2 August 2018

ROLLS-ROYCE HOLDINGS PLC
2018 Half Year Results
Good half year progress: growing confidence for the year

Commenting on the results, Warren East, Chief Executive, said: *"We continued to make good progress in the first half. Financial results were ahead of our expectations with strong growth from Civil Aerospace and Power Systems and we achieved a number of operational and technological milestones. Reflecting our progress to date and growing confidence for the full year, we now expect both underlying profit and cash flow for 2018 to be in the upper half of our guidance range. We continue to be impacted by the challenge of managing significant Trent 1000 in-service issues and have recognised an exceptional charge of £554m, representing the profit impact of that part of the total current and estimated costs out to 2022 that is considered to be abnormal in nature."*

	Underlying[1]			Reported		
Year to 30 June	**H1 2018**	H1 2017[2]	**Organic change[3]**	**H1 2018**	H1 2017[2]	**Change**
			Group			
Revenue (£m)	**7,040**	6,041	+14%	**7,487**	6,656	+12%
Operating profit (£m)	**141**	(84)	205	**(775)**	(103)	(672)
Earnings per share	**2.5p**	(8.1)p	n/a	**(52.0)p**	63.9p	n/a
			Core[4]			
Revenue (£m)	**6,680**	5,611	+16%			
Operating profit (£m)	**146**	(70)	183			
Earnings per share	**3.1p**	(6.5)p	n/a			
(Net debt) / Cash (£m)[5]	**165**	(305)	n/a			
Group free cash flow (£m)[6]	**(72)**	(339)	211			
Core free cash flow (£m)	**10**	(264)	214			
Payment per share	**4.6p**	4.6p				

For notes to table see page 6

Group financial highlights

- Underlying revenue of £7,040m up 14%; reported revenue of £7,487m up 12%. Civil Aerospace revenues up 26%, Power Systems up 13% and Defence remains flat
- Underlying operating profit up £205m to £141m; strong growth in Civil Aerospace and Power Systems; reported operating loss of £775m
- Group free cash flow improvement of £211m on prior year outflow of £339m driven by good cash flows in Defence and reduced outflow in Civil Aerospace
- Exceptional charge in the income statement for Trent 1000 in-service issues of £554m representing that part of the total estimated cost for the period to 2022 that is considered to be abnormal in nature
- Estimate of FY 2018 cash costs for Trent 1000 and Trent 900 in-service issues approximately £450m, in line with 15 June 2018 guidance, FY 2019 combined cash cost now expected to be at a similar level to 2018, before declining by at least £100m in 2020; despite this we expect to deliver improved 2019 underlying free cash flow compared to our guidance for 2018
- Since the year end net funds have improved by £470m primarily driven by proceeds from the disposal of L'Orange (€673m) completed on 1 June 2018; Commercial Marine sale (expected net proceeds £350m-£400m) announced on 6 July 2018
- FY 2018 underlying profit and free cash flows; now expected to be in the upper half of our guidance range

Group operational highlights

- Positive early progress on the restructuring plan. Target run-rate savings of £400m p.a. by end of 2020
- Civil Aerospace widebody service revenues up 22% on an underlying basis; large engine production ramp-up continues; widebody deliveries up 24%; 259 engines sold in H1 2018; Trent 7000 certification; launch of Pearl engine for business jets, successful testing of Advance3
- Continued strong growth at Power Systems; OE and Service growth across almost all end markets

2018 Half Year Results: Business units

	Underlying revenue (£m)	Organic change	Underlying op. profit (£m)	Organic change
Civil Aerospace	3,600	+26%	(112)	+59%
Defence	1,415	0%	162	-3%
Power Systems	1,471	+13%	80	+193%
ITP Aero	375	-	40	-
Corporate / eliminations	(181)	-	(24)	-
Core operating business	6,680	+16%	146	183
Commercial Marine	333	-13%	(31)	+32%
L'Orange	89	-	21	-
Other / eliminations	(62)	-	5	-
Non-core business	360	-	(5)	-
Total Group	**7,040**	**+14%**	**141**	**205**

For notes to table see page 6

2018 Outlook: Increasing confidence

At our 2017 Full Year Results in March, we provided a 2018 full year outlook for the Group excluding ITP Aero and under our prior reporting structure. Our guidance has been updated to reflect our revised reporting structure. We are now providing guidance on the basis of our core business (which includes ITP Aero and excludes non-core operations either already sold or held for sale). For our core business, we expect 2018 underlying operating profit of around £450m +/- £100m and underlying free cash flow of around £400m +/- £100m.

£m	2018 Outlook	Prior guidance
Guidance on a consistent basis as provided at FY 2017 results		
Group op profit (incl. non-core, excl. ITP Aero)	**£400m +/- £100m***	£400m +/- £100m
Group FCF (incl. non-core, excl. ITP Aero)	**£450m +/- £100m***	£450m +/- £100m
Guidance for core business only		
Underlying revenue		
Civil Aerospace	High single-digit growth	High single-digit growth
Defence	Stable	Stable
Power Systems	Low double-digit growth	High single-digit growth
ITP Aero	Double-digit growth	Double-digit growth
Core business		
Underlying operating profit		
Civil Aerospace	Losses up to a third lower	Losses up to a third lower
Defence	Margins around 150bps lower	Margins around 250bps lower
Power Systems	Margins stable	Margins stable
ITP Aero	Modest decline in profit	Modest decline in profit
Core business op. profit (incl. ITP Aero)	**£450m +/- £100m***	
Core business FCF[7]	**£400m +/- £100m***	

For notes to table see page 6
* Expected to be in the upper half of the guidance range

- Guidance for foreign exchange, net R&D, tax charge, capital expenditure and finance charges remain unchanged for 2018
- Percentage or absolute change figures in this document are on an organic basis (see page 6) unless otherwise stated

Commenting on the Group's outlook, Warren East, added: "*Rolls-Royce is at a pivotal moment in its history. After a long period of significant investment and innovation, we are poised to become the world-leader in large aircraft engines. Now we need to deliver the fundamental changes that will enable us to realise the potential of our position, delivering improved returns while continuing to invest in the innovation needed to realise our long-term aspiration to be the world's leading industrial technology company. Our new business structure and drive for greater pace and simplicity, combined with our growing installed base, means we are well placed to exceed free cash flow of £1bn by 2020 and push towards our mid-term ambition for free cash flow per share to exceed £1.*

This is the time for execution. In Civil Aerospace our installed widebody fleet will continue to grow and we will strive to further reduce cash deficits on engine sales, whilst working hard to minimise the disruption caused to our customers by in-service issues. The benefits of creating a single Defence operation with greater scale and the ability to offer customers a broader range of products and services, should present us with new opportunities. In Power Systems the continued expansion of our end markets is driving strong volume and this, combined with the further product portfolio rationalisation and the development of new service offerings, gives us confidence for the full year."

