

ROLLS-ROYCE HOLDINGS PLC - 2021 Half Year Results

Delivering on financial priorities and looking forwards to a lower carbon future

- Good start to the year with improving cash flow and profits from continuing operations
 - Underlying operating profit £307m, up from a £(1,630)m loss in 2020 H1
 - Free cash flow £(1,174)m, significantly better than prior year (2020 H1: £(2,862)m)
 - Strong liquidity position with no maturities before 2024
- Focused on delivering to plan and driving results
 - Restructuring delivering results and expected to achieve >£1bn savings in 2021
 - Disposal programme progressing well towards targeted proceeds of at least £2bn
 - Target to turn free cash flow positive during the second half 2021
 - On track to improve FY2021 free cash flow to approximately £(2.0)bn (2020: £(4.2)bn)
- Net zero pathway launched confirming our targets and commitment to play a leading role in the transition of the markets we serve to net zero carbon emissions by 2050

Warren East, Chief Executive said: “Our continued focus on the elements within our control, together with a good performance from Defence and order intake recovery in Power Systems have enabled us to deliver solid progress in the first half. The benefits of our fundamental restructuring programme in Civil Aerospace are evident in our reduced cash outflow and improved operational efficiency. This leaner cost base together with a strong liquidity position gives us confidence in our ability to withstand uncertainties around the pace of recovery in international travel and benefit from the eventual rebound. We are making disciplined investments in the new opportunities to drive future growth, particularly in net zero power where we are leading the way with innovation and engineering excellence. Our net zero pathway and targets, announced in June, set out our plan to enable the sectors in which we operate achieve net zero by 2050 by driving step-change improvements in engine efficiency, helping accelerate the take-up of sustainable fuels and developing new technologies.”

First half 2021 Group financial performance

£ million	Statutory 2021 H1	Statutory 2020 H1	Underlying 2021 H1	Underlying 2020 H1
Revenue	5,159	5,673	5,227	5,410
Gross profit/(loss)	814	(590)	1,097	(965)
Operating profit/(loss)	38	(1,617)	307	(1,630)
Profit/(loss) before taxation	114	(5,213)	133	(3,203)
Profit/(loss) from continuing operations	394	(5,261)	104	(3,293)
(Loss)/profit from discontinued operations ¹	(1)	(117)	43	(33)
Profit/(loss) for the period	393	(5,378)	147	(3,326)
Earnings/(loss) per share (pence) ²	4.72p	(96.12)p	1.76p	(59.44)p

	2021 H1	2020 H1	Change
Group free cash flow (FCF)	(1,151)	(2,801)	1,650
Group free cash flow from continuing operations	(1,174)	(2,862)	1,688
Reported movements in net debt from cash flows (ex. lease liabilities)	(1,503)	(3,152)	1,649

	30 June 2021	31 December 2020	Change
Net debt (ex. lease liabilities)	(3,083)	(1,533)	(1,550)

For footnotes referenced in tables on pages 1-14, see page 15.

Business unit underlying performance summary

Underlying performance excludes the impact of period-end mark-to-market adjustments, the effect of acquisition accounting and business disposals, impairment of goodwill and other non-current and current assets, and exceptional items. Adjustments between the underlying income statement and the reported income statement are set out in note 2 in the condensed consolidated interim financial statements on page 28.

£ million	Underlying revenue	Organic Change ³	Underlying operating profit/(loss)	Organic Change ³
Civil Aerospace ⁴	2,168	(336)	39	1,860
Defence	1,721	266	269	72
Power Systems ⁵	1,181	(49)	41	9
Other businesses ⁶	152	21	5	22
Corporate / eliminations ⁷	5	12	(47)	(7)
Continuing operations	5,227	(86)	307	1,956
ITP Aero ⁴	317	(79)	7	7
Inter-segment eliminations	(171)	76	(23)	16
Total Group	5,373	(89)	291	1,979

Group underlying revenue from continuing operations of £5.2bn, down 2%, reflected a more balanced contribution from the business units compared with the prior period. It included a positive £160m Civil Aerospace LTSA revenue catch-up compared with a £(866)m negative revenue catch-up in first half 2020.

Group underlying operating profit from continuing operations of £307m included significant cost savings from the restructuring programme, primarily in Civil Aerospace, and favourable timing and mix of activity in Defence and Power Systems. The prior period comparative underlying loss of £(1.6)bn included £(1.2)bn of one-off charges mostly related to the impact of COVID-19 on Civil Aerospace.

