11 March 2021

ROLLS-ROYCE HOLDINGS PLC - 2020 Full Year Results

Decisive and effective actions to address challenging market conditions

- Severe impact of COVID-19 pandemic on Group performance and near-term outlook
- More than £1bn saved in 2020 from in-year cash mitigations, compared to pre-COVID plans
- Strengthened liquidity to £9bn and protected financial position with £7.3bn of new debt and equity and launched programme to raise at least £2.0bn from disposals
- Strong progress on fundamental restructuring programme; around 7,000 roles removed in 2020
- Targeting free cash flow (FCF) to turn positive during second half 2021 and at least £750m as early as 2022, dependent on the pace of the recovery in engine flying hours and underpinned by the restructuring programme

Warren East, Chief Executive said*:*
"2020 was an unprecedented year and I would like to thank everyone at Rolls-Royce for their hard work, dedication and sacrifice to help secure the Group's future. The impact of the COVID-19 pandemic on the Group was felt most acutely by our Civil Aerospace business. In response, we took immediate actions to address our cost base, launching the largest restructuring in our recent history, consolidating our global manufacturing footprint and delivering significant cost reduction measures. We have taken decisive actions to enhance our financial resilience and permanently improve our operational efficiency, resulting in a regrettable, but unfortunately very necessary, reduction in the size of our workforce. With the support of our stakeholders we successfully secured additional liquidity with a rights issue, bond issuance and further credit facilities put in place during the year. We have made a good start on our programme of disposals and will continue with this in 2021. We continue to invest in developing market-leading technology and low carbon opportunities in all our end markets, to create value for our stakeholders and ensure we are well positioned to take advantage of the transition to a lower carbon economy and growing demand for more sustainable power solutions."

Group financial performance

£million	Reported 2020	Reported 2019	Underlying 2020	Underlying 2019
Revenue	**11,824**	**16,587**	**11,763**	**15,450**
Gross (loss)/profit	**(210)**	**942**	**(512)**	**2,387**
Operating (loss)/profit	**(2,081)**	**(852)**	**(1,972)**	**808**
(Loss)/gain on acquisition/disposal	(14)	139	–	–
Net losses on closing over-hedged position [1]	–	–	(1,705)	–
Other financing costs	(815)	(178)	(281)	(225)
(Loss)/profit before taxation	**(2,910)**	**(891)**	**(3,958)**	**583**
Taxation	(259)	(420)	(39)	(277)
(Loss)/profit for the period	**(3,169)**	**(1,311)**	**(3,997)**	**306**
(Loss)/earnings per share (pence) [2]	**(52.95)**	**(23.70)**	**(66.78)**	**5.44**

£m	2020	2019	Change
Group free cash flow (FCF)	(4,185)	873	(5,058)
Reported movements in net funds	(2,915)	701	(3,616)
Net (debt)/cash (ex. leases)	(1,533)	1,361	(2,894)

[1] *Underlying financing charge of £1,705m reflects the cost of closing $11.8bn over-hedged £/US$ position across 2020-26 (£1,689m) and cost of closing over-hedged jet fuel position in 2020 (£16m). £202m of the cash cost was realised in 2020 with £1,503m cash cost across 2021-26.*

[2] *2019 EPS restated to reflect the impact of the 2020 rights issue.*

Summary of 2020 financial performance and financial impact of COVID-19

Our financial performance in 2020 was significantly affected by the COVID-19 pandemic. The global spread of the virus from March resulted in a sudden deterioration of some of our end markets. A positive albeit reduced contribution from Power Systems and growth in Defence were important to the Group's overall performance, partly offsetting the severe impact to our Civil Aerospace business.

Cash flow

- FCF of £(4.2)bn, reflecting deterioration in underlying performance as a result of the impact of COVID-19 on Civil Aerospace in particular, and a deterioration in working capital which included a £(1.1)bn impact from the cessation of invoice discounting.
- Actions to reduce non-critical spend and payroll delivered more than £1bn of savings in year compared to pre-COVID plans partly mitigating the impact of lower flying hour receipts.
- Reported movement in net funds of £(2.9)bn was helped by £2.0bn inflow from the rights issue.

Underlying performance

- Underlying revenue of £11.8bn reflected lower activity and included a £(1.1)bn revenue impact from Civil Aerospace LTSA contract accounting catch-ups.
- Underlying operating loss of £(2.0)bn included £(1.3)bn of one-off charges largely due to COVID-19 comprising charges for LTSA catch-ups, contracts that have become loss-making in the year and customer provisions.
- Underlying loss before tax of £(4.0)bn included a £(1.7)bn underlying finance charge related to the FX hedge book reduction, due to lower USD receipts in 2020 and forecast future years.

Reported performance

- Reported operating loss of £(2.1)bn included £(1.3)bn net exceptional charges, largely as a result of COVID-19, including £(1.4)bn from impairments and write offs, £(489)m from restructuring, and a £620m exceptional provision release on the Trent 1000 programme.
- A full reconciliation of reported results to underlying results is presented on page 6.

Financial and liquidity position at year end

- Liquidity of £9.0bn at year end comprised £3.5bn cash and £5.5bn undrawn credit facilities.
- A total of £7.3bn additional liquidity was secured during 2020, including £2.0bn rights issue and £5.3bn new credit through bonds, bank loan facilities and commercial paper.
- Net debt of £(1.5)bn excluding leases (£(3.6)bn including leases).
- Under the terms of recent loan agreements, we are restricted from making or declaring payments to our shareholders until after 31 December 2022. Regardless of these restrictions, the Board recognises that it would be inappropriate to make payments at this time due to the Group's financial position.

2020 Business unit performance summary

£ million	Underlying Revenue	Organic change [1]	Underlying operating (loss)/profit	Organic change [1]
Civil Aerospace	5,089	(3,025)	(2,574)	(2,612)
Power Systems [2]	2,745	(530)	178	(192)
Defence	3,366	125	448	34
ITP Aero	705	(240)	68	(43)
Corporate / eliminations	(389)	192	(70)	46
Non-core business	247	(104)	(22)	(15)
Total Group	**11,763**	**(3,582)**	**(1,972)**	**(2,782)**

[1] *Organic change at constant translational currency (constant currency) applying 2019 average rates to 2020 and excluding M&A. All commentary is provided on an organic basis unless otherwise stated.*

[2] *The underlying results for Power Systems for 2019 have been restated to reclassify Bergen Engines AS and the Civil Nuclear Instrumentation and Control business as non-core.*

Responding to the impact of COVID-19

We reacted quickly to the outbreak and rapidly implemented a number of proactive safety measures, in line with local and national guidelines, which helped us to protect our people and ensure continuity of our operations. We also increased our focus on employee mental health and wellbeing through our Employee Assistance Programme and additional resources. Additionally, we have supported the countries and communities in which we operate, providing practical assistance including support with PPE supply, ventilator production and educational tools. Furthermore, we launched the Emergent Alliance, a global community that uses data analytics to assist the global recovery.

To help mitigate the financial impact of COVID-19, we promptly implemented a number of cash cost saving actions to reduce our cash outflow in 2020. These included tighter controls on all discretionary expenditure and a 10% salary reduction for senior managers and executives. Our early response, with many of these measures in place by April, enabled us to achieve more than £1.0bn in-year cash cost savings for 2020 compared to our pre-COVID-19 expectations.

The impact of COVID-19 on international travel significantly altered the near and medium-term outlook for civil aviation. In May 2020 we launched a major restructuring programme to fundamentally re-size the cost base and capital requirements of our Civil Aerospace business. In total we expect the restructuring to lead to the reduction of at least 9,000 roles by the end of 2022, most of which are in Civil Aerospace. By the end of the year, approximately 7,000 permanent and contractor roles had been removed with a significant proportion achieved through voluntary severance and natural attrition. Through these role reductions and a continued focus on costs, we expect to reduce our operating costs and capital spend by £1.3bn versus 2019 levels, with full run-rate savings realised by the end of 2022.

In 2020, $500m of bonds matured and we secured £7.3bn of additional debt and equity funding to strengthen our liquidity. Our strong liquidity position ensures that, even in a severe but plausible downside scenario (page 25) we have enough funding for our operations, business development and near-term debt maturities. In addition, in March 2021 we secured approvals for a £1.0bn increase, which we intend to leave undrawn, to the existing £2.0bn term-loan facility supported by an 80% guarantee from UK Export Finance. We are targeting at least £2.0bn from disposals by early 2022 and have already announced agreements to sell our Civil Nuclear Instrumentation and Control and Bergen Engines businesses. We expect the proceeds from the rights issue in 2020, together with business disposals and cash generated from operations over the next few years, to help us to return to a net cash position in the medium term.

Our recovery expectations

Our diversified portfolio helped to protect the Group's performance during the COVID-19 crisis, with support from governmental end-markets in Power Systems and Defence in particular. Looking ahead over the next couple of years, we are encouraged by the outlook for vaccinations and testing and we expect the rebound in global GDP and lifting of travel restrictions to drive our recovery.

Although the pace and timing of the air travel recovery remains outside our control, we have acted quickly to reset our cost base, particularly in Civil Aerospace, to deliver improved returns and greater operational efficiency. Our large engine LTSA flying hours (EFH) in 2021 are expected to increase to around 55% of 2019 levels (2020: 43%) with an acceleration in the second half as global vaccination programmes enable travel restrictions to be lifted. In 2022, our base case is for EFH to reach around 80% of 2019 levels (previously 90%). Large engine deliveries are expected to remain at the current lower levels for the next few years.

In Power Systems, the shorter-cycle nature of its business means that many of its end markets are expected to recover from the effects of the pandemic by the end of 2021 supporting our expectation that our revenues will be back to 2019 levels by 2022. In addition, our success in China is enabling us to continue to expand our business and win market share. Beyond 2021, we expect structural growth to be driven by global economic activity and the shift towards more sustainable, lower carbon power solutions, most notably hybrid-electric and hydrogen solutions as well as microgrids.

Our Defence business has a strong order book providing good visibility, with around 90% order cover for 2021, and steady growth into the medium term. With an installed base of more than 16,000 engines, we see potential to expand our aftermarket services with through-life upgrades for existing products. We expect broadly stable Defence revenues in the medium term, with strong cash conversion. Defence has substantial new programme opportunities, with good prospects in the US that could generate more than $7bn of lifetime revenue. We are also a key member of the Tempest programme in the UK.

Well positioned for the future

Despite the challenges we faced in 2020, we continued to invest organically and acquisitively in new opportunities, focused on technologies which enable our net zero carbon ambitions as the pace of adoption of low carbon solutions accelerates.

In 2020, approximately 7% of our research and development (R&D) spending was related to low carbon technologies (2019: 4%) and 38% towards next generation engine development with the remainder spent on delivering or enhancing our current product portfolio. The engine programmes we launched in recent years are now maturing and our investment priorities are pivoting towards lower carbon solutions as well as a more equitable balance across our business units. We intend to dedicate approximately 20% of our annual R&D expenditure to low carbon solutions including small modular reactors (SMRs), hybrid, hydrogen and electric power technologies, by 2023.

We publicly affirmed our ambition to enable the sectors we serve to achieve net zero carbon by 2050 when we joined the UN Race to Zero campaign in 2020.

Outlook and financial guidance

In this challenging environment, near-term financial forecasting is more difficult and the potential range of outcomes wider. Our expectations and targets are based on the pace of delivery of our fundamental restructuring programme and our current view of the shape and timing of the recovery.

- We expect Group FCF in the region of £(2.0)bn in 2021, based on EFH at around 55% of 2019 levels, with the outflow weighted towards the first half before the Group turns cash flow positive at some point during the second half of the year.
- Group FCF of at least £750m (excluding disposals) is achievable when EFH exceed 80%, on average, of 2019 levels for a 12-month period. We aim to reach this as early as 2022, underpinned by our cost reductions and management actions, however the exact timing is dependent on the pace of air travel recovery.
- Medium-term, we aim to return to a net cash position and an investment grade credit position driven by free cash generation and our planned £2.0bn disposal programme.

The near-term outlook remains uncertain and highly sensitive to the developments of the COVID-19 virus and the related measures taken by governments around the world.

This announcement has been determined to contain inside information.
LEI: 213800EC7997ZBLZJH69

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This announcement contains forward-looking statements. Any statements that express forecasts, expectations and projections are not guarantees of future performance and will not be updated. By their nature, these statements involve risk and uncertainty, and a number of factors could cause material differences to the actual results or developments. This report is intended to provide information to shareholders, is not designed to be relied upon by any other party, or for any other purpose and Rolls-Royce Holdings plc and its directors accept no liability to any other person other than under English law.

Results webcast and conference call

A webcast and conference call will be held at 09:00 (GMT) today. To register for the webcast, including Q&A participation, please visit: https://edge.media-server.com/mmc/p/egc88ogi
A webcast replay will be made available shortly after the event concludes on the same link.

Conference call dial-in details:
UK / International: +44 203 009 5709 / US: +1 646 787 1226
Participant passcode: 549 8743

Downloadable materials

Please visit the Investor Relations section of the Rolls-Royce website to download PDF copies of our Results materials: https://www.rolls-royce.com/investors/results-and-events.aspx
Photographs and broadcast-standard video are available at www.rolls-royce.com.

Group Trading Summary

The commentary and income statement below describe underlying performance, with percentage and absolute change figures presented on an organic basis, unless otherwise stated.

Summary income statement

£m	2020	2019	Change [2]	Organic change [1]
Underlying revenue	**11,763**	**15,450**	**(3,687)**	**(3,582)**
Underlying OE revenue	5,887	7,456	(1,569)	(1,593)
Underlying services revenue	5,876	7,994	(2,118)	(1,989)
Underlying gross (loss)/profit	**(512)**	**2,387**	**(2,899)**	**(2,872)**
Gross margin %	(4.4)%	15.4%	(19.8)%pt	(19.9)%pt
Commercial and administration costs	(904)	(993)	89	63
Research and development costs	(735)	(696)	(39)	(43)
Joint ventures and associates	179	110	69	70
Underlying operating (loss)/profit	**(1,972)**	**808**	**(2,780)**	**(2,782)**
Underlying operating margin	**(16.8)%**	**5.2%**	**(22.0)%pt**	**(22.2)%pt**
Financing costs	(1,986)	(225)	(1,761)	(1,763)
Underlying (loss)/profit before taxation	**(3,958)**	**583**	**(4,541)**	**(4,545)**
Taxation	(39)	(277)	238	236
Underlying (loss)/profit for the period	**(3,997)**	**306**	**(4,303)**	**(4,309)**
Underlying (loss)/earnings per share [3] (p)	**(66.78)**	**5.44**	**(72.22)**	**(72.25)**

[1] *Organic change at constant translational currency (constant currency) by applying 2019 average rates to 2020 numbers, and excluding M&A. All commentary is provided on an organic basis unless otherwise stated.*
[2] *The impact of M&A was £147m on revenue and £6m on underlying operating loss.*
[3] *2019 earnings per share has been adjusted to reflect the 2.91 bonus element of the rights issue*

Note: 2019 transactions were translated at an achieved rate of £$1.53, close to the average rate of our hedge book, whereas 2020 transactions were translated at £$1.24 in the first half and £$1.33 in the second half, due to not being able to utilise our hedge book in 2020.

- **Underlying revenue:** Organic change of £(3.6)bn (23)% reflected a significant fall in both OE and services revenue largely due to the impact of COVID-19 on end-market demand. Civil Aerospace was the most impacted, down £(3.0)bn (37%) including £(1,061)m of COVID-related negative LTSA catch-ups. Power Systems was down £(530)m (17%) mostly due to lower OE revenue and ITP Aero was £(240)m lower (26%) with a reduction in OE partly offset by a small increase in services. Defence revenue increased by £125m (4%), showing continuity of demand from government customers and effective measures to minimise operational disruption from COVID-19.
- **Underlying gross loss:** The loss of £(512)m was predominantly driven by a £(2.0)bn loss in Civil Aerospace (including £(1.3)bn of COVID-related charges), partly offset by savings from role reductions and cost mitigations. Power Systems, Defence and ITP Aero all contributed positively, with Defence achieving an increase on the prior year.
- **Commercial and administration costs:** reduced by £63m, reflecting some of the savings from the Group-wide focus on cost mitigations in response to COVID-19.
- **Research and development costs:** An increase of £43m reflected lower capitalisation due to the maturity of key aero engine programmes, partly offset by a reduction in expenditure due to our cost mitigation efforts to rephase non-critical spending.
- **Underlying operating loss:** The loss of £(2.0)bn reflected the gross loss and a higher R&D charge, partly offset by higher profit from joint ventures and associates and a reduction in C&A costs.
- **Financing costs:** Costs of £(2.0)bn included a one-off underlying finance charge of £(1.7)bn, mostly taken in the first half, to reduce the size of our USD hedge book by $11.8bn in response to a lower medium-term outlook for US$ cash receipts following COVID-19.
- **Taxation:** The £(39)m tax charge (2019: £(277)m) reflected the tax on overseas profits together with the fact that we have not recognised any deferred tax on UK losses arising in 2020. In addition, £(51)m of the deferred tax previously recognised on UK losses was derecognised.

Group Reported Results

Consistent with past practice, we provide both reported and underlying figures. As the Group does not generally hedge account for forecast transactions in accordance with IFRS 9 *Financial Instruments*, we believe underlying figures are more representative of the trading performance by excluding the impact of period-end mark-to-market adjustments. In particular, the USD:GBP hedge book has a significant impact on the reported results. In 2020, the USD:GBP spot rate moved from 1.32 to 1.36 while the EUR:GBP rate moved from 1.18 to 1.11. Underlying performance also excludes the effect of acquisition accounting and business disposals, impairment of goodwill and other non-current and current assets, and exceptional items. These are included in arriving at reported results. The adjustments between the underlying income statement and the reported income statement are set out in Note 2 to the Consolidated Financial Statements. This basis of presentation has been applied consistently.

Reconciliation between underlying and reported results

	£m	**Revenue**		**(Loss)/profit before financing and tax**		**Net financing**	
	Year to 31 December	**2020**	2019	**2020**	2019	**2020**	2019
	Underlying	**11,763**	**15,450**	**(1,972)**	**808**	**(1,986)**	**(225)**
1	Impact of settled derivative contracts on trading transactions	61	1,137	998	145	(324)	80
2	Unrealised fair value changes on derivative contracts held for trading	–	–	8	(1)	(85)	(6)
3	Unrealised net losses on closing future over-hedged position	–	–	–	–	1,503	–
4	Realised net losses on closing over-hedged position	–	–	–	–	202	–
5	Unrealised fair value change to derivative contracts held for financing	–	–	–	–	(86)	1
6	Exceptional programme credits/(charges)	–	–	620	(1,409)	(36)	–
7	Impact of discount rate changes	–	–	–	–	3	(40)
8	Exceptional restructuring charge	–	–	(489)	(136)	–	–
9	Impairments	–	–	(1,293)	(84)	–	–
10	Other write-offs	–	–	(124)	–	–	–
11	Effect of acquisition accounting	–	–	(133)	(163)	–	(8)
12	Pension past-service credit	–	–	308	–	–	–
	Other	–	–	(4)	(12)	(6)	20
13	Gains/(loss) arising on the acquisitions and disposals of businesses	–	–	(14)	139	–	–
	Total underlying adjustments	**61**	**1,137**	**(123)**	**(1,521)**	**1,171**	**47**
	Reported	**11,824**	**16,587**	**(2,095)**	**(713)**	**(815)**	**(178)**

The most significant items included in the reported income statement, but not in underlying, are summarised below.

1 The impact of measuring revenues and costs and the impact of valuation of assets and liabilities using the period end exchange rate rather than the achieved rate or the exchange rate that is expected to be achieved by the use of the hedge book increased reported revenues by £61m (2019: £1,137m) and reduced loss before financing and taxation by £998m (2019: increased profit by £145m). Underlying financing excludes the impact of revaluing monetary assets and liabilities at the period end exchange rate.

2 The underlying results exclude the fair value changes on derivative contracts held for trading. These fair value changes are subsequently recognised in the underlying results when the contracts are settled.

3 In response to the deterioration in the medium-term outlook caused by COVID-19 and the related reduction in anticipated net US Dollar cash inflows, the Group has taken action to reduce the size of the US Dollar hedge book by $11.8bn predominately by transacting offsetting foreign exchange forward contracts across 2020-2026, resulting in a £1,689m charge to underlying results. The £1,503m included in unrealised loss (shown above) is the net cost of closing out the over-hedged

position in future years. The cost related to future years has been included within the underlying performance. It is reversed in arriving at reported performance on the basis that, the cumulative fair value changes on these derivative contracts are recognised as they arise.

[4] In 2020, the Group incurred a cash outflow of £186m as a result of closing out $1.2bn of the $11.8bn hedge book reduction and a cash outflow of £16m to settle an over-hedged jet fuel position. The realised loss of £202m is included in underlying financing costs.

[5] Includes the losses on hedge ineffectiveness in the year of £11m (2019: losses £13m) and net fair value losses of £75m (2019: profit £14m) on any interest rate swaps not designated into hedging relationships for accounting purposes.

[6] In 2019, abnormal wastage costs were recorded in respect of the Trent 1000, related to remediation shop visit costs, customer disruption costs and contract losses. During the year, the total estimated Trent 1000 abnormal wastage costs have reduced by £620m as a result of COVID-19 made up of £390m (a gross provision release of £560m, offset by the impact of expected actual exchange rates and the share of the costs borne by RRSAs) related to remediation shop visit costs and customer disruption costs and an improvement of £230m in the position on contract losses.

[7] Discount rates have increased on exceptional contract loss provisions in relation to the Trent 900 and Trent 1000.

[8] At 31 December 2020, the Group recorded an exceptional restructuring charge of £489m following the announcement on 20 May 2020 to reshape and resize the Group due to the financial and operational impact of COVID-19 (see note 21 for more detail).

[9] The Group has assessed the carrying value of its assets given the financial and operational impact of COVID-19 on the Group's future cash flow forecasts. Consequently, a number of impairments and write-offs have been recorded at 31 December 2020. Impairments comprise: intangible assets £567m, mainly related to programme intangibles; property, plant and equipment £318m (including £219m related to site rationalisation); right-of-use assets £384m, comprising engines of £311m, £69m of site rationalisation and £4m of other impairments; and a £24m impairment on the carrying value of investments held.

[10] Other write-offs include £149m of participation fees in contract assets, £2m in provisions for site rationalisation, offset by £(27)m for RRSA deferred cost contributions in payables. These write-offs are primarily a result of the impact of COVID-19.

[11] The effect of acquisition accounting includes the amortisation of intangible assets arising on previous acquisitions.

[12] The Group recorded a past service gain of £308m (of which £248m was recorded at 30 June 2020) following changes to the pension benefits under the terms of the Rolls-Royce UK Pension Fund (RRUKPF), a defined benefit scheme. In respect of the £248m gain recorded at 30 June 2020, £127m was subsequently recognised as actuarial losses through other comprehensive income at 31 December 2020 – see note 2 and 22.

[13] Gains/(losses) arising on the acquisitions and disposals of businesses includes the acquisition of Qinous GmbH (increasing the Group's shareholding from 24% to 100%), the sale of the North America Civil Nuclear business, the sale of the Knowledge Management Systems business and the sale of Trigno Energy Srl.

Tax affecting these adjustments resulted in a tax charge of £(220)m (2019: £(143)m). The charges in 2020 and 2019 are mainly due to the non-recognition of deferred tax on UK losses arising in those years. The charge in 2020 includes a tax credit of £160m in respect of the change in the UK tax rate and a tax charge of £(276)m relating to the derecognition of some of the deferred tax asset on UK losses previously recognised. The 2019 charge included £(86)m relating to the derecognition of UK deferred tax assets on foreign exchange and commodity financial assets and liabilities.

Group Funds Flow

Free cash flow

Group free cash outflow of £(4,185)m deteriorated from a £873m inflow in 2019. The key drivers of this outflow were significantly lower engine flying hour receipts as global travel dramatically declined and working capital outflows, including the decision to cease invoice discounting, as our OE and aftermarket volumes declined. Trent 1000 in-services cash costs were £(524)m (2019: £(578)m).

Summary funds flow statement [1]	**Full-year to 31 December**		
£m	**2020**	2019	Change
Underlying operating (loss)/profit	**(1,972)**	808	(2,780)
Depreciation, amortisation and impairment	**951**	1,068	(117)
Lease payments (capital plus interest)	**(379)**	(319)	(60)
Expenditure on intangible assets	**(316)**	(591)	275
Capital expenditure (PPE)	**(579)**	(747)	168
Change in inventory	**588**	(43)	631
Movement in receivables/payables/contract balances (excluding Civil LTSA)	**(2,207)**	492	(2,699)
Civil Aerospace net LTSA balance change	**479**	754	(275)
Of which: underlying change	***(582)***	*654*	*(1,236)*
Of which: impact of contract catch-ups	***1,061***	*100*	*961*
Movement on provisions	**(195)**	(506)	311
Cash flows on settlement of excess derivative contracts	**(202)**	–	(202)
Fees on undrawn facilities	**(97)**	–	(97)
Net interest received and paid	**(75)**	(73)	(2)
Trent 1000 insurance receipt	–	173	(173)
Other	**(110)**	41	(151)
Trading cash flow	**(4,114)**	1,057	(5,171)
Contributions to defined benefit pensions in excess of underlying PBT charge	**160**	(9)	169
Taxation paid	**(231)**	(175)	(56)
Group free cash flow	**(4,185)**	873	(5,058)
Shareholder payments	**(92)**	(224)	132
Rights Issue	**1,972**	–	1,972
Disposals and acquisitions	**(119)**	409	(528)
Exceptional Group restructuring	**(323)**	(216)	(107)
Payment of financial penalties	**(135)**	(102)	(33)
Other underlying adjustments	**(33)**	(39)	6
Movements in net funds from cash flows (excluding lease liabilities)	**(2,915)**	**701**	**(3,616)**
Capital element of lease repayments	284	271	13
Movements in net funds from cash flows	**(2,631)**	**972**	**(3,603)**
Movement in short-term investments	6	–	6
Net cash flow from changes in borrowings and lease liabilities	1,630	(1,385)	3,015
Reported cash flow	**(995)**	(413)	(582)

[1] *The derivation of the summary funds flow statement above from the reported cash flow statement is included on page 60.*

Key changes in the funds flow items are described below:

Depreciation, amortisation and impairments: The decrease of £(117)m was largely driven by lower overall additions across intangible assets and property, plant and equipment as a result of management actions to reduce cash expenditure and a £102m adjustment to residual value guarantees which is non-cash and increased underlying operating profit.