Restructuring update

Since our initial announcement on 17 January 2018, we have made progress with our plans to simplify the Group into three customer-focused business units. Our new Defence business has been formed by combining both our Naval and Submarine businesses with Defence Aerospace; Civil Nuclear has been moved into Power Systems; we successfully completed the sale of L'Orange and we announced an agreement to sell Commercial Marine.

While we are determined to establish a strong foundation for the future of Rolls-Royce, we are also acutely aware that this restructuring will impact 4,600 colleagues. Restructuring efforts are now focused on removing duplication and fixing the inefficient processes and interfaces across our business. All parts of the business will be managed under a radically simplified structure, alongside an operating framework that clearly outlines roles and responsibilities.

Communication with our people is key and since the restructuring announcement on 14 June 2018, the Executive Leadership Team has held many face-to-face discussions with thousands of employees across the Group, collecting feedback, helping us to set priorities and identifying challenges ahead. This is a tremendous opportunity to create the world's leading industrial technology company.

Trent 1000 in-service issues and costs

The Trent 1000 in-service engine issues have caused significant disruption for a number of our customers, which we sincerely regret. We continue to work hard to remedy this situation and have made further good progress on the implementation of long-term solutions in the first half of the year. We have significantly increased our Trent 1000 maintenance and overhaul capacity, sought ways to reduce engine shop visit turnaround times and have added approximately 50% more turbine blade capacity since the start of the year. We recently confirmed that we have now started certification testing of a redesigned intermediate compressor rotor blade for Trent 1000 Package C engines, with a redesign for Trent 1000 Package B engines to follow. In addition, as a precautionary measure, we have launched and, are in the process of testing, a redesign of the blade common to the Trent 1000 TEN and Trent 7000 engines. We continue to make good progress in addressing the other known issues affecting Trent 1000 engines.

Having provided updated guidance on the cost of these actions in 2018 at our Capital Markets Event in June we are now clarifying the incremental cost of this dynamic situation on 2019 and beyond. Our current assessment is that the combined cash cost of both the Trent 1000 and Trent 900 in-service issues will be at a similar level in 2019 to the approximately £450m we expect in 2018, before declining by at least £100m in 2020. We still expect to deliver an improvement in 2019 underlying core free cash flow compared to our guidance for 2018, marking a further step towards our 2020 free cash flow ambition. The cash costs of the Trent 1000 and Trent 900 issues are expected to step down materially after 2020, with all technical changes expected to be fully embodied into the Trent 1000 and Trent 900 fleets by 2022.

In H1 2018, following the Airworthiness Directives mandating additional inspections, an exceptional charge of £554m has been taken to the income statement. It reflects the impact of the abnormal costs we are incurring to resolve the Trent 1000 in-service issues, which fall outside the scope of our normal TotalCare costs. The charge represents around 40% of the total cash costs expected to be incurred in resolving the Trent 1000 issues for the period to 2022 and is not incremental to them. The remainder of these costs will

be recognised over time through our normal contract accounting margins. Cash costs on the Trent 1000 in-service issues will continue to be fully reflected in free cash flow.

Free cash flow improvement of £211m versus prior year
Overall Group free cash flow improved materially in H1, with an outflow of £72m (2017: £(339m)). Our core business generated a free cash inflow of £10m (2017 H1: £(264)m). The good year-on-year cash flow improvement was driven by increased cash flows in the Civil Aerospace aftermarket from strong growth in engine flying hours and T&M aftermarket activity, better deposit inflows at Defence and a more balanced profile of Civil spare engine deliveries in H1 vs H2 than in the prior year. These more than offset the increased level of R&D cash spend and higher cash costs incurred on Trent 1000 and Trent 900 in-service issues.

L'Orange disposal and announcement of sale of Commercial Marine
The disposal of L'Orange to Woodward Inc. for €673m proceeds completed on 1 June 2018. We also announced the sale of Commercial Marine to KONGSBERG on 6 July 2018 for a total value of £500m, with expected net proceeds of around £350m to £400m dependent upon the final outturn working capital at completion. The proceeds from these disposals will be used to strengthen our balance sheet and provide additional capital to judiciously pursue opportunities that will drive greater returns for the Group. Both L'Orange and Commercial Marine have been reported as non-core businesses in our 2018 Half Year Results.

Balance sheet, capital allocation and payments to shareholders
As we outlined at our Capital Markets Event, a disciplined approach to capital allocation and to sustaining a healthy balance sheet will play a major part in driving our long-term growth. Focusing on improving our return on capital is key and implementing a new KPI, Cash Return on Invested Capital (CROIC), will help us drive this across the Group. Through improved free cash flow generation, we aim to maintain a strong investment grade rating and ultimately return to A-grade status. In the first half net funds have improved by £470m to a net cash position of £165m. The interim payment to shareholders is held at 4.6 pence (H1 2017: 4.6 pence). Restoring our shareholder payments to an appropriate level over time as free cash flow grows will be a key capital allocation priority.

Financial highlights – core business data table (unless otherwise stated)

Financial			**Civil Aerospace metrics available at Half Year**		
£m	**H1 2018**	**H1 2017[2]**		**H1 2018**	**H1 2017[2]**
Underlying op. profit	146	(70)	Large engine in-service fleet	4,567	4,409[8]
Underlying profit before tax	81	(126)			
Underlying effective tax rate	27.2%	4.8%	Large engines deliveries	259	209
Gross R&D spend	663	620			
Net R&D spend	518	442	Large engine invoiced flying hours	6.9m	5.8m
R&D capitalisation	239	84			
Capex	384	427	Total service revenue growth	+22%	n/a
Free Cash Flow	10	(264)			
Group net debt/cash[5]	165	(305)	Large engine LTSA[8] major refurbs	137	91
Hedge book $/£ average[5]	1.55	1.55			
Hedge book (US$bn)[5]	$37.3	$38.5	Large engine check & repair	242	158

For notes to table see page 6

Key drivers of increased returns:
- Civil Aerospace OE cash deficit per engine reduced by 15% from 2017 full year average
- Reduction in C&A cost in Civil Aerospace and Defence; Power Systems C&A costs increased as pay escalation not yet offset by headcount changes, together with phasing differences compared to 2017
- Cash R&D costs increased as planned due to launch of new engines. Mid-term R&D still expected to fall in-line with our mid-term ambition
- Progress on restructuring with consultations underway. Retain confidence in target run-rate savings of £400m p.a. by end of 2020

2018 Business Unit highlights
The commentary in this section relates to the core business and is provided on an underlying basis with year-on-year changes at constant currency[3].

