Financial review

Reported results

The changes resulting from underlying trading are described on pages 7 to 18.

Consistent with past practice and IFRS, 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 year-end mark-to-market adjustments. In particular, the USD:GBP hedge book has a significant impact on the reported results. In 2018, the USD:GBP rate fell from 1.35 to 1.32 while the EUR:GBP remained stable at 1.13. The adjustments between the underlying income statement and the reported income statement are set out in Note 2 to the condensed consolidated financial statements. This basis of presentation has been applied consistently.

Reconciliation between underlying and reported results

	Six months to 30 June	**Revenue**		**Profit before financing**		**Financing**		**Profit/(loss) before tax**	
	£m	**2018**	2017	**2018**	2017	**2018**	2017	**2018**	2017
	Underlying	**7,040**	6,041	**141**	(84)	**(68)**	(59)	**73**	(143)
1	Revenue recognised at exchange rate on date of transaction	**447**	615	**–**	–	**–**	–	**–**	–
1, 2	Mark-to-market adjustments on derivatives and related foreign exchange adjustments	**–**	–	**103**	78	**(786)**	1,604	**(683)**	1,682
3	Trent 1000 exceptional charge	**–**	–	**(554)**	–	**–**	–	**(554)**	–
4	Effects of acquisition accounting	**–**	–	**(124)**	(62)	**–**	–	**(124)**	(62)
5	Exceptional restructuring	**–**	–	**(179)**	(31)	**–**	–	**(179)**	(31)
6	Disposal of L'Orange	**–**	–	**358**	–	**–**	–	**358**	–
7	Impairments of Commercial Marine	**–**	–	**(160)**	–	**–**	–	**(160)**	–
	Other	**–**	–	**(2)**	(4)	**9**	2	**7**	(2)
	Reported	**7,487**	6,656	**(417)**	(103)	**(845)**	1,547	**(1,262)**	1,444

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 at spot rates rather than achieved hedge rates increased revenues by £447m (2017: £615m) and profit before financing by £103m (2017: £78m).

[2] There was a mark to market loss on the Group's hedge book of £854m (2017: gain of £1,407m). These reflect: the large hedge book held by the Group (eg USD $37bn); and the weakening of sterling, against the US dollar. At each period end, our foreign exchange hedge book is included in the balance sheet at fair value ('mark to market') and the movement in the year included in reported financing costs.

Adjustments are also included to recognise the gain on derivatives settled during the period (2018: £240m, 2017: £342m) and the impact of valuation of assets and liabilities using the spot exchange rate rather than the exchange rate that is expected to be achieved by the use of the hedge book.

[3] As described on page 8 and the accounting policy on page 28, the exceptional charge relating to the Trent 1000 aero engine has been excluded from the underlying results.

[4] The effects of acquisition accounting £124m (2017: £62m) principally relate to the amortisation of intangible assets arising on the acquisition of Power Systems in 2013 and ITP Aero at the end of 2017.

[5] Exceptional restructuring costs of £179m (2017: £31m). These are costs associated with the substantial closure or exit of a site, facility or activity related to the significant transformation project that the business is currently undertaking. A number of the projects within the transformation programme are spread over several years. Of the 2018 costs £132m relates to the Group Restructure announced in June 2018.

[6] The disposal of L'Orange in June 2018 gave rise to a gain of £358m.

[7] As described on page 4, the sale of the Commercial Marine business was announced on 6 July. It has been reclassified as 'held for sale', and written down to its expected disposal value, resulting in a loss of £160m.

Appropriate tax rates are applied to these additional items included in the reported results, leading to an additional tax credit of £327m (2017: charge £267m), the most significant components being the mark to market adjustments (tax effect £134m and £(249)m in 2018 and 2017 respectively), the effect of acquisition accounting (tax effect £52m and £18m in 2018 and 2017 respectively), and the abnormal Trent 1000 costs (tax effect £100m in 2018). In 2018, a gain of £54m was also recognised in respect of changes in the Basque tax rates, applying to ITP Aero.

Funds flow

Summary funds flow statement [1]	Half-year to 30 June		
£m	**2018**	2017	Change
Opening net (debt)/funds	**(305)**	(225)	
Closing net funds/(debt)	**165**	(931)	
Change in net funds	**470**	(706)	
Underlying profit before tax	**73**	(143)	216
Depreciation and amortisation	**313**	331	(18)
Movement in net working capital	**129**	324	(195)
Expenditure on property, plant and equipment and intangible assets	**(669)**	(599)	(70)
Other	**128**	(169)	297
Trading cash flow	**(26)**	(256)	230
Contributions to defined benefit pensions in excess of underlying PBT charge	**31**	(12)	43
Taxation paid	**(77)**	(71)	(6)
Free cash flow	**(72)**	(339)	267
Shareholder payments	**(85)**	(85)	–
Disposal of L'Orange	**584**	–	584
Other acquisitions and disposals	**13**	5	8
Payment of financial penalties	**–**	(267)	267
Foreign exchange	**30**	(20)	50
Change in net funds	**470**	(706)	

[1] The derivation of the summary funds flow statement above from the reported cash flow statement is included on page 44.

Movement in working capital - There was a £129m contribution to free cash flow from lower working capital in H1. The main drivers of this were:

- inventories rose by £427m due to volume growth in Civil and Power Systems and the phasing of product deliveries in Defence;
- trade and other receivables increased £300m primarily driven by an increase in risk and revenue sharing partner related debtor balances in Civil; and
- trade and other payables rose by £997m due to phasing ahead of the H2 volume ramp up at Power Systems, underlying volume growth in Civil and a £715m increase in long term contract creditor balance in Civil, reflecting growth in EFH cash receipts in advance of revenues being recognised and the negative £154m prior year contract catch up adjustment.

Expenditure on property, plant and equipment and intangibles:

Expenditure on:

- intangible assets of £327m intangible assets includes £241m of development costs on the Trent 1000/XWB/7000 and Pearl and software; and
- property plant and equipment of £343m, largely investment in industrial footprint and IT infrastructure spend.

Pensions – The 2017 UK triennial actuarial valuation has reduced the contributions in the first half of 2018 by £43m; this includes the impact of a switch to making cash contributions quarterly in arrears, a one off cash flow saving in 2018.

Shareholder payments – There was no change between the 2016 and 2017 interim payments (paid in the following year).

Acquisitions and disposals – the L'Orange business (part of the Power Systems segment) was sold on 1 June 2018.

Payment of financial penalties – following the agreements reached with investigating authorities in January 2017, £286m of penalties were paid in the UK, US and Brazil. Further UK payments of £378m (plus interest) will be made in 2019-2021.

Balance sheet

Summary balance sheet £m	30 June 2018	31 December 2017 Excluding L'Orange and Commercial Marine	L'Orange and Commercial Marine	Total	Change excluding L'Orange and Commercial Marine
Intangible assets	**5,266**	5,098	567	5,665	168
Property, plant and equipment	**4,494**	4,482	190	4,672	12
Joint ventures and associates	**717**	688	–	688	29
Net working capital[1]	**(7,082)**	(7,132)	83	(7,049)	50
Net funds[2]	**165**	(305)	–	(305)	470
Provisions	**(1,625)**	(816)	(52)	(868)	(809)
Net post-retirement scheme surpluses/(deficits)	**1,215**	793	(55)	738	422
Net financial assets and liabilities[2]	**(3,226)**	(2,640)	–	(2,640)	(586)
Held for sale (Commercial Marine)	**366**	–	7	7	366
Other net assets and liabilities[3]	**480**	305	(2)	303	175
Net assets	**770**	473	738	1,211	297
Other items					
US$ hedge book (US$bn)	**37.3**			38.5	
Civil LTSA asset	**1,215**			1,044	
Civil LTSA liability	**(5,318)**			(4,603)	
Civil net LTSA liability[4]	**(4,103)**			(3,559)	

[1] Net working capital includes inventories, trade and other receivables, trade and other payables and current tax assets and liabilities.
[2] Net funds includes £220m (2017: £227m) of the fair value of financial instruments which are held to hedge the fair value of borrowings.
[3] Other includes other investments and deferred tax assets and liabilities.
[4] In December 2017 we disclosed a provisional LTSA net creditor of £3.5bn. In finalising our IFRS 15 reporting we have analysed all balance sheet items classifying RRSP prepayments and other smaller balances out of the LTSA liability balance.

Excluding L'Orange and Commercial Marine:

Intangible assets: (page 37), increase of £168m. Additions of £327m (including £241m of development costs) were partially offset by amortisation of £165m.

Property, plant and equipment: (page 38) increase of £12m. Additions of £241m are largely offset by depreciation of £244m.

Investments in joint ventures and associates: increase of £29m. This includes the Group's share of retained profit of £6m and exchange benefits of £15m.

Movements in **net funds** are shown on page 26.

Net working capital: increase of £50m.The £129m contribution to funds flow described on the previous page was offset by a reduction of £240m in the liability to Sener for the ITP Aero acquisition, which has been settled by the issue of ordinary shares. Other differences largely relate to movements on capital creditors.

Provisions: increased of £809m. This is largely due to the Trent 1000 provision of £649m (technical issues) and restructuring provision of £130m relating to the group restructuring programme.

Net post-retirement scheme surpluses: (page 40) increase of £422m (UK £411m, Overseas £11m). The UK increase in the surplus is primarily the result of plan assets outperforming the change in value of liabilities measured on an IAS 19 basis.

Net financial assets and liabilities: (page 39) reduction of £586m**.** These principally relate to the fair value of foreign exchange, commodity and interest rate contracts. The movement primarily relates to an adverse mark to market movement on the foreign exchange book of £854m, offset by contracts settled of £237m. All contracts continue to be held for hedging purposes.

The **US$ hedge book** at $37.3bn remain broadly stable as contracts settled were replaced with new contracts.

L’Orange and Commercial Marine

L’Orange was sold on 1 June 2018 and, following the announcement of the anticipated sale of Commercial Marine, it has been classified as held for sale. Consequently, amounts for these businesses are not included in the 2018 balance sheet categories. To provide a more meaningful comparison, they have also been excluded from the 31 December 2017 balance sheet.

Condensed consolidated half-year financial statements

Condensed consolidated income statement

For the half-year ended 30 June 2018

	Notes	Half-year to 30 June 2018 £m	Restated* Half-year to 30 June 2017 £m	Restated* Year to 31 December 2017 £m
Revenue	2	**7,487**	6,656	14,814
Cost of sales		**(7,231)**	(5,801)	(12,514)
Gross profit	2	**256**	855	2,300
Commercial and administrative costs	2	**(723)**	(552)	(1,222)
Research and development costs	3	**(360)**	(457)	(843)
Share of results of joint ventures and associates		**52**	51	131
Operating (loss)/profit		**(775)**	(103)	366
Gain arising on the acquisition of ITP Aero	14	**–**	–	1,066
Gain arising on the disposal of L'Orange	14	**358**	–	–
(Loss)/profit before financing and taxation		**(417)**	(103)	1,432
Financing income	4	**106**	1,648	2,911
Financing costs	4	**(951)**	(101)	(164)
Net financing		**(845)**	1,547	2,747
(Loss)/profit before taxation [1]		**(1,262)**	1,444	4,179
Taxation	5	**302**	(272)	(515)
(Loss)/profit for the period		**(960)**	1,172	3,664
Attributable to:				
Ordinary shareholders		**(962)**	1,172	3,663
Non-controlling interests		**2**	–	1
(Loss)/profit for the period		**(960)**	1,172	3,664
Earnings per ordinary share attributable to ordinary shareholders	6			
Basic		**(52.03)p**	63.90p	199.73p
Diluted		**(52.03)p**	63.80p	199.08p
Underlying earnings per ordinary share are shown in note 6.				
Payments to ordinary shareholders in respect of the period	7			
Pence per share		**4.6p**	4.6p	11.7p
Total		**86**	85	216
[1] Underlying profit before taxation	2	**73**	(143)	199

[2] Included within cost of sales and commercial and administrative costs are exceptional charges in respect of costs relating to the Trent 1000 Civil Aerospace programme and restructuring costs, respectively. Further details can be found in note 2.

***** The prior period has been restated for IFRS 15 *Revenue from Contracts with Customers*, an interim update to the provisional fair values of the ITP Aero acquisition and other adjustments. See note 16 for more details.