Lease payments (capital plus interest): Lease payments were higher than prior year largely due to changes in FX achieved rates used to convert US dollar lease payments into GBP.

Additions of intangible assets: Expenditure included £(232)m capitalised R&D (2019: £481m), lower than 2019 due to completion of capitalisation of the Trent 1000 and Pearl 15 engine R&D, reflecting the maturity of these programmes, and no further capitalisation on the Pearl 700 programme.

Purchases of property, plant and equipment: Investment was lower than 2019 primarily as a result of management actions to reduce cash costs to mitigate the impact of COVID-19.

Decrease in inventory: The £588m decrease in 2020 (2019: £(43)m increase) was led by COVID-19 driven demand reductions as well as significant improvement measures delivered in Civil Aerospace, partly offset by certain actions to safeguard necessary parts supply in 2021.

Movement in receivables/payables/contract balances (excluding Civil LTSA):

The £(2,207)m movement in 2020 reflected:

- £0.4bn increase in receivables reflecting the decision to cease invoice discounting (£(1.1)bn increase), partly offset by significantly lower trading activity especially in Civil Aerospace.
- £1.8bn reduction in payables reflecting lower amounts owed to suppliers, JVs and Risk and Revenue Share Partners (RRSPs) due to COVID-19 led demand reductions. In addition, reduction in OE deposits reflecting utilisation in Civil Aerospace. This was partly offset by new deposits in Defence and an increase in the Civil Aerospace OE engine concessions payable, due to aircraft delivery delays and associated concession payment deferrals.

Movement in underlying Civil Aerospace net LTSA balance: The LTSA net balance increased by £479m. There was a significant reduction in widebody and regional invoiced engine flying hour receipts during 2020 due to lower flying activity, resulting in a £(582)m underlying reduction to the net LTSA balance as revenues traded exceeded invoiced flying hour receipts. However, this was more than offset by the impact of £1,061m of contract catch-ups, principally driven by a forecast reduction in engine flying hour receipts due to the COVID-19 pandemic, which reduced revenue recognised during the year.

Movement on provisions: The £(195)m movement reflected a decrease in the provision balance driven by Trent 1000 provision utilisation during the period partly offset by new provisions charges (details on page 10), largely as a result of COVID-19 which include the impact from the up-front recognition of future losses on a small number of loss-making Civil Aerospace contracts.

Interest: The net payment of £(75)m in 2020 was £2m higher than prior year, reflecting movements in the overall total amount of debt and interest rates. £5.3bn of additional debt was raised during 2020. At 31 December 2020, £5.5bn of total debt was undrawn.

Contributions to defined benefit pensions: Cash contributions were £160m lower than the charge on the income statement (2019: £9m higher). The £169m year-on-year movement reflected early payment in 2019 of contributions due in 2020 and deferral of certain 2020 contributions into 2021.

Taxation: The cash tax payments in 2020 were £(231)m compared to £(175)m in 2019. The increase reflected higher payments in Germany, largely due to timing.

Payments to shareholders: The £(92)m interim dividend was announced in August 2019 and paid in January 2020. Reflecting the Group's financial priorities and the challenging macro environment, the Board did not recommend a final dividend in respect of 2019.

Rights issue: In November 2020, a 10:3 rights issue raised net proceeds of £1,972m.

Acquisitions and disposals: Net costs of £(119)m included the acquisitions of Qinous, Kinolt and Servowatch; offset by disposal proceeds related to Civil Nuclear North America, Knowledge Management Systems, Trigno, Exostar and a L'Orange earn-out adjustment and M&A costs.

Exceptional Group restructuring: Payments of £(323)m relating to the 2020 fundamental restructuring programme were made in 2020, of which £55m related to restructuring capital expenditure.

Payment of financial penalties: The penultimate payment of £(135)m relating to the deferred prosecution agreement (DPA) was made in January 2020.

Other underlying adjustments: Outflow of £(33)m includes timing of cash flows on a prior period disposal where the Group retains the responsibility for collecting cash before passing it on to the acquirer.

Net cash flow from changes in borrowings (excluding lease liabilities): During the year, the Group issued £1,972m ($1,000m, €750m and £545m) of bond notes as well as £300m of commercial paper under the Covid Corporate Financing Facility. The Group also repaid a maturing $500m (£328m) bond.

Balance sheet

£m	31 Dec 2020	31 Dec 2019 adj HfS [3]	31 Dec 2019 as reported	Change adj HfS [3]
Intangible assets	5,145	5,431	5,442	(286)
Property, plant and equipment	4,515	4,798	4,803	(283)
Right-of-use assets	1,405	2,001	2,009	(596)
Joint ventures and associates	394	402	402	(8)
Contract assets and liabilities	(8,922)	(8,736)	(8,745)	(186)
Working capital [1]	570	(1,243)	(1,136)	1,813
Provisions	(1,945)	(2,780)	(2,804)	835
Net debt [2]	(3,627)	(1,020)	(993)	(2,607)
Net financial assets and liabilities [2]	(3,111)	(3,275)	(3,277)	164
Net post-retirement scheme surpluses/(deficits)	(673)	(199)	(208)	(474)
Tax	1,295	1,130	1,136	165
Held for sale	60	123	3	(63)
Other net assets	19	14	14	5
Net liabilities	**(4,875)**	**(3,354)**	**(3,354)**	**(1,521)**
Other items				
US$ hedge book (US$bn)	25	37	37	(12)
Civil LTSA asset	726	1,086	1,086	(360)
Civil LTSA liability	(6,841)	(6,784)	(6,784)	(57)
Civil net LTSA liability	(6,115)	(5,698)	(5,698)	(417)

1 Net working capital includes inventory, trade receivables and payables and similar assets and liabilities.
2 Net debt includes £251m (2019: £243m) of the fair value of financial instruments held to hedge the fair value of borrowings.
3 2019 adjusted for assets held for sale (HfS) (Bergen Engines AS and Civil Nuclear Instrumentation and Control business) to aid comparability.

Key drivers of balance sheet movements (adjusted for assets held for sale) were:

Intangible assets: Net decrease of £(286)m included impairments of £(579)m, mostly related to the impact of COVID-19. Additions of £364m primarily related to programme development in Civil Aerospace and investment in software applications. Acquisitions of Kinolt Group, Qinous GmbH and Servowatch Systems added £137m. There was a £137m FX impact and amortisation was £(323)m.

Property, plant and equipment: Net decrease of £(283)m included impairments of £(332)m and depreciation of £(489)m partly offset by £38m FX impact and additions of £553m. The additions were lower than the prior year as spending was limited to critical infrastructure projects.

Right-of-use assets: Net reduction of £(596)m was driven by impairments of £(386)m, primarily of lease engines in Civil Aerospace and land and buildings as part of our footprint consolidation. The depreciation charge was £(346)m. Additions were £135m, £92m lower than the prior year.

Contract assets and liabilities: The net liability balance increased by £(186)m, of which £(417)m related to the Civil Aerospace LTSA balance and included foreign exchange of £62m and negative LTSA catch-ups of £(1,061)m. The remainder largely covered reduction in deposits in Civil Aerospace partly offset by new deposits in Defence.

Working capital: The £570m net current asset position reflected a £1.8bn change on the prior year.

- Receivables increased by £0.4bn as a £1.1bn reduction in invoice discounting was partly offset by lower trading activity in Civil Aerospace.
- Payables reduced by £1.8bn primarily due to COVID-19 led demand reductions and comparatively stronger Q4 2019 trading activity.
- Inventory reduced by £0.5bn largely due to COVID-19 led demand reductions and parts rescheduling in Civil Aerospace partly offset by growth in Defence to protect 2021 deliveries and support the supply chain.
- The movement also included a financial penalty payment of £135m related to agreements reached with investigating authorities in January 2017.

Provisions: The £835m decrease reflected net restructuring charges of £(373)m, of which £206m was utilised in 2020 and Trent 1000 provisions utilisation and release of £541m and £560m respectively.

Net debt: Increased to £(3.6)bn (including lease liabilities) primarily driven by free cash outflow of £(4.2)bn partly offset by £2.0bn of rights issue proceeds.

Net financial assets and liabilities: The £164m change was primarily driven by the utilisation of derivatives of £246m partially offset by the fair value movement in currency exchange rates and other derivatives.

Net post-retirement scheme surpluses/deficits: The £(474)m movement was driven by reduction in the UK surplus reflecting changes to members' benefits as part of restructuring the UK pension, closure of the scheme and deferral of company contributions. There have also been changes in financial and demographic assumptions across both the UK and overseas schemes. See note 22.

US$ hedge book: Due to the impact of COVID-19 on Civil Aerospace our forecast future US$ receipts reduced significantly. As a result, we took the necessary decision to reduce the size of our hedge book by $11.8bn to $25bn. Our US$ hedge book runs to 2028. The total cost of closing out the over-hedged position is £(1.7)bn, of which £(186)m was incurred in 2020. The remainder of the cash outflow will be incurred over the next six years.

Civil Aerospace

£m	2020	2019	Change	Organic Change
Underlying revenue	**5,089**	**8,107**	**(37)%**	**(37)%**
Underlying OE revenue	2,298	3,246	(29)%	(29)%
Underlying services revenue	2,791	4,861	(43)%	(43)%
Underlying gross (loss)/profit	**(2,005)**	**622**	**(422)%**	**(422)%**
Gross margin %	(39.4)%	7.7%	(47.1)%pt	(47.1)%pt
Commercial and administration costs	(302)	(306)	(1)%	(2)%
Research and development costs	(436)	(374)	17%	16%
Joint ventures and associates	169	102	66%	66%
Underlying operating (loss)/profit	**(2,574)**	**44**	**(2,618)**	**(2,612)**
Underlying operating margin %	(50.6)%	0.5%	(51.1)%pt	(51.0)%pt

Key operational metrics:	2020	2019	Change
Large engine deliveries	264	510	(48)%
Business jet engine deliveries	184	219	(16)%
Total engine deliveries	**448**	**729**	(39)%
Large engine LTSA flying hours	**6.6m**	**15.3m**	(57)%
Large engine LTSA major refurbs	272	306	(11)%
Large engine LTSA check & repairs	559	660	(15)%
Total large engine LTSA shop visits	**831**	**966**	(14)%

- Production cuts from airframer customers resulted in substantially fewer large engine deliveries in 2020. Business jet deliveries were resilient in the first half of the year but reduced during the second half as the airframers adjusted to the impact on demand from COVID-19.
- Large engine LTSA flying hours were 43% of 2019 level. Flying hour performance was significantly more robust in newer engine programmes than more mature types.
- Business aviation LTSA engine flying hours were resilient, however there was a significant reduction in both regional and V2500 flying hours.
- Large engine LTSA major service visits were 11% lower than prior year, particularly in the second half of the year when we saw a substantial reduction in activity.
- Roles reduced by approximately 5,500 (20%), with most of the departures taking place in the second half of 2020 as a result of the fundamental restructuring programme.
- Agreement reached with Airbus to extend Trent XWB-84 exclusive position on A350-900 to 2030.
- **Underlying revenue** reduced by 37% to £5.1bn (2019: £8.1bn). This decline was driven by the reduction in engine delivery volumes, particularly for large engines, lower aftermarket revenues reflecting fall in shop visit volumes, and included a £(1.1)bn impact from negative LTSA contract catch-ups.
- **Underlying gross loss** of £(2.0)bn, £(2.6)bn lower than 2019. This reflected:

  £(1.3)bn of largely COVID-related one-time charges:

  - LTSA catch-ups: £(974)m impact to profit from negative LTSA catch-ups, mainly driven by a forecast reduction in engine flying hour receipts as a result of COVID-19 and principally impacting mature engine programmes;
  - up-front recognition of future losses: primarily due to COVID-19 certain contracts have either become loss-making or have seen an increase in expected losses, driving a £(213)m charge; and
  - £(86)m charge: reflecting specific customer provisions due to the impact of COVID-19 on the civil aviation industry and our customers' financial positions.

A material reduction in trading performance, primarily reflecting the impact of COVID-19:

  - a substantial reduction in large engine aftermarket, driven by lower shop visit volumes, adverse margin mix on LTSA shop visits, and reduced time & materials (T&M) profits;
  - lower OE profits from business aviation and reduced volumes of large spare engine sales, which offset the benefit from lower installed widebody engine volumes; and
  - a material impact in 2020 from under-recovery of fixed costs.

- **Commercial and administration costs** were relatively unchanged year-over-year, with cost reduction actions delivered in the year reflected more heavily in cost of sales and R&D spend.
- **Research and development costs** of £(436)m reflected a significant reduction in capitalisation during the period due to the maturity of key aero engine programmes partly offset by a reduction in expenditure due to the reducing investment burden on our new engine programmes and the rephasing of some R&D spending in light of COVID-19. Spending continued to shift towards next-generation gas turbine technology and low carbon solutions such as electric and hybrid-electric aircraft.
- **Underlying operating loss** of £(2.6)bn reflected the fall in gross profit and slightly higher R&D charge, partly offset by an increase in profits from joint ventures and associates.
- **Trading cash flow** was a £(4.6)bn outflow during the year (2019: £419m inflow). This deterioration was driven by significantly lower engine flying hour receipts as well as a material working capital outflow, including the one-time impact from the cessation of invoice factoring in 2020.
- **Trent 1000 and Trent XWB update:** During 2020 in-service cash costs on Trent 1000 were in line with guidance at £(524)m and in June we reached our goal of zero aircraft on ground (AoG) due to the durability issues. There was a £620m exceptional credit reflecting a £390m net improvement in the outlook for future in-service cash costs, alongside a £230m improvement in expected future losses on our small number of loss-making contracts primarily due to the impact of COVID-19 on flying activity. Early identification and action regarding durability issues on the Trent XWB announced in August 2020 did not result in any grounded aircraft and it was not necessary to provide for any material additional costs in the year.

Outlook

The near-term environment for Civil Aerospace remains highly uncertain. We continue to plan for a range of recovery scenarios, including the risk of further setbacks to the recovery in air travel caused by new strains of the COVID-19 virus. However, our central assumption is for a gradual market recovery in 2021, with a slow start to the year but accelerating in the second half as global vaccine roll-outs progress and travel restrictions ease.

We anticipate large engine flying hours of approximately 55% of 2019 levels in 2021 (2020: 43%), with a strong second-half weighting as the recovery accelerates, and approximately 80% of 2019 levels in 2022. Engine deliveries will remain low with 200 to 250 large engines and 100 to 150 business jet engine deliveries planned for 2021.

Our severe but plausible downside scenario assumes approximately 45% EFH in 2021 and 70% in 2022, both compared to the 2019 level. More details on page 25.

Power Systems

£m	2020	2019 [1]	Change [2]	Organic change
Underlying revenue	**2,745**	**3,184**	**(14)%**	**(17)%**
Underlying OE revenue	1,794	2,183	(18)%	(21)%
Underlying services revenue	951	1,001	(5)%	(6)%
Underlying gross profit	**681**	**878**	**(22)%**	**(25)%**
Gross margin %	24.8%	27.6%	(2.8)%pt	(2.7)%pt
Commercial and administration costs	(337)	(343)	(2)%	(6)%
Research and development costs	(167)	(166)	1%	(2)%
Joint ventures and associates	1	(2)	-	-
Underlying operating profit	**178**	**367**	**(51)%**	**(52)%**
Underlying operating margin %	6.5%	11.5%	(5.0)%pt	(4.9)%pt

[1] *The underlying results for 2019 have been restated to reclassify Bergen Engines AS and the Civil Nuclear Instrumentation and Control business as non-core.*

[2] *The impact of M&A was £55m on revenue and £nil on underlying operating profit.*

Diversified end market exposure resulted in a relatively resilient performance for Power Systems. Lower economic activity and reduced utilisation of the installed base of engines due to COVID-19 caused a substantial drop in commercial and industrial markets. However, governmental demand remained intact and we grew strongly in China, where economic conditions were better.

- **Order intake** of £2.7bn was 17% lower year-on-year, a book-to-bill of 1.0x during 2020. Commercial marine was impacted by lower tourism and yacht production facility closures, while economic uncertainty led to a deferral of capital spending across power generation and industrial customers. However, there were signs of recovery in order intake in the second half and the underlying demand in key areas including mission-critical back-up generation remained strong.
- **Underlying revenue** reduced by 17% to £2,745m. This reflected a fall in industrial and power generation revenues, with marine relatively stable due to strong governmental demand. OE revenue was down 21% while Services were more resilient, down just 6%.
- **Underlying gross profit** of £681m was 25% lower year-over-year. This reflects the lower sales, reduced factory utilisation, and an adverse mix effect due to the sharper fall in high-margin aftermarket spare parts.
- **Commercial and administration costs** fell 6% to £(337)m primarily reflecting management actions to mitigate costs.
- **Research and development costs** of £(167)m were focused on the investment in lower carbon areas across our portfolio. This includes our expanding gas engine family, electric and hybrid-electric solutions (supported by the acquisition of battery storage company Qinous), and hydrogen solutions, such as our new co-operation with Daimler on hydrogen fuel cells.
- **Underlying operating profit** of £178m with a margin of 6.5%, 4.9%pts lower than prior year, reflecting the drop in gross profit, partly offset by the improvements in C&A and R&D.

Outlook

Uncertainty remains over the near-term economic outlook. However, based on Power Systems' short-cycle exposures and the growth potential in key markets such as China, we expect an improvement in order intake during the first half of 2021, converting into a recovery in sales from the second half of the year with revenues returning to approximately 2019 levels in 2022. Longer term there are significant growth opportunities for Power Systems across both existing activities (notably in mission-critical back-up power and expansion in China) and in new low carbon solutions such as microgrids, hydrogen and hybrid-electric power solutions.

Defence

£m	2020	2019	Change	Organic change
Underlying revenue	**3,366**	**3,250**	**4%**	**4%**
Underlying OE revenue	1,436	1,461	(2)%	(1)%
Underlying services revenue	1,930	1,789	8%	8%
Underlying gross profit	**686**	**669**	**3%**	**3%**
Gross margin %	20.4%	20.6%	(0.2)%pt	(0.2)%pt
Commercial and administration costs	(151)	(158)	(4)%	(4)%
Research and development costs	(96)	(105)	(9)%	(9)%
Joint ventures and associates	9	9	-	-
Underlying operating profit	**448**	**415**	**8%**	**8%**
Underlying operating margin %	13.3%	12.8%	0.5%pt	0.5%pt

Defence had a strong year, with resilient financial performance despite the COVID-19 pandemic. Government customers remained supportive throughout the year, and effective business continuity plans were enacted to minimise the disruptions experienced to the supply chain and facilities.

- **Order intake** was £2.4bn, representing a book-to-bill ratio of 0.7x. This follows on from a record order intake of £5.3bn in 2019 (1.6x book-to-bill) and an average book to bill ratio of 1.2x between 2015 and 2019. Order cover for 2021 is in excess of 90% and the healthy order book currently represents approximately 2.3 years of Defence sales.
- **Underlying revenue** increased by 4% to £3.4bn. This was largely driven by higher LiftSystem aftermarket revenues as the in-fleet service expands together with international sales of the EJ200 engine powering the Eurofighter Typhoon. Naval sales and UK parts sales also improved compared to the prior year.
- **Underlying gross profit** of £686m was 3% higher year-over-year. This reflects the higher sales volumes, with gross margin relatively stable at 20.4%.
- **Commercial and administration costs** were 4% lower year-on-year at £(151)m despite the underlying business growth.
- **Research and development costs** fell by £9m despite an increase in expenditure on key strategic programmes in the period to support new growth opportunities.
- **Underlying operating profit** increased by 8% to £448m, with margins 0.5%pts higher. This reflected the stronger gross profit and modestly lower C&A and R&D charges outlined above.

Outlook

We anticipate another good year for Defence in 2021. Revenue is expected to be stable, with a strong level of order cover coming into the year. Operating margins are also expected to be broadly flat at approximately 13%. We continue to pursue large opportunities in the US which would drive a step-change in growth prospects for Defence, notably the B-52 engine replacement programme for the US Air Force and the Future Vertical Long Range Assault Aircraft competition for the US Army. We also continue to progress Project Tempest in UK air combat. Finally, we are investing in adjacent technologies such as small engines and directed energy power systems in order to drive further medium-term growth.

ITP Aero

£m	2020	2019	Change	Organic change
Underlying revenue	**705**	**936**	**(25)%**	**(26)%**
Underlying OE revenue	537	782	(31)%	(32)%
Underlying services revenue	168	154	9%	8%
Underlying gross profit	**133**	**206**	**(35)%**	**(36)%**
Gross margin %	18.9%	22.0%	(3.1)%pt	(3.2)%pt
Commercial and administration costs	(38)	(62)	(39)%	(40)%
Research and development costs	(27)	(33)	(18)%	(18)%
Underlying operating profit	**68**	**111**	**(39)%**	**(39)%**
Underlying operating margin %	9.6%	11.9%	(2.3)%pt	(2.1)%pt

Due to ITP Aero's significant exposure to civil aviation, which accounted for around 70% of its revenues in 2020, performance was heavily negatively impacted by the COVID-19 pandemic.

- **Underlying revenue** was £705m, down 26% versus 2019, primarily reflecting lower engine (OE) volumes on civil programmes, particularly in widebody. Defence OE revenue was more resilient, supported by EJ200 orders. Service revenue increased 8%.
- **Commercial and administration costs** of £(38)m were 40% lower year-on-year, including some benefit from management actions to reduce discretionary costs, with headcount 13% lower at the year-end compared to 2019.
- **Research and development costs** were £6m lower in the period mainly due to phasing of projects.
- **Underlying operating profit** of £68m, 39% lower year-on-year, reflecting the lower OE revenues and under-utilisation of the fixed cost base.

Outlook

We expect some stabilisation in 2021 followed by a recovery in our performance from 2022 onwards reflecting the wider recovery in commercial aerospace as well as the outcomes from our actions to reduce costs to improve profitability. We remain focused on cost savings, including the workforce capacity adjustment of approximately 15% globally from 2019 levels, which is already well underway and will be completed by the end of the first half of 2021. Our planned sale of ITP Aero is progressing well with ongoing conversations with a number of potential buyers.

Condensed consolidated financial statements

Condensed consolidated income statement

For the year ended 31 December 2020

	Notes	2020 £m	2019 £m
Revenue	2	**11,824**	16,587
Cost of sales [1,2]		**(12,034)**	(15,645)
Gross (loss)/profit	2	**(210)**	942
Commercial and administrative costs [1]	2	**(808)**	(1,128)
Research and development costs [1]	3	**(1,254)**	(770)
Share of results of joint ventures and associates	12	**191**	104
Operating loss		**(2,081)**	(852)
(Loss)/gain arising on acquisition and disposal of businesses [3]	24	**(14)**	139
Loss before financing and taxation		**(2,095)**	(713)
Financing income	4	**67**	252
Financing costs [4]	4	**(882)**	(430)
Net financing costs		**(815)**	(178)
Loss before taxation [5]		**(2,910)**	(891)
Taxation	5	**(259)**	(420)
Loss for the year		**(3,169)**	(1,311)
Attributable to:			
Ordinary shareholders		**(3,170)**	(1,315)
Non-controlling interests		**1**	4
Loss for the year		**(3,169)**	(1,311)
Other comprehensive expense		**(265)**	(1,013)
Total comprehensive expense for the year		**(3,434)**	(2,324)

Loss per ordinary share attributable to ordinary shareholders:	6		
Basic [6]		**(52.95)p**	(23.70)p
Diluted [6]		**(52.95)p**	(23.70)p
Underlying earnings per ordinary share are shown in note 6.			

Payments to ordinary shareholders in respect of the year	7		
Pence per share [6]		**–**	1.6p
Total		**–**	87
Underlying (loss)/profit before taxation [5]	2	**(3,958)**	583

[1] Included within cost of sales, commercial and administrative costs and research and development costs are: exceptional items relating to impairments and write-offs arising as a result of the financial and operational impact of COVID-19 plus other market driven events; impairments and provisions related to the fundamental restructuring activity announced on 20 May 2020 to reshape and resize the Group have also been recorded; and reflecting the impact of COVID-19 and the work we have performed to reduce fleet AOG levels and improve the availability of spare engines, the Trent 1000 provision has been reduced. In the prior year, exceptional charges related to the Trent 1000 and Trent 900 Civil Aerospace programmes and restructuring costs were included within cost of sales and commercial and administrative costs. Further details can be found in note 2.

[2] Cost of sales includes a charge for expected credit losses of £119m (2019: £54m).

[3] North America Civil Nuclear business was disposed of on 31 January 2020, Knowledge Management System business was disposed of on 3 February 2020, Trigno Energy Srl was disposed of on 7 May 2020 and Exostar LLC was disposed of on 6 July 2020. Qinous GmbH was acquired on 15 January 2020, Kinolt Group S.A was acquired on 1 July 2020 and Servowatch Systems Limited was acquired on 7 December 2020. Sales proceeds on a prior period disposal has been adjusted during the year. Commercial Marine was disposed of on 1 April 2019 and Rolls-Royce Power Development Limited was disposed of on 15 April 2019. Further details can be found in note 24.

[4] Included within financing costs are fair value changes on derivative contracts. Further details can be found in notes 2 and 4.

[5] (Loss)/profit before taxation disclosed on a statutory and underlying basis. Further details can be found in note 2.

[6] The comparative figures for earnings per share and payments to shareholders per share have been adjusted to reflect the bonus element of the rights issue - see note 6. As a result of the COVID-19 pandemic, the Directors cancelled the proposed final payment to shareholders of 2.4p (adjusted) per share.

Condensed consolidated statement of comprehensive income

For the year ended 31 December 2020

	Notes	2020 £m	2019 £m
Loss for the year		**(3,169)**	(1,311)
Other comprehensive income (OCI)			
Actuarial movements in post-retirement schemes [1]	22	**(590)**	(934)
Share of OCI of joint ventures and associates	12	**(1)**	(1)
Related tax movements		**195**	324
Items that will not be reclassified to profit or loss		**(396)**	(611)
Foreign exchange translation differences on foreign operations		**121**	(313)
Reclassified to income statement on disposal of businesses	24	**6**	(98)
Movement on fair values (debited)/credited to cash flow hedge reserve		**(16)**	12
Reclassified to income statement from cash flow hedge reserve		**26**	10
Share of OCI of joint ventures and associates	12	**(4)**	(7)
Related tax movements		**(2)**	(6)
Items that may be reclassified to profit or loss		**131**	(402)
Total other comprehensive expense		**(265)**	(1,013)
Total comprehensive expense for the year		**(3,434)**	(2,324)
Attributable to:			
Ordinary shareholders		**(3,435)**	(2,328)
Non-controlling interests		**1**	4
Total comprehensive expense for the year		**(3,434)**	(2,324)

[1] Included in actuarial movements in post-retirement schemes is an experience loss of £188m which includes the impact of updated membership data and members leaving on voluntary severance. Included in the prior period is an asset re-measurement net loss estimated at £600m following the agreement to transfer the future pension obligation of circa 33,000 pensioners in the UK scheme to Legal & General Assurance Society Limited. See note 22 for further information.

