

Group at a glance

UNDERLYING REVENUE ^{1, 2}	STATUTORY REVENUE ¹	FREE CASH FLOW ^{1, 2}	STATUTORY CASH FLOWS FROM OPERATING ACTIVITIES ³
£15,409m 2022: £12,691m	£16,486m 2022: £13,520m	£1,285m 2022: £505m	£2,485m 2022: £1,524m
UNDERLYING OPERATING PROFIT ^{1, 2}	STATUTORY OPERATING PROFIT ¹	UNDERLYING OPERATING MARGIN	STATUTORY OPERATING MARGIN
£1,590m 2022: £652m	£1,944m 2022: £837m	10.3% 2022: 5.1%	11.8% 2022: 6.2%
UNDERLYING PROFIT BEFORE TAX ^{1, 2}	STATUTORY PROFIT/(LOSS) BEFORE TAX ¹	TOTAL UNDERLYING CASH COSTS AS A PROPORTION OF UNDERLYING GROSS MARGIN ^{1, 2, 4}	RETURN ON CAPITAL ^{1, 2, 5}
£1,262m 2022: £206m	£2,427m 2022: £(1,502)m	0.59 2022: 0.80	11.3% 2022: 4.9%
UNDERLYING EARNINGS PER SHARE ^{1, 2}	STATUTORY EARNINGS/(LOSS) PER SHARE ¹	NET DEBT	LIQUIDITY ⁶
13.75p 2022: 1.95p	28.85p 2022: (14.24)p	£(1,952)m 2022: £(3,251)m	£7.2bn 2022: £8.1bn
ORDER BACKLOG ^{1, 7}	GROSS R&D EXPENDITURE ^{1, 2, 8}	COUNTRIES WITH ROLLS-ROYCE PRESENCE	EMPLOYEES (MONTHLY AVERAGE)
£68.5bn 2022: £60.2bn	£1.4bn 2022: £1.3bn	48 2022: 48	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 215 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

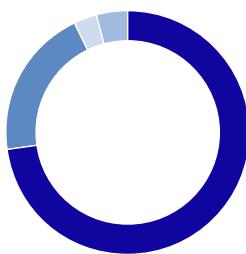
8 See note 3 on page 144 for a reconciliation of gross R&D expenditure to total R&D expenditure

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%

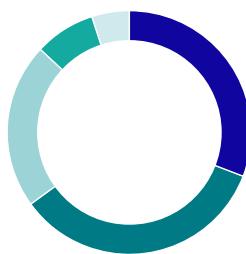
2022: 2.5%

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%

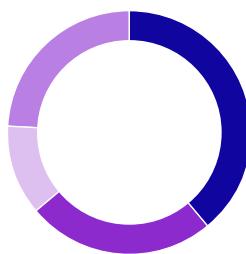
2022: 11.8%

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%

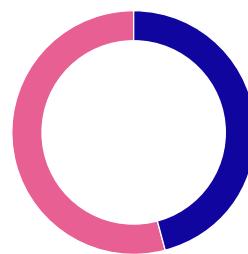
2022: 8.4%

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.



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.



