Notes	Attributable to ordinary shareholders									
		Share capital £m	Share premium £m	Capital redemption reserve £m	Hedging reserves £m	Merger reserve £m	Trans-lation reserve £m	Accum-ulated losses [1] £m	Total £m	NCI £m	Total equity £m
At 1 January 2022		1,674	1,012	165	(45)	650	342	(9,189)	(5,391)	26	(5,365)
Loss for the year		–	–	–	–	–	–	(1,269)	(1,269)	(5)	(1,274)
Foreign exchange translation differences on foreign operations		–	–	–	–	–	452	–	452	–	452
Foreign exchange translation differences reclassified to income statement on disposal of businesses		–	–	–	–	–	65	–	65	–	65
Hedging reserves reclassified to income statement on disposal of businesses		–	–	–	111	–	–	–	111	–	111
NCI disposed of on disposal of business		–	–	–	–	–	–	–	–	1	1
Actuarial movements on post-retirement schemes	22	–	–	–	–	–	–	(156)	(156)	–	(156)
Fair value movement on cash flow hedges		–	–	–	(7)	–	–	–	(7)	–	(7)
Reclassified to income statement from cash flow hedge reserve		–	–	–	(55)	–	–	–	(55)	–	(55)
Costs of hedging		–	–	–	10	–	–	–	10	–	10
Revaluation to fair value of other investments	12	–	–	–	–	–	–	(4)	(4)	–	(4)
OCI of joint ventures and associates	12	–	–	–	–	–	–	2	2	–	2
Related tax movements	5	–	–	–	12	–	2	89	103	–	103
Total comprehensive income/ (expense) for the year		–	–	–	71	–	519	(1,338)	(748)	(4)	(752)
Redemption of C Shares	20	–	–	1	–	–	–	(1)	–	–	–
Share-based payments – direct to equity [2]		–	–	–	–	–	–	46	46	–	46
Dividends to NCI		–	–	–	–	–	–	–	–	(3)	(3)
Transactions with NCI [3]		–	–	–	–	–	–	42	42	15	57
Transfer to realised profit [4]		–	–	–	–	(650)	–	650	–	–	–
Related tax movements		–	–	–	–	–	–	1	1	–	1
Other changes in equity in the year		–	–	1	–	(650)	–	738	89	12	101
At 31 December 2022		1,674	1,012	166	26	–	861	(9,789)	(6,050)	34	(6,016)

1 At 31 December 2023, 52,912,406 ordinary shares with a net book value of £22m (2022: 11,402,796 ordinary shares with a net book value of £27m) were held for the purpose of share-based payment plans and included in accumulated losses. During the year:
- 7,875,240 ordinary shares with a net book value of £15m (2022: 18,488,558 ordinary shares with a net book value of £39m) vested in share-based payment plans;
- the Company issued 49,100,000 (2022: none) new ordinary shares to the Group's share trust for its employee share-based payment plans with a net book value of £10m (2022: £nil); and
- the Company acquired none (2022: none) of its ordinary shares via reinvestment of dividends received on its own shares and purchased 284,850 (2022: 486,163) of its ordinary shares through purchases on the London Stock Exchange

2 Share-based payments – direct to equity is the share-based payment charge for the year less actual cost of vesting excluding those vesting from own shares and cash received on share-based schemes vesting

3 Relates to NCI investment received in the year in respect of Rolls-Royce SMR Limited

4 On disposal of ITP Aero on 15 September 2022, the premium recognised on issue of shares for the previous acquisition became realised on receipt of qualifying consideration. As such, the total merger reserve has been transferred to accumulated losses

1 Accounting policies

The Company and the Group

Rolls-Royce Holdings plc (the 'Company') is a public company limited by shares incorporated under the Companies Act 2006 and domiciled in England in the United Kingdom. The Consolidated Financial Statements of the Company for the year ended 31 December 2023 consist of the audited consolidation of the Financial Statements of the Company and its subsidiaries (together referred to as the Group) together with the Group's interest in jointly controlled and associated entities.

Basis of preparation and statement of compliance

The Company has elected to prepare its individual Company Financial Statements under FRS 101 *Reduced Disclosure Framework*. They are set out on pages 185 to 189 with the associated accounting policies from page 187.

The Consolidated Financial Statements have been prepared in accordance with UK adopted International Accounting Standards (IAS) in conformity with the requirements of the Companies Act 2006 and interpretations issued by the IFRS Interpretations Committee (IFRS IC) applicable to companies reporting under UK adopted IFRS.

The Consolidated Financial Statements have been prepared on a going concern basis as described on page 58. The historical cost basis has been used except where IFRS require the revaluation of financial instruments to fair value and certain other assets and liabilities on an alternative basis, most significantly post-retirement scheme obligations are valued on the basis required by IAS 19 *Employee Benefits*.

The Consolidated Financial Statements are presented in sterling, which is the Company's functional currency.

The preparation of the Consolidated Financial Statements requires management to make judgements and estimates that affect the statutory amounts of assets and liabilities at the date of the Consolidated Financial Statements and the statutory amounts of revenue and expenses during the reporting period. Actual future outcomes could differ from those estimates.

Going concern

The Directors have undertaken a comprehensive going concern review. In adopting the going concern basis for preparing the Consolidated and Company Financial Statements, the Directors have undertaken a review of the Group's cash flow forecasts and available liquidity, along with consideration of possible risks and uncertainties over an 18-month period from the date of this report to August 2025. The Directors have determined that an 18-month period is an appropriate timeframe over which to assess going concern as it considers the Group's short- to medium-term cash flow forecasts and available liquidity.

Recognising the challenges of reliably estimating and forecasting the impact of external factors on the Group, the Directors have considered the following two forecasts in their assessment of going concern, along with a likelihood assessment of these forecasts:

- the base case forecast, which reflects the Directors current expectations of future trading; and
- a stressed downside forecast, which has also been modelled and envisages a 'stressed' or 'downside' situation that is considered severe but plausible.

Further details are given in the going concern review on page 58. After reviewing the current liquidity position and the cash flow forecasts modelled under both the base case and stressed downside, the Directors consider that the Group has sufficient liquidity to continue in operational existence for a period of at least 18 months from the date of this report and are therefore satisfied that it is appropriate to adopt the going concern basis of accounting in preparing the financial statements.

Climate change

In preparing the Consolidated Financial Statements the Directors have considered the potential impact of climate change, particularly in the context of the disclosures included in the 2023 Strategic Report and the stated sustainability approach. The Group's climate strategy sets out how it is responding to the climate challenge by:

- decarbonising its operations, facilities and business activities. This will be met through continued investment in onsite renewable energy installations; the procurement of renewable energy; and continued investment in energy efficiency improvements to reduce the Group's overall energy demands and operating costs. An estimate of the investment required to meet these scope 1 + 2 emission improvements is included in the forecasts that support these Consolidated Financial Statements;
- enabling customers to operate their products in a way that is compatible with low or net zero carbon emissions. To accelerate this, the Group has demonstrated that all the commercial aero engines it produces, and the most popular reciprocating engines (that represent 80% of the Power Systems product portfolio) are compatible for use on sustainable fuels. The Group is also working with its armed forces customers to achieve the same for the engines they use from Defence;
- delivering new products and solutions that can accelerate the global energy transition, including investment in battery energy storage solutions in Power Systems, and in small modular reactors (SMRs). In the year, research and development (R&D) costs of £137m (2022: £108m) within New Markets included investment to ready the SMR to progress through the Great British Nuclear SMR technology selection process and the second stage of the design assessment process. Future investment required to deliver these technologies is included in the forecasts that support the Consolidated Financial Statements; and by
- creating the necessary enabling environment, with public and policy support, to achieve our collective climate goals, through actively engaging with policy makers, regulators and others to advocate for the necessary policy and economic support we have identified.

1 Accounting policies continued

Climate change continued

The climate change scenarios previously prepared to assess the Group's strategic planning and its approach to managing climate-related risk have continued to develop over the last year, as set out in the Strategic Review. The scenarios are used to assess how each of them impacts: the life of assets; future revenue projections; future profitability; and whether additional costs may occur. There remains inherent uncertainty around how the scenarios will impact the Group. The Directors assess the assumptions on a regular basis to ensure that they are consistent with the risk management activities and the commitments made to investors and other stakeholders.

Based on the Taskforce for Climate-related Financial Disclosures (TCFD) recommendations, the Group assesses the potential impact of climate-related transition and physical risks and opportunities. The Group has identified four key transition risks (relating to customer demand, cost due to carbon pricing, cost due to commodity pricing and changing investment needs) and three key physical risks (relating to facility disruption, supply chain disruption and impact on product performance) which may arise from the energy transition. The transition risks are the most likely to have an impact on the Consolidated Financial Statements, as exposure to physical risks will be greater in the longer-term.

The key sources of estimation uncertainty at the balance sheet date are set out on page 126 and the Directors have considered the impact of climate change on those estimates. The key assumptions used in this assessment are consistent with those used in the climate scenarios presented in the Strategic Review. A summary of the assessment is set out below.

Risk	How reflected in the Financial Statements	Impact on Civil Aerospace LTSAs	Impact on impairment of non-financial assets	Impact on UK deferred tax asset recoverability
Changing customer demand	Overall forecast demand is expected to be robust in each scenario, although product mix may change with customer requirements.	Forecast EFH are based on customer and market data and therefore already include the latest expectation of the impact of climate change on demand. A sensitivity disclosing the impact of a 1% change in EFH forecasts over the remaining term of Civil LTSA contracts is disclosed on page 129.	Given the level of headroom in the programme intangible assets and Rolls-Royce Power Systems and Rolls-Royce Deutschland goodwill, the potential impact of a change in customer demand does not indicate any potential impact.	Forecast EFH are based on customer and market data and therefore include the latest expectation of the impact of climate change on demand. A sensitivity disclosing the impact of a 5% change in margin or shop visits is disclosed on page 130.
Changes in costs due to carbon pricing [1] and commodity price changes [2] 1 Based on the IEA Net Zero by 2050 scenario ($60 per tonne of carbon in 2023 to $250 in 2050) 2 Commodity prices from the Oxford Economics Global Climate Service and Databank	The potential impact of carbon pricing has been estimated by applying carbon prices to the forecast emissions generated by the Group and its supply chain. This impact, together with that from estimated commodity prices under each scenario, have been added/deducted to forecast costs in the base forecasts. The analysis reflects that: decarbonisation activities will occur in both the Group and its supply chain; and that some supplier contracts offer protection from cost increases in the short to medium term where pricing is fixed or subject to capped escalation clauses.	The increase in the cost base of the current Civil LTSA contracts due to carbon and commodity prices is estimated to be around 1% (2022: 1%) with the incremental cost included in the cost to complete estimates that drive revenue recognition. Changes in estimates have not had a material impact on revenue catch-ups or contract loss provisions in the year (2022: not material). A sensitivity disclosing the impact of a 2% change in shop visit costs over the remaining term of Civil LTSA contracts is disclosed on page 129.	Given the level of headroom in the programme intangible assets and Rolls-Royce Power Systems and Rolls-Royce Deutschland goodwill, the potential impact of the cost increased in the scenarios does not indicate any potential impact. The assessment has considered each of the Group's <1.5°C, 1.7°C and 3.5°C scenarios.	The forecast of probable future taxable profits reflects the increase in the cost base that could arise from carbon and commodity prices consistent with the methodology applied for Civil Aerospace LTSA. Disclosed on page 130 is the impact of changing the proportion of cost increases that can be passed onto customers following the expiry of existing LTSAs.
Change in investment requirement	Changing investment requirements may arise due to the introduction/ acceleration of new technologies. Research is expensed and development costs capitalised as incurred.	No impact to existing LTSAs.	Impairment tests are either: performed on a value in use basis and the investment associated with new products is required to be excluded; or have sufficient headroom such that the estimated investment requirement is not significant.	Given the UK deferred tax asset recoverability is largely dependent on Civil and Defence aerospace markets, the increase in research and development expenditure required under this scenario does not have a material impact.

1 Accounting policies continued

Climate change continued

Items that may be impacted by climate-related risks, but which are not considered to be key areas of judgement or sources of estimation uncertainty in the current financial year are outlined below.

Useful lives of assets – The useful lives of property, plant and equipment and right-of-use assets could be reduced by climate-related matters, for example, as a result of physical risks, obsolescence or legal restrictions. The change in useful lives would have a direct impact on the amount of depreciation or amortisation recognised each year from the date of reassessment. The Directors' review of useful lives has taken into consideration the impacts of the Group's decarbonisation strategy (including the remaining useful life of assets that might be incompatible with the Group's commitment to decarbonise its facilities and considering the Group's physical risk assessment) and has not had a material impact on the results for the year. The Directors have also considered the remaining useful economic lives of material intangible assets, including the £1,920m and £238m capitalised development spend associated with the Trent and business aviation programmes disclosed in note 9. Given the measures the Group is taking, including demonstration that all the commercial aero-engines and 80% of the portfolio in Power Systems are compatible with SAF, the Directors judge that no adjustment is required to the useful economic lives.

Inventory valuation – Climate-related matters may affect the value of inventories as a result of a decline in selling prices, or they could become obsolete due to a reduction in demand. After consideration of the typical stock-turns of the inventory in relation to the rate of change in the market, the Directors consider that inventory is appropriately valued.

Recoverability of trade receivables and contract assets – The impact of climate-related matters could have an impact on the Group's customers in the future, especially those customers in the Civil Aerospace division. No material climate-related issues have arisen during the year that have impacted the assessment of the recoverability of receivables. The Group's expected credit loss (ECL) provision uses credit ratings which inherently will include the market's assessment of the climate change impact on credit risk of the counter parties. Given the maturity time of trade receivables and the majority of contract assets, climate change is unlikely to cause a material increase on counter party credit risk in that time.

Share-based payments – A number of remuneration packages have included sustainability metrics. The Group is committed to reaching net zero carbon emissions by 2050, short-term targets were announced to help accelerate progress against this goal. These targets formed part of the Groups remuneration policy and at the end of the 2023, these targets have been met. A new remuneration policy is to be considered by shareholders at the AGM in May 2024. In addition, sustainability metrics are included as a performance condition in some of the long-term incentive plans awarded to employees. The charge to the income statement reflects both where performance conditions have been met in 2023 and the expected outcome of future performance conditions.

Defined benefit pension plans – Climate-related risks could influence the performance of the invested assets and affect the financial position of defined benefit pension plans. As a result, this could have implications on the expected return on plan assets and measurement of defined benefit liabilities in future years. The Trustee of the Rolls-Royce UK Pension Fund (RRUKPF) meets the UK climate-related regulatory requirements. When making decisions about the plan, its analysis is carried out in a way consistent with TCFD. The Trustee has set a target for the plan asset portfolio to be net zero by 2050. Having assessed the risks and opportunities of climate change and considered the nature of the assets of the fund, climate change is unlikely to have a material impact on the position in the Consolidated Financial Statements.

Going concern – Given the short-term nature of the Group's going concern assessment, the impact of climate change does not have a significant impact. The Directors have considered the level of liquidity available, and the potential impact of the climate change risks, in making their assessment.

Presentation of underlying results

The Group measures financial performance on an underlying basis and discloses this information as an alternative performance measure (APM). This is consistent with the way that financial performance is measured by the Directors and reported to the Board in accordance with IFRS 8 *Operating Segments*. The Group believes this is the most appropriate basis to measure the in-year performance, as underlying results reflect the substance of trading activity, including the impact of the Group's foreign exchange forward contracts, which economically hedge net foreign currency cash flows at predetermined exchange rates. In addition, underlying results exclude the accounting impact of acquisition accounting and business disposals, impairment charges where the reasons are outside of normal operating activities, exceptional items, and certain other items which are market driven and outside of the control of management. Further details are given in note 2. A reconciliation of APMs to the statutory equivalent is provided on pages 213 to 217.

1 Accounting policies continued

Revisions to IFRS applicable in 2023

IFRS 17 Insurance Contracts

IFRS 17, issued in May 2018, establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the Standard. The Standard is effective for years beginning on or after 1 January 2023 with a requirement to restate comparatives.

The Group has reviewed whether its arrangements meet the accounting definition of an insurance contract. While some contracts, including Civil Aerospace LTSAs, may transfer an element of insurance risk, they relate to warranty and service type agreements that are issued in connection with the Group's sales of its goods or services and therefore will remain accounted for under the existing revenue and provisions standards. The Directors have judged that such arrangements entered into after the original equipment sale remain sufficiently related to the sale of the Group's goods and services to allow the contracts to continue to be measured under IFRS 15 *Revenue from Contracts with Customers* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*

The Group has identified that the Standard will impact the results of its captive insurance company as it issues insurance contracts, however, since the contracts insure other group companies, there is no impact on the Consolidated Financial Statements.

The Group has assessed that its parent company guarantee arrangements in the form of financial or performance guarantees, that meet the IFRS 17 definition of insurance contracts, have no impact on the Consolidated Financial Statements of the Group for the year to 31 December 2023, however there could be an impact on individual sets of financial statements of companies within the Group.

The Directors are not aware of any other contracts where IFRS 17 would have an impact on the Consolidated Financial Statements.

Other

IAS 12 *Income Taxes* has been amended to incorporate the following revisions for 'Deferred Tax related to Assets and Liabilities arising from a Single Transaction' and 'International Tax Reform: Pillar Two Model Rules'. There is no material impact on the Group as a result of the amendments relating to Deferred Tax related to Assets and Liabilities arising from a Single Transaction.

The Group is within the scope of the OECD Pillar Two (Global Minimum Tax) model rules. The legislation has been substantively enacted in some of the material jurisdictions in which the Group operates, including the UK and Germany, where the rules will be effective from 1 January 2024. Further information can be found in note 5.

There are no other new standards or interpretations issued by the IASB that had a significant impact on the Consolidated Financial Statements.

Change in accounting policy

At 31 December 2023, cash flows on settlement of excess derivatives have been reclassified from cash flows from financing activities to cash flows from operating activities in the cash flow statement as a result of a change in accounting policy. In line with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, a change in accounting policy can be made either where it is required by an IFRS or results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, performance or cash flows.

The previous classification as cash flows from financing activities was based on the Directors' judgement of the economic nature of the activities as the cash flows relate to cash payments deferred in connection with the Group's action taken in 2020 to reduce the size of the USD hedge book by $11.8bn across 2020 to 2026. The Directors have reassessed their judgement in line with IAS 7 *Statement of Cash Flows* and have concluded that it would be more appropriate to classify these cash flows as cash flows from operating activities.

As a result of the above, cash flows from operating activities during the year to 31 December 2022 have reduced by £(326)m to £1,524m with a corresponding decrease in cash outflow from financing activities from £(2,866)m to £(2,540)m. There is no impact to the total change in cash and cash equivalents or to any alternative performance measures.

The above change resulted from a review which was prompted by an enquiry arising from a review of the Group's 2022 Annual Report and Accounts by the Corporate Reporting Review team of the Financial Reporting Council (FRC). The FRC review was part of a regular review and assessment of the quality of corporate reporting in the UK undertaken by the FRC. Further information regarding the review of the Group's 2022 Annual Report and Accounts is set out in the Audit Committee report on page 80. The Group agreed to make the above change within its 2023 Annual Report and Accounts.

The FRC review was limited to the published 2022 Annual Report; it did not benefit from a detailed understanding of underlying transactions and provides no assurance that the 2022 Annual Report is correct in all material respects.

1 Accounting policies continued

Key areas of judgement and sources of estimation uncertainty

The determination of the Group's accounting policies requires judgement. The subsequent application of these policies requires estimates, and the actual outcome may differ from that calculated. The key judgements and key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year, are summarised below. Further details, together with sensitivities for key sources of estimation uncertainty where appropriate and practicable, are included within the significant accounting policies section of this note.

Area	Key judgements	Key sources of estimation uncertainty	Page ref
Revenue recognition and contract assets and liabilities	— Whether Civil Aerospace OE and aftermarket contracts should be combined. — How performance on long-term aftermarket contracts should be measured. — Whether long-term aftermarket contracts contain a significant financing component. — Whether any costs should be treated as wastage. — Whether the Civil Aerospace LTSA contracts are warranty style contacts entered into in connection with OE sales and therefore can be accounted for under IFRS 15. — Whether sales of spare engines to joint ventures are at fair value. — When revenue should be recognised in relation to spare engine sales.	— Estimates of future revenue, including customer pricing, and costs of long-term contractual arrangements, including the impact of climate change.	128
Risk and revenue sharing arrangements	— Determination of the nature of entry fees received.		129
Taxation		— Estimates necessary to assess whether it is probable that sufficient suitable taxable profits will arise in the UK to utilise the deferred tax assets recognised.	130
Research and development	— Determination of the point in time where costs incurred on an internal programme development meet the criteria for capitalisation. — Determination of the basis for amortising capitalised development costs.		132
Leases	— Determination of the lease term.		133
Impairment of non-current assets	— Determination of cash-generating units for assessing impairment of goodwill. — Whether there are indicators of potential reversal of previous impairments of programme-related intangible assets.		134
Provisions	— Whether any costs should be treated as wastage. — Whether the criteria to recognise transformation and restructuring provisions have been met.	— Estimates of the time to incorporate a modified and certified high-pressure turbine (HPT) blade into the fleet to resolve technical issues on the Trent 1000, and the implications of this on forecast future costs when assessing onerous contracts. — Estimates of the future revenues and costs to fulfil onerous contracts. — Assumptions implicit within the calculation of discount rates.	135
Post-retirement benefits		— Estimates of the assumptions for valuing the net defined benefit obligation.	136

Material accounting policies

The Group's material accounting policies are set out on pages 126 to 136. These accounting policies have been applied consistently to all periods presented in these Consolidated Financial Statements.

Basis of consolidation

The Consolidated Financial Statements include the Company Financial Statements and its subsidiary undertakings, together with the Group's share of the results in joint arrangements and associates made up to 31 December.

A subsidiary is an entity controlled by the Company. Control exists when the Company has power over an entity, exposure to variable returns from its involvement with an entity and the ability to use its power over an entity so as to affect the Company's returns. Subsidiaries are consolidated in accordance with IFRS 10 *Consolidated Financial Statements*.

1 Accounting policies continued

Basis of consolidation continued

A joint arrangement is an entity in which the Group holds a long-term interest and which is jointly controlled by the Group and one or more other investors under a contractual arrangement. Joint arrangements may be either joint ventures or joint operations. Joint ventures are accounted for using the equity method of accounting and joint operations are accounted for using proportionate accounting.

An associate is an entity that is neither a subsidiary nor a joint arrangement, in which the Group holds a long-term interest and where the Group has a significant influence. The results of associates are accounted for using the equity method of accounting.

All intra-group transactions, balances, income and expenses are eliminated on consolidation. Adjustments are made to eliminate the profit or loss arising on transactions with joint arrangements and associates to the extent of the Group's interest in the entity. Transactions with non-controlling interests are recorded directly in equity.

Any subsidiary undertaking, joint arrangement or associate sold or acquired during the year are included up to, or from, the date of change of control. Details of transactions in the year are set out in note 27.

Revenue recognition and contract assets and liabilities

Revenue recognised comprises sales to the Group's customers after discounts and amounts payable to customers. Revenue excludes value added taxes. The transaction price of a contract is typically clearly stated within the contract, although the absolute amount may be dependent on escalation indices and long-term contracts that require the key estimates highlighted below to be made. Refund liabilities, where sales are made to customers with a right of return, are not typical in the Group's contracts. Where they do exist, and consideration has been received, a portion based on an assessment of the expected refund liability is recognised within other payables. The Group has elected to use the practical expedient not to adjust revenue for the effect of financing components where the expectation is that the period between the transfer of goods and services to customers and the receipt of payment is less than a year. Consideration is received in the form of deposits and payments for completion of milestones or performance obligations. LTSA cash receipts are typically received based on EFHs.

Sales of standard OE, spare parts and time and material (T&M) overhaul services are generally recognised on transfer of control to the customer. This is generally on delivery to the customer, unless the specific contractual terms indicate a different point. The Directors consider whether there is a need to constrain the amount of revenue to be recognised on delivery based on the contractual position and any relevant facts, however, this is not typically required.

Sales of OE and services that are specifically designed for the contract (most significantly in the Defence division) are recognised by reference to the progress towards completion of the performance obligation, using the cost method described in the key judgements, provided the outcome of contracts can be assessed with reasonable certainty.

The Group generates a significant portion of its revenue on aftermarket arrangements arising from the installed OE fleet. As a consequence, in particular in the Civil Aerospace large engine business, the Group will often agree contractual prices for OE deliveries that take into account the anticipated aftermarket arrangements. Sometimes this may result in losses being incurred on OE. As described in the key judgements, these contracts are not combined. The consideration in the OE contract is therefore allocated to OE performance obligations and the consideration in the aftermarket contract to aftermarket performance obligations.

Key areas of the accounting policy are:

- Future variable revenue from long-term contracts is constrained to take account of the risk of reduced utilisation e.g. EFHs, based on historical forecasting experience and the risk of aircraft being parked by the customer.
- A significant amount of revenue and cost related to long-term contract accounting is denominated in currencies other than that of the relevant Group undertaking, most significantly USD transactions in sterling and euro denominated undertakings. These are translated at estimated long-term exchange rates.
- The assessment of stage of completion is generally measured for each contract. However, in certain cases, such as for CorporateCare agreements, where there are many contracts covering aftermarket services each for a small number of engines, the Group accounts for a portfolio of contracts together, as the effect on the Consolidated Financial Statements would not differ materially from applying the standard to the individual contracts in the portfolio. When accounting for a portfolio of LTSAs, the Group uses estimates and assumptions that reflect the size and composition of the portfolio.
- A contract asset/liability is recognised where payment is received in arrears/advance of the revenue recognised in meeting performance obligations.
- Contract modifications of LTSAs can be accounted for as separate contracts, termination of the existing contract and the creation of a new contract, or as part of the existing contract. The treatment is dependent on whether the change in scope is because of the addition of promised goods or services that are distinct and whether the price increases by an amount that reflects their standalone selling prices.
- Where material, wastage costs (see key judgements on page 128) are recorded as an expense and excluded from the measure of progress of LTSA contracts.
- The Group recognises a liability for their obligation to repurchase parts it has sold to the maintenance, repair and overhaul bases who overhaul the Group's customers' engines.

If the expected costs to fulfil a contract exceed the expected revenue, a contract loss provision is recognised for the excess costs.

The Group pays participation fees to airframe manufacturers, its customers for OE, on certain programmes. Amounts paid are initially treated as contract assets and subsequently charged as a reduction to the OE revenue when the engines are transferred to the customer.

The Group has elected to use the practical expedient to expense as incurred any incremental costs of obtaining or fulfilling a contract if the amortisation period of an asset created would have been one year or less. Where costs to obtain a contract are recognised in the balance sheet, they are amortised over the performance of the related contract (eight to 23 years).

1 Accounting policies continued

Key judgement – Whether Civil Aerospace OE and aftermarket contracts should be combined
In the Civil Aerospace division, OE contracts for the sale of engines to be installed on new aircraft are with the airframers, while the contracts to provide spare engines and aftermarket goods and services are with the aircraft operators, although there may be interdependencies between them. IFRS 15 includes guidance on the combination of contracts, in particular that contracts with unrelated parties should not be combined. Notwithstanding the interdependencies, the Directors consider that the engine contract should be considered separately from the aftermarket contract. In making this judgement, they also took account of industry practice.

Key judgement – How performance on long-term aftermarket contracts should be measured
The Group generates a significant proportion of its revenue from aftermarket arrangements. These aftermarket contracts, such as TotalCare and CorporateCare agreements in the Civil Aerospace division, cover a range of services and generally have contractual terms covering more than one year. Under these contracts, the Group's primary obligation is to maintain customers' engines in an operational condition. This is achieved by undertaking various activities, such as maintenance, repair and overhaul, and engine monitoring over the period of the contract. Revenue on these contracts is recognised over the period of the contract and the basis for measuring progress is a matter of judgement. The Directors consider that the stage of completion of the contract is best measured by using the actual costs incurred to date compared to the estimated costs to complete the performance obligations, as this reflects the extent of completion of the activities to be performed.

Key judgement – Whether long-term aftermarket contracts contain a significant financing component
Long-term aftermarket contracts typically cover a period of eight to 15 years. Their pricing is the subject of negotiation with individual customers under competitive circumstances. It is the Directors' judgement that the consideration received approximates to the cash selling price and any timing difference between consideration being received and the supply of goods and services is typical of the industry and arises for reasons other than to provide financing. The customers typically pay on an 'as used' basis (e.g. USD/EFH), which reflects the wear and tear of the engine as it flies and aligns to the customer's own revenue streams. An adjustment to the transaction price is therefore not required.

Key judgement – Whether any costs should be treated as wastage
In rare circumstances, the Group may incur costs of wasted material, labour or other resources to fulfil a contract where the level of cost was not reflected in the contract price. The identification of such costs is a matter of judgement and would only be expected to arise where there has been a series of abnormal events which give rise to a significant level of cost of a nature that the Group would not expect to incur and hence is not reflected in the contract price. Examples include technical issues that: require resolution to meet regulatory requirements; have a wide-ranging impact across a product type; and cause significant operational disruption to customers. Similarly, in these rare circumstances, significant disruption costs to support customers resulting from the actual performance of a delivered good or service may be treated as a wastage cost. Provision is made for any costs identified as wastage when the obligation to incur them arises – see note 21.

Key judgement – Whether the Civil Aerospace LTSA contracts are warranty style contacts entered into in connection with OE sales and therefore can be accounted for under IFRS 15
The Group has considered whether these arrangements are insurance contracts as defined in IFRS 17. While they may transfer an element of insurance risk, they relate to warranty and service type agreements that are entered into in connection with the Group's sales of its goods or services and therefore continue to be accounted for under the existing revenue and provisions standards. The Directors have judged that such arrangements entered into after the original equipment sale remain sufficiently related to the sale of the Group's goods and services to allow the contracts to continue to be measured under IFRS 15 and IAS 37.

Key judgement – Whether sales of spare engines to joint ventures are at fair value
The Civil Aerospace division maintains a pool of spare engines to support its customers. Some of these engines are sold to, and held by, joint venture companies. The assessment of whether the sales price reflects fair value is a key judgement. The Group considers that based upon the terms and conditions of the sales, and by comparison to the sales price of spare engines to other third parties, the sales made to joint ventures reflect the fair value of the goods sold. See note 26 for the value of sales to joint ventures during the year.

Key judgement – When revenue should be recognised in relation to spare engine sales
Revenue is recognised at the point in time when a customer obtains control of a spare engine. The customer could be a related party, an external operator or a spare engine service provider. Depending on the contractual arrangements, judgement is required on when the Group relinquishes control of spare engines and, therefore, when the revenue is recognised. The point of control passing has been concluded to correspond to the point of legal sale, even for instances where the customer is contracted to provide some future spare engine capacity to the Group to support its installed engine base. In such cases, the customer has responsibility for generating revenue from the engines and exposure to periods of non-utilisation, exposure to risk of damage or loss, risk from residual value movements, and will determine if and when profits will be made from disposal. The spare engine capacity, that will be made available to the Group in the future, does not consist of identified assets and the provider retains a substantive right to substitute the asset through the Group's period of use. It is, therefore, appropriate to recognise revenue from the sale of the spare engines at the point that title transfers. During 2023, of the total 53 (2022: 44) large spare engine sales delivered, 27 (2022: 20) engines were sold to customers where contractual arrangement allows for some future spare engine capacity to be used by the Group. These sales contributed £578m (2022: £454m) to revenue for the year.

1 Accounting policies continued

Key estimate – Estimates of future revenue, including customer pricing, and costs of long-term contractual arrangements, including the impact of climate change
The Group has long-term contracts that fall into different accounting periods and which can extend over significant periods. The most significant of these are LTSAs in the Civil Aerospace division, with contracts typically covering a period of 8 to 15 years. The estimated revenue and costs are inherently imprecise and significant estimates are required to assess: EFHs, time-on-wing and other operating parameters; the pattern of future maintenance activity and the costs to be incurred; lifecycle cost improvements over the term of the contracts; and escalation of revenue and costs (that both include the impact of inflation). The impact of climate change on EFHs and costs is also considered when making these estimates. Industry and customer data on expected levels of utilisation is included in the forecasts used. Across the length of the current Civil Aerospace LTSA contracts, allowance has been made for around a 1% (2022: 1%) projected cost increase resulting from carbon pricing and commodity price changes.

The sensitivities below demonstrate how changes in assumptions (including as a result of climate change) could impact the level of revenue recognised were assumptions to change. The Directors believe that the estimates used to prepare the Consolidated Financial Statements take account of the inherent uncertainties, constraining the expected level of revenue as appropriate.

Estimates of future LTSA revenue within Civil Aerospace are based upon future EFH forecasts, influenced by assumptions over the recovery of the civil aviation industry. Finally, many of the revenues and costs are denominated in currencies other than that of the relevant group undertaking. These are translated at an estimated long-term exchange rate, based on historical trends and economic forecasts.

During the year, changes to the estimate in relation to the Civil Aerospace LTSA contracts resulted in adverse catch-up adjustments to revenue of £104m (2022: favourable catch up adjustment of £360m).

Based upon the stage of completion of all LTSA contracts within Civil Aerospace as at 31 December 2023, the following reasonably possible changes in estimates would result in catch-up adjustments being recognised in the period in which the estimates change (at underlying rates):

- A change in forecast EFHs of 1% over the remaining term of the contracts would impact LTSA income and to a lesser extent costs, resulting in an in-year impact of around £20m. This would be expected to be seen as a catch-up change in revenue or, to the extent it impacts onerous contracts, within cost of sales.
- A 2% increase or decrease in our pricing to customers over the life of the contracts would lead to a revenue catch-up adjustment in the next 12 months of around £280m.
- A 2% increase or decrease in shop visit costs over the life of the contracts would lead to a revenue catch-up adjustment in the next 12 months of around £80m.

Risk and revenue sharing arrangements (RRSAs)

Cash entry fees received are initially deferred on the balance sheet as deferred receipts from RRSA workshare partners within trade payables and other liabilities. The cash entry fee is a transaction with a supplier and is recognised as a reduction in cost of sales incurred. Individual programme amounts are allocated pro rata to the estimated number of units to be produced. Amortisation commences as each unit is delivered and then recognised on a 15-year straight-line basis.

The payments to suppliers of their shares of the programme cash flows for their production components are charged to cost of sales when OE sales are recognised or as LTSA costs are incurred. These prepayments are initially recognised within trade receivables and other assets.

The Group also has arrangements with third parties who invest in a programme and receive a return based on its performance, but do not undertake development work or supply parts. Such arrangements (financial RRSAs) are financial instruments as defined by IAS 32 *Financial Instruments: Presentation* and are accounted for using the amortised cost method.

Key judgement – Determination of the nature of entry fees received
RRSAs with key suppliers (workshare partners) are a feature of the civil aviation industry. Under these contractual arrangements, the key commercial objectives are that: (i) during the development phase, the workshare partner shares in the risks of developing an engine by performing its own development work, providing development parts and paying a non-refundable cash entry fee; and (ii) during the production phase, the workshare partner supplies components in return for a share of the programme cash flows as a 'life of type' supplier (i.e. as long as the engine remains in service).

The non-refundable cash entry fee is considered to be one element of a long-term supply agreement. These receipts are deferred on the balance sheet and recognised against the cost of sales over the estimated number of units to be delivered on a similar basis to the amortisation of development costs.

Royalty payments

Royalty payments include payments to government bodies that have previously acquired an interest in a programme. These are recognised as a charge in cost of sales in line with sales made.

1 Accounting policies continued

Government grants

Government grants received are varied in nature and are recognised in the income statement so as to match them with the related expenses that they are intended to compensate. Where grants are received in advance of the related expenses, they are initially recognised as liabilities within trade payables and other liabilities and released to match the related expenditure. Non-monetary grants are recognised at fair value.

Interest

Interest receivable/payable is credited/charged to the income statement using the effective interest method. Where borrowing costs are attributable to the acquisition, construction or production of a qualifying asset, such costs would be capitalised as part of the specific asset.

Taxation

The tax charge/credit on the profit or loss for the year comprises current and deferred tax:

- Current tax is the expected tax payable for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.
- Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the amounts used for tax purposes and is calculated using the enacted or substantively enacted rates that are expected to apply when the asset or liability is settled. In the UK, the deferred tax liability on the pension scheme surplus is recognised consistently with the basis for recognising the surplus i.e. at the rate applicable to refunds from a trust.

Tax is charged or credited to the income statement or OCI as appropriate, except when it relates to items credited or charged directly to equity in which case the tax is also dealt with in equity.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and joint arrangements, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax is not recognised on taxable temporary differences arising on the initial recognition of goodwill or for temporary differences arising from the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit.

Deferred tax assets are recognised only to the extent that it is probable that future taxable profits, which include the reversal of taxable temporary differences, will be available against which the assets can be utilised. Further details on the Group's tax position can be found on pages 147 and 148.

Key estimate – Estimates necessary to assess whether it is probable that sufficient suitable taxable profits will arise in the UK to utilise the deferred tax assets recognised

Deferred tax assets are only recognised to the extent it is probable that future taxable profits will be available, against which the deductible temporary difference can be utilised. On this basis, as at 31 December 2023, a deferred tax asset of £1,635m (2022: £2,040m) is not recognised in respect of UK tax losses. Further details are included in note 5.

In addition to taking into account a severe but plausible downside forecast (see below), the climate-related estimates and assumptions (set out on pages 122 to 124) have also been considered when assessing the recoverability of the deferred tax assets. Recognising the longer term over which these assets will be recovered, the Group has considered the risk that regulatory changes could materially impact demand for our products and shifting investment focus towards more sustainable products and solutions. The climate scenarios prepared do not indicate a significant deterioration in demand or profitability for Civil Aerospace programmes, given that all in production engines are now compatible with sustainable fuels.

While carbon and commodity pricing may put pressure on costs, decarbonisation and new supplier and customer contracts offer the opportunity to receive value for more efficient and sustainable products.

As explained in note 5, a 25% probability of there being a severe but plausible downside forecast in relation to the civil aviation industry has been taken into account in the assessment of the recoverability of deferred tax assets.

The estimates take account of the inherent uncertainties constraining the expected level of profit as appropriate. Changes in these estimates will affect future profits and, therefore, the recoverability of the deferred tax assets. The following sensitivities have been modelled to demonstrate the impact of changes in assumptions on the recoverability of deferred tax assets.

- A 5% change in margin of the main Civil Aerospace large engine programmes;
- A 5% change in the number of shop visits; and
- Assumed future cost increases from climate change expected to pass through to customers at 100% are restricted to 90% pass through.

All of these could be driven by a number of factors, including the impact of climate change (as explained on pages 122 to 124) and macroeconomic factors.

A 5% change in margin or shop visits (which could be driven by EFHs) would result in an increase/decrease in the deferred tax asset of around £90m.

If only 90% of assumed future cost increases from climate change are passed on to customers, this would result in a decrease in the deferred tax asset of around £10m, and if carbon prices were to double this would be £50m.

1 Accounting policies continued

Foreign currency translation

Transactions denominated in currencies other than the functional currency of the transacting group undertaking are translated into the functional currency at the average monthly exchange rate when the transaction occurs. Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the rate prevailing at the year end. Exchange differences arising on foreign exchange transactions and the retranslation of monetary assets and liabilities into functional currencies at the rate prevailing at the year end are included in profit/(loss) before taxation.

The trading results of Group undertakings are translated into sterling at the average exchange rates for the year. The assets and liabilities of overseas undertakings, including goodwill and fair value adjustments arising on acquisition, are translated at the exchange rates prevailing at the year end. Exchange adjustments arising from the retranslation of the opening net assets, and from the translation of the profits or losses at average rates, are recognised in OCI.

Discontinued operations, held for sale and business disposals

A discontinued operation is defined in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* as a component of an entity that has been disposed of or is classified as held for sale, represents a separate major line of business or geographical area of operations, is part of a single coordinated plan to dispose of such a line of business or is a subsidiary acquired exclusively with a view to resale. The results of discontinued operations are required to be presented separately in the income statement.

Assets and businesses are classified as held for sale when their carrying amounts will be recovered through sale rather than through continuing use.

Financial instruments – Classification and measurement

Financial assets primarily include trade receivables and other non-derivative financial assets, cash and cash equivalents, short-term investments, derivatives (foreign exchange, commodity and interest rate contracts), and listed and unlisted investments.