Condensed consolidated balance sheet

At 31 December 2020

	Notes	**31 December 2020 £m**	31 December 2019 £m
ASSETS			
Intangible assets	9	**5,145**	5,442
Property, plant and equipment	10	**4,515**	4,803
Right-of-use assets	11	**1,405**	2,009
Investments – joint ventures and associates	12	**394**	402
Investments – other	12	**19**	14
Other financial assets	18	**687**	467
Deferred tax assets	5	**1,826**	1,887
Post-retirement scheme surpluses	22	**907**	1,170
Non-current assets		**14,898**	16,194
Inventories	13	**3,690**	4,320
Trade receivables and other assets	14	**5,455**	5,065
Contract assets	17	**1,510**	2,095
Taxation recoverable		**117**	39
Other financial assets	18	**107**	86
Short-term investments		**–**	6
Cash and cash equivalents	15	**3,452**	4,443
Current assets		**14,331**	16,054
Assets held for sale	24	**288**	18
TOTAL ASSETS		**29,517**	32,266
LIABILITIES			
Borrowings and lease liabilities	19	**(1,272)**	(775)
Other financial liabilities	18	**(608)**	(493)
Trade payables and other liabilities	16	**(6,653)**	(8,450)
Contract liabilities	17	**(4,187)**	(4,228)
Current tax liabilities		**(154)**	(172)
Provisions for liabilities and charges	21	**(826)**	(858)
Current liabilities		**(13,700)**	(14,976)
Borrowings and lease liabilities	19	**(6,058)**	(4,910)
Other financial liabilities	18	**(3,046)**	(3,094)
Trade payables and other liabilities	16	**(1,922)**	(2,071)
Contract liabilities	17	**(6,245)**	(6,612)
Deferred tax liabilities	5	**(494)**	(618)
Provisions for liabilities and charges	21	**(1,119)**	(1,946)
Post-retirement scheme deficits	22	**(1,580)**	(1,378)
Non-current liabilities		**(20,464)**	(20,629)
Liabilities associated with assets held for sale	24	**(228)**	(15)
TOTAL LIABILITIES		**(34,392)**	(35,620)
NET LIABILITIES		**(4,875)**	(3,354)
EQUITY			
Called-up share capital		**1,674**	386
Share premium		**1,012**	319
Capital redemption reserve		**162**	159
Cash flow hedging reserve		**(94)**	(96)
Merger reserve		**650**	650
Translation reserve		**524**	397
Accumulated losses		**(8,825)**	(5,191)
Equity attributable to ordinary shareholders		**(4,897)**	(3,376)
Non-controlling interests		**22**	22
TOTAL EQUITY		**(4,875)**	(3,354)

Condensed consolidated cash flow statement

For the year ended 31 December 2020

	Notes	2020 £m	2019 £m
Reconciliation of cash flows from operating activities			
Operating loss [1]		**(2,081)**	(852)
Loss/(profit) on disposal of property, plant and equipment		**37**	(13)
Share of results of joint ventures and associates	12	**(191)**	(104)
Dividends received from joint ventures and associates	12	**60**	92
Amortisation and impairment of intangible assets	9	**902**	372
Depreciation and impairment of property, plant and equipment	10	**821**	532
Depreciation and impairment of right-of-use assets	11	**732**	411
Adjustment of amounts payable under residual value guarantees within lease liabilities [2]		**(102)**	–
Impairment of and other movements on investments		**24**	1
(Decrease)/increase in provisions		**(801)**	1,108
Decrease/(Increase) in inventories		**588**	(43)
Movement in trade receivables/payables and other assets/liabilities		**(2,655)**	73
Movement in contract assets/liabilities		**259**	1,737
Financial penalties paid [3]		**(135)**	(102)
Cash flows on other financial assets and liabilities held for operating purposes		**(126)**	(757)
Interest received		**13**	31
Net defined benefit post-retirement (credit)/cost recognised in loss before financing	22	**(68)**	222
Cash funding of defined benefit post-retirement schemes	22	**(80)**	(266)
Share-based payments		**25**	30
Net cash (outflow)/inflow from operating activities before taxation		**(2,778)**	2,472
Taxation paid		**(231)**	(175)
Net cash (outflow)/inflow from operating activities		**(3,009)**	2,297
Cash flows from investing activities			
Net movement in unlisted investments		**(5)**	3
Additions of intangible assets	9	**(365)**	(640)
Disposals of intangible assets	9	**18**	13
Purchases of property, plant and equipment		**(585)**	(747)
Disposals of property, plant and equipment		**23**	50
Acquisition of businesses	24	**(106)**	(43)
Disposal of businesses [4]	24	**23**	453
Movement in investments in joint ventures and associates and other movements on investments		**(19)**	(7)
Decrease in short-term investments		**6**	–
Net cash outflow from investing activities		**(1,010)**	(918)
Cash flows from financing activities			
Repayment of loans [5]		**(2,884)**	(1,136)
Proceeds from increase in loans [5]		**4,774**	22
Capital element of lease payments		**(284)**	(271)
Net cash flow from increase/(decrease) in borrowings and leases		**1,606**	(1,385)
Interest paid		**(88)**	(104)
Interest element of lease payments		**(74)**	(88)
Fees paid on undrawn facilities		**(97)**	–
Cash flows on settlement of excess derivative contracts [6]		**(202)**	–
Issue of ordinary shares – rights issue (net of expenses and rights taken by share trust) [7]		**1,972**	–
Issue of ordinary shares – other (net of expenses)		**–**	24
Purchase of ordinary shares		**(1)**	(15)
Dividends to NCI		**(1)**	(4)
Redemption of C Shares		**(91)**	(220)
Net cash inflow/(outflow) from financing activities		**3,024**	(1,792)
Change in cash and cash equivalents		**(995)**	(413)
Cash and cash equivalents at 1 January		**4,435**	4,952
Exchange gains/(losses) on cash and cash equivalents		**56**	(104)
Cash and cash equivalents at 31 December [8]		**3,496**	4,435

Condensed consolidated cash flow statement continued

For the year ended 31 December 2020

[1] During the year, the Group received £47m from the British Government as part of the UK furlough scheme. This was recognised within operating loss.

[2] Where the cost of meeting residual value guarantees is less than that previously estimated, as costs have been mitigated or liabilities waived by the lessor, the lease liability has been remeasured. Where the value of this remeasurement exceeds the value of the right-of-use asset, the reduction in the lease liability is credited to cost of sales.

[3] Relates to penalties paid on agreements with investigating bodies.

[4] Includes £5m adjustment of cash consideration on prior period disposal paid during the year. Further detail is provided in note 24.

[5] Repayment of loans includes repayment of the £2.5bn revolving credit facility. Proceeds for increase in loans includes the drawdown of £2.5bn revolving credit facility, proceeds of £2.0bn from new unsecured loan notes and £0.3bn cash received from the Covid Corporate Financing Facility (CCFF). Further detail is provided in note 19.

[6] The impact of COVID-19 on the aerospace industry resulted in a deterioration in net US Dollar receipts across the Group leading to a net US Dollar outflow in the period. During the year, the Group incurred a cash outflow of £186m as a result of needing to buy US Dollars to settle $1,211m of foreign exchange contracts that were originally in place to sell US Dollar receipts. The Group also incurred a cash outflow of £16m to settle excess jet fuel hedges. Further detail is provided in notes 2 and 4.

[7] Expenses of £79m, of which £1m was unpaid at 31 December 2020, and the cost of the Employee Share Trust subscribing for the new shares of £10m have been deducted off the gross proceeds of £2,060m.

[8] The Group considers overdrafts (repayable on demand) and cash held for sale to be an integral part of its cash management activities and these are included in cash and cash equivalents for the purposes of the cash flow statement.

In deriving the consolidated cash flow statement, movements in balance sheet line items have been adjusted for non-cash items. The cash flow in the period includes the sale of goods and services to joint ventures and associates – see note 12.

	2020 £m	2019 £m
Reconciliation of movements in cash and cash equivalents to movements in net funds/(debt)		
Change in cash and cash equivalents	**(995)**	(413)
Cash flow from (increase)/decrease in borrowings and leases	**(1,606)**	1,385
Less: settlement of related derivatives included in fair value of swaps below	**50**	–
Cash flow from decrease in short-term investments	**(6)**	–
Change in net (debt)/funds resulting from cash flows	**(2,557)**	972
New leases and other non-cash adjustments to lease liabilities and borrowings	**(38)**	(217)
Net debt (excluding cash and cash equivalents) of previously unconsolidated subsidiary	**–**	(1)
Exchange gains/(losses) on net funds/(debt)	**143**	(32)
Fair value adjustments	**(126)**	48
Debt assumed on acquisition of business	**(24)**	–
Transferred to liabilities associated with assets held for sale	**11**	3
Movement in net (debt)/funds	**(2,591)**	773
Net (debt)/funds at 1 January excluding the fair value of swaps (as previously reported)	**(1,236)**	318
Reclassifications [1]	**–**	(79)
Adoption of IFRS 16	**–**	(2,248)
Net debt at 1 January	**(1,236)**	(2,009)
Net debt at 31 December excluding the fair value of swaps	**(3,827)**	(1,236)
Fair value of swaps hedging fixed rate borrowings	**251**	243
Net debt at 31 December	**(3,576)**	(993)

[1] In 2019, the Group reclassified £79m as borrowings previously included in other financial liabilities. These borrowings mature during periods up to 2029.

Condensed consolidated cash flow statement continued

For the year ended 31 December 2020

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

	At 1 January [2]	Funds flow	Net funds on acquisition/ disposal	Exchange differences	Fair value adjustments	Reclassifi-cations	Other movements	At 31 December
	£m	£m	£m	£m	£m	£m	£m	£m
2020								
Cash at bank and in hand	**825**	**163**	**–**	**3**	**–**	**(51)**	**–**	**940**
Money market funds	**1,095**	**(426)**	**–**	**–**	**–**	**–**	**–**	**669**
Short-term deposits	**2,523**	**(733)**	**–**	**53**	**–**	**–**	**–**	**1,843**
Cash and cash equivalents (per balance sheet)	**4,443**	**(996)**	**–**	**56**	**–**	**(51)**	**–**	**3,452**
Cash and cash equivalents included within assets held for sale	**–**	**–**	**–**	**–**	**–**	**51**	**–**	**51**
Overdrafts	**(8)**	**1**	**–**	**–**	**–**	**–**	**–**	**(7)**
Cash and cash equivalents (per cash flow statement)	**4,435**	**(995)**	**–**	**56**	**–**	**–**	**–**	**3,496**
Short-term investments	**6**	**(6)**	**–**	**–**	**–**	**–**	**–**	**–**
Other current borrowings	**(427)**	**134**	**(24)**	**(1)**	**–**	**(686)**	**(2)**	**(1,006)**
Non-current borrowings	**(2,896)**	**(1,974)**	**–**	**38**	**(126)**	**686**	**(2)**	**(4,274)**
Lease liabilities	**(2,354)**	**284**	**–**	**50**	**–**	**11**	**(34)**	**(2,043)**
Financial liabilities	**(5,677)**	**(1,556)**	**(24)**	**87**	**(126)**	**11**	**(38)**	**(7,323)**
Net debt excluding fair value of swaps	**(1,236)**	**(2,557)**	**(24)**	**143**	**(126)**	**11**	**(38)**	**(3,827)**
Fair value of swaps hedging fixed rate borrowings [1]	**243**	**(50)**	**–**	**(42)**	**114**	**(14)**	**–**	**251**
Net debt	**(993)**	**(2,607)**	**(24)**	**101**	**(12)**	**(3)**	**(38)**	**(3,576)**
Net funds/(debt) (excluding lease liabilities)	***1,361***							***(1,533)***
2019								
Cash at bank and in hand	1,023	(179)	–	(19)	–	–	–	825
Money market funds	1,222	(124)	–	(3)	–	–	–	1,095
Short-term deposits	2,729	(124)	–	(82)	–	–	–	2,523
Cash and cash equivalents (per balance sheet) [3]	4,974	(427)	–	(104)	–	–	–	4,443
Overdrafts	(22)	14	–	–	–	–	–	(8)
Cash and cash equivalents (per cash flow statement)	4,952	(413)		(104)	–	–	–	4,435
Short-term investments	6	–	–	–	–	–	–	6
Other current borrowings	(816)	799	–	2	5	(417)	–	(427)
Non-current borrowings	(3,674)	315	(1)	4	43	417	–	(2,896)
Lease liabilities	(2,477)	271	–	66	–	3	(217)	(2,354)
Financial liabilities	(6,967)	1,385	(1)	72	48	3	(217)	(5,677)
Net debt excluding fair value of swaps	(2,009)	972	(1)	(32)	48	3	(217)	(1,236)
Fair value of swaps hedging fixed rate borrowings	293	–	–	–	(50)	–	–	243
Net debt	(1,716)	972	(1)	(32)	(2)	3	(217)	(993)
Net funds (excluding lease liabilities)	*761*							*1,361*

[1] Fair value of swaps hedging fixed rate borrowings reflects the impact of derivatives on repayments of the principal amount of debt. Net debt therefore includes the fair value of derivatives included in fair value hedges (2020 £293m, 2019 £229m) and the element of fair value relating to exchange differences on the underlying principal of derivatives in cash flow hedges (2020 £(42)m and 2019 £nil). During the year, the Group reclassified £14m relating to the fair value of derivatives for which hedge accounting was not applied as these relate to the future payments of interest only.

[2] In 2019, the Group reclassified £79m as borrowings previously included in other financial liabilities. These borrowings mature during periods up to 2029.

[3] Includes Trent 1000 insurance receipts of £173m.

Condensed consolidated statement of changes in equity

For the year ended 31 December 2020

	Attributable to ordinary shareholders									
	Share capital	Share premium	Capital redemption reserve	Cash flow hedging reserve	Merger reserve	Translation reserve	Accumulated losses [1]	Total	Non-controlling interests (NCI)	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2020	**386**	**319**	**159**	**(96)**	**650**	**397**	**(5,191)**	**(3,376)**	**22**	**(3,354)**
Loss for the year	**–**	**–**	**–**	**–**	**–**	**–**	**(3,170)**	**(3,170)**	**1**	**(3,169)**
Foreign exchange translation differences on foreign operations	**–**	**–**	**–**	**–**	**–**	**121**	**–**	**121**	**–**	**121**
Reclassified to income statement on disposal of businesses	**–**	**–**	**–**	**–**	**–**	**6**	**–**	**6**	**–**	**6**
Movement on post-retirement schemes	**–**	**–**	**–**	**–**	**–**	**–**	**(590)**	**(590)**	**–**	**(590)**
Fair value movement on cash flow hedges	**–**	**–**	**–**	**(16)**	**–**	**–**	**–**	**(16)**	**–**	**(16)**
Reclassified to income statement from cash flow hedge reserve	**–**	**–**	**–**	**26**	**–**	**–**	**–**	**26**	**–**	**26**
OCI of joint ventures and associates	**–**	**–**	**–**	**(4)**	**–**	**–**	**(1)**	**(5)**	**–**	**(5)**
Related tax movements	**–**	**–**	**–**	**(4)**	**–**	**–**	**197**	**193**	**–**	**193**
Total comprehensive income/(expense) for the year	**–**	**–**	**–**	**2**	**–**	**127**	**(3,564)**	**(3,435)**	**1**	**(3,434)**
Issues of ordinary shares										
− Rights issue [2]	**1,288**	**693**	**–**	**–**	**–**	**–**	**(10)**	**1,971**	**–**	**1,971**
Issue of C Shares [3]	**–**	**–**	**(89)**	**–**	**–**	**–**	**1**	**(88)**	**–**	**(88)**
Redemption of C Shares	**–**	**–**	**92**	**–**	**–**	**–**	**(92)**	**–**	**–**	**–**
Ordinary shares purchased	**–**	**–**	**–**	**–**	**–**	**–**	**(1)**	**(1)**	**–**	**(1)**
Share-based payments - direct to equity [4]	**–**	**–**	**–**	**–**	**–**	**–**	**27**	**27**	**–**	**27**
Transactions with NCI	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(1)**	**(1)**
Related tax movements	**–**	**–**	**–**	**–**	**–**	**–**	**5**	**5**	**–**	**5**
Other changes in equity in the year	**1,288**	**693**	**3**	**–**	**–**	**–**	**(70)**	**1,914**	**(1)**	**1,913**
At 31 December 2020	**1,674**	**1,012**	**162**	**(94)**	**650**	**524**	**(8,825)**	**(4,897)**	**22**	**(4,875)**
At 1 January 2019 including the impact of IFRS 16	379	268	161	(106)	406	809	(3,031)	(1,114)	22	(1,092)
Loss for the year	–	–	–	–	–	–	(1,315)	(1,315)	4	(1,311)
Foreign exchange translation differences on foreign operations	–	–	–	–	–	(313)	–	(313)	–	(313)
Reclassified to the income statement on disposal of Commercial Marine	–	–	–	–	–	(98)	–	(98)	–	(98)
Movement on post-retirement schemes	–	–	–	–	–	–	(934)	(934)	–	(934)
Fair value movement on cash flow hedges	–	–	–	12	–	–	–	12	–	12
Reclassified to income statement from cash flow hedge reserve		–	–	10	–	–	–	10	–	10
OCI of joint ventures and associates	–	–	–	(7)	–	–	(1)	(8)	–	(8)
Related tax movements	–	–	–	(5)	–	(1)	324	318	–	318
Total comprehensive income/(expense) for the year	–	–	–	10	–	(412)	(1,926)	(2,328)	4	(2,324)
Arising on issues of ordinary shares	1	51	–	–	–	–	–	52	–	52
Shares issued in respect of acquisition of ITP Aero [5]	6	–	–	–	244	–	–	250	–	250
Issue of C Shares [3]	–	–	(222)	–	–	–	1	(221)	–	(221)
Redemption of C Shares	–	–	220	–	–	–	(220)	–	–	–
Ordinary shares purchased	–	–	–	–	–	–	(15)	(15)	–	(15)
Shares issued to employee share trust	–	–	–	–	–	–	(51)	(51)	–	(51)
Share-based payments - direct to equity [4]	–	–	–	–	–	–	50	50	–	50
Transactions with NCI	–	–	–	–	–	–	–	–	(4)	(4)
Related tax movements	–	–	–	–	–	–	1	1	–	1
Other changes in equity in the year	7	51	(2)	–	244	–	(234)	66	(4)	62
At 31 December 2019	386	319	159	(96)	650	397	(5,191)	(3,376)	22	(3,354)

Condensed consolidated statement of changes in equity continued

For the year ended 31 December 2020

[1] At 31 December 2020, 39,866,717 ordinary shares with a net book value of £89m (2019:12,476,576 ordinary shares with a net book value of £108m) were held for the purpose of share-based payment plans and included in accumulated losses. During the year, 3,458,865 ordinary shares with a net book value of £29m (2019: 8,984,219 ordinary shares with a net book value of £82m) vested in share-based payment plans. During the year, the Company acquired 85,724 (2019: 118,831) of its ordinary shares via reinvestment of dividends received on its own shares and purchased 30,763,282 (2019: 1,673,143) of its ordinary shares through purchases on the London Stock Exchange. During the year, the Company issued no new ordinary shares (2019: 7,803,043) to the Group's share trust for its employee share-based payment plans with a net book value of nil (2019: £66m).

[2] During the year, the Company issued 6,436,601,676 new ordinary shares and the Employee Share Trust subscribed for new shares at a value of £10m relating to the November 2020 rights issue. The amount credited to share premium is net of £79m in relation to transaction costs associated with the rights issue.

[3] In Rolls-Royce Holdings plc's own Financial Statements, C Shares are issued from the merger reserve. This reserve was created by a scheme of arrangement in 2011. As this reserve is eliminated on consolidation, in the consolidated financial statements, the C Shares are shown as being issued from the capital redemption reserve.

[4] Share-based payments – direct to equity is the share-based payment charge for the year less the actual cost of vesting excluding those vesting from own shares and cash received on share-based schemes vesting.

[5] During 2019, the Company issued 28,973,262 new ordinary shares relating to the final three (of eight) instalments for the acquisition of ITP Aero.

Notes to the year-end financial statements

1 Basis of preparation and accounting policies

Reporting entity

Rolls-Royce Holdings plc (the 'Company') is a public company incorporated under the Companies Act 2006 and domiciled in the United Kingdom. The Condensed Consolidated Financial Statements of the Company for the year ended 31 December 2020 consist of the consolidation of the Financial Statements of the Company and its subsidiaries (together referred to as the Group) and include the Group's interest in jointly controlled and associated entities.

The Consolidated Financial Statements of the Group as at and for the year ended 31 December 2020 (2020 Annual Report) are available upon request from the Company Secretary, Rolls-Royce Holdings plc, Kings Place, 90 York Way, London, N1 9FX.

Statement of compliance

These Condensed Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS). They do not include all of the information required for full annual statements and should be read in conjunction with the 2020 Annual Report.

The comparative figures for the financial year 31 December 2019 have been extracted from the Group's statutory accounts for that financial year. The Group Financial Statements for the year ended 31 December 2020 were approved by the Board on 11 March 2021. They have been reported on by the Group's auditors and will be delivered to the registrar of companies in due course. The report of the auditors was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report, and (iii) did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

The Board of directors approved the Condensed Consolidated Financial Statements on 11 March 2021. They are not statutory accounts within the meaning of section 435 of the Companies Act 2006.

Significant accounting policies

The accounting policies applied by the Group in these Condensed Consolidated Financial Statements are the same as those that were applied to the Consolidated Financial Statements of the Group for the year ended 31 December 2019 (International Financial Reporting Standards issued by the International Accounting Standards Board (IASB), effective at 31 December 2019).

Other than IFRS 17 Insurance Contracts described below, the Group does not consider that any standards, amendments or interpretations issued by the IASB, but not yet applicable will have a significant impact on the Consolidated Financial Statements.

Post balance sheet events

The Group have taken the latest legal position in relation to ongoing legal proceedings and reflected these in the 2020 results as appropriate. In addition, the Group entered into an agreement to sell Bergen Engines on 1 February 2021. Further details are included in note 24. The Spring Budget 2021 announced that the UK corporation tax rate will increase to 25% from 1 April 2023. Further details are included in note 5.

Going concern

The Group operates an annual planning process. The Group's plans and risks to their achievement are reviewed by the Board and once approved, are used as the basis for monitoring the Group's performance, incentivising employees and providing external guidance to shareholders.

The risk management process, and the going concern and viability statements, are designed to provide reasonable but not absolute assurance.

Given the economic uncertainty of the COVID-19 pandemic, and taking into account the recent guidance issued by the FRC, the Directors have undertaken a comprehensive going concern review over an eighteen-month period to September 2022, considering the forecast cash flows of the Group and the liquidity headroom available over that eighteen-month period. The Group has modelled two scenarios in its assessment of going concern which have been considered by the Directors, along with a likelihood assessment of these scenarios, being:

- base case, which reflects the Directors' current expectations of future trading; and
- severe but plausible downside scenario, which envisages a 'stress' or 'downside' situation.

Further details, including the analysis performed and conclusion reached, are set out below.

Background

The COVID-19 pandemic has had a significant impact on the Group, with the Civil Aerospace and ITP Aero businesses being the most significantly impacted. Uncertainty remains over the severity, extent and duration of the disruption caused by the COVID-19 pandemic and therefore the timing of recovery to pre-crisis levels. Safeguarding the health and wellbeing of our people and protecting our business have been at the heart of our decision-making from the outset of this pandemic. During 2020, we have taken decisive action to reduce cash expenditure and maintain liquidity through the following measures:

- A number of proactive steps starting in March 2020, to conserve cash, which delivered more than £1.0bn in-year cash cost savings compared to our pre COVID-19 cash costs in 2020. These savings were delivered through cutting non-critical capital expenditure, minimising discretionary costs, including projects, consulting spend, professional fees and sub-contractor costs, reviewing and rephasing R&D spend, together with a temporary 10% salary reduction for our senior management, and making use of the UK Government's Coronavirus Job Retention Scheme.
- The final shareholder payment in respect of 2019 was not recommended and there will be no shareholder payment in respect of 2020.
- In May 2020, the Group launched a major restructuring programme to reshape and resize the Group and in particular, the Civil Aerospace business. This will remove at least 9,000 roles across the Group, with forecast annualised savings of over £1.3bn by the end of 2022. At 31 December 2020, approximately 7,000 roles had been removed across the Group.
- In August 2020, the Group secured a £2bn term-loan facility, 80% of which is guaranteed by UK Export Finance (UKEF). This is repayable in August 2025.
- In October 2020, the Group launched a rights issue which was completed in November 2020, raising £2bn of proceeds.
- In October 2020, the Group completed a £2bn bond issuance with maturities in 2026 and 2027 and secured a new £1bn loan facility that matures in October 2022.

Whilst vaccination programmes are now underway across the globe, uncertainties remain in respect of more contagious variants of the virus and the potential impact of this on the timing of recovery of demand, in particular in relation to the civil aviation industry. The actions we have taken during 2020 have been necessary to right-size the business to achieve a longer-term sustainable cost base that is fit for purpose in a post COVID-19 environment, as well as securing additional funding to provide sufficient liquidity headroom for the Group.

1 Basis of preparation and accounting policies continued

Going concern assessment

In assessing the adoption of the going concern basis of accounting in the Company and Consolidated Financial Statements, the Directors have considered the FRC Company Guidance (updated 20 May 2020) (COVID-19), which has encouraged companies to assess current forecasts with more vigour, and to consider the impact of different potential scenarios along with a likelihood assessment, taking into account both the uncertainty and the likely success of any realistic mitigations. In adopting this more vigorous approach, the Directors have assessed the Group's future financial performance, cash flows and liquidity headroom available over an eighteen-month period to September 2022, taking into account a base case and a severe but plausible downside scenario. The Directors have paid attention to the impact of the COVID-19 pandemic on the Group, particularly on the Civil Aerospace and ITP Aero businesses, which have been the most significantly impacted, recognising the challenges of reliably estimating and forecasting the effects of COVID-19 on the civil aviation industry, as well as the extent and timing of recovery to pre-crisis levels. Key areas of estimation uncertainty include:

- The magnitude of the impact on EFHs and consequently cashflows from the aftermarket business. The estimates in respect of EFHs and future recovery are influenced by assumptions in respect of:
  - the roll-out of vaccination programmes across the globe and their ability to deal with different variants of the COVID-19 virus;
  - the extent and timing of the easing of restrictions on cross-border movement, including quarantine rules; and
  - the recovery rate of flying hours with a potential growth in the number of people holidaying in their home country, and the increased use of video conferencing reducing the need for business travel.
- The extent of the impact of the pandemic on our customers, and consequently the purchase new aircraft, and/or renew of aftermarket contracts in the future.
- A shift towards more efficient, lower-cost aircraft as airlines look to recover post COVID-19, leading to a risk of higher aircraft retirements in the future.
- Right-sizing the business is underpinned by the assumed size needed to meet future demand.