In **Civil Aerospace**, our first half operational performance saw an overall improvement with a recovery in business aviation and domestic large engine flying activity together with substantial cost benefits from our fundamental restructuring programme, which is reducing the size of our cost base by around a third. Large engine LTSA flying hours were 43% of the 2019 level, up from the 34% in H2 2020; 92 large engine major shop visits were completed and 100 large engines were delivered. We have already seen a return to 2019 levels of flying activity for our business aviation engines and for large engines operated on domestic flying routes. However, international travel is recovering more gradually, hindered by global variation in vaccination rates and ongoing travel restrictions. We are continuing to mitigate this through the actions within our control.

Our **Defence** business continues to perform well with resilient demand that has not been impacted by COVID-19. First half performance benefitted from improving operational performance which enabled the earlier delivery of spare engines and higher spare parts sales, which historically have been more second half weighted. This favourable timing and mix in the first half is expected to result in a stronger first half versus second half performance, hence our full year expectations for Defence are unchanged. Our strong order book in Defence gives us confidence in our outlook with £1.2bn order intake in period and more than 70% of 2022 expected revenues covered by the order book.

In **Power Systems**, revenues were broadly stable in the first half with an increase in services offset by a reduction in original equipment (OE) deliveries. Operating profit benefitted from a rise in higher-margin aftermarket spare parts, partly offset by low factory utilisation on OE manufacturing. Order intake was up 19% to £1.4bn (2020 H1: £1.2bn), with a 1.2x book-to-bill ratio, showing recovery in our end markets led by demand in marine, governmental and power generation markets. Interest in lower carbon solutions is growing and we are increasing our relative R&D investment in these products. The recovery in OE order intake is expected to be realised as revenue over the next 6-12 months.

Delivering on our commitments

Our ongoing focus on areas within our control - cost reduction, liquidity and operational improvement - enabled us to deliver a significant improvement in first half profit and cash flow while continuing to invest in new products, including new low carbon technology and solutions to decarbonise our end markets.

- **Restructuring:** We delivered further good progress on our fundamental restructuring programme with around 8,000 roles now having been removed and we expect to deliver more than £1bn of savings in FY2021 as compared with FY2019. This keeps us on track to achieve our aim of a reduction of at least 9,000 roles and run rate savings of more than £1.3bn by the end of 2022.
- **Disposal Programme:** Our disposal programme, which aims to achieve at least £2bn in proceeds is progressing well. The planned sale of ITP Aero is moving forwards and we continue to work closely with all key stakeholders. Although the disposal of Bergen Engines was interrupted in the first half, we remain committed to its sale and this week announced a new disposal agreement with enterprise value of €63m and €40m cash on its balance sheet will remain with the Group. We expect to complete the disposal of the Civil Nuclear Instrumentation & Control business later this year.

Strong liquidity position and improvement in free cash flow

Our liquidity position is strong with £7.5bn of liquidity including £3.0bn in cash at the end of the half year after repaying the 2021 €750m loan notes and the £300m Covid Corporate Financing Facility (CCFF) loan in the first half. Net debt (before leases) was £(3.1)bn at the period end. This week the Group signed an extension to the 2022 £1bn unused loan facility to 2024, consequently the Group has no debt maturities before 2024 (excluding ITP Aero).

Free cash outflow of £(1.2)bn represented a significant improvement on the prior year period of £(2.9)bn, which included a £(1.1)bn negative impact from the cessation of invoice factoring. The £0.6bn underlying improvement reflected good progress on cost reduction, stronger operating performance and reduced capital expenditure.

Our £2.0bn UKEF-backed 2025 loan facility, which we drew down in the first half, restricts us from declaring or making shareholder payments until 2023. In 2023, payments can resume provided certain conditions are satisfied. Therefore, no interim shareholder payment will be made for 2021.

Our priorities for capital allocation are to rebuild the balance sheet and to invest in the business to grow returns ahead of returning surplus cash to shareholders. We are focused on generating appropriate value on our disposals and improving free cash flow. This will reduce net debt and take us towards our ambition to return to an investment grade credit profile in the medium term.

Outlook and financial guidance

We continue to expect to turn free cash flow positive sometime during the second half of this year and to achieve an improvement in full year free cash outflow to around £(2.0)bn (FY2020: £(4.2)bn). This is driven by our actions to reduce costs, continued strength in Defence, growth in Power Systems and a gradual recovery in Civil Aerospace. Our guidance remains sensitive to the timing of OE concession outflows on already delivered widebody engines, as we previously highlighted in our full year results in March.

Looking further ahead, we are confident that when border restrictions are lifted the recovery of international travel will accelerate. Free cash flow of at least £750m (before disposals) is still achievable in a 12-month period when EFH exceed 80% of 2019 levels, supported by our lower cost base in Civil Aerospace which is now a third smaller. However, based on current industry forecasts for the pace of recovery in international travel, this is likely to occur beyond the initial expected timeframe of 2022. We are positive on the near-term opportunities in Defence and Power Systems and in our new business areas in electricals and small modular reactors (SMR). We will remain agile in our response to external factors, continuing to deliver on our restructuring, rebuilding our balance sheet while investing in our future.