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

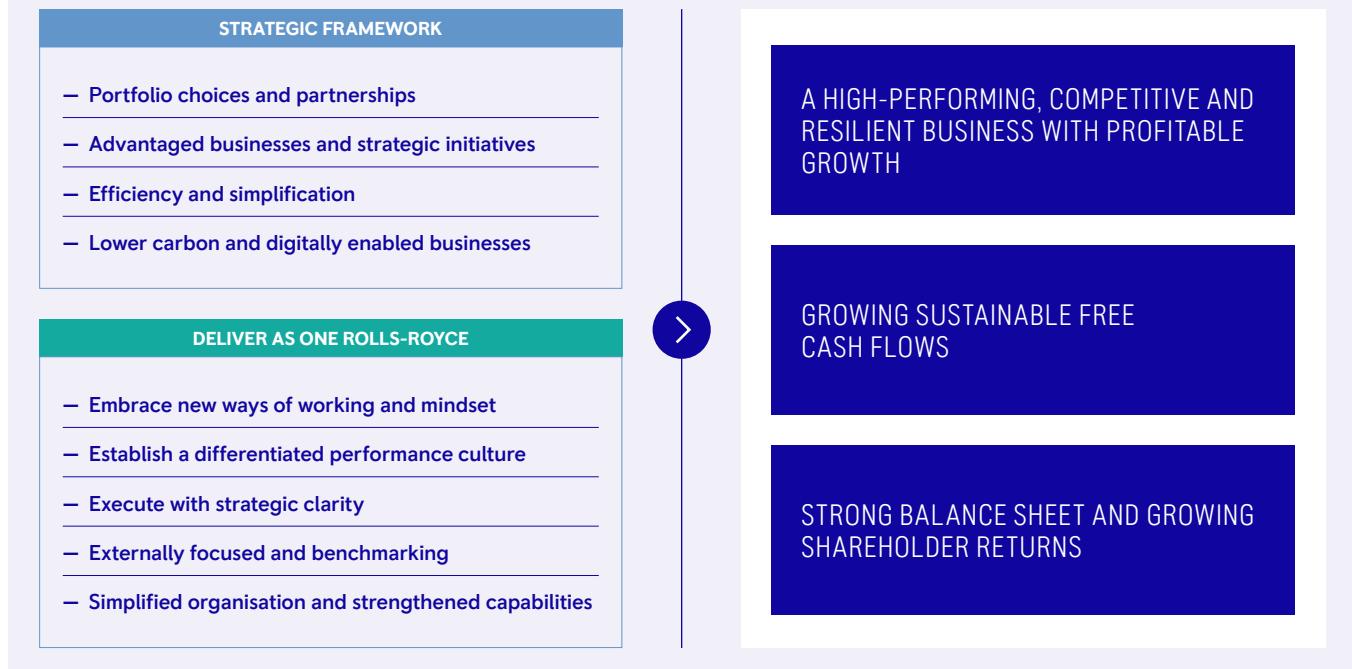
1. Build a high-performing, competitive and resilient business with profitable growth.
2. Grow sustainable free cash flow.
3. Build a strong balance sheet and grow shareholder returns.

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



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

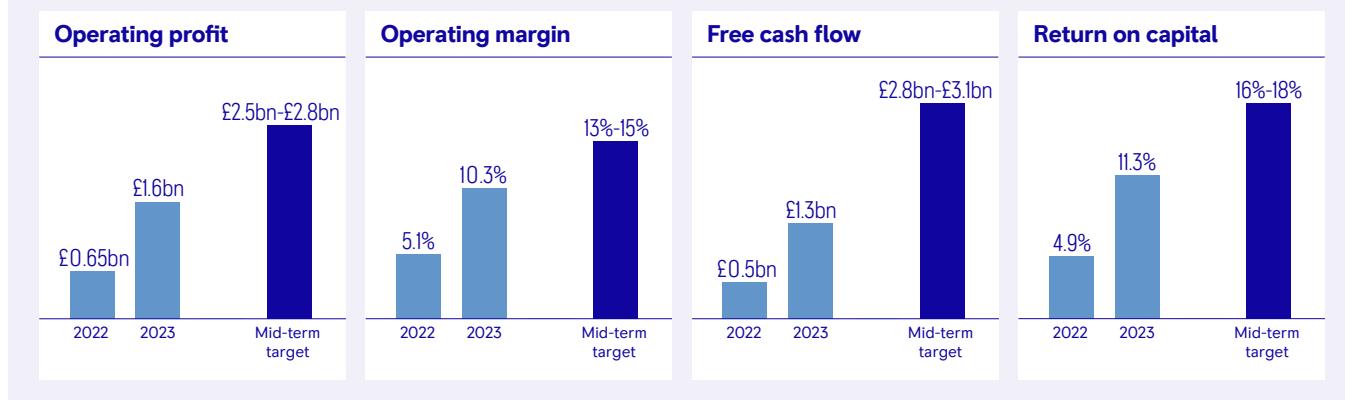
During our strategic review in 2023, we developed a new set of targets that represent a step change in ambition and performance. They are underpinned by our strategy and demonstrate we are creating a new Company, taking Rolls-Royce significantly beyond any previous financial results.

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.