Civil Aerospace - underlying revenue £3,600m, growing 26%, underlying operating loss £(112m)

- Underlying revenue growth of 26% driven by a 24% increase in sales volumes of installed engines and spare engines, including to joint ventures, and increased services activity
- Underlying operating loss reduced by £149m to £(112)m reflecting strong aftermarket trading including increased spare parts sales, higher OE spare engine volumes and increased net R&D capitalisation of £174m, offsetting £(154)m of contract accounting adjustments
- Continued expansion of the in-service fleet; widebody underlying engine flying hours +20%; increase in major LTSA shop visits as expected as a number of Trent 700 engine have had first overhauls
- Continuing progress on installed OE unit deficit reduction – fell by 15% in the first half; cost reduction and pricing improvements on Trent XWB-84, where we continue to work towards break even by 2020
- Milestone achievements in new engine programmes; launched first of a new family of engines for business aviation with the Pearl 15; Trent XWB-97 entered into service on the Airbus A350-1000; Trent 7000 achieved EASA certification

Defence - underlying revenue £1,415m, remaining flat, underlying operating profit £162m

- Underlying revenue flat with modest increase in OE offset by largely stable services revenues
- Underlying operating profit down £6m due to higher R&D spend reflecting ongoing future programme development partly offset by reduced C&A
- Progress combining our enlarged Defence business; providing integrated customer solutions
- The MT30 has maintained its position as a core naval engine of choice with Japan the fifth nation to select the engine for a major naval programme
- Partner in Team Tempest, a collaboration to develop the UK's future Combat Air Strategy
- Orders weighted to second half with a strong pipeline in Combat, Naval and Submarines

Power Systems - underlying revenue £1,471m, growing +13%, underlying operating profit £80m

- Core underlying revenue increased by 13% driven by growth in both OE 14% and services 12%; following good growth in almost all applications from both market strength and management actions on sales
- Core underlying operating profit saw a material improvement on the prior year driven primarily by higher volumes; 180bps rise in underlying gross margin to 24.1%
- Growth in digitalisation increasing fleet connectivity; recent launch of pilot Factory of the Future and Service of the Future to better align internal processes and customer demands
- Recent launch of pioneering Series 4000 marine gas engine demonstrates capability in meeting stringent emissions regulation
- Full year order coverage currently over 80% versus circa 70% in prior year
- Meaningful progress made on MTU Yuchai Power joint venture as part of wider growth strategy in China

ITP Aero – underlying revenue £375m, growth of 19%, underlying operating profit £40m

- Strong revenue progress in H1 to £375m driven by higher Civil Aerospace OE and aftermarket revenues primarily on Rolls-Royce related programmes
- Significantly improved underlying operating profit in H1, increasing £32m to £40m reflecting the higher Civil Aerospace revenues and better product mix in the period
- Confidence in the full year outlook

Reported Group results
The reported loss before tax was £(1,262)m, a significant decrease compared to the 2017 half year profit before tax of £1,444m. The principal differences are: (i) the improvements in operational performances as described earlier; (ii) a positive impact from measuring revenues at spot rates rather than rates achieved on hedging of £447m (H1 2017: £615m); (iii) a loss included in profit before tax of £683m (H1 2017 gain of £1,682m) including negative FX mark-to-market adjustment on the Group's hedge books of £854m (H1 2017: gain of £1,407m) and gains on derivatives settled during the period of £240m (H1 2017: £342m); (iv) the exceptional charge of £554m relating to the Trent 1000 engine, described on page 8; (v) the amortisation of assets recognised under acquisition accounts of £124m (H1 2017 £62m); (vi) exceptional restructuring charges of £179m (H1 2017 £31m), described on page 8; and (vii) a gain of £358m on the disposal of L'Orange in June 2018 and the write down of Commercial Marine goodwill by £160m to the expected disposal value as these assets have been reclassified as 'held for sale'. Further details are shown on page 19.

Notes to financial tables on pages 1-4:
[1] Underlying: for definition see Note 2 on page 30
[2] All prior year comparatives have been restated for IFRS15 see Note 16 on page 45
[3] Organic change at constant translational currency ('constant currency') by applying 2017 rates to 2018 numbers and excluding M&A, specifically ITP Aero and L'Orange
[4] Core Group includes Civil Aerospace, Defence, Power Systems and ITP Aero and excludes L'Orange and Commercial Marine
[5] Comparators at FY 2017 position
[6] Free cash flow is defined as operating cash after capital expenditure, pensions and taxes, before payments to shareholders and acquisitions & disposals. The derivation of free cash flow from the cash flow statement is shown on page 43
[7] Free cash flow outlook includes in-service engine costs as outlined on page 3
[8] LTSA is long-term service agreement

This announcement has been determined to contain inside information.

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Photographs and broadcast-standard video are available at www.rolls-royce.com.
A PDF copy of this report can be downloaded from www.rolls-royce.com/investors.

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

Results presentation
A presentation will be held at 09:00 (BST) today. Details of how to join the event online are provided below. Downloadable materials will be available on the Investor Relations section of the Rolls-Royce website from the start of the event.

Online webcast registration details for 2 August presentation
To register for the live webcast, including Q&A participation, please visit the following link:

https://edge.media-server.com/m6/p/8wxstddj

Please use this same link to access the webcast replay which will be made available shortly after the event concludes.

Core Trading Summary

The P&L table below and all commentary relate to the underlying performance of the core business, and percentage or absolute change figures in this document are on an organic basis, unless otherwise stated.

Summary income statement: Core business

£m	H1 2018	H1 2017	Change	Organic change*
Underlying revenue	**6,680**	**5,611**	**+19%**	**+16%**
Underlying OE revenue	3,247	2,594	+25%	+19%
Underlying services revenue	3,433	3,017	+14%	+14%
Underlying gross profit	**870**	**712**	**+22%**	**+12%**
Gross margin %	13.0%	12.7%	+30bps	-50bps
Commercial and administration costs	(479)	(436)	+10%	+4%
Research and development costs	(296)	(396)	-25%	-28%
Joint ventures and associates	51	50	+2%	+8%
Underlying operating profit	**146**	**(70)**	**216**	**183**
Underlying operating margin	**2.2%**	**-1.2%**	**+340bps**	**+300bps**
Financing costs	(65)	(56)	+16%	+2%
Underlying profit before tax	**81**	**(126)**	**207**	**182**
Tax	(22)	6	-	-
Underlying profit for H1	**59**	**(120)**	**-**	**n/a**
Underlying earnings per share	**3.1p**	**(6.5)p**	**n/a**	**n/a**
Free cash flow	**10**	**(264)**	274	-

*Organic change – 2018 excludes ITP Aero in order to be comparable to 2017

Underlying revenue up 16%

Underlying revenue rose 16% led by good growth in both Civil Aerospace and Power Systems. Civil Aerospace revenue increased 26% driven by higher invoiced volumes of both installed and spare engines together with increased services activity. Strong growth in engine flying hours continued. Power Systems delivered good progress, up 13%, with growth across almost all of its end markets driving double-digit growth in both OE and services revenues. Defence revenue remained stable in H1, with modest growth in OE offsetting a small decline in aftermarket due to Submarines. Civil Aerospace production ramp up continues. Widebody invoiced volumes rose by 50 engines to 259, reflecting good growth in both installed and spare engines, including higher sales to joint ventures – with a much more balanced delivery profile of spare engines H1:H2 this year relative to 2017.