- Trade receivables and other assets are classified either as held to collect and measured at amortised cost, or as held to collect and sell and measured at fair value, with movements in fair value recognised through other comprehensive income (FVOCI). The Group may sell trade receivables due from certain customers before the due date. Any trade receivables from such customers that are not sold at the reporting date are classified as 'held to collect and sell'.
- Cash and cash equivalents (consisting of balances with banks and other financial institutions, money-market funds, short-term deposits) and short-term investments are subject to low market risk. Cash balances, short-term deposits (with a maturity of primarily three months or less) and short-term investments are measured at amortised cost. Money market funds are measured at fair value, with movements in fair value recognised in the income statement as a profit or loss (FVPL).
- Derivatives and unlisted investments are measured at FVPL. The Company has elected to measure its listed investments at FVOCI.

Financial liabilities primarily consist of trade payables and other non-derivative financial liabilities, borrowings, derivatives, financial RRSAs and C Shares.

- Derivatives are classified and measured at FVPL.
- All other financial liabilities are classified and measured at amortised cost.

Financial instruments – Impairment of financial assets and contract assets

IFRS 9 *Financial Instruments* sets out the basis for the accounting of ECLs on financial assets and contract assets resulting from transactions within the scope of IFRS 15. The Group has adopted the simplified approach to provide for ECLs, measuring the loss allowance at a probability weighted amount that considers reasonable and supportable information about past events, current conditions and forecasts of future economic conditions of customers. These are incorporated in the simplified model adopted by using credit ratings which are publicly available, or through internal risk assessments derived using the customer's latest available financial information. The ECLs are updated at each reporting date to reflect changes in credit risk since initial recognition. ECLs are calculated for all financial assets in scope, regardless of whether or not they are overdue.

Financial instruments – Hedge accounting

Forward foreign exchange contracts and commodity swaps (derivative financial instruments) are held to manage the cash flow exposures of forecast transactions denominated in foreign currencies or in commodities, respectively. Derivative financial instruments qualify for hedge accounting when: (i) there is a formal designation and documentation of the hedging relationship and the Group's risk management objective and strategy for undertaking the hedge at the inception of the hedge; and (ii) the hedge is expected to be effective. In general, the Group has chosen to not apply hedge accounting in respect of these exposures.

The Group economically hedges the fair value and cash flow exposures of its borrowings. Cross-currency interest rate swaps are held to manage the fair value or cash flow exposures of borrowings denominated in foreign currencies and are designated as fair value hedges or cash flow hedges as appropriate. Interest rate swaps are held to manage the interest rate exposures of fixed and floating rate borrowings and may be designated as fair value hedges or cash flow hedges as appropriate. If the swaps are not designated as fair value or cash flow hedges, the economic effect is included in the underlying results – see note 2.

Changes in the fair values of derivatives that are designated as fair value hedges are recognised directly in the income statement. The fair value changes of effective cash flow hedge derivatives are recognised in OCI and subsequently recycled to the income statement in the same period or periods during which the hedged cash flows affect profit or loss. Any ineffectiveness in the hedging relationship is included in the income statement.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. At that time, for cash flow hedges and, if the forecast transaction remains probable, any net cumulative gain or loss on the hedging instrument recognised in the SOCIE is retained until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss is recycled to the income statement.

1 Accounting policies continued

Business combinations and goodwill

Goodwill recognised represents the excess of the fair value of the purchase consideration over the fair value to the Group of the net of the identifiable assets acquired and the liabilities assumed. On transition to IFRS on 1 January 2004, business combinations were not retrospectively adjusted to comply with UK-adopted International Accounting Standards and goodwill was recognised based on the carrying value under the previous accounting policies. Goodwill, in respect of the acquisition of a subsidiary, is recognised as an intangible asset. Goodwill arising on the acquisition of joint arrangements and associates is included in the carrying value of the investment.

Customer relationships

The fair value of customer relationships recognised as a result of a business combination relate to the acquired company's established relationships with its existing customers that result in repeat purchases and customer loyalty. Amortisation is charged on a straight-line basis over its useful economic life, up to a maximum of 15 years.

Certification costs

Costs incurred, in respect of meeting regulatory certification requirements for new Civil Aerospace aero-engine/aircraft combinations, including payments made to airframe manufacturers for this, are recognised as intangible assets to the extent that they can be recovered out of future sales. They are charged to the income statement over the programme life. Individual programme assets are allocated pro rata to the estimated number of units to be produced. Amortisation commences as each unit is delivered and then charged on a 15-year straight-line basis.

Research and development

Expenditure incurred on research and development is distinguished as relating either to a research phase or to a development phase. All research phase expenditure is charged to the income statement. Development expenditure is recognised as an internally generated intangible asset (programme asset) only if it meets strict criteria, relating in particular to technical feasibility and generation of future economic benefits. More specifically, development costs are capitalised from the point at which the following conditions have been met:

- the technical feasibility of completing the programme and the intention and ability (availability of technical, financial and other resources) to complete the programme asset and use or sell it;
- the probability that future economic benefits will flow from the programme asset; and
- the ability to measure reliably the expenditure attributable to the programme asset during its development.

Capitalisation continues until the point at which the programme asset meets its originally contracted technical specification (defined internally as the point at which the asset is capable of operating in the manner intended by the Directors).

Subsequent expenditure is capitalised where it enhances the functionality of the programme asset and demonstrably generates an enhanced economic benefit to the Group. All other subsequent expenditure on programme assets is expensed as incurred.

Individual programme assets are allocated pro rata to the estimated number of units to be produced. Amortisation commences as each unit is delivered and then charged on a straight-line basis over a maximum of 15-years. In accordance with IAS 38 *Intangible Assets*, the basis on which programme assets are amortised is assessed annually.

Key judgement – Determination of the point in time where costs incurred on an internal programme development meet the criteria for capitalisation

The Group incurs significant research and development expenditure in respect of various development programmes. Determining when capitalisation should commence and cease is a key judgement, as is the determination of when subsequent expenditure on the programme assets should be capitalised. During the year, £192m (2022: £131m) of development expenditure was capitalised.

Within the Group, there are established processes in place, e.g. the Product Introduction and Lifecycle Management process (PILM). Within these processes, the technical feasibility, the commercial viability and financial assessment of the programme is assessed at certain milestones. When these are met, development expenditure is capitalised. Prior to this, expenditure is expensed as incurred.

The Group continues to invest in new technologies as a result of its decarbonisation commitments. As these are new technologies, there is a higher level of uncertainty over potential outcomes and, therefore, this could impact the level of expenditure that is capitalised or recognised in the income statement in future years. During 2023, no development costs incurred within New Markets were capitalised.

Subsequent expenditure after entry into service which enhances the performance of the engine and the economic benefits to the Group is capitalised. This expenditure is referred to as enhanced performance and is governed by the PILM process referred to above. All other development costs are expensed as incurred.

Key judgement – Determination of the basis for amortising capitalised development costs

The economic benefits of the development costs are primarily those cash inflows arising from LTSAs, which are expected to be relatively consistent for each engine within a programme. Amortisation of development costs is recognised on a straight-line basis over the estimated period of operation of the engine by its initial operator.

1 Accounting policies continued

Software

Software that is not specific to an item of property, plant and equipment is classified as an intangible asset, recognised at its acquisition cost and amortised on a straight-line basis over its useful economic life, up to a maximum of 10 years. The amortisation period of software assets is reviewed annually. The cost of internally developed software includes direct labour and an appropriate proportion of overheads.

Other intangible assets

These include intangible assets arising on acquisition of businesses, such as technology and which is amortised on a straight-line basis over a maximum of 15 years, and trademarks which are not amortised. They also include the costs incurred testing and analysing engines with the longest time in service (fleet leader engines) to gather technical knowledge on engine endurance, which are amortised on a straight-line basis over a maximum of 15 years.

Property, plant and equipment

Property, plant and equipment are stated at acquisition cost less accumulated depreciation and any provision for impairment in value. The cost of self-constructed assets includes the cost of materials, direct labour, an appropriate proportion of overheads and, where appropriate, interest.

Depreciation is provided on a straight-line basis to write off the cost, less the estimated residual value, of property, plant and equipment over their estimated useful lives. No depreciation is recorded on assets in the course of construction. Estimated useful lives are reassessed annually and are as follows:

- Land and buildings, as advised by the Group's professional advisers:
  - freehold buildings – three to 50 years (average 23 years); and
  - no depreciation is provided on freehold land.
- Plant and equipment – two to 27 years (average 11 years).
- Aircraft and engines – five to 20 years (average 16 years).

Leases

Assets and liabilities arising from a lease are initially measured on a present value basis.

Lease liabilities include the net present value of the following lease payments:

- fixed payments less any lease incentive receivable;
- variable lease payments that are based on an index or a rate;
- amounts expected to be payable by the Group under residual value guarantees;
- the exercise price of a purchase option if the Group is reasonably certain to exercise that option; and
- payments of penalties for termination of the lease, if the lease term reflects the Group exercising that option.

Where leases commenced after the initial IFRS 16 *Leases* transition date, the lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be determined, the Group's incremental borrowing rate is used, being the rate that the Group would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions. Where appropriate, lease liabilities are revalued at each reporting date using the spot exchange rate.

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability or a revaluation of the liability;
- any lease payments made at or before the commencement date less any lease incentives received;
- any initial direct costs; and
- restoration costs.

Each right-of-use asset is depreciated over the shorter of its useful economic life and the lease term on a straight-line basis unless the lease is expected to transfer ownership of the underlying asset to the Group, in which case the asset is depreciated to the end of the useful life of the asset.

Short-term leases are leases with a lease term of 12 months or less. Payments associated with short-term leases and low-value leases are recognised on a straight-line basis as an expense in the income statement.

Key judgement – Determination of lease term
In determining the lease term, the Group considers all facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. Extension options (or periods after termination) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated). Certain land and building leases have renewal options although there are no renewal dates for any of the most significant property leases in the next 12 months. Other renewals are evenly spread between 2025 to 2032 and then post 2038. The Group reviews its judgements on lease terms annually, including the operational significance of the site, especially where utilised for manufacturing activities.

1 Accounting policies continued

Impairment of non-current assets

Impairment of non-current assets is considered in accordance with IAS 36 *Impairment of Assets*. Where the asset does not generate cash flows that are independent of other assets, impairment is considered for the cash-generating unit (CGU) to which the asset belongs. Goodwill, indefinite life intangible assets and intangible assets not yet available for use are tested for impairment annually. Other intangible assets (including programme-related intangible assets), property, plant and equipment, right-of-use assets and investments are assessed for any indications of impairment annually. If any indication of impairment is identified, an impairment test is performed to estimate the recoverable amount.

If the recoverable amount of an asset (or CGU) is estimated to be below the carrying value, the carrying value is reduced to the recoverable amount and the impairment loss is recognised as an expense. The recoverable amount is the higher of value in use or fair value less costs of disposal. The value in use is the present value of future cash flows using a pre-tax discount rate that reflects the time value of money and the risk specific to the asset (or CGU). Fair value less costs of disposal (FVLCOD) reflects market inputs or inputs based on market evidence if readily available. If these inputs are not readily available, the fair value is estimated by discounting future cash flows modified for market participants' views. The relevant local statutory tax rates have been applied in calculating post-tax to pre-tax discount rates.

Key judgement – Determination of CGUs for assessing impairment of goodwill
The Group conducts impairment reviews at the CGU level. As permitted by IAS 36, impairment reviews for goodwill are performed at the groups of CGUs level, representing the lowest level at which the Group monitors goodwill for internal management purposes and no higher than the Group's operating segments. The main CGUs for which goodwill impairment reviews have been performed are Rolls-Royce Deutschland Ltd & Co KG and at an aggregated Rolls-Royce Power Systems AG level.

Key judgement – Whether there are indicators of potential reversal of previous impairments of programme-related intangible assets
Previously impaired intangible assets (including programme intangible assets but excluding goodwill) have been reviewed to ensure that no impairment reversal is required in accordance with IAS 36. In determining whether there was an indication that an impairment loss recognised in a prior period may no longer exist or may have decreased, the Directors considered whether the estimated service potential from the use of impaired assets had increased, other than by amounts generated through the passage of time (which would not represent an economic change in the value of the asset). An impairment of £573m was recorded in previous periods in relation to Business Aviation programme-related intangible assets. No indicator of reversal was present at 31 December 2023. Small changes to assumptions, including those related to discount rates which would be impacted by changes in market interest rates, could result in an increase in the asset's recoverable amount requiring a reversal in the future.

Inventories

Inventories are valued on a first-in, first-out basis, at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs and those direct and indirect overheads, including depreciation of property, plant and equipment, that have been incurred in bringing the inventories to their present location and condition. Net realisable value represents the estimated selling prices less all estimated costs of completion and costs to be incurred in marketing, selling and distribution. All inventories are classified as current, as it is expected that they will be used in the Group's operating cycle, regardless of whether this is expected to be within 12 months of the balance sheet date.

Cash and cash equivalents

Cash and cash equivalents include cash at bank and in hand, investments in money-market funds and short-term deposits with a maturity of three months or less on inception. The Group considers overdrafts (repayable on demand) to be an integral part of its cash management activities and these are included in cash and cash equivalents for the purposes of the cash flow statement. Where the Group operates pooled banking arrangements across multiple accounts, these are presented on a net basis when it has both a legal right and intention to settle the balances on a net basis.

The Group's suppliers have access to a supply chain financing (SCF) programme through partnership with banks. This enables smaller suppliers, who are on standard 75 day or more payment terms, and joint ventures (90-day standard payment terms) to receive their payment sooner. The election to utilise the programme is at the sole decision of the supplier. As the Group continues to have a contractual obligation to pay its suppliers under commercial terms, which are unaffected by any utilisation of the programme, and it does not retain any ongoing involvement in the SCF, the related payables are retained on the Group's balance sheet and classified as trade payables. Further details are disclosed in note 19.

Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are discounted to present value where the effect is material.

The principal provisions are recognised as follows:

- contract losses based on an assessment of whether the direct costs to fulfil a contract are greater than the expected revenue;
- warranty and guarantees based on an assessment of future claims with reference to past experience and recognised at the earlier of when the underlying products and services are sold and when the likelihood of a future cost is identified;
- Trent 1000 in-service issues when wastage costs are identified as described on page 128; and
- transformation and restructuring (included in other provisions) when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has created a valid expectation to those affected.

1 Accounting policies continued

Key judgement – Whether any costs should be treated as wastage
As described further on page 128, in rare circumstances, the Group may incur costs of wasted material, labour or other resources to fulfil a contract where the level of cost was not reflected in the contract price. The identification of such costs is a matter of judgement and would only be expected to arise where there has been a series of abnormal events which give rise to a significant level of cost of a nature that the Group would not expect to incur and hence is not reflected in the contract price. Provision is made for any costs identified as wastage when the obligation to incur them arises.

Specifically for the Trent 1000 wastage costs, provision has been made as the Group is an owner of an engine Type Certificate under which it has a present obligation to develop appropriate design changes to address certain engine conditions that have been noted in issued Airworthiness Directives. The Group is also required to ensure engine operators can continue to safely operate engines within the terms of their LTSAs, and this requires the engines to be compliant with the requirements of those issued Airworthiness Directives. These requirements cannot be met without the Group incurring significant costs in the form of replacement parts and customer claims. Given the significant activities of the Group in designing and overhauling aero engines, it is very experienced in making the required estimates in relation to the number and timing of shop visits, parts costs, overhaul labour costs and customer claims.

Key judgement – Whether the criteria to recognise a transformation and restructuring provision have been met
On 17 October 2023, the Group announced plans for a simpler, more streamlined, organisation as part of its multi-year transformation. It is estimated that 2,000 to 2,500 roles will be removed globally.

IAS 19 requires that a liability and expense for termination benefits should be recognised at the earlier of: (a) when an offer of those benefits can no longer be withdrawn; and (b) when the cost for a restructuring that is within the scope of IAS 37 that involves the payment of termination benefits is recognised.

The Directors have considered whether the Group's communications to employees during 2023 have led to an offer of benefits that could no longer be withdrawn. In a small number of situations this has been the case and a charge of £6m has been recognised in the year. For the significant majority of the 2,000 to 2,500 roles, the Directors do not consider that the plan of termination met the requirement for a provision to be recognised on the basis that communications as at 31 December 2023 had not yet been in sufficient detail to identify the functions or locations of the roles, the expected completion date, or the type and amount of benefits that would be received should employees employment be terminated.

Key estimates – Estimates of the time to incorporate a modified and certified high-pressure turbine (HPT) blade into the fleet to resolve technical issues on the Trent 1000, and the implications of this on forecast future costs when assessing onerous contracts
The Group has provisions for Trent 1000 wastage costs at 31 December 2023 of £116m (2022: £179m). These represent the Directors' best estimate of the expenditure required to settle the obligations at the balance sheet date. These estimates take account of information available and different possible outcomes.

The Group considers that at 31 December 2023 the Trent 1000 contract loss provisions and the Trent 1000 wastage cost provision are most sensitive to changes in estimates. A 12-month delay in the availability of the modified HPT blade could lead to around a £30m-£50m charge in relation to the Trent 1000 programme.

Key estimates – Estimates of the future revenues and costs to fulfil onerous contracts
The Group has provisions for onerous contracts at 31 December 2023 of £1,472m (2022: £1,592m).

An increase in Civil Aerospace large engine estimates of LTSA costs of 1% over the remaining term of the contracts could lead to around a £90m-£120m increase in the provision for contract losses across all programmes.

Key estimates – Assumptions implicit within the calculation of discount rates
The contract loss provisions for onerous contracts are sensitive to changes in the discount rate used to value the provisions. The rate used for each contract is derived from bond yields (i.e. risk-free rates) with a similar duration and currency to the contract that they are applied to. The rate is adjusted to reflect the specific inflation characteristics of the contracts. The forecast rates are determined from third-party market analysis and average 4%. A 1% change in the discount rates used could lead to around a £70m-£80m change in the provision.

Customer financing support

In connection with the sale of its products, the Group will, on occasion, provide financing support for its customers. Credit-based guarantees are disclosed as commitments or contingent liabilities dependent on whether aircraft have been delivered or not. As described on page 181, the Directors consider the likelihood of crystallisation in assessing whether provision is required for any liabilities.

The Group's contingent liabilities relating to financing arrangements are spread over many years and relate to a number of customers and a broad product portfolio and are reported on a discounted basis.

1 Accounting policies continued

Post-retirement benefits

Pensions and similar benefits (principally healthcare) are accounted for under IAS 19.

For defined benefit plans, obligations are measured at discounted present value, using a discount rate derived from high-quality corporate bonds denominated in the currency of the plan, whilst plan assets are recorded at fair value. Surpluses in schemes are recognised as assets only if they represent economic benefits available to the Group in the future. Actuarial gains and losses are recognised immediately in OCI. The service and financing costs of such plans are recognised separately in the income statement:

— current service costs are spread systematically over the lives of employees;

— past-service costs and settlements are recognised immediately; and

— financing costs are recognised in the periods in which they arise.

UK pension obligations include the estimated impact of the obligation to equalise defined benefit pensions and transfer values for men and women.

Payments to defined contribution schemes are charged as an expense as they fall due.

Key estimate – Estimates of the assumptions for valuing the net defined benefit obligation
The Group's defined benefit pension schemes and similar arrangements are assessed annually in accordance with IAS 19. The valuations, which are based on assumptions determined with independent actuarial advice, resulted in a net deficit of £253m before deferred taxation being recognised on the balance sheet at 31 December 2023 (2022: deficit of £420m). The size of the net surplus/deficit is sensitive to the actuarial assumptions, which include the discount rate, price inflation, pension and salary increases, longevity and, in the UK, the number of plan members who take the option to transfer their pension to a lump sum on retirement or who choose to take the Bridging Pension Option. Following consultation, the UK scheme closed to future accrual on 31 December 2020.

A reduction in the discount rate of 0.25% from 4.50% could lead to an increase in the defined benefit obligations of the RR UK Pension Fund (RRUKPF) of approximately £185m. This would be expected to be broadly offset by changes in the value of scheme assets, as the scheme's investment policies are designed to mitigate this risk.

An increase in the assumed rate of inflation of 0.25% (RPI of 3.30% and CPI of 2.85%) could lead to an increase in the defined benefit obligations of the RRUKPF of approximately £75m.

A one-year increase in life expectancy from 20.8 years (male aged 65) and from 21.5 years (male aged 45) would increase the defined benefit obligations of the RRUKPF by approximately £155m.

Further details and sensitivities are included in note 22.

Share-based payments

The Group provides share-based payment arrangements to certain employees. These are principally equity-settled arrangements and are measured at fair value (excluding the effect of non-market based vesting conditions) at the date of grant. The fair value is expensed on a straight-line basis over the vesting period. The amount recognised as an expense is adjusted to reflect the actual number of shares or options that will vest based on expected performance, except where additional shares vest as a result market-based performance conditions where no adjustment is required as allowance for these performance conditions are included in the initial fair value.

Cash-settled share options (grants in the International ShareSave plan) are measured at fair value at the balance sheet date. The Group recognises a liability at the balance sheet date based on these fair values, taking into account the estimated number of options that are expected to vest and the relative completion of the vesting period. Changes in the value of this liability are recognised in the income statement for the year.

The cost of shares of Rolls-Royce Holdings plc held by the Group for the purpose of fulfilling obligations in respect of employee share plans is deducted from equity in the consolidated balance sheet. See note 24 for a further description of the share-based payment plans.

Revisions to IFRS not applicable in 2023

Standards and interpretations issued by the IASB are only applicable if endorsed by the UK. The Group does not consider that any standards, amendments or interpretations issued by the IASB, but not yet applicable will have a significant impact on the Consolidated Financial Statements.

Other

IBOR reform transition

A number of the Group's lease liabilities have been based on a USD LIBOR index. The majority of contracts in which the Group is a lessee have been amended. These have been amended to Secured Overnight Financing Rate (USD Term SOFR) plus credit adjustment spread (CAS), and the impact to the Financial Statements is not material. There are a number of lease contracts which currently have fixed rentals which will move to floating rentals based on USD LIBOR after the end of the fixed rental period. These will be amended before the end of the fixed rental period to USD Term SOFR plus CAS. The Group has taken the practical expedient available to account for the lease modification required by the IBOR reform by applying IFRS 16 paragraph 42.

Post balance sheet events

The Group has taken the latest legal position in relation to any ongoing legal proceedings and reflected these in the 2023 results as appropriate.

2 Segmental analysis

The analysis by segment is presented in accordance with IFRS 8, on the basis of those segments whose operating results are regularly reviewed by the Board (who acts as the Chief Operating Decision Maker as defined by IFRS 8). The Group's four divisions are set out below.

Civil Aerospace	development, manufacture, marketing and sales of commercial aero engines and aftermarket services
Defence	development, manufacture, marketing and sales of military aero engines, naval engines, submarine nuclear power plants and aftermarket services
Power Systems	development, manufacture, marketing and sales of integrated solutions for onsite power and propulsion
New Markets	development, manufacture and sales of small modular reactor (SMR) and new electrical power solutions

Other businesses include the trading results of the UK Civil Nuclear business.

Underlying results

The Group presents the financial performance of the divisions in accordance with IFRS 8 and consistently with the basis on which performance is communicated to the Board each month.

Underlying results are presented by recording all relevant revenue and cost of sales transactions at the average exchange rate achieved on effective settled derivative contracts in the period that the cash flow occurs. The impact of the revaluation of monetary assets and liabilities (other than lease liabilities) using the exchange rate that is expected to be achieved by the use of the effective hedge book is recorded within underlying cost of sales. Underlying financing excludes the impact of revaluing monetary assets and liabilities to period end exchange rates. Lease liabilities are not revalued to reflect the expected exchange rates due to their multi-year remaining term, the Directors believe that doing so would not be the most appropriate basis to measure the in-year performance. Transactions between segments are presented on the same basis as underlying results and eliminated on consolidation. Unrealised fair value gains/(losses) on foreign exchange contracts, which are recognised as they arise in the statutory results, are excluded from underlying results. To the extent that the previously forecast transactions are no longer expected to occur, an appropriate portion of the unrealised fair value gain/(loss) on foreign exchange contracts is recorded immediately in the underlying results.

Amounts receivable/(payable) on interest rate swaps which are not designated as hedge relationships for accounting purposes are reclassified from fair value movement on a statutory basis to interest receivable/(payable) on an underlying basis, as if they were in an effective hedge relationship.

In the year to 31 December 2023, the Group was a net seller of USD at an achieved exchange rate GBP:USD of 1.50 (2022: 1.50) based on the USD hedge book.

In 2020, the Group experienced a significant decline in its medium-term outlook and consequently a significant deterioration to its forecast net USD cash inflows. The Group took action to reduce the size of the USD hedge book by $11.8bn across 2020 to 2026 to reflect the fact that, at that time, future operating cash flows were no longer forecast to materialise. An underlying charge of £1.7bn was recognised within the underlying finance costs in 2020 and the associated cash settlement costs occur over the period 2020 to 2026. The derivatives relating to this underlying charge have been subsequently excluded from the hedge book, and therefore are also excluded from the calculation of the average exchange rate achieved in the current and future periods.

Underlying performance also excludes the following:

— the effect of acquisition accounting and business disposals;

— impairment of goodwill, other non-current and current assets where the reasons for the impairment are outside of normal operating activities;

— exceptional items; and

— certain other items which are market driven and outside of the control of management.

Subsequent changes in items excluded from underlying performance in a prior period will also be excluded from underlying performance. All other changes will be recognised within underlying performance.

Acquisition accounting, business disposals and impairment

The Group exclude these from underlying results so that the current year and comparative results are directly comparable.

2 Segmental analysis continued

Exceptional items

Items are classified as exceptional where the Directors believe that presentation of the results in this way is useful in providing an understanding of the Group's financial performance. Exceptional items are identified by virtue of their size, nature or incidence.

In determining whether an event or transaction is exceptional, the Directors consider quantitative as well as qualitative factors such as the frequency or predictability of occurrence. Examples of exceptional items include one-time costs and charges in respect of aerospace programmes, costs of exceptional transformation and restructuring programmes and one-time past service charges and credits on post-retirement schemes.

Exceptional items are not allocated to segments and may not be comparable to similarly titled measures used by other companies.

Other items

The financing component of the defined benefit pension scheme cost is determined by market conditions and has therefore been included as a reconciling difference between underlying and statutory performance.

The tax effects of adjustments above are excluded from the underlying tax charge. Changes in tax rates are excluded from the underlying tax charge. In addition, changes in the amount of recoverable deferred tax recognised are excluded from the underlying results to the extent that their recognition or derecognition was not originally recorded within the underlying results.

The following analysis sets out the results of the Group's divisions on the basis described above and also includes a reconciliation of the underlying results to those reported in the consolidated income statement.

	Civil Aerospace £m	Defence £m	Power Systems £m	New Markets £m	Other businesses £m	Corporate and Inter-segment[1] £m	Total Underlying £m
Year ended 31 December 2023							
Underlying revenue from sale of original equipment	2,703	1,766	2,661	2	12	–	7,144
Underlying revenue from aftermarket services	4,645	2,311	1,307	2	–	–	8,265
Total underlying revenue	7,348	4,077	3,968	4	12	–	15,409
Gross profit/(loss)	1,394	804	1,050	1	(15)	(3)	3,231
Commercial and administrative costs	(354)	(173)	(456)	(24)	–	(57)	(1,064)
Research and development costs	(343)	(72)	(187)	(137)	–	–	(739)
Share of results of joint ventures and associates	153	3	6	–	–	–	162
Underlying operating profit/(loss)	850	562	413	(160)	(15)	(60)	1,590
Year ended 31 December 2022							
Underlying revenue from sale of original equipment	1,982	1,634	2,187	1	–	(5)	5,799
Underlying revenue from aftermarket services	3,704	2,026	1,160	2	–	–	6,892
Total underlying revenue	5,686	3,660	3,347	3	–	(5)	12,691
Gross profit/(loss)	853	726	918	(1)	(29)	10	2,477
Commercial and administrative costs	(371)	(174)	(441)	(23)	(2)	(51)	(1,062)
Research and development costs	(452)	(122)	(204)	(108)	–	–	(886)
Share of results of joint ventures and associates	113	2	8	–	–	–	123
Underlying operating profit/(loss)	143	432	281	(132)	(31)	(41)	652

1 Corporate and Inter-segment consists of costs that are not attributable to a specific segment and consolidation adjustments

2 Segmental analysis continued

Reconciliation to statutory results

	Total underlying £m	Underlying adjustments and adjustments to foreign exchange £m	Group statutory results £m
Year ended 31 December 2023			
Continuing operations			
Revenue from sale of original equipment	7,144	491	7,635
Revenue from aftermarket services	8,265	586	8,851
Total revenue	15,409	1,077	16,486
Gross profit	3,231	389	3,620
Commercial and administrative costs	(1,064)	(46)	(1,110)
Research and development costs	(739)	–	(739)
Share of results of joint ventures and associates	162	11	173
Operating profit	1,590	354	1,944
Gain arising on the disposal of businesses	–	1	1
Profit before financing and taxation	1,590	355	1,945
Net financing	(328)	810	482
Profit before taxation	1,262	1,165	2,427
Taxation	(120)	97	(23)
Profit for the year	1,142	1,262	2,404
Attributable to:			
Ordinary shareholders	1,150	1,262	2,412
NCI	(8)	–	(8)
Year ended 31 December 2022			
Continuing operations			
Revenue from sale of original equipment	5,799	474	6,273
Revenue from aftermarket services	6,892	355	7,247
Total revenue	12,691	829	13,520
Gross profit	2,477	280	2,757
Commercial and administrative costs	(1,062)	(15)	(1,077)
Research and development costs	(886)	(5)	(891)
Share of results of joint ventures and associates	123	(75)	48
Operating profit	652	185	837
Gain arising on the disposal of businesses	–	81	81
Profit before financing and taxation	652	266	918
Net financing	(446)	(1,974)	(2,420)
Profit/(loss) before taxation	206	(1,708)	(1,502)
Taxation	(48)	356	308
Profit/(loss) for the year from continuing operations	158	(1,352)	(1,194)
Discontinued operations [1]	67	(147)	(80)
Profit/(loss) for the year	225	(1,499)	(1,274)
Attributable to:			
Ordinary shareholders	230	(1,499)	(1,269)
NCI	(5)	–	(5)

1 Discontinued operations relate to the results of ITP Aero and are presented net of intercompany trading eliminations and related consolidation adjustments

2 Segmental analysis continued

Disaggregation of revenue from contracts with customers

Analysis by type and basis of recognition

	Civil Aerospace £m	Defence £m	Power Systems £m	New Markets £m	Other businesses £m	Corporate and Inter-segment £m	Total Underlying £m
Year ended 31 December 2023							
Original equipment recognised at a point in time	2,703	632	2,611	2	–	–	5,948
Original equipment recognised over time	–	1,134	50	–	12	–	1,196
Aftermarket services recognised at a point in time	1,227	854	1,206	2	–	–	3,289
Aftermarket services recognised over time	3,335	1,457	101	–	–	–	4,893
Total underlying customer contract revenue	7,265	4,077	3,968	4	12	–	15,326
Other underlying revenue [1]	83	–	–	–	–	–	83
Total underlying revenue [2]	7,348	4,077	3,968	4	12	–	15,409
Year ended 31 December 2022							
Original equipment recognised at a point in time	1,982	689	2,155	1	–	(5)	4,822
Original equipment recognised over time	–	945	32	–	–	–	977
Aftermarket services recognised at a point in time	865	769	1,076	2	–	–	2,712
Aftermarket services recognised over time	2,772	1,257	84	–	–	–	4,113
Total underlying customer contract revenue	5,619	3,660	3,347	3	–	(5)	12,624
Other underlying revenue [1]	67	–	–	–	–	–	67
Total underlying revenue [2]	5,686	3,660	3,347	3	–	(5)	12,691

1 Includes leasing revenue
2 Includes £(136)m, of which £(104)m relates to Civil LTSA contracts, (2022: £367m, of which £360m relates to Civil LTSA contracts) of revenue recognised in the year relating to performance obligations satisfied in previous years

	Total underlying £m	Underlying adjustments and adjustments to foreign exchange £m	Group statutory results [1] £m
Year ended 31 December 2023			
Original equipment recognised at a point in time	5,948	491	6,439
Original equipment recognised over time	1,196	–	1,196
Aftermarket services recognised at a point in time	3,289	186	3,475
Aftermarket services recognised over time	4,893	382	5,275
Total customer contract revenue	15,326	1,059	16,385
Other revenue	83	18	101
Total revenue	15,409	1,077	16,486
Year ended 31 December 2022			
Original equipment recognised at a point in time	4,822	474	5,296
Original equipment recognised over time	977	–	977
Aftermarket services recognised at a point in time	2,712	164	2,876
Aftermarket services recognised over time	4,113	176	4,289
Total customer contract revenue	12,624	814	13,438
Other revenue	67	15	82
Total revenue	12,691	829	13,520

1 During the year to 31 December 2023, revenue recognised within Civil Aerospace, Defence and Power Systems of £1,766m (2022: £1,788m) was received from a single customer

2 Segmental analysis continued

Analysis by geographical destination

The Group's revenue by destination of the ultimate operator is as follows:

	2023 £m	2022 £m
United Kingdom	2,230	1,669
Germany	1,035	855
Ireland	504	328
Turkey	399	220
Switzerland	379	334
France	351	255
Spain	290	188
Italy	282	238
Netherlands	149	95
Portugal	110	43
Norway	71	61
Rest of Europe	308	463
Europe	6,108	4,749
United States	4,668	4,334
Canada	430	267
North America	5,098	4,601
South America	230	168
Central America	106	91
Saudi Arabia	394	322
United Arab Emirates	148	180
Qatar	128	231
Rest of Middle East	200	164
Middle East	870	897
China	1,263	1,246
Japan	586	276
Singapore	437	317
South Korea	303	164
India	221	119
Thailand	132	–
Rest of Asia	529	381
Asia	3,471	2,503
Africa	313	282
Australasia	290	229
	16,486	13,520

Order backlog

Contracted consideration, translated at the estimated long-term exchange rates, that is expected to be recognised as revenue when performance obligations are satisfied in the future (referred to as order backlog) is as follows:

	2023			2022		
	Within five years £bn	After five years £bn	Total £bn	Within five years £bn	After five years £bn	Total £bn
Civil Aerospace	28.4	26.8	55.2	25.7	22.0	47.7
Defence	8.3	0.9	9.2	7.8	0.7	8.5
Power Systems	3.9	0.2	4.1	3.7	0.3	4.0
New Markets	–	–	–	–	–	–
Other businesses	–	–	–	–	–	–
	40.6	27.9	68.5	37.2	23.0	60.2

The parties to these contracts have approved the contract and customers do not have a unilateral enforceable right to terminate the contract without compensation. The Group excludes Civil Aerospace OE orders (for deliveries beyond the next seven-12 months) that customers have placed where they retain a right to cancel. The Group's expectation based on historical experience is that these orders will be fulfilled. Within the five years category, contracted revenue in Defence will largely be recognised in the next three years and Power Systems will be recognised over the next two years, as it is a short cycle business.