Condensed consolidated statement of comprehensive income

For the half-year ended 30 June 2018

	Notes	Half-year to 30 June 2018 £m	Restated* Half-year to 30 June 2017 £m	Restated * Year to 31 December 2017 £m
(Loss)/profit for the period		**(960)**	1,172	3,664
Other comprehensive income (OCI)				
Movements in post-retirement schemes	11	**451**	(112)	735
Share of OCI of joint ventures and associates		**–**	(1)	(1)
Related tax movements		**(154)**	42	(307)
Items that will not be reclassified to profit or loss		**297**	(71)	427
Foreign exchange translation differences on foreign operations		**47**	(55)	(136)
Reclassification to income statement on disposal of business		**(19)**	–	–
Share of OCI of joint ventures and associates		**8**	(3)	(5)
Related tax movements		**–**	1	1
Items that may be reclassified to profit or loss		**36**	(57)	(140)
Total comprehensive (expense)/income for the period		**(627)**	1,044	3,951
Attributable to:				
Ordinary shareholders		**(629)**	1,044	3,950
Non-controlling interests		**2**	–	1
Total comprehensive (expense)/income for the period		**(627)**	1,044	3,951

***** The prior period has been restated for IFRS 15 *Revenue from Contracts with Customers*, an interim update to the provisional fair values of the ITP Aero acquisition and other adjustments. See note 16 for more details.

Condensed consolidated balance sheet

At 30 June 2018

	Notes	30 June 2018 £m	Restated* 31 December 2017 £m
ASSETS			
Intangible assets	8	**5,266**	5,665
Property, plant and equipment	9	**4,494**	4,672
Investments – joint ventures and associates		**717**	688
Investments – other		**27**	26
Other financial assets	10	**409**	610
Deferred tax assets		**938**	842
Post-retirement scheme surpluses	11	**2,521**	2,125
Non-current assets		**14,372**	14,628
Inventories		**4,065**	3,888
Trade and other receivables		**6,363**	6,341
Taxation recoverable		**9**	17
Other financial assets	10	**47**	36
Short-term investments		**7**	3
Cash and cash equivalents		**4,379**	2,953
Current assets		**14,870**	13,238
Assets held for sale	14	**829**	7
TOTAL ASSETS		**30,071**	27,873
LIABILITIES			
Borrowings		**(797)**	(82)
Other financial liabilities	10	**(768)**	(601)
Trade and other payables		**(10,183)**	(11,653)
Current tax liabilities		**(141)**	(209)
Provisions for liabilities and charges [1]		**(843)**	(495)
Current liabilities		**(12,732)**	(13,040)
Borrowings		**(3,644)**	(3,406)
Other financial liabilities	10	**(2,694)**	(2,458)
Trade and other payables		**(7,195)**	(5,433)
Deferred tax liabilities		**(485)**	(565)
Provisions for liabilities and charges [1]		**(782)**	(373)
Post-retirement scheme deficits	11	**(1,306)**	(1,387)
Non-current liabilities		**(16,106)**	(13,622)
Liabilities associated with assets held for sale	14	**(463)**	–
TOTAL LIABILITIES		**(29,301)**	(26,662)
NET ASSETS		**770**	1,211
EQUITY			
Called-up share capital		**374**	368
Share premium account		**435**	195
Capital redemption reserve		**162**	162
Cash flow hedging reserve		**(103)**	(112)
Other reserves		**687**	660
Retained earnings		**(804)**	(65)
Equity attributable to ordinary shareholders		**751**	1,208
Non-controlling interests		**19**	3
TOTAL EQUITY		**770**	1,211

***** The prior period has been restated for IFRS 15 *Revenue from Contracts with Customers*, an interim update to the provisional fair values of the ITP Aero acquisition and other adjustments. See note 16 for more details.

[1] Explanation for the movement in provisions for liabilities and charges can be found on page 21.

Condensed consolidated cash flow statement

For the half-year ended 30 June 2018

	Notes	Half-year to 30 June 2018 £m	Restated* Half-year to 30 June 2017 £m	Restated* Year to 31 December 2017 £m
Reconciliation of cash flows from operating activities				
Operating (loss)/profit		**(775)**	(103)	366
Loss on disposal of property, plant and equipment		**(11)**	6	11
Share of results of joint ventures and associates		**(52)**	(51)	(131)
Dividends received from joint ventures and associates		**46**	28	79
Amortisation and impairment of intangible assets	8	**325**	172	345
Depreciation and impairment of property, plant and equipment	9	**239**	221	450
Impairment of investments		**–**	–	14
Increase/(decrease) in provisions		**814**	(30)	77
Increase in inventories		**(427)**	(428)	(196)
Increase in trade and other receivables		**(287)**	(482)	(291)
Decrease in amounts payable for financial penalties from agreements with investigating bodies		**–**	(267)	(286)
Other increase in trade and other payables		**997**	1,374	1,893
Cash flows on other financial assets and liabilities held for operating purposes		**(261)**	(340)	(663)
Net defined benefit post-retirement cost recognised in profit before financing	11	**118**	118	240
Cash funding of defined benefit post-retirement schemes	11	**(87)**	(130)	(249)
Share-based payments		**22**	15	33
Net cash inflow from operating activities before taxation		**661**	103	1,692
Taxation paid		**(77)**	(71)	(180)
Net cash inflow from operating activities		**584**	32	1,512
Cash flows from investing activities				
Additions of unlisted investments		**(4)**	–	(4)
Additions of intangible assets	8	**(327)**	(213)	(647)
Disposals of intangible assets		**2**	-	7
Purchases of property, plant and equipment	9	**(343)**	(389)	(801)
Government grants received		**1**	3	14
Disposals of property, plant and equipment		**60**	9	4
Acquisition of business		**–**	–	263
Consolidation of previously unconsolidated subsidiary		**–**	–	1
Reclassification of joint operations to subsidiaries		**4**	–	–
Disposal of business	14	**584**	–	–
Other investments in joint ventures and associates		**–**	(8)	(48)
Net cash outflow from investing activities		**(23)**	(598)	(1,211)
Cash flows from financing activities				
Repayment of loans	10	**(5)**	(5)	(166)
Proceeds from increase in loans and finance leases		**969**	280	366
Capital element of finance lease payments		**(8)**	(1)	-
Net cash flow from increase in borrowings and finance leases		**956**	274	200
Interest received		**11**	3	14
Interest paid		**(47)**	(36)	(64)
Interest element of finance lease payments		**–**	-	(3)
Increase in short-term investments		**(4)**	-	-
Issue of ordinary shares (net of expenses)		**–**	20	21
Purchase of ordinary shares - other		**–**	(22)	(24)
Redemption of C Shares		**(85)**	(85)	(214)
Net cash inflow/(outflow) from financing activities		**831**	154	(70)
Change in cash and cash equivalents		**1,392**	(412)	231
Cash and cash equivalents at 1 January		**2,933**	2,771	2,771
Exchange gains/(losses) on cash and cash equivalents		**33**	(25)	(69)
Cash and cash equivalents at period end **		**4,358**	2,334	2,933

***** The prior period has been restated for IFRS 15 *Revenue from Contracts with Customers*, an interim update to the provisional fair values of the ITP Aero acquisition and other adjustments. See note 16 for more details.

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

Condensed consolidated cash flow statement continued

	Half-year to 30 June 2018 £m	Restated* Half-year to 30 June 2017 £m	Restated* Year to 31 December 2017 £m
Reconciliation of movements in cash and cash equivalents to movements in net funds			
Change in cash and cash equivalents	**1,392**	(412)	231
Cash flow from increase in borrowings and finance leases	**(956)**	(274)	(200)
Cash flow from increase in short-term investments	**4**	–	–
Change in net funds resulting from cash flows	**440**	(686)	31
Net funds (excluding cash and cash equivalents) on acquisition of ITP Aero	**–**	–	(34)
Net funds (excluding cash and cash equivalents) of previously unconsolidated subsidiary	**–**	–	(18)
Exchange gains/(losses) on net funds	**30**	(20)	(59)
Fair value adjustments	**7**	56	131
Movement in net funds	**477**	(650)	51
Net funds at 1 January excluding the fair value of swaps	**(532)**	(583)	(583)
Net funds at period end excluding the fair value of swaps	**(55)**	(1,233)	(532)
Fair value of swaps hedging fixed rate borrowings	**220**	302	227
Net funds at period end	**165**	(931)	(305)

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

	At 1 January 2018 £m	Funds flow £m	Exchange differences £m	Fair value adjustments £m	Reclass-ifications* £m	At 30 June 2018 £m
Cash at bank and in hand	**838**	**17**	**4**	**–**	**4**	**863**
Money market funds	**589**	**641**	**3**	**–**	**–**	**1,233**
Short-term deposits	**1,526**	**731**	**26**	**–**	**–**	**2,283**
Cash and cash equivalents (as per reported balance sheet)	**2,953**	**1,389**	**33**	**–**	**4**	**4,379**
Overdrafts	**(20)**	**(1)**	**–**	**–**	**–**	**(21)**
Cash and cash equivalents (per cash flow statement)	**2,933**	**1,388**	**33**	**–**	**4**	**4,358**
Short-term investments	**3**	**4**	**–**	**–**		**7**
Other current borrowings	**(39)**	**5**	**–**	**8**	**(724)**	**(750)**
Non-current borrowings	**(3,292)**	**(969)**	**1**	**(1)**	**724**	**(3,537)**
Finance leases	**(137)**	**8**	**(4)**	**–**	**–**	**(133)**
Financial liabilities	**(3,468)**	**(956)**	**(3)**	**7**	**–**	**(4,420)**
Net funds excluding the fair value of swaps	**(532)**	**436**	**30**	**7**	**4**	**(55)**
Fair value of swaps hedging fixed rate borrowings	**227**			**(7)**		**220**
Net funds	**(305)**	**436**	**30**	**–**	**4**	**165**

* Reclassifications relate predominantly to the movement of non-current borrowings to current borrowings as maturity dates approach.

Condensed consolidated statement of changes in equity

For the half-year ended 30 June 2018

	Attributable to ordinary shareholders								
	Share capital	Share premium	Capital redemption reserve	Cash flow hedging reserve	Other reserves [2]	Retained earnings [3]	Total	Non-controlling interests	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2017 as previously reported	367	181	162	(107)	814	445	1,862	2	1,864
Impact of adopting IFRS 15 [1]	–	–	–	–	(19)	(4,445)	(4,464)	–	(4,464)
Other [1]	–	–	–	–	–	43	43	–	43
At 1 January 2017 restated [1]	367	181	162	(107)	795	(3,957)	(2,559)	2	(2,557)
Profit for the period	–	–	–	–	–	3,663	3,663	1	3,664
Foreign exchange translation differences on foreign operations	–	–	–	–	(136)	–	(136)	–	(136)
Movement on post-retirement schemes	–	–	–	–	–	735	735	–	735
Share of other comprehensive income of joint ventures and associates	–	–	–	(5)	–	(1)	(6)	–	(6)
Related tax movements	–	–	–	–	1	(307)	(306)	–	(306)
Total comprehensive income for the year	–	–	–	(5)	(135)	4,090	3,950	1	3,951
Arising on issue of ordinary shares	1	14	–	–	–	(14)	1	–	1
Issue of C Shares	–	–	(215)	–	–	1	(214)	–	(214)
Redemption of C Shares	–	–	215	–	–	(215)	–	–	–
Ordinary shares purchased	–	–	–	–	–	(24)	(24)	–	(24)
Share-based payments – direct to equity [4]	–	–	–	–	–	51	51	–	51
Related tax movements	–	–	–	–	–	3	3	–	3
Other changes in equity in the year	1	14	–	–	–	(198)	(183)	–	(183)
At 31 December 2017	368	195	162	(112)	660	(65)	1,208	3	1,211
Impact of adopting IFRS 9	–	–	–	–	–	(15)	(15)	–	(15)
At 1 January 2018 including the impact of IFRS 9	**368**	**195**	**162**	**(112)**	**660**	**(80)**	**1,193**	**3**	**1,196**
Profit for the period	**–**	**–**	**–**	**–**	**–**	**(962)**	**(962)**	**2**	**(960)**
Foreign exchange translation differences on foreign operations	**–**	**–**	**–**	**–**	**47**	**–**	**47**	**–**	**47**
Reclassification to income statement on disposal of business	**–**	**–**	**–**	**–**	**(19)**	**–**	**(19)**	**–**	**(19)**
Movement on post-retirement schemes	**–**	**–**	**–**	**–**	**–**	**451**	**451**	**–**	**451**
Share of other comprehensive income of joint ventures and associates	**–**	**–**	**–**	**9**	**(1)**	**–**	**8**	**–**	**8**
Related tax movements	**–**	**–**	**–**	**–**	**–**	**(154)**	**(154)**	**–**	**(154)**
Total comprehensive income for the period	**–**	**–**	**–**	**9**	**27**	**(665)**	**(629)**	**2**	**(627)**
Arising on issues of ordinary shares [5]	**6**	**240**	**–**	**–**	**–**	**–**	**246**	**–**	**246**
Issue of C Shares	**–**	**–**	**(85)**	**–**	**–**	**–**	**(85)**	**–**	**(85)**
Redemption of C Shares	**–**	**–**	**85**	**–**	**–**	**(85)**	**–**	**–**	**–**
Share-based payments – direct to equity [4]	**–**	**–**	**–**	**–**	**–**	**22**	**22**	**–**	**22**
Reclassification of joint operations to subsidiaries	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**15**	**15**
Transactions with non-controlling interest	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(1)**	**(1)**
Related tax movements	**–**	**–**	**–**	**–**	**–**	**4**	**4**	**–**	**4**
Other changes in equity in the period	**6**	**240**	**–**	**–**	**–**	**(59)**	**187**	**14**	**201**
At 30 June 2018	**374**	**435**	**162**	**(103)**	**687**	**(804)**	**751**	**19**	**770**

[1] The prior period has been restated for IFRS 15 *Revenue from Contracts with Customers*, an interim update to the provisional fair values of the ITP Aero acquisition and other adjustments. See note 16 for more details.