Underlying gross profit up 12%

Underlying gross profit rose 12% to £870m, with gross margins of 13% driven by Power Systems, reflecting volume growth and improved factory utilisation. Civil Aerospace gross profit was broadly flat, with strong aftermarket trading including increased sales of spare parts for mature engines and higher OE spare engine volumes offsetting a large negative contract accounting adjustment of £(154)m (vs £(90)m in H1 2017).

Self-funded R&D cash spend up 14%; P&L charge down 28%

Gross research & development expenditure grew £44m to £663m. After funding from customers and other third parties, self-funded cash R&D spend rose 14% to £518m, reflecting increased investment on new engine demonstrators and technology for future products including the new business aviation Pearl family of engines and UltraFan / Advance3 in Civil Aerospace. Capitalisation of R&D rose from £84m to £239m consistent with the revised R&D policy application as outlined at our FY17 results (see Note 1). This led to a reduction in R&D charge to the income statement of £113m to £296m.

C&A costs up 4%

Commercial & administration costs were £479m, up £18m on the prior year driven by Power Systems where pay escalation was not yet offset by headcount changes, together with phasing differences compared to 2017. Within our other businesses, C&A costs were modestly lower in Defence and Civil Aerospace reflecting good discretionary spend control. Over the mid-term, as restructuring benefits start to accelerate, we continue to target a reduction in C&A costs.

Underlying operating profit up £183m

Group underlying operating profit saw a material £183m improvement on the prior year to £146m, reflecting good profit growth at Power Systems of £52m to £80m led by higher volumes and an improvement at Civil Aerospace, where the operating loss reduced by £149m to a £112m loss in H1, reflecting a number of factors:

- Good aftermarket growth led by higher spare parts sales for mature widebody engines
- Increased spare engine deliveries (reflecting a better H1:H2 balance to these than in prior year) which more than offset increased volumes of loss making installed OE engines
- The increased level of net capitalised R&D contributed £173m more than the prior year driven primarily by the policy application change which was absent from H1 2017
- These more than offset the impact of higher negative contract accounting adjustments, with a £(154)m impact in H1 vs £(90)m in the prior year

Interest

Interest and other financial costs marginally increased year-on-year by £1m to £65m. Net interest payable increased by £4m whilst other underlying financing costs reduced by £3m.

Taxation

Core underlying income statement tax charge was £22m vs a £6m credit in H1 2017, a core underlying rate of 27.2% compared with 4.8% in H1 2017.

Exceptional charge on Trent 1000

In H1 2018, an exceptional charge of £554m has been taken to the income statement. It reflects the income statement impact of the abnormal costs we are incurring to resolve the Trent 1000 in-service issues, which fall outside the scope of our normal TotalCare costs. The charge represents around 40% of the total cash costs expected to be incurred in resolving the Trent 1000 issues for the period to 2022 and is not incremental to them. The remainder of these costs will be recognised over time through our normal contract accounting margins. Cash costs on the Trent 1000 in-service issues will continue to be fully reflected in underlying free cash flow.

Exceptional restructuring charge

An exceptional restructuring charge of £179m was recognised in the first half (H1 2017: £31m), of which £47m relates to restructuring programmes that are already in place at Power Systems and Defence, reflecting actions to remove cost and improve operational efficiency. £132m relates to the cost of restructuring already disclosed at the Capital Markets Event and reflects the maturity of the restructuring plans. As we disclosed, the total cash cost to implement this restructuring is expected to be around £500m with approximately 25% of that in 2018 and the remainder in 2019 and 2020.

Summary funds flow: Group

£m	H1 2018	H1 2017	Change
Underlying profit before tax - Group	**73**	**(143)**	**216**
Depreciation & amortisation	313	331	(18)
Movement in net working capital	129	324	(195)
Expenditure on PPE & intangible assets	(669)	(599)	(70)
Other	128	(169)	297
Trading cash flow - Group	**(26)**	**(256)**	**230**
Taxation paid & pensions*	(46)	(83)	37
Free cash flow - Group	**(72)**	**(339)**	**267**
Of which: Free cash flow – Core business	***10***	***(264)***	***274***
Shareholder payments	(85)	(85)	-
Payment of financial penalties & other**	13	(262)	275
Foreign exchange	30	(20)	50
L'Orange disposal proceeds	584	-	584
Change in net funds	**470**	**(706)**	

*Includes contributions to defined benefits pensions in excess of underlying PBT charge

**Includes net funds acquired/acquisitions and Other Items

Group free cash flow improvement of £211m versus prior year

Overall Group free cash flow improved materially in H1, with an outflow of £72m (H1 2017: £(339m)). Our core business generated free cash flow of £10m (H1 2017: £(264)m). The good year-on-year cash flow improvement was driven by increased cash flows in the Civil Aerospace aftermarket from strong growth in

engine flying hours and T&M aftermarket activity, better deposit inflows at Defence and a more balanced profile of Civil spare engine deliveries in H1 versus H2 than in the prior year. These more than offset the increased level of R&D cash spend and higher cash costs incurred on Trent 1000 and Trent 900 in-service issues.

Working capital contribution

The working capital contribution was £129m positive to cash flow in H1, well below the prior year of £324m. Key drivers were the strong growth in engine flying hour receipts in advance of revenues being recognised, more than offsetting the growth in inventories in the period. A full description of working capital movement is provided on page 21.

Payment to shareholders held flat at 4.6p per share

For H1 2018 the final payment to shareholders is held at 4.6 pence (H1 2017: 4.6 pence), a cash cost of £86m. Restoring our shareholder payments to an appropriate level over time as free cash flow grows will be a key capital allocation priority.

Group net debt

At H1 2018 the Group moved to a net cash position of £165m (2017 Full Year: £(305)m) largely reflecting the €673m proceeds from the sale of L'Orange which was completed on 1 June 2018, group free cash outflow of £72m and shareholder payments of £85m.