Given these estimation uncertainties, the Directors believe it is appropriate to provide additional disclosure of the key COVID-19 related assumptions underpinning the base case and severe but plausible downside scenario, as set out below.

Base case scenario

The Group's base case scenario assumes a deep impact on the Civil Aerospace and ITP Aero businesses, with a slow and gradual recovery in demand in 2021. Whilst new variants of the COVID-19 virus create some uncertainty, vaccination programmes are successfully rolled out and/or mass airport testing is introduced to alleviate quarantine restrictions in place across many countries. Widebody flying hours returns to 55% of the pre-crisis baseline in 2021 and approximately 80% in 2022, with slower growth to a full recovery to 2019 levels of widebody activity by the end of 2024 based on industry data.

The Civil Aerospace and ITP Aero forecast assumes:

- **flying hours of widebody aircraft** are 55% of 2019 level in 2021 recovering to 80% of 2019 level in 2022 (based on year averages);
- **flying hours of business aviation** are 2% above 2019 level in 2021 and increase to 10% above the 2019 level in 2022 (based on year averages);
- **widebody OE engine sales** reduce from 450 in 2019 to 187 in 2021 (42% of 2019 level) before increasing to 204 in 2022 (45% of 2019 level);
- **widebody spare engine sales** are 80% of 2019 level in 2021 and 75% of 2019 level in 2022;
- **business aviation engine sales** are 54% of 2019 level in 2021 increasing to 88% of 2019 level in 2022;
- **newer aircraft fleets** (A350, A330neo and 787) recover at a faster pace than older fleets due to the economics and investment value of the aircraft;
- **older aircraft fleets** (A330, A380 and 777) recover on a slower, more varied profile taking into account regional market recovery and unique market dynamics; and
- **the pressure on the transitions market**, driven by new aircraft delivery and volume of surplus assets, results in an elongation in transition time to ~24 months.

1 Basis of preparation and accounting policies continued

Severe but plausible downside scenario

As noted above, due to the inherent uncertainty over the extent and duration of the disruption caused by the COVID-19 pandemic and therefore the timing of recovery of civil aviation to pre-crisis levels, the Directors have also considered a severe but plausible downside scenario.

This severe but plausible downside is based in principle on a general assumption that recovery remains subdued due to ongoing infection rates and an increase in new variants of the COVID-19 virus, with a slower recovery in demand compared with the base case. Restrictions on travel between countries remain in place across many parts of the world during the first part of 2021, with a gradual recovery of the global economy and the Group taking place once those restrictions are lifted.

The resulting key underlying COVID-19 specific assumptions included in the severe but plausible downside scenario in relation to each of the Civil Aerospace and ITP Aero businesses are as follows:

- **flying hours of widebody aircraft** are 45% of 2019 level in 2021, recovering to 70% of 2019 level in 2022 (based on year averages);
- **flying hours of business aviation** are 1% above 2019 level in 2021 and increase to 8% above 2019 level in 2022 (based on year averages);
- **widebody OE engine sales** are 28% of 2019 level in 2021 before falling to 26% of 2019 level in 2022;
- **widebody spare engine sales** are 20% of 2019 in 2021 and remain at 20% of 2019 in 2022;
- **business aviation engine sales** are 54% of 2019 level in 2021 increasing to 80% of 2019 level in 2022;
- **newer aircraft fleets** (A350, A330neo and 787) recover at a faster pace than older fleets due to the economics and investment value of the aircraft;
- **older aircraft fleets** (A330, A380 and 777) recover on a slower, more varied profile taking into account regional market recovery and unique market dynamics; and
- **the pressure on the transitions market**, driven by new aircraft delivery and volume of surplus assets, results in an elongation in transition time to ~24 months.

Liquidity and borrowings

At 31 December 2020, the Group had liquidity of £9.0bn, including cash and cash equivalents of £3.5bn and undrawn facilities of £5.5bn.

The Group's committed borrowing facilities at 31 December 2020, March 2021 and September 2022 are set out below. None of the facilities are subject to any financial covenants or rating triggers which could accelerate repayment.

(£m)	31 December 2020	March 2021	September 2022
Issued Bond Notes [1]	4,634	4,634	3,995
Bank of England Commercial Paper [2]	300	–	–
Other loans	87	87	61
UKEF loan [3]	2,000	2,000	2,000
Revolving Credit Facility [4]	2,500	2,500	2,500
Bank Loan Facility [5]	1,000	1,000	1,000
Total committed borrowing facilities	**10,521**	**10,221**	**9,556**

[1] The value of Issued Bond Notes reflects the impact of derivatives on repayments of the principal amount of debt. A €750m (£639m) bond matures in June 2021, a €550m bond matures in May 2024, and the remainder of the bonds mature between October 2025 and May 2028.

[2] The £300m CCFF facility matures in March 2021.

[3] The £2,000m UKEF loan matures in August 2025 (currently undrawn).

[4] The £2,500m Revolving Credit Facility matures in April 2025 (currently undrawn).

[5] The £1,000m bank loan facility matures in October 2022 (currently undrawn).

Taking into account the maturity of borrowing facilities the Group had committed facilities of £10.5bn at 31 December 2020, £10.2bn at the end of March 2021 and £9.6bn will be available throughout the period to September 2022.

Under both of the scenarios modelled by the Directors (as detailed above), the projections indicate that the Group will continue to operate within its available committed borrowing facilities for the next eighteen months to September 2022 whilst maintaining a sufficient level of liquidity headroom when taking into account debt maturities across this eighteen-month period.

Mitigating actions

Mitigations that are within the control of the Directors and deliverable over the short term have been considered by the Directors. Such mitigations include the restriction of capital and other expenditure to only committed and essential levels, reduce or eliminate discretionary spend, reinstate the implementation of pay deferrals and undertake further restructuring.

Other mitigations that could be considered in more severe circumstances, which are not directly in the control of the Directors, include raising other new funding through the bond or bank markets, pursuing a £1bn increase in the existing £2bn UKEF-backed loan and raising further equity. The anticipated £2bn proceeds from business disposals announced in August 2020 have not been included when assessing the going concern, although completion of these disposals is anticipated during 2022 and within the eighteen-month period being considered. Further potential business disposals could be considered if required.

Conclusion

After due consideration of the matters set out above, the Directors consider that the Group has sufficient liquidity headroom to continue in operational existence for a period of at least eighteen months from the date of this report and are therefore satisfied that it is appropriate to adopt the going concern basis of accounting in preparing the financial statements.

Climate Change

In preparing the Consolidated Financial Statements management has considered the impact of climate change, particularly in the context of the disclosures included in the Strategic Report this year and the stated net zero targets. These considerations did not have a material impact on the financial reporting judgements and estimates, consistent with the assessment that climate change is not expected to have a significant impact on the Group's going concern assessment to September 2022 nor the viability of the Group over the next five years. The following specific points were considered:

- The Group continues to invest in new technologies including hybrid electric solutions in Power Systems, continued development of the more efficient UltraFan aero engine, testing of sustainable aviation fuels, SMRs and hybrid and fully electric propulsion.
- The Group continues to invest in onsite renewable energy generation solutions for our facilities and investment is included in our five year forecasts to enable us to meet our 2030 target for zero greenhouse gas emissions (scope 1 and 2) from our operations and facilities.
- Management has considered the impact of climate change on a number of key estimates within the financial statements, including:
    - the estimates of future cash flows used in impairment assessments of the carrying value of non-current assets (such as programme intangible assets and goodwill) (see note 8);
    - the estimates of future profitability used in our assessment of the recoverability of deferred tax assets in the UK (see note 5); and
    - the long-term contract accounting assumptions, such as the level of EFHs assumed, which consider our future expectations of consumer and airline customer behaviour (see note 17).

Key areas of judgement and sources of estimation uncertainty

The determination of the Group's accounting policies requires judgement. The subsequent application of these policies requires estimates and the actual outcome may differ from that calculated. The key areas of judgement and sources of estimation uncertainty as at 31 December 2020, that were assessed as having a significant risk of causing material adjustment to the carrying amounts of assets and liabilities are set out in note 1 to the Financial Statements in the 2020 Annual Report and are summarised below. Sensitivities for key sources of estimation uncertainty are disclosed where this is appropriate and practicable.

Area	**Key judgements**	**Key sources of estimation uncertainty**	**Sensitivities performed**
Revenue recognition and contract assets and liabilities	Whether Civil Aerospace OE and aftermarket contracts should be combined. How performance on long-term aftermarket contracts should be measured. Whether any costs should be treated as wastage. Whether sales of spare engines to joint ventures are at fair value.	Estimates of future revenue and costs of long-term contractual arrangements. The COVID-19 pandemic has resulted in significant uncertainty across the aerospace industry. Airline customers have grounded a significant number of their aircraft in response to COVID-19 which has resulted in a reduction to engine flying hours (EFHs) in Civil Aerospace during 2020. Further details have been included in the 'going concern' disclosure above. Estimates of future revenue within Civil Aerospace are based upon future EFH forecasts, influenced by assumptions over the time period and profile over which the aerospace industry will recover.	Based upon the stage of completion of all widebody LTSA contracts within Civil Aerospace as at 31 December 2020, the following changes in estimate would result in catch-up adjustments being recognised in the period in which the estimates change (at underlying rates): - A further reduction in forecast EFHs of 15% over the remaining term of the contracts would decrease LTSA income and to a lesser extent costs, resulting in a catch-up adjustment of £100m - £300m. An estimated 90% of this would be expected to be a reduction in revenue with the remainder relating to onerous contracts which would be an increase in cost of sales. - A 5% increase or decrease in shop visit costs over the life of the contracts would lead to a catch-up adjustment of £200m. - A 2% increase or decrease in revenue over the life of the contracts would lead to a catch-up adjustment of £150m.
Risk and revenue sharing arrangements	Determination of the nature of entry fees received.		
Taxation		Estimates are necessary to assess whether it is probable that sufficient suitable taxable profits will arise in the UK to utilise the deferred tax assets. This is largely driven by the Civil Aerospace business and the estimates described above in 'revenue recognition'.	A 5% change in margin in the main Civil Aerospace widebody programmes or a 5% change in the number of shop visits (driven by EFHs which are influenced by a number of factors including climate change) over the remaining life of the programmes, would result in an increase/decrease in the deferred tax asset by around £100m.
Business combinations	Identification of acquired assets and liabilities.		
Research and development	Determination of the point in time where costs incurred on an internal programme development meet the criteria for capitalisation or ceasing capitalisation. Determination of the basis for amortising capitalised development costs.		
Leases	Determination of the lease term.	Estimates of the payments required to meet residual value guarantees at the end of engine leases. Amounts due can vary depending on the level of utilisation of the engines, overhaul activity prior to the end of the contract, and decisions taken on whether ongoing access to the assets is required at the end of the lease term.	During the year, adjustments to return conditions at the end of leases resulted in a credit of £102m to the income statement. The lease liability at 31 December 2020 included £347m relating to the cost of meeting these residual value guarantees in the Civil Aerospace business. Up to £19m is payable in the next 12 months, £133m is due over the following four years and the remaining balance after five years.

Area	Key judgements	Key sources of estimation uncertainty	Sensitivities performed
Impairment of non-current assets	Determination of cash-generating units for assessing impairment of goodwill	In accordance with IAS 36, COVID-19 is considered to be a trigger event to reassess whether an asset is impaired. The carrying value of intangible assets (including programme-related intangible assets) is dependent on the estimates of future cash flows which are influenced by assumptions over the recovery of the industries in which we operate and the discount rates applied. Details of the review performed have been disclosed in note 42.	A weaker than expected recovery could result in a deterioration in future cash flow forecasts that support programme intangible assets. A 5% deterioration in EFHs (and hence future cash flows) across the life of the Civil Aerospace programmes would result in programme intangible assets that have previously been subject to impairment incurring an additional impairment of £50m. For programmes that have not been previously impaired, but where there is existing headroom that could be significantly reduced over the next 12 months, any of the following individual changes in assumptions would cause the recoverable amount of the programme assets to equal the carrying value: - An increase in costs of 2% - A reduction in engine sales that are forecast but not contracted by 14% - An increase in discount rates of 1%
Provisions	Whether any costs should be treated as wastage.	Estimates of the time to resolve the technical issues on the Trent 1000, including the development of the modified HPT blade and estimates of the expenditure required to settle the obligation relating to Trent 1000 claims and to settle Trent 1000 long-term contracts assessed as onerous. Estimates of the future revenues and costs to fulfil onerous contracts. Further details have been included in the going concern disclosure above.	A 12-month delay in the availability of the modified HPT blade could lead to a £60m-£100m increase in the Trent 1000 exceptional costs provision. A reduction in Civil Aerospace widebody flying hours of 15% over the remaining term of the contracts and the associated decrease in revenues and costs could lead to a £10m – £15m increase in the provision for contract losses.
Post-retirement benefits		The valuation of the Group's defined benefit pension schemes are based on assumptions determined with independent actuarial advice. The size of the net surplus is sensitive to the actuarial assumptions, which include the discount rate used to determine the present value of the future obligation, longevity, and the number of plan members who take the option to transfer their pension to a lump sum on retirement or who choose to take the newly implemented Bridging Pension Option.	A reduction in the discount rate from 1.45% by 0.25% could lead to an increase in the defined benefit obligations of the RR UK Pension Fund of approximately £530m. This would be expected to be broadly offset by changes in the value of scheme assets, as the scheme's investment policies are designed to mitigate this risk. A one-year increase in life expectancy from 21.8 years (male aged 65) and from 23.2 years (male aged 45) would increase the defined benefit obligations of the RR UK Pension Fund by approximately £455m. It is assumed that 40% (31 December 2019: 45%) of members of the RR UK Pension Fund will transfer out of the fund on retirement. The reduction in this assumption is a result of the introduction of the Bridging Pension Option. An increase of 5% in this assumption would increase the defined benefit obligation by £45m.

2 Analysis by business segment

The analysis by business segment is presented in accordance with IFRS 8 *Operating Segments*, on the basis of those segments whose operating results are regularly reviewed by the Board (who act as the Chief Operating Decision Maker as defined by IFRS 8). Our four divisions are set out below and referred to collectively as the core businesses.

Civil Aerospace	-	development, manufacture, marketing and sales of commercial aero engines and aftermarket services
Power Systems	-	development, manufacture, marketing and sales of reciprocating engines and power systems
Defence	-	development, manufacture, marketing and sales of military aero engines, naval engines, submarines nuclear power plants and aftermarket services
ITP Aero	-	design, research and development, manufacture and casting, assembly and test of aeronautical engines and gas turbines, and maintenance, repair and overhaul (MRO) services

Non-core businesses include the trading results of the Bergen Engines AS business (the Group signed a sales agreement on 1 February 2021), the results of the Civil Nuclear Instrumentation & Control business (the Group signed a sales agreement on 7 December 2020), the results of the North America Civil Nuclear business until the date of disposal on 31 January 2020, the results of the Knowledge Management System business until the date of disposal on 3 February 2020, the Commercial Marine business until the date of disposal on 1 April 2019, Rolls-Royce Power Development Limited (RRPD) until the date of disposal on 15 April 2019 and other smaller businesses including former Energy businesses not included in the disposal to Siemens in 2014 (Retained Energy). The segmental analysis for 2019 has been restated to reflect the 2020 definition of non-core.

From 1 January 2021, all non-core businesses will be referred to as other businesses, and the reporting of core and non-core will cease.

Underlying results

We present the financial performance of our businesses in accordance with IFRS 8 and consistently with the basis on which performance is communicated to the Board each month.

Underlying results are presented by recording all relevant revenue and cost of sales transactions at the average exchange rate achieved on settled derivative contracts in the period that the cash flow occurs. The impact of the revaluation of monetary assets and liabilities using the exchange rate that is expected to be achieved by the use of the hedge book is recorded within underlying cost of sales. Underlying financing excludes the impact of revaluing monetary assets and liabilities to period end exchange rates. Transactions between segments are presented on the same basis as underlying results and eliminated on consolidation. Unrealised fair value gains and losses on foreign exchange contracts, which are recognised as they arise in the reported results, are excluded from underlying results. To the extent that the previously forecast transactions are no longer expected to occur, an appropriate portion of the unrealised fair value gain/(loss) on foreign exchange contracts is recorded immediately in the underlying results.

2 Analysis by business segment continued

Amounts receivable/(payable) on interest rate swaps which are not designated as hedge relationships for accounting purposes are reclassified from fair value movement on a reported basis to interest receivable/(payable) on an underlying basis, as if they were in an effective hedge relationship.

As a result of the reduction in Civil Aerospace US Dollar (USD) receipts, in the first half of the year the Group was a net purchaser of USD, with the consequence that the achieved exchange rate GBP:USD of 1.24 on settled contracts was similar to the average spot rate in the period. In the second half of 2020 the Group remained a net purchaser of USD with the consequence that the achieved exchange rate of GBP:USD of 1.33 on settled contracts was similar to the average spot rate in the period.

Estimates of future USD cash flows have been determined using the Group's base-case forecast, significantly influenced by the estimate of future EFH forecasts. These USD cash flows have been used to establish the extent of future USD hedge requirements and determine the need to close-out any over-hedged positions. In response to the deterioration in the medium-term outlook caused by COVID-19 and the related reduction in anticipated net USD cash inflows, the Group took action to reduce the size of the USD hedge book by $11.8bn across 2020-2026. An underlying charge of £1,689m relating to the total $11.8bn reduction in the size of the USD hedge book is included within underlying financing costs at 31 December 2020. Further detail on this is included within note 4.

Underlying performance excludes the following:

- the effect of acquisition accounting and business disposals;
- impairment of goodwill and other non-current and current assets where the reasons for the impairment are outside of normal operating activities;
- exceptional items; and
- other items which are market driven and outside of the control of management.

Acquisition accounting, business disposals and impairment

We exclude these from underlying results so that the current year and comparative results are directly comparable.

Exceptional items

We classify items as exceptional where the Directors believe that presentation of our results in this way is more relevant to an understanding of our financial performance, as exceptional items are identified by virtue of their size, nature or incidence.

In determining whether an event or transaction is exceptional, management considers quantitative as well as qualitative factors such as the frequency or predictability of occurrence. Examples of exceptional items include one-time costs and charges in respect of aerospace programmes, costs of restructuring programmes and one-time past service charges and credits on our post-retirement schemes.

A risk-free discount rate is applied to exceptional onerous contract provisions. The risk-free rate is subject to movements in US bonds. Changes in the risk-free rate are market driven and the impact of any increase or decrease in the rate is included as a reconciling difference between underlying performance and reported performance.

Subsequent changes in exceptional items recognised in a prior period will also be recognised as exceptional. All other changes will be recognised within underlying performance.

Exceptional items are not allocated to segments and may not be comparable to similarly titled measures used by other companies.

Other items

The financing component of the defined benefit pension scheme cost is determined by market conditions and has therefore been included as a reconciling difference between underlying performance and reported performance.

Penalties paid on agreements with investigating bodies are considered to be one-off in nature and are therefore excluded from underlying performance.

The tax effects of the adjustments above are excluded from the underlying tax charge. In addition, changes in tax rates or changes in the amount of recoverable advance corporation tax recognised are also excluded.

See page 36 for the reconciliation between underlying performance and reported performance.

2 Analysis by business segment continued

The following analysis sets out the results of the core businesses on the basis described above and also includes a reconciliation of the underlying results to those reported in the condensed consolidated income statement.

	Civil Aerospace £m	Power Systems [1] £m	Defence £m	ITP Aero £m	Corporate and inter-segment £m	Core businesses £m
Year ended 31 December 2020						
Underlying revenue from sale of original equipment	**2,298**	**1,794**	**1,436**	**537**	**(293)**	**5,772**
Underlying revenue from aftermarket services	**2,791**	**951**	**1,930**	**168**	**(96)**	**5,744**
Total underlying revenue	**5,089**	**2,745**	**3,366**	**705**	**(389)**	**11,516**
Gross (loss)/profit	**(2,005)**	**681**	**686**	**133**	**(18)**	**(523)**
Commercial and administrative costs	**(302)**	**(337)**	**(151)**	**(38)**	**(52)**	**(880)**
Research and development costs	**(436)**	**(167)**	**(96)**	**(27)**	**–**	**(726)**
Share of results of joint ventures and associates	**169**	**1**	**9**	**–**	**–**	**179**
Underlying operating (loss)/profit	**(2,574)**	**178**	**448**	**68**	**(70)**	**(1,950)**
Year ended 31 December 2020						
Segment assets	**16,723**	**3,497**	**3,127**	**1,988**	**(3,102)**	**22,233**
Interests in joint ventures and associates	**363**	**11**	**19**	**1**	**–**	**394**
Segment liabilities	**(22,331)**	**(1,358)**	**(3,085)**	**(1,036)**	**3,251**	**(24,559)**
Net (liabilities)/assets	**(5,245)**	**2,150**	**61**	**953**	**149**	**(1,932)**
Year ended 31 December 2019						
Underlying revenue from sale of original equipment	3,246	2,183	1,461	782	(502)	7,170
Underlying revenue from aftermarket services	4,861	1,001	1,789	154	(75)	7,730
Total underlying revenue	8,107	3,184	3,250	936	(577)	14,900
Gross profit/(loss)	622	878	669	206	(64)	2,311
Commercial and administrative costs	(306)	(343)	(158)	(62)	(53)	(922)
Research and development costs	(374)	(166)	(105)	(33)	–	(678)
Share of results of joint ventures and associates	102	(2)	9	–	–	109
Underlying operating profit/(loss)	44	367	415	111	(117)	820
Year ended 31 December 2019						
Segment assets	17,954	3,312	2,743	2,160	(2,476)	23,693
Interests in joint ventures and associates	365	18	19	–	–	402
Segment liabilities	(24,819)	(1,089)	(2,950)	(1,129)	2,645	(27,342)
Net (liabilities)/assets	(6,500)	2,241	(188)	1,031	169	(3,247)

[1] The underlying results for Power Systems for 31 December 2019 have been restated to reflect the 2020 non-core businesses as described above.

2 Analysis by business segment continued

Reconciliation to reported results

	Core businesses £m	Non-core businesses[1] £m	Total underlying £m	Underlying adjustments and adjustments to foreign exchange £m	Group at actual exchange rates £m
Year ended 31 December 2020					
Revenue from sale of original equipment	**5,772**	**115**	**5,887**	**(68)**	**5,819**
Revenue from aftermarket services	**5,744**	**132**	**5,876**	**129**	**6,005**
Total revenue	**11,516**	**247**	**11,763**	**61**	**11,824**
Gross (loss)/profit	**(523)**	**11**	**(512)**	**302**	**(210)**
Commercial and administrative costs	**(880)**	**(24)**	**(904)**	**96**	**(808)**
Research and development costs	**(726)**	**(9)**	**(735)**	**(519)**	**(1,254)**
Share of results of joint ventures and associates	**179**	**–**	**179**	**12**	**191**
Operating loss	**(1,950)**	**(22)**	**(1,972)**	**(109)**	**(2,081)**
Loss arising on the acquisition and disposal of businesses	**–**	**–**	**–**	**(14)**	**(14)**
Loss before financing and taxation	**(1,950)**	**(22)**	**(1,972)**	**(123)**	**(2,095)**
Net financing	**(1,982)**	**(4)**	**(1,986)**	**1,171**	**(815)**
Loss before taxation	**(3,932)**	**(26)**	**(3,958)**	**1,048**	**(2,910)**
Taxation	**(37)**	**(2)**	**(39)**	**(220)**	**(259)**
Loss for the year	**(3,969)**	**(28)**	**(3,997)**	**828**	**(3,169)**
Attributable to:					
Ordinary shareholders			**(3,998)**	**828**	**(3,170)**
Non-controlling interests			**1**	**–**	**1**
Year ended 31 December 2019					
Revenue from sale of original equipment	7,170	286	7,456	596	8,052
Revenue from aftermarket services	7,730	264	7,994	541	8,535
Total revenue	14,900	550	15,450	1,137	16,587
Gross profit/(loss)	2,311	76	2,387	(1,445)	942
Commercial and administrative costs	(922)	(71)	(993)	(135)	(1,128)
Research and development costs	(678)	(18)	(696)	(74)	(770)
Share of results of joint ventures and associates	109	1	110	(6)	104
Operating profit/(loss)	820	(12)	808	(1,660)	(852)
Gain on the disposal of businesses	–	–	–	139	139
Profit/(loss) before financing and taxation	820	(12)	808	(1,521)	(713)
Net financing	(221)	(4)	(225)	47	(178)
Profit/(loss) before taxation	599	(16)	583	(1,474)	(891)
Taxation	(280)	3	(277)	(143)	(420)
Profit/(loss) for the year	319	(13)	306	(1,617)	(1,311)
Attributable to:					
Ordinary shareholders			302	(1,617)	(1,315)
Non-controlling interests			4	–	4

[1] Non-core businesses are set out above. The underlying results for 31 December 2019 have been restated to reflect the 2020 non-core businesses.