[2] Other reserves include a merger reserve of £3m and a translation reserve of £684m.

[3] At 30 June 2018, 6,347,623 ordinary shares with a book value of £51m were held for the purposes of share-based payment plans and included in retained earnings. During the period, 153,281 ordinary shares with a net book value of £1m vested in share-based payment plans and the Company acquired 34,801 of its ordinary shares via reinvestment of dividends received on its own shares.

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

[5] Share premium on shares issued relate to the payment of the first three instalments for the acquisition of ITP Aero.

Notes to the half-year financial statements

1 Basis of preparation and accounting policies

Reporting entity
Rolls-Royce Holdings plc is a company incorporated and domiciled in the UK. These condensed consolidated half-year financial statements of the Company as at and for the six months ended 30 June 2018 comprises 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 2017 (Annual Report 2017) are available upon request from the Company Secretary, Rolls-Royce Holdings plc, 62 Buckingham Gate, London SW1E 6AT.

The Board of directors approved the condensed consolidated half-year financial statements on 2 August 2018.

Statement of compliance
These condensed consolidated half-year financial statements have been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the European Union. They do not include all of the information required for full annual statements, and should be read in conjunction with the 2017 Annual Report.

The comparative, unaudited figures for the financial year 31 December 2017 are not the Group's statutory accounts for that financial year. The interim figures up to 30 June 2018 and 2017 are unaudited. The 2017 financial statements have been reported on by the Group's previous auditors and delivered to the registrar of companies. 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.

Change of auditor
On 3 May 2018, following changes in the legislation requiring mandatory rotation of the audit firm the Group appointed PricewaterhouseCoopers LLP as the company's auditor.

Significant accounting policies
Except for the adoption of IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments, the accounting policies applied by the Group in these condensed consolidated half-year financial statements are the same as those that were applied to the consolidated financial statements of the Group for the year ended 31 December 2017 (International Financial Reporting Standards issued by the International Accounting Standards Board (IASB), as adopted for use in the EU effective at 31 December 2017).

The prior period has been restated for IFRS 15 *Revenue from Contracts with Customers*, an interim update to the provisional fair values of the ITP Aero acquisition and other adjustments. See note 16 for more details.

IFRS 15 *Revenue from Contracts with Customers*
The Group adopted IFRS 15 on 1 January 2018 using the 'full' retrospective approach.

IFRS 15 provides a single, principles based five-step model to be applied to all sales contracts. It is based on the transfer of control of goods and services to customers. In summary:

- Revenues on original equipment (OE) and time and material aftermarket contracts are generally recognised at the point of delivery;

- Revenues on long-term aftermarket contracts and some OE contracts (generally for products without an alternative use to the specific contract) are recognised on an activity basis using the costs incurred as the measure of the activity; and

- Costs are recognised as they are incurred.

Accounting policy
Revenue recognised comprises sales to the Group's customers after discounts and amounts payable to customers. It excludes value added taxes. The Group has elected to use the practical expedient not to adjust revenue for the effect of financing components where the expectation is that the period between the transfer of goods and services to customers and the receipt of payment is less than a year.

Sales of standard OE, spare parts and time and material overhaul services are generally recognised on delivery to the customer, unless the specific contractual terms indicate a different point.

Sales of services and OE specifically designed for the contract are recognised by reference to the progress towards completion of the performance obligation provided the outcome of contracts can be assessed with reasonable certainty.

- The Group generates a considerable proportion of its revenue and profit from aftermarket arrangements. These aftermarket contracts, such as TotalCare and CorporateCare agreements in Civil Aerospace, cover a range of services and generally have contractual terms covering more than one year. Under these contracts, the Group's primary obligation is to maintain customers' equipment in an operational condition and this is achieved by undertaking various activities, such as repair, overhaul and engine monitoring over the period of the contract. Revenue on these contracts is recognised over the period of the contract and the measure of progress is a matter of judgement. The stage of completion of the contract is best measured by using the actual costs incurred to date compared to the estimated costs to complete the performance obligations, as this reflects the extent of completion of the activities performed.

- The estimated revenue and costs under such agreements are inherently imprecise and significant estimates are required to take into account uncertainties relating to: (i) the forecast utilisation of the engines by the operator and related pricing; (ii) payments due to the customer that are either contractual and based on measures of performance or that could reasonably be expected to have been reflected in the contract price; (iii) the frequency of engine overhauls where the principal variables are the operating parameters of the engine and operational lives of components; and (iv) the forecast costs to maintain the engines in accordance with the contractual requirements where the cost of each overhaul is dependent on the required work-scope and the cost of parts and labour at the time.

- Future variable revenue is constrained to take account of the risk of non-recovery of resulting contract balances from reduced utilisation e.g. engine flying hours, based on historical forecasting experience, the risk of aircraft being parked by the customer and the customer's creditworthiness.

- A significant amount of revenue and cost is denominated in currencies other than that of the relevant Group undertaking. These are translated at estimated long-term exchange rates.

- The assessment of stage of completion is generally measured for each contract. However, in certain cases, such as for CorporateCare agreements where there are many contracts covering aftermarket services, each for a small number of engines, the Group accounts for a portfolio of contracts together as the effects on the Condensed Financial Statements would not differ materially from applying the standard to the individual contracts in the portfolio. When accounting for a portfolio of long-term service arrangements the Group uses estimates and assumptions that reflect the size and composition of the portfolio.

- A contract asset/liability is recognised where payment is received in arrears/advance of the costs incurred to meet performance obligations.

- In rare circumstances we may incur costs of wasted material, labour or other resources to fulfil a contract where the level of cost was not reflected in the contract price, these are expensed when the trigger to incur these costs arises. The identification of such costs is a matter of judgement and would only be expected to arise where there has been a series of abnormal events which give rise to a significant level of cost which is also of a nature we would not expect to incur and hence is not reflected in the contract price. For example, where we have technical issues that require resolution to meet regulatory requirements; have a wide-ranging impact across a product type; and cause significant operational disruption to customers. Similarly, in these rare circumstances, significant disruption costs to support customers resulting from the actual performance of a delivered good or service may be treated as a warranty type cost in the period. Where material these costs are recorded as an exceptional non-underlying expense.

The Group has paid participation fees to airframe manufacturers, its customers for OE on certain programmes. Amounts paid are initially treated as contract assets within trade and other receivables and subsequently charged as a reduction to the OE revenue when it is transferred to the customer over the estimated number of units to be delivered. This estimate of the number of units may change over the course of the programme.

In assessing the accounting for the participation fee payments we make to our OE customers, we have also assessed the accounting for up-front payments we sometimes receive from the Group's suppliers under RRSAs to allow them to participate in an engine programme. These receipts are deferred and recognised against cost of sales over the estimated number of units to be delivered.

The Group has elected to use the practical expedient to expense as incurred any incremental costs of obtaining or fulfilling a contract if the amortisation period of an asset created would have been one year or less. Where costs to obtain a contract are capitalised, they are amortised over the performance of the related contract.

IFRS 9 *Financial Instruments*

The Group adopted IFRS 9 on 1 January 2018. IFRS 9 relates to the accounting for financial instruments and covers: classification and measurement; impairment; and hedge accounting. Except for hedge accounting, retrospective application is required with any adjustment being made to reserves on 1 January 2018. The Group has not restated its 2017 comparative information.

The Group has adopted the simplified approach to provide for losses on receivables and contract assets resulting from transactions within the scope of IFRS 15 applying credit ratings and business information to determine the expected credit losses on receivables. The adoption of the expected credit loss approach has not resulted in a significant impairment loss for trade receivables as at 30 June 2018.

IFRS 16 *Leases*

IFRS 16 (effective for the year beginning 1 January 2019) will require all leases to be recognised on the balance sheet. Currently, IAS 17 Leases only requires leases categorised as finance leases to be recognised on the balance sheet.

The Group is progressing well in its analysis of how IFRS 16 should be implemented and is developing the data-set, systems and processes that will be required. The most significant leases, by value, relate to property and aircraft engines. The Group expects to apply the standard retrospectively with the cumulative effect of initial application recognised on 1 January 2019. Under this approach the Group will not restate comparative periods.

In broad terms the impact of the standard will be to:

- recognise an additional lease liability equivalent to the present value of the lease commitments at the date of transition. Further work is required to validate the contracts which will represent leases under IFRS 16, including ongoing consideration of some supply chain contracts. The Group is also considering whether there are any re-assessments of lease term required and the discount rate to be applied. Under the expected transition option, payments will be discounted using incremental borrowing rates at 1 January 2019. The Group holds some leases in non-functional currencies where the value of the lease liability will be dependent on spot exchange rates on transition; and

- recognise a right-of-use asset measured either: as if the standard had applied since commencement of the lease; or at an amount equal to the lease liability on transition.

Research and development
In the Annual Report 2017 the Group announced a change in estimate to amortise programme assets on a 15 year straight-line basis pro rata over the estimated number of units produced. This approach has been applied prospectively from 1 January 2018.

Following a review of progress on Civil Aerospace programmes, from 1 July 2017 the point at which the criteria for capitalisation is met, was moved one gate earlier than in the past. If this had been in place from 1 January 2017, an additional £129m of expenditure would have been capitalised in the first half of 2017.

The Group does not consider that any other standards, amendments or interpretations issued by the IASB, but not yet applicable will have a significant impact on the Financial Statements.

2 Analysis by business segment

The analysis by Divisions (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).

Civil	development, manufacture, marketing and sales of commercial aero engines and aftermarket services.
Defence	development, manufacture, marketing and sales of military aero engines, naval engines, submarines and aftermarket services.
Power Systems	development, manufacture, marketing and sales of reciprocating engines, power systems and nuclear systems for civil power generation.
ITP Aero	design, research and development, manufacture and casting, assembly and test of aeronautical engines and gas turbines.

In 2017, the Group had five operating segments; Civil Aerospace, Defence, RRPS, Marine and Nuclear. Following the decision to simplify the Group, announced on 17 January 2018, the Group now has four operating segments as set out above. These are referred to collectively as the “Core Businesses”. Non-core businesses includes the results of L’Orange until the date of its disposal on 1 June 2018 (see note 14), the trading results of Commercial Marine through 30 June 2018 (from which date the business has been classified as held for sale), and other smaller businesses including Retained Energy. The 2017 segmental analysis has been presented on a consistent basis with the new segmental structure.

Underlying results are presented to reflect the economic impact of the Group’s foreign exchange risk management activities and exclude significant items of a one-off nature. Trading transactions are valued at the exchange rates achieved on the derivative contracts settled to cover the net exposures.

In addition to the impact of exchange rates on trading above, the reported results are adjusted for:

Operating profit
- one-off past service costs or credits on post-retirement schemes;
- exceptional restructuring costs (associated with the substantial closure or exit of a site, facility or line of business or other major transformation activities);
- the effect of acquisition accounting and business disposals;
- the impairment of goodwill and other assets arising on acquisition;

Financing
- amounts realised from settled derivative contracts and revaluation of relevant assets and liabilities to exchange rates forecast to be achieved from future settlement of derivative contracts;
- unrealised amounts arising from revaluations required by IFRS 9 Financial Instruments; and
- the net impact of financing costs related to post-retirement scheme benefits.

Taxation – the tax effect of the adjustments above are excluded from the underlying tax charge. In addition, changes in the amount of recoverable advance corporation tax recognised are also excluded.

This analysis also includes a reconciliation of the underlying results to those reported in the condensed consolidated income statement.