Credit rating

The Group is committed to maintaining a robust balance sheet with an investment-grade credit rating. We aim to maintain stable ratings in the single A rating. We believe that this is important for our customers given that we deliver high-performance products and support for equipment which will be in operation for decades.

IFRS 15

Following transition to IFRS 15 on 1 January 2018 on a 'full retrospective' basis the financial results for both the current and comparative period are disclosed on an IFRS 15 basis. The impact of IFRS 15 on our accounting policies and our financial results in 2017 are shown on pages 28 and 45, respectively.

Foreign exchange

The Group hedges transactional foreign exchange exposures to reduce volatility of revenues and costs. The most significant exposure is net US dollar income which is converted into GBP (currently approximately $5-6bn per year and forecast to increase over time). The Group has a hedge book of $37.3bn (at an average rate of USD:GBP 1.55) covering this exposure. We expect the achieved £/$ hedge rate to remain unchanged at around USD:GBP 1.54 through to 2020.

Board update

During the first six months of the year we have appointed one new Non-Executive Director to the Board. Nick Luff was appointed with effect from the close of the Annual General Meeting on 3 May 2018 and joined the Nominations & Governance and Audit Committees.

Civil Aerospace overview

Financial overview

£m	H1 2018	H1 2017	Change	Organic change
Engine deliveries (volume)	**365**	**308**	**+19%**	**+19%**
Underlying revenue	**3,600**	**2,858**	**+26%**	**+26%**
Underlying OE revenue	1,530	1,151	+33%	+32%
Underlying services revenue	2,070	1,707	+21%	+22%
Underlying gross profit	**148**	**137**	**+8%**	**+12%**
Gross margin %	*4.1%*	*4.8%*	*-70bps*	*-50bps*
Commercial and administrative	(157)	(155)	+1%	+1%
Research and development cost	(152)	(280)	-46%	-46%
Joint ventures and associates	49	48	+2%	+6%
Underlying operating profit	**(112)**	**(250)**	**138**	**149**
Underlying operating margin %	**-3.1%**	**-8.7%**	**+560bps**	**+590bps**

Underlying revenue

£m	H1 2018	H1 2017	Change	Organic change
Original Equipment	**1,530**	**1,151**	**33%**	**32%**
Large engine	1,157	763	52%	51%
Business aviation	305	284	7%	5%
V2500	68	104	-35%	-35%
Services	**2,070**	**1,707**	**21%**	**22%**
Large engine	1,328	1,061	25%	25%
Business aviation	201	175	15%	18%
Regional	151	138	9%	14%
V2500	390	333	17%	17%

Underlying revenue increased 26% to 3,600m, reflecting growth in OE, up 32% to £1,530m, and in services, up 22% to £2,070m. This was driven by the continued ramp up of large engine production with deliveries growing to 259 from 209 in the prior year and strong year-on-year growth in spare engine OE sales to support the growing in-service fleet. Revenue growth from increased sales of spare engines to joint ventures contributed £141m to revenue growth in H1. The rise in OE deliveries includes higher sales of Trent 1000 engines for the Boeing 787 and Trent XWB, including the new Trent XWB-97 for the Airbus A350-1000, which entered into service earlier in the year.

Large engine service revenue increased 25% to £1,328m (H1 2017: £1,061m) driven by higher shop visit volumes, with 137 major LTSA shop visits (H1 2017: 91) as expected as a number of Trent 700 engine have had first overhauls combined with growth in spare parts sales and increased repair activity on engines not covered by LTSAs, notably RB211-535s.

Within business aviation, OE sales were 5% higher largely driven by increased engine sales to Bombardier and Gulfstream for large cabin aircraft. The 18% increase in service revenue reflects the impact of lower servicing costs for long-term support contracts which generated a positive contract accounting impact on revenue. The level of service activity on business aviation engines has remained broadly stable.

The 14% increase in regional revenue was driven by higher sales of spare parts to third party MRO bases. On the V2500, OE revenue was 35% lower, reflecting production slowdown on the Airbus A320ceo. The 17% increase in V2500 service revenue to £390m was driven by increased servicing and higher spare part sales. The payment from IAE for flying hours remained broadly stable.

Underlying operating profit
The underlying operating loss of £(112)m improved by £149m. Gross profit increased 12% to £148m with gross margins falling 50bps to 4.1%. Strong servicing activity driving increased spare part sales and higher profit from increased spare OE sales was partly offset by a materially higher negative impact from long-term contract assumption changes. Under long-term accounting, a variation in revenue or cost assumptions, up or down, can lead to contract accounting adjustments, positive or negative, for profits that have already been recognised over the life of a programme to date. In the period there was a negative contract accounting impact of £(154)m (2017: £(90)m) which comprised three components:

- Life-cycle cost benefits of £19m primarily reflecting lower servicing costs for business aviation
- Higher technical costs of £(71)m to reflect the reassessed costs of technical issues across various engine programmes including the additional inspection requirements on the Trent 1000
- Higher costs of £(102)m reflecting the latest information around future aircraft utilisation patterns and the resultant effects on shop visit cost and efficiency

£m	H1 2018	H1 2017
Life-cycle costs	19	(14)
Technical costs	(71)	(9)
Operational changes	(102)	(67)
Total contract accounting adjustments	**(154)**	**(90)**

Investment in self-funded R&D rose by £44m, reflecting increased investment in the new family of engines for business aviation engines and next generation technology, including for the UltraFan demonstrator. This was more than offset by an increase in R&D capitalisation and amortisation of £174m largely reflecting the stage of capitalisation of a number of development programmes which were applied from H2 2017. Overall the expensed R&D charge in the first half reduced from £(280)m in 2017 to £(152)m in H1 2018. While C&A charges of £(157)m were 1% higher, this reflected higher restructuring costs. Excluding such restructuring, C&A costs were £1m lower year-on-year. Profit from joint ventures and associates of £49m was 6% higher due to higher shop visit volumes and a change in the mix of work in joint venture overhaul bases. 2017 profit from joint ventures included £8m from ITP Aero when it was a still a joint venture and reported within Civil Aerospace.

Trent 1000 in-service update
Since 2016, we have been undertaking a proactive maintenance programme on the Trent 1000 to address lower than expected durability of a small number of parts. This has caused disruption to customers which we sincerely regret. On 7 March 2018, with our FY 2017 results, we provided further detail as we progressed our understanding of the technical issues impacting compressor rotor blades, and intermediate and high pressure turbine blades within the Trent 1000. We reported that £119m of cash costs were incurred in 2017 in relation to accelerated maintenance activities on the Trent 1000.