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

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

Link to risk

1 3 6 9 11

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

POWER SYSTEMS

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

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%

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

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

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

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

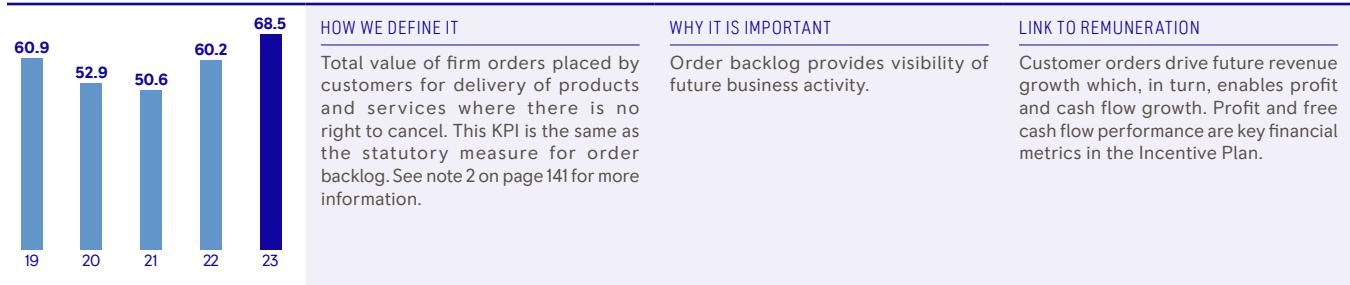


Read more about our principal risks on pages 50 to 57

Key performance indicators

Financial performance indicators ^{1,2}

Order backlog (£bn)



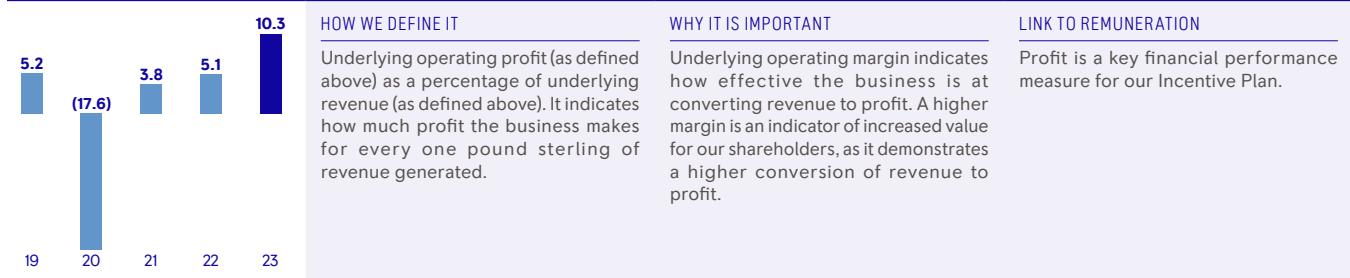
Underlying revenue (£m)



Underlying operating profit/(loss) (£m)



Underlying operating margin (%)



Free cash flow from continuing operations (£m)



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

KEY PERFORMANCE INDICATORS

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.

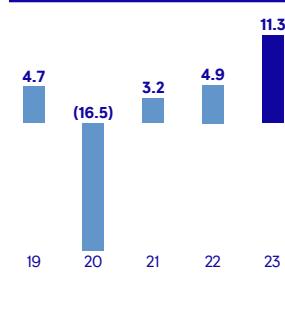
WHY IT IS IMPORTANT

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.

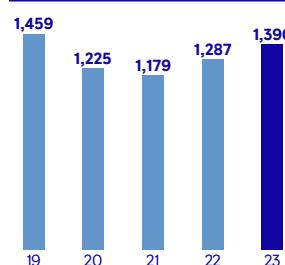
NOPAT is defined as underlying net profit excluding net finance costs and the tax shield on net finance costs. Invested capital is defined as current and non-current assets less current liabilities. It excludes pension assets, cash and cash equivalents and debt. See page 217 for more detail on how we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

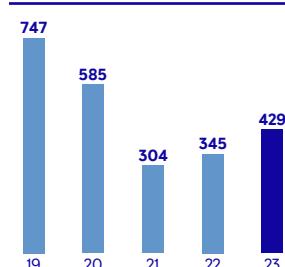
In-year gross cash expenditure on R&D excluding the impact of contributions and fees, amortisation and impairment of capitalised costs and amounts capitalised during the year.