2 Segmental analysis continued

Underlying adjustments

		2023				2022			
		Revenue £m	Profit before financing £m	Net financing £m	Taxation £m	Revenue £m	Profit before financing £m	Net financing £m	Taxation £m
Underlying performance		**15,409**	**1,590**	**(328)**	**(120)**	12,691	652	(446)	(48)
Impact of foreign exchange differences as a result of hedging activities on trading transactions [1]	A	**1,077**	**469**	**394**	**(210)**	829	267	(358)	(81)
Unrealised fair value changes on derivative contracts held for trading [2]	A	**–**	**6**	**514**	**(130)**	–	(3)	(1,768)	451
Unrealised fair value changes on derivative contracts held for financing [3]	A	**–**	**–**	**7**	**(2)**	–	–	191	(47)
Exceptional programme credits/(charges) [4]	B	**–**	**21**	**–**	**(5)**	–	69	(3)	–
Exceptional transformation and restructuring (charges)/credits [5]	B	**–**	**(102)**		**25**	–	(47)	–	4
Impairment reversals/(charges) [6]	C	**–**	**8**	**–**	**(2)**	–	(65)	–	–
Effect of acquisition accounting [7]	C	**–**	**(50)**	**–**	**12**	–	(58)	–	9
Other [8]	D	**–**	**2**	**(105)**	**24**	–	22	(36)	(71)
Gains arising on the disposals of businesses	C	**–**	**1**	**–**	**–**	–	81	–	(2)
Recognition of deferred tax assets [9]	D	**–**	**–**	**–**	**385**	–	–	–	93
Total underlying adjustments		**1,077**	**355**	**810**	**97**	829	266	(1,974)	356
Statutory performance per consolidated income statement		**16,486**	**1,945**	**482**	**(23)**	13,520	918	(2,420)	308

A – FX, B – Exceptional, C – M&A and impairment, D – Other

1 The impact of measuring revenues and costs at the average exchange rate during the year and the impact of valuation of assets and liabilities using the year end exchange rate rather than the achieved rate or the exchange rate that is expected to be achieved by the use of the hedge book increased statutory revenues by £1,077m (2022: £829m) and increased profit before financing and taxation by £469m (2022: £267m). Underlying financing excludes the impact of revaluing monetary assets and liabilities at the year end exchange rate
2 The underlying results exclude the fair value changes on derivative contracts held for trading. These fair value changes are subsequently recognised in the underlying results when the contracts are settled
3 Includes net fair value gains of £1m (2022: £190m) on any interest rate swaps not designated into hedging relationships for accounting purposes
4 During the year to 31 December 2023, £21m of Trent 1000 wastage costs provision previously recognised in respect of estimated costs to settle obligations have been reversed to reflect the current status of claims in respect of the Trent 1000 technical issues which were identified in 2019
5 During the year to 31 December 2023, the Group incurred total transformation and restructuring related charges of £102m (2022: £47m). In 2023, the Group announced a major multi-year transformation programme which consists of seven workstreams that were set out in the 2022 Annual Report. During the year, £88m was incurred in relation to this multi-year programme, comprising £45m for advisory fees and transformation office costs, £37m related to impairments and write-offs and £6m related to severance costs. In the year to 31 December 2023, a £14m (2022: £47m) charge related to initiatives to enable restructuring under a previous programme
6 The Group has assessed the carrying value of its assets. Further details are provided in notes 9, 10, 11 and 12
7 The effect of acquisition accounting includes the amortisation of intangible assets arising on previous acquisitions
8 Includes interest received of £83m (2022: interest received of £14m) on interest rate swaps which are not designated into hedge relationships for statutory purposes from interest payable on an underlying basis to fair value movement and £2m (2022: credit of £22m) of past-service credit on defined benefit schemes
9 Relates to the recognition of deferred tax assets on UK tax losses of £328m and foreign exchange derivatives of £57m. The £93m recognised in 2022 relates to foreign exchange derivatives

2 Segmental analysis continued

Balance sheet analysis

At 31 December 2023	Civil Aerospace £m	Defence £m	Power Systems £m	New Markets £m	Total reportable segments £m
Segment assets	17,718	3,517	3,814	115	25,164
Interests in joint ventures and associates	444	7	28	–	479
Segment liabilities	(24,447)	(3,376)	(1,765)	(88)	(29,676)
Net (liabilities)/assets	(6,285)	148	2,077	27	(4,033)
Investment in intangible assets, property, plant and equipment, right-of-use assets and joint ventures and associates	562	176	160	17	915
Depreciation, amortisation and impairment	719	105	194	9	1,027
At 31 December 2022					
Segment assets	17,537	3,430	4,084	135	25,186
Interests in joint ventures and associates	387	4	31	–	422
Segment liabilities	(25,357)	(3,146)	(1,802)	(97)	(30,402)
Net (liabilities)/assets	(7,433)	288	2,313	38	(4,794)
Investment in intangible assets, property, plant and equipment, right-of-use assets and joint ventures and associates	415	146	177	16	754
Depreciation, amortisation and impairment	755	128	193	6	1,082

Reconciliation to the balance sheet

	2023 £m	2022 £m
Total reportable segment assets (excluding held for sale)	25,164	25,186
Other businesses	8	19
Corporate and Inter-segment	(2,010)	(2,460)
Interests in joint ventures and associates	479	422
Assets held for sale	109	–
Cash and cash equivalents and short-term investments	3,784	2,618
Fair value of swaps hedging fixed rate borrowings	118	194
Deferred and income tax assets	3,078	2,858
Post-retirement scheme surpluses	782	613
Total assets	31,512	29,450
Total reportable segment liabilities (excluding held for sale)	(29,676)	(30,402)
Other businesses	(58)	(34)
Corporate and Inter-segment	2,010	2,456
Liabilities associated with assets held for sale	(55)	–
Borrowings and lease liabilities	(5,759)	(5,955)
Fair value of swaps hedging fixed rate borrowings	(95)	(108)
Deferred and income tax liabilities	(473)	(390)
Post-retirement scheme deficits	(1,035)	(1,033)
Total liabilities	(35,141)	(35,466)
Net liabilities	(3,629)	(6,016)

The carrying amounts of the Group's non-current assets including investments but excluding financial instruments, deferred tax assets and post-retirement scheme surpluses/(deficits), by the geographical area in which the assets are located, are as follows:

	2023 £m	2022 £m
United Kingdom	4,981	5,202
Germany	2,052	2,151
United States	1,414	1,465
Other	705	735
	9,152	9,553

3 Research and development

	2023 £m	2022 £m
Gross research and development costs	(1,390)	(1,287)
Contributions and fees [1]	548	359
Expenditure in the year	(842)	(928)
Capitalised as intangible assets	192	131
Amortisation and impairment of capitalised costs [2]	(89)	(94)
Net cost recognised in the income statement	(739)	(891)
Underlying adjustments relating to effects of acquisition accounting and foreign exchange	–	5
Net underlying cost recognised in the income statement	(739)	(886)

1 Includes £531m (2022: £350m) of government funding
2 See note 9 for analysis of amortisation and impairment

4 Net financing

	2023		2022	
	Statutory £m	Underlying [1] £m	Statutory £m	Underlying [1] £m
Interest receivable and similar income [2]	164	164	35	35
Net fair value gains on foreign currency contracts	574	–	–	–
Net fair value gains on non-hedge accounted interest rate swaps [3]	1	–	190	–
Net fair value gains on commodity contracts	–	–	106	–
Financing on post-retirement scheme surpluses	30	–	24	–
Net foreign exchange gains	394	–	–	–
Financing income	1,163	164	355	35
Interest payable	(369)	(275)	(343)	(320)
Net fair value losses on foreign currency contracts	–	–	(1,875)	–
Foreign exchange differences and changes in forecast payments relating to financial RRSAs	(1)	–	(7)	–
Net fair value losses on commodity contracts	(60)	–	–	–
Financing on post-retirement scheme deficits	(42)	–	(26)	–
Net foreign exchange losses	–	–	(358)	–
Cost of undrawn facilities	(57)	(57)	(61)	(61)
Other financing charges	(152)	(160)	(105)	(100)
Financing costs	(681)	(492)	(2,775)	(481)
Net financing income/(costs)	482	(328)	(2,420)	(446)
Analysed as:				
Net interest payable	(205)	(111)	(308)	(285)
Net fair value gains/(losses) on derivative contracts	515	–	(1,579)	–
Net post-retirement scheme financing	(12)	–	(2)	–
Net foreign exchange gains/(losses)	394	–	(358)	–
Net other financing	(210)	(217)	(173)	(161)
Net financing income/(costs)	482	(328)	(2,420)	(446)

1 See note 2 for definition of underlying results
2 Includes interest income on cash balances and short-term deposits of £117m (2022: £28m) and similar income of £47m (2022: £7m) on money market funds
3 The consolidated income statement shows the net fair value gain/(loss) on any interest rate swaps not designated into hedging relationships for accounting purposes. Underlying financing reclassifies the realised fair value movements on these interest rate swaps to net interest payable

5 Taxation

	UK		Overseas		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Current tax charge for the year	19	18	256	159	275	177
Adjustments in respect of prior years	–	(5)	2	(8)	2	(13)
Current tax	19	13	258	151	277	164
Deferred tax charge/(credit) for the year	224	(427)	(69)	(61)	155	(488)
Adjustments in respect of prior years	(5)	4	2	12	(3)	16
Recognition of deferred tax	(406)	–	–	–	(406)	–
Deferred tax	(187)	(423)	(67)	(49)	(254)	(472)
(Credited)/charged in the income statement	(168)	(410)	191	102	23	(308)

Other tax (charges)/credits

	OCI				Equity	
	Items that will not be reclassified		Items that will be reclassified			
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Deferred tax:						
Movement in post-retirement schemes	(43)	89	–	–	–	–
Cash flow hedge	–	–	5	12	–	–
Net investment hedge	–	–	(1)	2	–	–
Share-based payments – direct to equity	–	–	–	–	22	1
Other tax (charges)/credits	(43)	89	4	14	22	1

Tax reconciliation on continuing operations

	2023 £m	2022 £m
Profit/(loss) before taxation from continuing operations	2,427	(1,502)
Less: share of results of joint ventures and associates (note 12)	(139)	(9)
Profit/(loss) before taxation from continuing operations excluding joint ventures and associates	2,288	(1,511)
Nominal tax charge/(credit) at UK corporation tax rate 23.5% (2022: 19%)	538	(287)
UK tax rate differential [1]	16	(69)
Overseas rate differences [2]	9	18
Exempt gain on disposal of businesses [3]	–	(14)
R&D credits	(16)	(7)
Other permanent differences	16	23
Benefit to deferred tax from previously unrecognised tax losses and temporary differences [4]	(57)	(134)
Tax losses and other temporary differences not recognised in deferred tax [5]	9	159
Benefit arising from previously unrecognised tax losses [6]	(85)	–
Recognition of deferred tax assets [7]	(406)	–
Adjustments in respect of prior years	(1)	3
	23	(308)
Underlying items (note 2)	120	48
Non-underlying items	(97)	(356)
	23	(308)

Tax on discontinued operations

	2023 £m	2022 £m
Tax charge on loss before taxation from discontinued operations	–	10
Tax credit on disposal of discontinued operations	–	(31)
	–	(21)

1 The UK tax rate differential arises on the difference between the deferred tax rate and the statutory tax rate
2 Overseas rate differences mainly relate to tax on profits or losses in countries such as the US and Germany
3 The exempt gain in 2022 relates to the disposal of Airtanker Holdings Ltd
4 Benefit to deferred tax from previously unrecognised tax losses and temporary differences mainly relate to foreign exchange derivatives
5 Movement on tax losses not recognised relate to foreign exchange derivatives
6 Relates to foreign exchange derivatives
7 The recognition of deferred tax relates to UK tax losses

5 Taxation continued

Deferred taxation assets and liabilities

	2023 £m	2022 £m
At 1 January	2,445	1,792
Amount credited to income statement	254	495
Amount (charged)/credited to OCI	(44)	91
Amount credited to hedging reserves	5	12
Amount credited to equity	22	1
On acquisition/disposal of businesses [1]	(1)	28
Exchange differences	(13)	26
At 31 December	2,668	2,445
Deferred tax assets	2,998	2,731
Deferred tax liabilities	(330)	(286)
	2,668	2,445

1 The 2023 deferred tax relates to the acquisition of Team Italia Marine S.R.L. The 2022 deferred tax relates to the disposal of ITP Aero

The analysis of the deferred tax position is as follows:

	At 1 January £m	Recognised in income statement £m	Recognised in OCI £m	Recognised in equity £m	Disposals and acquisition related activity £m	Exchange differences £m	At 31 December £m
2023							
Intangible assets	(436)	6	–	–	(1)	–	(431)
Property, plant and equipment	230	(7)	–	–	–	6	229
Other temporary differences [1]	650	88	4	22	–	(12)	752
Net contract liabilities	64	(4)	–	–	–	–	60
Pensions and other post-retirement scheme benefits	(57)	(15)	(43)	–	–	(8)	(123)
Foreign exchange and commodity financial assets and liabilities	693	(243)	–	–	–	1	451
Losses	1,072	417	–	–	–	–	1,489
R&D credit	67	12	–	–	–	–	79
Advance corporation tax [2]	162	–	–	–	–	–	162
	2,445	254	(39)	22	(1)	(13)	2,668
Recognised in:							
Continuing operations		254					
2022							
Intangible assets	(464)	29	–	–	–	(1)	(436)
Property, plant and equipment	193	33	–	–	6	(2)	230
Other temporary differences [1]	465	133	(1)	1	44	8	650
Net contract liabilities	73	(9)	–	–	–	–	64
Pensions and other post-retirement scheme benefits	(140)	(19)	89	–	–	13	(57)
Foreign exchange and commodity financial assets and liabilities	362	329	15	–	(22)	9	693
Losses	1,085	(12)	–	–	–	(1)	1,072
R&D credit	56	11	–	–	–	–	67
Advance corporation tax [2]	162	–	–	–	–	–	162
	1,792	495	103	1	28	26	2,445
Recognised in:							
Continuing operations		472					
Discontinued operations		23					

1 Other temporary differences mainly relate to the deferral of relief for interest expenses in the UK and revenue recognised earlier under local GAAP compared to IFRS in Germany
2 Prior to 1999 advance corporation tax was paid to the UK Tax Authority when cash dividends were paid by the Group. This was a payment on account which was available to offset against UK corporation tax liabilities. Any unused balance remaining after 1999 can be carried forward indefinitely and utilised against future UK corporation tax liabilities

5 Taxation continued

Unrecognised deferred tax assets

	2023 £m	2022 £m
Advance corporation tax	19	19
UK losses	1,635	2,040
Foreign exchange and commodity financial assets and liabilities	69	218
Losses and other unrecognised deferred tax assets	34	33
Deferred tax not recognised on unused tax losses and other items on the basis that future economic benefit is uncertain	1,757	2,310

Gross amount and expiry of losses and other deductible temporary differences for which no deferred tax asset has been recognised.

	2023					2022				
	Total gross losses and deductible temporary differences £m	UK losses £m	Foreign exchange and commodity financial assets and liabilities £m	Other losses £m	Other deductible temporary differences £m	Total gross losses and deductible temporary differences £m	UK losses £m	Foreign exchange and commodity financial assets and liabilities £m	Other losses £m	Other deductible temporary differences £m
Expiry within five years	81	–	–	81	–	83	–	–	83	–
Expiry within six to 30 years	216	–	–	216	–	265	–	–	265	–
No expiry	6,891	6,537	275	79	–	9,057	8,157	871	27	2
	7,188	6,537	275	376	–	9,405	8,157	871	375	2

In addition to the gross balances shown above, advance corporation tax of £19m (2022: £19m) has not been recognised. Advance corporation tax has no expiry.

Of the total deferred tax asset of £2,998m, £2,399m (2022: £2,183m) relates to the UK and is made up as follows:

— £1,476m (2022: £1,054m) relating to tax losses;

— £412m (2022: £668m) arising on unrealised losses on derivative contracts;

— £162m (2022: £162m) of advance corporation tax; and

— £349m (2022: £299m) relating to other deductible temporary differences, in particular tax depreciation and relief for interest expenses.

The UK deferred tax assets primarily arise in Rolls-Royce plc and have been recognised based on the expectation that the business will generate taxable profits and tax liabilities in the future against which the losses and deductible temporary differences can be utilised.

Most of the UK tax losses relate to the Civil Aerospace large engine business which makes initial losses through the investment period of a programme and then makes a profit through its contracts for services. The programme lifecycles are typically in excess of 30 years.

Deferred tax assets are recognised only to the extent it is probable that future taxable profits will be available against which the assets can be utilised. A recoverability assessment has been undertaken, taking account of deferred tax liabilities against which the reversal can be offset and using latest UK forecasts, which are mainly driven by the Civil Aerospace large engine business, to assess the level of future taxable profits.

The recoverability of deferred tax assets has been assessed on the following basis:

— using the most recent UK profit forecasts, covering the next five years which are consistent with external sources on market conditions;

— the long-term forecast profit profile of existing large engine programmes which are typically in excess of 30 years from initial investment to retirement of the fleet, including the aftermarket revenues earned from airline customers;

— the long-term forecast is adjusted to exclude engine programmes which are in the development stage with no confirmed orders;

— taking into account the risk that regulatory changes could materially impact demand for our products;

— consideration that although all Civil Aerospace large engines are now compatible with sustainable fuels, there is a risk that in the longer term demand will shift towards more sustainable products and solutions;

— the long-term forecast profit and cost profile of the other parts of the UK business;

— taking into consideration past performance and experience as well as a 25% probability of a severe but plausible downside forecast materialising in relation to the civil aviation industry; and

— consideration that, whilst profitable in 2023, the UK business has historically been loss making.

5 Taxation continued

The assessment takes into account UK tax laws that, in broad terms, restrict the offset of carried forward tax losses to 50% of current year profits. In addition, the amounts and timing of future taxable profits incorporate:

— the impact of new contracts signed in 2023. These include the trilateral AUKUS agreement involving the UK Defence business;

— the outcomes of strategic initiatives including cost and commercial optimisation;

— the growth in Civil Aerospace engine flying hours; and

— management's assumptions on the impact of macroeconomic factors and climate change on the UK business.

The climate change scenarios previously prepared to assess the viability of our business strategy, decarbonisation plans and approach to managing climate-related risks have continued to develop over the last year. The scale up of sustainable aviation fuel is expected to play a crucial role in reaching net zero carbon emissions by 2050 and the Group has demonstrated that all Civil Aerospace production engines are compatible with sustainable aviation fuels. The impact that this could have on our costs and customer pricing is factored into the deferred tax assessment. However, benefits that may arise in the future from the development of breakthrough new technologies are not taken into account.

Based on the assessment, the Group has recognised a total UK deferred tax asset of £2,399m, which includes the re-recognition of a £57m deferred tax asset on unrealised losses on foreign exchange derivative contracts and recognition of a further £406m (of which £328m is non-underlying and £78m is underlying) deferred tax asset relating to UK tax losses. This reflects the conclusions that:

— Based on current financial results and an improved outlook it is probable that the UK business will generate taxable income and tax liabilities in the future against which these losses can be utilised.

— Using current forecasts and various scenarios these losses and other deductible temporary differences will be used in full within 30-40 years, which is within the expected programme lifecycles. An explanation of the potential impact of climate change on forecast profits and sensitivity analysis can be found in note 1.

Any future changes in tax law or the structure of the Group could have a significant effect on the use of losses and other deductible temporary differences, including the period over which they can be used. In view of this and the significant judgement involved the Board continuously reassesses this area.

The other significant deferred tax asset arises in Rolls-Royce Deutschland Ltd & Co KG, where the main activity is business aviation. The total net deferred tax asset is £328m (2022: £284m), which has been recognised in full. The deferred tax asset relates to revenue being recognised and taxed earlier under local tax rules resulting in a benefit when revenue is recognised in the accounts.

The Group is within the scope of the OECD Pillar Two (Global Minimum Tax) model rules. The legislation has been substantively enacted in some of the main jurisdictions in which the Group operates including the UK and Germany where the rules will be effective from 1 January 2024. Initial assessments indicate that Pillar Two income taxes will not be material to the Group and a majority of the jurisdictions in which the Group operates will meet one of the transitional safe harbours. For those jurisdictions which are material or where the statutory tax rate is close to 15%, the assessment is based on 2023 data. Elsewhere prior year data has been used.

For the year to 31 December 2023, the Group has applied the mandatory exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes.

The temporary differences associated with investments in subsidiaries, joint ventures and associates, for which a deferred tax liability has not been recognised, aggregate to £1,230m (2022: £1,062m). No deferred tax liability has been recognised on the potential withholding tax due on the remittance of undistributed profits as the Group is able to control the timing of such remittances and it is probable that consent will not be given in the foreseeable future.

6 Earnings per ordinary share

Basic earnings per ordinary share (EPS) is calculated by dividing the profit/(loss) attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares held under trust, which have been treated as if they had been cancelled.

Where there is a continuing loss during the year, the effect of potentially dilutive ordinary shares is anti-dilutive.

	2023			2022		
	Basic	Potentially dilutive share options	Diluted	Basic	Potentially dilutive share options	Diluted
Profit/(loss) attributable to ordinary shareholders (£m):						
Continuing operations	2,412		2,412	(1,189)		(1,189)
Discontinued operations	–		–	(80)		(80)
	2,412		2,412	(1,269)		(1,269)
Weighted average number of ordinary shares (millions)	8,361	44	8,405	8,349	–	8,349
EPS (pence):						
Continuing operations	28.85	(0.15)	28.70	(14.24)	–	(14.24)
Discontinued operations	–	–	–	(0.96)	–	(0.96)
	28.85	(0.15)	28.70	(15.20)	–	(15.20)

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

	2023		2022	
	Pence	£m	Pence	£m
Underlying EPS/Underlying profit from continuing operations attributable to ordinary shareholders	13.75	1,150	1.95	163
Total underlying adjustments to profit/(loss) before taxation (note 2)	13.94	1,165	(20.45)	(1,708)
Related tax effects	1.16	97	4.26	356
EPS/Profit/(loss) from continuing operations attributable to ordinary shareholders	28.85	2,412	(14.24)	(1,189)
Diluted underlying EPS from continuing operations attributable to ordinary shareholders	13.68		1.95	

7 Auditors' remuneration

	2023 £m	2022 £m
Fees payable to the Company's auditor for the audit of the Company's annual Financial Statements	3.6	3.5
Fees payable to the Company's auditor and its associates for the audit of the Company's subsidiaries pursuant to legislation	8.6	8.5
Total fees payable for audit services	12.2	12.0
Fees payable to the Company's auditor and its associates for other services:		
Audit related assurance services [1]	0.7	1.3
Other assurance services [2]	0.2	0.2
Total fees payable to the Company's auditor and its associates [3]	13.1	13.5
Fees payable in respect of the Group's pension schemes:		
Audit	0.1	0.1

1 This includes £0.7m (2022: £0.7m) for the review of the half-year report and £nil (2022: £0.6m) in respect of assurance procedures over certain grant claims
2 This includes £0.1m (2022: £0.1m) in respect of agreed upon procedures in respect of levies payable and £0.1m for sustainability assurance work (2022: £0.1m)
3 Audit fees for overseas entities are reported at the average exchange rate for the year

8 Employee information

	2023 Number	2022 Number
United Kingdom	20,900	19,900
Germany	10,000	9,700
United States	5,300	5,000
Italy	900	900
Singapore	700	700
Canada	700	700
India	600	500
Spain	100	1,800
Rest of world	2,200	2,600
Monthly average number of employees	**41,400**	41,800
Civil Aerospace	18,300	17,700
Defence	12,000	11,000
Power Systems	9,800	9,400
New Markets	1,200	800
Corporate [1]	100	100
Monthly average number of employees excluding discontinued operations	**41,400**	39,000
ITP Aero (classified as discontinued operation)	–	2,800
Monthly average number of employees	**41,400**	41,800

	2023	2022		
	Total £m	Continuing operations £m	Discontinued operations £m	Total £m
Wages, salaries and benefits	2,940	2,629	117	2,746
Social security costs	416	378	27	405
Share-based payments (note 24)	66	47	–	47
Pensions and other post-retirement scheme benefits (note 22)	346	268	2	270
Group employment costs [2]	**3,768**	3,322	146	3,468

1 Corporate consists of employees who do not provide a shared service to the segments. Where corporate functions provide such a service, employees have been allocated to the segments on an appropriate basis
2 Remuneration of key management personnel is shown in note 26

9 Intangible assets

	Goodwill £m	Certification costs £m	Development expenditure £m	Customer relationships £m	Software [1] £m	Other [2] £m	Total £m
Cost:							
At 1 January 2022	1,060	933	3,393	475	978	833	7,672
Additions	–	–	131	–	78	21	230
Disposals	–	–	–	–	(90)	(1)	(91)
Exchange differences	75	2	80	37	12	33	239
At 31 December 2022	1,135	935	3,604	512	978	886	8,050
Additions	–	–	192	–	79	13	284
Acquisition of businesses (see note 27)	8	–	–	2	–	–	10
Transferred to held for sale [3]	(10)	–	–	–	–	(185)	(195)
Transferred to current assets [4]	–	–	–	–	(23)	–	(23)
Disposals	–	(4)	–	–	(27)	(2)	(33)
Reclassifications [5]	–	–	(1)	–	3	(1)	1
Exchange differences	(32)	(1)	(32)	(16)	(6)	(12)	(99)
At 31 December 2023	**1,101**	**930**	**3,763**	**498**	**1,004**	**699**	**7,995**
Accumulated amortisation and impairment:							
At 1 January 2022	34	425	1,760	342	650	420	3,631
Charge for the year [6]	–	21	77	35	86	33	252
Impairment	–	–	17	–	13	5	35
Disposals	–	–	–	–	(82)	(1)	(83)
Exchange differences	2	1	58	29	8	19	117
At 31 December 2022	36	447	1,912	406	675	476	3,952
Charge for the year [6]	–	24	89	41	84	41	279
Impairment	–	–	–	–	–	(7)	(7)
Transferred to held for sale [3]	–	–	–	–	–	(144)	(144)
Transferred to current assets [4]	–	–	–	–	(14)	–	(14)
Disposals	–	(4)	–	–	(23)	(2)	(29)
Reclassifications [5]	–	–	–	–	1	(1)	–
Exchange differences	(1)	–	(25)	(14)	(5)	(6)	(51)
At 31 December 2023	**35**	**467**	**1,976**	**433**	**718**	**357**	**3,986**
Net book value at:							
At 31 December 2023	**1,066**	**463**	**1,787**	**65**	**286**	**342**	**4,009**
At 31 December 2022	1,099	488	1,692	106	303	410	4,098

1 Includes £97m (2022: £93m) of software under course of construction which is not amortised
2 Other intangibles includes trademarks, brands and the costs incurred testing and analysing engines with the longest time in service (fleet leader engines) to gather technical knowledge on engine endurance, which will improve reliability and enable the Group to reduce the costs of meeting LTSA obligations
3 At 31 December 2023, the Group held for sale the assets and liabilities of the off-highway engines business in the lower power range based in Power Systems. See note 27 for further detail
4 During the year, the Group signed a service concession arrangement with a customer effective from 1 January 2024. Accordingly, assets that will be derecognised have been transferred to trade receivables and other assets to reflect the nature of these assets as current assets
5 Includes reclassifications within intangible assets or from property, plant and equipment when available for use
6 Charged to cost of sales and commercial and administrative costs except development costs, which are charged to research and development costs

At 31 December 2023, the Group had expenditure commitments for software of £30m (2022: £37m).

The carrying amount of goodwill or intangible assets allocated across multiple CGUs is not significant in comparison with the Group's total carrying amount of goodwill or intangible assets with indefinite useful lives.

9 Intangible assets continued

Goodwill

In accordance with the requirements of IAS 36, goodwill is allocated to the Group's CGUs, or groups of CGUs, that are expected to benefit from the synergies of the business combination that gave rise to the goodwill as follows:

Cash-generating unit (CGU) or group of CGUs

	Primary operating segment	2023 £m	2022 £m
Rolls-Royce Power Systems AG	Power Systems	**798**	818
Rolls-Royce Deutschland Ltd & Co KG	Civil Aerospace	**237**	241
Other	Various	**31**	40
		1,066	1,099

Goodwill has been tested for impairment during 2023 on the following basis:

- The carrying values of goodwill have been assessed by reference to the recoverable amount, being the higher of value in use or fair value less costs of disposal (FVLCOD).
- The recoverable amount has been estimated using cash flows from the most recent forecasts prepared by the Directors, which are consistent with past experience and external sources of information on market conditions. These forecasts generally cover the next five years. Growth rates for the period not covered by the forecasts are based on growth rates of 2% which reflects the products, industries and countries in which the relevant CGU or group of CGUs operate. Inflation has been included based on contractual commitments where relevant. Where general inflation assumptions have been required, these have been estimated based on externally sourced data. General inflation assumptions of 2% to 4% have been included in the forecasts, depending on the nature and geography of the flows.
- The key forecast assumptions for the impairment tests are the discount rate and the cash flow projections, in particular the programme assumptions (such as sales volumes and product costs), the impact of foreign exchange rates on the relationship between selling prices and costs, and growth rates. Impairment tests are performed using prevailing exchange rates.
- The Group believes there are significant business growth opportunities to come from Rolls-Royce playing a leading role in the transition to net zero, whilst at the same time climate change poses potentially significant risks. The assumptions used by the Directors are based on past experience and external sources of information. Based on the climate scenarios prepared, the forecasts do not assume a significant deterioration of demand for Civil Aerospace (including Rolls-Royce Deutschland) programmes given that all commercial aero-engines were compatible with sustainable fuels by the end of 2023. Similarly, 80% of the engines in Power Systems are compatible with sustainable fuels. The investment required to ensure our new products will be compatible with net zero operation, and to achieve net zero scope 1 + 2 GHG emissions is reflected in the forecasts used.

A 1.5°C scenario has been prepared using key data points from external sources, including Oxford Economics, Global Climate Service and Databank and the International Energy Agency. This scenario has been used as the basis of a sensitivity. It is assumed that governments adopt stricter product and behavioural standards and measures that result in higher carbon pricing. Under these conditions, it is assumed that markets are willing to pay for low carbon solutions and that there is an economic return from strategic investments in low carbon alternatives. The sensitivity has considered the likelihood of demand changes for our products based on their relative fuel efficiency in the marketplace and the probability of alternatives being introduced earlier than currently expected. The sensitivity also reflects the impact of a broad range of potential costs imposed by policy or regulatory interventions (through carbon pricing). This sensitivity does not indicate the need for an impairment charge.

The principal assumptions for goodwill balances considered to be individually significant are:

Rolls-Royce Power Systems AG

- Recoverable amount represents FVLCOD to reflect the future strategy of the business. The Directors consider that disclosing information prepared on a FVLCOD basis here is a more useful representation of the recoverable amount when considering the future strategy of the business, including the impact of climate-related risks and opportunities. Due to the unavailability of observable market inputs or inputs based on market evidence, the fair value is estimated by discounting future cash flows (Level 3 as defined by IFRS 13 *Fair Value Measurement*) modified for market participants views;
- Trading assumptions (e.g. volume of equipment deliveries, pricing achieved and cost escalation) that are based on current and known future programmes, estimates of market share and long-term economic forecasts;
- Plausible downside scenario in relation to macro-economic factors included with a 25% weighting;
- Cash flows beyond the five-year forecasts are assumed to grow at 2.0% (2022: 1.0%); and
- Nominal post-tax discount rate 9.2% (2022: 10.0%).

The Directors do not consider that any reasonably possible changes in the key assumptions (including taking consideration of the climate-related risks above) would cause the FVLCOD of the business to fall below its carrying value of goodwill.

9 Intangible assets continued

Rolls-Royce Deutschland Ltd & Co KG

— Recoverable amount represents the value in use of the assets in their current condition;

— Trading assumptions (e.g. volume of engine deliveries, flying hours of installed fleet, including assumptions on the recovery of the aerospace industry, and cost escalation) that are based on current and known future programmes, estimates of market share and long-term economic forecasts;

— Plausible downside scenario in relation to macro-economic factors included with a 25% weighting;

— Cash flows beyond the five-year forecasts are assumed to grow at 2.0% (2022: 2.0%); and

— Nominal pre-tax discount rate 14.4% (2022: 13.2%).

The Directors do not consider that any reasonably possible changes in the key assumptions (including taking consideration of the climate-related risks above) would cause the value in use of the goodwill to fall below its carrying value.

Other CGUs

Goodwill balances across the Group that are not considered to be individually significant were also tested for impairment, resulting in no impairment charge (2022: £nil) being recognised at 31 December 2023.

Material intangible assets (excluding goodwill)

The carrying amount and the residual life of the material intangible assets (excluding goodwill) for the Group is as follows:

	Residual life [1]	Net book value	
		2023 £m	2022 £m
Trent programme intangible assets [2]	2-15 years	1,920	1,826
Business aviation programme intangible assets [3]	11-15 years	238	250
Intangible assets related to Power Systems [4]		370	466
		2,528	2,542

1 Residual life reflects the remaining amortisation period of those assets where amortisation has commenced. As per page 133, the amortisation period of 15 years will commence on those assets which are not being amortised as the units are delivered
2 Included within the Trent programmes are the Trent 1000, Trent 7000 and Trent XWB
3 Included within business aviation are the Pearl 700 and Pearl 15
4 Includes £112m (2022: £114m) in respect of a brand intangible asset which is not amortised. Remaining assets are amortised over a range of three to 15 years

Intangible assets (including programme intangible assets) have been reviewed for impairment in accordance with IAS 36. Assessments have considered potential triggers of impairment such as external factors including climate change, significant changes with an adverse effect on a programme and by analysing latest management forecasts against those prepared in 2022 to identify any deterioration in performance. Where a trigger event has been identified, an impairment test has been carried out. Where an impairment was required, the test was 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 the Directors, which are consistent with past experience and external sources of information on market conditions over the lives of the respective programmes; and

— The key assumptions underpinning cash flow projections are based on estimates of product performance related estimates, future market share and pricing and cost for uncontracted business. Climate-related risks are considered when making these estimates consistent with the assumptions above.

There have been no (2022: none) individually material impairment charges or reversals recognised during the year.

10 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 2022	1,865	4,986	1,046	300	8,197
Additions	34	127	26	162	349
Disposals/write-offs	(38)	(142)	(81)	(1)	(262)
Reclassifications [1]	3	82	(3)	(82)	–
Exchange differences	72	172	11	21	276
At 31 December 2022	1,936	5,225	999	400	8,560
Additions	19	147	34	223	423
Transferred to current assets [2]	(90)	(93)	–	(43)	(226)
Disposals/write-offs	(19)	(309)	(33)	(9)	(370)
Reclassifications [1]	69	78	13	(146)	14
Exchange differences	(32)	(86)	(7)	(13)	(138)
At 31 December 2023	**1,883**	**4,962**	**1,006**	**412**	**8,263**
Accumulated depreciation and impairment:					
At 1 January 2022	614	3,244	414	8	4,280
Charge for the year [3]	79	296	55	–	430
Impairment	5	(5)	–	–	–
Disposals/write-offs	(24)	(142)	(57)	–	(223)
Reclassifications [1]	(2)	5	(3)	–	–
Exchange differences	23	109	4	1	137
At 31 December 2022	695	3,507	413	9	4,624
Charge for the year [3]	70	296	40	–	406
Impairment [4]	4	6	1	6	17
Transferred to current assets [2]	(48)	(61)	–	–	(109)
Disposals/write-offs	(18)	(299)	(25)	–	(342)
Reclassifications [1]	17	(9)	8	(7)	9
Exchange differences	(11)	(56)	(3)	–	(70)
At 31 December 2023	**709**	**3,384**	**434**	**8**	**4,535**
Net book value at:					
At 31 December 2023	**1,174**	**1,578**	**572**	**404**	**3,728**
At 31 December 2022	1,241	1,718	586	391	3,936

1 Includes reclassifications of assets under construction to the relevant classification in property, plant and equipment, right-of-use assets or intangible assets when available for use
2 During the year, the Group signed a service concession arrangement with a customer effective from 1 January 2024. Accordingly, assets that will be derecognised have been transferred to trade receivables and other assets to reflect the nature of these assets as current assets
3 Depreciation is charged to cost of sales and commercial and administrative costs or included in the cost of inventory as appropriate
4 The carrying values of property, plant and equipment have been assessed during the year in line with IAS 36. Material items of plant and equipment and aircraft and engines are assessed for impairment together with other assets used in individual programmes – see potential triggers considered in note 9. Land and buildings are generally used across multiple programmes and are considered based on future expectations of the use of the site, which includes any implications from climate-related risks. As a result of this assessment, there are no (2022: none) individually material impairment charges or reversals in the year

Property, plant and equipment includes:

	2023			2022		
	Land and buildings £m	**Plant and equipment £m**	**Aircraft and engines £m**	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m
Assets held for use in leases where the Group is the lessor:						
Cost	6	38	760	6	41	732
Depreciation	(4)	(21)	(348)	(4)	(22)	(317)
Net book value	2	17	412	2	19	415

	2023 £m	2022 £m
Capital expenditure commitments	222	221
Cost of fully depreciated assets	2,084	2,184

The Group's share of equity accounted entities' capital commitments is £16m (2022: £34m).

11 Right-of-use assets

	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m	Total £m
Cost:				
At 1 January 2022	456	143	1,785	2,384
Additions/modification of leases	52	34	59	145
Disposals	(30)	(19)	(22)	(71)
Exchange differences	28	4	5	37
At 31 December 2022	506	162	1,827	2,495
Additions/modification of leases	38	56	104	198
Acquisition of business (see note 27)	2	–	–	2
Disposals	(6)	(22)	(54)	(82)
Transferred to current assets [1]	(4)	–	–	(4)
Reclassifications to PPE	(5)	–	(10)	(15)
Exchange differences	(18)	(2)	(3)	(23)
At 31 December 2023	513	194	1,864	2,571
Accumulated depreciation and impairment:				
At 1 January 2022	186	66	929	1,181
Charge for the year [2]	43	37	190	270
Impairment [3]	(2)	(1)	20	17
Disposals	(13)	(19)	(22)	(54)
Exchange differences	16	1	3	20
At 31 December 2022	230	84	1,120	1,434
Charge for the year [2]	42	42	179	263
Impairment [3]	3	6	62	71
Disposals	(6)	(22)	(54)	(82)
Transferred to current assets [1]	–	–	–	–
Reclassifications from PPE	(1)	–	(8)	(9)
Exchange differences	(9)	(1)	(1)	(11)
At 31 December 2023	259	109	1,298	1,666
Net book value:				
At 31 December 2023	254	85	566	905
At 31 December 2022	276	78	707	1,061
Right-of-use assets held for use in operating leases where the Group is the lessor:				
Cost	6	–	1,864	1,870
Depreciation	(3)	–	(1,298)	(1,301)
Net book value at 31 December 2023	3	–	566	569
Cost	6	–	1,827	1,833
Depreciation	(3)	–	(1,120)	(1,123)
Net book value at 31 December 2022	3	–	707	710

1 During the year, the Group signed a service concession arrangement with a customer effective from 1 January 2024. Accordingly, assets that will be derecognised have been transferred to trade receivables and other assets to reflect the nature of these assets as current assets
2 Depreciation is charged to cost of sales and commercial and administrative costs as appropriate
3 The carrying values of right-of-use assets have been assessed during the year in line with IAS 36. Material items of plant and equipment and aircraft and engines are assessed for impairment together with other assets used in individual programmes – see potential triggers considered in note 9. Land and buildings are generally used across multiple programmes and are considered based on future expectations of the use of the site (which includes any implications from climate-related risks). As a result of this assessment, the carrying values of assets, where a trigger was identified, have been assessed by reference to value in use considering assumptions such as estimated future cash flows, product performance related estimates and climate-related risks. An impairment charge of £71m has been recognised, which includes £27m in relation to lease engines that have been returned following the termination of the lease by the lessee. In addition, during the year, a number of existing leases were extended as a result of renegotiations. An assessment was performed in reference to value in use to support the increase in asset value over the extended lease term, and as a result, an impairment of £26m has been recognised in Civil Aerospace (2022: no individually material impairment charges or reversals)

12 Investments

Composition of the Group

The entities contributing to the Group's financial results are listed on pages 190 to 195.

Where the Group does not own 100% of the shares of a group undertaking, there are a number of arrangements with the other shareholder(s) that give the Group the option or potential obligation to acquire the third parties' shares. These arrangements have been assessed and are not considered to have a significant value, individually or in aggregate.

The Group does not have any non-wholly owned subsidiaries that have a material non-controlling interest.

Equity accounted and other investments

	Equity accounted			Other[1]
	Joint ventures £m	Associates £m	Total £m	£m
At 1 January 2022	403	1	404	36
Additions	29	–	29	7
Disposals	–	(1)	(1)	(2)
Impairment	(74)	–	(74)	(1)
Share of retained loss [2]	(25)	–	(25)	–
Reclassification of deferred profit to deferred income [3]	(4)	–	(4)	–
Repayment of loans	(5)	–	(5)	–
Revaluation of other investments accounted for as FVOCI	–	–	–	(4)
Exchange differences	96	–	96	–
Share of OCI	2	–	2	–
At 1 January 2023	**422**	**–**	**422**	**36**
Additions [4]	**9**	**–**	**9**	**–**
Disposals	**(5)**	**–**	**(5)**	**(1)**
Share of retained profit [2]	**119**	**–**	**119**	**–**
Reclassification of deferred profit to deferred income [3]	**(18)**	**–**	**(18)**	**–**
Revaluation of other investments accounted for as FVOCI	**–**	**–**	**–**	**(4)**
Exchange differences	**(50)**	**–**	**(50)**	**–**
Share of OCI	**2**	**–**	**2**	**–**
At 31 December 2023	**479**	**–**	**479**	**31**

1 Other investments includes unlisted investments of £24m (2022: £26m) and listed investments of £7m (2022: £10m)
2 See table below
3 The Group's share of unrealised profit on sales to joint ventures is eliminated against the carrying value of the investment in the entity. Any excess amount, once the carrying value is reduced to £nil, is recorded as deferred income
4 During the year, additions to investments of £9m includes the second instalment of investment related to the joint venture, Beijing Aero Engine Services Company Limited of £6m

Reconciliation of share of retained profit/(loss) to the income statement and cash flow statement:

	2023 £m	2022 £m
Share of results of joint ventures and associates	**139**	9
Adjustments for intercompany trading [1]	**34**	39
Share of results of joint ventures and associates to the Group	**173**	48
Dividends paid by joint ventures and associates to the Group (cash flow statement)	**(54)**	(73)
Share of retained profit/(loss) above	**119**	(25)

1 During the year, the Group sold spare engines to Rolls-Royce & Partners Finance, a joint venture and subsidiary of Alpha Partners Leasing Limited. The Group's share of the profit on these sales is deferred and released to match the depreciation of the engines in the joint venture's financial statements. In 2023 and 2022, profit deferred on the sale of engines was lower than the release of that deferred in prior years

12 Investments continued

The following joint ventures are considered to be individually material to the Group:

	Principal location	Activity	Ownership interest
Alpha Partners Leasing Limited (APL)	UK	Aero-engine leasing	50.0%
Hong Kong Aero Engine Services Limited (HAESL)	Hong Kong	Aero-engine repair and overhaul	50.0%
Singapore Aero Engine Services Pte Limited (SAESL)	Singapore	Aero-engine repair and overhaul	50.0%

Summarised financial information of the Group's individually material joint ventures is as follows:

	APL		HAESL		SAESL	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Revenue	371	310	3,214	2,388	2,224	2,012
Profit and total comprehensive income for the year	106	55	73	72	29	31
Dividends paid during the year	(5)	(22)	(67)	(66)	–	–
Profit for the year included the following:						
Depreciation and amortisation	(166)	(190)	(11)	(13)	(20)	(21)
Interest income	15	–	–	–	7	1
Interest expense	(122)	(89)	(4)	(2)	(2)	(3)
Income tax expense	(37)	(13)	(14)	(14)	(2)	(2)
Current assets	336	375	1,103	886	954	865
Non-current assets	3,048	3,199	93	98	130	154
Current liabilities	(261)	(480)	(886)	(716)	(790)	(687)
Non-current liabilities	(2,358)	(2,389)	(73)	(26)	(8)	(60)
Net assets	765	705	237	242	286	272
Included in the above:						
Cash and cash equivalents	223	239	12	6	99	61
Current financial liabilities [1]	(165)	(411)	–	(135)	–	–
Non-current financial liabilities [1]	(1,914)	(2,003)	(66)	(17)	(8)	(60)
Reconciliation to the carrying amount recognised in the Consolidated Financial Statements						
Ownership interest	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%
Group share of net assets above	383	353	119	121	143	136
Goodwill	–	–	36	38	11	11
Adjustments for intercompany trading	(383)	(353)	–	(2)	(4)	–
Included in the balance sheet	–	–	155	157	150	147

1 Excluding trade payables and other liabilities

The summarised aggregated results of the Group's share of equity accounted investments is as follows:

	Individually material joint ventures (above)		Other joint ventures		Associates		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Profit/(loss) and total comprehensive income for the year	104	79	37	(68)	–	–	141	11
Assets:								
Non-current assets	1,637	1,726	159	199	–	–	1,796	1,925
Current assets	1,197	1,063	359	327	–	–	1,556	1,390
Liabilities: [1]								
Current liabilities	(969)	(942)	(264)	(245)	–	–	(1,233)	(1,187)
Non-current liabilities	(1,220)	(1,237)	(43)	(58)	–	–	(1,263)	(1,295)
Group adjustment for goodwill	47	49	–	–	–	–	47	49
Adjustment for intercompany trading	(387)	(355)	(37)	(105)	–	–	(424)	(460)
Included in the balance sheet	305	304	174	118	–	–	479	422
1 Liabilities include borrowings of:	*(1,076)*	*(1,313)*	*(60)*	*(84)*	–	–	*(1,136)*	*(1,397)*

13 Inventories

	2023 £m	2022 £m
Raw materials	516	479
Work in progress	1,679	1,633
Finished goods	2,653	2,593
Payments on account	–	3
	4,848	4,708

Inventories stated at net realisable value	187	209
Amount of inventory write-down	79	85
Reversal of inventory write-down	21	27

14 Trade receivables and other assets

	Current		Non-current [1]		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Trade receivables	2,724	2,376	40	43	2,764	2,419
Prepayments [2]	1,032	737	102	37	1,134	774
RRSA prepayment for LTSA parts [2]	236	149	1,084	856	1,320	1,005
Receivables due on RRSAs	1,159	928	193	255	1,352	1,183
Amounts owed by joint ventures and associates	731	632	10	16	741	648
Other taxation and social security receivable	160	147	13	9	173	156
Costs to obtain contracts with customers [3]	7	12	109	67	116	79
Other receivables and similar assets [4]	478	617	45	55	523	672
	6,527	5,598	1,596	1,338	8,123	6,936

Trade receivables and other assets are analysed as follows:		
Financial instruments (note 20):		
Trade receivables and similar items	4,857	4,147
Other non-derivative financial assets	332	775
Non-financial instruments	2,934	2,014
	8,123	6,936

1 Trade receivables and other assets have been presented on the face of the balance sheet, in line with the operating cycle of the business. Further disclosure is included in the table above and relate to amounts not expected to be received in the next 12 months, in line with specific customer payment arrangements, including customers on payment plans
2 At 31 December 2023, prepayments to RRSA partners for LTSA parts have been shown separately to provide additional detail for the reader. These amounts reflect the contractual share of EFH flows from customers paid to RRSA partners in return for the supply of parts in future periods under long-term supply contracts. In the prior year, these amounts were included within prepayments. There is no change to the total amount of trade receivables and other assets
3 These are amortised over the term of the related contract in line with engine deliveries, resulting in amortisation of £9m (2022: £11m) in the year. There were no impairment losses
4 Other receivables includes unbilled recoveries relating to completed overhaul activity where the right to consideration is unconditional

The Group has adopted the simplified approach to provide for ECLs, measuring the loss allowance at a probability weighted amount incorporated by using credit ratings which are publicly available, or through internal risk assessments derived using the customer's latest available financial information.