2 Analysis by business segment continued

Disaggregation of revenue from contracts with customers

Analysis by type and basis of recognition	Civil Aerospace £m	Power Systems [1] £m	Defence £m	ITP Aero £m	Corporate and inter-segment £m	Core businesses £m
Year ended 31 December 2020						
Original equipment recognised at a point in time	**2,293**	**1,771**	**523**	**471**	**(262)**	**4,796**
Original equipment recognised over time	**4**	**23**	**912**	**66**	**(32)**	**973**
Aftermarket services recognised at a point in time	**1,170**	**827**	**797**	**85**	**(58)**	**2,821**
Aftermarket services recognised over time	**1,398**	**123**	**1,132**	**83**	**(37)**	**2,699**
Total underlying customer contract revenue [2]	**4,865**	**2,744**	**3,364**	**705**	**(389)**	**11,289**
Other underlying revenue	**224**	**1**	**2**	**–**	**–**	**227**
Total underlying revenue	**5,089**	**2,745**	**3,366**	**705**	**(389)**	**11,516**
Year ended 31 December 2019						
Original equipment recognised at a point in time	3,246	2,108	567	702	(478)	6,145
Original equipment recognised over time	–	75	894	80	(24)	1,025
Aftermarket services recognised at a point in time	1,599	874	696	48	(32)	3,185
Aftermarket services recognised over time	3,138	127	1,093	106	(43)	4,421
Total underlying customer contract revenue [2]	7,983	3,184	3,250	936	(577)	14,776
Other underlying revenue	124	–	–	–	–	124
Total underlying revenue	8,107	3,184	3,250	936	(577)	14,900

[1] The underlying results for Power Systems for 31 December 2019 have been restated to reflect the 2020 non-core businesses as described above.

[2] Includes £(1,012)m (2019: £(93)m) of revenue recognised in the year relating to performance obligations satisfied in previous years.

	Core businesses £m	Non-core businesses [1] £m	Total underlying £m	Underlying adjustments and adjustments to foreign exchange £m	Group at actual exchange rates £m
Year ended 31 December 2020					
Original equipment recognised at a point in time	**4,796**	**114**	**4,910**	**(63)**	**4,847**
Original equipment recognised over time	**973**	**–**	**973**	**(6)**	**967**
Aftermarket services recognised at a point in time	**2,821**	**133**	**2,954**	**53**	**3,007**
Aftermarket services recognised over time	**2,699**	**–**	**2,699**	**110**	**2,809**
Total customer contract revenue [2]	**11,289**	**247**	**11,536**	**94**	**11,630**
Other revenue	**227**	**–**	**227**	**(33)**	**194**
Total revenue	**11,516**	**247**	**11,763**	**61**	**11,824**
Year ended 31 December 2019					
Original equipment recognised at a point in time	6,145	217	6,362	596	6,958
Original equipment recognised over time	1,025	69	1,094	–	1,094
Aftermarket services recognised at a point in time	3,185	246	3,431	313	3,744
Aftermarket services recognised over time	4,421	18	4,439	228	4,667
Total customer contract revenue [2]	14,776	550	15,326	1,137	16,463
Other revenue	124	–	124	–	124
Total revenue	14,900	550	15,450	1,137	16,587

[1] Non-core businesses are set out above. The underlying results for 31 December 2019 have been restated to reflect the 2020 non-core businesses.

[2] Includes £nil (2019: £(187)m) of revenue recognised in the year relating to performance obligations satisfied in previous years over and above that in underlying revenue.

2 Analysis by business segment continued

Underlying profit adjustments

		2020				2019			
		Revenue £m	**Loss before financing £m**	**Net financing £m**	**Taxation [14] £m**	Revenue £m	Profit/(loss) before financing £m	Net financing £m	Taxation £m
Underlying performance		**11,763**	**(1,972)**	**(1,986)**	**(39)**	15,450	808	(225)	(277)
Impact of settled derivative contracts on trading transactions [1]	A	**61**	**998**	**(324)**	**(40)**	1,137	145	80	(100)
Unrealised fair value changes on derivative contracts held for trading [2]	A	**–**	**8**	**(85)**	**(182)**	–	(1)	(6)	(88)
Unrealised net losses on closing future over-hedged position [3]	A	**–**	**–**	**1,503**	**(106)**	–	–	–	–
Realised net losses on closing over-hedged position [4]	A	**–**	**–**	**202**	**(38)**	–	–	–	–
Unrealised fair value change to derivative contracts held for financing [5]	A	**–**	**–**	**(86)**	**–**	–	–	1	–
Exceptional programme credits/(charges) [6]	B	**–**	**620**	**(36)**	**–**	–	(1,409)	–	–
Impact of discount rate changes [7]	B	**–**	**–**	**3**	**–**	–	–	(40)	–
Exceptional restructuring charge [8]	B	**–**	**(489)**	**–**	**37**	–	(136)	–	17
Impairments [9]	C	**–**	**(1,293)**	**–**	**273**	–	(84)	–	7
Other write-offs [10]	C	**–**	**(124)**	**–**	**30**	–	–	–	–
Effect of acquisition accounting [11]	C	**–**	**(133)**	**–**	**34**	–	(163)	(8)	41
Pension past-service credit [12]	D	**–**	**308**	**–**	**(108)**	–			–
Other	D	**–**	**(4)**	**(6)**	**(7)**	–	(12)	20	(20)
(Loss)/gains arising on the acquisitions and disposals of businesses [13]	C	**–**	**(14)**	**–**	**3**	–	139	–	–
Impact of tax rate change		**–**	**–**	**–**	**160**	–	–	–	–
De-recognition of UK losses		**–**	**–**	**–**	**(276)**	–	–	–	–
Total underlying adjustments		**61**	**(123)**	**1,171**	**(220)**	1,137	(1,521)	47	(143)
Reported performance per consolidated income statement		**11,824**	**(2,095)**	**(815)**	**(259)**	16,587	(713)	(178)	(420)

A - FX, B Exceptional, C - M&A and impairment, D - Other

1 The impact of measuring revenues and costs and the impact of valuation of assets and liabilities using the period end exchange rate rather than the achieved rate or the exchange rate that is expected to be achieved by the use of the hedge book increased reported revenues by £61m (2019: £1,137m) and reduced loss before financing and taxation by £998m (2019: increased profit by £145m). Underlying financing excludes the impact of revaluing monetary assets and liabilities at the period end exchange rate.

2 The underlying results exclude the fair value changes on derivative contracts held for trading. These fair value changes are subsequently recognised in the underlying results when the contracts are settled.

3 In response to the deterioration in the medium-term outlook caused by COVID-19 and the related reduction in anticipated net USD cash inflows, the Group has taken action to reduce the size of the USD hedge book by $11.8bn predominately by transacting offsetting foreign exchange forward contracts across 2020-2026, resulting in a £1,689m charge to underlying results. The £1,503m included in unrealised loss (shown above) is the net cost of closing out the over-hedged position in future years. The cost related to future years has been included within the underlying performance. It is reversed in arriving at reported performance on the basis that, the cumulative fair value changes on these derivative contracts are recognised as they arise. Further detail is provided in note 4.

4 In 2020, the Group incurred cash outflows of £186m as a result of closing out $1.2bn of the $11.8bn hedge book reduction above and £16m to settle an over-hedged jet fuel position. The realised loss of £202m is included in underlying financing costs.

5 Includes the losses on hedge ineffectiveness in the year of £11m (2019: losses £13m) and net fair value losses of £75m (2019: profit £14m) on any interest rate swaps not designated into hedging relationships for accounting purposes.

6 In 2019, abnormal wastage costs were recorded in respect of the Trent 1000, related to remediation shop visit costs, customer disruption costs and contract losses. During the year ended 31 December 2020, the total estimated Trent 1000 abnormal wastage costs have reduced by £620m as a result of COVID-19 and the work we have performed to reduce fleet AOG levels and improve the availability of spare engines, made up of £390m (a gross provision release of £560m, offset by the impact of expected actual exchange rates and the share of the costs borne by RRSAs) related to remediation shop visit costs and customer disruption costs, and an improvement of £230m in the position on contract losses.

7 Discount rates have increased on exceptional contract loss provisions in relation to the Trent 900 and Trent 1000.

8 At 31 December 2020, the Group recorded an exceptional charge of £489m following the announcement on 20 May 2020 of a fundamental restructuring to reshape and resize the Group due to the financial and operational impact of COVID-19 (see note 21 for more detail).

9 The Group has assessed the carrying value of its assets given the financial and operational impact of COVID-19 on the Group's future cash flow forecasts. Consequently, a number of impairments and write-offs have been recorded at 31 December 2020. Impairments comprise: intangible assets £567m, mainly related to programme intangibles; property, plant and equipment £318m (including £219m related to site rationalisation); right-of-use assets £384m, comprising engines of £311m, £69m of site rationalisation and £4m of other impairments; and a £24m impairment of the carrying value of investments held. Further details are provided in notes 8, 9, 10, 11 and 12.

10 Other write-offs include £149m of participation fees in contract assets, £2m in provisions for site rationalisation, offset by £(27)m for RRSA deferred cost contributions in payables. These write-offs are primarily a result of the impact of COVID-19.

11 The effect of acquisition accounting includes the amortisation of intangible assets arising on previous acquisitions.

12 The Group recorded a past service gain of £308m (of which £248m was recorded at 30 June 2020) following changes to the pension benefits under the terms of the Rolls-Royce UK Pension Fund (RRUKPF), a defined benefit scheme. Of the £308m gain, £79m related to the restructuring described in footnote 8 above. The gain also comprises £134m on introduction of the Bridging Pension Option, £67m as a result of the scheme closure and £35m as a result of manager consultation offset by a £7m past-service cost. In respect of the £248m gain recorded at 30 June 2020, £127m was subsequently recognised as actuarial losses through other comprehensive income at 31 December 2020 – see note 22.

13 Gains/(losses) arising on the acquisitions and disposals of businesses includes the acquisition of Qinous GmbH (increasing the Group's shareholding from 24% to 100%), the sale of the North America Civil Nuclear business, the sale of the Knowledge Management Systems business and the sale of Trigno Energy Srl. During the year, sales proceeds received on the disposal of L'Orange in a prior period. See note 24 for further details.

14 Appropriate rates of tax have been applied to adjustments made to (loss)/profit before tax in the table above. Adjustments in 2020 which impact the UK tax loss have an effective tax rate of zero. See note 5 for more details. The total underlying adjustments to loss before tax in 2020 are a charge of £220m (2019: £143m). The overall charge in 2020 includes a tax credit of £160m in respect of the change in the UK tax rate and a tax charge of £276m relating to the derecognition of some of the deferred tax asset on UK losses previously recognised.

2 Analysis by business segment continued

Reconciliation to the balance sheet

	2020 £m	2019 £m
Reportable segment assets	**22,233**	23,693
Interests in joint ventures and associates	**394**	402
Non-core businesses	**7**	359
Assets held for sale	**288**	18
Cash and cash equivalents and short-term investments	**3,452**	4,449
Fair value of swaps hedging fixed rate borrowings	**293**	249
Deferred and income tax assets	**1,943**	1,926
Post-retirement scheme surpluses	**907**	1,170
Total assets	**29,517**	32,266
Reportable segment liabilities	**(24,559)**	(27,342)
Non-core businesses	**(5)**	(404)
Liabilities associated with assets held for sale	**(228)**	(15)
Borrowings and lease liabilities	**(7,330)**	(5,685)
Fair value of swaps hedging fixed rate borrowings	**(42)**	(6)
Deferred and income tax liabilities	**(648)**	(790)
Post-retirement scheme deficits	**(1,580)**	(1,378)
Total liabilities	**(34,392)**	(35,620)
Net liabilities	**(4,875)**	(3,354)

3 Research and development

	2020 £m	2019 £m
Gross research and development costs	**(1,252)**	(1,459)
Contributions and fees [1]	**353**	341
Expenditure in the year	**(899)**	(1,118)
Capitalised as intangible assets	**232**	481
Amortisation and impairment of capitalised costs [2]	**(587)**	(133)
Net cost recognised in the income statement	**(1,254)**	(770)
Underlying adjustments relating to the effects of acquisition accounting, impairment and foreign exchange [3]	**519**	74
Net underlying cost recognised in the income statement	**(735)**	(696)

[1] Includes funding from local government.

[2] See note 9 for analysis of amortisation and impairment.

[3] During the year, impairment of research and development of £481m was recorded. Of this £1m was charged to underlying results and £480m was charged as exceptional. See note 2 and 9 for more information.

4 Net financing

	2020		2019	
	Per consolidated income statement £m	**Underlying financing [1] £m**	Per consolidated income statement £m	Underlying financing [1] £m
Interest receivable	**22**	**22**	31	31
Net fair value gains on non-hedge accounted interest rate swaps [2]	**–**	**–**	14	–
Financial RRSAs - foreign exchange differences and changes in forecast payments	**17**	**–**	11	–
Net fair value gains on commodity contracts	**–**	**–**	36	–
Financing on post-retirement scheme surpluses	**28**	**–**	60	–
Net foreign exchange gains	**–**	**–**	100	–
Financing income	**67**	**22**	252	31
Interest payable	**(180)**	**(175)**	(182)	(163)
Net fair value losses on foreign currency contracts	**(23)**	**–**	(43)	–
Net fair value losses on non-hedge accounted interest rate swaps [2]	**(75)**	**–**	–	–
Unrealised net losses on closing future over-hedged position [3]	**–**	**(1,503)**	–	–
Realised net losses on closing over-hedged position [4]	**–**	**(202)**	–	–
Financial RRSAs - foreign exchange differences and changes in forecast payments	**(20)**	**–**	(10)	–
Financial charge relating to financial RRSAs	**(3)**	**(3)**	(3)	(3)
Net fair value losses on commodity contracts	**(62)**	**–**	–	–
Financing on post-retirement scheme deficits	**(29)**	**–**	(37)	–
Net foreign exchange losses	**(324)**	**–**	–	–
Other financing charges	**(166)**	**(125)**	(155)	(90)
Financing costs	**(882)**	**(2,008)**	(430)	(256)
Net financing costs	**(815)**	**(1,986)**	(178)	(225)
Analysed as:				
Net interest payable	**(158)**	**(153)**	(151)	(132)
Net fair value (losses)/gains on derivative contracts	**(160)**	**(1,705)**	7	–
Net post-retirement scheme financing	**(1)**	**–**	23	–
Net foreign exchange (losses)/gains	**(324)**	**–**	100	–
Net other financing	**(172)**	**(128)**	(157)	(93)
Net financing costs	**(815)**	**(1,986)**	(178)	(225)

[1] See note 2 for definition of underlying results.

[2] The condensed consolidated income statement shows the net fair value gain/(loss) on any interest rate swaps not designated into hedging relationships for accounting purposes. Underlying financing reclassifies the interest payable (2019: receivable) on these interest rates swaps from fair value movement to interest payable.

[3] In response to the deterioration in the medium-term outlook caused by COVID-19 and the related reduction in anticipated net US Dollar cash inflows, the Group took action during the year to reduce the size of the US Dollar hedge book by $11bn by transacting offsetting foreign exchange contracts across 2020-2026. A further $0.8bn of hedges have also been closed out in early 2021. An underlying charge of £1,689m relating to the total $11.8bn reduction in the size of the US Dollar hedge book is included within underlying financing costs. These costs are already recognised in the reported results as fair value losses on foreign currency contacts.

[4] In 2020, the Group incurred a cash outflow of £186m as a result of closing out an over-hedged position of $1,211m and a cash outflow of £16m to settle an over-hedged jet fuel position. The realised loss of £202m is included in underlying financing costs.

In response to the deterioration in the medium-term outlook caused by COVID-19 and the related reduction in anticipated net US Dollar cash inflows, the Group took action during the year to reduce the size of the US Dollar hedge book by $11bn by transacting offsetting foreign exchange contracts across 2020-2026. A further $0.8bn of hedges have also been closed out in early 2021. An underlying charge of £1,689m relating to the total $11.8bn reduction in the size of the US Dollar hedge book is included within underlying financing costs. These costs are already recognised in the reported results as fair value losses on foreign currency contacts. The cash settlement costs of the £1,689m will occur over the period 2020-2026, including £186m of cash costs incurred in 2020. The Group estimates that future cash outflows of £460m will occur in 2021, £327m in 2022, and £716m spread over 2023 to 2026. Subsequent to year-end, the Group took action to align the contractual settlement of derivatives in future periods with the forecast of net US Dollar cash inflows by extending $2bn of £/US Dollar hedging contracts from 2024-26 into 2027.

After taking into account the actions described above, the Group is forecast to be 100% hedged from 2021 to 2026 and approximately 90% hedged in 2027, based on Board approved forecasts. In the severe but plausible downside scenario forecast, the Group has modelled a further reduction in net US Dollar cash inflows. This would lead to an additional charge to underlying finance costs of £222m, with the associated cash cost unwinding across 2021-2027.

4 Net financing continued

The expected maturity analysis of derivative financial assets and liabilities, after taking into account closing the over-hedge position, is as follows:

	Gross values				
	Within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Carrying value £m
At 31 December 2020					
Derivative financial assets:					
Cash inflows	**2,153**	**984**	**6,358**	**2,777**	
Cash outflows	**(2,038)**	**(937)**	**(6,122)**	**(2,634)**	
Other net cash flows [1]	**18**	**20**	**35**	**12**	
	133	**67**	**271**	**155**	**766**
Derivative financial liabilities:					
Cash inflows	**5,019**	**5,810**	**13,308**	**4,340**	
Cash outflows	**(5,557)**	**(6,398)**	**(15,189)**	**(4,993)**	
Other net cash flows [1]	**(36)**	**(27)**	**(40)**	**(4)**	
	(574)	**(615)**	**(1,921)**	**(657)**	**(3,472)**

[1] Derivative financial assets and liabilities are settled on a net cash basis.

5 Taxation

	UK		Overseas		Total	
	2020 £m	2019 £m	**2020 £m**	2019 £m	**2020 £m**	2019 £m
Current tax charge for the year	**12**	15	**167**	228	**179**	243
Adjustments in respect of prior years	**–**	(4)	**(27)**	(3)	**(27)**	(7)
Current tax	**12**	11	**140**	225	**152**	236
Deferred tax charge/(credit) for the year	**177**	117	**(373)**	(24)	**(196)**	93
Adjustments in respect of prior years	**(12)**	20	**42**	(15)	**30**	5
Derecognition of deferred tax	**433**	86	**–**	–	**433**	86
Deferred tax credit resulting from increase in UK tax rates	**(160)**	–	**–**	–	**(160)**	–
Deferred tax	**438**	223	**(331)**	(39)	**107**	184
Charged/(credited) in the income statement	**450**	234	**(191)**	186	**259**	420

Deferred taxation assets and liabilities

	2020 £m	2019 £m
At 1 January	**1,269**	1,130
Impact of adopting of IFRS 16	**–**	8
Amount charged to income statement	**(107)**	(184)
Amount credited to other comprehensive income	**197**	323
Amount charged to cash flow hedge reserve	**(4)**	(5)
Amount credited to equity	**5**	1
On disposal/acquisition of businesses [1]	**(20)**	(3)
Transferred to assets held for sale [2]	**(4)**	(2)
Exchange differences	**(4)**	1
At 31 December	**1,332**	1,269
Deferred tax assets	**1,826**	1,887
Deferred tax liabilities	**(494)**	(618)
	1,332	1,269

[1] The 2020 deferred tax relates to the acquisition of businesses detailed in note 24. The 2019 deferred tax on disposal of businesses relates to Commercial Marine.

[2] The 2020 deferred tax transferred to assets held for sale relates to the Bergen Engines AS and Civil Nuclear Instrumentation & Control business. The 2019 deferred tax transferred to assets held for sale relates to the North America Civil Nuclear business.

5 Taxation continued

Deferred tax assets of £1,826m include £801m (2019: £1,010m) relating to UK tax losses and £163m (2019: £163m) relating to Advance Corporation Tax (ACT). These assets have been recognised based on the expectation that the business will generate taxable profits and tax liabilities in the future against which the losses and ACT can be utilised.

Most of the tax losses relate to the Civil Aerospace widebody business which makes initial losses through the investment period of a programme and then makes a profit through its contracts for services. The programme lifecycles typically range between 30 and 55 years with more of the widebody engine programmes forecast at the upper end of that range. In the past few years there have been four new engines that have entered into service (Trent 1000–TEN, Trent 7000 and Trent XWB-84 and Trent XWB-97).

Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the assets can be utilised. A recoverability assessment has been undertaken, taking account of deferred tax liabilities against which the reversal can be offset and using latest UK forecasts, which are mainly driven by the Civil Aerospace widebody business, to assess the level of future taxable profits.

The recoverability of deferred tax assets relating to tax losses and ACT has been assessed in 2020 on the following basis:

- Using the most recent UK profit forecasts prepared by management, which are consistent with past experience and external sources on market conditions. These forecasts cover the next five years;
- The long-term forecast profit profile of certain of the major widebody engine programmes which is typically between 30 and 55 years from initial investment to retirement of the fleet, including the aftermarket revenues earned from airline customers; and
- The long-term forecast profit and cost profile of the other parts of the business.

The assessment takes into account UK tax laws that, in broad terms, restrict the offset of the carried forward tax losses to 50% of current year profits.

Based on this assessment, the Group has recognised a deferred tax asset of £801m relating to losses and £163m relating to ACT. This reflects the conclusions that:

- It is probable that the business will generate taxable income and tax liabilities in the future against which these losses and the ACT can be utilised.
- Based on current forecasts and using various scenarios these losses and the ACT will be used in full within the expected widebody engine programme lifecycles.
- The Group has not recognised any deferred tax assets in respect of 2020 UK losses and de-recognised £327m of the deferred tax asset on the balance sheet at 31 December 2019. Of the total charge, £51m is underlying with the balance of £276m non-underlying.
- This is based on management’s assumptions relating to the amounts and timing of future taxable profits and takes into account the impact of COVID-19 and climate change on existing widebody engine programmes.

Changes in future profits will impact the recoverability of the deferred tax assets and as explained in note 1, the key assumptions impact contract margins. A 5% change in such margins over the remaining life of the programmes, against which the recovery of the tax losses and ACT is assessed, would result in a variance of around £100m in the related deferred tax balances recorded on the balance sheet, assuming a 19% tax rate and the 50% loss offset restriction mentioned above.

The assessment also considered the potential impact of climate change on profit forecasts, including additional taxes and levies that could arise and changes in consumer behaviour which could result in a reduction in shop visits (driven by EFHs, which are influenced by a number of factors including climate change). A 5% reduction in shop visits over the remaining life of the programmes would result in a variance of around £100m in the related deferred tax balances.

The Group has also reassessed the recovery of other deferred tax assets, including those arising on unrealised losses on derivative contracts.

Any future changes in tax law or the structure of the Group could have a significant effect on the use of losses and ACT, including the period over which they can be used. In view of this and the significant judgement involved the Board continuously reassess this area.

In 2020 a net DTA also arises for the first time in respect of tax losses and other deductible temporary differences arising in Rolls-Royce Deutschland Ltd & Co KG, where the main business is Business Aviation. The total net DTA is £252m which has been recognised in full as it is considered probable that the business will generate taxable income in the future against which these assets can be utilised.

The Spring Budget 2020 announced that the UK corporation tax rate would remain at 19% rather than reducing to 17% from 1 April 2020. The new law was substantively enacted on 17 March 2020. The prior year UK deferred tax assets and liabilities were calculated at 17%, as this was the enacted rate at the 2019 balance sheet date. As the 19% rate has been substantively enacted before 31 December 2020, the UK deferred tax assets and liabilities have been re-measured at 19%.

The resulting credits and charges have been recognised in the income statement except to the extent that they relate to items previously credited or charged to equity. Accordingly, in 2020, £160m has been credited to the income statement and £6m has been credited directly to equity.

5 Taxation continued

The Spring Budget 2021 announced that the UK corporation tax rate will increase to 25% from 1 April 2023. The deferred tax assets and liabilities of UK companies within the Group have been calculated at 19% as this rate has been substantively enacted at the Balance Sheet date. Had the 25% rate been substantively enacted on or before 31 December 2020 it would have had the effect of increasing the net deferred tax asset by £342m.

The temporary differences associated with investments in subsidiaries, joint ventures and associates, for which a deferred tax liability has not been recognised, aggregate to £907m (2019 restated: £770m). No deferred tax liability has been recognised on the potential withholding tax due on the remittance of undistributed profits as the Group is able to control the timing of such remittances and it is probable that consent will not be given in the foreseeable future.

6 Earnings per ordinary share

Basic earnings per share (EPS) is calculated by dividing the loss attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares held under trust, which have been treated as if they had been cancelled.

As there is a loss, the effect of potentially dilutive ordinary shares is anti-dilutive.

	2020			2019 (restated)		
	Basic	**Potentially dilutive share options**	**Diluted**	Basic	Potentially dilutive share options	Diluted
Loss attributable to ordinary shareholders (£m)	**(3,170)**	**–**	**(3,170)**	(1,315)	–	(1,315)
Weighted average number of ordinary shares (millions)	**5,987**	**–**	**5,987**	5,548	–	5,548
EPS (pence)	**(52.95)**	**–**	**(52.95)**	(23.70)p	–	(23.70)p

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

	2020		2019 (restated)	
	Pence	**£m**	Pence	£m
Underlying EPS / Underlying (loss)/profit attributable to ordinary shareholders	**(66.78)**	**(3,998)**	5.44	302
Total underlying adjustments to loss/profit before tax (note 2)	**17.50**	**1,048**	(26.56)	(1,474)
Related tax effects	**(3.67)**	**(220)**	(2.58)	(143)
EPS / loss attributable to ordinary shareholders	**(52.95)**	**(3,170)**	(23.70)	(1,315)
Diluted underlying EPS	**(66.78)**		5.44	

Basic and diluted earnings per share figures for the comparative periods have been restated and adjusted for the bonus factor of 2.91 to reflect the bonus element of the November 2020 rights issue, in accordance with IAS 33 Earnings per Share. Amounts as originally stated at 31 December 2019 were (69.07)p basic and diluted earnings per share and 15.86p basic and diluted underlying earnings per share.

7 Payments to shareholders in respect of the period

Payments to shareholders in respect of the period represent the value of C Shares to be issued in respect of the results for that period. In light of the ongoing COVID-19 pandemic, no issue of C Shares were declared for the year to 31 December 2020.

	2020		2019	
	Pence per share	**£m**	Pence per share	£m
Interim (issued in January) [1]	**–**	**–**	1.6	87
Final (issued in July) [1]	**–**	**–**	–	–
	–	**–**	1.6	87

[1] On the 6 April 2020, the Group announced that the final shareholder payment of 7.1 pence per share in respect of 2019 would not be paid. This decision was in response to the macro-economic situation and uncertainty caused by COVID-19, preserving £137m of cash.

8 Impairment of intangible assets, property, plant and equipment, right-of-use assets and investments

a) Summary

An impairment charge of £1,321m (2019: £108m) was recognised in the year. This was due to the impact of COVID-19, other market driven events and adverse foreign exchange movements reducing the recoverable amount of certain assets, as a result of reductions in the estimated original equipment (OE) volumes and aftermarket volumes (e.g. from lower EFHs) within the forecasts of future cash flows of each programme or CGU. These cashflow forecasts are discounted to generate the value in use of the programme intangible assets, lease engines (within property, plant and equipment), right-of-use assets and investments. The recoverable amount of other property, plant and equipment has been measured on a fair value less cost of disposal basis.