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

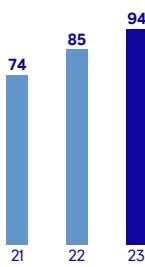
⁴ This is a new KPI added in 2023 to provide information on gross capital expenditure as this provides a more meaningful view of total capital expenditure. The previous KPI presented was capital expenditure as a proportion of underlying revenue



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

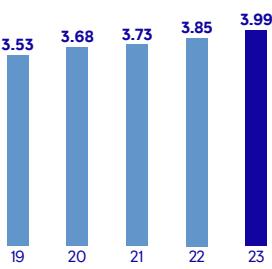
In 2023, we changed our people metric to incorporate a 50% weighting to an internal safety index. The safety index is the leading measure of our safety culture, which was introduced across the Group in 2021. The index consists of a composite score of five leading indicators, with each indicator measuring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

£ million	2023			2022	
	Statutory	Impact of hedge book ¹	Impact of acquisition accounting	Impact of other non-underlying items	Underlying
Revenue	16,486	(1,077)	–	–	15,409
Gross profit	3,620	(461)	46	26	3,231
Operating profit	1,944	(475)	50	71	1,590
Gain arising on disposal of businesses	1	–	–	(1)	–
Profit before financing and taxation	1,945	(475)	50	70	1,590
Net financing income/(costs)	482	(915)	–	105	(328)
Profit before taxation	2,427	(1,390)	50	175	1,262
Taxation ²	(23)	285	(12)	(370)	(120)
Profit for the year from continuing operations	2,404	(1,105)	38	(195)	1,142
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	Cash flow	2023			2022	
		Impact of hedge book	Impact of acquisition accounting	Impact of other non-underlying items	Funds flow	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 UK£ 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 debt²	(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.

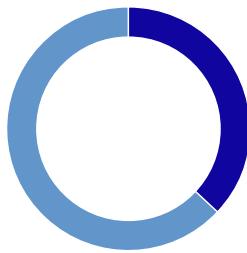
Taxation: The net tax asset has increased by £137m. This includes an overall increase in the deferred tax asset of £267m, due to increases in the deferred tax asset recognised on UK tax losses of £422m and other deferred tax assets of £101m, partly offset by a reduction of £256m on the deferred tax on 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

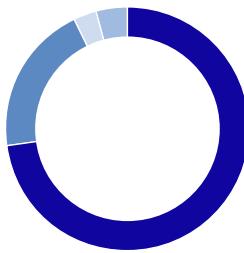


UNDERLYING REVENUE

£7,348m

2022: £5,686m

Underlying revenue mix by sector



UNDERLYING OPERATING PROFIT

11.6%

2022: 2.5%

ORDER BACKLOG

£55.2bn

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.

OUR DIVISIONS

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

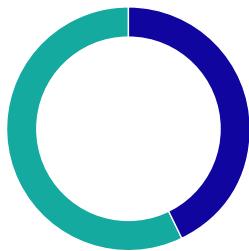
Executing on our strategic initiatives, which include the six key levers previously mentioned, will mean that we are less exposed to fluctuations in engine flying hours. Industry forecasts do predict a continued recovery in international travel and in 2024 we expect large engine flying hours to be in 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

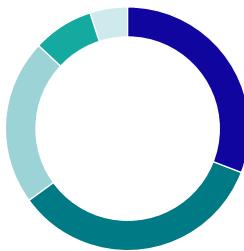


UNDERLYING REVENUE

£4,077m

2022: £3,660m

Underlying revenue mix by sector



UNDERLYING OPERATING PROFIT

13.8%

2022: 11.8%

ORDER BACKLOG

£9.2bn

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.

OUR DIVISIONS

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

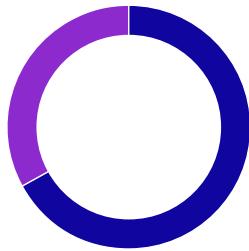
As we outlined at our CMD, we expect the defence market to grow. We expect our margins to improve to between 14%-16% in the mid-term, which we define as 2027, as long-term contracts underpin security for our Defence business for decades to come.

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



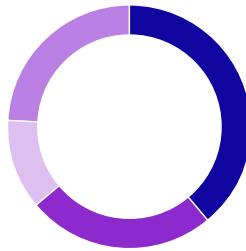
UNDERLYING REVENUE

£3,968m

2022: £3,347m

■ OE - 67%
■ Services - 33%

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 OPERATING PROFIT

£413m

2022: £281m

10.4%

2022: 8.4%

UNDERLYING OPERATING MARGIN

£4.1bn

2022: £4.0bn

ORDER BACKLOG

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.