The ECLs for trade receivables and other assets has decreased by £104m to £242m (2022: increased by £87m to £346m). This movement is mainly driven by the Civil Aerospace division of £(100)m, of which £(82)m relates to specific customers and £(18)m relates to updates to the recoverability of other receivables.

The assumptions and inputs used for the estimation of the ECLs are disclosed in the table below:

	2023			2022		
	Trade receivables and other financial assets £m	Loss allowance £m	Average ECL rate %	Trade receivables and other financial assets £m	Loss allowance £m	Average ECL rate %
Credit rating C and above	1,744	(102)	6%	1,637	(177)	11%
Credit rating below C	80	(6)	8%	124	(16)	13%
Without credit rating	3,607	(134)	4%	3,507	(153)	4%
	5,431	(242)	4%	5,268	(346)	7%

14 Trade receivables and other assets continued

The movements of the Group ECLs provision are as follows:

	2023 £m	2022 £m
At 1 January	(346)	(259)
Increases in loss allowance recognised in the income statement during the year	(80)	(118)
Loss allowance utilised	34	22
Releases of loss allowance previously provided	128	45
Exchange differences	22	(36)
At 31 December	(242)	(346)

15 Contract assets and liabilities

	Current		Non-current [1]		Total [2]	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Contract assets						
Contract assets with customers	534	621	481	617	1,015	1,238
Participation fee contract assets	26	28	201	215	227	243
	560	649	682	832	1,242	1,481

1 Contract assets and contract liabilities have been presented on the face of the balance sheet, in line with the operating cycle of the business. Contract liabilities are further split according to when the related performance obligation is expected to be satisfied and, therefore, when revenue is estimated to be recognised in the income statement. Further disclosure of contract assets is provided in the table above, which shows within current the element of consideration that will become unconditional in the next year
2 Contract assets are classified as non-financial instruments

The balance includes £494m (2022: £885m) of Civil Aerospace LTSA assets and £410m (2022: £263m) Defence LTSA assets.

The decrease in the Civil Aerospace balance is due to higher invoicing than revenue recognised in relation to the completion of performance obligations on those contracts with a contract asset balance. Revenue recognised relating to performance obligations satisfied in previous years was £64m (2022: £26m) in Civil Aerospace.

The increase in the Defence balance is due to revenue recognition in relation to performance obligations completed being higher than the payments received from the customer.

No impairment losses in relation to these contract assets (2022: none) have arisen during the year.

Participation fee contract assets have reduced by £16m (2022: £3m) due to amortisation of £15m and foreign exchange on consolidation of £1m.

The absolute value of ECLs for contract assets has decreased by £15m to £6m (2022: £21m).

	Current		Non-current		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Contract liabilities	6,098	4,825	8,438	7,337	14,536	12,162

Contract liabilities are analysed as follows [1]:		
Financial instruments (note 20)	1,358	1,006
Non-financial instruments	13,178	11,156
	14,536	12,162

1 Amounts within contract liabilities as at 31 December 2022 have been represented to better reflect the nature of the balance between financial and non-financial instruments. This resulted in an increase in financial instruments of £586m and a corresponding decrease in non-financial instruments. There is no impact to total contract liabilities

During the year, £3,813m (2022: £3,321m) of the opening contract liability was recognised as revenue.

Contract liabilities have increased by £2,374m. The movement in the Group balance is primarily as a result of increases in Civil Aerospace of £1,865m and Defence of £381m. The Civil Aerospace increase is primarily a result of growth in LTSA liabilities of £1,317m to £9,574m (2022: £8,257m) driven by price escalation, the continued rise in EFHs and the associated customer receipts, as well as commercial discipline driving more timely invoicing and recovery of contractual fees. In 2023 contract liabilities increased by £168m as a result of revenue recognised in relation to performance obligations satisfied in previous years (2022: £334m decrease). The increase in Defence is from the receipt of deposits in advance of performance obligations being completed.

16 Cash and cash equivalents

	2023 £m	2022 £m
Cash at bank and in hand	739	847
Money-market funds	1,077	34
Short-term deposits	1,968	1,726
Cash and cash equivalents per the balance sheet	3,784	2,607
Overdrafts (note 17)	(53)	(2)
Cash and cash equivalents per cash flow statement (page 118)	3,731	2,605

Cash and cash equivalents at 31 December 2023 includes £279m (2022: £235m) that is not available for general use by the Group. This balance includes £40m (2022: £40m), which is held in an account that is exclusively for the general use of Rolls-Royce Submarines Limited and £195m (2022: £138m), which is held exclusively for the use of Rolls-Royce Saudi Arabia Limited. This cash is not available for use by other entities within the Group. The remaining balance relates to cash held in non-wholly owned subsidiaries and joint arrangements.

Balances are presented on a net basis, when the Group has both a legal right of offset and the intention to either settle on a net basis or realise the asset and settle the liability simultaneously.

17 Borrowings and lease liabilities

	Current		Non-current		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Unsecured						
Overdrafts	53	2	–	–	53	2
Bank loans	3	1	–	–	3	1
0.875% Notes 2024 €550m [1]	475	–	–	472	475	472
3.625% Notes 2025 $1,000m [1]	–	–	770	801	770	801
3.375% Notes 2026 £375m [2]	–	–	361	351	361	351
4.625% Notes 2026 €750m [3]	–	–	649	661	649	661
5.75% Notes 2027 $1,000m [3]	–	–	782	825	782	825
5.75% Notes 2027 £545m	–	–	542	541	542	541
1.625% Notes 2028 €550m [1]	–	–	455	444	455	444
Other loans	–	–	9	10	9	10
Total unsecured	531	3	3,568	4,105	4,099	4,108
Lease liability – Land and buildings	42	46	382	400	424	446
Lease liability – Aircraft and engines	203	278	949	1,047	1,152	1,325
Lease liability – Plant and equipment	33	31	51	45	84	76
Total lease liabilities	278	355	1,382	1,492	1,660	1,847
Total borrowings and lease liabilities	809	358	4,950	5,597	5,759	5,955

All outstanding items described as loan notes above are listed on the London Stock Exchange

1 These notes are the subject of cross-currency interest rate swap agreements under which the Group has undertaken to pay floating rates of GBP interest, which form a fair value hedge. They are also subject to interest rate swap agreements under which the Group has undertaken to pay fixed rates of interest, which are classified as fair value through profit and loss
2 These notes are the subject of interest rate swap agreements under which the Group has undertaken to pay floating rates of interest, which form a fair value hedge. They are also subject to interest rate swap agreements under which the Group has undertaken to pay fixed rates of interest, which are classified as fair value through profit and loss
3 These notes are the subject of cross-currency interest rate swap agreements under which the Group has undertaken to pay fixed rates of GBP interest, which form a cash flow hedge

17 Borrowings and lease liabilities continued

The Group has access to the following undrawn committed borrowing facilities at the end of the year:

	Total	
	2023 £m	2022 £m
Expiring within one year	–	–
Expiring after one year	3,500	5,500
Total undrawn facilities	**3,500**	5,500

Further details can be found in the going concern and liquidity statements on page 58.

During the year to 31 December 2023, the Group cancelled its undrawn £1bn bank loan facility which was due to mature in January 2024 and its undrawn UK Export Finance (UKEF) £1bn facility which was due to mature in March 2026. These facilities had remained undrawn during the year. In addition, the Group replaced the £2,500m committed bank borrowing facility with a new £2,500m facility with a maturity date of November 2026 with the banks having the option to extend with two one-year extension options (3+1+1).

Under the terms of the £1bn UKEF loan facility, the Company is restricted from declaring, making or paying distributions to shareholders unless certain conditions are satisfied. The conditions are linked to free cash flow performance in the prior year, and actual and forecast minimum liquidity levels. At 31 December 2023, these conditions were met but the Group is not making shareholder distributions. Once the Group is comfortably within an investment grade profile and the strength of the balance sheet is assured, the Group is committed to reinstating and growing shareholder distributions. This loan facility expires in 2027. The restrictions on distributions do not prevent the Company from redeeming any unredeemed C Shares issued prior to March 2021.

18 Leases

Leases as lessee

The net book value of right-of-use assets at 31 December 2023 was £905m (2022: £1,061m), with a lease liability of £1,660m (2022: £1,847m), per notes 11 and 17, respectively. Leases that have not yet commenced to which the Group is committed have a future liability of £5m and consist of mainly plant and equipment and properties. The consolidated income statement shows the following amounts relating to leases:

	2023 £m	2022 £m
Land and buildings depreciation and impairment [1]	(45)	(41)
Plant and equipment depreciation and impairment [2]	(48)	(36)
Aircraft and engines depreciation and impairment [3]	(241)	(210)
Total depreciation and impairment charge for right-of-use assets	(334)	(287)
Adjustment of amounts payable under residual value guarantees within lease liabilities [3, 4]	10	3
Expense relating to short-term leases of 12 months or less recognised as an expense on a straight line basis [2]	(49)	(28)
Expense relating to variable lease payments not included in lease liabilities [3, 5]	(5)	(2)
Total operating costs	(378)	(314)
Interest expense [6]	(85)	(68)
Total lease expense	(463)	(382)
Income from sub-leasing right-of-use assets	31	32
Total amount recognised in the income statement	(432)	(350)

1 Included in cost of sales and commercial and administration costs depending on the nature and the use of the right-of-use asset
2 Included in cost of sales, commercial and administration costs, or research and development depending on the nature and use of the right-of-use asset
3 Included in cost of sales
4 Where the cost of meeting residual value guarantees is less than that previously estimated, as costs have been mitigated or liabilities waived by the lessor, the lease liability has been remeasured. Where the value of this remeasurement exceeds the value of the right-of-use asset, the reduction in the lease liability is credited to cost of sales
5 Variable lease payments primarily arise on a small number of contracts where engine lease payments are dependent upon utilisation rather than a periodic charge
6 Included in financing costs

The total cash outflow for leases in 2023 was £429m (2022: £316m). Of this, £375m related to leases reflected in the lease liability, £49m to short-term leases where lease payments are expensed on a straight-line basis and £5m for variable lease payments where obligations are only due when the assets are used. The timing difference between income statement charge and cash flow relates to costs incurred at the end of leases for residual value guarantees and restoration costs that are recognised within depreciation over the term of the lease, the most significant amounts relate to engine leases.

Engine leases in the Civil Aerospace division often include clauses that require the engines to be returned to the lessor with specific levels of usable life remaining or cash payments to the lessor. The costs of meeting these requirements are included in the lease payments. The amounts payable are calculated based upon an estimate of the utilisation of the engines over the lease term, whether the engine is restored to the required condition by performing an overhaul at our own cost or through the payments of amounts specified in the contract and any new contractual arrangements arising when the current lease contracts end. Amounts due can vary depending on the level of utilisation of the engines, overhaul activity prior to the end of the contract, and decisions taken on whether ongoing access to the assets is required at the end of the lease term. During the year, adjustments to return conditions at the end of leases resulted in a credit of £10m to the income statement. The lease liability at 31 December 2023 included £354m relating to the cost of meeting these residual value guarantees in the Civil Aerospace division. Up to £76m is payable in the next 12 months, £185m is due over the following four years and the remaining balance after five years.

18 Leases continued

Leases as lessor

The Group acts as lessor for engines to Civil Aerospace customers when they require engines to support their fleets. Lease agreements with the lessees provide protection over the assets. Usage in excess of specified limits and damage to the engine while on lease are covered by variable lease payment structures. Lessee bankruptcy risk is managed through the Cape Town Convention on International Interests in Mobile Equipment (including a specific protocol relating to aircraft equipment); an international treaty that creates common standards for the registration of lease contracts and establishes various legal remedies for default in financing agreements, including repossession and the effect of particular states' bankruptcy laws. Engines are only leased once the Group confirm that appropriate insurance documentation is established that covers the engine assets to pre-agreed amounts. All such contracts are operating leases. The Group also leases out a small number of properties, or parts of properties, where there is excess capacity under operating leases.

	2023 £m	2022 £m
Operating lease income [1, 2]	**104**	84

1 Includes variable lease payments received of £87m (2022: £73m) that do not depend on an index or a rate
2 Items of property, plant and equipment subject to an operating lease are disclosed in note 10

Total non-cancellable future operating lease rentals (undiscounted) of £91m (2022: £95m) are receivable over the next 12 years. £12m (2022: £12m) is due within one year, £43m (2022: £45m) between one to five years and £36m (2022: £38m) after five years.

In a limited number of circumstances, the Group sublets properties that are treated as a finance lease when the arrangement transfers substantially all the risks and rewards of ownership of the asset. At 31 December 2023, the total undiscounted lease payments receivable is £35m (2022: £39m) on annual lease income of £4m (2022: £4m). The discounted finance lease receivable at 31 December 2023 is £28m (2022: £32m). There was no (2022: £nil) finance income recognised during the year.

19 Trade payables and other liabilities

	Current		Non-current		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Trade payables	**1,608**	1,735	**–**	–	**1,608**	1,735
Accruals	**1,134**	1,477	**96**	199	**1,230**	1,676
Customer discounts [1]	**1,018**	828	**773**	1,016	**1,791**	1,844
Payables due on RRSAs	**1,713**	1,392	**–**	–	**1,713**	1,392
Deferred receipts from RRSA workshare partners	**56**	32	**774**	829	**830**	861
Amounts owed to joint ventures and associates	**542**	567	**–**	–	**542**	567
Government grants [2]	**30**	21	**54**	41	**84**	62
Other taxation and social security	**92**	88	**–**	–	**92**	88
Other payables [3]	**703**	843	**230**	279	**933**	1,122
	6,896	6,983	**1,927**	2,364	**8,823**	9,347

Trade payables and other liabilities are analysed as follows:		
Financial instruments (note 20): [4]		
Trade payables and similar items	**5,091**	5,376
Other non-derivative financial liabilities	**2,521**	2,748
Non-financial instruments	**1,211**	1,223
	8,823	9,347

1 Customer discounts include customer concession credits. Revenue recognised comprises sales to the Group's customers after such items. Customer concession credits are discounts given to a customer upon the sale of goods or services. A liability is recognised to correspond with the recognition of revenue when the performance obligation is met as set out on page 127. The largest element of the balance, approximately £1.2bn, arises when the Civil Aerospace division delivers its engines to an airframer. A concession is often payable to the end customer (e.g. an airline) on delivery of the aircraft from the airframer. The concession amounts are known and the payment date is reasonably certain, hence there is no significant judgement or uncertainty associated with the timing of these amounts. Warranty credits of £364m and customer concessions of £1,480m have been represented at 31 December 2023 to be included within customer discounts to better reflect the nature of these balances
2 During the year, £74m, (2022: £20m) of government grants were released to the income statement
3 Other payables includes payroll liabilities and HM Government UK levies
4 Amounts within financial instruments classified as trade payables and similar items and other non-derivative financial liabilities as at 31 December 2022 have been represented to better reflect the nature of the balance. This resulted in a decrease in trade payables and similar items of £363m and a corresponding increase in other non-derivative financial instruments. There is no impact to total trade payables and other liabilities

The Group's payment terms with suppliers vary on the products and services being sourced, the competitive global markets the Group operates in and other commercial aspects of suppliers' relationships. Industry average payment terms vary between 90 to 120 days. The Group offers reduced payment terms for smaller suppliers, who are typically on 75-day payment terms, so that they are paid in 30 days. In line with civil aviation industry practice, the Group offers a SCF programme in partnership with banks to enable suppliers, including joint ventures who are on 90-day standard payment terms, to receive their payments sooner. The SCF programme is available to suppliers at their discretion and does not change rights and obligations with suppliers or the timing of payment of suppliers. At 31 December 2023, suppliers had drawn £418m under the SCF scheme (2022: £422m) of which £154m (2022: £180m) is drawn by joint ventures. The Group, in some cases, settles the costs incurred by joint venture as a result of them utilising either the Group offered SCF arrangement, or an alternative SCF arrangement. During the year to 31 December 2023, the Group incurred costs of £28m (2022: £12m) to settle the costs incurred by joint ventures as a result of them utilising the Group offered SCF arrangement. These costs are included within other financing charges.

20 Financial instruments

Carrying values and fair values of financial instruments

	Notes	Basis for determining fair value	Assets FVPL £m	Assets FVOCI £m	Assets Amortised cost £m	Liabilities FVPL £m	Liabilities Other £m	Total £m
2023								
Other non-current asset investments	12	A	24	7	–	–	–	31
Trade receivables and similar items	14	B/C	–	9	4,848	–	–	4,857
Other non-derivative financial assets	14	B	–	–	332	–	–	332
Other assets		D/F	32	–	12	–	–	44
Derivative financial assets [1]		C	350	–	–	–	–	350
Cash and cash equivalents	16	B	1,077	–	2,707	–	–	3,784
Borrowings	17	E/F	–	–	–	–	(4,099)	(4,099)
Lease liabilities	17	G	–	–	–	–	(1,660)	(1,660)
Derivative financial liabilities [1]		C	–	–	–	(2,228)	–	(2,228)
Financial RRSAs		H	–	–	–	–	(17)	(17)
Other liabilities		H	–	–	–	–	(163)	(163)
C Shares		B	–	–	–	–	(23)	(23)
Trade payables and similar items	19	B	–	–	–	–	(5,091)	(5,091)
Other non-derivative financial liabilities	19	B	–	–	–	–	(2,521)	(2,521)
Contract liabilities	15	B	–	–	–	–	(1,358)	(1,358)
			1,483	16	7,899	(2,228)	(14,932)	(7,762)
2022								
Other non-current asset investments	12	A	26	10	–	–	–	36
Trade receivables and similar items	14	B/C	–	10	4,137	–	–	4,147
Other non-derivative financial assets	14	B		–	775	–	–	775
Other assets		D	35	–	–	–	–	35
Derivative financial assets [1]		C	648	–	–	–	–	648
Short-term investments		B	–	–	11	–	–	11
Cash and cash equivalents	16	B	34	–	2,573	–	–	2,607
Borrowings	17	E/F	–	–	–	–	(4,108)	(4,108)
Lease liabilities	17	G	–	–	–	–	(1,847)	(1,847)
Derivative financial liabilities [1]		C	–	–	–	(4,099)	–	(4,099)
Financial RRSAs		H	–	–	–	–	(22)	(22)
Other liabilities		H	–	–	–	–	(101)	(101)
C Shares		B	–	–	–	–	(24)	(24)
Trade payables and similar items [2]	19	B	–	–	–	–	(5,376)	(5,376)
Other non-derivative financial liabilities [2]	19	B	–	–	–	–	(2,748)	(2,748)
Contract liabilities [3]	15	B	–	–	–	–	(1,006)	(1,006)
			743	20	7,496	(4,099)	(15,232)	(11,072)

1 In the event of counterparty default relating to derivative financial assets and derivative financial liabilities, offsetting would apply and financial assets and liabilities held with the same counterparty would net off. If this occurred with every counterparty, total financial assets would be £3m (2022: £8m) and liabilities £1,881m (2022: £3,459m)
2 As described in note 19, trade payables and similar items at 31 December 2022 has decreased by £363m with a respective increase in other non-derivative financial liabilities
3 As described in note 15, contract liabilities at 31 December 2022 has increased by £586m

20 Financial instruments continued

Fair values equate to book values for both 2023 and 2022, with the following exceptions:

	Basis for determining fair value	2023 Book value £m	2023 Fair value £m	2022 Book value £m	2022 Fair value £m
Other assets	F	12	12	–	–
Borrowings	E	(4,034)	(3,977)	(4,095)	(3,812)
Borrowings	F	(65)	(67)	(13)	(15)
Financial RRSAs	H	(17)	(16)	(22)	(22)

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 arm's-length transaction. There have been no transfers during the year from or to Level 3 valuation. Fair values have been determined with reference to available market information at the balance sheet date, using the methodologies described below.

A These primarily comprise unconsolidated companies where fair value approximates to the book value. Listed investments are valued using Level 1 methodology
B Fair values 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. Money market funds are valued using Level 1 methodology
C Fair values of derivative financial assets and liabilities and trade receivables held to collect or sell are estimated by discounting expected future contractual cash flows using prevailing interest rate curves. For commodity derivatives, forward commodity prices are used to determine expected future cash flows. 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)
D Other assets are included on the balance sheet at fair value, derived from observable market prices or latest forecast (Level 2/Level 3). At 31 December 2023, Level 3 assets totalled £25m (2022: £25m)
E Borrowings are carried at amortised cost. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. The fair value of borrowings is estimated using quoted prices (Level 1)
F Other assets and borrowings are carried at amortised cost. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. The fair value of borrowings is estimated by discounting contractual future cash flows (Level 2)
G The fair value of lease liabilities are estimated by discounting future contractual cash flows using either the interest rate implicit in the lease or the Group's incremental cost of borrowing (Level 2)
H The fair value of RRSAs and other liabilities are estimated by discounting expected future cash flows. The contractual cash flows are based on future trading activity, which is estimated based on latest forecasts (Level 3)

IFRS 13 *Fair Value Measurement* defines a three level valuation hierarchy:
Level 1 – quoted prices for similar instruments
Level 2 – directly observable market inputs other than Level 1 inputs
Level 3 – inputs not based on observable market data

Carrying values of other financial assets and liabilities

	Foreign exchange contracts £m	Commodity contracts £m	Interest rate contracts[1] £m	Total derivatives £m	Financial RRSAs £m	Other £m	C Shares £m	Total £m
2023								
Non-current assets	72	–	254	326	–	34	–	360
Current assets	10	6	8	24	–	10	–	34
Assets	82	6	262	350	–	44	–	394
Current liabilities	(351)	(10)	(13)	(374)	(10)	(41)	(23)	(448)
Non-current liabilities	(1,766)	(15)	(73)	(1,854)	(7)	(122)	–	(1,983)
Liabilities	(2,117)	(25)	(86)	(2,228)	(17)	(163)	(23)	(2,431)
	(2,035)	(19)	176	(1,878)	(17)	(119)	(23)	(2,037)
2022								
Non-current assets	58	25	436	519	–	23	–	542
Current assets	87	40	2	129	–	12	–	141
Assets	145	65	438	648	–	35	–	683
Current liabilities	(966)	(1)	(2)	(969)	(8)	(15)	(24)	(1,016)
Non-current liabilities	(3,030)	(2)	(98)	(3,130)	(14)	(86)	–	(3,230)
Liabilities	(3,996)	(3)	(100)	(4,099)	(22)	(101)	(24)	(4,246)
	(3,851)	62	338	(3,451)	(22)	(66)	(24)	(3,563)

1 Includes the foreign exchange impact of cross-currency interest rate swaps

20 Financial instruments continued

Derivative financial instruments

The Group uses various financial instruments to manage its exposure to movements in foreign exchange rates. The Group uses commodity swaps to manage its exposure to movements in the price of commodities (jet fuel and base metals). To hedge the currency risk associated with a borrowing denominated in a foreign currency, the Group has currency derivatives designated as part of fair value or cash flow hedges. The Group uses interest rate swaps and forward rate agreements to manage its exposure to movements in interest rates.

Movements in the fair values of derivative financial assets and liabilities were as follows:

	Foreign exchange instruments		Commodity instruments		Interest rate instruments – hedge accounted [1]		Interest rate instruments – non-hedge accounted		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
At 1 January	(3,851)	(3,039)	62	32	125	57	213	37	(3,451)	(2,913)
Movements in fair value hedges	–	–	–	–	(71)	(74)	–	–	(71)	(74)
Movements in cash flow hedges	–	(56)	–	–	(78)	142	–	–	(78)	86
Movements in other derivative contracts [2]	574	(1,875)	(60)	106	–	–	1	190	515	(1,579)
Contracts settled	1,242	1,119	(21)	(76)	69	–	(83)	(14)	1,207	1,029
At 31 December	(2,035)	(3,851)	(19)	62	45	125	131	213	(1,878)	(3,451)

1 Includes the foreign exchange impact of cross-currency interest rate swaps
2 Included in net financing

Financial risk and RRSAs and other financial assets and liabilities

The Group has financial liabilities arising from financial RRSAs that are valued at each reporting date using the amortised cost method. This involves calculating the present value of the forecast cash flows of the arrangements using the internal rate of return at the inception of the arrangements as an appropriate discount rate. Other liabilities includes royalties payable to airframers where the present value of the liability is calculated using the Group's average borrowing rate as that reflects the nature of the balance in line with the effective interest method. In each case below, the fair value of the assets and liabilities reflect a level 3 valuation.

Movements in the carrying values were as follows:

	Financial RRSAs		Other – assets		Other – liabilities	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
At 1 January	(22)	(12)	25	15	(101)	(75)
Exchange adjustments included in OCI	1	(2)	–	2	2	(4)
Additions	–	(6)	–	11	(80)	(35)
Financing charge [1]	–	–	–	–	(8)	(4)
Excluded from underlying profit/(loss):						
Changes in forecast payments [1]	(1)	(7)	–	–	–	–
Cash paid	5	5	–	(3)	11	8
Other	–	–	–	–	13	9
At 31 December	(17)	(22)	25	25	(163)	(101)

1 Included in financing

20 Financial instruments continued

Effect of hedging instruments on the financial position and performance

To manage the risk of changes in the fair values of fixed rate borrowings (the hedged items), the Group has entered into fixed-to-floating interest rate swaps (the hedging instruments), which, for accounting purposes, are designated as fair value hedges. The impact of fair value hedges on the financial position and performance of the Group is as follows:

	Hedged item [1]				Hedging instrument [2]						
	Nominal £m	FV adjustment in the period £m	FV adjustment since inception £m	Carrying amount £m	Nominal £m	Carrying amount asset £m	Carrying amount liability £m	FV movement in the period £m	Hedge ineffect-iveness in the period [3] £m	Weighted average FX rate	Weighted average interest rate
At 31 December 2023											
Sterling	**(375)**	**(10)**	**14**	**(361)**	**375**	**–**	**(14)**	**10**	**–**	**1.00**	**SONIA + 0.89**
USD	**(658)**	**31**	**(112)**	**(770)**	**658**	**104**	**–**	**(30)**	**1**	**1.52**	**SONIA + 1.47**
Euro	**(968)**	**(14)**	**37**	**(931)**	**968**	**–**	**(56)**	**16**	**2**	**1.14**	**SONIA + 0.92**
At 31 December 2022											
Sterling	(375)	43	24	(351)	375	–	(24)	(43)	–	1.00	SONIA + 0.89
USD	(658)	(20)	(143)	(801)	658	134	–	18	(2)	1.52	SONIA + 1.47
Euro	(968)	49	52	(916)	968	–	(72)	(51)	(2)	1.14	SONIA + 0.92

1 Hedged items are included in borrowings in the balance sheet
2 Hedging instruments are included in other financial assets or liabilities in the balance sheet
3 Hedge ineffectiveness is included in net financing in the income statement

To manage the foreign exchange rate risk in cash flows on fixed rate non-GBP borrowings (the hedged items), the Group has entered into fixed-to-fixed cross-currency interest rate swaps (the hedging instruments) to hedge the cash flows into GBP, which, for accounting purposes, are designated as cash flow hedges.

The impact of cash flow hedges on the financial position and performance of the Group is as follows:

	Hedged item		Hedging instrument [1]						Hedging reserves		
	Nominal £m	FV movement in the period £m	Nominal £m	Carrying amount asset/ (liability) £m	FV movement in the period £m	Hedge ineffect-iveness in the period [2] £m	Weighted average FX rate	Weighted average interest rate	Amount recognised in OCI £m	Recycled to net financing £m	Closing cash flow hedge reserve £m
At 31 December 2023											
USD	**(772)**	**65**	**772**	**28**	**(62)**	**3**	**1.29**	**5.33**	**61**	**(41)**	**(5)**
Euro	**(677)**	**14**	**677**	**(17)**	**(14)**	**–**	**1.11**	**5.45**	**21**	**(20)**	**(8)**
At 31 December 2022											
USD	(772)	(104)	772	89	109	5	1.29	5.33	(111)	96	(25)
Euro	(677)	(35)	677	(2)	35	–	1.11	5.45	(27)	28	(9)

1 Hedging instruments are included in other financial assets or liabilities in the balance sheet
2 Hedge ineffectiveness is included in net financing in the income statement

20 Financial instruments continued

Risk management policies and hedging activities

The principal financial risks to which the Group is exposed are: foreign currency exchange rate risk; liquidity risk; credit risk; interest rate risk; and commodity price risk. The Board has approved policies for the management of these risks.

Foreign currency exchange rate risk – The Group has significant cash flows (most significantly USD, followed by the euro) denominated in currencies other than the functional currency of the relevant trading entity. To manage its exposures to changes in values of future foreign currency cash flows, so as to maintain relatively stable long-term foreign exchange rates on settled transactions, the Group enters into derivative forward foreign currency transactions. In addition, the Group enters in to fixed-to-floating cross-currency interest rate swaps to manage its exposure to changes in fair value as a result of foreign exchange risk. See below.

The Group economically hedges its GBP/USD exposure by forecasting highly probable net USD receipts up to five years forward. Hedges are taken out within prescribed maximum and minimum hedge positions set out in the Group FX Policy. The maximum and minimum policy bands decline gradually over the five-year horizon and are calculated as a percentage of forecast net income. A similar policy is operated for the Group's EUR/USD exposure. For accounting purposes, these derivative contracts are not designated in hedging relationships.

The Group also has exposures to cash flows on EUR and USD denominated fixed rate borrowings. To manage its exposures to changes in values of future foreign currency cash flows, the Group has entered into fixed-to-fixed cross-currency interest rate swaps, which, for accounting purposes, are designated as cash flow hedges. The swaps have similar critical terms to the hedged items, such as the initial exchange amounts, payment dates and maturities. Therefore, there is an economic relationship and the hedge ratio is established as 1:1. Possible sources of ineffectiveness in the cash flow hedge relationship are changes in the credit risk of either party to the interest rate swap. Another possible source of ineffectiveness would be if the notional of the borrowings is less than the notional of the derivative, for example, in the event of a partial repayment of hedged debt prior to its maturity.

The Group regards its interests in overseas subsidiary companies as long-term investments. The Group aims to match its translational exposures by matching the currencies of assets and liabilities.

Liquidity risk – The Group's policy is to hold financial investments and maintain undrawn committed facilities at a level sufficient to ensure that the Group has available funds to meet its medium-term capital and funding obligations and to meet any unforeseen obligations and opportunities. The Group holds cash and short-term investments, which, together with the undrawn committed facilities, enable the Group to manage its liquidity risk.

Credit risk – The Group is exposed to credit risk to the extent of non-payment by either its customers or the counterparties of its financial instruments. The effective monitoring and controlling of credit risk is a key component of the Group's risk management activities. The Group has credit policies covering both trading and financial exposures. Credit risks arising from treasury activities are managed by a central treasury function, in accordance with the Group credit policy. The objective of the policy is to diversify and minimise the Group's exposure to credit risk from its treasury activities by ensuring the Group transacts strictly with 'BBB' or higher rated financial institutions based on pre-established limits per financial institution. At the balance sheet date, there were no significant concentrations of credit risk to individual customers or counterparties. The Group's revenue is generated from customers located across multiple geographical locations (see note 2). These customers are typically: airframers and airline operators relating to Civil Aerospace; government defence departments for the UK and US; and multiple smaller entities for Power Systems. Whilst there are a limited number of customers related to Civil Aerospace and Defence, they are spread across various geographical locations. The maximum exposure to credit risk at the balance sheet date is represented by the carrying value of each financial asset, including derivative financial instruments.

Interest rate risk – The Group's interest rate risk is primarily in relation to its fixed rate borrowings (fair value risk), floating rate borrowings and cash and cash equivalents (cash flow risk). Interest rate derivatives are used to manage the overall interest rate profile of the Group. The fixed or floating rate interest rate decision on long-term borrowings is determined for each new agreement at the point it is entered into. The aggregate interest rate position of the Group is reviewed regularly and can be revised at any time in order to react to changes in market conditions or circumstances.

The Group also has exposures to the fair values of non-derivative financial instruments such as EUR, GBP and USD fixed rate borrowings. To manage the risk of changes in these fair values, the Group has entered into fixed-to-floating interest rate swaps and cross-currency interest rate swaps, which, for accounting purposes, are designated as fair value hedges. The swaps have similar critical terms to the hedged items, such as the reference rate, reset dates, notional amounts, payment dates and maturities. Therefore, there is an economic relationship and the hedge ratio is established as 1:1. Possible sources of ineffectiveness in the fair value hedge relationship are changes in the credit risk of either party to the interest rate swap and, for cross-currency interest rate swaps, the cross-currency basis risk as this risk is present in the hedging instrument only. Another possible source of ineffectiveness would be if the notional of the borrowings is less than the notional of the derivative, for example, in the event of a partial repayment of hedged debt prior to its maturity.

The Group has exposure to changes in cash flows due to changes in interest rates. To manage this risk, the Group has entered into floating-to-fixed interest rate swaps to hedge a proportion of its floating rate exposure to fixed rates. The swaps have similar critical terms to the floating leg of swaps that form part of the fair value hedges, such as the reference rate, reset dates, notional amounts, payment dates and maturities. For accounting purposes, these derivative contracts are generally not designated as hedging instruments.

Commodity price risk – The Group has exposures to the price of jet fuel and base metals arising from business operations. To minimise its cash flow exposures to changes in commodity prices, the Group enters into derivative commodity transactions. The commodity hedging policy is similar to the Group FX policy, in that the Group forecasts highly probable exposures to commodities, and takes out hedges within prescribed maximum and minimum levels as set out in the policy. The maximum and minimum policy bands decline gradually over time. For accounting purposes, these derivative contracts are generally not designated in hedging relationships.

Other price risk – The Group's cash equivalent balances represent investments in money-market instruments, with a term of up to three months. The Group does not consider that these are subject to significant price risk.

20 Financial instruments continued

Derivative financial instruments

The nominal amounts, analysed by year of expected maturity, and fair values of derivative financial instruments are as follows:

		Expected maturity				Fair value	
	Nominal amount £m	Within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Assets £m	Liabilities £m
At 31 December 2023							
Foreign exchange contracts:							
Non-hedge accounted	15,972	6,965	4,341	4,666	–	82	(2,117)
Interest rate contracts:							
Fair value hedges	2,001	484	658	859	–	103	(69)
Cash flow hedges	1,449	–	–	1,449	–	28	(17)
Non-hedge accounted	2,001	484	658	859	–	131	–
Commodity contracts:							
Non-hedge accounted	257	102	73	82	–	6	(25)
	21,680	8,035	5,730	7,915	–	350	(2,228)
At 31 December 2022							
Foreign exchange contracts:							
Non-hedge accounted	22,844	9,539	4,180	8,898	227	145	(3,996)
Interest rate contracts:							
Fair value hedges	2,001	–	484	1,033	484	135	(97)
Cash flow hedges	1,449	–	–	1,449	–	89	(2)
Non-hedge accounted	2,001	–	484	1,033	484	214	(1)
Commodity contracts:							
Non-hedge accounted	219	97	79	43	–	65	(3)
	28,514	9,636	5,227	12,456	1,195	648	(4,099)

As described above, all derivative financial instruments are entered into for risk management purposes, although these may not be designated into hedging relationships for accounting purposes.