	Impairment charge in the year							
	Goodwill £m	Other intangible assets £m	Property, plant and equipment £m	Right-of-use assets £m	Investments £m	Total £m	Recoverable amount £m	Discount rate at 31 December 2020 (31 December 2019) [1] £m
Civil Aerospace –Trent programme assets (where impairment recognised)	–	39	86	311	–	436	–	11.0% (12%)
Civil Aerospace – Business Aviation programme assets (where impairment recognised)	–	437	–	–	–	437	108	11.9% (11%)
Civil Aerospace – Specific assets	–	–	219	69	15	303	397	n/a [2] (n/a)
Power Systems – Specific assets	–	35	7	1	9	52	96	11.7% (n/a)
ITP Aero – Specific assets	–	49	11	–	–	60	229	10.6% (11%)
Other	8	11	9	5	–	33	–	Various
Total	8	571	332	386	24	1,321		

1 Discount rate for 31 December 2019 disclosed where an impairment test was performed.

2 The impairment charge for Civil Aerospace specific assets, other than investments (10.5% discount rate), has been calculated on a fair value less cost of disposal basis.

3 The impairment charge of £1,321m includes £28m charged to the income statement through underlying and £1,293m charged to non-underlying.

b) Intangible assets (see note 9)

Goodwill

Goodwill of £1,074m (31 December 2019: £994m) has been tested for impairment during 2020 on the following basis:

- The carrying values of goodwill have been assessed by reference to value in use, estimated using the expected cash flow approach allowable under IAS 36 *Impairment of Assets*. Cash flow forecasts used to derive value in use have been prepared by management using the most recent forecasts, which are consistent with external sources of information on market conditions. These forecasts generally cover the next five years, with cash flows beyond this period based on a growth rate of 2.0% that reflects the products, industries and countries in which the relevant CGU or group of CGUs operate. Whilst these forecasts represent management's best estimate, in addition, the impact on the cash flows of (i) a severe but plausible downside scenario and (ii) various sensitivities have also been considered.

- The key assumptions for the impairment tests are the discount rate and, in the cash flow projections, the programme assumptions, the growth rates and the impact of foreign exchange rates on the relationship between selling prices and costs. Impairment tests are performed using prevailing exchange rates.

The principal value in use assumptions for goodwill balances considered to be individually significant are:

Rolls-Royce Power Systems AG

- Trading assumptions (e.g. volume of equipment deliveries, pricing achieved and cost escalation) that are based on current and known future programmes, estimates of market share and long-term economic forecasts;
- Plausible downside scenario included with a 15% weighting;
- Cash flows beyond the five-year forecasts that are assumed to grow at 2.0% (2019: 1.0%); and
- Pre-tax discount rate of 11.7% (2019: 12.0%).

The Directors do not consider that any reasonably possible changes in the key assumptions would cause the value in use of the goodwill to fall below its carrying value.

Rolls-Royce Deutschland Ltd & Co KG

- Trading assumptions (e.g. volume of engine deliveries, flying hours of installed fleet, including assumptions on the recovery of the aerospace industry, and cost escalation) that are based on current and known future programmes, estimates of market share and long-term economic forecasts;
- Plausible downside scenario included with a 25% weighting;
- Cash flows beyond the five-year forecasts that are assumed to grow at 2.0% (2019: 1.0%); and
- Pre-tax discount rate of 11.9% (2019: 12.0%).

The Directors do not consider that any reasonably possible changes in the key assumptions would cause the value in use of the goodwill to fall below its carrying value.

8 Impairment of intangible assets, property, plant and equipment, right-of-use assets and investments continued

Other cash generating units

Goodwill balances across the Group that are not considered to be individually significant were also tested for impairment, resulting in an impairment charge of £8m being recognised at 31 December 2020 (31 December 2019: £18m).

Other intangible assets (including programme-related intangible assets)

As a result of the impact of COVID-19 on expected OE and aftermarket volumes and adverse foreign exchange movements, other intangible assets have been reviewed for impairment in accordance with the requirements of IAS 36. Where there is a triggering event, and for indefinite life brand assets, impairment tests have been performed on the following basis:

- The carrying values have been assessed by reference to value in use as this represents the highest value to the Group in terms of the future cash flows that it can generate. Values in use have been estimated using the expected cash flow approach allowable under IAS 36. Cash flow forecast scenarios have been prepared by management using the most recent forecasts, which are consistent with external sources of information on market conditions over the lives of the respective programmes and incorporate management's best estimate of key assumptions utilising a stochastic analysis to allow for variation in the actual outcome where appropriate. A severe but plausible scenario was also modelled and, in order to risk adjust the cash flows, a weighting (25%/15% downside for Civil Aerospace/Power Systems respectively) was taken between the two scenarios based on management judgement.
- These forecasts include contracted business and management's expectation of speculative business over the life of the programme, together with the cash outflows that are necessary to maintain the current level of economic benefit expected to arise from the asset in its current condition.
- The key programme assumptions underlying the cash flow projections are forecast market share and pricing, programme timings, unit cost assumptions, EFHs, number of shop visits, cost of each shop visit, R&D, capital investment, discount rates and foreign exchange rates.
- The pre-tax cash flow projections have been discounted at 9.6%–11.9% (31 December 2019: 7.0%–15.0%), based on the weighted average cost of capital of the relevant business.

It remains possible that a weaker than expected recovery could result in a deterioration in the future cash flow forecasts that support Civil Aerospace programme intangible assets:

- For intangible assets that have been impaired, a 5% deterioration in EFHs (and hence future cash flows) across the life of the programmes would result in these intangible assets incurring an additional impairment of £50m. An increase in the discount rate of 1% would cause the reduce the recoverable amount of the programme assets (£108m) to nil.

- For intangible assets where there is existing headroom in the impairment test (and thus no impairment) but where deteriorations in key assumptions over the next 12 months could lead to an impairment, any of the following individual changes in assumptions would cause the recoverable amount of the programme assets to equal the carrying value:

    - A reduction in engines sales that are forecast but not contracted by 14%;
    - An increase in costs of 2%; or
    - An increase in discount rates of 1%.

c) Property, plant and equipment (see note 10)

Property, plant and equipment has been reviewed for impairment in accordance with the requirements of IAS 36. Following the announcement on the 20 May 2020 to reshape and resize the Group given the financial and operational impact of COVID-19, a strategic review of the Group's sites has been performed. Where the Group expects to exit a Civil Aerospace site, the carrying value of the land and buildings and related plant and equipment have been impaired to their recoverable amount by reference to their fair value (based on professional advice - Level 3 in the IFRS 13 hierarchy) less cost of disposal. The Group has also reviewed whether plant and equipment and assets under construction relating to these locations can be relocated to other parts of the Group for future use. Where no alternative use has been identified, the carrying value of these assets have been impaired to their recoverable amount by reference to their scrap values. An impairment charge of £219m has been recognised.

Impairment tests were also considered necessary for Civil Aerospace and ITP Aero engines. An impairment charge of £97m was recognised. The impairment tests were performed on the following basis:

- The carrying value of assets have been assessed by reference to their value in use, together with other assets as part of a larger CGU. These have been estimated using the expected cash flow approach allowable under IAS 36 as set out in note 8b above.
- The key assumptions underlying cash flow projections in relation to engines are utilisation of the asset, lease rate, condition of the engine and cost of maintaining, discount rates and foreign exchange rates.
- The pre-tax cash flow projections have been discounted at 10.6%–11.0% based on the weighted average cost of capital of the relevant business.

Other smaller impairments totalling £16m were also recognised.

8 Impairment of intangible assets, property, plant and equipment, right-of-use assets and investments continued

d) Right-of-use assets (see note 11)

Right-of-use (RoU) assets have been reviewed for impairment in accordance with the requirements of IAS 36. RoU assets have typically been assessed together with other assets as part of a larger CGU. Other than the items referred to below there have been no impairments of RoU assets.

Impairment tests were considered necessary for lease engines as a result of the impact of COVID-19 on expected future EFHs, operators' fleet plans and the resultant requirement for fewer lease engines to support the aircraft fleets. An impairment charge of £311m was recognised against lease engine RoU assets.

Impairment tests were performed on the following basis:
- The carrying values of assets have been assessed by reference to their value in use as set out in note 8b above.
- The key assumptions underlying cash flow projections in relation to the lease engines are utilisation of the asset, lease rate, condition of the engine and cost of maintaining, discount rates and foreign exchange rates.
- The pre-tax cash flow projections have been discounted at 11.0% based on the weighted average cost of capital of the relevant business.

The Civil Aerospace specific asset impairments in the period of £69m primarily relate to land and buildings and are a consequence of the strategic review of the Group's sites described above. Assets have been written down to reflect the higher of their revised value in use (11.0% discount rate) or fair value less cost of disposal.

Other smaller impairments totalling £6m were also recognised.

e) Investments (see note 12)

As a result of reduced EFHs caused by COVID-19, joint venture investments in Civil Aerospace repair and overhaul facilities were tested for impairment. The value in use was estimated by discounting expected future dividends at 10.5% (cost of equity for the Civil Aerospace business). An impairment of £15m was recognised.

As a result of changes in the local market due to climate regulations impacting the offered product, and the impact of COVID-19 on market demand and the liquidity of the business, a Power Systems joint venture was tested for impairment. The value in use of the investment was estimated using the expected cash flow approach. The pre-tax cash flow projections were discounted at 11.7%. An impairment of £9m was recognised.

9 Intangible assets

	Goodwill £m	Certification costs £m	Development expenditure £m	Customer relationships £m	Software [4] £m	Other £m	Total £m
Cost:							
At 1 January 2020	**1,024**	**962**	**3,294**	**1,303**	**967**	**803**	**8,353**
Additions	**–**	**3**	**232**	**–**	**89**	**40**	**364**
Acquisition of businesses (see note 24)	**57**	**–**	**3**	**41**	**–**	**36**	**137**
Transferred to assets held for sale [1]	**(3)**	**–**	**(33)**	**–**	**(12)**	**(4)**	**(52)**
Disposals	**–**	**(1)**	**–**	**–**	**(93)**	**(2)**	**(96)**
Reclassifications	**4**	**(4)**	**(8)**	**–**	**15**	**(6)**	**1**
Exchange differences	**30**	**3**	**76**	**59**	**2**	**26**	**196**
At 31 December 2020	**1,112**	**963**	**3,564**	**1,403**	**968**	**893**	**8,903**
Accumulated amortisation and impairment:							
At 1 January 2020	**30**	**392**	**1,201**	**354**	**605**	**329**	**2,911**
Charge for the year [2]	**–**	**21**	**106**	**82**	**81**	**33**	**323**
Impairment [3]	**8**	**17**	**481**	**31**	**5**	**37**	**579**
Transferred to assets held for sale [1]	**–**	**–**	**(20)**	**–**	**(12)**	**(4)**	**(36)**
Disposals	**–**	**(1)**	**–**	**–**	**(75)**	**(2)**	**(78)**
Reclassifications	**–**	**–**	**(2)**	**–**	**2**	**–**	**–**
Exchange differences	**–**	**–**	**37**	**11**	**1**	**10**	**59**
At 31 December 2020	**38**	**429**	**1,803**	**478**	**607**	**403**	**3,758**
Net book value at:							
31 December 2020	**1,074**	**534**	**1,761**	**925**	**361**	**490**	**5,145**
1 January 2020	**994**	**570**	**2,093**	**949**	**362**	**474**	**5,442**

[1] Bergen Engines AS and the Civil Nuclear Instrumentation & Control business have been classified as disposal groups held for sale at 31 December 2020. The North America Civil Nuclear business was classified as a disposal group held for sale on 26 September 2019, prior to this an impairment of goodwill of £15m was recognised - see note 24.

[2] Charged to cost of sales and commercial and administrative costs except development costs, which are charged to research and development costs.

[3] As a result of the financial and operational impact of COVID-19 the Group has assessed the carrying value of its intangible assets. Consequently, impairments have been recorded at 31 December 2020. The impairment of development expenditure has arisen as a result of the anticipated reduction in OE volumes and future engine flying hours, and the consequential recoverability of these assets. The impairment charge of £579m includes £12m charged to the income statement through underlying and £567m charged to non-underlying. See note 8 for further details.

[4] Includes £110m (2019: £129m) of software under course of construction which is not amortised.

10 Property, plant and equipment

	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m	In course of construction £m	Total £m
Cost:					
At 1 January 2020	**2,020**	**5,497**	**876**	**401**	**8,794**
Additions	**14**	**145**	**162**	**232**	**553**
Acquisition of businesses	**9**	**7**	**–**	**1**	**17**
Transferred to assets held for sale [1]	**(32)**	**(77)**	**–**	**(9)**	**(118)**
Disposals of businesses	**–**	**(19)**	**–**	**–**	**(19)**
Disposals/write offs	**(52)**	**(264)**	**(19)**	**(24)**	**(359)**
Reclassifications [2]	**25**	**117**	**3**	**(150)**	**(5)**
Exchange differences	**10**	**36**	**3**	**–**	**49**
At 31 December 2020	**1,994**	**5,442**	**1,025**	**451**	**8,912**
Accumulated depreciation and impairment:					
At 1 January 2020	**590**	**3,167**	**223**	**11**	**3,991**
Charge for the year [3]	**71**	**362**	**56**	**–**	**489**
Impairment [4]	**71**	**137**	**97**	**27**	**332**
Transferred to assets held for sale [1]	**(29)**	**(74)**	**–**	**(8)**	**(111)**
Disposals of businesses	**–**	**(19)**	**–**	**–**	**(19)**
Disposals/write offs	**(33)**	**(248)**	**(2)**	**(13)**	**(296)**
Reclassifications [2]	**10**	**(1)**	**–**	**(9)**	**–**
Exchange differences	**(1)**	**12**	**–**	**–**	**11**
At 31 December 2020	**679**	**3,336**	**374**	**8**	**4,397**
Net book value at:					
31 December 2020	**1,315**	**2,106**	**651**	**443**	**4,515**
1 January 2020	**1,430**	**2,330**	**653**	**390**	**4,803**

[1] Bergen Engines AS and the Civil Nuclear Instrumentation & Control business have been classified as disposal groups held for sale at 31 December 2020. In 2019, the North America Civil Nuclear business was classified as a disposal group held for sale on 26 September 2019 - see note 24.

[2] Includes reclassifications of assets under construction to the relevant classification in property, plant and equipment or intangible assets when available for use.

[3] Depreciation charged during the year is presented in the income statement or included in the cost of inventory as appropriate.

[4] As a result of the financial and operational impact of COVID-19 the Group has assessed the carrying value of its property, plant and equipment. In addition, following the announcement on 20 May 2020 to reshape and resize the Group due to the financial and operational impact of COVID-19, certain assets have been impaired to their recoverable amount where the Group expects to exit the site. The impairment of £332m includes £14m charged to the income statement through underlying and £318m charged to non-underlying. See note 8 for further details.

11 Right-of-use assets

	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m	Total £m
Cost:				
At 1 January 2020	**504**	**128**	**1,767**	**2,399**
Additions/modification of leases	**(27)**	**33**	**129**	**135**
Acquisition of business	**–**	**1**	**–**	**1**
Transferred to assets held for sale [1]	**(13)**	**(3)**	**–**	**(16)**
Disposals	**(18)**	**(10)**	**(67)**	**(95)**
Exchange differences	**1**	**1**	**4**	**6**
At 31 December 2020	**447**	**150**	**1,833**	**2,430**
Accumulated depreciation and impairment:				
At 1 January 2020	**55**	**29**	**306**	**390**
Charge for the year	**56**	**35**	**255**	**346**
Impairment [2]	**66**	**9**	**311**	**386**
Transferred to assets held for sale [1]	**(5)**	**(2)**	**–**	**(7)**
Disposals	**(10)**	**(10)**	**(67)**	**(87)**
Exchange differences	**(3)**	**(1)**	**1**	**(3)**
At 31 December 2020	**159**	**60**	**806**	**1,025**
Net book value at:				
31 December 2020	**288**	**90**	**1,027**	**1,405**
1 January 2020	**449**	**99**	**1,461**	**2,009**

[1] Bergen Engines AS and the Civil Nuclear Instrumentation & Control business have been classified as disposal groups held for sale at 31 December 2020. In 2019, the North America Civil Nuclear business was classified as a disposal group held for sale on 26 September 2019 - see note 24.

[2] The impairment of £386m includes £2m charged to the income statement through underlying and £384m charged to non-underlying and is a result of the impact of COVID-19. See note 8 for further details.

12 Investments

Equity accounted and other investments

	Equity accounted			Other
	Joint ventures £m	**Associates £m**	**Total £m**	**Unlisted £m**
At 1 January 2020	**402**	**–**	**402**	**14**
Additions [1]	**19**	**–**	**19**	**5**
Disposals [2]	**(6)**	**–**	**(6)**	**–**
Impairment [3]	**(24)**	**–**	**(24)**	**–**
Share of retained profit [4]	**130**	**1**	**131**	**–**
Reclassification of deferred profit to deferred income [5]	**(96)**	**–**	**(96)**	**–**
Transfer to subsidiary [2]	**(4)**	**–**	**(4)**	**–**
Exchange differences	**(23)**	**–**	**(23)**	**–**
Share of OCI	**(5)**	**–**	**(5)**	**–**
At 31 December 2020	**393**	**1**	**394**	**19**

[1] On 18 May 2020, the Group increased its shareholding in Reaction Engines Limited from 2% to 10.1%.

[2] On 15 January 2020, the Group completed the acquisition of Qinous GmbH (increasing its shareholding from 24% to 100%). On 6 July 2020, the Group completed the disposal of its 18% shareholding in Exostar LLC. See note 24.

[3] During the year, the Group recognised an impairment of £24m charge to the income statement through non-underlying. See note 8.

[4] See table below.

[5] The Group's share of unrealised profit on sales to joint ventures is eliminated against the carrying value of the investment in the entity. Any excess amount once the carrying value is reduced to nil is recorded as deferred income.

Reconciliation of share of retained profit/(loss) to the income statement and cash flow statement:

	2020 £m	2019 £m
Share of results of joint ventures and associates	**133**	141
Adjustments for intercompany trading [1]	**58**	(37)
Share of results of joint venture and associates to the Group (income statement)	**191**	104
Dividends paid by joint ventures and associates to the Group (cash flow statement)	**(60)**	(92)
Share of retained profit above	**131**	12

[1] During the year, the Group sold spare engines to Rolls-Royce & Partners Finance, a joint venture company. The Group's share of the profit on these sales is deferred and released to match the depreciation of the engines in the joint venture's financial statements. In 2020, profit deferred on the sale of engines was lower than the release of that deferred in prior years.

13 Inventories

	2020 £m	2019 £m
Raw materials	**417**	522
Work in progress	**1,139**	1,652
Finished goods	**2,111**	2,119
Payments on account	**23**	27
	3,690	4,320

14 Trade receivables and other assets

	Current		Non-current		Total	
	2020 **£m**	2019 [4] £m	**2020** **£m**	2019 [4] £m	**2020** **£m**	2019 [4] £m
Trade receivables [1]	**2,479**	2,354	**–**	–	**2,479**	2,354
Receivables due on risk and revenue sharing arrangements (RRSAs)	**603**	719	**82**	150	**685**	869
Amounts owed by joint ventures and associates [1]	**486**	197	**16**	12	**502**	209
Costs to obtain contracts with customers [2]	**12**	12	**50**	33	**62**	45
Other taxation and social security receivable	**225**	187	**6**	29	**231**	216
Other receivables [3]	**639**	766	**20**	2	**659**	768
Prepayments	**412**	356	**425**	248	**837**	604
	4,856	4,591	**599**	474	**5,455**	5,065

[1] Includes £577m (2019: £267m) of trade receivables held to collect or sell and £361m (2019: £76m) of receivables from joint ventures and associates held to collect or sell.

[2] These are amortised over the term of the related contact, resulting in amortisation of £10m (2019: £8m). There were no impairment losses.

[3] Includes £2m owed by the UK Government at 31 December 2020 for amounts claimed by the Group under furlough arrangements. In addition, other receivables includes unbilled recoveries relating to overhaul activity.

[4] During the year the presentation of trade receivables and other assets have been analysed in greater detail, without changing the total amount previously reported. As a consequence some comparative balances and currency movements have been represented in additional and more appropriate line items. Trade receivables have decreased by £184m, costs to obtain contracts with customers have increased by £2m and other receivables have decreased by £903m. Receivables due on RRSAs and other taxation & social security receivable totalling £1,085m are now presented as separate lines. This has also resulted in an associated re-presentation between financial and non-financial assets, with an increase of non-financial instruments of £2m and a decrease in financial instruments of £2m (trade receivables and similar items £(91)m and other non-derivative financial assets £89m). The total amount of trade receivables and other assets from 2019 remains unchanged.

The Group has historically undertaken the sale of trade receivables, without recourse, to banks (commonly known as invoice discounting or factoring). This activity has previously been used to normalise customer receipts as certain aerospace customers have extended their payment terms. This in turn has helped normalise Group cash flows in line with physical delivery volumes. During the year to 31 December 2020, invoice discounting has substantially reduced. At 31 December 2020, £54m was drawn under factoring facilities, a decrease of £1,063m compared to December 2019, representing cash collected before it was contractually due from the customer. Trade receivables factored are generally due within the following quarter.

The expected credit losses for trade receivables and other assets has increased by £114m to £252m (31 December 2019: £138m). This increase is mainly driven by the impact of COVID-19 on the Civil Aerospace business of £97m, of which £46m relates to the deterioration of the market credit ratings of customers and £51m relates to updates to the recoverability of other receivables.

15 Cash and cash equivalents

	2020 **£m**	2019 £m
Cash at bank and in hand	**940**	825
Money-market funds	**669**	1,095
Short-term deposits	**1,843**	2,523
Cash and cash equivalents per the balance sheet	**3,452**	4,443
Cash and cash equivalents within assets held for sale	**51**	–
Cash and cash equivalents per net funds	**3,503**	4,443
Overdrafts (note 19)	**(7)**	(8)
Cash and cash equivalents per cash flow statement (page 20)	**3,496**	4,435

Cash and cash equivalents at 31 December 2020 includes £143m (2019: £34m) that is not available for general use by the Group. This balance includes £103m which is held in an account that is exclusively for the general use of Rolls-Royce Submarines Limited. This cash is not available for use by other entities within the Group. The remaining balance relates to cash held in non-wholly owned subsidiaries and joint arrangements.

Balances are presented on a net basis when the Group has both a legal right of offset and the intention to either settle on a net basis or realise the asset and settle the liability simultaneously.

16 Trade payables and other liabilities

	Current		Non-current		Total	
	2020 £m	2019 [3] £m	**2020 £m**	2019 [3] £m	**2020 £m**	2019 [3] £m
Trade payables	**1,418**	1,906	**–**	62	**1,418**	1,968
Payables due on RRSAs	**697**	1,029	**–**	–	**697**	1,029
Amounts owed to joint ventures and associates	**583**	916	**–**	36	**583**	952
Customer concession credits	**1,536**	1,463	**514**	495	**2,050**	1,958
Warranty credits	**173**	185	**196**	218	**369**	403
Accruals	**1,322**	1,712	**117**	89	**1,439**	1,801
Deferred receipts from RRSA workshare partners	**17**	17	**507**	516	**524**	533
Government grants [1]	**16**	12	**66**	71	**82**	83
Other taxation and social security	**127**	128	**7**	–	**134**	128
Other payables [2]	**764**	1,082	**515**	584	**1,279**	1,666
	6,653	8,450	**1,922**	2,071	**8,575**	10,521

1 During the year, £10m (2019: £12m) of government grants were released to the income statement.

2 Other payables includes financial penalties from agreements with investigating bodies, parts purchase obligations, payroll liabilities, HMG levies and deferred consideration for recent acquisitions.

3 During the year the presentation of trade payables and other liabilities have been analysed in greater detail, without changing the total amount previously reported. As a consequence some comparative balances and currency movements have been represented in additional and more appropriate line items. Trade payables have decreased by £332m, amounts owed to joint ventures and associates increased by £118m, accruals have decreased by £39m and other payables have decreased by £3,137m. Payables due on RRSAs, customer concession credits and warranty credits totalling £3,390m are now presented as separate lines. This has also resulted in an associated representation between financial and non-financial liabilities, with an increase of financial instruments of £1,655m (trade payables and similar items £(83)m and other non-derivative financial liabilities £1,738m) and a decrease in non-financial instruments of £1,655m. The total amount of trade payables and other liabilities from 2019 remains unchanged.

Our payment terms with suppliers vary on the products and services being sourced, the competitive global markets we operate in and other commercial aspects of suppliers' relationships. Industry average payment terms vary between 90-120 days. We offer reduced payment terms for smaller suppliers, so that they are paid in 30 days. In line with aerospace industry practice, we offer a supply chain financing (SCF) programme in partnership with banks to enable suppliers, including joint ventures, who are on our standard 75-day payment terms to receive their payments sooner. The SCF programme is available to suppliers at their discretion and does not change our rights and obligations with suppliers nor the timing of our payment of suppliers. At 31 December 2020 suppliers had drawn £582m under the SCF scheme (31 December 2019: £859m).

17 Contract assets and liabilities

	Current		Non-current [1]		Total [2]	
	2020 £m	2019 £m	**2020 £m**	2019 £m	**2020 £m**	2019 £m
Contract assets						
Contract assets with customers	**416**	404	**660**	1,092	**1,076**	1,496
Participation fee contract assets	**48**	57	**386**	542	**434**	599
	464	461	**1,046**	1,634	**1,510**	2,095

1 Contract assets and contract liabilities have been presented on the face of the balance sheet in line with the operating cycle of the business. Contract liabilities is further split according to when the related performance obligation is expected to be satisfied and therefore when revenue is estimated to be recognised in the income statement. Further disclosure of contract assets is provided in the table above, which shows within current the element of consideration that will become unconditional in the next year.

2 Contract assets are classified as non-financial instruments.

Contract assets with customers includes £726m (31 December 2019: £1,086m) of Civil Aerospace LTSA assets, with most of the remainder relating to Defence. The main driver of the decrease in the Group balance is a result of revenue relating to performance obligations satisfied in previous years being adjusted by £599m in Civil Aerospace, primarily as a result of COVID-19 reducing engine flying hours (resulting in a reduction in contract price) below the levels previously estimated over the term of the contracts with a corresponding reduction in the contract asset.