OUR DIVISIONS

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.

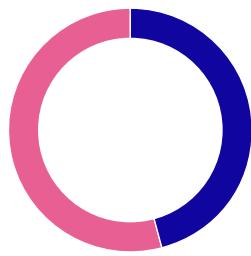
Outlook

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

Our sustainability approach

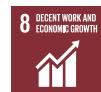
We look to operate and act in an ethically, environmentally and socially responsible manner by:

Managing and minimising environmental impacts across our value chain



See pages 33 to 43

Creating a positive social impact for our people, our partners and communities



See pages 44 to 48

Maintaining the highest standards of ethics and compliance



See page 49

Underpinned by our values and behaviours

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 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	– Safety – Talent & capability	52 and 57
Social matters	– Charitable contributions and social sponsorships	– Political	56
Human rights	– People – Diversity & inclusion – Human rights	– 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 ktCO₂e in 2023, a 18% decrease compared to 2022 (see page 41 for further detail).

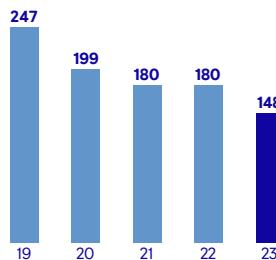
We have continued to make progress in decarbonising our global operations, as well as in reducing our overall energy consumption by approximately 10% in 2023. Both these activities will help ensure our facilities and internal supply chains are more resilient. To continue our progress we are: deploying 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) (ktCO₂e)^{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 CO₂ 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 of climate-related scenarios and the potential impacts against 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.

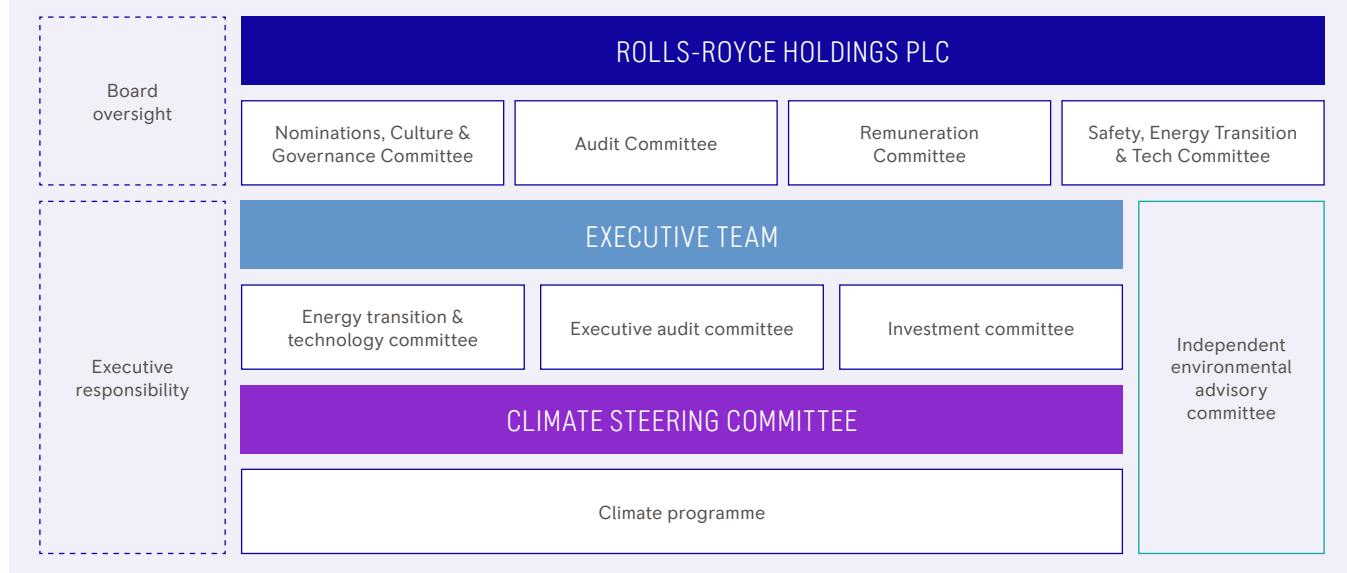
The Remuneration Committee determines our remuneration policy, which includes sustainability metrics.