Currency analysis

Foreign exchange contracts are denominated in the following currencies:

	Nominal amount of currencies purchased forward				
	Sterling £m	USD £m	Euro £m	Other £m	Total £m
At 31 December 2023					
Currencies sold forward:					
Sterling	–	1,573	–	115	1,688
USD	11,389	–	2,316	303	14,008
Euro	53	171	–	21	245
Other	6	3	22	–	31
At 31 December 2022					
Currencies sold forward:					
Sterling	–	4,321	45	146	4,512
USD	16,246	–	1,578	253	18,077
Euro	30	160	–	40	230
Other	–	8	17	–	25

The nominal value of interest rate and commodity contracts are denominated in the following currencies:

	2023 £m	2022 £m
Sterling	2,376	2,376
USD	1,671	1,629
Euro	1,661	1,665

20 Financial instruments continued

Non-derivative financial instruments are denominated in the following currencies:

	Sterling £m	USD £m	Euro £m	Other £m	Total £m
At 31 December 2023					
Other non-current investments	10	21	–	–	31
Trade receivables and similar items	219	4,039	513	86	4,857
Other non-derivative financial assets	94	163	58	17	332
Other assets	–	22	22	–	44
Cash and cash equivalents	1,242	869	1,463	210	3,784
Assets	1,565	5,114	2,056	313	9,048
Borrowings	(904)	(1,605)	(1,590)	–	(4,099)
Lease liabilities	(195)	(1,222)	(45)	(198)	(1,660)
Financial RRSAs	–	(7)	(10)	–	(17)
Other liabilities	(32)	(131)	–	–	(163)
C Shares	(23)	–	–	–	(23)
Trade payables and similar items	(976)	(3,561)	(493)	(61)	(5,091)
Other non-derivative financial liabilities	(334)	(2,008)	(134)	(45)	(2,521)
Contract liabilities	–	(1,358)	–	–	(1,358)
Liabilities	(2,464)	(9,892)	(2,272)	(304)	(14,932)
	(899)	(4,778)	(216)	9	(5,884)
At 31 December 2022					
Other non-current investments	10	16	10	–	36
Trade receivables and similar items	231	3,270	565	81	4,147
Other non-derivative financial assets	61	666	33	15	775
Other assets	–	24	11	–	35
Short-term investments	–	–	11	–	11
Cash and cash equivalents	398	897	1,155	157	2,607
Assets	700	4,873	1,785	253	7,611
Borrowings	(893)	(1,627)	(1,587)	(1)	(4,108)
Lease liabilities	(181)	(1,401)	(49)	(216)	(1,847)
Financial RRSAs	–	(7)	(15)	–	(22)
Other liabilities	(11)	(90)	–	–	(101)
C Shares	(24)	–	–	–	(24)
Trade payables and similar items [1]	(690)	(3,952)	(675)	(59)	(5,376)
Other non-derivative financial liabilities [1]	(271)	(2,304)	(129)	(44)	(2,748)
Contract liabilities [2]	–	(1,006)	–	–	(1,006)
Liabilities	(2,070)	(10,387)	(2,455)	(320)	(15,232)
	(1,370)	(5,514)	(670)	(67)	(7,621)

1 As described in note 19, trade payables and similar items at 31 December 2022 has decreased by £363m with a respective increase in other non-derivative financial liabilities
2 As described in note 15, contract liabilities at 31 December 2022 has increased by £586m

20 Financial instruments continued

Currency exposures

The Group's actual currency exposures on financial instruments after taking account of derivative foreign currency contracts, which are not designated as hedging instruments for accounting purposes, are as follows:

Functional currency of Group operations	Sterling £m	USD £m	Euro £m	Other £m	Total £m
At 31 December 2023					
Sterling	–	–	–	5	5
USD	(6)	–	1	–	(5)
Euro	1	4	–	(2)	3
Other	109	38	40	–	187
At 31 December 2022					
Sterling	–	–	1	4	5
USD	(7)	–	(2)	7	(2)
Euro	(1)	–	–	–	(1)
Other	108	26	86	–	220

Ageing beyond contractual due date of financial assets

	Within terms £m	Up to three months overdue £m	Between three months and one year overdue £m	More than one year overdue £m	Total £m
At 31 December 2023					
Other non-current asset investments	31	–	–	–	31
Trade receivables and similar items	4,054	650	87	66	4,857
Other non-derivative financial assets	328	–	4	–	332
Other assets	44	–	–	–	44
Derivative financial assets	350	–	–	–	350
Cash and cash equivalents	3,784	–	–	–	3,784
	8,591	650	91	66	9,398
At 31 December 2022					
Other non-current asset investments	36	–	–	–	36
Trade receivables and similar items	3,646	219	169	113	4,147
Other non-derivative financial assets	755	9	10	1	775
Other assets	35	–	–	–	35
Derivative financial assets	648	–	–	–	648
Short-term investments	11	–	–	–	11
Cash and cash equivalents	2,607	–	–	–	2,607
	7,738	228	179	114	8,259

20 Financial instruments continued

Contractual maturity analysis of non-derivative financial liabilities

	Gross values				
	Within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Carrying value £m
At 31 December 2023					
Borrowings	(694)	(943)	(3,042)	(14)	(4,099)
Lease liabilities	(358)	(366)	(697)	(735)	(1,660)
Financial RRSAs	(10)	–	(1)	(4)	(17)
Other liabilities	(42)	(6)	(25)	(90)	(163)
C Shares	(23)	–	–	–	(23)
Trade payables and similar items	(4,952)	(15)	(47)	(77)	(5,091)
Other non-derivative financial liabilities	(1,646)	(235)	(267)	(373)	(2,521)
Contract liabilities	(1,358)	–	–	–	(1,358)
	(9,083)	(1,565)	(4,079)	(1,293)	(14,932)
At 31 December 2022					
Borrowings	(168)	(653)	(3,612)	(510)	(4,108)
Lease liabilities	(435)	(311)	(886)	(734)	(1,847)
Financial RRSAs	(10)	(7)	(1)	(5)	(22)
Other liabilities	(15)	(10)	(30)	(46)	(101)
C Shares	(24)	–	–	–	(24)
Trade payables and similar items [1]	(5,128)	(131)	(65)	(52)	(5,376)
Other non-derivative financial liabilities [1]	(1,591)	(443)	(276)	(438)	(2,748)
Contract liabilities [2]	(1,006)	–	–	–	(1,006)
	(8,377)	(1,555)	(4,870)	(1,785)	(15,232)

1 As described in note 19, trade payables and similar items at 31 December 2022 has decreased by £363m with a respective increase in other non-derivative financial liabilities
2 As described in note 15, contract liabilities at 31 December 2022 has increased by £586m

Expected maturity analysis of derivative financial instruments

	Gross values				
	Within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Carrying value £m
At 31 December 2023					
Derivative financial assets:					
Cash inflows	2,024	1,943	2,333	–	
Cash outflows	(2,021)	(1,805)	(2,311)	–	
Other net cash flows [1]	88	43	33	–	
	91	181	55	–	350
Derivative financial liabilities:					
Cash inflows	5,535	3,296	4,377	–	
Cash outflows	(6,418)	(4,027)	(5,189)	–	
Other net cash flows [1]	(21)	(13)	(3)	–	
	(904)	(744)	(815)	–	(2,228)
At 31 December 2022					
Derivative financial assets:					
Cash inflows	3,002	551	3,179	–	
Cash outflows	(2,907)	(540)	(2,886)	–	
Other net cash flows [1]	131	90	98	7	
	226	101	391	7	648
Derivative financial liabilities:					
Cash inflows	6,658	4,238	8,290	722	
Cash outflows	(8,019)	(5,162)	(10,604)	(745)	
Other net cash flows [1]	(10)	(10)	(4)	–	
	(1,371)	(934)	(2,318)	(23)	(4,099)

1 Derivative financial assets and liabilities that are settled on a net cash basis

20 Financial instruments continued

Interest rate risk

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates. The value shown is the carrying amount before taking account of swaps.

	2023			2022		
	Fixed rate £m	Floating rate £m	Total £m	Fixed rate £m	Floating rate £m	Total £m
Short-term investments	–	–	–	–	11	11
Cash and cash equivalents[1]	–	3,784	3,784	–	2,607	2,607
Borrowings	(4,036)	(63)	(4,099)	(4,096)	(12)	(4,108)
Lease liabilities	(1,269)	(391)	(1,660)	(1,235)	(612)	(1,847)
	(5,305)	3,330	(1,975)	(5,331)	1,994	(3,337)
Weighted average interest rates						
Borrowings	3.7%	5.9%		3.7%	4.7%	
Lease liabilities[2]	4.6%	6.8%		3.9%	6.3%	

1 Cash and cash equivalents comprises bank balances and term deposits and earn interest based on short-term floating market interest rates
2 Interest rates for lease liabilities are considered to be the discount rates at the balance sheet date

None (2022: none) of the Group's borrowings are subject to the Group meeting certain obligations, including customary financial covenants. There are no rating triggers contained in any of the Group's facilities that could require the Group to accelerate or repay any facility for a given movement in the Group's credit rating.

£105m (2022: £111m) of the Group's lease liabilities include a customary loan-to-value covenant. The Group has several contractual cures available in the event the stipulated loan-to-value ratio is exceeded. Failure by the Group to satisfy its contractual obligations under the covenant gives rights to the lessor to terminate its lease and claim termination amounts for the outstanding lease balance. At 31 December 2023, none (2022: none) of these were in breach.

Sensitivity analysis

Sensitivities at 31 December (all other variables held constant) – impact on profit after tax and equity	2023 £m	2022 £m
Sterling 10% weaker against the USD	(1,207)	(1,600)
Sterling 10% stronger against the USD	988	1,309
Euro 10% weaker against the USD	(176)	(46)
Euro 10% stronger against the USD	144	38
Sterling 10% weaker against the Euro	(17)	(17)
Sterling 10% stronger against the Euro	14	14
Commodity prices 10% lower	(17)	(21)
Commodity prices 10% higher	17	21
Interest rates 50 basis points lower	(43)	(65)
Interest rates 50 basis points higher	42	64

C Shares and payments to shareholders

The Company issues non-cumulative redeemable preference shares (C Shares) as an alternative to paying a cash dividend. C Shares in respect of a year are issued in the following year. Shareholders are able to redeem any number of their C Shares for cash. Any C Shares retained attract a dividend of Bank of England base rate on the 0.1p nominal value of each share, paid on a twice-yearly basis, and have limited voting rights. The Company has the option to compulsorily redeem the C Shares, at any time, if the aggregate number of C Shares in issue is less than 10% of the aggregate number of C Shares issued, or on the acquisition or capital restructuring of the Company.

Movements in issued and fully paid C Shares during the year were as follows:

	2023		2022	
	Millions	Nominal value £m	Millions	Nominal value £m
At 1 January	23,855	24	24,928	25
Redeemed	(702)	(1)	(1,073)	(1)
At 31 December	23,153	23	23,855	24

Payments to shareholders represent the value of C Shares to be issued in respect of the results for the year. There have been no issues (2022: no issues) of C Shares declared in respect of the year to 31 December 2023.

21 Provisions for liabilities and charges

	At 1 January 2023 £m	Charged to income statement[1] £m	Reversed £m	Utilised £m	Transferred to held for sale £m	Exchange differences £m	At 31 December 2023 £m
Contract losses	1,592	500	(433)	(185)	–	(2)	1,472
Warranty and guarantees	317	112	(14)	(91)	(8)	(10)	306
Trent 1000 wastage costs	179	45	(29)	(79)	–	–	116
Employer liability claims	33	1	(7)	(3)	–	–	24
Tax related interest and penalties	16	9	–	(2)	–	(1)	22
Claims and litigation	122	71	(39)	(111)	–	–	43
Other	74	26	(18)	(35)	–	(1)	46
	2,333	764	(540)	(506)	(8)	(14)	2,029
Current liabilities	632						532
Non-current liabilities	1,701						1,497

1 The charge to the income statement within net financing includes £59m (2022: £33m) as a result of the unwinding of the discounting of provisions previously recognised

Contract losses

Provisions for contract losses are recorded when the direct costs to fulfil a contract are assessed as being greater than the expected recoverable amount. Provisions for contract losses are measured on a fully costed basis and during the year £185m of the provision has been utilised. Additional contract losses for the Group of £500m have been recognised as a result of increases in the estimates of future LTSA costs, due to inflationary increases and costs associated with supply chain challenges. Contract losses of £433m previously recognised have been reversed following the renegotiation of some major contracts resulting in contract extensions and improved margins. The Group continues to monitor the contract loss provision for changes in the market and revises the provision as required. The value of the remaining contract loss provisions reflect, in each case, the single most likely outcome. The provisions are expected to be utilised over the term of the customer contracts, typically within eight to 16 years.

IAS 37 requires a company to recognise any impairment loss that has occurred on assets used in fulfilling the contract before recognising a separate provision for an onerous contract. No impairments were required for any of the assets solely used in the fulfilment of onerous contracts. However, as per note 11, a number of aero engine lease right-of-use assets were impaired during the year and these will be used on a range of contracts some of which are onerous.

The Trent 1000 intangible assets (certification costs and development costs) and Trent 1000 spare engines (right of use and owned) are tested for impairment as part of the Trent 1000 Cash generating unit (CGU) and no impairment was required.

Warranty and guarantees

Provisions for warranty and guarantees relate to products sold and are calculated based on an assessment of the remediation costs related to future claims based on past experience. During the year, £112m of additional provision has been recognised representing the single best estimate of warranty and guarantee costs to be incurred on relevant sales and £91m of previously recognised costs have been utilised. The provision generally covers a period of up to three years.

Trent 1000 wastage costs

In November 2019, the Group announced the outcome of testing and a thorough technical and financial review of the Trent 1000 TEN programme, following technical issues which were identified in 2019, resulting in a revised timeline and a more conservative estimate of durability for the improved HP turbine blade for the TEN variant. During the year, the Group has utilised £79m of the Trent 1000 wastage costs provision. This represents customer disruption costs and remediation shop visit costs attributable to the wastage costs provision. During the year, a net charge to the provision of £16m has been recognised reflecting the discount unwind and updates to forecasted costs based on the latest available information. The value of the remaining provision reflects the single most likely outcome and is expected to be utilised in 2024.

Employer liability claims

The provision relating to employer healthcare liability claims is as a result of an historical insolvency of the previous provider and is expected to be utilised over the next 30 years.

21 Provisions for liabilities and charges continued

Tax related interest and penalties

Provisions for tax related interest and penalties relate to uncertain tax positions in some of the jurisdictions in which the Group operates. Utilisation of the provisions will depend on the timing of resolution of the issues with the relevant tax authorities.

Claims and litigation

Provisions for claims and litigation represent ongoing matters where the outcome for the Group may be unfavourable. On 3 July 2023, judgement in respect of a legal claim was rendered by the High Court, resulting in a charge to the income statement of £34m. The judgement was satisfied in August 2023 resulting in a £92m utilisation. The value of any remaining provisions reflects the single most likely outcome in each case.

The balance also includes the best estimate of any retained exposure by the Group's captive insurance company for any claims that have been incurred but not yet reported to the Group, as that entity retains a portion of the exposures it insures on behalf of the remainder of the Group. Such exposures include policies for aviation claims, employer liabilities and healthcare claims. Significant delays can occur in the notification and settlement of claims, and judgement is involved in assessing outstanding liabilities, the ultimate cost and timing of which cannot be known with certainty at the balance sheet date. The insurance provisions are based on information currently available, however, it is inherent in the nature of the business that ultimate liabilities may vary if the frequency or severity of claims differs from estimated.

Other

Other items are individually immaterial. The value of any remaining provisions reflects the single most likely outcome in each case.

22 Post-retirement benefits

The Group operates a number of defined benefit and defined contribution schemes:

- The UK defined benefit scheme is funded, with the assets held in a separate UK trust. The scheme closed to future accrual on 31 December 2020 for all active members and there are no new defined benefit accruals in the UK scheme. As at 31 December 2023, the scheme was estimated to be funded at 113% on the Technical Provisions basis.
- The Group also operates a large trust-based defined contribution scheme for current employees in the UK (Rolls-Royce Retirement Savings Trust). Pension contributions are generally paid as a salary sacrifice under which employees agree to a reduction in gross contractual pay in return for the Group making additional pension contributions on their behalf. As a result, there is a decrease in wages and salaries and a corresponding increase in pension costs of £72m (2022: £46m) in the year.
- Overseas defined benefit schemes are a mixture of funded and unfunded plans and provide benefits in line with local practice. Additionally, in the US, and to a lesser extent in some other countries, the Group's employment practices include the provision of healthcare and life insurance benefits for retired employees. These healthcare schemes are unfunded.

The valuations of the defined benefit schemes are based on the results of the most recent funding valuation from 31 March 2023, where relevant, updated by the scheme actuaries to 31 December 2023.

Changes to the defined benefit scheme

During the year, Power Systems continued to replace a number of their existing defined benefit schemes with a new company pension scheme to offer payment options at time of retirement for other employee populations not included in 2022. The new system, which is similar in structure to a defined contribution scheme with a guarantee from the company in accordance with German legislation, significantly reduces interest risks and longevity risks for the employer for future commitments. A past service cost of £3m has been recognised within non-underlying operating profit in relation to this new scheme. In addition, Rolls-Royce Power Systems concluded a works agreement resulting in a change to jubilee benefits offered to employees based in Friedrichshafen. A past service credit of £5m has been recognised within non-underlying operating profit.

Other

The Group is aware of a UK High Court legal ruling in June 2023 between Virgin Media Limited and NTL Pension Trustees II Limited, which decided that certain historic rule amendments were invalid if they were not accompanied by the actuarial certifications. The ruling is subject to appeal and the Group is monitoring developments. Whilst this ruling was in respect of another scheme, any final judgment would need to be reviewed for its relevance to the RRUKPF scheme. As yet the RRUKPF pension advisers have not completed any analysis and, as the outcome of the appeal is still unknown, no adjustments have been made to the Consolidated Financial Statements at 31 December 2023.

22 Post-retirement benefits continued

Amounts recognised in the income statement

	2023			2022		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Defined benefit schemes:						
Current service cost and administrative expenses	8	35	43	8	44	52
Past-service credit and settlement loss	–	(2)	(2)	(6)	(19)	(25)
	8	33	41	2	25	27
Defined contribution schemes	195	98	293	154	87	241
Operating cost	203	131	334	156	112	268
Net financing (credit)/charge in respect of defined benefit schemes	(29)	41	12	(21)	23	2
Total income statement charge	174	172	346	135	135	270

The operating cost is charged as follows:

	Defined benefit		Defined contribution		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Cost of sales	33	37	211	168	244	205
Commercial and administrative costs	2	(17)	41	38	43	21
Research and development costs	6	7	41	33	47	40
	41	27	293	239	334	266
Discontinued operations	–	–	–	2	–	2
	41	27	293	241	334	268

Net financing comprises:

	2023			2022		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Financing on scheme obligations	218	66	284	149	46	195
Financing on scheme assets	(247)	(25)	(272)	(170)	(23)	(193)
Net financing (income)/charge in respect of defined benefit schemes	(29)	41	12	(21)	23	2
Financing income on scheme surpluses	(29)	(1)	(30)	(21)	(3)	(24)
Financing cost on scheme deficits	–	42	42	–	26	26

Amounts recognised in OCI in respect of defined benefit schemes

	2023			2022		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Actuarial gains and losses arising from:						
Demographic assumptions [1]	180	–	180	19	–	19
Financial assumptions [2]	(132)	(63)	(195)	3,423	602	4,025
Experience adjustments [3]	116	1	117	(235)	(7)	(242)
Return on scheme assets excluding financing income [2]	(12)	26	14	(3,751)	(207)	(3,958)
	152	(36)	116	(544)	388	(156)

1 For the UK Scheme, this reflects latest available CMI mortality projections and an update of the post-retirement mortality assumptions based on an analysis prepared for the 31 March 2023 funding valuation
2 Actuarial gains and losses arising from financial assumptions arise primarily due to changes in discount rate and inflation
3 This reflects an experience gain as a result of allowance for updated membership data following the valuation during the year offset by realised inflation being higher than expected in the year

22 Post-retirement benefits continued

Amounts recognised in the balance sheet in respect of defined benefit schemes

	2023			2022		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Present value of funded obligations	(4,537)	(993)	(5,530)	(4,621)	(944)	(5,565)
Fair value of scheme assets	5,304	520	5,824	5,215	493	5,708
Net asset/(liability) on funded schemes	767	(473)	294	594	(451)	143
Present value of unfunded obligations	–	(547)	(547)	–	(563)	(563)
Net asset/(liability) recognised in the balance sheet	767	(1,020)	(253)	594	(1,014)	(420)
Post-retirement scheme surpluses [1]	767	15	782	594	19	613
Post-retirement scheme deficits	–	(1,035)	(1,035)	–	(1,033)	(1,033)

1 The surplus in the UK scheme is recognised as, on an ultimate wind-up when there are no longer any remaining members, any surplus would be returned to the Group, which has the power to prevent the surplus being used for other purposes in advance of this event

Overseas schemes are located in the following countries:

	2023			2022		
	Assets £m	Obligations £m	Net £m	Assets £m	Obligations £m	Net £m
Canada	199	(239)	(40)	187	(226)	(39)
Germany	31	(679)	(648)	10	(638)	(628)
US pension schemes	290	(301)	(11)	296	(308)	(12)
US healthcare schemes	–	(318)	(318)	–	(333)	(333)
Other	–	(3)	(3)	–	(2)	(2)
Net asset/(liability) recognised in the balance sheet	520	(1,540)	(1,020)	493	(1,507)	(1,014)

Defined benefit schemes

Assumptions

Significant actuarial assumptions for UK schemes at the balance sheet date were as follows:

		2023	2022
Discount rate		4.50%	4.80%
Inflation assumption (RPI)		3.30%	3.50%
Inflation assumption (CPI)		2.85%	2.95%
Transfer take-up assumption (employed deferred/deferred)		35%/25%	50%/40%
Bridging Pension Option (BPO) take-up assumption		30%	30%
Life expectancy from age 65:	current male pensioner	20.8 years	21.9 years
	future male pensioner currently aged 45	21.5 years	23.2 years
	current female pensioner	22.8 years	23.7 years
	future female pensioner currently aged 45	24.1 years	25.5 years

Discount rates are determined by reference to the market yields on AA rated corporate bonds. The rate is determined by using the profile of forecast benefit payments to derive a weighted average discount rate from the yield curve.

The inflation assumption is determined by the market-implied assumption based on the yields on long-term index-linked government securities.

The mortality assumptions adopted for the UK pension schemes are derived from the SAPS S3 'All' actuarial tables, with future improvements in line with the CMI 2022 core projections updated to reflect use of an 'A' parameter of 0.25% for future improvements and long-term improvements of 1.25%. Where appropriate, these are adjusted to take account of the scheme's actual experience.

The assumption for transfers and the BPO is based on actual experience and actuarial advice.

Other assumptions have been set on advice from the actuary, having regard to the latest trends in scheme experience and the assumptions used in the most recent funding valuation. The rate of increase of pensions in payment is based on the rules of the scheme, combined with the inflation assumption where the increase is capped.

22 Post-retirement benefits continued

Assumptions for overseas schemes are less significant and are based on advice from local actuaries. The principal assumptions are:

	2023	2022
Discount rate	4.20%	4.70%
Inflation assumption	1.60%	2.30%
Long-term healthcare cost trend rate	4.75%	4.75%
Male life expectancy from age 65: current pensioner	20.5 years	20.5 years
future pensioner currently aged 45	22.4 years	22.4 years

Changes in present value of defined benefit obligations

	2023			2022		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
At 1 January	(4,621)	(1,507)	(6,128)	(8,010)	(2,204)	(10,214)
Exchange differences	–	54	54	–	(165)	(165)
Current service cost	(4)	(33)	(37)	(4)	(43)	(47)
Past-service cost	–	2	2	6	24	30
Finance cost	(218)	(66)	(284)	(149)	(49)	(198)
Contributions by employees	–	(9)	(9)	–	(4)	(4)
Benefits paid out	142	80	222	329	102	431
Actuarial gains/(losses)	164	(61)	103	3,207	599	3,806
Transfers	–	(2)	(2)	–	(2)	(2)
Transferred to held for sale	–	2	2	–	–	–
Settlement	–	–	–	–	235	235
At 31 December	(4,537)	(1,540)	(6,077)	(4,621)	(1,507)	(6,128)
Funded schemes	(4,537)	(993)	(5,530)	(4,621)	(944)	(5,565)
Unfunded schemes	–	(547)	(547)	–	(563)	(563)
The defined benefit obligations are in respect of:						
Active plan participants [1]	(1,584)	(731)	(2,315)	(1,681)	(693)	(2,374)
Deferred plan participants	(1,287)	(100)	(1,387)	(1,172)	(93)	(1,265)
Pensioners	(1,666)	(709)	(2,375)	(1,768)	(721)	(2,489)
Weighted average duration of obligations (years)	16	12	15	17	13	16

1 Although the UK scheme closed to future accrual on 31 December 2020, members who became deferred as a result of the closure and remain employed by the Group retain some additional benefits compared to other deferred members. The obligations for these members are shown as active plan participants

Changes in fair value of scheme assets

	2023			2022		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
At 1 January	5,215	493	5,708	9,128	861	9,989
Exchange differences	–	(21)	(21)	–	77	77
Administrative expenses	(4)	(1)	(5)	(4)	(1)	(5)
Financing	247	25	272	170	23	193
Return on plan assets excluding financing	(12)	26	14	(3,751)	(207)	(3,958)
Contributions by employer	–	69	69	1	80	81
Contributions by employees	–	9	9	–	4	4
Benefits paid out	(142)	(80)	(222)	(329)	(102)	(431)
Settlement	–	–	–	–	(242)	(242)
At 31 December	5,304	520	5,824	5,215	493	5,708
Total return on scheme assets	235	51	286	(3,581)	(184)	(3,765)

22 Post-retirement benefits continued

Fair value of scheme assets at 31 December

	2023			2022		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Sovereign debt	3,259	118	3,377	3,574	120	3,694
Corporate debt instruments	1,996	270	2,266	1,492	257	1,749
Interest rate swaps	170	–	170	196	–	196
Inflation swaps	86	–	86	212	–	212
Cash and similar instruments [1]	(892)	–	(892)	(1,066)	–	(1,066)
Liability driven investment (LDI) portfolios [2]	4,619	388	5,007	4,408	377	4,785
Listed equities	–	69	69	–	78	78
Unlisted equities	32	–	32	40	–	40
Synthetic equities [3]	20	–	20	(8)	–	(8)
Corporate debt instruments	630	–	630	772	–	772
Cash	–	10	10	–	5	5
Other	3	53	56	3	33	36
At 31 December	5,304	520	5,824	5,215	493	5,708

1 UK cash and similar instruments include repurchase agreements on UK Government bonds amounting to £(993)m (2022: £(1,221)m). The latest maturity date for these short-term borrowings is September 2024
2 A portfolio of gilt and swap contracts, backed by investment-grade credit instruments and diversified liquidity funds, that is designed to hedge the majority of the interest rate and inflation risks associated with the schemes' obligations
3 Portfolios of swap contracts designed to provide investment returns in line with global equity markets. The maximum exposure (notional value and accrued returns) on the portfolios was £379m (2022: £344m)

The investment strategy for the UK scheme is controlled by the Trustee in consultation with the Group. The scheme assets do not directly include any of the Group's own financial instruments, nor any property occupied by, or other assets used by, the Group. At 31 December 2023, there was no indirect holding of the Group's financial instruments (2022: none).

Future contributions

The Group expects to contribute approximately £73m to its overseas defined benefit schemes in 2024 (2023: £70m).

In the UK, any cash funding of RRUKPF is based on a statutory triennial funding valuation process. The Group and the Trustee negotiate and agree the actuarial assumptions used to value the liabilities (Technical Provisions); assumptions which may differ from those used for accounting as set out on page 176. The assumptions used to value Technical Provisions must be prudent rather than a best estimate of the liability. Most notably, the Technical Provisions discount rate is currently based upon UK Government bond yields plus a margin (0.5% at the 31 March 2023 valuation) rather than being based on yields of AA corporate bonds. Once each valuation is signed, a Schedule of Contributions (SoC) must be agreed which sets out the cash contributions to be paid. The most recent valuation, as at 31 March 2023, agreed by the Trustee in October 2023, showed that the RRUKPF was estimated to be 115% funded on the Technical Provisions basis (estimated to be 113% at 31 December 2023). All cash due has been paid in full and the current SoC does not currently require any cash contributions to be made by the Group.

22 Post-retirement benefits continued

Sensitivities

The calculations of the defined benefit obligations are sensitive to the assumptions set out above. The following table summarises how the estimated impact of a change in a significant assumption would affect the UK defined benefit obligation at 31 December 2023, while holding all other assumptions constant. This sensitivity analysis may not be representative of the actual change in the defined benefit obligation as it is unlikely that the change in assumptions would occur in isolation of one another as some of the assumptions may be correlated.

For the most significant funded schemes, the investment strategies hedge the risks from interest rates and inflation measured on a proxy solvency basis.

For the UK scheme, the interest rate and inflation hedging is currently based on UK Government bond yields without any adjustment for any credit spread. The sensitivity analysis set out below has been determined based on a method that estimates the impact on the defined benefit obligation as a result of reasonable changes in key assumptions occurring at the end of the reporting period.

		2023 £m	2022 £m
Reduction in the discount rate of 0.25% [1]	Obligation	(185)	(205)
	Plan assets (LDI portfolio)	204	235
Increase in inflation of 0.25% [1]	Obligation	(75)	(70)
	Plan assets (LDI portfolio)	77	91
Increase of 1% in transfer value assumption	Obligations	(30)	(30)
One year increase in life expectancy	Obligations	(155)	(165)

1 The differences between the sensitivities on obligations and plan assets arise largely due to differences in the methods used to value the obligations for accounting purposes and the adopted proxy solvency basis

23 Share capital

	Non-equity		Equity	
	Special Share of £1	Nominal value £m	Ordinary shares of 20p each Millions	Nominal value £m
Issued and fully paid				
At 1 January 2022	1	–	8,368	1,674
At 31 December 2022	1	–	8,368	1,674
Shares issued to employee share trust	–	–	49	10
At 31 December 2023	1	–	8,417	1,684

The rights attaching to each class of share are set out on page 218.

In accordance with IAS 32, the Company's non-cumulative redeemable preference shares (C Shares) are classified as financial liabilities. Accordingly, movements in C Shares are included in note 20. In addition, the rights of C share holders are included on page 218.

24 Share-based payments

Effect of share-based payment transactions on the Group's results and financial position

	2023 £m	2022 £m
Total expense recognised for equity-settled share-based payments transactions	49	46
Total cost recognised for cash-settled share-based payments transactions	17	1
Share-based payments recognised in the consolidated income statement	66	47
Liability for cash-settled share-based payment transactions	18	1

A description of the share-based payment plans is included in the remuneration report on pages 84 to 110.

Movements in the Group's share-based payment plans during the year

	ShareSave		LTIP	DSBP
	Number Millions	Weighted average exercise price Pence	Number Millions	Number Millions
Outstanding at 1 January 2022	75.1	132	77.0	0.8
Granted	0.1	104	47.2	12.3
Forfeited	(9.6)	161	(13.4)	(0.2)
Exercised	–	–	(17.8)	(0.7)
Outstanding at 31 December 2022	65.6	127	93.0	12.2
Granted	0.1	115	44.7	7.0
Forfeited	(12.3)	203	(29.1)	(1.9)
Exercised	–	–	(7.6)	(0.1)
Outstanding at 31 December 2023	53.4	107	101.0	17.2
Exercisable at 31 December 2023	–	–	–	–
Exercisable at 31 December 2022	–	–	–	–

The weighted average share price at the date share options were exercised was 159p (2022: 95p). The closing price at 31 December 2023 was 300p (2022: 93p).

The weighted average remaining contractual life for the share options as at 31 December 2023 was one year (2022: two years) and the range of exercise prices for the share options as at 31 December 2023 was 97p to 261p.

Fair values of share-based payment plans

The weighted average fair value per share of equity-settled share-based payment plans granted during the year, estimated at the date of grant, are as follows:

	2023	2022
LTIP	216p	90p
DSBP	157p	91p

Long-term incentive plans (LTIP)

The fair value of shares awarded is calculated using a pricing model that takes account of the non-entitlement to dividends (or equivalent) during the vesting period and the market-based performance condition based on expectations about volatility and the correlation of share price returns in the group of FTSE 100 companies and which incorporates into the valuation the interdependency between share price performance and total shareholder return (TSR) vesting where market-based conditions are applicable. This adjustment decreases the fair value of the award relative to the share price at the date of grant.

ShareSave

The fair value of the options granted is calculated using a pricing model that assumes that participants will exercise their options at the beginning of the six-month window if the share price is greater than the exercise price. Otherwise, it assumes that options are held until the expiration of their contractual term. This results in an expected life that falls somewhere between the start and end of the exercise window.

Deferred Share Bonus Plan (DSBP)

The fair value of shares awarded under DSBP is calculated as the share price on the date of the award, excluding expected dividends (or equivalent).

25 Contingent liabilities and commitments

In January 2017, after full cooperation, the Company concluded deferred prosecution agreements (DPA) with the SFO and the US Department of Justice (DoJ) and a leniency agreement with the MPF, the Brazilian federal prosecutors. The terms of both DPAs have now expired. The Company has submitted a final report to the Controller General, Brazil (CGU) under the terms of a two-year leniency agreement, signed in October 2021, relating to the same historical matters. Certain authorities are investigating members of the Group for matters relating to misconduct in relation to historical matters. The Group is responding appropriately. Action may be taken by further authorities against the Company or individuals. In addition, the Group could still be affected by actions from other parties, including customers, customers' financiers and the Company's current and former investors, including certain potential claims in respect of the Group's historical ethics and compliance disclosures which have been notified to the Company. The Directors are not currently aware of any matters that are likely to lead to a material financial loss over and above the penalties imposed to date, but cannot anticipate all the possible actions that may be taken or their potential consequences.

The Group has, in the normal course of business, entered into arrangements in respect of export finance, performance bonds, grant funding, countertrade obligations and minor miscellaneous items, which could result in potential outflows if the requirements related to those arrangements are not met. Various Group undertakings are party to legal actions and claims (including with tax authorities) which arise in the ordinary course of business, some of which are for substantial amounts.

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 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 $0.9bn (2022: $1.2bn) (on a discounted basis) to provide facilities to enable customers to purchase aircraft (of which approximately $0.7bn could be called during 2024). 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. Significant events impacting the international aircraft financing market, the failure by customers to meet their obligations under such financing agreements, or inadequate provisions for customer financing liabilities may adversely affect the Group's financial position.

Customer financing provisions are made to cover guarantees provided where it is probable that a payment will be made. These are reported on a discounted basis at the Group's borrowing rate to better reflect the time span over which these exposures could arise. The values of aircraft providing security are based on advice from a specialist aircraft appraiser. There were no provisions for customer financing provisions at 31 December 2023 or 31 December 2022.

The Group has responded appropriately to the Russia-Ukraine conflict to comply with international sanctions and export control regime, and to continue to implement the business decision to exit from Russia. The Group could be subject to action by impacted customers, suppliers and other contract parties.

While the outcome of the above 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.

26 Related party transactions

	2023 £m	2022 £m
Sales of goods and services	6,700	5,074
Purchases of goods and services [1]	(7,471)	(5,577)
Lease payments to joint ventures and associates	(244)	(163)
Guarantees of joint arrangements' and associates' borrowings	2	3
Guarantees of non-wholly owned subsidiaries' borrowings	3	3
Dividends received from joint ventures and associates	54	73
Other income received from joint ventures and associates	6	2

1 The Group has both sales and purchasing arrangements with its maintenance, repair and overhaul joint ventures. As part of this arrangement, the Group issues and receives credit notes usable against amounts receivable and payable to these related parties. Purchases of goods and services from related parties are presented to be shown gross of these concessions. This is consistent with the presentation of sales to related parties. Purchases from related parties incurred during the year to 31 December 2022 have been represented on this basis resulting in an increase to this balance of £662m

Included in sales of goods and services to related parties are sales of spare engines amounting to £48m (2022: £19m). Profit recognised in the year on such sales amounted to £88m (2022: £50m), including profit on current year sales and recognition of profit deferred on similar sales in previous years. Cash receipts relating to the sale of spare engines amounted to £73m (2022: £40m).

Included in other financing charges in the income statement are interest costs of £34m (2022: £17m) incurred during the year which have been settled by the Group on behalf of joint ventures, including £28m of costs incurred for using the Group offered SCF arrangement set out in note 19.

The aggregated balances with joint ventures are shown in notes 14 and 19. Transactions with Group pension schemes are shown in note 22.

26 Related party transactions continued

Key management personnel are deemed to be the Directors (pages 70 to 71) and the members of the Executive Team (described on page 72). Remuneration for key management personnel is shown below:

	2023 £m	2022 £m
Salaries and short-term benefits	26	18
Post-retirement schemes	–	–
Share-based payments	15	10
	41	28

During the year, one director (2022: none) received termination benefits. For further detail, see the remuneration report

More detailed information regarding the Directors' remuneration, shareholdings, pension entitlements, share options and other long-term incentive plans is shown in the Remuneration Report on pages 84 to 110. The charge for share-based payments above is based on when the award is charged to the income statement in accordance with IFRS 2 *Share-Based Payments*, rather than when the shares vest, which is the basis used in the remuneration report.

27 Acquisitions, disposals, held for sale and discontinued operations

Acquisitions

On 30 June 2023, the Group completed its acquisition of Team Italia/Onyx Marine SRL for a cash consideration of £14m. Team Italia specialises in yacht bridges and marine navigation and automation systems. The acquisition will provide key technology for marine automation systems and will strengthen Power Systems' position as a yacht market leader. The acquisition price of £14m has been allocated to £8m of goodwill, £2m of customer relationships, £2m to right-of-use assets and £2m to other assets and liabilities.

Disposals

During the year, the Group divested of its 49% shareholding in its joint venture, Shanxi North MTU Diesel Co. Limited to the current JV partner for proceeds of £5m. The carrying value of the Group's investment that was derecognised was £5m resulting in nil profit on disposal.

Reconciliation of profit/(loss) on disposal of businesses in continuing operations to the income statement:

	Total £m
Profit/(loss) before taxation on disposal	–
Cumulative currency translation loss on liquidation of joint venture	(1)
Adjustment to consideration on disposals completed in prior periods	2
Profit on disposal of businesses per income statement	1

Reconciliation of cash flow on acquisition and disposal of businesses to the cash flow statement:

	Total £m
Proceeds on disposal	5
Cash outflow on acquisitions	(14)
Net cash flows on disposals completed in prior periods	(9)
Cash flow on acquisition and disposal of businesses per cash flow statement	(18)

27 Acquisitions, disposals, held for sale and discontinued operations continued

Held for sale

At 31 December 2023, the Group was in positive discussions with Deutz AG for the sale of the off-highway engines business in the lower power range based in Power Systems. The business is available for sale in its current condition and the sale is considered highly probable based on the agreement-in-principle reached as at 31 December 2023. In line with IFRS 5, the assets and liabilities related to the business have been classified as held for sale and measured at the lower of their carrying value or fair value less costs to sell, resulting in a £7m impairment reversal.

The table below summarises the categories of assets and liabilities classified as held for sale at 31 December 2023. There were no assets or liabilities held for sale at 31 December 2022.

	2023 £m
Intangible assets	51
Inventory	11
Trade receivables and other assets	47
Assets held for sale	109
Trade payables and other liabilities	(41)
Contract liabilities	(4)
Provisions for liabilities and charges	(8)
Post-retirement scheme deficits	(2)
Liabilities associated with assets held for sale	(55)
Net assets held for sale	54

Discontinued Operations

ITP Aero represented a separate major line of business and was classified as a disposal group held for sale up to the date of disposal. Therefore, the results up to 15 September 2022, in line with IFRS 5, were presented as discontinued operations.

The financial performance and cash flow information presented reflects the operations for the year that have been classified as discontinued operations.

	2023 £m	2022 £m
Revenue	–	275
Operating profit [1]	–	86
Profit before taxation [1]	–	78
Income tax charge [1]	–	(10)
Profit for the year from discontinued operations on ordinary activities	–	68
Costs of disposal on discontinued operations [2]	–	–
Loss on disposal of discontinued operations (see above)	–	(148)
Loss for the year from discontinued operations	–	(80)
Net cash inflow from operating activities [2]	–	85
Net cash outflow from investing activities [2]	–	(67)
Net cash outflow from financing activities	–	(25)
Exchange gain/(losses)	–	–
Net change in cash and cash equivalents	–	(7)

1 Profit from discontinued operations on ordinary activities is presented net of intercompany trading eliminations and related consolidation adjustments
2 Cash flows from investing activities include £nil (2022: £42m) costs of disposal paid during the year that are not a movement in the cash balance of the disposal group as they were borne centrally

28 Derivation of summary funds flow statement

	2023					2022
	Cash flow £m	Impact of hedge book £m	Impact of acquisition accounting £m	Impact of other non-underlying items £m	Funds flow £m	Funds flow £m
Operating profit/(loss)	1,944	(475)	50	71	1,590	652
Operating profit from discontinued operations	–	–	–	–	–	86
Depreciation, amortisation and impairment	1,019	–	(50)	9	978	953
Movement in provisions	(325)	46	–	21	(258)	(23)
Movement in Civil LTSA balance	1,708	(377)	–	–	1,331	792
Movement in prepayments to RRSAs for LTSA parts	(315)	63	–	–	(252)	(8)
Settlement of excess derivatives	(389)	–	–	–	(389)	(326)
Loss on disposal of property, plant and equipment [1]	18	–	–	–	18	18
Joint venture trading [1]	(119)	–	–	–	(119)	25
Interest received	159	–	–	–	159	36
Contributions to defined benefit schemes in excess of underlying operating profit charge [1]	(28)	–	–	2	(26)	(32)
Share-based payments [1]	66	–	–	–	66	47
Other [1]	–	(8)	–	1	(7)	(53)
Operating cash flow before working capital and taxation [2]	3,738	(751)	–	104	3,091	2,167
Increase in inventories [3]	(200)	–	–	–	(200)	(887)
Movement in trade receivables/payables and other assets/liabilities (excluding prepayments to RRSAs for LTSA parts) [3]	(2,090)	(164)	–	(37)	(2,291)	(745)
Movement in contract assets/liabilities (excluding Civil LTSA) [3]	995	51	–	–	1,046	892
Revaluation of trading assets (excluding exceptional items) [3]	206	(10)	–	–	196	(521)
Realised derivatives in financing [3]	853	–	–	–	853	737
Cash flows on other financial assets and liabilities held for operating purposes	(845)	853	–	–	8	77
Income tax	(172)	–	–	–	(172)	(174)
Cash from operating activities [2]	2,485	(21)	–	67	2,531	1,546
Capital element of lease payments	(291)	21	–	–	(270)	(198)
Capital expenditure	(699)	–	–	4	(695)	(504)
Investment	69	–	–	–	69	28
Interest paid	(333)	–	–	–	(333)	(352)
Other (M&A, exceptional transformation and restructuring costs)	54	–	–	(71)	(17)	(29)
Free cash flow	1,285	–	–	–	1,285	491
– of which is continuing operations	*1,285*				*1,285*	*505*

1 Included in other operating cash flows in the summarised free cash flow on page 22
2 The funds flow to 31 December 2022 has been represented to disclose cash flows on settlement of excess derivative contracts as cash flows from operating activities. As a result, operating cash flows before working capital and income tax during the year to 31 December 2022 have reduced by £(326)m to £2,167m. Cash flows on settlement of excess derivative contracts were previously shown after cash from operating activities in arriving at free cash flow. There is no impact to free cash flow
3 Included in working capital (excluding Civil LTSA balance) in the summarised free cash flow on page 22

The comparative information to 31 December 2023 has been presented in a different format to align to the current year presentation. In some instances, the groupings of items may have changed. All comparative figures remain unchanged versus those reported in the 2022 Annual Report.