Participation fee contract assets have reduced by £(165)m (31 December 2019: reduced by £55m) due to the impairment of engine programme participation fees of £(149)m, amortisation exceeding additions by £(36)m and foreign exchange on consolidation of overseas entities of £20m.

The absolute value of expected credit losses for contract assets has increased by £1m to £14m (31 December 2019: £13m).

No impairment losses of contract assets (31 December 2019: none) have arisen during the year to 31 December 2020.

17 Contract assets and liabilities continued

	Current		Non-current		Total	
	2020 £m	2019 £m	**2020 £m**	2019 £m	**2020 £m**	2019 £m
Contract liabilities	**4,187**	4,228	**6,245**	6,612	**10,432**	10,840

During the year £2,792m (2019: £3,491m) of the opening contract liability was recognised as revenue. Contract liabilities have decreased by £408m. The main driver of the change in the Group balance is as a result of a reduction in deposits held, reflecting utilisation of amounts received in previous years as engines and aftermarket services were delivered in 2020. As a result of COVID-19 the level of new deposits received were at lower than normal levels.

The Civil Aerospace LTSA liabilities increased by £58m to £6,841m (2019: £6,783m). LTSA revenue recognised as the performance obligations have been completed has exceeded cash receipts in the year due to the lower level of flying hours that drive cash receipts, decreasing the contract liability. This has been offset due to the 54% decrease in current year Civil Aerospace engine flying hours, together with a phased recovery, resulting in revenue relating to performance obligations satisfied in previous years being adjusted downwards by £462m which increases the contract liability.

18 Financial assets and liabilities

Carrying value of other financial assets and liabilities

	Derivatives							
	Foreign exchange contracts £m	**Commodity contracts £m**	**Interest rate contracts [1] £m**	**Total derivatives £m**	**Financial RRSAs £m**	**Other £m**	**C Shares £m**	**Total £m**
At 31 December 2020								
Non-current assets	**396**	**18**	**258**	**672**	**–**	**15**	**–**	**687**
Current assets	**45**	**7**	**42**	**94**	**–**	**13**	**–**	**107**
Assets	**441**	**25**	**300**	**766**	**–**	**28**	**–**	**794**
Current liabilities	**(522)**	**(17)**	**(11)**	**(550)**	**(5)**	**(25)**	**(28)**	**(608)**
Non-current liabilities	**(2,790)**	**(19)**	**(113)**	**(2,922)**	**(76)**	**(48)**	**–**	**(3,046)**
Liabilities	**(3,312)**	**(36)**	**(124)**	**(3,472)**	**(81)**	**(73)**	**(28)**	**(3,654)**
	(2,871)	**(11)**	**176**	**(2,706)**	**(81)**	**(45)**	**(28)**	**(2,860)**
At 31 December 2019								
Non-current assets	234	14	203	451	–	16	–	467
Current assets	16	9	49	74	–	12	–	86
Assets	250	23	252	525	–	28	–	553
Current liabilities	(394)	(5)	–	(399)	(31)	(32)	(31)	(493)
Non-current liabilities	(2,960)	(6)	(9)	(2,975)	(79)	(40)	–	(3,094)
Liabilities	(3,354)	(11)	(9)	(3,374)	(110)	(72)	(31)	(3,587)
	(3,104)	12	243	(2,849)	(110)	(44)	(31)	(3,034)

1 Includes the foreign exchange impact of cross-currency interest rate swaps.

Derivative financial instruments

Movements in fair value of derivative financial assets and liabilities were as follows:

	Foreign exchange instruments		Commodity instruments		Interest rate instruments – hedge accounted [2]		Interest rate instruments – non-hedge accounted		Total	
	2020 £m	2019 £m	**2020 £m**	2019 £m	**2020 £m**	2019 £m	**2020 £m**	2019 £m	**2020 £m**	2019 £m
At 1 January	**(3,104)**	(3,764)	**12**	(34)	**229**	292	**14**	–	**(2,849)**	(3,506)
Movements in fair value hedges	**–**	–	**–**	–	**139**	(27)	**–**	–	**139**	(27)
Movements in cash flow hedges	**18**	(4)	**6**	13	**(60)**	–	**–**	–	**(36)**	9
Movements in other derivative contracts [1]	**(23)**	(43)	**(62)**	36	**–**	–	**(75)**	14	**(160)**	7
Contracts settled	**238**	707	**33**	(3)	**(75)**	(36)	**4**	–	**200**	668
At 31 December	**(2,871)**	(3,104)	**(11)**	12	**233**	229	**(57)**	14	**(2,706)**	(2,849)

1 Included in net financing.

2 Includes the foreign exchange impact of cross-currency interest rate swaps.

18 Financial assets and liabilities continued

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

	Financial RRSAs		Other liabilities		Other assets	
	2020 £m	2019 £m	**2020 £m**	2019 £m	**2020 £m**	2019 £m
At 1 January as previously reported	**(110)**	(227)	**(72)**	(62)	**16**	–
Reclassification to borrowings [1]	**–**	79	**–**	–	**–**	–
At 1 January restated	**(110)**	(148)	**(72)**	(62)	**16**	–
Exchange adjustments included in OCI	**(6)**	10	**(2)**	1	**–**	–
Additions	**–**	(4)	**(17)**	(37)	**–**	–
Financing charge [2]	**(3)**	(3)	**(13)**	(3)	**–**	–
Excluded from underlying profit:						
Changes in forecast payments [2]	**(3)**	1	**–**	–	**–**	–
Exchange adjustments [2]	**–**	6	**–**	–	**–**	–
Cash paid	**39**	28	**18**	29	**(1)**	–
Other	**–**	–	**13**	–	**–**	–
Reclassification from trade receivables	**–**	–	**–**	–	**–**	16
Reclassification to held for sale	**2**	–	**–**	–	**–**	–
At 31 December	**(81)**	(110)	**(73)**	(72)	**15**	16

[1] In 2019, the Group reclassified £79m as borrowings previously included in other financial liabilities.
[2] Included in financing.

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

	2020		2019	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Borrowings – Level 1	**(4,886)**	**(4,814)**	(3,206)	(3,147)
Borrowings – Level 2	**(401)**	**(403)**	(125)	(130)
Financial RRSAs	**(81)**	**(89)**	(110)	(112)

Fair values

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

- Non-current investments – other comprise unconsolidated companies and are measured at fair value.
- Money market funds, included within cash and cash equivalents, are valued using Level 1 methodology. Fair values are assumed to approximately equal cost either due to the short-term maturity of the instruments or because the interest rate of the investments is reset after periods not exceeding six months.
- The fair values of held to collect trade receivables and similar items, trade payables and other similar items, other non-derivative financial assets and liabilities, short-term investments and cash and cash equivalents are assumed to approximate to cost either due to the short-term maturity of the instruments or because the interest rate of the investments is reset after periods not exceeding six months.
- Fair values of derivative financial assets and liabilities and trade receivable held to collect or sell (31 December 2020: £938m; 31 December 2019: £344m) are estimated by discounting expected future contractual cash flows using prevailing interest rate curves or cost of borrowing, as appropriate. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. These financial instruments are included on the balance sheet at fair value, derived from observable market prices (Level 2 as defined by IFRS 13 *Fair Value Measurement*).
- Borrowings are carried at amortised cost. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. The fair value of borrowings is estimated using quoted prices (Level 1 as defined by IFRS 13) or by discounting contractual future cash flows (Level 2 as defined by IFRS 13).
- The fair values of RRSAs and other liabilities are estimated by discounting expected future cash flows. The contractual cash flows are based on future trading activity, which is estimated based on latest forecasts (Level 3 as defined by IFRS 13).
- Other assets are included on the balance sheet at fair value, derived from observable market prices or latest forecast (Level 2/3 as defined by IFRS 13). At 31 December 2020, Level 3 assets totalled £15m (31 December 2019: £16m).
- The fair value of lease liabilities are estimated by discounting future contractual cash flows using either the interest rate implicit in the lease or the Group's incremental cost of borrowing (Level 2 as defined by IFRS 13).

19 Borrowings and lease liabilities

	Current		Non-current		Total	
	2020	2019	**2020**	2019	**2020**	2019
	£m	£m	**£m**	£m	**£m**	£m
Unsecured						
Overdrafts	**7**	8	**–**	–	**7**	8
Bank loans	**9**	27	**10**	16	**19**	43
Commercial paper [1]	**300**	–	**–**	–	**300**	–
2.375% Notes 2020 US$500m [2]	**–**	378	**–**	–	**–**	378
2.125% Notes 2021 €750m [2]	**680**	–	**–**	655	**680**	655
0.875% Notes 2024 €550m [3]	**–**	–	**511**	481	**511**	481
3.625% Notes 2025 US$1,000m [3]	**–**	–	**800**	781	**800**	781
3.375% Notes 2026 £375m [4]	**–**	–	**420**	410	**420**	410
4.625% Notes 2026 €750m [5]	**–**	–	**667**	–	**667**	–
5.75% Notes 2027 $1,000m [5]	**–**	–	**724**	–	**724**	–
5.75% Notes 2027 £545m	**–**	–	**539**	–	**539**	–
1.625% Notes 2028 €550m [3]	**–**	–	**545**	501	**545**	501
Other loans	**17**	22	**58**	52	**75**	74
Total unsecured	**1,013**	435	**4,274**	2,896	**5,287**	3,331
Lease liabilities	**259**	340	**1,784**	2,014	**2,043**	2,354
Total borrowings and lease liabilities	**1,272**	775	**6,058**	4,910	**7,330**	5,685

All outstanding items described above as notes are listed on the London Stock Exchange.

1 On the 27 April 2020, the Group issued Commercial paper of £300m to the Covid Corporate Financing Facility (CCFF), a fund operated by the Bank of England on behalf of HM Treasury. The borrowings are repayable on 17 March 2021 and are held on the balance sheet at amortised cost.

2 These notes are the subject of cross-currency interest rate swap agreements under which the Group has undertaken to pay floating rates of GBP interest, which form a fair value hedge.

3 These notes are the subject of cross-currency interest rate swap agreements under which the Group has undertaken to pay floating rates of GBP interest, which form a fair value hedge. They are also subject to interest rate swap agreements under which the Group has undertaken to pay fixed rates of interest, which are classified as fair value through profit and loss.

4 These notes are the subject of interest rate swap agreements under which the Group has undertaken to pay floating rates of interest, which form a fair value hedge. They are also subject to interest rate swap agreements under which the Group has undertaken to pay fixed rates of interest, which are classified as fair value through profit and loss.

5 These notes are the subject of cross-currency interest rate swap agreements under which the Group has undertaken to pay fixed rates of GBP interest, which form a cash flow hedge.

During the year, the Group issued $1,000m, €750m and £545m of bond notes, €750m of which matures in 2026 and $1,000m and £545m in 2027. The Group also repaid a $500m bond during the year. The Group issued £300m of commercial paper under the Covid Corporate Financing Facility made available by the Bank of England in response to COVID-19.

The Group also entered into a new £1,000m bank loan maturing in 2022 and a new committed £2,000m loan maturing in 2025 (supported by an 80% guarantee from UK Export Finance and available to draw until June 2021). Also during 2020 the Group extended the maturity of the £2,500m committed revolving credit facility from 2024 to 2025. These facilities were undrawn at the year end. None of these facilities are subject to any financial covenant.

Under the terms of certain of its recent loan facilities, the Company is restricted from declaring, making or paying distributions to shareholders on or prior to 31 December 2022 and from declaring, making or paying distributions to shareholders from 1 January 2023 unless certain conditions are satisfied. The restrictions on distributions do not prevent shareholders from redeeming C Shares issued in January 2020 or prior to that.

20 Leases

Leases as lessee

The net book value of lease right-of-use assets at 31 December 2020 was £1,405m (2019: £2,009m), with a lease liability of £2,043m (2019: £2,354m) (as per note 19). The condensed consolidated income statement shows the following amounts relating to leases:

	2020 £m	2019 £m
Land and buildings depreciation and impairment [1]	**(122)**	(59)
Plant and equipment depreciation [2]	**(44)**	(33)
Aircraft and engines depreciation and impairment [3]	**(566)**	(319)
Total depreciation and impairment charge for right-of-use assets	**(732)**	(411)
Adjustment of amounts payable under residual value guarantees within lease liabilities [3, 4]	**102**	–
Expense relating to short-term leases of 12 months or less recognised as an expense on a straight-line basis [2]	**(18)**	(23)
Expense relating to variable lease payments not included in lease liabilities [3,5]	**(1)**	(1)
Total operating costs	**(649)**	(435)
Interest expense [6]	**(74)**	(88)
Total lease expense	**(723)**	(523)
Income from sub-leasing right-of-use assets	**97**	79
Total amount recognised in income statement	**(626)**	(444)

[1] Included in cost of sales and commercial and administration costs depending on the nature and use of the right-of-use asset.

[2] Included in cost of sales, commercial and administration costs, or research and development depending on the nature and use of the right-of-use asset.

[3] Included in cost of sales.

[4] Where the cost of meeting residual value guarantees is less than that previously estimated, as costs have been mitigated or liabilities waived by the lessor, the lease liability has been remeasured. Where the value of this remeasurement exceeds the value of the right-of use asset, the reduction in the lease liability is credited to cost of sales.

[5] Variable lease payments primarily arise on a small number of contracts where engine lease payments are solely dependent upon utilisation rather than a periodic charge.

[6] Included in financing costs.

The total cash outflow for leases in 2020 was £377m (2019: £383m). Of this £358m related to leases reflected in the lease liability, £18m to short-term leases where lease payments are expensed on a straight-line basis and £1m for variable lease payments where obligations are only due when the assets are used. The timing difference between income statement charge and cash flow relates to costs incurred at the end of leases for residual value guarantees and restoration costs that are recognised within depreciation over the term of the lease, the most significant amounts relate to engine leases.

21 Provisions

	At 1 January 2020 £m	**Business acquisition £m**	**Charged to income statement [1] £m**	**Reversed £m**	**Utilised £m**	**Transfers to held for sale £m**	**Exchange differences £m**	**At 31 December 2020 £m**
Trent 1000 exceptional costs	**1,382**	**–**	**40**	**(560)**	**(541)**	**–**	**–**	**321**
Contract losses	**773**	**–**	**438**	**(345)**	**(58)**	**(4)**	**4**	**808**
Restructuring	**68**	**–**	**411**	**(38)**	**(206)**	**–**	**1**	**236**
Warranties and guarantees	**345**	**3**	**95**	**(9)**	**(104)**	**(14)**	**11**	**327**
Customer financing	**22**	**–**	**–**	**(5)**	**–**	**–**	**–**	**17**
Insurance	**70**	**–**	**10**	**(12)**	**(8)**	**–**	**–**	**60**
Tax related interest and penalties	**55**	**–**	**16**	**(24)**	**(15)**	**–**	**1**	**33**
Employer liability claims	**49**	**–**	**4**	**(1)**	**(2)**	**–**	**–**	**50**
Other	**40**	**1**	**97**	**(15)**	**(29)**	**–**	**(1)**	**93**
	2,804	**4**	**1,111**	**(1,009)**	**(963)**	**(18)**	**16**	**1,945**
Current liabilities	**858**							**826**
Non-current liabilities	**1,946**							**1,119**

[1] The charge to the income statement includes £48m as a result of the unwinding of the discounting of provisions previously recognised of which £15m has been charged to underlying and £33m charged to non-underlying.

21 Provisions continued

Trent 1000 exceptional costs

In November 2019, we announced the outcome of testing and a thorough technical and financial review of the Trent 1000 TEN programme, following technical issues which were identified in 2019, resulting in a revised timeline and a more conservative estimate of durability for the improved HP turbine blade for the TEN variant. An exceptional charge of £1,361m (at underlying exchange rates) was recorded in 2019, £1,531m at prevailing exchange rates and net of £203m reflecting insurance receipts and contract accounting adjustments. Of the charge, £1,275m was recorded in relation to Trent 1000 exceptional costs, and £459m in relation to contract losses (see below).During the year ended 31 December 2020, and reflecting the impact of COVID-19 and the work we have performed to reduce fleet AOG levels and improve the availability of spare engines, the total estimated Trent 1000 cash costs relating to remediation shop visits and customer disruption reduced the provision by £560m, taking into account the expected underlying exchange rates and a share of the costs borne by the RRSAs the income statement impact was £390m (see note 2). In the year we have utilised £541m of the Trent 1000 exceptional costs provision. This represents customer disruption costs settled in cash and credit notes, and remediation shop visit costs. The remaining provision is expected to be utilised over the period 2021 to 2023. A 12-month delay in the availability of the modified HPT blade could lead to a £60-100m increase in the Trent 1000 exceptional costs provision.

Contract losses

Provisions for contract losses are recorded when the direct costs to fulfil a contract are assessed as being greater than the expected revenue. Provisions for contract losses are expected to be utilised over the term of the customer contracts, typically within 10–15 years.

During 2019, contract losses of £459m (at prevailing exchange rates) were recognised relating to the upfront recognition of future losses on a small number of contracts which became loss-making as a result of the margin impact of the updated HP turbine durability expectations on the Trent 1000 TEN. During the year, these Trent 1000 TEN loss-making contracts have improved by £230m (see note 2). For these contracts, a reduction in EFHs resulting from COVID-19 has allowed for a reassessment of shop visits required and the cost savings identified have more than offset the reduction in future revenue leading to an improvement in the overall position of these contracts.

EFHs have reduced as a result of the impact of COVID-19. For certain Civil Aerospace contracts, the impact of this reduction across the contract term has been to significantly reduce revenue without an associated reduction in shop visit costs. Consequently, during the year there have been an increased number of contracts that have become loss-making. A reduction in Civil Aerospace widebody engine flying hours of 15% and the associated decrease in revenues and costs could lead to a £10m-£15m increase in the onerous contract provision.

Additional contract losses for the Group of £406m have been recognised in the year, together with £36m relating to changes in foreign exchange and the effect of discounting.

Warranties and guarantees

Provisions for warranties and guarantees primarily relate to products sold and generally cover a period of up to three years.

Restructuring

In May 2020, the Group announced a fundamental restructuring programme in response to the financial and operational impact caused by COVID-19. This activity will reshape and resize the Group with an anticipated headcount reduction of at least 9,000. As a consequence of this announcement, and based on the detailed plans communicated during 2020, a provision (net of reversals) of £373m has been recorded and recognised in cost of sales and commercial and administrative costs. During the year, £206m has been utilised as part of these plans. At 31 December 2020, the provision of £236m is expected to be utilised over the period 2021-2022. Included within the exceptional charge of £489m are costs of £116m associated with other initiatives to enable the restructuring which have been charged directly to the income statement.

Customer financing

Customer financing provisions have been made to cover guarantees provided for asset value and/or financing where it is probable that a payment will be made.

In addition to the provisions recognised, the Group has contingent liabilities for customer financing arrangements where they payment is not probable as described below.

In connection with the sale of its products the Group will, on some occasions, provide financing support for its customers, generally in respect of civil aircraft. The Group's commitments relating to these financing arrangements are spread over many years, relate to a number of customers and a broad product portfolio and are generally secured on the asset subject to the financing. These include commitments of $1.9bn (2019: $2.8bn) (on a discounted basis) to provide facilities to enable customers to purchase aircraft (of which approximately $630m could be called during 2021). These facilities may only be used if the customer is unable to obtain financing elsewhere and are priced at a premium to the market rate. Significant events impacting the international aircraft financing market, including the COVID-19 pandemic, the failure by customers to meet their obligations under such financing agreements, or inadequate provisions for customer financing liabilities may adversely affect the Group's financial position.

21 Provisions continued

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

	2020		2019	
	£m	**$m**	£m	$m
Gross commitments	**38**	**52**	60	79
Value of security	**(14)**	**(19)**	(9)	(11)
Guarantees	**(5)**	**(6)**	(8)	(11)
Net commitments	**19**	**27**	43	57
Net commitments with security reduced by 20% [1]	**22**	**30**	43	57

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

Insurance

The Group's captive insurance company retains a portion of the exposures it insures on behalf of the remainder of the Group. Significant delays occur in the notification and settlement of claims and judgement is involved in assessing outstanding liabilities, the ultimate cost and timing of which cannot be known with certainty at the balance sheet date. The insurance provisions are based on information currently available, however it is inherent in the nature of the business that ultimate liabilities may vary. Provisions for outstanding claims are established to cover the outstanding expected liability as well as claims incurred but not yet reported.

Tax related interest and penalties

Provisions for tax related interest and penalties relate to uncertain tax positions in some of the jurisdictions in which the Group operates. Utilisation of the provisions will depend on the timing of resolution of the issues with the relevant tax authorities.

Employer liability claims

The provision relating to employer healthcare liability claims is as a result of an historical insolvency of the previous provider and is expected to be utilised over the next 30 years.

Other

Other provisions comprise a number of liabilities with varying expected utilisation rates.

22 Pensions and other post-retirement and long-term employee benefits

Amounts recognised in the income statement

	2020			2019		
	UK schemes £m	**Overseas schemes £m**	**Total £m**	UK schemes £m	Overseas schemes £m	Total £m
Defined benefit schemes:						
Current service cost and administrative expenses	**153**	**67**	**220**	164	52	216
Other past service (credit)/cost [1]	**(308)**	**20**	**(288)**	–	6	6
	(155)	**87**	**(68)**	164	58	222
Defined contribution schemes	**80**	**84**	**164**	66	91	157
Operating (credit)/cost	**(75)**	**171**	**96**	230	149	379
Net financing (credit)/charge in respect of defined benefit schemes	**(26)**	**27**	**1**	(59)	36	(23)
Total income statement (credit)/charge	**(101)**	**198**	**97**	171	185	356

[1] The UK past-service credit of £308m comprises: £213m arising from the restructuring programme and the introduction of the Bridging Pension Option (BPO) - see above; £67m as a result of the closure of the scheme to future accrual - see above; £35m as a result of the manager consultation - see above; offset by a £7m past-service cost recognised as a result of the 20 November High Court judgement that previous statutory transfer values including guaranteed minimum pensions built up between May 1990 and April 1997 must be equalised between men and women.

22 Pensions and other post-retirement and long-term employee benefits continued

Amounts recognised in the balance sheet in respect of defined benefit schemes

	2020 UK schemes £m	2020 Overseas schemes £m	2020 Total £m	2019 UK schemes £m	2019 Overseas schemes £m	2019 Total £m
At 1 January	**1,141**	**(1,349)**	**(208)**	1,926	(1,312)	614
Exchange adjustments	**–**	**(32)**	**(32)**	–	54	54
Current service cost and administrative expenses	**(153)**	**(67)**	**(220)**	(164)	(52)	(216)
Other past service credit	**308**	**(20)**	**288**	–	(6)	(6)
Financing recognised in the income statement	**26**	**(27)**	**(1)**	59	(36)	23
Contributions by employer	**24**	**56**	**80**	199	67	266
Actuarial (losses)/gains recognised in OCI	**(1,629)**	**(219)**	**(1,848)**	(1,335)	(161)	(1,496)
Returns on plan assets excluding financing recognised in OCI	**1,166**	**92**	**1,258**	456	106	562
Disposal of businesses	**–**	**–**	**–**	–	28	28
Transfers	**–**	**(3)**	**(3)**	–	(37)	(37)
At 31 December	**883**	**(1,569)**	**(686)**	1,141	(1,349)	(208)
Post-retirement scheme surpluses – included in non-current assets [1]	**883**	**24**	**907**	1,141	29	1,170
Post-retirement scheme deficits – included in non-current liabilities	**–**	**(1,580)**	**(1,580)**	–	(1,378)	(1,378)
Post-retirement scheme deficits – liabilities held for sale	**–**	**(13)**	**(13)**	–	–	–
	883	**(1,569)**	**(686)**	1,141	(1,349)	(208)

[1] The surplus in the Rolls-Royce UK Pension Fund (RRUKPF) is recognised as, on ultimate wind-up when there are no longer any remaining members, any surplus would be returned to the Group, which has the power to prevent the surplus being used for other purposes in advance of this event.

Changes to UK defined benefit scheme

On 5 June 2019, the Group entered into a partial buy-in with Legal and General Assurance Society Limited covering the benefits of circa 33,000 in-payment pensioners. The buy-in was in anticipation of a buy-out, the final 10% of which concluded on 1 February 2020. Pension assets and liabilities of £422m were derecognised from the Group's balance sheet on this date and this had no impact on the income statement or OCI in the current period. In relation to this transaction, at 31 December 2019, an asset remeasurement net loss estimated at £600m was recognised within the line – 'Actuarial gains/(losses) recognised in OCI'.

A consultation with active managers in the UK scheme was concluded in January 2020. The consultation process agreed certain changes for the relevant manager group which would mitigate future funding cost increases. The changes gave rise to a past service gain of £35m which has been recognised as a non-underlying profit (see note 2).

On the 20 May 2020, the Group announced its intention to reshape and resize the Group due to the financial and operational impact of COVID-19. As part of this restructuring programme, a voluntary severance programme was offered to certain UK employees and pension liabilities were remeasured as at 30 June 2020 to reflect the number of members who were expected to leave the scheme. In addition, the Group agreed with the Trustee of the RRUKPF to offer a new BPO to both active members and also those members leaving on severance. This option allows members to take a larger proportion of their pension prior to reaching the state retirement age and a lower amount thereafter. The accounting impact of these changes gave rise to a past service gain of £213m which was been recognised as a non-underlying profit in the period to 30 June 2020 (see note 2). The assumptions for members remaining employed have subsequently been updated to reflect actual experience, resulting in a demographic loss of £80m, which is included in Actuarial gains/(losses) recognised in OCI. In addition, for members leaving on severance, an experience loss of £47m is also included in Actuarial gains/(losses) recognised in OCI.

On the 29 July 2020, the Group announced a consultation with the active members of the UK scheme on a proposal to close the scheme to future accrual on 31 December 2020. Following the conclusion of this consultation, the closure of the scheme was confirmed, which gave rise to a non-underlying past-service credit of £67m. This primarily arises from the breakage of the link between accrued pensions and salaries for non-manager members (this link had already been largely broken for manager members as a result of the January 2020 consultation described below). Following the confirmation of the scheme closure, the Group is in discussions with the employees' representatives and the Trustee regarding possible additional transitional protections that could be granted from the scheme. Based on the progress of the talks up to 31 December 2020, the Group has allowed for some reductions in the change to the obligation recognised at 31 December. The final details are expected to be agreed in 2021 when any differences will be recognised.

Sensitivities

A reduction in the discount rate from 1.45% by 0.25% could lead to an increase in the defined benefit obligations of the RR UK Pension Fund of approximately £530m. This would be expected to be broadly offset by changes in the value of scheme assets, as the scheme's investment policies are designed to mitigate this risk.