	Civil £m	Defence £m	Power Systems £m	ITP £m	Corporate £m	Inter-Segment £m	Core Businesses £m
For the half-year ended 30 June 2018							
Underlying revenue from sale of original equipment	**1,530**	**608**	**945**	**336**	**–**	**(172)**	**3,247**
Underlying revenue from aftermarket services	**2,070**	**807**	**526**	**39**	**–**	**(9)**	**3,433**
Total underlying revenue	**3,600**	**1,415**	**1,471**	**375**	**–**	**(181)**	**6,680**
Gross profit	**148**	**281**	**354**	**85**	**–**	**2**	**870**
Commercial and administrative costs	**(157)**	**(77)**	**(188)**	**(31)**	**(26)**	**–**	**(479)**
Research and development costs	**(152)**	**(44)**	**(86)**	**(14)**	**–**	**–**	**(296)**
Share of results of joint ventures and associates	**49**	**2**	**–**	**–**	**–**	**–**	**51**
Underlying operating profit/(loss)	**(112)**	**162**	**80**	**40**	**(26)**	**2**	**146**
For the half-year ended 30 June 2017 (restated)*							
Underlying revenue from sale of original equipment	1,151	629	814	–	–	–	2,594
Underlying revenue from aftermarket services	1,707	849	461	–	–	–	3,017
Total underlying revenue	2,858	1,478	1,275	–	–	–	5,611
Gross profit	137	292	283	–	–	–	712
Commercial and administrative costs	(155)	(83)	(172)	–	(26)	–	(436)
Research and development costs	(280)	(32)	(84)	–	–	–	(396)
Share of results of joint ventures and associates	48	3	(1)	–	–	–	50
Underlying operating profit/(loss)	(250)	180	26	–	(26)	–	(70)
Year ended 31 December 2017 (restated)*							
Underlying revenue from sale of original equipment	2,890	1,398	1,956	–	–	–	6,244
Underlying revenue from aftermarket services	3,708	1,782	1,052	–	–	–	6,542
Total underlying revenue	6,598	3,180	3,008	–	–	–	12,786
Gross profit	371	728	797	–	–	–	1,896
Commercial and administrative costs	(373)	(192)	(351)	–	(55)	–	(971)
Research and development costs	(454)	(89)	(181)	–	–	–	(724)
Share of results of joint ventures and associates	113	7	(4)	–	–	–	116
Underlying operating profit/(loss)	(343)	454	261	–	(55)	–	317

***** The prior periods have been restated for IFRS 15 *Revenue from Contracts with Customers*, an interim update to the provisional fair values of the ITP Aero acquisition and other adjustments. See note 16 for more details.

Reconciliation to reported results

	Core Businesses £m	Non-Core Businesses [1] £m	Total underlying £m	Underlying adjustments and adjustments to foreign exchange £m	Group results at actual exchange rates £m
For the half-year ended 30 June 2018					
Revenue from sale of original equipment	**3,247**	**177**	**3,424**	**196**	**3,620**
Revenue from aftermarket services	**3,433**	**183**	**3,616**	**251**	**3,867**
Total revenue	**6,680**	**360**	**7,040**	**447**	**7,487**
Gross profit	**870**	**109**	**979**	**(723)**	**256**
Commercial and administrative costs	**(479)**	**(92)**	**(571)**	**(152)**	**(723)**
Research and development costs	**(296)**	**(22)**	**(318)**	**(42)**	**(360)**
Share of results of joint ventures and associates	**51**	**–**	**51**	**1**	**52**
Operating profit/(loss)	**146**	**(5)**	**141**	**(916)**	**(775)**
Gain arising on disposal of L'Orange				**358**	**358**
Profit/(loss) before financing and taxation	**146**	**(5)**	**141**	**(558)**	**(417)**
Net financing			**(68)**	**(777)**	**(845)**
Profit/(loss) before taxation			**73**	**(1,335)**	**(1,262)**
Taxation			**(25)**	**327**	**302**
Profit/(loss) for the period			**48**	**(1,008)**	**(960)**
Attributable to:					
Ordinary shareholders			**46**	**(1,008)**	**(962)**
Non-controlling interests			**2**	**–**	**2**

Reconciliation to reported results continued **For the half-year ended 30 June 2017 (restated)***	**Core Businesses £m**	**Non-Core Businesses [1] £m**	**Total underlying £m**	**Underlying adjustments and adjustments to foreign exchange £m**	**Group results at actual exchange rates £m**
Revenue from sale of original equipment	2,594	233	2,827	291	3,118
Revenue from aftermarket services	3,017	197	3,214	324	3,538
Total revenue	5,611	430	6,041	615	6,656
Gross profit	712	120	832	23	855
Commercial and administrative costs	(436)	(99)	(535)	(17)	(552)
Research and development costs	(396)	(28)	(424)	(33)	(457)
Share of results of joint ventures and associates	50	(7)	43	8	51
Operating profit/(loss)	(70)	(14)	(84)	(19)	(103)
Net financing			(59)	1,606	1,547
Profit/(loss) before taxation			(143)	1,587	1,444
Taxation			(5)	(267)	(272)
Profit for the period			(148)	1,320	1,172
Attributable to:					
Ordinary shareholders			(148)	1,320	1,172
Non-controlling interests			–	–	–

Year ended 31 December 2017 (restated)*					
Revenue from sale of original equipment	6,244	504	6,748	520	7,268
Revenue from aftermarket services	6,542	381	6,923	623	7,546
Total revenue	12,786	885	13,671	1,143	14,814
Gross profit	1,896	248	2,144	156	2,300
Commercial and administrative costs	(971)	(197)	(1,168)	(54)	(1,222)
Research and development costs	(724)	(52)	(776)	(67)	(843)
Share of results of joint ventures and associates	116	(10)	106	25	131
Operating profit/(loss)	317	(11)	306	60	366
Gains arising on the acquisition of ITP Aero	–	–	–	1,066	1,066
Profit before financing and taxation	317	(11)	306	1,126	1,432
Net financing			(107)	2,854	2,747
Profit before taxation			199	3,980	4,179
Taxation			(155)	(360)	(515)
Profit for the year			44	3,620	3,664
Attributable to:					
Ordinary shareholders			43	3,620	3,663
Non-controlling interests			1	–	1

***** The prior periods have been restated for IFRS 15 *Revenue from Contracts with Customers*, an interim update to the provisional fair values of the ITP Aero acquisition and other adjustments. See note 16 for more details.

[1] Includes Commercial Marine (held for sale from 30 June 2018), L'Orange sold on 1st June and other smaller non-core businesses.

Disaggregation of revenue from contracts with customers

	Civil £m	Defence £m	Power Systems £m	ITP £m	Corporate £m	Inter-Segment £m	Core Businesses £m
For the half-year ended 30 June 2018							
Original equipment recognised at a point in time	1,530	281	905	336	–	(172)	2,880
Original equipment recognised over time	–	327	40	–	–	–	367
Aftermarket services recognised at a point in time	670	336	448	39	–	(28)	1,465
Aftermarket services recognised over time	1,384	471	78	–	–	19	1,952
Total underlying customer contract revenue	**3,584**	**1,415**	**1,471**	**375**	**–**	**(181)**	**6,664**
Other underlying revenue	16	–	–	–	–	–	16
Total underlying revenue	**3,600**	**1,415**	**1,471**	**375**	**–**	**(181)**	**6,680**
For the half-year ended 30 June 2017							
Original equipment recognised at a point in time	1,151	296	804	–	–	–	2,251
Original equipment recognised over time	–	333	10	–	–	–	343
Aftermarket services recognised at a point in time	438	381	399	–	–	–	1,218
Aftermarket services recognised over time	1,258	468	62	–	–	–	1,788
Total underlying customer contract revenue	**2,847**	**1,478**	**1,275**	**–**	**–**	**–**	**5,600**
Other underlying revenue	11	–	–	–	–	–	11
Total underlying revenue	**2,858**	**1,478**	**1,275**	**–**	**–**	**–**	**5,611**
Year ended 31 December 2017							
Original equipment recognised at a point in time	2,890	682	1,931	–	–	–	5,503
Original equipment recognised over time	–	716	25	–	–	–	741
Aftermarket services recognised at a point in time	1,077	829	929	–	–	–	2,835
Aftermarket services recognised over time	2,595	953	123	–	–	–	3,671
Total underlying customer contract revenue	**6,562**	**3,180**	**3,008**	**–**	**–**	**–**	**12,750**
Other underlying revenue	36	–	–	–	–	–	36
Total underlying revenue	**6,598**	**3,180**	**3,008**	**–**	**–**	**–**	**12,786**

	Core Businesses £m	Non-Core Businesses £m	Total underlying £m	Underlying adjustments and adjustments to foreign exchange £m	Group results at actual exchange rates £m
For the half-year ended 30 June 2018					
Original equipment recognised at a point in time	2,880	36	2,916	195	3,111
Original equipment recognised over time	367	141	508	1	509
Aftermarket services recognised at a point in time	1,465	183	1,648	113	1,761
Aftermarket services recognised over time	1,952	–	1,952	138	2,090
Total customer contract revenue	**6,664**	**360**	**7,024**	**447**	**7,471**
Other revenue	16	–	16	–	16
Total revenue	**6,680**	**360**	**7,040**	**447**	**7,487**
For the half-year ended 30 June 2017					
Original equipment recognised at a point in time	2,251	42	2,293	291	2,584
Original equipment recognised over time	343	191	534	–	534
Aftermarket services recognised at a point in time	1,218	197	1,415	187	1,602
Aftermarket services recognised over time	1,788	–	1,788	132	1,920
Total customer contract revenue	**5,600**	**430**	**6,030**	**610**	**6,640**
Other revenue	11	–	11	5	16
Total revenue	**5,611**	**430**	**6,041**	**615**	**6,656**
Year ended 31 December 2017					
Original equipment recognised at a point in time	5,503	106	5,609	520	6,129
Original equipment recognised over time	741	398	1,139	–	1,139
Aftermarket services recognised at a point in time	2,835	373	3,208	232	3,440
Aftermarket services recognised over time	3,671	8	3,679	391	4,070
Total customer contract revenue	**12,750**	**885**	**13,635**	**1,143**	**14,778**
Other revenue	36	–	36	–	36
Total revenue	**12,786**	**885**	**13,671**	**1,143**	**14,814**

	Total assets		Total liabilities		Net assets/(liabilities)	
	30 June 2018 £m	31 December 2017* £m	**30 June 2018 £m**	31 December 2017* £m	**30 June 2018 £m**	31 December 2017* £m
Civil	**14,352**	13,668	**(18,743)**	(16,876)	**(4,391)**	(3,208)
Defence	**2,156**	2,155	**(2,515)**	(2,549)	**(359)**	(394)
Power Systems	**3,585**	3,771	**(1,461)**	(1,388)	**2,124**	2,383
ITP	**2,308**	2,286	**(963)**	(1,010)	**1,345**	1,276
Corporate	**–**	–	**–**	–	**–**	–
Inter-segment	**(1,373)**	(1,424)	**1,373**	1,424	**–**	–
Core Businesses	**21,028**	20,456	**(22,309)**	(20,399)	**(1,281)**	57
Non-core Businesses	**969**	1,250	**(619)**	(614)	**350**	636
Net funds	**4,606**	3,183	**(4,441)**	(3,488)	**165**	(305)
Tax assets/(liabilities)	**947**	859	**(626)**	(774)	**321**	85
Post-retirement scheme surpluses/(deficits)	**2,521**	2,125	**(1,306)**	(1,387)	**1,215**	738
	30,071	27,873	**(29,301)**	(26,662)	**770**	1,211

Underlying revenue adjustments	**Half-year to 30 June 2018 £m**	Restated half-year to 30 June 2017* £m	Restated year to 31 December 2017* £m
Underlying revenue	**7,040**	6,041	13,671
Recognise revenue at exchange rate on date of transaction	**447**	615	1,143
Revenue per consolidated income statement	**7,487**	6,656	14,814

* The prior period has been restated for IFRS 15 *Revenue from Contracts with Customers*, an interim update to the provisional fair values of the ITP Aero acquisition and other adjustments. See note 16 for more details.