Free cash flow is a measure of the financial performance of the businesses' cash flows which is consistent with the way in which performance is communicated to the Board. Free cash flow is defined as cash flows from operating activities including capital expenditure and movements in investments, capital elements of lease payments, interest paid, amounts paid relating to the settlement of excess derivatives, and excluding amounts spent or received on activity related to business acquisitions or disposals and other material exceptional or one-off cash flows. The Board considers that free cash flow reflects cash generated from the Group's underlying trading.

Cash flow from operating activities is determined to be the nearest statutory measure to free cash flow. The reconciliation between free cash flow and cash flow from operating activities can be found on page 216.

Company balance sheet

At 31 December 2023

	Notes	2023 £m	2022 £m
ASSETS			
Investments – subsidiary undertakings	2	**14,810**	14,762
LIABILITIES			
Trade payables and other liabilities	3	**(336)**	(335)
Other financial liabilities	4	**(23)**	(24)
Current liabilities		**(359)**	(359)
NET ASSETS	6	**14,451**	14,403
EQUITY			
Called-up share capital	5	**1,684**	1,674
Share premium		**1,012**	1,012
Merger reserve		**6,962**	6,962
Capital redemption reserve		**2,749**	2,748
Other reserve		**397**	349
Retained earnings		**1,647**	1,658
TOTAL EQUITY		**14,451**	14,403

The Company has elected to take the exemption under section 408 of the Companies Act 2006 from presenting the parent company income statement. The result for the Company for the year was nil (2022: nil).

The Financial Statements on pages 185 to 189 were approved by the Board on 22 February 2024 and signed on its behalf by:

Tufan Erginbilgic
Chief Executive

Helen McCabe
Chief Financial Officer

Company's registered number: 7524813

Company statement of changes in equity

For the year ended 31 December 2023

	Attributable to ordinary shareholders						
	Share capital £m	Share premium £m	Merger reserve [1] £m	Capital redemption reserve £m	Other reserve [2] £m	Retained earnings [3, 4] £m	Total equity £m
At 1 January 2022	1,674	1,012	6,962	2,747	303	1,659	14,357
Redemption of C Shares	–	–	–	1	–	(1)	–
Share-based payments – direct to equity	–	–	–	–	46	–	46
At 1 January 2023	**1,674**	**1,012**	**6,962**	**2,748**	**349**	**1,658**	**14,403**
Arising on issues of ordinary shares	**10**	**–**	**–**	**–**	**–**	**(10)**	**–**
Redemption of C Shares	**–**	**–**	**–**	**1**	**–**	**(1)**	**–**
Share-based payments – direct to equity	**–**	**–**	**–**	**–**	**48**	**–**	**48**
At 31 December 2023	**1,684**	**1,012**	**6,962**	**2,749**	**397**	**1,647**	**14,451**

1 The Company's merger reserve was created as a result of a High Court approved scheme of arrangement in 2011, when the Company became the holding company for the Rolls-Royce Group
2 Other reserve represents the value of the share-based payments in respect of employees of subsidiary undertakings for which payment has not been received
3 The reserves, which are distributable to the Company's equity shareholders, are determined with reference to the Companies Act 2006 and requires judgement in determining the amount available for distribution, subject to the restrictions explained in note 17 of the Consolidated Financial Statements. Further guidance is given in the Institute of Chartered Accountants in England and Wales technical release 02/17BL in relation to what profits can be treated as distributable. At 31 December 2023, all the Company's retained earnings are distributable, however, the available amount may be different at the point any future distributions are made
4 At 31 December 2023, 52,912,406 ordinary shares with a net book value of £22m (2022: 11,402,796 ordinary shares with a net book value of £27m) were held for the purpose of share-based payment plans and included in accumulated losses. During the year:
- 7,875,240 ordinary shares with a net book value of £15m (2022: 18,488,558 ordinary shares with a net book value of £39m) vested in share-based payment plans;
- the Company issued 49,100,000 (2022: none) new ordinary shares to the Group's share trust for its employee share-based payment plans with a net book value of £10m (2022: £nil); and
- the Company acquired none (2022: none) of its ordinary shares via reinvestment of dividends received on its own shares and purchased 284,850 (2022: 486,163) of its ordinary shares through purchases on the London Stock Exchange

1 Accounting policies

Basis of accounting

Rolls-Royce Holdings plc (the Company) is a public company limited by shares incorporated and domiciled in England in the United Kingdom. These Financial Statements have been prepared in accordance with Financial Reporting Standard 101 *Reduced Disclosure Framework* on the historical cost basis.

These financial statements have been prepared on a going concern basis. Further details are given in the Going Concern Statement on page 58. After due consideration, the Directors consider that the Group has sufficient liquidity headroom to continue in operational existence for a period of at least 18 months from the date of this report and there are no material uncertainties that may cast doubt on the Company's going concern status, accordingly they are satisfied that it is appropriate to adopt the going concern basis of accounting in preparing the Company Financial Statements.

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards (IFRS) as adopted by the UK (UK-adopted international accounting standards), but makes amendments where necessary in order to comply with the Companies Act 2006 and to take advantage of FRS 101 disclosure exemptions:

- a cash flow statement and related notes;
- comparative period reconciliation for investments and financial liabilities;
- comparative period reconciliation for share capital;
- the effects of new, but not yet effective accounting standards; and
- the requirements of IAS 24 *Related Party Disclosures* and has, therefore, not disclosed transactions between the Company and its wholly-owned subsidiaries.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these Financial Statements.

There were no changes to accounting standards that had a material impact on these Financial Statements. The Company's Financial Statements are presented in sterling, which is the Company's functional currency.

As permitted by section 408 of the Companies Act 2006, a separate income statement for the Company has not been included in these Financial Statements. As permitted by the audit fee disclosure regulations, disclosure of non-audit fees information is not included in respect of the Company.

Key areas of judgement and sources of estimation uncertainty

The preparation of financial statements requires the use of certain critical accounting estimates. It also requires the Directors to exercise their judgement in the process of applying the accounting policies. The Directors have not identified any critical estimates or judgements where there is a significant risk of material change in the next 12 months at 31 December 2023.

Material accounting policies

Investments in subsidiary undertakings

Investments included in assets are investments in subsidiary companies, and these are held at historical cost less impairments which is considered annually by the Directors.

Trade payables

Trade payables are recognised initially at the transaction price and subsequently measured at amortised cost using the effective interest method.

Financial instruments

In accordance with IAS 32, the Company's C Shares are classified as financial liabilities and held at amortised cost from the date of issue until redeemed.

Equity

Ordinary shares are classified as equity. Equity instruments are measured at the fair value of the cash or other resources received or receivable, net of the direct costs of issuing the equity instruments. The cost of issuing ordinary shares are charged to the share premium account.

Share-based payments

As described in the Remuneration Report on pages 84 to 110, the Company grants awards of its own shares to employees of its subsidiary undertakings (see note 24 of the Consolidated Financial Statements). The costs of share-based payments in respect of these awards are accounted for, by the Company, as an additional investment in its subsidiary undertakings. The costs are determined in accordance with IFRS 2. Any payments made by the subsidiary undertakings in respect of these arrangements are treated as a return of this investment.

1 Accounting policies continued

Revisions to IFRS applicable in 2023

IFRS 17 Insurance Contracts

IFRS 17 issued in May 2018, establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the Standard. The Standard is effective for years beginning on or after 1 January 2023 with a requirement to restate comparatives.

The Company enters into: financial guarantees where the Company guarantees payment in case of its subsidiary defaulting on a debt; and performance guarantees where the Company guarantees certain subsidiaries performance to a customer. The Company has reviewed and concluded that its arrangements meet the accounting definition of an insurance contract under IFRS 17. The Company has elected to apply IFRS 17 (rather than IFRS 9) to all currently issued financial guarantee contracts. The Company has assessed the probability of losses on its financial and performance guarantees and has determined that the probability is remote after consideration of both historical and forward-looking triggers and as such the estimated liability is immaterial. As a result, no transition accounting entries were required as at 1 January 2023 and, as the estimated liability is immaterial at 31 December 2023, no liability has been recognised in the Company Financial Statements.

At 31 December 2023, financial guarantees of borrowings amounted to £7,601m (2022: £9,724m) of which the total amount of debt drawn is £4,101m (2022: £4,224m). Prior to adoption of IFRS 17, these potential exposures were considered to be contingent liabilities until such time that it became probable that the Company would be required to make a payment under the guarantee. Under IFRS 17, the Company must recognise any obligation at the inception of the contract for the expected fulfilment cash flows under the contract on a best estimate basis (liability for remaining coverage).

2 Investments – subsidiary undertakings

	£m
Cost:	
At 1 January 2023	**14,762**
Cost of share-based payments in respect of employees of subsidiary undertakings less receipts from subsidiaries in respect of those payments	**48**
At 31 December 2023	**14,810**

Details of the Company's subsidiary undertakings and joint venture and associates undertakings are listed on pages 190 to 195.

The carrying value of the Company's investments in subsidiary undertakings has been reviewed for impairment in accordance with IAS 36. No indicators of impairment were identified at 31 December 2023.

3 Trade payables and other liabilities

	2023 £m	2022 £m
Amounts owed to – subsidiary undertakings	**336**	335

Amounts owed to subsidiary undertakings are interest-free and repayable on demand.

4 Financial liabilities

C Shares

Movements during the year were as follows:

	C Shares of 0.1p millions	Nominal value £m
At 1 January 2023	**23,854**	24
Redeemed	**(702)**	(1)
At 31 December 2023	**23,152**	**23**

The rights attaching to C Shares are set out on page 218.

5 Share capital

	Non-equity			Equity	
	Special Share of £1	Preference shares of £1 each	Nominal value £m	Ordinary shares of 20p each Millions	Nominal value £m
Issued and fully paid					
At 1 January 2023	1	–	–	8,368	1,674
Shares issued to employee share trust	–	–	–	49	10
At 31 December 2023	1	–	–	8,417	1,684

The rights attaching to each class of share are set out on page 218.

In accordance with IAS 32, the Company's non-cumulative redeemable preference shares (C Shares) are classified as financial liabilities. Accordingly, movements in C Shares are included in note 4.

6 Reconciliation of net assets between Rolls-Royce Holdings plc Group and Company

As at 31 December 2023, Rolls-Royce Holdings plc consolidated group had net liabilities of £3.6bn (2022: £6.0bn) compared to £14.5bn (2022: £14.4bn) of net assets of the Company. The Company is a holding company and does not trade in its own right. The Company was incorporated in 2011 and became the Rolls-Royce holding company through a Scheme of Arrangement. On becoming the Rolls-Royce holding company, the value of the Company's investment in subsidiaries was based on the market capitalisation of the Rolls-Royce Group at that time. There was an increase in the investment as a result of a capital injection to Rolls-Royce Group Limited during 2020. The Group's consolidated financial statements are prepared on a historical cost basis except where UK adopted international accounting standards requires a valuation basis to be applied (see page 187 for further details). As different principles are applied in preparing the Company and consolidated group balance sheets, there is a difference in the financial position reported. Examples of such differences include the following items that are in the Consolidated balance sheet but not reflected in the Company's balance sheet: net contract liabilities of £13,294m (2022: £10,681m) as a result of IFRS 15; and net financial liabilities of £2,035m (2022: £3,851m) arising from the recognition at fair value of foreign exchange derivatives held to manage exposure on the Group's future trading.

7 Contingent liabilities

For further details on action related to historical matters that could have an impact on the Company, see page 181.

8 Other information

Employees
The Company had no employees in 2023 (2022: none).

Share-based payments
Shares in the Company have been granted to employees of the Group as part of share-based payment plans, and are charged in the employing company.

Emoluments of Directors
The remuneration of the Directors of the Company is shown below, further information is in the Remuneration Report on pages 84 to 110.

The total amount of remuneration paid to Directors for the year ended 31 December 2023 was £10,130,000 (2022: £7,577,000). £5,960,000 of this was attributed to the highest paid Director (2022: £3,718,000).A cash allowance in lieu of company contributions to a pensions scheme was also paid to three Directors (2022: two), which totalled £244,000 (2022: £199,000). No Directors exercised share options during the year (2022: none) or received vested shares under the Long-Term Incentive Plan (2022: none). One director received payments for loss of office which totalled £483,000 (2022: £nil).

No Director accrued any retirement benefits in the year (2022: none).

Subsidiaries

As at 31 December 2023, the companies listed below and on the following pages are indirectly held by Rolls-Royce Holdings plc, except Rolls-Royce Group Limited, which is 100% directly owned by Rolls-Royce Holdings plc and Rolls-Royce plc which Rolls-Royce Holdings plc directly owns 3.54%. The financial year end of each company is 31 December unless otherwise indicated.

Company name	Address	Class of shares	% of class held
Aerospace Transmission Technologies GmbH [1]	Adelheidstrasse 40, D-88046, Friedrichshafen, Germany	Capital Stock	50
Amalgamated Power Engineering Limited [2]	London [3]	Deferred Ordinary	100 100
Bristol Siddeley Engines Limited [2]	London [3]	Ordinary	100
Brown Brothers & Company, Limited [4]	Taxiway, Hillend Industrial Estate, Dalgety Bay, Dunfermline, Fife, KY11 9JT, Scotland	Ordinary	100
C.A. Parsons & Company Limited [4]	London [3]	Ordinary	100
Derby Specialist Fabrications Limited [2]	London [3]	Ordinary	100
Europea Microfusioni Aerospaziali S.p.A.	Zona Industriale AS1, 83040 Morra de Sanctis, Avellino, Italy	Ordinary	100
Heaton Power Limited [2]	London [3]	Ordinary	100
John Thompson Cochran Limited [2]	Taxiway, Hillend Industrial Estate, Dalgety Bay, Dunfermline, Fife, KY11 9JT, Scotland	6% Cumulative Preference Ordinary	100 100
Karl Maybach-Hilfe GmbH	Maybachplatz 1, 88045, Friedrichshafen, Germany	Capital Stock	100
Kinolt Immo SA	Rue de l'Avenir 61, 4460, Grace-Hollogne, Belgium	Ordinary	100
Kinolt Immobilien SA	Rue de l'Avenir 61, 4460, Grace-Hollogne, Belgium	Ordinary	100
Kinolt Trading and Contracting LLC [5]	REGUS Service Office, Office No. 1034, Shoumoukh Tower, 10th Floor, Tower B, C-Ring Road, Al Sadd, PO Box 207207, Doha, Qatar	Ordinary	49
Kinolt Sistemas de UPS SpA	Bucarest No 17 Oficina, No 33, Previdencia, Santiago, Chile	Ordinary	100
Kinolt UK Limited [2]	London [3]	Ordinary	100
LLC Rolls-Royce Solutions Rus	Shabolovka Street 2, 119049, Moscow, Russian Federation	Ordinary	100
MTU Cooltech Power Systems Co., Limited [1]	Building No 2, No 1633 Tianchen Road, Quingpu District, Shanghai, China	Equity	50
MTU India Private Limited [6]	6th Floor, RMZ Galleria, S/Y No. 144 Bengaluru, Bangalore, Kamataka 560,064, India	Ordinary	100
MTU Polska Sp. z o.o.	Ul. Lekka 3., Lokal U4. Raum, PLZ: 01-910, Ort: Warszawa, Poland	Ordinary	100
NEI International Combustion Limited [2]	London [3]	Ordinary	100
NEI Mining Equipment Limited [2]	London [3]	Ordinary	100
NEI Nuclear Systems Limited [2]	London [3]	Ordinary	100
NEI Parsons Limited [2]	London [3]	Ordinary	100
NEI Peebles Limited [2]	London [3]	Ordinary	100
NEI Power Projects Limited [2]	London [3]	Ordinary	100
Nightingale Insurance Limited	PO Box 33, Dorey Court, Admiral Park, St Peter Port GY1 4AT, Guernsey	Ordinary	100
No-Break Power Limited [2]	London [3]	Ordinary	100
Powerfield Limited [2]	Derby [7]	Ordinary	100
PT Rolls-Royce	Secure Building Blok B, Jl. Raya Protokol Halim, Perdanakusuma, Jakarta, 13610, Indonesia	Ordinary	100
PT Rolls Royce Solutions Indonesia	Secure Building Blok B, Jl. Raya Protokol Halim, Perdanakusuma, Jakarta, 13610, Indonesia	Ordinary	100
Rolls-Royce (Ireland) Unlimited Company [2]	Ulster International Finance, 1st Floor IFSC House, IFSC, Dublin 1, Ireland	Ordinary	100
Rolls-Royce (Thailand) Limited	989 Floor 12A, Unit B1, B2, Siam Piwat Tower, Rama 1, Pathumwan, Bangkok, 10330, Thailand	Ordinary	100
Rolls-Royce Aero Engine Services Limited [2]	London [3]	Ordinary	100
Rolls-Royce Australia Pty Limited	Level 1, 60 Martin Place, Sydney NSW 2000, Australia	Ordinary	100
Rolls-Royce Australia Services Pty Limited	Level 1, 60 Martin Place, Sydney NSW 2000, Australia	Ordinary	100
Rolls-Royce Brasil Limitada	Rua Jose Versolato, No. 111, Torre B, Sala 2502, Centro, São Bernando do Campo, Sao Paulo, CEP 09750-730, Brazil	Quotas	100
Rolls-Royce Canada Limited	9500 Côte de Liesse, Lachine, Québec H8T 1A2, Canada	Common Stock	100
Rolls-Royce Chile SpA	Alcantra 200 office 601, Piso 6, C.O, 7550159 Las Condes, Santiago, Chile	Ordinary	100
Rolls-Royce China Holding Limited	305 Indigo Building 1, 20 Jiuxianqiao Road, Beijing, 100016, China	Registered Capital	100
Rolls-Royce Commercial Aero Engines Limited [2]	London [3]	Ordinary	100
Rolls-Royce Controls and Data Services Limited [2]	London [3]	Ordinary	100
Rolls-Royce Controls and Data Services (NZ) Limited	c/o Deloitte, 80 Queen Street, Auckland Central, Auckland 1010, New Zealand	Ordinary	100

Company name	Address	Class of shares	% of class held
Rolls-Royce Controls and Data Services (UK) Limited [4]	Derby [7]	Ordinary	100
Rolls-Royce Corporation	Wilmington [8]	Common Stock	100
Rolls-Royce Crosspointe LLC	Wilmington [8]	Partnership (no equity)	100
Rolls-Royce Defense Products and Solutions, Inc.	Wilmington [8]	Common Stock	100
Rolls-Royce Defense Services, Inc.	Wilmington [8]	Common Stock	100
Rolls-Royce Deutschland Ltd & Co KG	Amtsgericht Potsdam, Blankenfelde-Mahlow, Germany	Ordinary	100
Rolls-Royce Electrical Norway AS	Jarleveien 8A, 7041, Trondheim 500, Norway	Ordinary	100
Rolls-Royce Energy Angola, Limitada [2]	Rua Rei Katyavala, Edificio Rei Katyavala, Entrada B, Piso 8, Luanda, Angola	Quota	100
Rolls-Royce Energy Systems Inc. [2]	Wilmington [8]	Common Stock	100
Rolls-Royce Engine Services Holdings Co.	Wilmington [8]	Common Stock	100
Rolls-Royce Engine Services Limitada Inc. [9]	Bldg. 06 Berthaphil Compound, Jose Abad Santos Avenue, Clark Special Economic Zone, Clark, Pampanga, Philippines	Capital Stock	100
Rolls-Royce Erste Beteiligungs GmbH	Eschenweg 11, 15827 Blankenfelde-Mahlow, Germany	Capital Stock	100
Rolls-Royce Finance Company Limited [2]	London [3]	Deferred Ordinary	100 100
Rolls-Royce Finance Holdings Co.	Wilmington [8]	Common Stock	100
Rolls-Royce Fuel Cell Systems Limited [4]	Derby [7]	Ordinary	100
Rolls-Royce General Partner (Ireland) Limited	29 Earlshot Terrace, Dublin 2, Ireland	Ordinary	100
Rolls-Royce General Partner Limited [2]	London [3]	Ordinary	100
Rolls-Royce Group Limited [13]	London [3]	Ordinary Ordinary A	100
Rolls-Royce High Temperature Composites, Inc.	Corporation Service Company, 2710 Gateway Oaks Drive, Suite 150N, Sacramento, California 95833, United States	Ordinary	100
Rolls-Royce Holdings Canada Inc.	9500 Côte de Liesse, Lachine, Québec H8T 1A2, Canada	Common C	100
Rolls-Royce Hungary Kft	Gizella U. 51–57, 1143 Budapest, Hungary	Cash shares	100
Rolls-Royce India Limited [2, 6, 10]	Derby [7]	Ordinary	100
Rolls-Royce India Private Limited [6]	Birla Tower West, 2nd Floor 25, Barakhamba Road, New Delhi, 110001, India	Equity	100
Rolls-Royce Industrial & Marine Power Limited [4]	London [3]	Ordinary	100
Rolls-Royce Industrial Power (India) Limited [2, 6, 10]	Derby [7]	Ordinary	100
Rolls-Royce Industrial Power Engineering (Overseas Projects) Limited [4]	Derby [7]	Ordinary	100
Rolls-Royce Industries Limited [4]	Derby [7]	Ordinary	100
Rolls-Royce International Limited	Derby [7]	Ordinary	100
Rolls-Royce Japan Co., Limited	31st Floor, Kasumigaseki Building, 3-2-5 Kasumigaseki, Chiyoda-Ku, Tokyo, 100-6031, Japan	Ordinary	100
Rolls-Royce Leasing Limited	Derby [7]	Ordinary	100
Rolls-Royce Malaysia Sdn. Bhd.	Unit A-3-6 TTDI Plaza, Jalan Wan Kadir 3, Taman Tun Dr Ismail, 6000 Kuala Lumpur, Malaysia	Ordinary	100
Rolls-Royce Marine North America, Inc.	Wilmington [8]	Common Stock	100
Rolls-Royce Military Aero Engines Limited [2, 6, 10]	London [3]	Ordinary	100
Rolls-Royce New Zealand Limited	c/o Deloitte, 80 Queen Street, Auckland Central, Auckland 1010, New Zealand	Ordinary	100
Rolls-Royce North America (USA) Holdings Co.	Wilmington [8]	Common Stock	100
Rolls-Royce North America Holdings, Inc.	Wilmington [8]	Common Stock	100
Rolls-Royce North America Ventures, Inc.	Wilmington [8]	Common Stock	100
Rolls-Royce North America, Inc.	Wilmington [8]	Common Stock	100

Company name	Address	Class of shares	% of class held
Rolls-Royce North American Technologies, Inc.	Wilmington [8]	Common Stock	100
Rolls-Royce Oman LLC	Bait Al Reem, Business Office #131, Building No 81, Way No 3409, Block No 234, Al Thaqafa Street, Al Khuwair, PO Box 20, Postal Code 103, Oman	Ordinary	100
Rolls-Royce Operations (India) Private Limited [2, 6]	Birla Tower West, 2nd Floor, 25 Barakhamba Road, New Delhi, 110001, India	Ordinary	100
Rolls-Royce Overseas Holdings Limited [4]	Derby [7]	Ordinary Ordinary A	100 100
Rolls-Royce Overseas Investments Limited [4]	Derby [7]	Ordinary	100
Rolls-Royce Placements Limited	London [3]	Ordinary	100
Rolls-Royce plc	London [3]	Ordinary	100
Rolls-Royce Power Engineering Limited	Derby [7]	Ordinary	100
Rolls-Royce Power Systems AG	Maybachplatz 1, 88045, Friedrichshafen, Germany	Ordinary	100
Rolls-Royce Retirement Savings Trust Limited [2, 6]	Derby [7]	Ordinary	100
Rolls-Royce Saudi Arabia Limited	3010 – Al Arid, Unit No 1, Riyadh 13332 – 7663, Saudi Arabia	Cash shares	100
Rolls-Royce Singapore Pte. Ltd.	6 Shenton Way, #33-00 OUE, Downtown Singapore 068809, Singapore	Ordinary	100
Rolls-Royce SMR Limited	Derby [7]	Ordinary	75.7
Rolls-Royce Solutions (Suzhou) Co. Ltd	9 Long Yun Road, Suzhou Industrial Park, Suzhou 215024, Jiang Su, China	Ordinary	100
Rolls-Royce Solutions Africa (Pty) Limited	36 Marconi Street, Montague Gardens, Cape Town, 7441, South Africa	Capital Stock	100
Rolls-Royce Solutions America Inc.	Wilmington [8]	Ordinary	100
Rolls-Royce Solutions Asia Pte. Limited	10 Tukang Innovation Drive, Singapore 618302	Ordinary	100
Rolls-Royce Solutions Augsburg GmbH	Dasinger Strasse 11, 86165, Augsburg, Germany	Capital Stock	100
Rolls-Royce Solutions Benelux B.V.	Merwedestraat 86, 3313 CS, Dordrecht, Netherlands	Ordinary	100
Rolls-Royce Solutions Berlin GmbH	Villa Rathenau, Wilhelminenhofstrasse 75, 12459 Berlin, Germany	Common Seed Preferred Series A Preferred	100 100 100
Rolls-Royce Solutions Brasil Limitada	Via Anhanguera, KM 29203, 05276-000 Sao Paulo – SP, Brazil	Ordinary	100
Rolls-Royce Solutions Enerji Deniz Ve Savunma Anonim Şirketi	Hatira Sokak, No. 5, Ömerli Mahellesi, 34555 Arnavutköy, Istanbul, Turkey	Ordinary	100
Rolls-Royce Solutions France S.A.S.	Immeuble Colorado, 8/10 rue de Rosa Luxembourg-Parc des Bellevues 95610, Erangy-sur-Oise, France	Ordinary	100
Rolls-Royce Solutions GmbH	Maybachplatz 1, 88045, Friedrichshafen, Germany	Capital Stock	100
Rolls-Royce Solutions Hong Kong Limited	No.8 Hart Avenue, Unit D, 8th Floor, Tsim Sha Tsui, Kowloon, Hong Kong	Ordinary	100
Rolls-Royce Solutions Ibérica s.l.u.	Calle Copérnico 26–28, 28823 Coslada, Madrid, Spain	Ordinary	100
Rolls-Royce Solutions Israel Limited	4 Ha'Alon Street, South Building, Third Floor, 4059300 Kfar Neter, Israel	Ordinary	100
Rolls-Royce Solutions Italia S.r.l.	Via Aurelia Nord, 328, 19021 Arcola (SP), Italy	Capital Stock	100
Rolls-Royce Solutions Japan Co. Limited	Resorttrust Building 4-14-3, Nishitenma Kita-ku, Osaka 530-0047, Japan	Ordinary	100
Rolls-Royce Solutions Korea Limited	22nd Floor, Olive Tower, 41 Sejongdaero 9 gil, Junggu, 100-737 Seoul, Republic of Korea	Ordinary	100
Rolls-Royce Solutions Liège Holding S.A.	Rue de l'Avenir 61, 4460, Grace-Hollogne, Belgium	Ordinary	100
Rolls-Royce Solutions Liège S.A.	Rue de l'Avenir 61, 4460, Grace-Hollogne, Belgium	Ordinary	100
Rolls-Royce Solutions Magdeburg GmbH	Friedrich-List-Strasse 8, 39122 Magdeburg, Germany	Capital Stock	100
Rolls-Royce Solutions Mexico City S.A. de C.V.	Xochicalco 620, Colonia Letran Valle, Delegacion Benito Juarez, Mexico City 03650, Mexico	Common Shares	100
Rolls-Royce Solutions Middle East FZE	S3B5SR06, Jebel Ali Free Zone, South P.O. Box 61141, Dubai, United Arab Emirates	Ordinary	100
Rolls-Royce Solutions Ruhstorf GmbH	Rotthofer Strasse 8, 94099 Ruhstorf a.d. Rott, Germany	Capital Stock	100
Rolls-Royce Solutions South Africa (Pty) Limited	36 Marconi Street, Montague Gardens, Cape Town, 7441, South Africa	Ordinary	100
Rolls-Royce Solutions UK Limited	Derby [7]	Ordinary	100
Rolls-Royce Solutions Willich GmbH	Konrad-Zuse-Str. 3, 47877, Willich, Germany	Ordinary	100
Rolls-Royce Sp z.o.o.	Opolska 100 31-323, Krakow, Poland	Ordinary	100
Rolls-Royce Submarines Limited	Atlantic House, Raynesway, Derby, Derbyshire DE21 7BE, United Kingdom	Ordinary	100
Rolls-Royce Technical Support Sarl	Centreda I, Avenue Didier Daurat, 31700 Blagnac, Toulouse, France	Ordinary	100

Company name	Address	Class of shares	% of class held
Rolls-Royce Total Care Services Limited [4]	Derby [7]	Ordinary	100
Rolls Royce Turkey Güç Çözümleri San. ve Tic.Ltd.Şti.	Acıbadem Mah. Çeçen Sk. Akasya A Kule Kent Etabı Blok No: 25, İç Kapı No:13, Üsküdar, Istanbul, Turkey	Cash shares	100
Rolls-Royce UK Pension Fund Trustees Limited [2]	Derby [7]	Ordinary	100
Rolls-Royce Zweite Beteiligungs GmbH	Eschenweg 11, 15827 Blankenfelde-Mahlow, Germany	Capital Stock	100
Ross Ceramics Limited	Derby [7]	Ordinary	100
Servowatch Systems Limited	Endeavour House, Benbridge Industrial Estate, Holloway Road, Heybridge, Maldon, Essex CM9 4ER, United Kingdom	Ordinary	100
Sharing in Growth UK Limited [11]	Derby [7]	Limited by guarantee	100
Spare IPG 20 Limited [4]	London [3]	Ordinary	100
Spare IPG 21 Limited [2]	London [3]	Ordinary	100
Spare IPG 24 Limited [4]	London [3]	Ordinary	100
Spare IPG 32 Limited [4]	London [3]	Ordinary	100
Spare IPG 4 Limited [2]	London [3]	Ordinary	100
Team Italia Marine S.R.L.	Kampanien, Via Luigi Einaudi 114/B, 61032 Fano, Pesaro and Urbino, Italy	Ordinary	100
The Bushing Company Limited [4]	London [3]	Ordinary	100
Timec 1487 Limited [2]	London [3]	Ordinary	100
Turbine Surface Technologies Limited [1]	Unit 13a, Little Oak Drive, Sherwood Park, Annesley, Nottinghamshire NG15 0DR, United Kingdom	Ordinary A Ordinary B	Nil 100
Vessel Lifter, Inc. [2]	Corporation Service Company, 1201 Hays Street, Tallahassee, Florida 32301, United States	Common Stock	100
Vinters Defence Systems Limited [2]	London [3]	Ordinary	100
Vinters Engineering Limited	Derby [7]	Ordinary	100
Vinters International Limited [4]	Derby [7]	Ordinary	100
Vinters Limited [4]	Derby [7]	Ordinary	100
Vinters-Armstrongs (Engineers) Limited [2]	London [3]	Ordinary	100
Vinters-Armstrongs Limited [2]	London [3]	Ordinary B	100
Yocova Private Ltd [2]	London [3]	Ordinary	100
Yocova PTE. Ltd.	6 Shenton Way, #33-00 OUE, Downtown Singapore 068809, Singapore	Ordinary	100

1 Although the interest held is 50%, the Company controls the entity (see note 1 to the Consolidated Financial Statements) and, as a result, consolidates the entity and records a non-controlling interest
2 Dormant entity
3 Kings Place, 90 York Way, London N1 9FX, United Kingdom
4 Entity to take advantage of s479A Companies Act 2006 (s479A) audit exemption for the year ended 31 December 2023. Rolls-Royce plc will issue a guarantee pursuant to s479A in relation to the liabilities of the entity
5 Although the interest held is 49%, the Company controls the entity (see note 1 to the Consolidated Financial Statements) and, as a result, consolidates the entity and records a non-controlling interest
6 Reporting year end is 31 March 2024
7 Moor Lane, Derby, Derbyshire DE24 8BJ, United Kingdom
8 Corporation Service Company, 251 Little Falls Drive, Wilmington, Delaware 19809, United States
9 Entity in liquidation
10 Entity to take advantage of s479A Companies Act 2006 (s479A) audit exemption for the year ending 31 March 2024. Rolls-Royce plc will issue a guarantee pursuant to S479A in relation to the liabilities of the entity
11 The entity is not included in the consolidation, as Rolls-Royce plc does not have a beneficial interest in the net assets of the entity
12 The entity is accounted for as a joint operation (see note 1 to the Consolidated Financial Statements)
13 Entity to take advantage of s479A Companies Act 2006 (s479A) audit exemption for the year ended 31 December 2023. The Company will issue a guarantee pursuant to s479A in relation to the liabilities of the entity
14 Entity is accounted for as a joint venture as approval is required from the other shareholder for operationally running the affairs of the entity

Joint ventures and associates

Company name	Address	Class of shares	% of class held	Group interest held %
Aero Gearbox International SAS [12]	18 Boulevard Louis Sequin, 92700 Colombes, France	Ordinary	50	50
Airtanker Services Limited	Airtanker Hub, RAF Brize Norton, Carterton, Oxfordshire OX18 3LX, United Kingdom	Ordinary	23.5	23.5
Alpha Leasing (US) (No.2) LLC	Wilmington [8]	Partnership (no equity held)	–	50
Alpha Leasing (US) (No.4) LLC	Wilmington [8]	Partnership (no equity held)	–	50
Alpha Leasing (US) (No.5) LLC	Wilmington [8]	Partnership (no equity held)	–	50
Alpha Leasing (US) (No.6) LLC	Wilmington [8]	Partnership (no equity held)	–	50
Alpha Leasing (US) (No.7) LLC	Wilmington [8]	Partnership (no equity held)	–	50
Alpha Leasing (US) (No.8) LLC	Wilmington [8]	Partnership (no equity held)	–	50
Alpha Leasing (US) LLC	Wilmington [8]	Partnership (no equity held)	–	50
Alpha Partners Leasing Limited	1 Brewer's Green, London SW1H 0RH, United Kingdom	Ordinary A	100	50
Beijing Aero Engine Services Company Limited	Room 711, Building 2, No.1 Jinhang Middle Road, Shunyi District, Beijing, China	Capital	50	50
CFMS Limited	43 Queen Square, Bristol BS1 4QP, United Kingdom	Limited by guarantee	–	50
Clarke Chapman Portia Port Services Limited	Maritime Centre, Port of Liverpool, Liverpool L21 1LA, United Kingdom	Ordinary A	100	50
Egypt Aero Management Services [9]	EgyptAir Engine Workshop, Cairo International Airport, Cairo, Egypt	Ordinary	50	50
EPI Europrop International GmbH	Pelkovenstr. 147, 80992 München, Germany	Capital Stock	28	28
Eurojet Turbo GmbH	Lilienthalstrasse 2b, 85399 Halbergmoos, Germany	Ordinary	33	33
Force MTU Power Systems Private Limited	Mumbai Pune Road, Akurdi, Pune, Maharashtra 411035, India	Capital Stock	49	49
Genistics Holdings Limited	Derby [7]	Ordinary A	100	50
Global Aerospace Centre for Icing and Environmental Research Inc. [12]	1000 Marie-Victorin Boulevard, Longueuil Québec J4G 1A1, Canada	Ordinary	50	50
Hoeller Electrolyzer GmbH [14]	Alter Holzhafen, 23966 Wismar, Germany	Ordinary	54.2	54.2
Hong Kong Aero Engine Services Limited	33rd Floor, One Pacific Place, 88 Queensway, Hong Kong	Ordinary	50	50
International Aerospace Manufacturing Private Limited [6, 12]	Survey No. 3 Kempapura Village, Varthur Hobli, Bangalore, KA 560037, India	Ordinary	50	50
ITP Next Generation Turbines SLU	Parque Tecnologico Edificio 300, 48170, Zamudio, Vizcaya, Spain	Ordinary-B	25	25
Light Helicopter Turbine Engine Company (unincorporated partnership)	Suite 119, 9238 Madison Boulevard, Madison, Alabama 35758, United States	Partnership (no equity held)	–	50
Manse Opus Management Company Limited [6]	Third Floor Queensberry House, 3 Old Burlington Street, London W1S 3AE, United Kingdom	Limited by guarantee	33	33
MEST Co., Limited	97 Bukjeonggongdan 2-gil, Yangsan-si, Gyeongsangnam-do, 50571, Republic of Korea	Normal	46.8	46.8
MTU Power Systems Sdn. Bhd.	Level 10 Menara LGB, 1 Jalan Wan Kadir Taman Tun Dr Ismail 6000 Kuala Lumpur, Malaysia	Ordinary A	100	49
MTU Turbomeca Rolls-Royce ITP GmbH	Am Söldnermoos 17, 85399 Hallbergmoos, Germany	Capital Stock	25	25
MTU Turbomeca Rolls-Royce GmbH	Am Söldnermoos 17, 85399 Hallbergmoos, Germany	Capital Stock	33.3	33.3
MTU Yuchai Power Company Limited	No 7 Danan Road, Yuzhou, Yulin, Guangxi, China, 537005, China	Capital Stock	50	50
N3 Engine Overhaul Services GmbH & Co KG	Gerhard-Höltje-Strasse 1, D-99310, Arnstadt, Germany	Capital Stock	50	50
N3 Engine Overhaul Services Verwaltungsgesellschaft Mbh	Gerhard-Höltje-Strasse 1, D-99310, Arnstadt, Germany	Capital Stock	50	50
Rolls Laval Heat Exchangers Limited [2]	Derby [7]	Ordinary	50	50
Rolls-Royce & Partners Finance (US) (No 2) LLC	Wilmington [8]	Partnership (no equity held)	–	50
Rolls-Royce & Partners Finance (US) LLC	Wilmington [8]	Partnership (no equity held)	–	50
SAFYRR Propulsion Limited [2]	Derby [7]	B Shares	100	50
Singapore Aero Engine Services Private Limited	11 Calshot Road, 509932, Singapore	Ordinary	50	50
Taec Ucak Motor Sanayi AS	Levent Mahallesi Prof. Ahmet Kemal Aru Sk. No: 4/1, Beşiktaş, Turkey	Cash Shares	49	49

Company name	Address	Class of shares	% of class held	Group interest held %
Techjet Aerofoils Limited [12]	Tefen Industrial Zone, PO Box 16, 24959, Israel	Ordinary A Ordinary B	50 50	50
TRT Limited	Derby [7]	Ordinary B	100	50
Turbo-Union GmbH	Lilienthalstrasse 2b, 85399 Halbergmoos, Germany	Capital Stock	40.0	40.0
United Battery Management GmbH [9]	Wilhelminenhofstr. 76/77, 12459, Berlin, Germany	Ordinary	30	30
Xian XR Aero Components Co., Limited [12]	Xujiawan, Beijiao, Po Box 13, Xian 710021, Shaanxi, China	Ordinary	49	49

1 Although the interest held is 50%, the Company controls the entity (see note 1 to the Consolidated Financial Statements) and, as a result, consolidates the entity and records a non-controlling interest
2 Dormant entity
3 Kings Place, 90 York Way, London N1 9FX, United Kingdom
4 Entity to take advantage of s479A Companies Act 2006 (s479A) audit exemption for the year ended 31 December 2023. Rolls-Royce plc will issue a guarantee pursuant to s479A in relation to the liabilities of the entity
5 Although the interest held is 49%, the Company controls the entity (see note 1 to the Consolidated Financial Statements) and, as a result, consolidates the entity and records a non-controlling interest
6 Reporting year end is 31 March 2024
7 Moor Lane, Derby, Derbyshire DE24 8BJ, United Kingdom
8 Corporation Service Company, 251 Little Falls Drive, Wilmington, Delaware 19809, United States
9 Entity in liquidation
10 Entity to take advantage of s479A Companies Act 2006 (s479A) audit exemption for the year ending 31 March 2024. Rolls-Royce plc will issue a guarantee pursuant to S479A in relation to the liabilities of the entity
11 The entity is not included in the consolidation, as Rolls-Royce plc does not have a beneficial interest in the net assets of the entity
12 The entity is accounted for as a joint operation (see note 1 to the Consolidated Financial Statements)
13 Entity to take advantage of s479A Companies Act 2006 (s479A) audit exemption for the year ended 31 December 2023. The Company will issue a guarantee pursuant to s479A in relation to the liabilities of the entity
14 Entity is accounted for as a joint venture as approval is required from the other shareholder for operationally running the affairs of the entity

Independent auditors' report

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF ROLLS-ROYCE HOLDINGS PLC

Report on the audit of the financial statements

Opinion

In our opinion:

- Rolls-Royce Holdings plc's consolidated financial statements and company financial statements (the "financial statements") give a true and fair view of the state of the group's and of the company's affairs as at 31 December 2023 and of the group's profit and the group's cash flows for the year then ended;
- the consolidated financial statements have been properly prepared in accordance with UK-adopted international accounting standards as applied in accordance with the provisions of the Companies Act 2006;
- the company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, including FRS 101 "Reduced Disclosure Framework", and applicable law); and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report, which comprise: the consolidated and company balance sheets as at 31 December 2023; the consolidated income statement, the consolidated statement of comprehensive income, the consolidated cash flow statement, the consolidated and company statements of changes in equity for the year then ended; and the notes to the financial statements, comprising material accounting policy information and other explanatory information.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided.