A one-year increase in life expectancy from 21.8 years (male aged 65) and from 23.2 years (male aged 45) would increase the defined benefit obligations of the RR UK Pension Fund by approximately £455m.

It is assumed that 40% (31 December 2019: 45%) of members of the RR UK Pension Fund will transfer out of the fund on retirement. The reduction in this assumption is a result of the introduction of the Bridging Pension Option. An increase of 5% in this assumption would increase the defined benefit obligation by £45m.

22 Pensions and other post-retirement and long-term employee benefits continued

Future contributions

The Group expects to contribute approximately £160m to its defined benefit schemes in 2021 (2020: £170m): UK: £100m, Overseas: £60m (2019: UK: £100m, Overseas: £70m).

In the UK, the funding is based on a statutory triennial funding valuation process. This includes a negotiation between the Group and the Trustee on actuarial assumptions used to value obligations (Technical Provisions) which may differ from those used for accounting set out above. The assumptions used to value Technical Provisions must be prudent rather than a best estimate of the liability. Most notably, the Technical Provision discount rate is currently based upon UK Government yields plus a margin (0.5% at the 31 March 2017 valuation) rather than being based on yields of AA corporate bonds. Following the triennial valuation process, a Schedule of Contributions (SoC) must be agreed which sets out the agreed rate of cash contributions and any contributions from the employer to eliminate a deficit. The most recent valuation, as at 31 March 2017, agreed by the Trustee in December 2017, showed that the UK scheme was estimated to be 112% funded on the Technical Provisions basis. Following the closure of the scheme to future accrual on 31 December 2020, no contributions will be made in respect of future accrual and there are no deficit reduction contributions. The 2021 contributions included above are in respect of 2020 accrual, payment of some of which were deferred in agreement with the Trustee as a result of the COVID-19 pandemic. The current SoC (amended in 2020) includes an arrangement for potential contributions during 2024 to 2027 (capped at £48.3m a year) if the Technical Provisions funding position is below 107% at 31 March 2023. As at 31 December 2020 discussions on the 31 March 2020 triennial valuation were ongoing and the Technical Provisions funding position cannot be estimated until these discussions are concluded in the first half of 2021.

23 Contingent liabilities

Contingent liabilities in respect of customer financing commitments are described in note 21.

In January 2017, after full cooperation, the Company concluded deferred prosecution agreements (DPA) with the SFO and the US Department of Justice (DoJ) and a leniency agreement with the MPF, the Brazilian federal prosecutors. Following the expiry of its term the DPA with the DoJ was dismissed by the US District Court on 19 May 2020. Certain authorities are investigating members of the Group for matters relating to misconduct in relation to historical matters. The Group is responding appropriately. Action may be taken by further authorities against the Company or individuals. In addition, we could still be affected by actions from customers and customers' financiers. The Directors are not currently aware of any matters that are likely to lead to a material financial loss over and above the penalties imposed to date, but cannot anticipate all the possible actions that may be taken or their potential consequences.

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

The Group's share of equity accounted entities' contingent liabilities is nil (2019: nil).

24 Acquisitions and disposals

Acquisitions

On 15 January 2020, the Group completed the acquisition of Qinous GmbH (increasing its shareholding from 24% to 100%) for a cash consideration of €15m, of which €10m was paid on completion. A further €2m is payable in September 2021 and €3m in September 2023. Under the sale agreement, the cash consideration may be adjusted up by €3m to €18m based on a revenue target being achieved by 31 December 2023. In accordance with IFRS 3 *Business Combinations* the pre-acquisition shareholding of 24% has been re-measured to fair value of €5m and a revaluation gain of €2m has been recognised in the income statement.

On the 7 March 2020, the Group signed an agreement to acquire 100% of the shares of Kinolt Group S.A., a Belgium company which designs and manufactures uninterruptible power supply systems. The transaction was completed on 1 July 2020 for net proceeds of €115m. The acquisition of Kinolt Group S.A. completes the Group's power supply product offering, accelerates its strategy of offering integrated solutions and enables the Group to strengthen its market position in safety critical applications with a leader in dynamic uninterruptible power supply. Provisional fair values are determined on the basis of an assessment performed by an independent professional expert, using measurement techniques and estimation of future cash flows to assess the values of identifiable assets and liabilities at the date of acquisition. The total fair value of acquired identifiable assets and liabilities was €65m, primarily related technology and customer relationships. Goodwill of €50m was recognised on acquisition in relation to workforce, future products, synergies and access to new customers and markets.

On 18 May 2020, the Group entered into an agreement to increase its shareholding in Reaction Engines Ltd from 2.0% to 10.1% for a cash consideration of £20m. The consideration is payable (and the associated shares acquired) in four instalments that will be made between July 2020 – January 2022. Reaction Engines is accounted for as an investment.

24 Acquisitions and disposals continued

On the 7 December 2020, the Group completed the acquisition of Servowatch Systems Limited (SSL) for a cash consideration of £5m. The acquisition will provide key technology within Power Systems for the Naval and Commercial Marine markets. The Group has performed a final assessment to determine the fair values of the identifiable assets and liabilities acquired in accordance with IFRS 3 and has identified intangible assets amounting to £5m and £(4)m of other assets and liabilities. Goodwill of £4m was recognised on acquisition in relation to workforce and synergies.

	Qinous £m	Kinolt £m	Servowatch £m	Total £m
Recognised amounts of identifiable assets acquired and liabilities assumed				
Intangible assets	**14**	**61**	**5**	**80**
Property, plant and equipment	**–**	**17**	**–**	**17**
Right-of-use assets	**–**	**1**	**–**	**1**
Inventory	**3**	**42**	**1**	**46**
Trade receivables and other assets	**1**	**17**	**1**	**19**
Cash and cash equivalents	**–**	**11**	**–**	**11**
Trade payables and other liabilities	**(5)**	**(47)**	**(5)**	**(57)**
Provisions	**–**	**(4)**	**–**	**(4)**
Borrowings and lease liabilities	**–**	**(24)**	**–**	**(24)**
Deferred tax	**(3)**	**(16)**	**(1)**	**(20)**
Total identifiable assets and liabilities	**10**	**58**	**1**	**69**
Goodwill arising	**7**	**46**	**4**	**57**
Total consideration	**17**	**104**	**5**	**126**
Consideration satisfied by:				
Existing shareholding	**4**	**–**	**–**	**4**
Cash	**8**	**104**	**5**	**117**
Deferred consideration	**5**	**–**	**–**	**5**
	17	**104**	**5**	**126**
Net cash outflow arising on acquisition:				
Cash and cash equivalents	**8**	**104**	**5**	**117**
less: Cash and cash equivalents acquired	**–**	**(11)**	**–**	**(11)**
	8	**93**	**5**	**106**
Identifiable intangible assets comprise				
Customer relationships	**–**	**37**	**4**	**41**
Development expenditure	**–**	**2**	**1**	**3**
Technology assets	**14**	**22**	**–**	**36**
	14	**61**	**5**	**80**

The gross contractual value of trade receivables acquired was £15m. At the acquisition dates, it was estimated that contractual cash flows of £1m would not be collected.

The acquisitions of Qinous and Kinolt contributed £5m and £50m to revenue respectively and Qinous contributed £(10)m to loss before tax (including amortisation of the acquisition accounting adjustments) for the period between the date of acquisition and the 31 December 2020. If the acquisitions had been completed on 1 January 2020, the contribution to the Group's revenues and loss before tax due to Qinous would have been £5m and £(10)m respectively and due to Kinolt would have been £68m and £(4)m respectively.

Transaction costs of £3m have been expensed during the year relating to the acquisitions of Qinous, Kinolt and Servowatch.

Disposals

On the 31 January 2020, the Group completed the sale of its North America Civil Nuclear (NACN) business to Westinghouse Electric Company LLC. for $25m. The business was disclosed as a disposal group held for sale at 31 December 2019. In our 2019 financial statements, the Group reported an impairment charge of £25m as a result of the decision to classify NACN as a business held for sale. Upon the disposal of NACN on 31 January 2020, and in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates,* the Group have recycled the cumulative currency translation reserve through the income statement in 2020. This has resulted in a cumulative currency translation loss of £7m.

On the 3 February 2020, the Group sold its Knowledge Management Systems (KMS) business to Valsoft Corp. for a cash consideration of $3m. Upon the disposal of KMS, and in accordance with IAS 21 the Group have recycled the cumulative currency translation reserve through the income statement in 2020. This has resulted in a cumulative currency translation gain of £3m.

On the 7 May 2020, the Group sold Trigno Energy Srl (Trigno) to Pilkington Italia S.p.A for a cash consideration of €6m. Upon the disposal of Trigno, and in accordance with IAS 21 we have recycled the cumulative currency translation reserve through the income statement in 2020. This has resulted in a cumulative currency translation gain of £1m.

On the 17 May 2020, the Group signed an agreement to sell its 18% shareholding in Exostar LLC for an initial cash consideration of $23m. The transaction was completed on 6 July 2020. Upon the disposal of Exostar, and in accordance with IAS 21 we have recycled the cumulative currency translation reserve through the income statement in 2020. This has resulted in a cumulative currency translation loss of £3m.

	NACN £m	KMS £m	Trigno £m	Total subsidiaries £m	Exostar £m	Total £m
Proceeds						
Cash consideration	19	2	4	25	18	43
Cash and cash equivalents disposed	(9)	(2)	(4)	(15)	–	(15)
Net cash consideration per cash flow statement	10	–	–	10	18	28
Less: Net (assets)/liabilities disposed	(4)	1	(2)	(5)	(6)	(11)
Profit/(loss) on disposal before disposal costs and continuing obligations	6	1	(2)	5	12	17
Cumulative currency translation (loss)/gain	(7)	3	1	(3)	(3)	(6)
Disposal costs	(1)	–	–	(1)	–	(1)
Non-underlying (loss)/profit before tax	(2)	4	(1)	1	9	10

Disposal completed in prior periods

On 1 June 2018, the Group sold its L'Orange business, part of Rolls-Royce Power Systems, to Woodward Inc. for €673m. Under the sale agreement, the cash consideration may be adjusted by up to +/-€44m, based on L’Orange aftermarket sales over the five-year period to 31 May 2023. This is reviewed at each reporting date over the adjustment period, based on actual sales. Cash consideration has been adjusted by £5m which has been paid during the year. During the year, a liability of €29m has been recognised for amounts that are now expected to be payable in relation to the years 2020 - 2023 as a result of a reduction in aftermarket sales as a consequence of the impact of COVID-19. This €29m liability has been reflected as an adjustment to sales proceeds.

Reconciliation of loss on acquisition & disposal of businesses per the income statement	**Total £m**
Profit on disposal of businesses	10
Gain on revaluation of Qinous	1
Adjustment to L'Orange sales proceeds	(25)
Loss on acquisition & disposal of businesses (income statement – non-underlying)	(14)

Businesses held for sale

On 28 February 2020 the Group announced the decision to carry out a strategic review of Bergen, our medium-speed gas and diesel engine business. Bergen formed part of the Power Systems business and from 2020 it has been reclassified as non-core following the announcement of the strategic review. On 1 February 2021, the Group signed an agreement for the sale of Bergen to TMH Group for a cash consideration of approximately €150m (subject to closing adjustments) which is expected to complete in the second half of 2021. Consequently, in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations,* Bergen has been classified as held for sale at 31 December 2020. As at 31 December 2020, Bergen had an additional £25m of cash which, as part of bank pooling arrangements, was held by another Group company and consequently is not included in the disposal group as the resulting intra-group balances are eliminated on consolidation. On completion, such cash will be included in the disposal group.

On 7 December 2020 the Group signed an agreement for the sale of Civil Nuclear Instrumentation & Control business to Framatome. Consequently, in accordance with IFRS 5, the business has been classified as held for sale at 31 December 2020 and its carrying value assessed against the anticipated proceeds and disposal costs.

24 Acquisitions and disposals continued

The table below summarises the categories of assets and liabilities classified as held for sale.

During the year, the Group announced its intention to sell ITP Aero. At 31 December 2020, ITP Aero was not available for

	Bergen £m	Civil Nuclear £m	Total £m
Intangible assets	**–**	**16**	**16**
Property, plant and equipment	**3**	**4**	**7**
Right-of-use assets	**2**	**7**	**9**
Deferred tax assets	**2**	**4**	**6**
Cash and cash equivalents	**25**	**26**	**51**
Inventory	**97**	**14**	**111**
Trade receivables and other assets	**50**	**38**	**88**
Assets held for sale	**179**	**109**	**288**
Trade payables and other liabilities	**(100)**	**(84)**	**(184)**
Provisions for liabilities and charges	**(11)**	**(7)**	**(18)**
Borrowings and lease liabilities	**(4)**	**(7)**	**(11)**
Deferred tax liabilities	**(2)**	**–**	**(2)**
Post-retirement scheme deficits	**–**	**(13)**	**(13)**
Liabilities associated with assets held for sale	**(117)**	**(111)**	**(228)**
Net assets held for sale	**62**	**(2)**	**60**

immediate sale in its present condition and therefore, in line with IFRS 5 has not been classified as a disposal group. The assets of ITP Aero have been assessed for impairment in accordance with IAS 36 on a value in use basis which assumes the value will be realised over the long-term.

25 Derivation of summary funds flow statement from reported cash flow statement

	2020		2019		
	£m	£m	£m	£m	Source
Underlying operating (loss)/profit (see note 2)		**(1,972)**		808	Note 2
Amortisation and impairment of intangible assets	**902**		372		Cash flow statement (CFS)
Depreciation and impairment of property, plant and equipment	**821**		532		CFS
Depreciation and impairment of right-of-use assets	**732**		411		CFS
Adjustment to residual value guarantees in lease liabilities	**(102)**		–		CFS
Impairment of joint ventures	**24**		–		Note 13
Reversal of non-underlying impairments of non-current assets	**(1,293)**		(84)		Reversal of underlying adjustment (note 2)
Acquisition accounting	**(133)**		(163)		Reversal of underlying adjustment (note 2)
Depreciation and amortisation		**951**		1,068	
Additions of intangible assets		**(316)**		(591)	CFS less exceptional restructuring (see below)
Purchases of property, plant and equipment		**(579)**		(747)	CFS
Lease payments (capital plus interest)		**(379)**		(319)	CFS (capital and interest payments adjusted for foreign exchange (FX))
Decrease/(increase) in inventories		**588**		(43)	CFS
Movement in receivables/payables	**(2,332)**		(33)		CFS adjusted for the impact of exceptional programme charges and exceptional restructuring shown on the basis of the FX rate achieved on settled derivative contracts
Movement in contract balances	**(276)**		526		CFS adjusted for the impact of exceptional programme charges and FX and excluding Civil LTSAs (shown separately below)
Underlying movement in Civil Aerospace LTSA contract balances	**479**		754		Movement in Civil LTSA balances within movement of contract balances in CFS less impact of FX
Revaluation of trading assets (excluding exceptional items)	**(299)**		265		Adjustment to reflect the impact of the FX contracts held on receivables/payables
Realised derivatives in financing	**700**		(266)		Realised cash flows on FX contracts not included in underlying operating profit less cash flows on settlement of excess derivative contracts
Movement on receivables/payables/contract balances		**(1,728)**		1,246	
Movement on provisions		**(195)**		(506)	CFS adjusted for the impact of exceptional programme charges and anticipated recoveries, exceptional restructuring and FX contracts held
Net interest received and paid		**(75)**		(73)	CFS
Fees paid on undrawn facilities		**(97)**		–	CFS
Cash flows on settlement of excess derivative contracts		**(202)**		–	CFS
Cash flows on financial instruments net of realised losses included in operating profit		**(8)**		(15)	Cash flows on other financial instruments (CFS) not allocated to lease payments or exceptional programme expenditure adjusted for the impact of FX not held for trading .
Trent 1000 insurance				173	Included in movements in payables and provisions in CFS
Other		**(102)**		56	Principally disposals of non-current assets, joint venture trading and the effect of share-based payments
Trading cash flow		**(4,114)**		1,057	
Underlying operating profit charge in excess of contributions to defined benefit schemes		**160**		(9)	CFS excluding additional contribution of £35m shown below
Tax		**(231)**		(175)	CFS
Free cash flow		**(4,185)**		873	
Shareholder payments		**(92)**		(224)	CFS (includes dividends to NCI)
Rights issue		**1,972**		–	CFS
Acquisition of businesses		**(130)**		(43)	CFS
Disposal of businesses		**23**		453	CFS
Exceptional restructuring costs		**(323)**		(216)	£268m related to severance costs and £55m capital expenditure (2019: £167m and £49m respectively)
DPA payments		**(135)**		(102)	CFS
Pension fund contribution		**–**		(35)	CFS
Difference in fair values of derivative contracts held for financing		**(26)**		(2)	CFS
Payments of lease principal less new leases and other non-cash adjustments to lease liabilities		**311**		123	CFS adjusted for the impact of FX
Foreign exchange		**51**		(98)	CFS less allocation to leases above
Other		**(49)**		(6)	Cash outflow on M&A spend and timing of cash flows on a prior period disposal. See below.
Change in net (debt)/funds		**(2,583)**		723	
Change in net (debt)/funds		**(2,583)**		723	
Non-cash lease impact		**(311)**		(123)	
Reclassification of other financial liabilities to borrowings		**–**		(79)	
Change in net (debt)/funds excluding lease liabilities		**(2,894)**		521	

25 Derivation of summary funds flow statement from reported cash flow statement continued

The comparative information for the year ended 31 December 2019 has been re-presented to be on a comparable basis with the presentation adopted for the year ended 31 December 2020. There is no change to trading or group free cash flow. In summary: (i) 'cash flows on financial instruments net of realised losses included in operating profit' previously included in 'other' within 'trading cash flow', have been shown separately; and (ii) foreign exchange transactions have been represented within line items to be consistent with presentation throughout the financial statements.

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

The table below shows a reconciliation of free cash flow to the change in cash and cash equivalents presented in the condensed consolidated cash flow statement on page 20.

	2020		2019		
	£m	**£m**	£m	£m	**Source**
Change in cash and cash equivalents	**(995)**		(413)		CFS
Net cash flow from changes in borrowings and lease liabilities	**(1,630)**		1,385		CFS excluding repayment of debt acquired. See below.
Decrease in short-term investments	**(6)**		–		CFS
Movement in net (debt)/funds from cash flows	**(2,631)**		972		
Exclude: Capital element of lease repayments	**(284)**		(271)		CFS
Movement in net (debt)/funds from cash flows (excluding lease liabilities)		**(2,915)**		701	
Rights issue		**(1,972)**		–	CFS
Returns to shareholders		**92**		224	CFS
Acquisition of businesses	**130**		43		CFS including repayment of debt acquired
Disposal of businesses	**(23)**		(453)		CFS
Other acquisitions and disposals	**12**		1		£12m related to costs incurred on central M&A activity
Changes in group structure		**119**		(409)	
Penalties paid on agreements with investigating bodies		**135**		102	CFS
Exceptional restructuring costs		**323**		216	£268m related to severance costs and £55m capital expenditure (2019: £167m and £49m respectively)
Pension fund contribution		**–**		35	Additional contribution in connection with the pensioner buy-out (note 23)
Other		**33**		4	Timing of cash flows on a prior period disposal where the Group retains the responsibility for collecting cash before passing it on to the acquirer
Free cash flow		**(4,185)**		873	

Principal risks and uncertainties

The following table describes the principal risks facing the Group, notwithstanding that there are other risks that may occur and may impact the achievement of the Group's objectives:

<table>
<tr><th>RISK</th><th>HOW WE MANAGE IT</th></tr>
<tr><td rowspan="2">Safety
Failure to: i) meet the expectations of our customers to provide safe products; or ii) 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.</td><td>Product
• Our product safety management system includes activities 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.</td></tr>
<tr><td>People
• Our HSE management system includes activities 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</td></tr>
<tr><td>Business continuity
The major disruption of the Group's operations, which results in our failure to meet agreed customer commitments and damages our prospects of winning future orders. Disruption could be caused by a range of events, for example: extreme weather or natural hazards (for example earthquakes, floods); political events; financial insolvency of a critical supplier; scarcity of materials; loss of data; fire; or infectious disease. The consequences of these events could have an adverse impact on our people, our internal facilities or our external supply chain.</td><td>• 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 safety stock.
• We plan and practice IT disaster recovery, business continuity and crisis management exercises.
• We undertake supplier diligence. We take out relevant and appropriate insurance.</td></tr>
<tr><td>Climate change
We recognise the urgency of the climate challenge and have committed to net zero carbon by 2050. The principal risk to meeting these commitments is the need to transition our products and services to a lower carbon economy. Failure 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.</td><td>• We invest in i) reducing carbon impact of existing products; and ii) zero carbon technologies to replace our existing products.
• We balance our portfolio of products, customers and revenue streams to reduce our dependence on any one product, customer or carbon emitting fuel source.
• We acknowledge and communicate our role in the problem and the solution, and the actions we are taking to enact a credible plan of action in line with societal expectations.</td></tr>
</table>

RISK	HOW WE MANAGE IT
Competitive environment Existing competitors: the presence of competitors in the majority of our markets means that the Group is susceptible to significant price pressure for original equipment or services. Our main competitors have access to significant government funding programmes as well as the ability to invest heavily in technology and industrial capability. Existing products: failure to achieve cost reduction, contracted technical specification, product (or component) life or falling significantly short of customer expectations, would have potentially significant adverse financial and reputational consequences, including the risk of impairment of the carrying value of the Group's intangible assets and the impact of potential litigation. New programmes: failure to deliver an NPI project on time, within budget, to technical specification or falling significantly short of customer expectations would have potentially significant adverse financial and reputational consequences. Disruptive technologies (or new entrants with alternative business models): could reduce our ability to sustainably win future business, achieve operating results and realise future growth opportunities.	• We review product life cycles. • We make investment choices to improve the quality, delivery and durability of our existing products and services and to develop new technologies and service offering to differentiate us competitively. • We protect our intellectual property (e.g. through patents). • We monitor our performance against plans. • We scan the horizon for emerging technology and other competitive threats, including through patent searches.
Cyber threat An attempt to cause harm to the Group, its customers, suppliers and partners through the unauthorised access, manipulation, corruption, or destruction of data, systems or products through cyberspace.	• We deploy web gateways, filtering, firewalls, intrusion, advanced persistent threat detectors and integrated reporting. • We test software. • We use our crisis management framework.
Market shock The Group is exposed to a number of market risks, some of which are of a macroeconomic nature (e.g. economic growth rates) and some of which are more specific to the Group (for example, reduction in air travel or defence spending, or disruption to other customer operations). A large proportion of our business is reliant on the civil aviation industry, which is cyclical in nature. 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.	• 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 original equipment and aftermarket services, providing a broad product range and addressing diverse markets that have differing business cycles.
Financial shock The Group is exposed to a number of financial risks, some of which are of a macroeconomic nature (for example, foreign currency, oil price, interest rates) and some of which are more specific to the Group (for example, liquidity and credit risks). Significant extraneous market events could also materially damage the Group's competitiveness and/or creditworthiness and our ability to access funding. This would affect operational results or the outcomes of financial transactions.	• Our financial control framework activities are designed to reduce financial reporting risks. • Group strategic planning process. • We incorporate trends, demand and other dependencies in our financial forecasts. • 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.

RISK	HOW WE MANAGE IT
Political risk Geopolitical factors that lead to an unfavourable business climate and significant tensions between major trading parties or blocs which could impact the Group's operations. 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.	• We develop Group and country strategies and consider associated dependencies. • We horizon scan for political implications and dependencies including around Brexit. • We include diversification considerations in our investment and procurement choices.
Restructuring Failure to deliver our restructuring, including changing our behaviours could result in: missed opportunities; dissatisfied customers; disengaged employees; ineffective use of our scarce resources; and increasing the likelihood of other principal risks occurring. This could lead to a business that is overly dependent on a small number of products and customers; failure to achieve our vision; non-delivery of financial targets; and not meeting investor expectations.	• We develop, implement and review status of restructuring programme and project plans including on M&A, transformation and restructuring activities. • We maintain knowledge management systems. • We simplify the processes in our management systems whilst ensuring we comply with our legal, contractual and regulatory requirements.
Talent and capability Inability to identify, attract, retain and apply the critical capabilities and skills needed in appropriate numbers to effectively organise, deploy and incentivise our people would threaten the delivery of our strategies.	• We undertake succession planning and monitor the talent pipeline. • We survey employee opinion. • We develop, implement and review strategic resourcing plans.

Annual General Meeting
This year's AGM will be held at 11.00am on Thursday 13 May 2021 at King's Place, 90 York Way, London, N1 9FX,full details of which will be set out in our Notice of Meeting which will be made available to shareholders on 31 March 2021

Payments to shareholders

The Board decided in 2020 that, given the uncertain macro outlook, they would not recommend a final shareholder payment for 2019 or make an interim shareholder payment for 2020. In addition, under the terms of certain of its recent loan facilities, the Company is restricted from declaring, making or paying distributions to shareholders on or prior to 31 December 2022 and from declaring, making or paying distributions to shareholders from 1 January 2023 unless certain conditions are satisfied. The restrictions on distributions do not prevent shareholders from redeeming C Shares issued in January 2020 or prior to that.

Shareholders wishing to redeem their existing C Shares must lodge instructions with the Registrar to arrive no later than 5.00pm on 1 June 2021 (CREST holders must submit their election in CREST by 2.55pm). The payment of C Share redemption monies will be made on 5 July 2021 and the CRIP purchase will begin as soon as practicable after 5 July 2021.

Annual report and financial statements

The statements below have been prepared in connection with the Company's full Annual Report for the year ended 31 December 2020. Certain parts thereof are not included in this announcement.

Directors' confirmations

The Directors consider that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group and parent company's position and performance, business model and strategy.

Each of the Directors, whose names and functions are listed in the Directors' Report, confirm that to the best of his or her knowledge:

- the Group Financial Statements, which have been prepared in accordance with IFRSs, give a true and fair view of the assets, liabilities, financial position and loss of the Group;

- the parent company Financial Statements, which have been prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 Reduced Disclosure Framework, and applicable law), give a true and fair view of the assets, liabilities, financial position and result of the Company;

- the Strategic Report includes a fair review of the development and performance of the business and the position of the Group and parent company, together with a description of the principal risks and uncertainties that it faces; and

- there is no relevant audit information of which the Company's auditor is unaware. Each Director has taken all steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

By order of the Board

Warren East	Stephen Daintith
Chief Executive	Chief Financial Officer

11 March 2021