Underlying profit adjustments	**Half-year to 30 June 2018**			Restated* half-year to 30 June 2017			Restated* year to 31 December 2017		
	Profit before financing £m	**Net financing £m**	**Taxation £m**	Profit before financing £m	Net financing £m	Taxation £m	Profit before financing £m	Net financing £m	Taxation £m
Underlying performance	**141**	**(68)**	**(25)**	(84)	(59)	(5)	306	(107)	(155)
Realised losses/(gains) on settled derivative contracts [1]	**207**	**33**	**(40)**	211	131	(57)	453	195	(111)
Net unrealised fair value changes to derivative contracts [2]	**1**	**(815)**	**134**	8	1,391	(249)	24	2,648	(463)
Effect of currency on contract accounting	**(30)**	**–**	**15**	(137)	–	39	(153)	–	31
Revaluation of trading assets and liabilities [7]	**(75)**	**(4)**	**7**	(4)	82	(11)	(6)	1	(17)
Financial RRSAs – exchange differences and changes in forecast payments	**–**	**(2)**	**–**	–	4	(1)	–	11	(3)
Effect of acquisition accounting	**(124)**	**–**	**52**	(62)	–	18	(129)	–	35
Impairment of goodwill [5]	**(160)**	**–**	**–**	–	–	–	–	–	–
Net post-retirement scheme financing	**–**	**11**	**(5)**	–	(1)	–	–	1	(1)
Disposal of business [6]	**358**	**–**	**(8)**	–	–	–	–	–	–
Exceptional restructuring [3, 7]	**(179)**	**–**	**37**	(31)	–	9	(104)	–	31
Trent 1000 exceptional charge [7]	**(554)**	**–**	**100**	–	–	–	–	–	–
Gain arising on the acquisition of ITP Aero	**–**	**–**	**–**	–	–	–	1,066	–	–
Consolidation of previously non-consolidated subsidiary	**–**	**–**	**–**	–	–	–	(12)	–	–
Other	**(2)**	**–**	**(19)**	(4)	(1)	(15)	(13)	(2)	25
Recognition of advance corporation tax	**–**	**–**	**–**	–	–	–	–	–	163
Reduction in corporation tax rates [4]	**–**	**–**	**54**	–	–	–	–	–	(50)
Total underlying adjustments	**(558)**	**(777)**	**327**	(19)	1,606	(267)	1,126	2,854	(360)
Reported per consolidated income statement	**(417)**	**(845)**	**302**	(103)	1,547	(272)	1,432	2,747	(515)

* The prior period has been restated for IFRS 15 *Revenue from Contracts with Customers*, an interim update to the provisional fair values of the ITP Aero acquisition and other adjustments. See note 16 for more details.

1 The adjustments for realised losses/(gains) on settled derivative contracts include adjustments to reflect the losses/(gains) in the same period as the related trading cash flows.

2 The adjustments for unrealised fair value changes to derivative contracts include those included in equity accounted joint ventures and exclude those for which the related trading contracts have been cancelled when the fair value changes are recognised immediately in underlying profit.

3 Restructuring is excluded from underlying performance when it concerns the closure of a significant business or site or a fundamental reorganisation of the business.

4 The 2018 reduction in corporation tax rates relates to the reduction in the Spanish Basque region tax rate. The 2017 full year comparative relates to the reduction in the Federal tax rate in the US.

5 Relates to the impairment of Commercial Marine goodwill following a review of the carrying value to fair value less costs to sell (note 14).

6 Gain on disposal of L'Orange business to Woodward Inc. on 1 June 2018 (note 14).

[7] **Exceptional charges**

	Half-year to 30 June 2018 £m	Half-year to 30 June 2017 £m	Year to 31 December 2017 £m
Restructuring	**179**	31	104
Trent 1000 abnormal costs	**554**	–	–
Foreign exchange	**95**	–	–
	828	31	104

The Group recorded an exceptional restructuring charge of £179m (2017 half-year: £31m) in the period. The costs include: £132m in respect of the Group wide restructuring programme announced on 14 June 2018; costs relating to ongoing multi-year significant restructuring programmes including restructuring at Power Systems (RRPS2018) and in respect of Defence, reflecting actions to remove cost and improve operational efficiency.

An exceptional charge was made in respect of the Trent 1000 costs of £554m at the achieved exchange rate. The balance sheet provision has been recorded at the prevailing spot rate on 30 June 2018 resulting in foreign exchange of £95m, which has been included in Cost of Sales.

3 Research and development

	Half-year to 30 June 2018 £m	Half-year to 30 June 2017 £m	Year to 31 December 2017 £m
Expenditure in the period	**(542)**	(465)	(1,041)
Capitalised as intangible assets	**241**	84	347
Amortisation of capitalised costs [1]	**(59)**	(76)	(149)
Net cost recognised in the income statement	**(360)**	(457)	(843)
Underlying adjustments relating to the effects of acquisition accounting and foreign exchange	**42**	33	67
Net underlying cost recognised in the income statement	**(318)**	(424)	(776)

[1] From 1 January 2018 the company adopted the approach of amortising programme assets on a 15 year straight-line basis pro rata over the estimated number of units produced. See note 1 for more details.

4 Net financing

	Half-year to 30 June 2018		Half-year to 30 June 2017*		Year to 31 December 2017*	
	Per consolidated income statement *£m*	***Underlying financing £m***	Per consolidated income statement £m	*Underlying financing £m*	Per consolidated income statement £m	*Underlying financing £m*
Financing income						
Interest receivable	**11**	***11***	5	*5*	11	*11*
Net fair value gains on foreign currency contracts	**–**	**–**	1,407	–	2,611	–
Financial RRSAs – foreign exchange differences and changes in forecast payments	**–**	**–**	4	–	17	–
Net fair value gains on commodity contracts	**39**	**–**	–	–	37	–
Financing on post-retirement scheme surpluses	**27**	**–**	18	–	39	–
Net foreign exchange gains	**29**	**–**	214	–	196	–
	106	***11***	1,648	*5*	2,911	*11*
Financing costs						
Interest payable	**(48)**	***(48)***	(36)	*(36)*	(67)	*(64)*
Net fair value losses on foreign currency contracts	**(854)**	**–**	–	–	–	–
Financial RRSAs – foreign exchange differences and changes in forecast payments	**(2)**	**–**	–	–	(6)	–
Financial charge relating to financial RRSAs	**(5)**	***(5)***	(2)	*(2)*	(5)	*(5)*
Net fair value losses on commodity contracts	**–**	**–**	(16)	–	–	–
Financing on post-retirement scheme deficits	**(16)**	**–**	(19)	–	(38)	–
Net foreign exchange losses	**–**	**–**	–	–	–	–
Other financing charges	**(26)**	***(26)***	(28)	*(26)*	(48)	*(49)*
	(951)	***(79)***	(101)	*(64)*	(164)	*(118)*
Net financing	**(845)**	***(68)***	1,547	*(59)*	2,747	*(107)*
Analysed as:						
Net interest payable	**(37)**	***(37)***	(31)	*(31)*	(56)	*(53)*
Net fair value (losses)/gains on derivative contracts	**(815)**	**–**	1,391	–	2,648	–
Net post-retirement scheme financing	**11**	**–**	(1)	–	1	–
Net other financing	**(4)**	***(31)***	188	*(28)*	154	*(54)*
Net financing	**(845)**	***(68)***	1,547	*(59)*	2,747	*(107)*

***** The prior period has been restated for IFRS 15 *Revenue from Contracts with Customer*s, an interim update to the provisional fair values of the ITP Aero acquisition and other adjustments. See note 16 for more details.

5 Taxation

The effective tax rate for the half year is 23.9% (2017 restated half year 18.8%, full year 12.3%). The rates are not directly comparable as in this half year there is a tax credit on a reported loss and in 2017 (both half year and full year) there is a tax charge on a reported profit. The key drivers of the effective tax rates are the tax effect of underlying adjustments further details of which can be found in note 2.

Changes in tax rates

As announced in the Spanish Basque region tax reform legislation, the corporation tax rate reduced from 28% to 26% with effect from 1 January 2018 and will reduce to 24% with effect from 1 January 2019. The impact of the rate reduction to 24% is reflected in the 2018 half year deferred tax balances of the Spanish ITP companies, as the rate change was substantively enacted prior to the period end.

6 Earnings per ordinary share (EPS)

Basic EPS are calculated by dividing the profit attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period, excluding ordinary shares held under trust, which have been treated as if they had been cancelled. Diluted EPS are calculated by adjusting the weighted average number of ordinary shares in issue during the period for the bonus element of share options.

	Half-year to 30 June 2018			Restated * Half-year to 30 June 2017			Restated * Year to 31 December 2017		
	Basic	**Potentially dilutive share options[1]**	**Diluted**	Basic	Potentially dilutive share options	Diluted	Basic	Potentially dilutive share options[1]	Diluted
(Loss)/profit attributable to ordinary shareholders (£m)	**(962)**	**–**	**(962)**	1,172	–	1,172	3,663	–	3,663
Weighted average shares (millions)	**1,849**	**–**	**1,849**	1,834	3	1,837	1,834	6	1,840
EPS (pence)	**(52.03)p**	**–**	**(52.03)p**	63.90p	(0.10)p	63.80p	199.73p	(0.65)p	199.08p

***** The prior period has been restated for IFRS 15 *Revenue from Contracts with Customers*, an interim update to the provisional fair values of the ITP Aero acquisition and other adjustments. See note 16 for more details.

[1] As there is a loss on continuing operations, the effect of potentially dilutive ordinary shares is anti-dilutive.

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

	Half-year to 30 June 2018		Restated * Half-year to 30 June 2017 *		Restated * Year to 31 December 2017 *	
	Pence	**£m**	Pence	£m	Pence	£m
Underlying EPS / Underlying profit attributable to ordinary shareholders re-presented	**2.49**	**46**	(8.07)	(148)	2.34	43
Total underlying adjustments to profit before tax (note 2)	**(72.20)**	**(1,335)**	86.53	1,587	217.01	3,980
Related tax effects	**17.68**	**327**	(14.56)	(267)	(19.62)	(360)
EPS / Profit attributable to ordinary shareholders	**(52.03)**	**(962)**	63.90	1,172	199.73	3,663
Diluted underlying EPS	**2.48**		(8.06)		2.34	

***** The prior period has been restated for IFRS 15 *Revenue from Contracts with Customers*, an interim update to the provisional fair values of the ITP Aero acquisition and other adjustments. See note 16 for more details.

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 the period. Issues of C Shares were declared as follows:

	Half-year to 30 June 2018		Year to 31 December 2017	
	Pence per share	**£m**	Pence per share	£m
Interim (issued in January)	**4.6**	**86**	4.60	85
Final (issued in July)	**–**	**–**	7.10	131
	4.6	**86**	11.70	216

8 Intangible assets

	Goodwill £m	Certification costs £m	Development expenditure £m	Contractual aftermarket rights £m	Customer relationships £m	Software £m	Other £m	Total £m
Cost:								
At 1 January 2017 as previously reported	**1,874**	**1,325**	**1,944**	**1,007**	**540**	**742**	**663**	**8,095**
Impact of adoption of IFRS 15 [1]	–	(475)	–	(1,007)	–	–	–	(1,482)
Foreign exchange adjustment [1]	–	(21)	–	–	–	–	–	(21)
At 1 January 2017 restated	**1,874**	**829**	**1,944**	**–**	**540**	**742**	**663**	**6,592**
Exchange differences	(5)	–	15	–	(3)	(3)	8	12
Reclassifications	–	–	(9)	–	–	–	9	–
Additions	–	112	347	–	–	135	53	647
Acquisition of business [2]	–	4	158	–	989	7	44	1,202
Disposals	–	–	–	–	–	(13)	–	(13)
At 1 January 2018	**1,869**	**945**	**2,455**	**–**	**1,526**	**868**	**777**	**8,440**
Exchange differences	**7**	**–**	**2**	**–**	**3**	**2**	**2**	**16**
Additions	**–**	**27**	**241**	**–**	**–**	**49**	**10**	**327**
Transferred to assets held for sale [3]	**(666)**	**–**	**(26)**	**–**	**(27)**	**(6)**	**(12)**	**(737)**
Disposal of business [4]	**(136)**	**–**	**(49)**	**–**	**(39)**	**–**	**(11)**	**(235)**
Disposals	**–**	**–**	**–**	**–**	**–**	**(2)**	**–**	**(2)**
At 30 June 2018	**1,074**	**972**	**2,623**	**–**	**1,463**	**911**	**766**	**7,809**
Accumulated amortisation and impairment:								
At 1 January 2017 as previously reported	337	440	888	433	209	414	294	3,015
Impact of adoption of IFRS 15 [1]	–	(134)	–	(433)	–	–	–	(567)
At 1 January 2017 restated	**337**	**306**	**888**	**–**	**209**	**414**	**294**	**2,448**
Exchange differences	(13)	–	8	–	(4)	(1)	–	(10)
Charge for the period	–	33	149	–	51	81	29	343
Disposals	–	–	–	–	–	(6)	–	(6)
At 1 January 2018	**324**	**339**	**1,045**	**–**	**256**	**488**	**323**	**2,775**
Exchange differences	**5**	**–**	**1**	**–**	**3**	**–**	**2**	**11**
Charge for the period	**–**	**18**	**59**	**–**	**38**	**40**	**10**	**165**
Impairment [3]	**160**	**–**	**–**	**–**	**–**	**–**	**–**	**160**
Transferred to assets held for sale [3]	**(444)**	**–**	**(23)**	**–**	**(21)**	**(2)**	**(12)**	**(502)**
Disposal of business [4]	**–**	**–**	**(31)**	**–**	**(27)**	**–**	**(8)**	**(66)**
At 30 June 2018	**45**	**357**	**1,051**	**–**	**249**	**526**	**315**	**2,543**
Net book value at:								
30 June 2018	**1,029**	**615**	**1,572**	**–**	**1,214**	**385**	**451**	**5,266**
31 December 2017 restated	1,545	606	1,410	–	1,270	380	454	5,665
31 December 2017 as previously reported	1,545	1,117	1,450	873	1,247	380	451	7,063

1 IFRS 15 adoption results in the reclassification of Participation Fees as contract assets within Trade and Other Receivables and the de-recognition of Contractual Aftermarket Rights (CARs). Further, the prior period has been restated for IFRS 15 Revenue from Contracts with Customers, an interim update to the provisional fair values of the ITP Aero acquisition and other adjustments. See note 16 for more details.