Other than those disclosed in note 7, we have provided no non-audit services to the company or its controlled undertakings in the period under audit.

Our audit approach

Overview

Audit scope

- Following our assessment of the risks of material misstatement of the financial statements, including the impact of climate change, we subjected 35 individual components (including three joint ventures) to full scope audits for group reporting purposes, which with an element of sub-consolidation, equates to 16 group reporting opinions. In addition, nine components performed targeted specified audit procedures.
- The group engagement team audited the company and other centralised functions including those covering the group treasury operations, corporate taxation, post-retirement benefits, and certain goodwill and intangible asset impairment assessments. The group engagement team performed audit procedures over the group consolidation and financial statements disclosures and performed group level analytical procedures over out of scope components.
- The components on which audit procedures were performed accounted for 96% of revenue, 76% of profit before taxation and 90% of total assets.
- Some centralised audit testing was performed where appropriate for reporting components in group audit scope who are supported by the group's Finance Service Centres (FSCs).
- As part of the group audit supervision process, the group engagement team met with and discussed the approach and results of audit procedures with component teams and reviewed their audit files and final deliverables. In person site visits to components in the UK, Germany and US were also performed.

Key audit matters

- Long-term contract accounting and associated provisions (group)
- Deferred tax asset recognition and recoverability (group)
- Translation of foreign currency denominated transactions and balances (group)
- Presentation and accuracy of underlying results and disclosure of other one-off items (including exceptional items) (group)
- Recoverability of the company's investments in subsidiary undertakings (company)

Materiality

- Overall group materiality: £93m (2022: £80m) based on approximately 0.6% of underlying revenue (2022: approximately 0.6% of five year average underlying revenues from continuing operations).
- Overall company materiality: £147m (2022: £147m) based on approximately 1.0% of total assets.
- Performance materiality: £70m (2022: £60m) (group) and £110m (2022: £110m) (company).

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

This is not a complete list of all risks identified by our audit.

The key audit matters below are consistent with last year.

Key audit matter	How our audit addressed the key audit matter
Long-term contract accounting and associated provisions (group) *Audit Committee report and note 1 to the consolidated financial statements – Accounting policies – Revenue recognition and contract assets and liabilities* The Civil Aerospace and Defence businesses operate primarily with long-term customer contracts that span multiple periods. These long-term contracts require a number of assumptions to be made in order to determine the expected lifetime revenue and costs of the contract and the amounts of revenue and profit/loss that are recognised in each reporting period. Small adjustments in assumptions can have a significant impact on the results of an individual financial year. Changes to the profile of shop visits or operating conditions of engines can result in different performance assumptions and hence cost profiles. Some contracts include inflation linked price escalations which require judgement to determine the extent to which future price increases are highly probable not to reverse and therefore can be recognised. These changes to forecasts can result in revisions to the revenue previously recognised. For Defence, long-term contracts tend to be for a fixed price or based on a cost plus or target cost reimbursement for qualifying costs and there are also some flying hours arrangements. For Civil Aerospace aftermarket contracts, income is earned based on engine flying hours (EFH). Management is required to estimate this to determine the total income expected over the life of a contract. The group expects large engine EFH to recover to pre-pandemic levels during 2024. In addition, the profitability of Civil Aerospace aftermarket contracts typically assumes that there will be significant cost improvements over the lifetime (eight to 15 years) of the contracts. Significant assumptions need to be made in determining time-on-wing, whether incremental costs should be treated as wastage or are part of the ongoing cost of servicing a contract, future exchange rates used to translate foreign currency income and costs and other operating parameters used to calculate the projected life cycle. These future costs are also risk adjusted to take into account forecasting accuracy which represents an additional judgement. At the development stage of a programme, agreements are entered into with certain Civil Aerospace suppliers to share in the risk and rewards of the contracts (Risk and Revenue Sharing Partners – 'RRSP'). This can involve upfront participation fees from the RRSP that are amortised over the engine production phase. In addition, certain revenue and costs are recorded in the consolidated income statement net of the RRSP's share. The nature of the Civil Aerospace business gives rise to a number of contractual guarantees, warranties and potential claims, including the in-service issues of the Trent 1000 programme. The accounting for these can be complex and judgemental and may impact the consolidated income statement immediately or over the life of the contract. The valuation of provisions for the associated amounts are judgemental and need to be considered on a contract by contract basis.	We focused our work on a number of contracts where we consider there to be the highest degree of management judgement or estimation and designed specific procedures over the long-term contract accounting targeted at the associated risks. We also sample tested the remaining population of contracts. The audit procedures performed included: – We attended meetings with Civil Aerospace and Defence engine programme and customer contract managers in order to understand the operational matters impacting the performance of specific contracts and any amendments to contractual arrangements that could have an impact on performance; – We obtained and read the relevant sections of a sample of contracts to understand the key terms including performance obligations and pricing structures; – We assessed how management had forecast the speed and shape of the recovery of engine flying hours including by considering the downside scenarios modelled and comparing the assumptions to industry data; – We challenged management's judgments and associated risk adjustments relating to the risk of customer default and insolvency; – We re-performed the calculations used to determine the degree of completion for a sample of contracts and this was also used in assessing the magnitude of any catch-up adjustments; – We compared the previously forecast results of a sample of contracts with the actual results to assess the performance of the contract and the historical accuracy of forecasting; – We verified a sample of costs incurred to third party documentation in order to assess the validity of the forecast costs to complete; – We assessed the assumptions relating to life cycle cost reductions to determine the likelihood of realisation and where relevant the speed at which they would be achieved, including the impact on the number of shop visits, validating these assumptions directly with the senior programme engineers; – We obtained support for the risk adjustments made in respect of future costs and challenged management's assumptions through assessment against historical performance, known technical issues and the stage of completion of the programme; – We recalculated the price escalation included within the contracts; – We challenged the assessment of provisions for onerous contracts to determine the completeness of the unavoidable costs to fulfil the contractual obligations. We also validated the rates used to discount the future cash flows; – We assessed the sensitivity of the Trent 1000 provision to reasonable changes in estimates, particularly in respect of the repair and overhaul facility capacity, technical cost creep on the known issues and cost outturns against previous provisions, in determining whether the provision was sufficient; – We read and understood the key terms of a sample of RRSP contracts to assess whether revenue and costs had been appropriately reflected, net of the share attributable to the RRSP in the consolidated income statement;

Key audit matter	How our audit addressed the key audit matter
Long-term contract accounting and associated provisions (group) continued Management has modelled the potential impact of climate change on its forecasts and has incorporated these estimates into the long-term contracts for Civil Aerospace, which is the business with the highest expected exposure to the impact of climate change. This included incorporating the potential impact of carbon prices on the group's direct emissions including engine testing and those of its suppliers and the potential impact of climate change on commodity prices in cost estimates. The impact of climate change on long-term contracts is highly uncertain and requires estimates on carbon prices, the cost and speed of decarbonisation, the ability of the group and its suppliers to pass on incremental costs and assessing the associated impact on aviation demand.	— With assistance from our valuation experts, we considered the appropriateness of the key assumptions used by management to model the impact of climate change, including deploying valuation experts to benchmark the carbon and commodity price forecasts utilised. We validated management's assertions on the ability of suppliers and the group to pass on incremental costs by reviewing supplier and customer contracts for price change mechanisms. Where appropriate we performed independent sensitivity analysis to determine to what extent reasonably possible changes in these assumptions could result in material changes to the revenue recorded in the year and assessed the appropriateness of the associated disclosures; — We read and challenged management's accounting papers that were prepared to explain the positions taken in respect of their key contract judgements; — We considered whether there were any indicators of management override of controls or bias in arriving at their reported position; and — We also assessed the adequacy of disclosures in note 1 of the key judgements and estimates involved in long-term contract accounting. Based on the work performed, we concur that management's estimates for long-term contract accounting and associated provisions are materially appropriate, in the context of the financial statements taken as a whole.
Deferred tax asset recognition and recoverability (group) *Audit Committee report, note 1 to the consolidated financial statements – Accounting policies – Taxation and note 5 to the consolidated financial statements – Taxation* The recognition and recoverability of deferred tax assets in Rolls-Royce plc, where there have been significant taxable losses in the past, is based on a number of significant assumptions. Deferred tax assets can be recognised in relation to these losses to the extent it is probable that there will be sufficient future taxable profits to utilise them. Rolls-Royce plc has recognised significant deferred tax assets on the basis of expected future levels of profitability. The magnitude of the assets recognised necessitates the need for a number of assumptions in assessing the future levels of profitability in the UK over an extended period. This requires assumptions on future profits from the group's aftermarket and original equipment sales including EFH, associated costs and the future exchange rates used to translate foreign currency denominated amounts. At 31 December 2023, the group recognised £2,399m (2022: £2,183m) of deferred tax assets in the UK of which £1,476m (2022: £1,054m) relate to tax losses. £406m of additional deferred tax assets have been recognised in the year as a result of the latest assessment, including from the impact of new contracts (including the trilateral AUKUS agreement) signed in the year, the growth in Civil EFH, the expected outcome of the group's strategic initiatives and other macroeconomic factors. £1,635m of potential deferred tax assets in relation to UK losses remain unrecognised on the basis that management has judged there are not yet sufficient probable future taxable profits for them to be utilised against.	We evaluated management's methodology for assessing the recognition and recoverability of deferred tax assets, including the ability to offset certain deferred tax liabilities and deferred tax assets. Where recognition is supported by the availability of sufficient probable taxable profits in future periods against which brought forward tax losses can be utilised, our evaluation of these future profits considered both the business model and the applicable UK tax legislation. We assessed the future profit forecasts of the UK tax group and the underpinning assumptions including management's risk weighting of particular profit streams in Rolls-Royce plc and tested that the assumptions, including the forecasts for periods beyond the normal five year forecasting horizon, were reasonable. In doing this, we verified that the forecasts did not include taxable profit growth that could not be demonstrated as probable. Where applicable we assessed the consistency of the forecasts used to justify the recognition of deferred tax assets to those used elsewhere in the business, including for long-term contract accounting, for the going concern assessment and longer term viability statement. We also assessed the risk adjustments applied by management to these profit forecasts to future periods that are significantly further in time than the group's normal five year forecasting process and considered whether these appropriately reflect the estimation risk in the longer term forecasts.

Key audit matter	How our audit addressed the key audit matter
Deferred tax asset recognition and recoverability (group) continued The existence of tax losses brought forward from prior periods and other deductible temporary differences in Rolls-Royce plc, combined with the impact of climate change on future forecasts, presents a heightened risk that deferred tax assets previously recognised may not be recoverable. Since the recognised deferred tax asset is recoverable over a long period, management has reflected their assessment of the impact of climate change within the model forecasting probable taxable profits. This incorporates multiple assumptions including future carbon prices, commodity prices, the impact of government action on aviation demand, the cost and speed of decarbonisation and the ability of suppliers and Rolls-Royce plc to pass on price changes. To assess the impact of inherent uncertainty management has performed sensitivities over key estimates.	We considered the appropriateness of the climate change assumptions modelled as part of their probability weighted scenarios to forecast probable profit levels and performed consistent procedures to those set-out in the long-term contract accounting and associated provisions key audit matter. We also performed additional sensitivity analysis to understand whether reasonably possible changes to these assumptions could lead to a material change in the recognised asset and where appropriate ensured that adequate disclosure was provided. We assessed the treatment of the losses that are realised or unrealised on the group's hedge book and whether they were treated appropriately and how they are recovered using the same profit forecasts. We also assessed the adequacy of disclosures over this area, particularly the impact of changes in key estimates of the asset recognised and this has been disclosed in notes 1 and 5. We did not identify any material uncorrected exceptions from our audit work.
Translation of foreign currency denominated transactions and balances (group) *Note 1 to the consolidated financial statements – Accounting policies – Foreign currency translation* Foreign exchange rate movements influence the reported consolidated income statement, the consolidated cash flow statement and consolidated balance sheet. One of the group's primary accounting systems that is used by a number of its subsidiaries translates transactions and balances denominated in foreign currencies at a fixed budget rate for management information purposes. Foreign currency denominated transactions and balances are then re-translated to actual average and closing spot rates through manual adjustments. Due to the manual nature of the process and significance of the recurring adjustments needed there is a risk that transactions and balances denominated in foreign currencies are incorrectly translated in the consolidated financial statements.	We performed the following specific audit procedures over this area: — Obtained an understanding of the process employed by management to correctly record the translation of foreign currency balances and transactions; — Tested system reports identifying transactions and balances in source currency by agreeing these to general ledger balances; — Tested on a sample basis the manual calculations of the adjustment needed to correctly record the translation of the foreign currency denominated transactions and balances; — Sampled balances and transactions requiring adjustment by source currency and tested to source data and assessed the completeness of these balances and transactions; — Created an independent expectation of the gain on the translation of monetary assets and liabilities based on the movements in the group's key exchange rates and associated balances in the year and compared this to the gain recorded in the year; and — Agreed the exchange rates used in management's translation adjustments to an independent source. There were no material uncorrected exceptions from our audit work.

Key audit matter	How our audit addressed the key audit matter
Presentation and accuracy of underlying results and disclosure of other one-off items (including exceptional items) (group) *Note 1 to the consolidated financial statements – Accounting policies – Presentation of underlying results, note 2 to the consolidated financial statements – Segmental analysis and note 28 to the consolidated financial statements – Derivation of summary funds flow statement* In addition to the performance measures prescribed by International Financial Reporting Standards, the group also presents its results on an underlying basis, as the Directors believe this better reflects the performance of the group during the year. The group also presents a free cash flow metric which the Directors believe reflects the cash generated from underlying trading. This differs from the cash flows presented in the consolidated cash flow statement. The underlying results differ significantly from the reported statutory results and are used extensively to explain performance to shareholders. Alternative performance measures can provide investors with additional understanding of the group's performance if consistently calculated, properly used and presented. However, when improperly used and presented, these non-GAAP measures can mislead investors and may mask the real financial performance and position. There is judgement in determining whether items should be excluded from underlying profit or free cash flow. A key adjustment between the statutory results and the underlying results relates to the foreign exchange rates used to translate foreign currency transactions and balances. The underlying results reflect the achieved rate on foreign currency derivative contracts settled in the period and retranslates assets and liabilities at the foreign currency rates at which they are expected to be realised or settled in the future. As the group can influence which derivative contracts are settled in each reporting period it has the ability to influence the achieved rate and hence the underlying results. One of the items excluded from underlying profit is exceptional restructuring costs associated with the new transformation programme. Judgement is required to determine what costs are related to this programme to warrant exclusion from underlying profit.	We have considered the judgements taken by management to determine what should be treated as an exceptional item and the translation of foreign currency amounts and obtained corroborative evidence for these. We also considered whether there were items that were recorded within underlying profit that are exceptional in nature and should be reported as an exceptional item. No such material items were identified. As part of this assessment we challenged management's rationale for the designation of certain items as exceptional or one-off and assessed such items against the group's accounting policy, considering the nature and value of those items. Within underlying results, foreign currency transactions are presented at rates achieved on derivative contracts hedging the net operating cash flows of the group and monetary assets and liabilities are retranslated at rates forecast to be achieved on derivative contracts when the associated cash flows occur. We have agreed these forecast rates to the profile of the derivatives that are expected to mature in the future and tested their application to the relevant monetary assets and liabilities. We tested the reconciling items between the underlying operating profit and free cash flow disclosed in note 28 including verifying that the items adjusted for are consistent with the prior period. This included validating a sample of restructuring costs and verifying that the costs were sufficiently related to the announced transformation programme. We also considered whether free cash flow contains material one-off items which require further disclosure. We assessed the appropriateness and completeness of disclosures of the impact of one-off or non-underlying items primarily in notes 1, 2 and 28 to the consolidated financial statements and found them to be appropriate. This included assessing the explanations management provided on the reconciling items between underlying performance and statutory performance in note 2. Overall we found that the classification judgements made by management were in line with their policy for underlying results and exceptional items, had been consistently applied and there are no material uncorrected misstatements resulting from our testing.
Recoverability of the company's investments in subsidiary undertakings (company) *Note 2 to the company financial statements – Investments – subsidiary undertakings* Investments in subsidiary undertakings of £14,810m (2022: £14,762m) are accounted for at cost less provision for impairment in the company balance sheet at 31 December 2023. Investments are tested for impairment if impairment indicators exist. If such indicators exist, the recoverable amounts of the investments in subsidiaries are estimated in order to determine the extent of the impairment loss, if any. Any such impairment loss is recognised in the income statement. A review of potential indicators of impairment was performed by management focusing on the developments in the year, concluding that no such indicators were present and therefore that the investments' carrying values remain recoverable.	We evaluated management's assessment of whether any potential indicators of impairment existed at 31 December 2023. In doing this, we considered the market capitalisation of the company at 31 December 2023, which exceeded the carrying value of investments in subsidiary undertakings. We also considered the latest expected performance of the group by comparing the latest cash flow forecasts audited as part of other key audit matters to those estimated in the 2022 impairment model as well as the performance in the year. Overall, we found that management's judgement that there has been no indicator of potential impairment to be appropriate.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the group and the company, the accounting processes and controls, and the industry in which they operate.

Our scoping is based on the group's consolidation structure. We define a component as a single reporting unit which feeds into the group consolidation. Of the group's 324 reporting components, 35 individual components (including three joint ventures) were subject to full scope audits for group purposes, which following an element of sub-consolidation, equates to 16 group reporting opinions; and nine components performed targeted specified audit procedures.

In order to achieve audit coverage over the financial statements, under our audit methodology, we test both the design and operation of relevant business process controls and perform substantive testing over each financial statement line item.

The group operates Finance Service Centres (FSCs) to bulk process financial transactions in Derby (UK), Indianapolis (US) and Bengaluru (India). Based on our assessment it is not possible to fully test revenue and profit centrally as certain key processes, such as long-term contracting, remain within the business due to their nature and are not handled by the FSCs.

Our audit covered 96% of revenue, 76% of profit before tax and 90% of total assets. All entities that contribute in excess of 1% of the group's revenue were included in scope.

Further specific audit procedures over central functions, the group consolidation and areas of significant judgement (including corporate taxation, certain goodwill balances and intangible assets, treasury and post-retirement benefits) were performed by the group audit team.

Where work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the consolidated financial statements.

We issued formal written instructions to all component auditors setting out the audit work to be performed by each of them and maintained regular communication with the component auditors throughout the audit cycle. These interactions included attending certain component clearance meetings and holding regular conference calls, as well as reviewing and assessing any matters reported. The group engagement team also reviewed selected audit working papers for certain component teams to evaluate the sufficiency of audit evidence obtained and fully understand the matters arising from the component audits.

In addition, senior members of the group engagement team have visited component teams across all group's major segments in the UK, US and Germany. These visits were in-person for these locations. They included meetings with the component auditor and with local management.

Reflective of its nature, our audit of the company financial statements focused on the investments in subsidiary undertakings and validating amounts owed to subsidiary undertakings.

The impact of climate risk on our audit

As part of our audit we made enquiries of management to understand the process they adopted to assess the extent of the potential impact of climate risk on the group's and company's financial statements and to support the disclosures made within the Sustainability section of the Strategic report. In addition to enquiries with management, we understood the governance process in place to assess climate risk, reviewed the group's assessment of climate related risk including both physical and transition risks and read additional reporting made on climate related matters, including its CDP public submission and the group's disclosures in line with the Task Force on Climate-related Financial disclosure (TCFD) framework.

We held meetings with management including the group's sustainability team to consider the completeness of management's climate risk assessment and its consistency with internal climate plans and board minutes, including whether the time horizons management have used take account of all relevant aspects of climate change such as transition risks. We also considered the consistency with the group's communications on climate related impacts. The group's short and medium term targets are currently under review, although it remains committed to emission reductions. The group has also set out net zero 2050 commitments, albeit the pathway to this is not fully developed.

We considered the following areas which depend on medium to long-term profit or cash flow forecasts to potentially be materially impacted by climate risk and consequently we focused our audit work in these areas: long-term contract accounting in the UK Civil business (including contract loss provisions); the recoverability of deferred tax assets in the UK and the recoverability of the carrying value of goodwill and certain intangible assets. Our findings were reported to and discussed with the Audit Committee and management. Where significant, further details of how climate change has been considered in these areas and our audit response is given in the key audit matters above.

To respond to the audit risks identified in these areas we tailored our audit approach to address these, in particular, we:

- Deployed our valuation experts to benchmark carbon pricing and key commodity price forecasts against forecasts of future prices and found them to be materially reasonable. These have been incorporated by management in their forecasts of the group's future cost base for long-term contract accounting and associated provisions as well as scenarios utilised in assessing the recoverability of deferred tax assets, goodwill and other assets;
- Considered the reasonableness of management's assertion that climate change is unlikely to have a material impact on aviation demand by comparing management's EFH forecasts against other industry benchmarks and considering the sensitivity of EFH to different GDP growth rates expected under differing climate scenarios;
- Verifying that estimates of capital and cash costs from reductions to the group's scope 1 and scope 2 emissions have been incorporated in the group's forecasts including those used for going concern and the disclosures around the viability of the group that are included in the Strategic Report;
- Considered whether management had adequately reflected the risk of regulatory changes or demand changes to the extent known in the useful economic lives and recoverable value of other intangible assets including those related to diesel engines produced by Power Systems;
- Validated management's judgement that climate change is unlikely to have a material impact on other estimates at 31 December 2023 including the recoverability of inventory or the expected credit loss provision associated with trade receivables and contract assets by considering the short timeframe these assets are expected to be utilised compared to the period over which transition and physical risks are expected to arise; and
- Where appropriate, performed independent sensitivity analysis to determine to what extent reasonably possible changes in the climate related assumptions in the group's forecasts could result in material changes to the impacted balances and assessed the appropriateness of the associated disclosures.

We also considered the consistency of the disclosures in relation to climate change (including the disclosures in the Sustainability section of the Strategic Report) within the Annual Report and our knowledge obtained from our audit. This included considering the models management used in the TCFD scenario analysis and if the assumptions in those models are consistent with the assumptions used elsewhere in the financial statements.

As disclosed within the Sustainability section of the Strategic Report the achievement of net zero by 2050 will require significant change across the aviation sector in particular, including widespread adoption of Sustainable Aviation Fuels or other alternative fuel sources. Management has not included the incremental cost of this in its longer term forecasts, based on the assumptions that such costs can be passed onto customers and will occur after the average life of the current existing contracts.

Our procedures did not identify any material impact in the context of our audit of the financial statements as a whole for the year ended 31 December 2023. The future estimated financial impacts of climate risk are clearly uncertain given the medium to long-term timeframes involved and their dependency on how governments, global markets, corporations and society respond to the issue of climate change and the speed of technological advancements that may be necessary. Accordingly, financial statements cannot capture all possible future outcomes as these are not yet known.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Financial statements – group	Financial statements – company
Overall materiality	£93m (2022: £80m).	£147m (2022: £147m).
How we determined it	Approximately 0.6% of underlying revenue (2022: approximately 0.6% of five year average underlying revenues from continuing operations).	Approximately 1.0% of total assets.
Rationale for benchmark applied	We have consistently used underlying revenue to determine materiality as opposed to a profit based benchmark. This is because there is considerable volatility in profit before tax as a result of revenue recognition under IFRS 15 and from the fair value movement in the group's derivatives. Underlying revenue continues to be a key performance metric for the group and is more stable than the profit metric. Reflecting the reduced impact that the COVID-19 pandemic has had on the group's revenue in the year, we have reverted back to basing our materiality on in-year underlying revenue only.	We determined our materiality based on total assets, which is more applicable than a performance-related measure as the company is an investment holding company for the group. The higher company materiality level was used for the purposes of testing balances not relevant to the group audit, such as investments in subsidiary undertakings and intercompany balances.

For each component in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across components was between £4m and £70m. Certain components were audited to a local statutory audit materiality that was also less than our overall group materiality.

We use performance materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality. Specifically, we use performance materiality in determining the scope of our audit and the nature and extent of our testing of account balances, classes of transactions and disclosures, for example in determining sample sizes. Our performance materiality was 75% (2022: 75%) of overall materiality, amounting to £70m (2022: £60m) for the group financial statements and £110m (2022: £110m) for the company financial statements.

In determining the performance materiality, we considered a number of factors – the history of misstatements, risk assessment and aggregation risk and the effectiveness of controls – and concluded that an amount at the upper end of our normal range was appropriate.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £3m (group audit) (2022: £3m) and £7m (company audit) (2022: £7m) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

Our evaluation of the directors' assessment of the group's and the company's ability to continue to adopt the going concern basis of accounting included:

- Testing the model used for management's going concern assessment which is primarily a liquidity assessment given there are no significant financial covenants in its committed debt facilities. Management's assessment covered the 18 months to August 2025. We focused on this period and also considered the subsequent four months to the end of 2025;
- Management's base case forecasts are based on its normal budget and forecasting process for each of its businesses for the next five years. We understood and assessed this process by business including the assumptions used for 2024 and 2025 and assessed whether there was adequate support for these assumptions. We also considered the reasonableness of the monthly phasing of cash flows. A similar assessment was performed on the stressed downside cash flows, including understanding of the scenarios modelled by management, how they were quantified and the resultant monthly phasing of the stressed downside cash flow forecast;
- We have read and understood the key terms of all committed debt facilities to understand any terms, covenants or undertakings that may impact the availability of the facility;
- Using our knowledge from the audit and assessment of previous forecasting accuracy we calculated our own sensitivities to apply to management's cash flow forecasts. We overlaid these on management's forecasts to arrive at our own view of management's downside forecasts. This included consideration of management's assessment of the impact of climate change and the likelihood of any downside risks crystallising in the period to August 2025;
- We considered the potential mitigating actions that management may have available to it to reduce costs, manage cash flows or raise additional financing and assessed whether these were within the control of management and possible in the period of the assessment; and
- We assessed the adequacy of disclosures in the Going concern statement and statements in note 1 of the consolidated and company financial statements and found these appropriately reflect the key areas of uncertainty identified.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the group's and the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

However, because not all future events or conditions can be predicted, this conclusion is not a guarantee as to the group's and the company's ability to continue as a going concern.

In relation to the directors' reporting on how they have applied the UK Corporate Governance Code, we have nothing material to add or draw attention to in relation to the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic report and Directors' report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on our work undertaken in the course of the audit, the Companies Act 2006 requires us also to report certain opinions and matters as described below.

Strategic report and Directors' report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Directors' report for the year ended 31 December 2023 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the group and company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic report and Directors' report.

Directors' Remuneration

In our opinion, the part of the Remuneration Committee report to be audited has been properly prepared in accordance with the Companies Act 2006.

Corporate governance statement

The Listing Rules require us to review the directors' statements in relation to going concern, longer-term viability and that part of the corporate governance statement relating to the company's compliance with the provisions of the UK Corporate Governance Code specified for our review. Our additional responsibilities with respect to the corporate governance statement as other information are described in the Reporting on other information section of this report.

Based on the work undertaken as part of our audit, we have concluded that each of the following elements of the corporate governance statement, included within the governance report is materially consistent with the financial statements and our knowledge obtained during the audit, and we have nothing material to add or draw attention to in relation to:

- The directors' confirmation that they have carried out a robust assessment of the emerging and principal risks;
- The disclosures in the Annual Report that describe those principal risks, what procedures are in place to identify emerging risks and an explanation of how these are being managed or mitigated;
- The directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the group's and company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- The directors' explanation as to their assessment of the group's and company's prospects, the period this assessment covers and why the period is appropriate; and
- The directors' statement as to whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of its assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Our review of the directors' statement regarding the longer-term viability of the group and company was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statement; checking that the statement is in alignment with the relevant provisions of the UK Corporate Governance Code; and considering whether the statement is consistent with the financial statements and our knowledge and understanding of the group and company and their environment obtained in the course of the audit.

In addition, based on the work undertaken as part of our audit, we have concluded that each of the following elements of the corporate governance statement is materially consistent with the financial statements and our knowledge obtained during the audit:

- The directors' statement that they consider the Annual Report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for the members to assess the group's and company's position, performance, business model and strategy;
- The section of the Annual Report that describes the review of effectiveness of risk management and internal control systems; and
- The section of the Annual Report describing the work of the Audit Committee.

We have nothing to report in respect of our responsibility to report when the directors' statement relating to the company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified under the Listing Rules for review by the auditors.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' responsibilities in respect of the Financial Statements, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the group and industry, we identified that the principal risks of non-compliance with laws and regulations related to the regulations of country aviation authorities such as the Civil Aviation Authority, import and export restrictions including sanctions, and the UK Bribery Act, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the financial statements such as the Listing Rules of the UK Financial Conduct Authority, the Companies Act 2006 and tax legislation. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to (1) posting inappropriate journal entries to manipulate financial results; (2) management bias in accounting estimates such as long-term contract accounting and associated provisions; (3) the sale of Civil engines to joint ventures for no clear commercial purpose or above market prices; and (4) inappropriately including or excluding transactions from the group's underlying or free cash flow alternative performance metrics. The group engagement team shared this risk assessment with the component auditors so that they could include appropriate audit procedures in response to such risks in their work. Audit procedures performed by the group engagement team and/or component auditors included:

- Discussions throughout the year with management, internal audit, the group's legal counsel, and the head of ethics and compliance, including consideration of known or suspected instances of non-compliance with laws and regulation and fraud;
- Reading the minutes of the group's Safety, Energy Transition & Tech Committee and assessment of 'speak-up' matters reported through the group's Ethics Line and the results of management's investigation of such matters;
- Verifying sales of spare engines to joint ventures are in line with the approved timetable and are at a price supported by external valuation;
- Reading the minutes of Board meetings to identify any inconsistencies with other information provided by management;
- Reviewing legal expense accounts to identify significant legal spend that may be indicative of non-compliance with laws and regulations;
- Challenging assumptions and judgements made by management in determining significant accounting estimates (because of the risk of management bias), in particular in relation to long-term contract accounting and associated provisions;
- Identifying and testing unusual journal entries, in particular journal entries posted with unusual account combinations, and testing all material consolidation journals; and
- Challenging why certain items are excluded or included from underlying profit or free cash flow and review of disclosures included in the Annual Report explaining and reconciling alternative performance measures to statutory metrics.

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the financial statements. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Our audit testing might include testing complete populations of certain transactions and balances, possibly using data auditing techniques. However, it typically involves selecting a limited number of items for testing, rather than testing complete populations. We will often seek to target particular items for testing based on their size or risk characteristics. In other cases, we will use audit sampling to enable us to draw a conclusion about the population from which the sample is selected.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditors responsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not obtained all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the company financial statements and the part of the Remuneration Committee report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Audit Committee, we were appointed by the members on 3 May 2018 to audit the financial statements for the year ended 31 December 2018 and subsequent financial periods. The period of total uninterrupted engagement is six years, covering the years ended 31 December 2018 to 31 December 2023.

Other matter

In due course, as required by the Financial Conduct Authority Disclosure Guidance and Transparency Rule 4.1.14R, these financial statements will form part of the ESEF-prepared annual financial report filed on the National Storage Mechanism of the Financial Conduct Authority in accordance with the ESEF Regulatory Technical Standard ('ESEF RTS'). This auditors' report provides no assurance over whether the annual financial report will be prepared using the single electronic format specified in the ESEF RTS.

Ian Morrison (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
22 February 2024

Sustainability assurance statement

Independent assurance report

To the stakeholders of Rolls-Royce Holdings plc

1. Introduction and objectives of work

Bureau Veritas UK Limited (Bureau Veritas) has been engaged by Rolls-Royce Holdings plc (Rolls-Royce) to provide limited assurance of its selected sustainability performance indicators for inclusion in its 2023 Annual Report (the 'Report'). The objective is to provide assurance to Rolls-Royce and its stakeholders over the accuracy and reliability of the reported information and data.

2. Scope of work

The scope of our work was limited to assurance over the following information included within the Report for the period 1 January to 31 December 2023 (the 'Selected Information'):

- Total Energy Consumption;
- Total Scope 1 + 2 Greenhouse Gas (GHG) Emissions (market based): Operations and facility emissions (excluding product testing activities);
- Total Solid and Liquid Waste Generated;
- Recycling and Recovery Rate (%);
- Number of Total Reportable Injuries;
- Number of People Reached Through Science, Technology, Engineering and Mathematics (STEM) Education Outreach Programmes; and
- Employee Engagement Score – 'grand mean' and increase compared to 2022.

3. Reporting criteria

The Selected Information needs to be read and understood together with the Rolls-Royce 'Sustainability Data Basis of Reporting', a copy of which is set out at www.rollsroyce.com/sustainability/performance/reporting-approach.aspx. These internal definitions draw on externally available guidance, the Greenhouse Gas Protocol Corporate Accounting and Reporting standard (revised edition).

4. Limitations and exclusions

Excluded from the scope of our work is assurance of information relating to:

- activities outside the defined assurance period;
- positional statements of a descriptive or interpretative nature, or of opinion, belief, aspiration or commitment to undertake future actions; and
- other information included in the Report other than the Selected Information, including but not limited to normalised figures, total reportable injury rate etc.

The following limitations should be noted:

- This limited assurance engagement relies on a risk-based selected sample of sustainability data and the associated limitations that this entails.
- The reliability of the reported data is dependent on the accuracy of metering and other production measurement arrangements employed at site level, not addressed as part of this assurance.
- This independent statement should not be relied upon to detect all errors, omissions or misstatements that may exist.
- For the sites Solihull, Raynesway and Barnoldswick (collectively contributing approximately 7% of the total waste reported by Rolls-Royce) we received excel reports from the third-party waste management provider as evidence but additional waste documentation (waste transfer notes, consignment notes, invoices) were not provided for all the waste movements sampled within the timeframe.
- For Aiken site, we did not receive evidence for the liquid waste reported by the site, as the documentation was not available within the timeframe. The liquid waste from Aiken contributes approximately 1% of the total waste reported by Rolls-Royce.

5. Responsibilities

This preparation and presentation of the Selected Information in the Report are the sole responsibility of the management of Rolls-Royce.

Bureau Veritas was not involved in the drafting of the Report or of the Reporting Criteria. Our responsibilities were to:

- obtain limited assurance about whether the Selected Information has been prepared in accordance with the Reporting Criteria;
- form an independent conclusion based on the assurance procedures performed and evidence obtained; and
- report our conclusions to the directors of Rolls-Royce.

6. Assessment standard

We performed our work to a limited level of assurance in accordance with International Standard on Assurance Engagements (ISAE) 3000 Revised, Assurance Engagements Other than Audits or Reviews of Historical Financial Information (effective for assurance reports dated on or after December 15, 2015), issued by the International Auditing and Assurance Standards Board.

7. Summary of work performed

As part of our independent assurance our work included:

1. Conducting interviews with relevant personnel of Rolls-Royce, including the central corporate team and representatives from nine sites;
2. Reviewing the data collection and consolidation processes used to compile Selected Information, including assessing assumptions made and the data scope and reporting boundaries;
3. Reviewing documentary evidence provided by Rolls-Royce;
4. Agreeing a selection of the Selected Information to the corresponding source documentation;
5. Reviewing Rolls-Royce systems for quantitative data aggregation and analysis;
6. Assessing the disclosure and presentation of the Selected Information to ensure consistency with assured information;
7. Carrying out six remote site visits to Aiken, USA; Friedrichshafen, Germany; Indianapolis, USA; Raynesway, UK; Solihull, UK; Tukang, Singapore, and three physical site visits Barnoldswick (Bankfield), UK; EMA, Italy; and Magdeburg, Germany selected on a risk-based basis following discussion with Bureau Veritas and Rolls Royce, with consideration of contribution to assured data, geographical contribution and type of operations;
8. Re-performing a selection of aggregation calculations of the Selected Information; and
9. Re-performing greenhouse gas emissions conversions calculations.

A 5% materiality threshold was applied to this assurance. It should be noted that the procedures performed in a limited assurance engagement vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement. Consequently, the level of assurance obtained in a limited assurance engagement is substantially lower than the assurance that would have been obtained had a reasonable assurance engagement been performed.

8. Conclusion

On the basis of our methodology and the activities and limitations described above nothing has come to our attention to indicate that the Selected Information is not fairly stated in all material respects.

9. Statement of independence, integrity and competence

Bureau Veritas is an independent professional services company that specialises in quality, environmental, health, safety and social accountability with over 190 years history. Its assurance team has extensive experience in conducting verification over environmental, social, ethical and health and safety information, systems and processes.

Bureau Veritas operates a certified [1] Quality Management System which complies with the requirements of ISO 9001:2015, and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards, quality reviews and applicable legal and regulatory requirements which we consider to be equivalent to ISQM 1 & 2 [2].

Bureau Veritas has implemented and applies a Code of Ethics, which meets the requirements of the International Federation of Inspections Agencies (IFIA) [3], across the business to ensure that its employees maintain integrity, objectivity, professional competence and due care, confidentiality, professional behaviour and high ethical standards in their day-to-day business activities. We consider this to be equivalent to the requirements of the IESBA code [4]. The assurance team for this work does not have any involvement in any other Bureau Veritas projects with Rolls-Royce.

Bureau Veritas UK Limited
Registered in England & Wales, Company Number: 1758622
Registered Office: Suite 206 Fort Dunlop, Fort Parkway, Birmingham, B24 9FD
London, 13 February 2024

1 Certificate available on request
2 International Standard on Quality Management 1 (Previously International Standard on Quality Control 1) & International Standard on Quality Management 2
3 International Federation of Inspection Agencies – Compliance Code – Third Edition
4 Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants

Greenhouse gas emissions

In 2023, our total gross Scope 1 + 2 greenhouse gas (GHG) emissions were 328,277 tonnes of carbon dioxide equivalent (tCO_2e). This represents a decrease of 14% compared with 381,530 tCO_2e in 2022.

Aspect	tCO_2e	2019	2020	2021	2022	**2023**
Emissions from activities for which the Company own or control including the combustion of fuel and operation of facilities. [Direct GHG Emissions (Scope 1)]	Global (excluding UK)	154,353	150,169	146,666	129,705	**109,257**
	UK	90,540	84,684	72,689	101,389	**72,346**
Emissions from the purchase of electricity, heat, steam and cooling purchased for our own use. [Indirect GHG Emissions (Scope 2) location-based]	Global (excluding UK)	120,836	98,816	101,916	97,682	**88,504**
	UK	80,469	60,945	53,608	52,754	**58,170**
Total gross GHG emissions	Global (excluding UK)	275,189	248,985	248,582	227,387	**197,761**
	UK	171,009	145,629	126,297	154,143	**130,516**
Energy consumption used to calculate above emissions – kWh	Global (excluding UK)	1,045,900,361	950,440,181	915,918,407	853,562,740	**766,756,722**
	UK	740,382,626	656,739,567	591,579,063	733,201,790	**631,964,645**
Intensity Ratio (total GHG emissions per £m revenue)	Total	27.9	34.3	33.4	28.3	**19.9**
Emissions from the purchase of electricity, heat, steam and cooling purchased for our own use. [Indirect GHG Emissions (Scope 2) market-based]	Global (excluding UK)	303	2,023	203	4,294	**751**
	UK	1,707	1,900	1,830	1,033	**1,326**
Outside of Scopes	Global (excluding UK)	–	–	–	–	**–**
	UK	20,743	45,213	23,614	2,802	**2,960**
Additional supporting information						
Electricity purchased from renewable sources – kWh	Global (including UK)	245,314,593	304,067,206	297,013,845	306,978,404	**307,898,844**
Energy generated on-site from renewable sources – kWh	Global (including UK)	7,517,844	7,401,115	3,350,779	9,209,251	**13,849,461**

The above figures include 307,898,844 kWh of renewable energy purchases either backed by the Renewable Energy Guarantees of Origin (REGO) scheme in the UK or the Guarantees of Origin (GoO) from a relevant EU Member State. This energy is used by the majority of our facilities in the UK and Germany. The source in the UK includes a proportion of electricity that was generated by the combustion of biofuel. The associated emissions are included above under the location based Scope 2 emissions (using grid average emission factors). They are also reported separately as market-based Scope 2 emissions (covering the emissions of nitrous oxide and methane) and Outside of Scopes (covering the emissions of carbon dioxide). In addition, the above figures include 13,849,461 kWh of electricity and heat generated on-site from renewable energy sources, including solar panels and ground source heat pumps.