Our net zero commitment and new low-carbon growth opportunities

In June, we announced our net zero pathway setting our short and medium-term targets and showing how we will focus our technological capabilities to play a leading role in enabling significant elements of the global economy to reach net zero carbon by 2050. To achieve this, we are developing new technologies, enabling an accelerated take-up of sustainable fuels and driving step-change improvements in fuel efficiency, within aviation, shipping and power generation. By 2030, we plan to make all our new products compatible with net zero and by 2050 all our products in operation will be compatible.

In addition to meeting the net zero challenge for our existing activities, we are also investing in new opportunities and markets, laying the foundations for future growth beyond our current portfolio.

We are at the forefront of the development of electrical aerospace propulsion systems which are opening up exciting incremental growth opportunities with significant commercial potential. Earlier this year we announced an agreement with Wideroe and Tecnam to power an electric regional aircraft by 2026. We are testing our 2.5MW power generation system for potential use in hybrid-electric aerospace propulsion. Our urban air mobility partner, Vertical Aerospace, took a step forwards in June with the announcement of its planned US listing and up to \$4bn in pre-orders for up to 1,000 eVTOL aircraft.

Rolls-Royce SMR power stations have been designed to deliver low cost, net zero carbon nuclear power and are on a pathway to be connected to the UK grid in the early 2030s with the further opportunity of substantial export potential. In addition to stable base load power, they will be able to provide energy for the net-zero manufacture of green hydrogen and synthetic fuels. We are now approaching the second phase of the programme, which will include entering the UK licensing process later this year, supported by new third party investment that unlocks multi-year UK Government matched funding of £210m.

To enable our net zero ambitions and to drive new business growth in low-carbon technologies we are increasing the proportion of gross R&D spend on lower carbon and net zero technologies to 75% by 2025.

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 Rolls-Royce Holdings plc and its directors accept no liability to any other person other than under English law.

Results webcast and conference call

A webcast will be held at 08:30 (BST) today and details of how to join are provided below. Conference call details are also available for those who would prefer to dial-in. Downloadable materials will also be available on the Investor Relations section of the Rolls-Royce website.

Webcast details

To register for the webcast, including Q&A participation, please visit the following link: <https://edge.media-server.com/mmc/p/4rvsdubk>

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

Conference call details

UK dial-in: +44 (0) 203 009 5709 / US dial-in: +1 646 787 1226

International dial-in for all participants: +44 (0) 203 009 5709

Participant passcode: 5215 215

Downloadable materials

Please visit the Investor Relations section of the Rolls-Royce website to download our Half Year Results materials: <https://www.rolls-royce.com/investors/results-and-events.aspx>

Group Statutory Results

Statutory Income Statement

£ million	Statutory 2021 H1	Statutory 2020 H1	Change
Revenue	5,159	5,673	(514)
Gross profit/(loss)	814	(590)	1,404
Operating profit/(loss)	38	(1,617)	1,655
(Loss)/gain on acquisition/disposal	(7)	2	(9)
Financing income/(costs)	83	(3,598)	3,681
Profit/(loss) before taxation	114	(5,213)	5,327
Taxation	280	(48)	328
Profit/(loss) for the period from continuing operations	394	(5,261)	5,655
Loss for the period from discontinued operations ¹	(1)	(117)	116
Profit/(loss) for the period	393	(5,378)	5,771
Earnings/(loss) per share (p) ²	4.72	(96.12)	100.84

Statutory revenue of £5.2bn, down 9%, reflected a more balanced contribution from the business units compared with the prior period. Civil Aerospace revenue declined, as lower large engine OE deliveries and shop visit volumes offset the non-repeat of large negative LTSA catch-ups. Defence revenue grew strongly helped by favourable timing of high margin spare parts and spare engine sales and Power Systems revenue was broadly stable with an increase in aftermarket services offset by lower OE deliveries. Revenue included a positive £160m Civil Aerospace LTSA catch-up compared with a £(866)m negative revenue catch-up in the prior period. The large negative LTSA catch-up in 2020 H1 reflected the impact of COVID-19 on our expected flying hours and aircraft retirement risk.

Gross profit returned to profit of £814m compared with a prior period loss of £(590)m as the restructuring programme achieved substantial cost savings, particularly in Civil Aerospace, and Defence delivered strong growth in higher margin products. It also included a £166m Civil Aerospace LTSA catch-up to profit compared with an £(814)m negative charge in 2020 H1.