At the time of our FY 2017 results, we provided details of the anticipated future annual cash impact of the in-service issues with the Trent 1000 and issues with the durability of high pressure turbine blades for Trent 900. The impact was expected to broadly double in 2018 from the £170m incurred in 2017 across both the Trent 1000 and Trent 900, before falling by around £100m in 2019. The majority of the work is expected to have been undertaken in 2018 and 2019 and be fully complete by 2022.

On 13 April 2018, we announced the decision to undertake more frequent inspections of the compressors of our fleet of 386 Trent 1000 Package C engines. This was followed by EASA and the FAA issuing airworthiness directives related to repeat inspection requirements for Package C compressors. We said that we would mitigate the incremental cash cost of this accelerated inspection regime by reprioritising various items of discretionary spend. On 11 June 2018 we reported that a similar durability issue had been identified on a small number of high life Package B engines and we had agreed with the regulatory authorities to carry out a one-off inspection of the whole fleet of 166 Package B engines. We have since agreed with the authorities to carry out a regular inspection regime which we will manage as part of our ongoing maintenance programme.

On 15 June 2018, at our Capital Markets Event, we reported that our current assessment was that the further issues encountered since our FY 2017 results could lead to combined additional 2018 cash costs for both the Trent 1000 and Trent 900 in-service issues of around £100m on top of the doubling we had already guided, thus taking the total to approximately £450m. We added that we had successfully enacted a

number of short-term discretionary cost mitigation actions and free cash flow guidance for 2018 was maintained unchanged at around £450m +/- £100m.

Having provided updated guidance on the cost of these actions in 2018 at our Capital Markets Event in June we are now clarifying the incremental cost of this dynamic situation on 2019 and beyond. Our current assessment is that the combined cash cost of both the Trent 1000 and Trent 900 in-service issues will be at a similar level in 2019 to the approximately £450m we expect in 2018, before declining by at least £100m in 2020. We still expect to deliver an improvement in 2019 underlying core free cash flow compared to our guidance for 2018, marking a further step towards our 2020 free cash flow ambition. The cash costs of the Trent 1000 and Trent 900 issues are expected to step down materially after 2020, with all technical changes expected to be fully embodied into the Trent 1000 and Trent 900 fleets by 2022.

The Trent 1000 in-service engine issues have caused significant disruption for a number of our customers, which we sincerely regret. We continue to work hard to remedy this situation and have made further good progress on the implementation of long-term solutions in the first half of the year. We have significantly increased our Trent 1000 maintenance and overhaul capacity, sought ways to reduce engine shop visit turnaround times and have added approximately 50% more turbine blade capacity since the start of the year. We recently confirmed that we have now started certification testing of a redesigned intermediate compressor rotor blade for Trent 1000 Package C engines, with a redesign for Trent 1000 Package B engines to follow. In addition, as a precautionary measure, we have launched and, are in the process of testing, a redesign of the blade common to the Trent 1000 TEN and Trent 7000 engines. We continue to make good progress in addressing the other known issues affecting Trent 1000 engines.

Trent 1000 exceptional charge
In H1 2018, an exceptional charge of £554m has been taken to the income statement. It reflects the impact of the abnormal costs we are incurring to resolve the Trent 1000 in-service issues, which fall outside the scope of our normal TotalCare costs. The charge represents around 40% of the total cash costs expected to be incurred in resolving the Trent 1000 issues for the period to 2022 and is not incremental to them. The remainder of these costs will be recognised over time through our normal contract accounting margins. The treatment of such a charge as exceptional reflects a number of factors, primarily:

- The unprecedented nature of the issues with the Trent 1000 – being a fleet-wide issue of an unusual and abnormal scale, impacting multiple airline customers and resulting in a significant level of aircraft on the ground
- The fact that this technical issue has resulted in a number of separate airworthiness directives and non-modification service bulletins – a highly abnormal situation for Rolls-Royce

The costs which have been included in the exceptional charge cover those which we would not typically incur, such as responding to customer claims in connection with the significant disruption caused and wastage costs related to remediation shop visits, i.e. wasted material and labour to fulfil the contract that are not reflected in the price of the contract.

All other normal course of business costs associated with TotalCare service provision on Trent 1000 engines will continue to be expensed through the income statement within underlying profit in each financial period, in line with our normal contract accounting approach. Cash costs on the Trent 1000 in-service issues will continue to be fully reflected in underlying free cash flow.

Operational and strategic review
The long term trends driving demand for growth in passenger aircraft remain strong, in particular, a growing aspirational and mobile middle-class. We continue to expect strong widebody airframe demand, with an increased focus on newer, more fuel-efficient aircraft, which will support our continued growth in market share and installed base, delivering strong service revenues for decades. The total widebody engines on order is 2,416. In H1 2018, there were 259 widebody engines delivered and 185 orders were placed, including 106 Trent XWB engines and 46 Trent 7000 engines.

Our in-service large engine fleet grew by 4% in the first half to 4,567 and wide-body engine flying hours increased 20%, driven by growth in our Trent 700, Trent 1000 and Trent XWB fleets. The Trent 700 fleet, which now represents 35% of our in-service fleet with over 1,600 engines in service, achieved its 50 millionth flying hour in June. The Trent 700 engine which is known for its dependability and has become the engine of choice for Airbus A330ceo customers, helping us increase our in-service widebody passenger aircraft market share from 14% in 1995, when it was introduced, to 34% today. Our Trent XWB-84, which now represents 8% of our in-service widebody fleet, and has achieved over 2 million flying hours with

excellent levels of reliability. With over 1,300 engines on order, our Trent XWB engines will be a key driver of the continued growth in our market share to over 50% in the early 2020's.

Our strong position in new widebody aircraft was underpinned by progress with three new engines in the period. We powered the first test flight and entry into service of the Boeing 787-10 Dreamliner with delivery of the first Trent 1000 TEN powered Boeing 787-10 to Singapore Airlines. The Trent XWB-97 is now powering three Airbus A350-1000 aircraft with full ETOPs capability and we achieved full certification of the Trent 7000 which will power the Airbus A330neo, with entry into service expected later this summer.

We have seen positive signs of recovery in the business aviation market and are well placed to respond with our new family of engines, launched earlier this year with the announcement of the Pearl 15, which will power the new Bombardier Global 5500 and Global 6500 aircraft. This supports our strategy of regaining market share and reaffirms our position as the top engine supplier in the long range, large cabin sector of the market.

We have made good progress on our future technology programmes, including successfully starting icing tests on our new lean burn and low emission combustion system (ALECSys), which will be used in our UltraFan engine, as well as running our Advance3 engine demonstrator at full power for the first time.

We have taken steps to increase our capacity for engine testing in the first half. We signed a lease with American Airlines for a testbed in Texas which will be used for endurance testing on large engines. We also entered into an agreement with Thai Airways International to support maturity testing on our Trent XWB engines. In addition, we have started work to support the construction of a new testbed in Derby which will provide testing capability for the next generation of engines.