We include the reporting of fugitive emissions of hydrofluorocarbons (HFCs), associated with air conditioning equipment, into our GHG emissions figures. These include emissions from our facilities in the US and Canada only. We do not anticipate that emissions from other facilities will have a significant impact on the above figures.

With the exceptions noted above, we have reported on the underlying energy use and emission sources required under the Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018. In accordance with these regulations, the above statement excludes emissions associated with the ITP Aero business, sold on 15 September 2022. Historical data has been restated to reflect this. All these sources fall within the scope of our Consolidated Financial Statements.

We have used the GHG Protocol Corporate Accounting and Reporting Standard (revised edition) as of 31 December 2014 utilising the operational control approach, supplemented by the GHG Reporting Guidance for the Aerospace Industry (version 3) and emission factors from the UK Government's GHG Conversion Factors for Company Reporting 2023. We report our emissions of: carbon dioxide; methane; nitrous oxide; hydrofluorocarbons and perfluorocarbons on a carbon dioxide equivalent basis. We had no emissions of sulphur hexafluoride or nitrogen trioxide.

Further details on our methodology for reporting and the criteria used can be found within our basis of reporting, available to download at www.rolls-royce.com

Other financial information

Foreign exchange

Foreign exchange rate movements influence the reported income statement, the cash flow and closing net debt balance. The average and spot rates for the principal trading currencies of the Group are shown in the table below:

		2023	2022	Change
USD per GBP	Year-end spot rate	**1.27**	1.20	+6%
	Average spot rate	**1.24**	1.24	0%
EUR per GBP	Year-end spot rate	**1.15**	1.13	+2%
	Average spot rate	**1.15**	1.17	-2%

The Group's global corporate income tax contribution

The Group's total corporation tax payments in 2023 were £172m. Around 90% of this was paid in the US, Germany, Singapore and Canada. Together with the UK, the operations in these countries are where the majority of the Group's business is undertaken and employees are based. Although the UK group was profitable in 2023, UK tax payments were not material due to the availability of losses and other tax reliefs which have been brought forward from loss making years. The balance of tax payments were made in around 40 other countries.

In common with most multinational groups, the total of all profits and losses for corporate income tax purposes is not the same as the consolidated loss before taxation reported on page 114.

The main reasons for this are:

(i) the consolidated income statement is prepared under IFRS, whereas the corporate income tax profits and losses for each company are determined by local tax accounting rules;

(ii) accounting rules require certain income and costs relating to our commercial activities to be eliminated from, or added to, the aggregate of all the profits of the Group companies when preparing the consolidated income statement (consolidation adjustments); and

(iii) specific tax rules including exemptions or incentives as determined by the tax laws in each country.

In most cases, paragraphs (i) and (ii) above are only a matter of timing and therefore tax will be paid in an earlier or later year. The impact of paragraph (iii) above will often be permanent, depending on the relevant tax law. Further information on the tax position of the Group can be found as follows:

- Audit Committee Report (page 80) – updates given to the Audit Committee during the year;
- note 1 to the Consolidated Financial Statements (page 122) – details of key areas of uncertainty and accounting policies for tax;
- note 5 to the Consolidated Financial Statements (pages 145 to 148); and
- Details of the tax balances in the Consolidated Financial Statements together with a tax reconciliation. This explains the main drivers of the tax rate and the impact of our assessment on the recovery of UK deferred tax assets.

Information on the approach to managing the Group's tax affairs can be found at www.rolls-royce.com

Investments and capital expenditure

The Group subjects all major investments and capital expenditure to a rigorous examination of risks and future cash flows. Investments and capital expenditure must align to the Group's strategy and create shareholder value. All major investments, including the launch of major programmes, require Board approval.

The Group has a portfolio of projects at different stages of their lifecycles. All of our major investments and projects are assessed using a range of financial metrics, including discounted cash flow and return on investment.

Financial risk management

The Board has established a structured approach to financial risk management. The Financial risk committee (Frc) is accountable for managing, reporting and mitigating the Group's financial risks and exposures. These risks include the Group's principal counterparty, currency, interest rate, commodity price, liquidity and credit rating risks outlined in more depth in note 20. The Frc is chaired by the Chief Financial Officer. The Group has a comprehensive financial risk policy that advocates the use of financial instruments to manage and hedge business operations risks that arise from movements in financial, commodities, credit or money markets. The Group's policy is not to engage in speculative financial transactions. The Frc sits quarterly to review and assess the key risks and agree any mitigating actions required.

Capital structure

£m	2023	2022
Total equity	**(3,629)**	(6,016)
Cash flow hedges	**(12)**	(26)
Group capital	**(3,641)**	(6,042)
Net debt	**(1,952)**	(3,251)

Operations are funded through various shareholders' funds, bank borrowings, bonds and notes. The capital structure of the Group reflects the judgement of the Board as to the appropriate balance of funding required. Funding is secured by the Group's continued access to the global debt markets. Borrowings are funded in various currencies using derivatives where appropriate to achieve a required currency and interest rate profile. The Board's objective is to retain sufficient financial investments and undrawn facilities to ensure that the Group can both meet its medium-term operational commitments and cope with unforeseen obligations and opportunities.

The Group holds cash and short-term investments which, together with the undrawn committed facilities, enable it to manage its liquidity risk.

During the year to 31 December 2023, the Group cancelled its undrawn £1bn bank loan facility, which was due to mature in January 2024 and its undrawn UKEF £1bn facility, which was due to mature in March 2026. These facilities had remained undrawn during the year. In addition, the Group replaced the £2,500m committed bank borrowing facility with a new £2,500m facility with a maturity date of November 2026 with the banks having the option to extend with two one-year extension options (3+1+1).

At the year end, the Group retained aggregate liquidity of £7.2bn, including cash and cash equivalents of £3.7bn and undrawn borrowing facilities of £3.5bn.

The Group has one material debt maturity in 2024. The maturity profile of the borrowing facilities is regularly reviewed to ensure that refinancing levels are manageable in the context of the business and market conditions. There are no rating triggers in any borrowing facility that would require the facility to be accelerated or repaid due to an adverse movement in the Group's credit rating. The Group conducts some of its business through a number of joint ventures. A major proportion of the debt of these joint ventures is secured on the assets of the respective companies and is non-recourse to the Group. This debt is further outlined in note 17.

Credit rating

£m	Rating	Outlook
Moody's Investors Service	Ba2	Positive
Standard & Poor's	BB+	Positive
Fitch	BB+	Positive

The Group subscribes to Moody's, Standard & Poor's and Fitch for independent long-term credit ratings with the ratings in the table above being applicable at the date of this report.

Accounting

The Consolidated Financial Statements have been prepared in accordance with IFRS, as adopted by the UK.

During the year, the Group adopted IFRS 17 described on page 125. The Group identified that the Standard will impact the results of its captive insurance company as it issues insurance contracts, however, since the contracts insure other group companies, there is no material impact on the Consolidated Financial Statements. The Group also concluded that its parent company guarantee arrangements in the form of financial or performance guarantees, that meet the IFRS 17 definition of insurance contracts, have no impact on the Consolidated Financial Statements of the Group for the year to 31 December 2023.

There are no other new standards or interpretations issued by the IASB that had a significant impact on the Consolidated Financial Statements.

Following a review which was prompted by an enquiry arising from a review of the Group's 2022 Annual Report and Accounts by the Corporate Reporting Review team of the Financial Reporting Council (FRC), cash flows on settlement of excess derivatives have been reclassified from cash flows from financing activities to cash flows from operating activities in the cash flow statement as a result of a change in accounting policy as at 31 December 2023.

The previous classification as cash flows from financing activities was based on the Directors judgement of the economic nature of the activities as the cash flows relate to cash payments deferred in connection with the Group's action to reduce the size of the USD hedge book by $11.8bn across 2020-2026 in 2021. The Directors have reassessed their judgement in line with IAS 7 Statement of Cash Flows and have concluded that it would be more appropriate to classify these cash flows as cash flows from operating activities.

As a result of the above, cash flows from operating activities during the year to 31 December 2022 have reduced by £(326)m to £1,524m with a corresponding decrease in cash outflows from financing activities from £(2,866)m to £(2,540)m. There is no impact to the total change in cash and cash equivalents or to any alternative performance measures.

The Group does not consider that any standards, amendments or interpretations issued by the IASB, but not yet applicable will have a significant impact on the Consolidated Financial Statements in 2024.

Reconciliation of alternative performance measures

Alternative performance measures (APMs)

Business performance is reviewed and managed on an underlying basis. These alternative performance measures reflect the economic substance of trading in the year. In addition, a number of other APMs are utilised to measure and monitor the Group's performance.

Definitions and reconciliations to the relevant statutory measure are included below. All comparative periods relate to 31 December 2022.

Underlying results from continuing operations

Underlying results are presented by recording all relevant revenue and cost of sales transactions at the average exchange rate achieved on effective settled derivative contracts in the period that the cash flow occurs. Underlying results also exclude: the effect of acquisition accounting and business disposals, impairment of goodwill and other non-current assets where the reasons for the impairment are outside of normal operating activities, exceptional items and certain other items which are market driven and outside of managements control. Statutory results have been adjusted for discontinued operations and underlying results from continuing operations have been presented on the same basis. Further detail can be found in note 2 and note 27.

	2023 £m	2022 £m
Revenue from continuing operations		
Statutory revenue	16,486	13,520
Derivative and FX adjustments	(1,077)	(829)
Underlying revenue	15,409	12,691
Gross profit from continuing operations		
Statutory gross profit	3,620	2,757
Derivative and FX adjustments	(461)	(262)
Programme exceptional credits	(21)	(69)
Exceptional transformation and restructuring charges	55	8
Acquisition accounting and M&A	46	53
Impairments	(8)	(10)
Underlying gross profit	3,231	2,477
Commercial and administrative costs from continuing operations		
Statutory commercial and administrative (C&A) costs	(1,110)	(1,077)
Derivative and FX adjustments	1	(2)
Exceptional transformation and restructuring charges	47	39
Other underlying adjustments	(2)	(22)
Underlying C&A Costs	(1,064)	(1,062)
Research and development costs from continuing operations		
Statutory research and development (R&D) costs	(739)	(891)
Derivative and FX adjustments	(4)	–
Acquisition accounting	4	5
Underlying R&D costs	(739)	(886)
Operating profit from continuing operations		
Statutory operating profit	1,944	837
Derivative and FX adjustments	(475)	(264)
Programme exceptional credits	(21)	(69)
Exceptional transformation and restructuring charges	102	47
Acquisition accounting and M&A	50	58
Impairments	(8)	65
Other underlying adjustments	(2)	(22)
Underlying operating profit	1,590	652
Underlying operating margin	*10.3%*	*5.1%*

	2023 pence	2022 pence
Basic EPS from continuing operations		
Statutory basic EPS	28.85	(14.24)
Effect of underlying adjustments to profit/(loss) before tax	(13.94)	20.45
Relate tax effects	(1.16)	(4.26)
Basic underlying EPS	13.75	1.95

Underlying results from discontinued operations

	2023 £m	2022 £m
Results from discontinued operations		
Profit for the year from ordinary activities	–	68
Loss on disposal of discontinued operations	–	(148)
Statutory operating loss	–	(80)
Acquisition accounting and M&A	–	179
Derivative and FX adjustments	–	(1)
Related tax effects	–	(31)
Underlying operating profit	–	67

Organic change

Organic change is the measure of change at constant translational currency applying full year 2022 average rates to 2023. The movement in underlying change to organic change is reconciled below.

All amounts below and on the following page are shown on an underlying basis and reconciled to the nearest statutory measure above.

Total Group income statement

	2023 £m	2022 £m	Change £m	FX £m	Organic change £m	Organic change %
Underlying revenue	15,409	12,691	2,718	88	2,630	21%
Underlying gross profit	3,231	2,477	754	22	732	30%
Underlying operating profit	1,590	652	938	5	933	143%
Net financing costs	(328)	(446)	118	–	118	(26)%
Underlying profit before taxation	1,262	206	1,056	5	1,051	–
Taxation	(120)	(48)	(72)	(1)	(71)	–
Underlying profit for the year (continuing operations)	1,142	158	984	4	980	–

Civil Aerospace

	2023 £m	2022 £m	Change £m	FX £m	Organic change £m	Organic change %
Underlying revenue	7,348	5,686	1,662	17	1,645	29%
Underlying OE revenue	2,703	1,982	721	15	706	36%
Underlying services revenue	4,645	3,704	941	2	939	25%
Underlying gross profit	1,394	853	541	1	540	63%
Commercial and administrative costs	(354)	(371)	17	(1)	18	(5)%
Research and development costs	(343)	(452)	109	(3)	112	(25)%
Joint ventures and associates	153	113	40	–	40	35%
Underlying operating profit	850	143	707	(3)	710	–

Defence

	2023 £m	2022 £m	Change £m	FX £m	Organic change £m	Organic change %
Underlying revenue	4,077	3,660	417	(11)	428	12%
Underlying OE revenue	1,766	1,634	132	(4)	136	8%
Underlying services revenue	2,311	2,026	285	(7)	292	14%
Underlying gross profit	804	726	78	–	78	11%
Commercial and administrative costs	(173)	(174)	1	(1)	2	(1)%
Research and development costs	(72)	(122)	50	1	49	(40)%
Joint ventures and associates	3	2	1	–	1	50%
Underlying operating profit	562	432	130	–	130	30%

Power Systems

	2023 £m	2022 £m	Change £m	FX £m	Organic change £m	Organic change %
Underlying revenue	**3,968**	3,347	621	82	539	16%
Underlying OE revenue	**2,661**	2,187	474	55	419	19%
Underlying services revenue	**1,307**	1,160	147	27	120	10%
Underlying gross profit	**1,050**	918	132	21	111	12%
Commercial and administrative costs	**(456)**	(441)	(15)	(8)	(7)	2%
Research and development costs	**(187)**	(204)	17	(4)	21	(10)%
Joint ventures and associates	**6**	8	(2)	–	(2)	(25)%
Underlying operating profit	**413**	281	132	9	123	44%

New Markets

	2023 £m	2022 £m	Change £m	FX £m	Organic change £m	Organic change %
Underlying revenue	**4**	3	1	–	1	33%
Underlying OE revenue	**2**	1	1	–	1	100%
Underlying services revenue	**2**	2	–	–	–	–
Underlying gross profit/(loss)	**1**	(1)	2	–	2	–
Commercial and administrative costs	**(24)**	(23)	(1)	–	(1)	4%
Research and development costs	**(137)**	(108)	(29)	(2)	(27)	25%
Joint ventures and associates	**–**	–	–	–	–	–
Underlying operating loss	**(160)**	(132)	(28)	(2)	(26)	20%

Trading cash flow

Trading cash flow is defined as free cash flow (on page 216) before the deduction of recurring tax and post-employment benefit expenses. Trading cash flow per segment is used as a measure of business performance for the relevant segments.

	2023 £m	2022 £m
Civil Aerospace	**626**	226
Defence	**511**	426
Power Systems	**461**	158
New Markets	**(63)**	(57)
Total reportable segments trading cash flow	**1,535**	753
Other businesses	**5**	5
Central and inter-segment	**(57)**	(49)
Trading cash flow from continuing operations	**1,483**	709
Discontinued operations	**–**	(12)
Trading cash flow	**1,483**	697
Underlying operating profit charge exceeded by contributions to defined benefit schemes	**(26)**	(32)
Tax [1]	**(172)**	(174)
Free cash flow	**1,285**	491

1 See page 117 for tax paid in the statutory cash flow statement

Free cash flow

Free cash flow is a measure of the financial performance of the businesses' cash flow which is consistent with the way in which performance is communicated to the Board. Free cash flow is defined as cash flows from operating activities, including capital expenditure and movements in investments, capital elements of lease payments, interest paid, amounts paid relating to the settlement of excess derivatives, and excluding amounts spent or received on activity related to business acquisitions or disposals and other material exceptional or one-off cash flows. Free cash flow from continuing operations has been presented to remove free cash flow from discontinued operations as defined in note 27. For further detail, see note 28.

Free cash flow from cash flows from operating activities

	2023 £m	2022 £m
Statutory cash flows from operating activities [1]	2,485	1,524
Capital expenditure	(699)	(540)
Investment (including investment from NCI and movement in joint ventures, associates and other investments)	69	28
Capital element of lease payments	(291)	(218)
Interest paid	(333)	(352)
Exceptional transformation and restructuring costs	69	76
M&A costs	2	2
Other	(17)	(29)
Free cash flow	1,285	491
Discontinued operations free cash flow [2]	–	14
Free cash flow from continuing operations	1,285	505

1 Statutory cash flows from operating activities at 31 December 2022 has been re-presented. See note 1
2 Discontinued operations free cash flow excludes: transactions with parent company of £nil (2022: £(65)m), movements in borrowings of £nil (2022: £22m), exceptional restructuring costs of £nil (2022: £nil), M&A costs of £nil (2022: £44m) and other of £nil (2022: £(6)m)

Group R&D expenditure

In year gross cash expenditure on R&D excludes contributions and fees, amortisation and impairment of capitalised costs and amounts capitalised during the year. For further detail, see note 3.

Gross capital expenditure

Gross capital expenditure during the year, excluding capital expenditure from discontinued operations. All proposed investments are subject to rigorous review to ensure that they are consistent with forecast activity and provide value for money. The Group measures annual capital expenditure as the cash purchases of PPE acquired during the year.

	2023 £m	2022 £m
Purchases of PPE (cash flow statement)	429	359
Less: capital expenditure from discontinued operations	–	(14)
Net capital expenditure	429	345

Key performance indicators

The following measures are key performance indicators and are calculated using alternative performance measures or statutory results. See below for calculation of these amounts.

All comparative periods relate to 31 December 2022, unless otherwise stated.

Order backlog

Order backlog, also known as unrecognised revenue, is the amount of revenue on current contracts that is expected to be recognised in future periods. Civil Aerospace OE orders, where the customer has retained the right to cancel (for deliveries in the next seven to 12 months), are excluded. Further details are included in note 2 of the Consolidated Financial Statements.

Adjusted return on capital (abbreviated to return on capital)

Return on capital is defined as net operating profit after tax (NOPAT) as a percentage of average invested capital. NOPAT is defined as underlying net profit excluding net finance costs and the tax shield on net finance costs. Invested capital is defined as current and non-current assets less current liabilities. It excludes pension assets, cash and cash equivalents, and borrowings and lease liabilities. Return on capital assesses the efficiency in allocating capital to profitable investments.

	2023 £m	2022 £m
Underlying operating profit	1,590	652
Less: taxation [1]	(151)	(48)
Underlying operating profit (post-taxation)	**1,439**	604
Total assets	31,512	29,450
Less: post-retirement schemes surpluses	(782)	(613)
Less: cash and cash equivalents	(3,784)	(2,607)
Current liabilities	(14,926)	(13,918)
Liabilities held for sale	(55)	–
Less: borrowings and lease liabilities	809	358
Invested capital (closing)	12,774	12,670
Invested capital (average)	12,722	12,334
Return on capital	11.3%	4.9%

1 Excluding underlying taxation on underlying finance income/(costs) of £31m (2022: £nil)

Total underlying cash costs as a proportion of underlying gross margin (abbreviated to TCC/GM)

Total underlying cash costs during the year (represented by underlying research and development (R&D) expenditure and underlying commercial and administrative (C&A) costs) as a proportion of underlying gross profit. This measure provides an indicator of total cash costs relative to gross profit. A reduction in total cash costs relative to gross profit indicates how effective the business is at managing and/or reducing its costs.

	2023 £m	2022 £m
Underlying R&D expenditure [1]	836	928
Underlying C&A	1,064	1,062
Total cash costs	1,900	1,990
Underlying gross profit	3,231	2,477
Total cash costs as a proportion of underlying gross profit	0.59	0.80

1 Excludes £6m (2022: £nil) impact of derivative and FX adjustments

Directors' report

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Board of Directors

The Directors of the Company who were in office during the year and up to the date of signing the financial statements were Dame Anita Frew, Tufan Erginbilgic, Helen McCabe, Birgit Behrendt, Stuart Bradie, Paulo Cesar Silva, George Culmer, Lord Jitesh Gadhia, Beverly Goulet, Nick Luff, Wendy Mars and Dame Angela Strank. In addition, Paul Adams, Panos Kakoullis, Mike Manley and Sir Kevin Smith served as Directors during the year, before stepping down from the Board. Their respective resignation dates can be found on page 18.

Directors' indemnities

The Directors have the benefit of an indemnity provision contained in the Articles. In addition, the Directors have been granted a qualifying third-party indemnity provision which was in force throughout the financial year and remains in force. Also, throughout the year, the Company purchased and maintained directors' and officers' liability insurance in respect of the Company and its subsidiaries and for their directors and officers.

Share price

During the year, the share price increased by 227% from 92p to 300p, compared to a 67% increase in the FTSE aerospace and defence sector and a 3% increase in the FTSE 100. The Company's share price ranged from 91p in January 2023 to 313p in December 2023.

Share capital

On 31 December 2023, the Company's issued share capital comprised:

8,416,696,989	Ordinary Shares	20p each
23,152,464,515	C Shares	0.1p each
1	Special Share	£1

The ordinary shares are listed on the London Stock Exchange.

The Company issues non-cumulative redeemable preference shares (C Shares) as an alternative to paying a cash dividend. Further information on payments to shareholders is on page 221.

Share class rights

The full share class rights are set out in the Company's Articles, which are available at www.rolls-royce.com. The rights are summarised below.

Ordinary Shares

Each member has one vote for each Ordinary Share held. Holders of Ordinary Shares are entitled to: receive the Company's Annual Report; attend and speak at general meetings of the Company; appoint one or more proxies or, if they are corporations, corporate representatives; and exercise voting rights. Holders of Ordinary Shares may receive a bonus issue of C Shares or a dividend and on liquidation may share in the assets of the Company.

C Shares

C Shares have limited voting rights and attract a preferential dividend, paid on a twice-yearly basis. On a return of capital on a winding-up, the holders of C Shares shall be entitled, in priority to any payment to the holders of Ordinary Shares, to the repayment of the nominal capital paid-up or credited as paid-up on the C Shares held by them, together with a sum equal to the outstanding preferential dividend which will have been accrued but not paid until the date of return of capital. The holders of C Shares are only entitled to attend, speak and vote at a general meeting if a resolution to wind up the Company is to be considered, in which case they may vote only on that resolution. The Company has the option to redeem the C Shares compulsorily, at any time if: the aggregate number of C Shares in issue is less than 10% of the aggregate number of all C Shares issued on or prior to that time or the event of a capital restructuring of the Company; the introduction of a new holding company; the acquisition of the Company by another company; or a demerger from the Group.

Special Share

Certain rights attach to the special rights non-voting share (Special Share) issued to the UK Secretary of State for the Department of Business and Trade (Special Shareholder). These rights are set out in the Articles. Subject to the provisions of the Companies Act 2006 (the Act), the Treasury Solicitor may redeem the Special Share at par value at any time. The Special Share confers no rights to dividends but, in the event of a winding-up, it shall be repaid at its nominal value in priority to any other shares.

Certain provisions of the Articles (in particular those relating to the foreign shareholding limit, disposals and the nationality of the Company's Directors) that relate to the rights attached to the Special Share may only be altered with the consent of the Special Shareholder. The Special Shareholder is not entitled to vote at any general meeting or any other meeting of any class of shareholders.

Restrictions on transfer of shares and limitations on holdings

There are no restrictions on transfer or limitations on the holding of the Ordinary Shares or C Shares other than under the Articles (as described here), under restrictions imposed by law or regulation (for example, UK Market Abuse Regulations) or pursuant to the Company's inside information and share dealing policy. The Articles provide that the Company should be and remain under UK control. As such, an individual foreign shareholding limit is set at 15% of the aggregate votes attaching to the share capital of all classes (taken as a whole) and capable of being cast on a poll and to all other shares that the Directors determine are to be included in the calculation of that holding. The Special Share may only be issued to, held by and transferred to the Special Shareholder or their successor or nominee.

Shareholder agreements and consent requirements

No disposal may be made to a non-Group member which, alone or when aggregated with the same or a connected transaction, constitutes a disposal of the whole or a material part of either the nuclear propulsion business or the assets of the Group as a whole, without the consent of the Special Shareholder.

Authority to issue shares

At the 2023 AGM, an ordinary resolution was passed authorising the Directors to allot new ordinary shares up to a nominal value of £557,839,799, equivalent to one-third of the issued share capital of the Company. This resolution also authorised the Directors to allot up to two-thirds of the total issued share capital of the Company, although only in the case of a rights issue. A further special resolution was passed to effect a disapplication of pre-emption rights for a maximum of 5% of the issued share capital of the Company. These authorities are valid until the 2024 AGM or 30 June 2024, whichever is sooner. During the year, 49,100,000 ordinary shares were issued to the Employee Benefit Trust to satisfy awards under the Company's share plans. The Directors propose to renew each of these authorities at the 2024 AGM to be held on 23 May 2024. The Board believes that these authorities will allow the Company to retain flexibility to respond to circumstances and opportunities as they arise.

Authority to purchase own shares

At the 2023 AGM, the Company was authorised by shareholders to purchase up to 836,759,698 of its own ordinary shares, representing 10% of its issued ordinary share capital.

The authority for the Company to purchase its own shares expires at the conclusion of the 2024 AGM or 30 June 2024, whichever is sooner. A resolution to renew the authority will be proposed at the 2024 meeting.

The Company did not purchase any of its own ordinary shares under this authority during 2023.

Deadlines for exercising voting rights

Electronic and paper proxy appointments, together with voting instructions, must be received by the Registrar not less than 48 hours before a general meeting.

Voting rights for employee share plan shares

Shares are held in an employee benefit trust for the purpose of satisfying awards made under the various employee share plans. For shares held in a nominee capacity or if plan/trust rules provide the participant with the right to vote in respect of specifically allocated shares, the trustee votes in line with the participants' instructions. For shares that are not held absolutely on behalf of specific individuals, the general policy of the trustees, in accordance with investor protection guidelines, is to abstain from voting in respect of those shares.

Major shareholdings

At 31 December 2023, the following shareholders had notified an interest in the issued ordinary share capital of the Company in accordance with section 5.1.2 of the Disclosure and Transparency Rules. No notifications have been received in the period 1 January to 22 February 2024.

Shareholder	Date of change in interest	% of issued ordinary share capital
Blackrock, Inc.	18 December 2023	5.01
Causeway Capital Management LLC	29 September 2023	4.99
Harris Associates L.P.	16 November 2020	4.99
Massachusetts Financial Services Company	28 March 2022	4.94
The Capital Group Companies, Inc.	3 February 2022	4.98

Changes to the Articles of Association

The Articles may be amended or new articles may be adopted by a special resolution of the Company's shareholders, subject to the provisions of the Act. The Company will propose certain changes to the Articles at the 2024 AGM, full details of which can be found in the Notice of Meeting available at www.rolls-royce.com

Change of control

Contracts and joint venture agreements

There are a number of contracts and joint venture agreements which would allow the counterparties to terminate or alter those arrangements in the event of a change of control of the Company. These arrangements are commercially confidential and their disclosure could be seriously prejudicial to the Company.

Borrowings and other financial instruments

The Group has several borrowing facilities provided by various banks. These facilities generally include provisions which may require any outstanding borrowings to be repaid or the alteration or termination of the facility upon the occurrence of a change of control of the Company. At 31 December 2023, these facilities were 36% drawn (2022: 27%).

The Group has entered into a series of financial instruments to hedge its currency, interest rate and commodity exposures. These contracts provide for termination or alteration in the event that a change of control of the Company materially weakens the creditworthiness of the Group.

Employee share plans

In the event of a change of control of the Company, the effect on the employee share plans would be as follows:

- Incentive Plan – deferred share awards will normally vest immediately, and may be time pro-rated. The new controlling company might offer an award in exchange instead (normally on substantially equivalent terms to the existing award).
- ShareSave – options would become exercisable immediately. The new controlling company might offer an equivalent option in exchange for cancellation of the existing option.
- Share Purchase Plan (SPP) – consideration received as shares would be held within the SPP, if possible, otherwise the consideration would be treated as a disposal from the SPP.
- LTIP – awards would vest on the change of control, subject to the Remuneration Committee's judgement of performance and may be reduced pro rata to service in the vesting period. Any applicable holding period will cease in the event of a change of control.

Political donations

The Company's policy is that it does not, directly or through any subsidiary, make what are commonly regarded as donations to any political party. However, the Act defines political donations very broadly and so it is possible that normal business activities, such as sponsorship, subscriptions, payment of expenses, paid leave for employees fulfilling certain public duties and support for bodies representing the business community in policy review or reform, which might not be thought of as political expenditure in the usual sense, could be captured. Activities of this nature would not be thought of as political donations in the ordinary sense of those words. The resolution to be proposed at the 2024 AGM, authorising political donations and expenditure, is to ensure that the Group does not commit any technical breach of the Act.

During the year, expenses incurred by Rolls-Royce North America, Inc. in providing administrative support for the Rolls-Royce North America political action committee (PAC) was $60,584.71 (2022: $59,169.05). PACs are a common feature of the US political system and are governed by the Federal Election Campaign Act.

The PAC is independent of the Group and independent of any political party. The PAC funds are contributed voluntarily by employees and the Group cannot affect how they are applied, although under US law, the business expenses are paid by the employee's company. Such contributions do not count towards the limits for political donations and expenditure for which shareholder approval will be sought at the 2024 AGM to renew the authority given at the 2023 AGM.

Disclosures in the Strategic Report

The Board has taken advantage of section 414C(11) of the Act to include disclosures in the Strategic Report including:

- employee involvement;
- the employment of disabled people;
- the future development, performance and position of the Group; and
- research and development activities.

Information required by UK Listing Rule (LR) 9.8.4

There are no disclosures to be made under LR 9.8.4.

Management report

The Strategic Report and the Directors' Report together are the management report for the purposes of Rule 4.1.8R of the DTR.

By order of the Board

Pamela Coles
Chief Governance Officer
22 February 2024

Disclosures required under Listing Rule 9.8.6 as at 31 December 2023

Gender identity

	Number of Board members	Percentage of the Board	Number of senior positions on the Board	Number in executive management	Percentage of executive management
Men	6	50%	Chief Executive, SID	7	70%
Women	6	50%	Chair, Chief Financial Officer	3	30%
Other categories	–	–	–	–	–
Not specified/prefer not to say	–	–	–	–	–

Ethnic background

	Number of Board members	Percentage of the Board	Number of senior positions on the Board	Number in executive management	Percentage of executive management
White British or other White (including minority-white groups)	11	92%	Chair, Chief Executive Chief Financial Officer, SID	10	100%
Mixed/multiple ethnic groups	–	–	–	–	–
Asian/Asian British	1	8%	–	–	–
Black/African/Caribbean/Black British	–	–	–	–	–
Other ethnic group, including Arab	–	–	–	–	–
Not specified/prefer not to say	–	–	–	–	–

Shareholder information

Managing your shareholding

Your shareholding is managed by Equiniti Limited (the Registrar). When making contact with the Registrar, please quote your shareholder reference number (SRN). This is an 11-digit number that can be found on your share certificate or on any other shareholder correspondence. You can manage your shareholding at www.shareview.co.uk, speak to the Registrar on +44 (0)371 384 2637 (8.30am to 5.30pm, Monday to Friday) or you can write to the Registrar at Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA. If you hold your shares in a share dealing account (sometimes referred to as a nominee account) then you must contact your account provider with any questions about your shareholding.

Payments to shareholders

The Company makes payments to shareholders by issuing redeemable C Shares of 0.1p each. You can redeem C Shares for cash and either take the cash or reinvest the proceeds in the C Share Reinvestment Plan (CRIP) to purchase additional Ordinary Shares providing you complete a payment instruction form, which is available from the Registrar. Once you have submitted your payment instruction form, you will receive cash or additional Ordinary Shares each time the Company issues C Shares. If you choose to receive cash, we strongly recommend that you include your bank details on the payment instruction form and have payments credited directly to your bank account. This removes the risk of a cheque going astray and means that cleared payments will be credited to your bank account on the payment date.

As set out in further detail elsewhere (see page 19), our capital framework is focused on three clear priorities: a strong balance sheet with an investment grade profile; a commitment to reinstating and growing shareholder returns; and a disciplined approach to investments. Strengthening the balance sheet is a clear priority. We are positioning Rolls-Royce to withstand better volatility and external shocks and to give us financial flexibility for the future. When the Board is confident that the strength of the balance sheet is assured and we are comfortably within an investment grade profile, we are committed to reinstating and growing shareholder distributions.

Shareholders wishing to redeem their existing C Shares, or participate in the CRIP must lodge instructions with the Registrar to arrive no later than 5.00pm on 31 May 2024 (CREST holders must submit their election in CREST by 2.55pm). The payment of C Share redemption monies will be made on 4 July 2024 and the CRIP purchase will begin as soon as practicable after 5 July 2024.

Share dealing

The Registrar offers ordinary shareholders an internet dealing service at www.shareview.co.uk and a postal dealing service. Real-time dealing is available during market hours, 8.00am to 4.30pm, Monday to Friday excluding bank holidays. Orders can still be placed outside of market hours. The fee for internet dealing is 1.5% of the transaction value, subject to a minimum fee of £45. The fee for telephone dealing is 1.5% of the transaction value, subject to a minimum fee of £60. The fee for postal dealing is 1.9% of the transaction value, subject to a minimum fee of £70. This service is only available to shareholders resident in certain jurisdictions. Before you can trade you must register to use the service. Other share dealing facilities are available, but you should always use a firm regulated by the FCA (see register.fca.org.uk).

Your share certificate

Your share certificate is an important document. If you sell or transfer your shares you must make sure that you have a valid share certificate in the name of Rolls-Royce Holdings plc. If you place an instruction to sell your shares and cannot provide a valid share certificate, the transaction cannot be completed and you may be liable for any costs incurred by the broker. If you are unable to find your share certificate, please inform the Registrar immediately.

American Depositary Receipts (ADR)

ADR holders should contact the depositary, JP Morgan, by calling +1(800) 990 1135 (toll free within the US) or +1(651) 453 2128 (outside the US) or via www.adr.com/contact/jpmorgan

Warning to shareholders – investment scams

We are aware that some of our shareholders have received unsolicited telephone calls or correspondence, offering to buy or sell their shares at very favourable terms. The callers can be very persuasive and extremely persistent and often have professional websites and telephone numbers to support their activities. They will sometimes imply a connection to Rolls-Royce and provide incorrect or misleading information. This type of call should be treated as an investment scam – the safest thing to do is hang up. Remember: if it sounds too good to be true, it probably is. You should always check that any firm contacting you about potential investment opportunities is properly authorised by the FCA. If you deal with an unauthorised firm you will not be eligible for compensation under the Financial Services Compensation Scheme. You can find out more about protecting yourself from investment scams by visiting the FCA's website at www.fca.org.uk/scamsmart, or by calling the FCA's consumer helpline on 0800 111 6768 (overseas callers dial +44 207 066 1000). If you have already paid money to share fraudsters, contact Action Fraud immediately on 0300 123 2040, whose website is www.actionfraud.police.uk

Visit Rolls-Royce online

Visit www.rolls-royce.com to find out more about the latest financial results, the share price, payments to shareholders, the financial calendar and shareholder services.

Communication preferences

You can sign up to receive the latest news updates to your phone or email by visiting www.rolls-royce.com and registering for our alert service. If you do not wish to receive a hard copy Annual Report in future, you can do this online at www.shareview.co.uk

Annual general meeting (AGM)

The 2024 AGM will be held at 11.00am on 23 May 2024 as a hybrid meeting. Full details are available on our website at www.rolls-royce.com

Analysis of ordinary shareholders at 31 December 2023

Type of holder	Number of shareholders	% of total shareholders	Number of shares	% of total shares
Individuals	156,041	98.81	192,398,711	2.29
Institutional and other investors	1,884	1.19	8,224,298,278	97.71
Total	157,925	100	8,416,696,989	100
Size of holding (number of ordinary shares)				
1 – 150	47,764	30.25	4,182,746	0.05
151 – 500	55,557	35.18	14,854,037	0.17
501 – 10,000	50,289	31.84	95,754,916	1.14
10,001 – 100,000	3,426	2.17	84,657,464	1.01
100,001 – 1,000,000	498	0.31	170,166,920	2.02
1,000,001 and over	391	0.25	8,047,080,906	95.61
Total	157,925	100	8,416,696,989	100

Glossary

AGM	annual general meeting
AI	artificial intelligence
APM	alternative performance measure
Articles	Articles of Association of Rolls-Royce Holdings plc
AUKUS	Australia, United Kingdom, United States
BESS	battery energy storage system
bps	basis points
C&A	commercial and administrative
CDP	Carbon Disclosure Project
C Shares	non-cumulative redeemable preference shares
Our Code	Global Code of Conduct
the Code	2018 UK Corporate Governance Code
CMD	capital markets day
Company	Rolls-Royce Holdings plc
CPS	cash flow per share
CRIP	C Share Reinvestment Plan
D&I	diversity and inclusion
DoJ	US Department of Justice
DPAs	deferred prosecution agreements
DTR	the FCA's Disclosure Guidance and Transparency Rules
EFH	engine flying hours
ELG	Enterprise Leadership Group
EPS	earnings per share
ESG	environment, social, governance
ET&S	engineering, technology and safety
EU	European Union
EUR	euro
FCA	Financial Conduct Authority
FCF	free cash flow
FLAAA	Future Long Range Assault Aircraft
FRC	Financial Reporting Council
FTE	full time equivalent
FX	foreign exchange
GBP	Great British pound or pound sterling
GCAP	Global Combat Air Programme
GDA	generic design assessment
GDP	gross domestic product
GHG	greenhouse gas
Group	Rolls-Royce Holdings plc and its subsidiaries
HPT	high pressure turbine
HSE	health, safety and environment
HVO	hydrotreated vegetable oil
IASB	International Accounting Standards Board
ICAO	International Civil Aviation Organisation
IFRS	International Financial Reporting Standards
KPIs	key performance indicators
$ktCO_2e$	kilotonnes of carbon dioxide equivalent
kW	kilowatts
LIBOR	London inter-bank offered rate
LTIP	long-term incentive plan
LTSA	long-term service agreement
M&A	mergers and acquisitions
MoU	memorandum of understanding
MRO	maintenance repair and overhaul
MSP	Manchester Square Partners
$MtCO_2e$	million tonnes of carbon dioxide equivalent
MWh	megawatt-hour
NCI	non-controlling interest
NED	Non-Executive Director
net zero company	net zero carbon emissions from our operations and facilities and our products are compatible with net zero operations by 2050
NOPAT	net operating profit after tax
OCI	other comprehensive income
OE	original equipment
OECD	Organisation for Economic Cooperation and Development
P&L	profit and loss
PBT	profit before tax
PPE	property, plant and equipment
PSP	performance share plan
R&D	research and development
Registrar	Equiniti Limited
RMS	risk management system
RRMS	Rolls-Royce management system
RRSAs	risk and revenue sharing arrangements
SAF	sustainable aviation fuel
SBTs	Science-Based Targets
SID	Senior Independent Director
SFO	UK Serious Fraud Office
SMR	small modular reactors
STEM	science, technology, engineering and mathematics
TCC	total cash costs
TCC/GM	total underlying cash costs as a proportion of underlying gross margin
TCFD	Task Force on Climate-related Financial Disclosures
TRI	total reportable injuries
TSR	total shareholder return
UKEF	UK Export Finance
UNSDG	United Nations Sustainable Development Goals
USD/US$	United States dollar

Trade marks

The following trade marks which appear throughout this Annual Report are trade marks registered and owned by companies within the Rolls-Royce Group:

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Rolls-Royce