Operating profit improved significantly to £38m from a prior period £(1.6)bn loss. The prior period included one-off charges comprising negative catch-ups, impairments and write-offs. R&D charges decreased from £(678)m to £(390)m primarily as a consequence of one-off impairments in the prior period. Self-funded R&D expenditure was £(396)m, down 10%. C&A costs of £(424)m were broadly flat.

Profit before tax of £114m included higher charges from interest bearing debt and committed undrawn facilities compared with the prior year period. It also benefitted from a £25m non-cash profit from revaluation of the hedge book compared with a prior period revaluation loss of £(2.6)bn.

Profit from continuing operations of £394m included a tax credit of £280m. The tax credit mainly relates to the remeasurement of the opening UK deferred tax balances from 19% to 25%, following the enactment of the change in UK corporation tax rate, together with the tax on profits and losses in overseas jurisdictions.

Discontinued operations: ITP Aero has been classified as discontinued in the 2021 H1 results.

EPS of 4.72p (2020 H1: (96.12)p) reflected the improvement in profit and an increase in weighted average number of shares compared with the prior period, which was restated and adjusted for the bonus factor of 2.91 to reflect the bonus element of the rights issue in 2020.

Statutory Balance Sheet

£ million	30 June 2021	ITP Aero classified as HfS 31 December 2020		As Reported 31 December 2020		Change excluding ITP Aero
		ITP Aero				
Intangible assets	4,063	4,191	954	5,145	(128)	
Property, plant and equipment	3,992	4,184	331	4,515	(192)	
Right-of-use assets	1,266	1,391	14	1,405	(125)	
Joint ventures and associates	413	393	1	394	20	
Contact assets and liabilities	(8,836)	(8,945)	23	(8,922)	109	
Working capital ⁹	1,229	473	97	570	756	
Provisions	(1,720)	(1,907)	(38)	(1,945)	187	
Net debt ¹⁰	(4,941)	(3,558)	(69)	(3,627)	(1,383)	
Net financial assets and liabilities ¹⁰	(2,605)	(3,077)	(34)	(3,111)	472	
Net post-retirement scheme surpluses/(deficits)	(530)	(673)	-	(673)	143	
Tax	1,653	1,224	71	1,295	429	
Held for sale ¹¹	1,402	1,410	(1,350)	60	(8)	
Other net assets and liabilities	24	19	-	19	5	
Net liabilities	(4,590)	(4,875)	-	(4,875)	285	
Other items						
US\$ hedge book (US\$bn)	24			25		
Civil LTSA asset	847			726		
Civil LTSA liability	(6,895)			(6,841)		
Civil net LTSA liability	(6,048)			(6,115)		

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

Intangible assets: Net decrease of £(128)m included additions of £89m primarily related to programme development in Civil Aerospace and Power Systems, and investment in the development of software applications across the business. There was an adverse foreign exchange impact of £(124)m and amortisation for the period was £(154)m.

Property, plant and equipment: Net decrease of £(192)m included additions of £95m, more than offset by £(239)m depreciation and a foreign exchange impact of £(65)m. Additions were £83m lower as a result of continued focus on prioritisation of business critical infrastructure projects and efforts to reduce capital intensity in Civil Aerospace with the ongoing cost reduction programme.

Right-of-use assets: Net reduction of £(125)m was driven by £(137)m depreciation charged in the period partly offset by additions of £10m.

Contract assets and liabilities: The net liability balance decreased by £(109)m, of which £67m related to the Civil Aerospace net LTSA balance change, and included positive LTSA catch-ups of £160m, offset by LTSA revenue billed being ahead of revenue recognised in the period of £(52)m and foreign exchange movements of £(41)m.

Working capital: The £1,229m net current asset position reflected a £756m movement driven by a £239m increase in inventory for planned second half sales, and a £758m decrease in payables driven by lower concessions and Risk and Revenue Sharing Partner (RRSPs) payables in Civil Aerospace and the final financial penalty payment of £156m related to agreements reached in January 2017. Partly offset by a £(241)m decrease in receivables reflecting the phasing of trading and customer receipts.

Provisions: The £187m decrease primarily reflected the utilisation of restructuring provisions of £59m and Trent 1000 provisions of £148m during the period.

Net debt: Reduced by £(1.4)bn to £(4.9)bn primarily driven by free cash outflow of £(1.2)bn.

Net financial assets and liabilities: There was an increase of £472m, primarily related to settled contracts in the period of £333m and the fair value movement in foreign exchange and other derivatives.

Net post-retirement scheme surpluses/deficits: £143m movement driven by an increase in the UK scheme surplus reflecting company contributions offset by actuarial changes and a decrease in the overseas schemes deficit mainly attributable to actuarial changes and foreign exchange. See note 16.