2 Fair values relating to the acquisition ITP have been revised for the adoption of IFRS 15 and alignment with Group Accounting policies (note 14).

3 Relates to the Commercial Marine business classified as a "held for sale" business at 30 June 2018 (note 14).

4 Sale of L'Orange business to Woodward Inc. on 1 June 2018 (note 14).

Certification costs and development expenditure have been reviewed for impairment in accordance with the requirements of IAS 36 *Impairment of Assets*. Where an impairment test was considered necessary, it has been performed on the following basis:

- The carrying values have been assessed by reference to value in use. These have been estimated using cash flows from the most recent forecasts prepared by management, which are consistent with past experience and external sources of information on market conditions over the lives of the respective programmes.
- The key assumptions underlying cash flow projections are assumed market share, programme timings, unit cost assumptions, discount rates and foreign exchange rates.
- The pre-tax cash flow projections have been discounted at 9-13% (2017 full year 9-13%), based on the Group's weighted average cost of capital.
- No impairment is required on this basis. However, a combination of changes in assumptions and adverse movements in variables that are outside the Company's control (discount rate, exchange rate and airframer delays), could result in impairment in future periods.

During the period, the derecognition of contractual aftermarket rights, as a result of the implementation of IFRS 15, and the recognition of the provision for exceptional Trent 1000 costs have both had the effect of improving the impairment assessments.

9 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 2018 as previously reported	**1,842**	**5,035**	**687**	**773**	**8,337**
Foreign exchange adjustment	–	–	48	–	48
At 1 January 2018 re-stated*	**1,842**	**5,035**	**735**	**773**	**8,385**
Exchange differences	**7**	**29**	**2**	**5**	**43**
Additions	**7**	**95**	**23**	**116**	**241**
Additions – arising from TotalCare Flex contracts (non-cash)	**–**	**–**	**3**	**–**	**3**
Reclassification of joint operations to subsidiaries	**1**	**18**	**–**	**–**	**19**
Reclassifications	**19**	**75**	**8**	**(102)**	**–**
Transferred to assets held for sale [1]	**(77)**	**(150)**	**–**	**(37)**	**(264)**
Disposal of business [2]	**(23)**	**(72)**	**–**	**(4)**	**(99)**
Disposals	**(20)**	**(59)**	**(16)**	**–**	**(95)**
At 30 June 2018	**1,756**	**4,971**	**755**	**751**	**8,233**
Accumulated depreciation and impairment:					
At 1 January 2018	**554**	**2,984**	**173**	**2**	**3,713**
Exchange differences	**3**	**17**	**–**	**–**	**20**
Reclassification of joint operations to subsidiaries	**1**	**8**	**–**	**–**	**9**
Reclassifications	**–**	**1**	**(1)**	**–**	**–**
Charge for the period	**31**	**183**	**30**	**–**	**244**
Transferred to assets held for sale [1]	**(36)**	**(97)**	**–**	**–**	**(133)**
Impairment	**(2)**	**(3)**	**–**	**–**	**(5)**
Disposal of business [2]	**(4)**	**(34)**	**–**	**–**	**(38)**
Disposals	**(11)**	**(58)**	**(2)**	**–**	**(71)**
At 30 June 2018	**536**	**3,001**	**200**	**2**	**3,739**
Net book value at:					
30 June 2018	**1,220**	**1,970**	**555**	**749**	**4,494**
31 December 2017 restated	1,288	2,051	562	771	4,672
31 December 2017 as previously reported	1,288	2,051	514	771	4,624

***** The prior period has been restated for IFRS 15 Revenue from Contracts with Customers, an interim update to the provisional fair values of the ITP Aero acquisition and other adjustments. See note 16.

[1] Relates to the Commercial Marine business classified as a “held for sale” business at 30 June 2018 (note 14).

[2] Sale of L’Orange business to Woodward Inc. on 1 June 2018 (note 14).

10 Financial assets and liabilities

Other financial assets and liabilities comprise:

	Derivatives: Foreign exchange contracts £m	Derivatives: Commodity contracts £m	Derivatives: Interest rate contracts [1] £m	Derivatives: Total £m	Financial RRSAs £m	Other £m	C Shares £m	Total £m
At 30 June 2018								
Non-current assets	**165**	**33**	**211**	**409**	**–**	**–**	**–**	**409**
Current assets	**16**	**19**	**12**	**47**	**–**	**–**	**–**	**47**
Current liabilities	**(670)**	**(3)**	**–**	**(673)**	**(39)**	**(28)**	**(28)**	**(768)**
Non-current liabilities	**(2,447)**	**(5)**	**(4)**	**(2,456)**	**(204)**	**(34)**	**–**	**(2,694)**
	(2,936)	**44**	**219**	**(2,673)**	**(243)**	**(62)**	**(28)**	**(3,006)**
At 31 December 2017								
Non-current assets	362	16	232	610	–	–	–	610
Current assets	27	9	–	36	–	–	–	36
Current liabilities	(493)	(10)	–	(503)	(50)	(20)	(28)	(601)
Non-current liabilities	(2,208)	(14)	(5)	(2,227)	(194)	(37)	–	(2,458)
	(2,312)	1	227	(2,084)	(244)	(57)	(28)	(2,413)

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

Derivative financial instruments	**Half-year to 30 June 2018** Foreign exchange £m	Commodity £m	Interest rate £m	Total £m	Year to 31 December 2017 Total £m
At 1 January	(2,312)	1	227	**(2,084)**	(5,249)
Movements in fair value hedges	–	–	(7)	**(7)**	9
Movement in cash flow hedges	(7)	6	(1)	**(2)**	(131)
Movements in other derivative contracts	(854)	39	–	**(815)**	2,648
Contracts settled	237	(2)	–	**235**	639
At period end	**(2,936)**	**44**	**219**	**(2,673)**	(2,084)

Financial risk and revenue sharing arrangements (RRSAs) and other financial liabilities	Financial RRSAs: **Half-year to 30 June 2018 £m**	Financial RRSAs: Year to 31 December 2017 £m	Other: **Half-year to 30 June 2018 £m**	Other: Year to 31 December 2017 £m
At 1 January as previously reported		**(101)**		(15)
Impact of adoption of IFRS 15 [1]		**–**		(42)
At 1 January restated	**(244)**	**(101)**	**(57)**	(57)
Exchange adjustments included in OCI	**–**	**(14)**	**(22)**	
Additions	**–**	**–**		(3)
Acquisition of ITP Aero	**–**	**(157)**		
Financing charge [2]	**(5)**	**(5)**		(1)
Changes to forecast payments	**(2)**	**1**		
Exchange adjustments – excluded from underlying results [2]	**–**	**10**	**(1)**	1
Cash paid to partners	**8**	**22**	**18**	
Other	**–**	**–**		3
At period end	**(243)**	**(244)**	**(62)**	(57)

[1] IFRS 15 adoption results in a change in accounting treatment for parts sold with an option to repurchase and also future obligations to airframers arising from sale of our OE on their airframes (see note 16).

[2] Included in net financing.

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

	Half-year to 30 June 2018 Book value £m	**Fair value £m**	Year to 31 December 2017 Book value £m	Fair value £m
Borrowings	**(4,441)**	**(4,479)**	(3,488)	(3,557)
Financial RRSAs	**(243)**	**(252)**	(244)	(247)

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.

- Unlisted non-current investments primarily comprise unconsolidated companies where the fair value approximates to the book value.
- The fair values of trade receivables (held to collect), contractual cash flows and payables, 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 for sale 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 and money-market funds 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 by discounting contractual future cash flows (Level 2 as defined by IFRS 13).
- The fair values of RRSAs and TotalCare Flex 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).
- At 30 June 2018 the Group does not hold any financial instruments classified as Level 1 (as defined by IFRS 13).

Borrowings

During the period, the Group has issued €550m 0.875% Notes maturing 2024 and €550m 1.625% Notes maturing 2028 to prefund the 2019 debt maturities. There were no other significant changes in the Group's borrowings during the six months ended 30 June 2018.

11 Pensions and other post-retirement benefits

The net post-retirement scheme surplus as at 30 June 2018 is calculated on a year to date basis, using the latest valuation as at 31 December 2017, updated to 30 June 2018 for the principal schemes.

Movements in the net post-retirement position recognised in the balance sheet were as follows:

	UK schemes £m	Overseas schemes £m	Total £m
At 1 January 2018	**2,108**	**(1,370)**	**738**
Exchange adjustments	–	(8)	(8)
Current service cost	(91)	(27)	(118)
Net financing	27	(16)	11
Contributions by employer	45	42	87
Actuarial gains [1]	410	41	451
Disposal of business	–	31	31
Other	–	(1)	(1)
At 30 June 2018	**2,499**	**(1,308)**	**1,191**
Analysed as:			
Post-retirement scheme surpluses - included in non-current assets	2,499	22	2,521
Post-retirement scheme deficits - included in non-current liabilities	–	(1,306)	(1,306)
Post-retirement scheme deficits – liabilities held for sale	–	(24)	(24)
	2,499	**(1,308)**	**1,191**

[1] The net actuarial gains in the UK arose principally due to changes in the yield curves used to value the assets and the liabilities.

12 Contingent liabilities

In January 2017, after full cooperation, the Company concluded deferred prosecution agreements with the Serious Fraud Office and the US Department of Justice and a leniency agreement with the MPF, the Brazilian federal prosecutors. Prosecutions of individuals may follow and enforcement action may be taken by other authorities. 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 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.

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 US$2.4bn (2017:$3.3bn) (on a discounted basis) to provide facilities to enable customers to purchase aircraft (of which approximately US$27m could be called during 2018). 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. Consequently the Directors do not consider that there is a significant exposure arising from the provision of these facilities.

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 reflect better 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.

	30 June 2018		31 December 2017	
	£m	***$m***	£m	*$m*
Gross contingent liabilities	**141**	***186***	145	*196*
Value of security [1]	**(41)**	***(54)***	(41)	*(55)*
Indemnities	**(40)**	***(52)***	(51)	*(69)*
Net commitments	**60**	***80***	53	*72*
Net commitments with security reduced by 20% [2]	**70**	***92***	64	*86*
[1] Security includes unrestricted cash collateral of:	**22**	***30***	22	*29*

[2] 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.

Contingent liabilities exist in respect of guarantees provided by the Group in the ordinary course of business for product delivery, 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.

13 Related party transactions

Transactions with related parties are shown on page 166 of the 2017 Annual Report. Significant transactions in the current financial period are as follows:

	Half-year to 30 June 2018 £m	Half-year to 30 June 2017 £m	Year to 31 December 2017 £m
Sales of goods and services to joint ventures and associates	**1,400**	**980**	2,469
Purchases of goods and services from joint ventures and associates	**(1,556)**	**(1,399)**	(2,224)

Included in sales of goods and services to joint ventures and associates are sales of spare engines amounting to £185m (2017: half-year £24m, full-year £418m).

Profit recognised in the year on such sales amounted to £54m (2017: half-year £23m, full-year £75m), including profit on current year sales and recognition of profit deferred on similar sales in previous years. On an underlying basis (at actual achieved rates on settled derivative transactions), the amounts were £47m (2017: half-year £19m, full-year £67m).

14 Acquisition and disposals

L'Orange disposal

On 1 June 2018 the Group sold its L'Orange business, part of Rolls-Royce Power Systems, to Woodward Inc. for €673m.

	2018 £m
Proceeds	
Cash consideration [1]	589
Cash and cash equivalents disposed	(3)
Disposal costs paid	(2)
Cash inflow per cash flow statement	**584**
Assets and liabilities disposed	
Intangible assets	169
Property, plant and equipment	61
Investments	3
Deferred tax assets	6
Inventory	40
Deposits (payments received on account)	(1)
Trade and other receivables	27
Trade and other payables	(21)
Current tax	(1)
Provisions for liabilities and charges	(6)
Deferred tax liabilities	(12)
Post-retirement scheme deficits	(31)
Net assets disposed	**234**
Profit on disposal before disposal costs and continuing obligations	352
Cumulative currency translation gain	19
Profit on disposal of business	371
Disposal costs	(13)
Non-underlying profit before tax	**358**

[1] 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. The table above assumes that no adjustments arise; this will be reviewed at each reporting date over the adjustment period, based on actual sales.