We continue to design and deliver new digital services for our customers, under the banner of our IntelligentEngine vision. With the support of our newly-established R^2 DataLabs team we are able to combine our pioneering technology with advancements in the digital realm to deliver greater reliability, efficiency and value for our customers.

Defence overview

Financial overview

£m	H1 2018	H1 2017	Change	Organic change
Aero engine deliveries (volumes)	**258**	**273**	**-5%**	**-5%**
Underlying revenue	**1,415**	**1,478**	**-4%**	**-**
Underlying OE revenue	608	629	-3%	+1%
Underlying services revenue	807	849	-5%	-1%
Underlying gross profit	**281**	**292**	**-4%**	**+1%**
Gross margin %	19.9%	19.8%	+10bps	+30bps
Commercial and administrative	(77)	(83)	-7%	-5%
Research and development cost	(44)	(32)	+38%	+41%
Joint ventures and associates	2	3	-33%	-33%
Underlying operating profit	**162**	**180**	**-10%**	**-3%**
Underlying operating margin %	**11.4%**	**12.2%**	**-80bps**	**-40bps**

Underlying revenue
Underlying revenue of £1,415m was broadly flat compared to the prior year on a constant currency basis. OE revenue remained broadly unchanged as combat volumes reduced after the completion of the Oman EJ200 production contract in 2017. This was offset by increased demand for transport engines such as the Multi-Role Tanker Transport (MRTT) aircraft and AE2100 variants and an OE contract for the UK's Dreadnought submarine programme. Service revenue was largely flat as increased Long Term Service Agreement (LTSA) revenues driven by EJ200 and Adour were offset by lower service revenue related to the phasing of work on UK submarines.

Underlying operating profit
Underlying operating profit of £162m was £6m lower than the prior year. Gross profit of £281m grew 1% driven by increased sales of MRTT engines and higher LTSA margin improvements of £28m (2017: £21m). This is reflective of cost improvements and increased flying hours on combat and patrol contracts, partially offset by lower OE combat volumes and lower margin on a bridging contract following completion of a submarine service agreement in the prior year.

An increase in R&D spend of £13m largely reflects ongoing future programmes across our Defence portfolio. C&A costs were £4m lower as a result of actions taken across the business to manage discretionary spend.

Operational and strategic review
Following the Group's restructuring announcement in January of this year, Tom Bell, previously Global Sales & Marketing for Defense, Space & Security at The Boeing Company, was appointed to lead the enlarged Defence business comprising Defence Aerospace, Submarine and Naval operations. During the first six months, meaningful progress has been made on integration in order to identify and pursue cost efficiency, leveraging our technology and operational experience across this enlarged business to provide integrated solutions to better serve our customers.

As part of this restructuring, Defence has streamlined to a five-layer organisation from top to bottom, focused upon Defence Programmes, Services and Submarine activities with aligned functional support. Opportunities have been actively pursued to incorporate elements of work previously done by central functions. An example of this is a move to combine the former head office function of the US Government Relations and the US Customer Business team within Defence in order to better serve one of the business' key customers.

Outlook for full year orders is positive, with a strong pipeline of expected opportunity in Combat, Naval and Submarines. Orders secured in the first half of 2018 reflect activity across markets to secure aftermarket contract renewals such as with the US Department of Defense to support in-service fleets, ongoing work related to the UK's submarine programmes and other smaller contracts. Notable orders include £300m of contracts in Submarines representing orders for decommissioning, development and sustainment activity in the near-term, and a sustainment agreement worth up to $420m over six years to support both US Air Force and Navy AE3007H engines. This is part of our innovative public-private partnership first formed in

2016 at Tinker Air Force Base in Oklahoma, US, which enables closer collaboration with our customer to maximise engine availability.

Naval continues to see good demand for its MT30 marine gas turbine with an initial MT30 powered Daegu-class frigate delivered to the Republic of Korea Navy, marking the first deployment of this engine outside the UK and US markets. In June, Japan was the fifth nation to select the MT30 engine for a major naval ship programme, while the Australian government's selection of the Type 26 Global Combat Ship as the preferred design for the SEA 5000 Future Frigate program presents further opportunity to provide a naval propulsion system with the MT30 engine at its core.

Operationally, there was solid progress across Defence. LiftSystem™ continued its good in-service fleet performance with the Royal Air Force deploying the first four F-35B Lightning II aircraft to the UK. EJ200 production volumes remain at a lower level; although the expectation remains for further orders following agreement of a contract to purchase 24 aircraft in December 2017 from the State of Qatar, and the signing of a memorandum of understanding to purchase a second batch of 48 aircraft for the Kingdom of Saudi Arabia.

We continue positioning the business to maximise the strengths of our teams to develop strong long-term relationships with current and future customers. This includes the modernisation of the Indianapolis facility, which continues on track to achieve its 2018 milestones, including substantial completion of construction and refurbishment and a quarter of manufacturing relocation. In addition, the business made good progress towards securing a substantive role to deliver a new combat power and propulsion system through its position as one of four partner companies in Team Tempest, a collaboration set up to explore a range of concepts as part of UK's Future Combat Air strategy. The signature of a contract during the Farnborough Airshow allows us to further advance our combat R&D activities and mature key next generation power and propulsion capabilities.

Power Systems overview

Financial overview

£m	H1 2018	H1 2017	Change	Organic change
Underlying revenue	**1,471**	**1,275**	**+15%**	**+13%**
Underlying OE revenue	945	814	+16%	+14%
Underlying services revenue	526	461	+14%	+12%
Underlying gross profit	**354**	**283**	**+25%**	**+23%**
Gross margin %	24.1%	22.2%	+190bps	+180bps
Commercial and administrative	(188)	(172)	+9%	+8%
Research and development cost	(86)	(84)	+2%	0%
Joint ventures and associates	-	(1)	n/a	n/a
Underlying operating profit	**80**	**26**	**+208%**	**+193%**
Underlying operating margin %	**5.4%**	**2.0%**	**+340bps**	**+330bps**

Underlying revenue
Underlying revenue was £1,471m, an increase of 13%. This excludes L'Orange which is now treated as non-core following its disposal in June. OE rose 14% with good growth in almost all segments, notably led by improved commodity end markets, Medium Speed Land, Rail and Marine / Government project wins. Power Generation was the only end market not to experience growth in H1, solely due to the tough comparison base after the high level of demand seen in 2017 from Chinese Telecoms related sales. Services revenue increased 12% with improved commodity markets driving higher engine running hours and hence improved spare parts and engine remanufacturing demand, particularly in the US.