Group Underlying Results

The commentary and income statement below describe underlying performance, with percentage and absolute change figures presented on an organic basis, unless otherwise stated. Adjustments between the underlying income statement and the reported income statement are set out in note 2 to the condensed consolidated interim financial statements on page 28.

Underlying Income Statement

£ million	2021 H1	2020 H1	Change	Organic Change ³	M&A ⁸	FX
Underlying revenue	5,227	5,410	(183)	(86)	24	(121)
Underlying OE revenue	2,239	2,728	(489)	(466)	24	(47)
Underlying services revenue	2,988	2,682	306	380	-	(74)
Underlying gross profit/(loss)	1,097	(965)	2,062	2,082	8	(28)
Gross margin %	21.0%	(17.8%)	38.8%pt	38.7%pt		
Commercial and administration costs	(444)	(435)	(9)	(7)	(8)	6
Research and development costs	(386)	(321)	(65)	(71)	-	6
Joint ventures and associates	40	91	(51)	(48)	-	(3)
Underlying operating profit/(loss)	307	(1,630)	1,937	1,956	-	(19)
Underlying operating margin	5.9%	(30.1%)	36.0%pt	36.1%pt		
Financing costs	(174)	(1,573)	1,399	1,397	-	2
Underlying profit/(loss) before tax	133	(3,203)	3,336	3,353	-	(17)
Taxation	(29)	(90)	61	61	-	-
Profit/(loss) for the period from continuing operations	104	(3,293)	3,397	3,414	-	(17)
Profit/(loss) for the period from discontinued operations	43	(33)	76	75	-	1
Underlying profit/(loss) for the period	147	(3,326)	3,473	3,489	-	(16)
Underlying earnings/(loss) per share (p) ²	1.76	(59.44)	61.20	61.42		

Underlying revenue of £5.2bn reflected a more balanced contribution from our business units. Services revenue increased 14% while OE fell 17%. Services revenue included a £160m Civil Aerospace LTSA revenue catch-up compared with £(866)m in the prior period.

Underlying gross profit of £1.1bn reflected the benefit of cost reductions and a £166m Civil Aerospace LTSA catch-up. The prior period loss of £(965)m included £(1.2)bn of one-off charges, mainly relating to negative Civil Aerospace LTSA catch-ups.

Underlying operating profit was £307m, with a return to profit reflecting the higher gross profit in the period. The R&D charge increase demonstrates the continued focus on early stage technology and innovation. The lower JV and associates contribution reflected the impact of lower services activity on our MRO joint venture businesses.

Underlying profit before tax included financing costs of £(174)m with higher charges relating to interest bearing debt and committed undrawn facilities compared with the prior period. In 2020 H1, a £(1.5)bn one-off underlying finance charge was taken to close out over hedged positions on the USD hedge book.

Underlying profit included a tax charge of £(29)m (2020 H1: £(90)m), an underlying rate of 21.8% compared with (2.8)% in the prior period.

Underlying EPS reflected the improvement in profit and an increase in weighted average number of shares compared with the prior period, which was restated and adjusted for the bonus factor of 2.91 to reflect the bonus element of the rights issue in 2020.

Group Funds Flow Statement

£ million	2021 H1	2020 H1	Change
Underlying operating profit/(loss) – total Group	291	(1,669)	1,960
Depreciation, amortisation and impairment	480	499	(19)
Lease payments (capital plus interest)	(171)	(190)	19
Expenditure on intangible assets	(71)	(176)	105
Expenditure on property, plant and equipment	(124)	(221)	97
Change in inventory	(219)	(301)	82
Movement in receivables/payables/contract balances (excluding Civil LTSA)	(420)	(1,541)	1,121
Civil Aerospace net LTSA balance change	(108)	788	(896)
Movement on provisions	(136)	132	(268)
Cash flows on settlement of excess foreign exchange contracts	(303)	(88)	(215)
Fees on undrawn facilities and net interest	(116)	(26)	(90)
Cash flow on financial instruments net of realised losses included in operating profit	(52)	(33)	(19)
Other	(6)	(35)	29
Trading cash flow	(955)	(2,861)	1,906
Contributions to defined benefit pensions in excess of underlying PBT charge	(94)	94	(188)
Taxation paid	(102)	(34)	(68)
Group free cash flow	(1,151)	(2,801)	1,650
Free cash flow from continuing operations	(1,174)	(2,862)	1,688
Free cash flow from discontinuing operations	23	61	(38)
Shareholder payments	(2)	(90)	88
Disposals and acquisitions	(30)	2	(32)
Exceptional group restructuring	(134)	(87)	(47)
Payment of financial penalties	(156)	(135)	(21)
Other	(30)	(41)	11
Movement in net funds from cash flows (excluding lease liabilities)	(1,503)	(3,152)	1,649
Capital element of lease payments	147	149	(2)
Movement in net funds from cash flows	(1,356)	(3,003)	1,647
Change in short-term investments	(1)	6	(7)
Net cash flow from changes in borrowings and lease liabilities	914	2,637	(1,723)
Statutory cash flow	(443)	(360)	(83)

Key changes in the funds flow items are described below:

Expenditure on intangible assets: Expenditure of £(71)m included £(42)m capitalised R&D (30 June 2020: £(152)m), lower than prior period reflecting the maturity of Civil Aerospace engine programmes.