ITP Aero acquisition

On 19 December 2017 the Group completed the acquisition of ITP Aero. The fair value of the assets and liabilities acquired has been presented on a provisional basis in the 2017 Annual Report. The opening balance sheet position has since been updated for the impact of the transition to IFRS 15 *Revenues from Contracts with Customers* and adjustments to the recognition of deferred tax and long-term contracts. This has resulted in an increase in net assets acquired of £1,918m and has increased the bargain purchase value to £513m. As a consequence, the total gain on acquisition has increased to £1,066m.

In accordance with IFRS 3 *Business Combinations*, the provisional amounts recognised at the acquisition date have been adjusted retrospectively.

Commercial Marine – held for sale

On 6 July 2018 the Group announced the sale of Commercial Marine to KONGSBERG for a cash consideration of approximately £425m. The disposal is expected to complete in the first quarter of 2019.

On 30 June 2018 the transaction met the criteria of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* that where the carrying value of a 'disposal group' is expected to be recovered through a sale transaction, the disposal group should be treated as 'held for sale', with net assets presented as a single line on the balance sheet measured at the lower of carrying value or fair value less costs to sell.

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

	2018 £m
Assets and liabilities held for sale	
Intangible assets	235
Property, plant and equipment	133
Deferred tax assets	5
Inventory	215
Trade and other receivables	237
Current tax assets	4
Assets held for sale	**829**
Trade and other payables	(388)
Current tax liabilities	(5)
Provisions for liabilities and charges	(46)
Post-retirement scheme deficits	(24)
Liabilities associated with assets held for sale	**(463)**
Net assets held for sale	**366**

As a result of the decision to classify the Commercial Marine business as held for sale, its carrying value has been assessed against the anticipated proceeds and the disposal costs. An impairment charge of £160m for the related goodwill has been recognised in the income statement.

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

The table below shows the derivation of the summary funds flow statement (lines marked * below) as stated on page 20 and from the consolidated cash flow statement on page 25.

		Half-year to 30 June 2018		Half-year to 30 June 2017		Year to 31 December 2017		
		£m	**£m**	£m	£m	£m	£m	**Source**
*	**Underlying profit before tax (PBT) - below**		**73**		(143)		199	
	Depreciation of property, plant and equipment	**239**		221		450		A
	Amortisation of intangible assets	**325**		172		345		A
	Impairment of goodwill	**(160)**		–		(12)		B
	Acquisition accounting	**(91)**		(62)		(129)		B
*	**Depreciation and amortisation**		**313**		331		654	
	Increase in inventories	**(427)**		(428)		(196)		A
	Acquisition accounting	**(33)**		–		–		
	Increase in trade and other receivables	**(300)**		(487)		(294)		C
	Increase in trade and other payables	**997**		1,374		1,893		C
	Realised losses on settled foreign exchange derivatives in financing	**(33)**		(131)		(195)		B
	Revaluation of trading assets	**(75)**		(4)		(6)		B
*	**Movement on net working capital**		**129**		324		1,202	
	Additions of intangible assets	**(327)**		(213)		(647)		A
	Purchases of property, plant and equipment	**(343)**		(389)		(801)		A
	Government grants received	**1**		3		14		A
*	**Expenditure on property, plant and equipment and intangible assets**		**(669)**		(599)		(1,434)	
	Realised losses on hedging instruments	**207**		211		453		B
	Net unrealised fair value to changes to derivatives	**1**		8		24		B
	Foreign exchange on contract accounting	**(30)**		(137)		(153)		B
	Exceptional restructuring	**(179)**		(31)		(104)		B
	Trent 1000 exceptional charge	**(554)**		–		–		B
	Other	**(2)**		(4)		(1)		B
	Underlying financing	**68**		59		107		B
	Additions of unlisted investments	**(4)**		–		–		A
	(Loss)/profit on disposal of property, plant and equipment	**(11)**		6		11		A
	Joint ventures	**(6)**		(23)		(52)		A
	(Decrease)/increase in provisions	**814**		(30)		77		A
	Cash flows on other financial assets and liabilities excluding realised losses on settled foreign exchange derivatives in financing	**(228)**		(209)		(468)		A and B
	Share based payments	**22**		15		33		A
	Disposal of intangible assets	**2**		–		–		A
	Disposal of property, plant and equipment	**60**		9		4		A
	Investments in joint ventures and associates	**–**		(8)		(48)		A
	Net interest	**(36)**		(33)		(53)		A
	Net funds of joint operations reclassified to subsidiaries	**4**		–		–		A
	Issue of ordinary shares	**–**		–		21		A
	Purchase of ordinary shares for share schemes	**–**		(2)		(24)		A
*	**Other**		**128**		(169)		(173)	
*	**Trading cash flow**		**(26)**		(256)		448	
	Net defined benefit plans – underlying operating charge	**118**		118		240		A
	Cash funding of defined benefit plans	**(87)**		(130)		(249)		A
*	**Contributions to defined benefit schemes in excess of underlying PBT charge**		**31**		(12)		(9)	
*	**Tax**		**(77)**		(71)		(180)	A
*	**Free cash flow** †		**(72)**		(339)		259	
*	**Shareholder payments**		**(85)**		(85)		(214)	A
*	**Acquisition on ITP Aero**		**–**		–		229	
	Disposal of L'Orange		**584**		–		–	A
*	**Payments of financial penalties from agreements with investigating bodies**		**–**		(267)		(286)	A
*	**Other**		**13**		5		(9)	A
*	**Foreign exchange**		**30**		(20)		(59)	A
*	**Change in net debt**		**470**		(706)		(80)	

† Free cash flow is defined in Note 1.

	Half-year to 30 June 2018		Half-year to 30 June 2017		Year to 31 December 2017		
	£m	**£m**	£m	£m	£m	£m	**Source**
Reported operating profit		**(775)**		(103)		366	
Realised losses on hedging instruments	**(207)**		(211)		(453)		B
Net unrealised fair value to changes to derivatives	**(1)**		(8)		(24)		B
Foreign exchange on contract accounting	**30**		137		153		B
Revaluation of trading assets and liabilities	**75**		4		6		B
Effect of acquisition accounting	**124**		62		129		B
Impairment of goodwill	**160**		–		24		B
Trent 1000 exceptional charge	**554**		–		–		B
Exceptional restructuring	**179**		31		104		B
Financial penalties from agreements with investigating bodies	**–**		4		–		B
Other	**2**		–		1		B
Adjustments to reported operating profit		**916**		19		(60)	
Underlying profit before financing		**141**		(84)		306	
Underlying financing		**(68)**		(59)		(107)	B
Underlying profit before tax		**73**		(143)		199	

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 25.

	Half-year to 30 June 2018		Half-year to 30 June 2017		Year to 31 December 2017		
	£m	**£m**	£m	£m	£m	£m	**Source**
Change in cash and cash equivalents		**1,392**		(412)		231	A
Returns to shareholders		**85**		85		214	A
Net cash flow from changes in borrowings and finance leases		**(956)**		(274)		(200)	A
Increase in short-term investments		**4**		–		–	A
Acquisition of ITP Aero	**–**		–		(263)		A
Disposal of L'Orange	**(584)**		–		–		A
Other acquisitions and disposals	**(13)**		(5)		(1)		C
Changes in group structure		**(597)**		(5)		(264)	
Payments of financial penalties from agreements with investigating bodies				267		286	A
Other				–		(8)	
Free cash flow		**(72)**		(339)		259	
Exclude cash outflow of ITP Aero						14	
Free cash flow excluding ITP Aero						273	

Sources:

A Cash flow statement
B Note 2 - underlying profit adjustments
C Cash flow statement adjusted for non-underlying items including exchange differences

16 Impact of adopting IFRS 15 and other adjustments

Condensed consolidated income statement

For 30 June and 31 December 2017

	Previous accounting	IFRS 15 impact	Other adjustments [1]	IFRS 15 basis	Previous accounting	IFRS 15 impact	Other adjustments [1]	IFRS 15 basis
	Six months to 30 June 2017				Year to 31 December 2017			
	£m	£m	£m	£m	£m	£m	£m	£m
Revenue	7,566	(904)	(6)	6,656	16,307	(1,480)	(13)	14,814
Cost of sales	(6,158)	357	–	(5,801)	(13,134)	620	–	(12,514)
Gross profit [2]	1,408	(547)	(6)	855	3,173	(860)	(13)	2,300
Commercial and administrative costs	(552)	–	–	(552)	(1,222)	–	–	(1,222)
Research and development costs [3]	(436)	(21)	–	(457)	(795)	(48)	–	(843)
Share of results of joint ventures and associates	51	–	–	51	131	–	–	131
Operating (loss)/profit	471	(568)	(6)	(103)	1,287	(908)	(13)	366
Gain arising on the acquisition of ITP Aero	–	–	–	–	798	96	172	1,066
Profit/(loss) before financing and taxation	471	(568)	(6)	(103)	2,085	(812)	159	1,432
Financing income	1,570	49	29	1,648	2,973	(58)	(4)	2,911
Financing costs	(100)	(3)	2	(101)	(161)	(8)	5	(164)
Net financing [4]	1,470	46	31	1,547	2,812	(66)	1	2,747
Profit/(loss) before taxation	1,941	(522)	25	1,444	4,897	(878)	160	4,179
Taxation [5]	(360)	90	(2)	(272)	(689)	172	2	(515)
Profit for the period	1,581	(432)	23	1,172	4,208	(706)	162	3,664
Attributable to:								
Ordinary shareholders	1,581	(432)	23	1,172	4,207	(706)	162	3,663
Non-controlling interests	–	–	–	–	1	–	–	1
Profit for the period	1,581	(432)	23	1,172	4,208	(706)	162	3,664
Earnings per ordinary share attributable to ordinary shareholders								
Basic	86.21p	(23.56)p	1.25p	63.90p	229.40p	(38.50)p	8.83p	199.73p
Diluted	86.06p	(23.51)p	1.25p	63.80p	228.64p	(38.36)p	8.80p	199.08p

[1] The other adjustments arise from: the revised calculation of the foreign exchange rate applied to non-monetary assets and liabilities £29m credit in June 2017 and (£4m) charge in December 2017; the revised unwind of discounting of non-current liabilities of (£4m) in June 2017 and (£8m) in December 2017; and a preliminary update of the provisional fair values arising on the acquisition of ITP Aero increasing the gain arising on acquisition in December 2017 by £172m.

[2] Predominantly due to de-recognition of contractual aftermarket rights, de-linkage of OE from aftermarket contracts and a change to recognise revenue on long-term service agreements as costs are incurred rather than when the engines are operated.

[3] Re-classification of the recognition of contributions received from the Group's suppliers under Risk and Revenue Sharing Agreements (RRSAs) to cost of sales.

[4] Revised phasing of foreign exchange in line with revised phasing of long-term service agreement revenues and unwind of discounting of future guarantee payments due to customers.

[5] Consequential change from the restated reported profit.

Condensed consolidated statement of comprehensive income

For 30 June and 31 December 2017

	Previous accounting	IFRS 15 impact	Other adjustments [1]	IFRS 15 basis	Previous accounting	IFRS 15 impact	Other adjustments [1]	IFRS 15 basis
	£m	£m	£m	£m	£m	£m	£m	£m
	Six months to 30 June 2017				Year to 31 December 2017			
Profit for the period	1,581	(432)	23	1,172	4,208	(706)	162	3,664
Other comprehensive income (OCI)								
Movements in post-retirement schemes	(112)	–	–	(112)	735	–	–	735
Share of OCI of joint ventures and associates	(1)	–	–	(1)	(1)	–	–	(1)
Related tax movements	42	–	–	42	(307)	–	–	(307)
Items that will not be reclassified to profit or loss	(71)	–	–	(71)	427	–	–	427
Foreign exchange translation differences on foreign operations	(59)	4	–	(55)	(142)	6	–	(136)
Share of OCI of joint ventures and associates	(3)	–	–	(3)	(5)	–	–	(5)
Related tax movements	1	–	–	1	1	–	–	1
Items that may be reclassified to profit or loss	(61)	4	–	(57)	(146)	6	–	(140)
Total comprehensive income for the period	1,449	(428)	23	1,044	4,489	(700)	162	3,951
Attributable to:								
Ordinary shareholders	1,449	(428)	23	1,044	4,488	(700)	162	3,950
Non-controlling interests	–	–	–	–	1	–	–	1
Total comprehensive income for the period	1,449	(428)	23	1,044	4,489	(700)	162	3,951

[1] See footnote 1 above.