Underlying operating profit
Overall, excluding L'Orange, underlying operating profit rose by £52m to £80m, 193% growth, reflecting the benefits of higher volumes. This also drove an increase in gross margin, up 180bps to 24%.

C&A costs were 8% higher with pay escalation not yet offset by headcount changes, together with phasing differences compared to 2017. Ongoing discipline around R&D investment saw costs held broadly flat despite continued investment in future engine platforms and in support of our electrification strategy and engineering capabilities.

Operational and strategic review
In the first half of 2018, market conditions remained robust across Power Systems' diverse end-markets. There was continued demand in Power Generation, particularly for diesel powered solutions to support infrastructure projects in emerging markets and for gas-engine power solutions driven by increasing availability of gas and requirements for fast response capability to support time-critical operations. Industrial end markets remain supported by higher commodity prices and rising demand for solutions tailored to offshore wind markets, however challenges remain in offshore markets, and Civil Nuclear faced some headwinds from project delays.

Order intake was up year-on-year primarily driven by the recovery of key markets, such as Oil & Gas, Mining and Agriculture, and also as some customers brought forward their orders into 2018 ahead of new emissions standards coming into effect in 2019. Bergen land engines are notable as all sales year-to-date have been accompanied by long term service contracts, contributing to further growth in services. Demand for Power Generation also continued to grow driven by an agreement signed in July to deliver 475MW of backup capacity for Chile's national electricity grid as part of a consortium led by TSK. Continued strong interest from naval customers has generated a pipeline of opportunity. Our confidence in full year delivery is underpinned by over 80% order coverage for the full year compared to circa 70% at the same time in the prior year.

Following the Group's restructuring announcement in January of this year, Power Systems has achieved milestones such as the integration of the Civil Nuclear operations and also completed the sale of L'Orange, a fuel injector business, to Woodward Inc. for total proceeds of €673m. L'Orange will remain an important partner and supplier for Power Systems in the future through a long-term supply agreement. Other key activities include projects to enable greater digitalisation, increasing fleet connectivity to support growth in the level of long-term Value Care Agreements (VCA) covering our in-service engines. This demonstrates

the strong drive from the leadership team to transform the business into a solutions-provider and achieve a greater share of the engine service opportunity.

The business is implementing MTU customer service 4.0, a service and digital strategy to transform the Power Systems service and distribution networks is focused on improving customer interfaces such as the opening of a new Customer Care Centre's based in Friedrichshafen, Novi in the US, and Singapore. The recent launch of pilot programmes will explore concepts for both the Factory of the Future and Service of the Future, informing how the business will align its internal processes more closely to meet customer needs. This highlights the commitment by the business to achieving strengthened service offerings and is complemented by further optimisation of inventory levels to increase availability of spare parts at the point of sale beyond 80%.

Good progress has been made to establish production capability in lower cost locations closer to key end markets. In early 2018, the joint venture MTU Yuchai Power began localised production of the MTU Series 4000 diesel engines under license as the business took receipt of the first engine from the production line in the city of Yulin, China, and production continues to ramp up. In April, an agreement was signed with Goa Shipyard Limited to assemble Series 8000 engines, further reinforcing a commitment to 'Make in India' after an earlier agreement to assemble Series 4000 naval engines in the country.

R&D activity focused on delivering efficient and disciplined investment in the current and future product portfolio. The business continued to reprioritise its product roadmap, with a reduction in product variants of around 30% achieved since 2015, and positioning of future products towards growth markets to reflect the structural shift away from traditional engine solutions. Investments focused on hybrid and gas technology with the first prototype of a 1MWh battery storage container for micro-grid solutions or off-grid power supply, while the launch of the pioneering Series 4000 marine gas engine demonstrates our capability to enable operators to meet stringent emissions regulation.

ITP Aero overview

Financial overview

£m	H1 2018	H1 2017*	Change	Organic change
Underlying revenue	**375**	**309**	**+21%**	**+19%**
Underlying OE revenue	336	-	-	-
Underlying services revenue	39	-	-	-
Underlying gross profit	**85**	**50**	**+70%**	**+67%**
Gross margin %	*22.7%*	*16.2%*	*+650bps*	*+650bps*
Commercial and administrative	(31)	-	-	-
Research and development charge	(14)	-	-	-
Joint ventures and associates	-	-	-	-
Underlying operating profit	**40**	**8**	**+400%**	**+400%**
Underlying operating margin %	**10.7%**	**2.6%**	***+810bp***	***+820bps***

* ITP Aero was acquired on 19 December 2017. Prior year comparatives are unaudited and are presented for comparison purposes only

Underlying revenues
Underlying revenue was £375m, an increase of 19% versus H1 2017. Growth was led by higher engine volumes, with significant ramp-up across various Civil Aerospace programmes in ITP Aero's portfolio. Civil Aerospace aftermarket growth was strong, with Defence sales modestly lower and flat revenues in MRO and services.

Underlying operating profit
Operating profit of £40m was a £32m improvement versus H1 2017 driven by significantly improved gross margins. Civil Aerospace was the key driver of progress driven mostly by Rolls-Royce programmes, with a combination of higher volumes, improved mix of engine types and a better aftermarket performance.

Operational and strategic review
The long-term trends driving demand for growth in passenger aircraft remain strong. The business continues to expect strong airframe demand for both narrow and wide body aircraft, with an increased focus on newer more fuel efficient aircraft. This, coupled with ITP Aero's presence on newly launched platforms which are currently ramping up, provides a solid base for ongoing growth, particularly in Civil Aerospace.

The business continued to deliver good operational progress underpinning production ramp-up. Production volumes have now reached a record level, driven by the considerable increases across Rolls-Royce and Pratt & Whitney civil engine programs, with a solid volume base from GE and Honeywell and also at Defence. In order to support this growth, we have continued to successfully execute on its capital investment plans, with expansion of production facilities in Spain and Mexico and across various products including turbo-machinery, externals and castings.

Execution continued on our Research & Technology plan, which includes among others, new technologies for future low pressure turbines (both conventional and high speed designs suitable for use in future geared drive systems). We also continue to invest in advanced manufacturing processes, including additive manufacturing and digitalisation.

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)*	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	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	Commodity contracts £m	Interest rate contracts [1] £m	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				Year to 31 December 2017
	Foreign exchange £m	Commodity £m	Interest rate £m	Total £m	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		Other	
	Half-year to 30 June 2018 £m	Year to 31 December 2017 £m	**Half-year to 30 June 2018 £m**	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		Year to 31 December 2017	
	Book value £m	**Fair value £m**	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			31 Dec 2017		1 Jan 2018
	£m	£m	£m	£m	£m	£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	Stephen Daintith
Chief Executive	*Chief Financial Officer*
2 August 2018	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