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

CLIMATE-RELATED GOVERNANCE STRUCTURE



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-CO₂ 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 predictions 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	
	(1.2)	(0.4)	0.4	4.0	(0.3)	0.9	(0.1)	0	(0.1)	0	0.4	4.0	10yrs+
Changing customer demand	(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 carbon pricing	0.9	0	0.1	0	(4.8)	0.2	(1.9)	(0.2)	2.0	(0.1)	0.4	0	5-10yrs
Change in costs due to commodity pricing	0	0	(0.3)	0	0	0	0.3	0	0	0	(0.3)	0	5-10yrs
Changing investment requirement	(0.4)	(0.4)	(0.4)	0	(0.4)	(0.4)	(0.4)	0	(0.4)	(0.4)	(0.4)	0	10yrs+
Facility disruption	(1.4)	(0.3)	(0.3)	0	(1.4)	(0.3)	(0.3)	0	(1.4)	(0.3)	(0.3)	0	10yrs+
Supply chain disruption	0	0	0	0	(0.5)	0	0	0	(0.5)	0	0	0	10yrs+
Impact on product performance	(4.8)	(0.7)	(3.3)	4.0	(8.2)	0.1	(1.2)	(0.2)	(1.1)	(0.9)	0.6	4.0	
Total													

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 than 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 ₂ e	180 ktCO ₂ e	180 ktCO ₂ e	148 ktCO ₂ e
Scope 1 + 2: emissions from product testing activities	126 ktCO ₂ e	133 ktCO ₂ e	136 ktCO ₂ e	109 ktCO ₂ e
Total Scope 1 + 2 emissions	326 ktCO₂e	313 ktCO₂e	316 ktCO₂e	257 ktCO₂e
Total Scope 1 + 2 emissions normalised by revenue (ktCO ₂ e/£m)	0.0283 ktCO ₂ e/£m revenue	0.0279 ktCO ₂ e/£m revenue	0.0234 ktCO ₂ e/£m revenue	0.0156 ktCO ₂ e/£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 ₂ e	97.3 MtCO ₂ e
Use of sold products on a fossil fuel based pathway (without weight based adjustment)	247.4 MtCO ₂ e	315.5 MtCO ₂ e
Use of sold products of a sustainable fuel based pathway (with weight based adjustment)	70.0 MtCO ₂ e	77.0 MtCO ₂ e
Use of sold products of a sustainable fuel based pathway (without weight based adjustment)	185.1 MtCO ₂ e	229.1 MtCO ₂ e

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.