Capital expenditure: Investment of £(124)m was £97m lower than prior period as a result of continued focus on prioritisation of business critical infrastructure projects and efforts to reduce capital intensity in Civil Aerospace in line with the ongoing cost reduction programme.

Increase in inventory: The £219m increase in the period was primarily driven by planned inventory build in Power Systems to meet expected sales volumes in the second half of the year alongside a modest increase in Civil Aerospace expected to mostly unwind in the second half.

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

The movement of £(420)m was primarily driven by Civil Aerospace. This included reduced deposits as well as lower amounts owed to suppliers, JVs and RRSPs, driven in part by the reduced level of OE volumes. In addition, there was a decrease in the Civil Aerospace OE engine concessions payable, due to the timing of concession payments and aircraft deliveries, albeit the decrease was lower than expected as some aircraft deliveries were delayed. It also includes increased receivables in Defence reflecting the timing of customer receipts.

Movement in underlying Civil Aerospace net LTSA creditor: In H1 2021, there was a £108m reduction in the net LTSA balance as revenues recognised exceeded invoiced flying hour receipts. This included £160m positive contract catch-ups, which increased revenue recognised during the period. These catch-ups were principally driven by improved shop visit cost expectations in Business Aviation and the impact of specific customer negotiations with airlines.

Movement on provisions: The £(136)m movement reflected a decrease in the provision balance primarily driven by Trent 1000 provision utilisation and progress on the restructuring programme.

Cash flows on settlement of excess derivative contracts: Relates to the cash settlement costs in the period to 30 June 2021 for the offsetting foreign exchange contracts that were entered into to reduce the size of the US Dollar hedge book. The cash settlement costs of £1.7bn occur across 2020-2026, of which £1.2bn remains to be paid in future periods.

Interest and fees: The net payment of £(116)m in the period was higher than the prior period, reflecting £(81)m of net interest paid (2020 H1: £(26)m) and commitment fees on undrawn facilities.

Contributions to defined benefit pensions: In H1 2021, cash contributions were £94m higher than the pensions charge in the income statement (H1 2020: £94m lower) reflecting payment deferrals from 2020 into H1 2021.

Taxation: Net cash tax payments in 2021 H1 were £(102)m (2020 H1: £(34)m). The increase in 2021 H1 is mainly due to the timing of certain payments. Net tax payments in 2021 H2 are expected to be significantly lower.

Disposals and acquisitions: The £(30)m outflow related to costs associated with disposal activity.

Exceptional restructuring: Payments of £(134)m related to the restructuring programme and associated initiatives, of which £20m related to restructuring capital expenditure.

Payment of financial penalties: The final payment of £(156)m relating to the deferred prosecution agreement (DPA) in the UK was made in January 2021.

Other underlying adjustments: Outflow of £(30)m includes timing of cash flows on a prior period disposal where the Group retains the responsibility for collecting cash before passing it on to the acquirer, along with other smaller items.

Net cash flow from changes in borrowings and lease liabilities: During the period, the Group drew down on its £2.0bn loan which is supported by an 80% guarantee from UK Export Finance and repaid £300m of commercial paper under the Covid Corporate Financing Facility and €750m (£639m) loan notes in line with repayment terms.

Civil Aerospace

£ million	2021 H1	Organic Change ³	FX	2020 H1 ⁴	Change	Organic Change ³
Underlying revenue	2,168	(336)	(12)	2,516	(14%)	(13%)
Underlying OE revenue	722	(466)	1	1,187	(39%)	(39%)
Underlying services revenue	1,446	130	(13)	1,329	9%	10%
Underlying gross profit/(loss)	380	1,940	(8)	(1,552)	(124%)	(125%)
Gross margin %	17.5%	79.4%pt		(61.7%)	79.2%pt	
Commercial and administrative costs	(145)	25	2	(172)	(16%)	(15%)
Research and development costs	(237)	(60)	3	(180)	32%	33%
Joint ventures and associates	41	(45)	(2)	88	(53%)	(52%)
Underlying operating profit/(loss)	39	1,860	(5)	(1,816)	(102%)	1,860
Underlying operating margin %	1.8%	74.1%pt		(72.2%)	74.0%pt	