Condensed consolidated balance sheet

At 31 December 2017

	Previous Accounting	IFRS 15 Impact	Other adjustments [1]	IFRS 15 basis	IFRS 9 impact [11]	Restated
	31 Dec 2017 £m	£m	£m	31 Dec 2017 £m	£m	1 Jan 2018 £m
ASSETS						
Intangible assets [2]	7,063	(1,439)	41	5,665	–	5,665
Property, plant and equipment	4,624	–	48	4,672	–	4,672
Investments – joint ventures and associates	688	–	–	688	–	688
Investments – other	26	–	–	26	–	26
Other financial assets	610	–	–	610	–	610
Deferred tax assets [3]	271	544	27	842	2	844
Post-retirement scheme surpluses	2,125	–	–	2,125	–	2,125
Non-current assets	15,407	(895)	116	14,628	2	14,630
Inventories [4]	3,660	64	164	3,888	–	3,888
Trade and other receivables [5]	7,919	(1,728)	150	6,341	(17)	6,324
Taxation recoverable	17	–	–	17	–	17
Other financial assets	36	–	–	36	–	36
Short-term investments	3	–	–	3	–	3
Cash and cash equivalents	2,953	–	–	2,953	–	2,953
Current assets	14,588	(1,664)	314	13,238	(17)	13,221
Assets held for sale	7	–	–	7	–	7
Total assets	30,002	(2,559)	430	27,873	(15)	27,858
LIABILITIES						
Borrowings	(82)	–	–	(82)	–	(82)
Other financial liabilities [6]	(581)	(20)	–	(601)	–	(601)
Trade and other payables [7]	(9,527)	(2,077)	(49)	(11,653)	–	(11,653)
Current tax liabilities	(209)	–	–	(209)	–	(209)
Provisions for liabilities and charges [8]	(526)	64	(33)	(495)	–	(495)
Current liabilities	(10,925)	(2,033)	(82)	(13,040)	–	(13,040)
Borrowings	(3,406)	–	–	(3,406)	–	(3,406)
Other financial liabilities [6]	(2,435)	(23)	–	(2,458)	–	(2,458)
Trade and other payables [7]	(4,178)	(1,169)	(86)	(5,433)	–	(5,433)
Deferred tax liabilities [3]	(1,144)	586	(7)	(565)	–	(565)
Provisions for liabilities and charges [8]	(357)	34	(50)	(373)	–	(373)
Post-retirement scheme deficits	(1,387)	–	–	(1,387)	–	(1,387)
Non-current liabilities	(12,907)	(572)	(143)	(13,622)	–	(13,622)
Total liabilities	(23,832)	(2,605)	(225)	(26,662)	–	(26,662)
Net assets	6,170	(5,164)	205	1,211	(15)	1,196
EQUITY						
Called-up share capital	368	–	–	368	–	368
Share premium account	195	–	–	195	–	195
Capital redemption reserve	162	–	–	162	–	162
Cash flow hedging reserve	(112)	–	–	(112)	–	(112)
Other reserves [9]	673	(13)	–	660	–	660
Retained earnings [10]	4,881	(5,151)	205	(65)	(15)	(80)
Equity attributable to ordinary shareholders	6,167	(5,164)	205	1,208	(15)	1,193
Non-controlling interests	3	–	–	3	–	3
Total equity	6,170	(5,164)	205	1,211	(15)	1,196

[1] The other adjustments primarily arise from: the revision of the foreign exchange rate applied to the initial recognition of non-monetary assets and liabilities that increases retained earnings by £140m; the reduction in deferred tax assets of (£18m); the use of a revised discount rate on non-current liabilities (£86m); and a reclassification of contract provisions from trade and other receivables to provisions for liabilities and charges (£12m current and £50m non-current). In addition a preliminary update has been made to the provisional fair values arising on the acquisition of ITP Aero in December 2017 increasing opening net assets by £172m. The tax effect of these items is to reduce net assets by (£3m).

[2] The change in intangible assets primarily arises from the de-recognition of Contractual Aftermarket Rights (CARs) and reclassification of participation fees as contract assets within trade and other receivables as a result of IFRS 15 providing additional guidance on the treatment of payments to customers. The change also includes movement on ITP Aero, see note 14.

[3] Consequential change from the restated cumulative profits.

[4] Relates to the cost of parts sold where we retain an option to repurchase e.g. within a larger manufactured assembly. The customer has not obtained control based on the IFRS 15 definition, so the asset has been added to the inventory balance.

[5] There are a number of factors impacting trade and other receivables as follows:
(a) Revised revenue allocation between years (deferred income) as a result of de-linkage of OE from aftermarket contracts and a change to recognise revenue on long-term service agreements as costs are incurred rather than as engines are operated.

(b) Recognition of an additional asset where we have incurred costs to obtain a contract that will subsequently be amortised as a reduction against the associated revenue as goods and services are delivered.
(c) Reclassifications of: participation fees from intangible assets; RRSA payments made ahead of parts usage as a prepayment from trade and other payables; and amounts billed in advance have increased the trade receivables asset (amount billed) and the contract liability within trade and other payables to better reflect the contractual position.

[6] Cash received for parts sold with an option to repurchase as per 4 and future obligations to airframers arising from sale of our OE on their airframes.

[7] Revised revenue allocation as a result of de-linkage of OE from aftermarket contracts and a change to recognise revenue on long-term service agreements as costs are incurred rather than when the engine is operated. Also includes reclassification of RRSA payments made ahead of parts usage as a prepayment within trade and other receivables.

[8] As a result of the more refined guidance on contract liabilities we have reclassified balance from provisions into trade and other receivables / payables

[9] Cumulative change from consolidating overseas entities IFRS 15 local currency income statement and closing balance sheet impacts into sterling.

[10] Cumulative impact of restating prior period's performance. Predominantly due to de-recognition of contractual aftermarket rights, de-linkage of OE from aftermarket contracts and a change to recognise revenue on long-term service agreements as costs are incurred rather than when the income is received.

[11] Re-assessment of recoverability of financial assets using IFRS 9 principles has resulted in a reduction in net assets of £(15)m.

Cash flows

The adjustments to the income statement and balance sheet described above do not affect the cash balances, but do alter the categorisation of some items in the cash flow statement. In particular, the de-recognition of contractual aftermarket rights and the transfer of participation fees to contractual assets reduce additions to intangible assets by £172m and £346m in the half year and full year respectively. These cash flows are now included in the net cash flows from operating activities and there is a consequential change to the adjustment for amortisation of intangible assets. Other adjustments are principally within monetary working capital movements.

Principal risks and uncertainties

Whilst the Group has a consistent strategy and long performance cycles, it continues to be exposed to a number of risks and has an established, structured approach to identifying, assessing and managing those risks.

The principal risks facing the Group for the remaining six months of the financial year are unchanged from those reported on pages 59 to 62 of the Annual Report 2017, as set out below:

Disruptive technologies and business models
Disruptive technologies, new entrants with alternative business models or disruptions to key markets or customers could reduce our ability to sustainably win future business, achieve operating results and realise future growth opportunities.

Competitive position
The presence of large, financially strong competitors in the majority of our markets means that the Group is susceptible to significant price pressure for original equipment or services even where our markets are mature or the competitors few. Our main competitors have access to significant government funding programmes as well as the ability to invest heavily in technology and industrial capability.

Major product programme delivery
Failure to deliver a major programme on time, within budget, to specification, or technical performance falling significantly short of customer expectations, or not delivering the planned business benefits, 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.

Product safety
The lives of people that our customers serve depend on the safety of our products wherever and whenever they operate them. Any failure to meet this expectation, or if our product causes significant environmental impact, would adversely affect our reputation and long-term sustainability.

Talent and capability
Inability to attract and retain the critical capabilities and skills needed in sufficient numbers to effectively organise, deploy and incentivise our people to deliver our strategies, business plans and projects.

Business continuity
Breakdown of external supply chain or internal facilities that could be caused by destruction of key facilities, natural disaster (including those caused by climate change), regional conflict, financial insolvency of a critical supplier or scarcity of materials which would reduce the ability to meet customer commitments, win future business or achieve operational results.

IT vulnerability
Breach of cyber security causing controlled or critical data to be lost, made inaccessible, corrupted or accessed by unauthorised users.

Market and financial shock
The Group is exposed to a number of market risks, some of which are of a macro-economic nature (e.g. foreign currency, oil price, rates) and some of which are more specific to the Group (e.g. liquidity and credit risks, reduction in air travel or disruption to other customer operations). Significant extraneous market events could also materially damage the Group's competitiveness and/or creditworthiness.

This would affect operational results or the outcomes of financial transactions.

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: explicit trade protectionism, differing tax or regulatory regimes, potential for conflict or broader political issues.

Compliance
Non-compliance by the Group with legislation, the terms of the deferred prosecution agreements or other regulatory requirements in the heavily regulated environment in which it operates (e.g. export controls; use of controlled chemicals and substances; and anti-bribery and corruption legislation) compromising the ability to conduct business in certain jurisdictions and exposing the Group to potential: reputational damage; financial penalties; debarment from government contracts for a period of time; and/or suspension of export privileges (including export credit financing), each of which could have a material adverse effect.

Going concern

After making enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future (which accounting standards require to be at least a year from the date of this report). There have been no significant changes to the basis described on page 63 of the Annual Report 2017. For this reason they continue to adopt the going concern basis in preparing the consolidated financial statements.

Payments to shareholders

The Company makes payments to shareholders by allotting non-cumulative redeemable preference shares of 0.1 pence each (C Shares). Shareholders can opt to redeem the C Shares for a cash payment, or reinvest the cash proceeds by purchasing additional ordinary shares via the C Share Reinvestment Plan (CRIP), which is operated by our Registrar, Computershare Investor Services PLC. On 3 January 2019, 46 C Shares, with a total nominal value of 4.6p, will be allotted for each ordinary share to those shareholders on the register on 26 October 2018. The final day of trading with entitlement to C Shares is 24 October 2018. Shareholders wishing to redeem their C Shares, or participate in the CRIP, must lodge instructions with our Registrar to arrive no later than 5.00 pm on 3 December 2018 (CREST holders must submit their election in CREST by 3pm GMT). The payment of C Shares redemption monies will be made on 7 January 2019 and the CRIP purchase will begin as soon as practicable after 7 January 2019.

Statement of directors' responsibilities

The directors confirm that, to the best of their knowledge:

- the condensed consolidated half-year financial statements have been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU;
- the interim management report includes a fair review of the information required by:
  - (a) DTR 4.2.7R of the *Disclosure and Transparency Rules*, being an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed consolidated half-year financial statements; and a description of the principal risks and uncertainties for the remaining six months of the year; and
  - (b) DTR 4.2.8R of the *Disclosure and Transparency Rules*, being related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or performance of the entity during that period; and any changes in the related party transactions described in the last Annual Report that could do so.

The directors of Rolls-Royce Holdings plc at 6 March 2018 are listed in its Annual Report 2017 on pages 66 to 68. Since that date, the following changes have taken place:

- Nick Luff was elected to the Board at the AGM on 3 May 2018.

By order of the Board

Warren East
Chief Executive
2 August 2018

Stephen Daintith
Chief Financial Officer
2 August 2018

Independent review report to Rolls-Royce Holdings plc

Report on the Condensed consolidated half-year financial statements

Our conclusion

We have reviewed Rolls-Royce Holdings plc's Condensed consolidated half-year financial statements (the 'interim financial statements') in the 2018 Half Year Results of Rolls-Royce Holdings plc for the six month period ended 30 June 2018. Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

What we have reviewed

The interim financial statements comprise:
- the Condensed consolidated balance sheet as at 30 June 2018;
- the Condensed consolidated income statement and Condensed consolidated statement of comprehensive income for the six month period then ended;
- the Condensed consolidated cash flow statement for the six month period then ended;
- the Condensed consolidated statement of changes in equity for the six month period then ended; and
- the explanatory notes to the interim financial statements.

The interim financial statements included in the 2018 Half Year Results have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1 to the interim financial statements, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the Group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Responsibilities for the interim financial statements and the review

Our responsibilities and those of the directors

The 2018 Half Year Results, including the interim financial statements, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the 2018 Half Year Results in accordance with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

Our responsibility is to express a conclusion on the interim financial statements in the 2018 Half Year Results based on our review. This report, including the conclusion, has been prepared for and only for the company for the purpose of complying with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority and for no other purpose. We do not, in giving this conclusion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What a review of interim financial statements involves

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

We have read the other information contained in the 2018 Half Year Results and considered whether it contains any apparent misstatements or material inconsistencies with the information in the interim financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants
London
2 August 2018