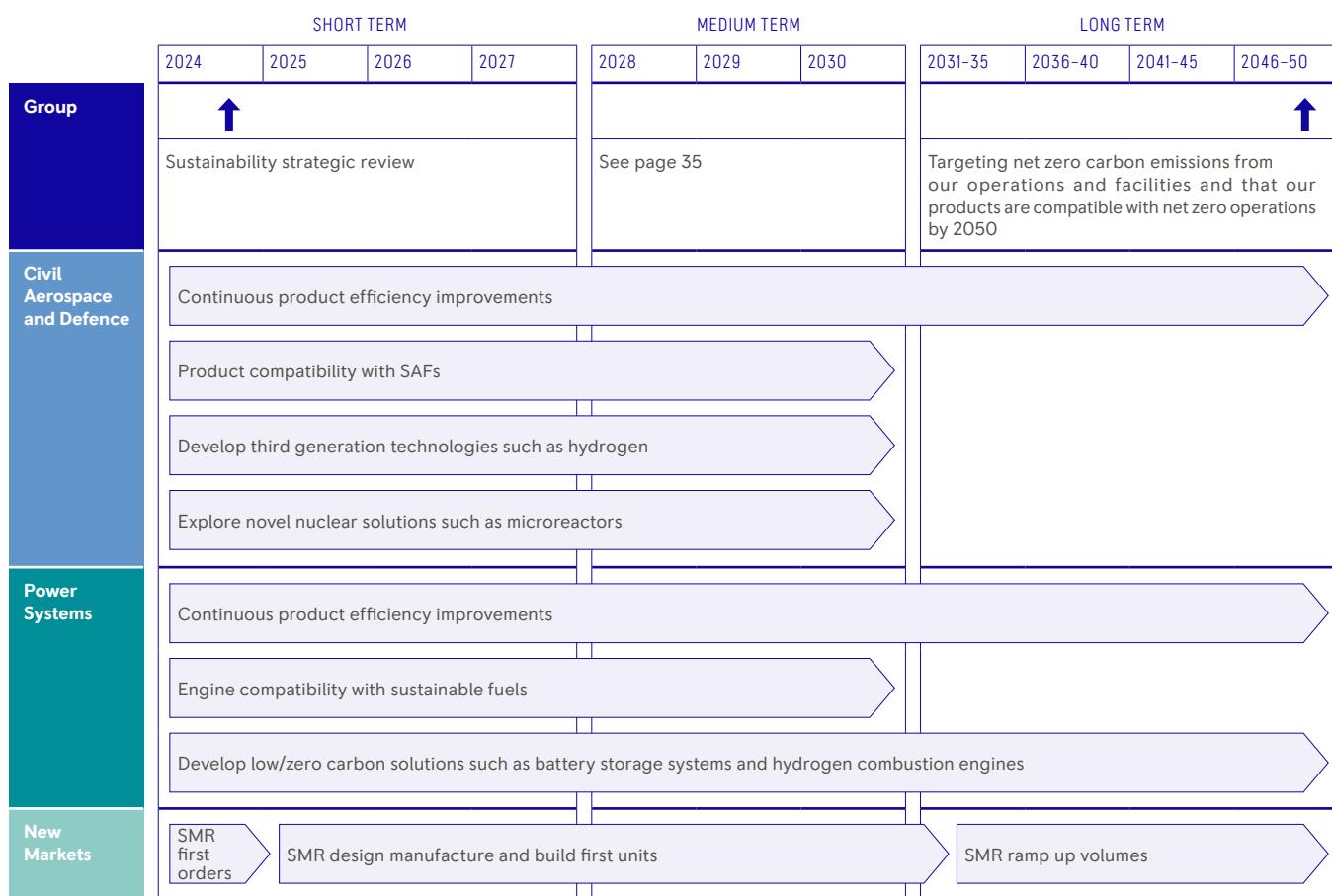
In 2024, it is our intent to complete a comprehensive review of our sustainability and climate-related strategy and approach to align and integrate with the outcomes of the strategic review. This will include redefining Group climate-related and emissions reduction targets.

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 <i>mtu</i> 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

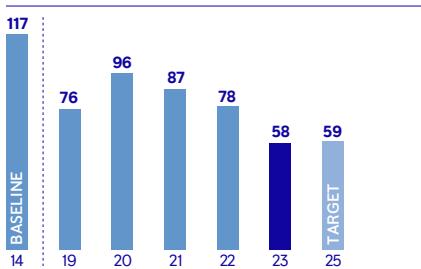
is broken down into different sub-targets for our individual divisions depending on the types of wastes they generate and the opportunity to recycle them whilst remaining compliant with relevant local legislation.

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)

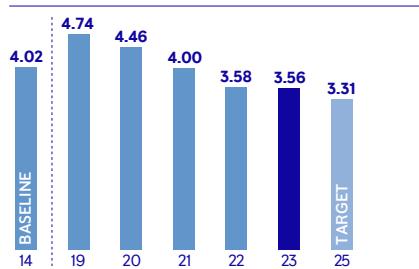


Target

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)

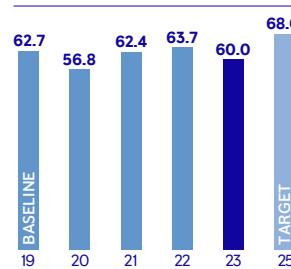


Target

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.