Key operational metrics:	2021 H1	2020 H1	Change
Large engine deliveries	100	137	(27%)
Business jet engine deliveries	48	103	(53%)
Total engine deliveries	148	240	(38%)
Large engine LTSA flying hours (million)	3.2	3.9	(18%)
Large engine LTSA major refurb	92	161	(43%)
Large engine LTSA check & repairs	192	310	(38%)
Total large engine LTSA shop visits	284	471	(40%)

Civil Aerospace operational performance in the first half was in line with expectations. Large engine LTSA flying hours were 43% of the 2019 level, a 9 percentage point improvement from second half 2020. Domestic large engine flying hours exceeded 2019 levels in May and made up approximately 20% of the large engine activity in the period. Business aviation flying recovered to 2019 levels by the end of the first half. Engine deliveries were down from the prior period, reflecting the build schedules of widebody airframer customers and the transition between engine programmes for business aviation.

- **Underlying revenue** of £2.2bn, down 13% on the prior period. OE revenue of £722m was down 39% reflecting the reduction in engine delivery volumes required to fulfil airframer customer build schedules. Services revenue of £1.4bn was up 10% on the prior year period and included £160m positive LTSA catch-ups (2020 H1: £(866)m negative contract catch-ups), offset by lower shop visit volumes.
- **Underlying gross profit** of £380m benefitted from strong operating cost performance resulting from our restructuring programme and £166m positive LTSA catch-ups. The £(1.6)bn gross loss in 2020 H1 included £(1.2)bn of largely COVID-related one-time charges including £(814)m negative LTSA catch-ups.
- **Underlying operating profit** of £39m reflected the good progress on restructuring cost savings, which were mostly related to direct costs, offset by the higher R&D charge and lower contribution from JVs and associates.
- **Trading cash outflow** was £(1,064)m in the first half, a significant improvement on 2020 H1 reflecting the return to underlying profitability, including restructuring savings, as well as a reduction in working capital related outflows driven partly by the non-repeat of the H1 2020 unwind of invoice factoring. OE concession outflows were higher than the prior period, driving a £239m reduction in the concession liability on the balance sheet.

Outlook

The timing of civil aviation recovery, particularly for international travel, remains uncertain and sensitive to the developments of the COVID-19 virus. For 2021, we expect the recovery in business aviation and domestic flying to be sustained and a continuation of the gradual improvement in international flying, which is constrained by the border restrictions in place worldwide. We are encouraged by forward indicators, including vaccination programmes and expect the recovery to accelerate once restrictions are lifted.

Defence

£ million	2021 H1	Organic Change ³	FX	2020 H1	Change	Organic Change ³
Underlying revenue	1,721	266	(98)	1,553	11%	17%
Underlying OE revenue	719	83	(42)	678	6%	12%
Underlying services revenue	1,002	183	(56)	875	15%	21%
Underlying gross profit	395	80	(17)	332	19%	24%
Gross margin %	23.0%	1.3%pt		21.4%	1.6%pt	
Commercial and administrative costs	(79)	(5)	2	(76)	4%	7%
Research and development costs	(47)	–	2	(49)	(4%)	–
Joint ventures and associates	–	(3)	–	3	–	–
Underlying operating profit	269	72	(13)	210	28%	35%
Underlying operating margin %	15.6%	2.0%pt		13.5%	2.1%pt	

Our Defence business continues to perform well with resilient demand for OE and services. First half growth was helped by the earlier timing of spare engine and spare parts sales, which typically have been in the second half in prior years. This favourable timing and mix in the first half is expected to result in a stronger first half versus second half performance, and our full year expectations for Defence are unchanged. The timing of order deposits resulted in a lower cash conversion in the first half compared with the prior year period but our full year expectation is unchanged.

Order intake was £1.2bn, representing a book-to-bill ratio of 0.7x. The order book is strong following several years' of high intake. Order cover for 2022 is in excess of 70%.

- **Underlying revenue** increased by 17% to £1.7bn. This was driven by improved operational performance that enabled earlier delivery of high margin spare parts and spare engine sales, historically weighted towards the second half. Actions taken to support the supply chain in 2020 have supported an improvement in on-time delivery to customers, with services revenue up 21% and OE revenue up 12%.
- **Underlying gross profit** of £395m was 24% higher year-over-year and the gross margin expanded 1.3%pt to 23.0%. This reflected a positive mix towards higher margin spare parts and spare engine sales.
- **Underlying operating profit** increased by 35% to £269m, with margin 2.0%pt higher at 15.6%. This reflected the beneficial phasing of revenue and profit, together with strong cost control.

Outlook

We expect revenue and profit to be broadly stable in 2021, with a stronger first half versus second half performance reflecting the earlier timing of sales in addition to an increase in R&D investment expected during the second half, in line with customer requirements and project phasing.