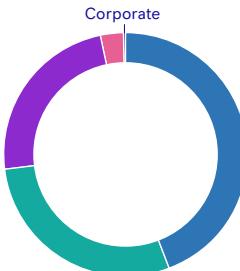
Safety, health and wellbeing

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:

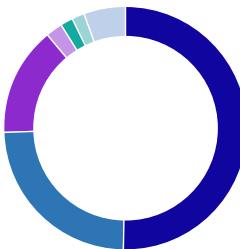
41,400 employees total (monthly average) *



Civil Aerospace	– 18,300
Defence	– 12,000
Power Systems	– 9,800
New Markets	– 1,200
Corporate	– 100

* Segments are defined in note 2 on page 137

Employees in 48 countries (monthly average) *



UK	– 20,900
Germany	– 10,000
US & Canada	– 6,000
Italy	– 900
Singapore	– 700
India	– 600
Rest of world	– 2,300

* Employee headcount data represents permanent employees and excludes contractors

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%).

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.

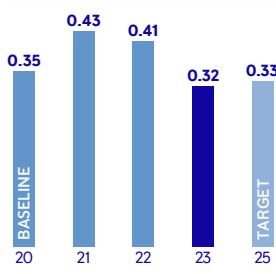
LiveWell is a global, evidence-based accreditation scheme through which sites, facilities and teams assess their workplace on supporting three key areas: healthy bodies, healthy minds and healthy workplaces. It empowers teams and individuals to set data-based goals and focused actions on removing barriers 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. Leatrot 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 2023¹

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 US⁴

	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		CONTROLS AND MITIGATING ACTIONS
Product: Failure to provide safe products		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: 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		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	OVERSIGHT FORUM(S)	BUSINESS MODEL
Product – Product safety assurance team – Product safety board – Technical product lifecycle audits	– Safety, Energy Transition & Tech Committee	– Our role in society – Our business model drivers – Our uniqueness
People – Safety case interventions – HSE audit team		
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  DecreasedCompliance 

PRINCIPAL RISK DESCRIPTION

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.

CONTROLS AND MITIGATING ACTIONS

- 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

- Compliance teams
- Financial controls team

OVERSIGHT FORUM(S)

- Board
- Nominations, Culture & Governance Committee
- Audit Committee

BUSINESS MODEL

- 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

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.

CONTROLS AND MITIGATING ACTIONS

- 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

- Group strategy team
- Challenge from external advisers

OVERSIGHT FORUM(S)

- Board

BUSINESS MODEL

- 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  DecreasedMarket & 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 or 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		CONTROLS AND MITIGATING ACTIONS		
ASSURANCE ACTIVITIES AND PROVIDERS	OVERTSIGHT FORUM(S)	BUSINESS MODEL		
– People leadership team	– Nominations, Culture & Governance Committee	– 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		CONTROLS AND MITIGATING ACTIONS		
ASSURANCE ACTIVITIES AND PROVIDERS	OVERTSIGHT FORUM(S)	BUSINESS MODEL		
– Disruptive technology horizon scanning process – Strategy reviews – Investment reviews – Technology reviews	– Safety, Energy Transition & Tech Committee	– 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.

GOING CONCERN AND VIABILITY STATEMENTS

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 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 	<p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p>	 See page 44 People and Culture  See page 78 Nominations, Culture & Governance Committee report
Customers 	<p>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.</p> <p>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.</p>	 See page 3 Our divisions
Suppliers and partners 	<p>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.</p> <p>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.</p>	 See page 6 Chief Executive's Review

STAKEHOLDER	ENGAGEMENT	REFERENCE
Communities 	<p>The Board recognises the importance of our communities and understands that everything we do can have an impact on our local and global communities.</p> <p>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.</p>	 See page 44 People and Culture
Governing bodies and regulators 	<p>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.</p> <p>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.</p>	 See page 3 Our divisions
Investors 	<p>The investor relations team is the key interface between the investment community and the Board, providing frequent dialogue and feedback.</p> <p>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.</p> <p>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.</p> <p>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.</p>	 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	Environment	Partners
<p>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.</p> <p>The Group is refocusing its portfolio choices into growing markets where the Group has a differentiated position, strong customer recognition and excellent technology.</p> <p>This allows us to effectively leverage our expertise into next generation technologies, including UltraFan and nuclear micro-reactors.</p>	<p>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.</p> <p>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.</p> <p>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.</p> <p>SMRs and micro-reactors will be needed to decarbonise the grid.</p>	<p>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.</p> <p>Such partnerships could assist with a re-entry into the narrowbody market or development of battery energy storage systems, where we have transferable capabilities.</p> <p>Regarding Rolls-Royce SMR, the Group values its existing partners and welcomes new ones to assist in delivering the overall solution.</p>

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