Our largest customers, the US DoD and the UK MoD, remain committed to the modernisation of their fleets with a particular focus on technology and an emerging interest in reducing their carbon footprint. Our work on the Tempest programme in the UK is progressing well and we have tendered a strong solution for the B-52 new engine programme in the US, which is being assessed by the DoD with a decision on selection expected in the second half of this year.

Power Systems

£ million	2021 H1	Organic Change ³	M&A ⁸	FX	2020 H1 ⁵	Change	Organic Change ³
Underlying revenue	1,181	(49)	24	(8)	1,214	(3%)	(4%)
Underlying OE revenue	718	(105)	24	(5)	804	(11%)	(13%)
Underlying services revenue	463	56	–	(3)	410	13%	13%
Underlying gross profit	301	34	8	(4)	263	14%	13%
Gross margin %	25.5%	3.8%pt			21.7%	3.8%pt	
Commercial and administrative costs	(190)	(37)	(8)	3	(148)	28%	25%
Research and development costs	(69)	12	–	1	(82)	(16%)	(14%)
Joint ventures and associates	(1)	–	–	(1)	0	–	–
Underlying operating profit	41	9	–	(1)	33	24%	26%
Underlying operating margin %	3.5%	0.8%pt			2.7%	0.8%pt	

Power Systems saw increased activity levels during the first half with improved order intake and growth in aftermarket revenue. This encouraging start to the recovery supports our expectations for OE recovery starting in the second half.

- **Order intake** of £1.4bn was 19% higher than the prior period and represented a book-to-bill ratio of 1.2x in the period. Year on year growth was strongest in marine, governmental and power generation end markets. Lower carbon solutions are gaining interest from customers as we continue to develop our product offerings in this area aligned with market progress and customer demand.
- **Underlying revenue** broadly unchanged at £1.2bn with 13% growth in aftermarket services as economic activity recovers in our end markets, offset by a 13% reduction in OE revenue, in line with expectations.
- **Underlying gross profit** of £301m was 13% higher benefitting from a positive mix effect due to the rise in higher-margin aftermarket spare parts and reallocation of certain direct costs to commercial and administrative costs. This was partly offset by lower utilisation in the period.
- **Underlying operating profit** of £41m with a margin of 3.5%, 0.8%pts higher than prior period, reflecting the positive mix of activity. The increase in commercial and administrative costs was largely due to one-off items in the period that are not expected to repeat and timing differences which are expected to unwind as well as the reallocation of certain costs from gross profit. The reduction in R&D in the first half reflected the timing of projects and is expected to increase in the second half.

Outlook

Revenues are expected to return to growth in the second half of 2021 as the encouraging recovery in order intake converts into sales. This will help improve factory utilisation and drive margin recovery in the second half despite the expected increase in R&D spend. Our strategy to focus on market share growth in China resulted in increased order intake compared with the prior year which we expect to convert into strong sales growth in China for the full year. Our target to return to 2019 levels of revenue by 2022 is unchanged and supported by the order intake recovery we have seen year to date.

ITP Aero

ITP Aero is classified as a discontinued business and held for sale in the 2021 H1 results.

£ million	2021 H1	Organic Change ³	FX	2020 H1 ⁴	Change	Organic Change ³
Underlying revenue	317	(79)	(2)	398	(20%)	(20%)
Underlying OE revenue	271	(47)	(1)	319	(15%)	(15%)
Underlying services revenue	46	(32)	(1)	79	(42%)	(41%)
Underlying gross profit	48	12	(1)	37	30%	32%
Gross margin %	15.1%	5.9%pt		9.3%	5.8%pt	
Commercial and administrative costs	(26)	(4)	1	(23)	13%	17%
Research and development costs	(15)	-	-	(15)	-	-
Joint ventures and associates	-	(1)	-	1	-	-
Underlying operating profit	7	7	-	-	-	-
Underlying operating margin %	2.2%	2.2%pt		0.0%	2.2%pt	

ITP Aero has performed well in challenging conditions in the first half with resilience in demand for its defence activities (approximately 30% of revenue) but low levels of demand for its civil aerospace activities (approximately 70% of revenue), impacted by the continued effect of COVID-19 on original equipment manufacturer (OEM) customers.

- **Underlying revenue** was £317m, down 20% in 2020 H1, reflecting the continued impact of COVID-19 on the civil aerospace market. Defence revenue remained resilient.
- **Underlying gross profit** of £48m, up 32%, benefitted from a favourable mix of higher margin products, particularly in defence.
- **Underlying operating profit** was £7m, a small improvement on the break-even result in 2020 H1 driven mostly by the increase in gross profit and saving from headcount reductions in 2020.
- **Hucknall and fabrications:** As part of the footprint review and reorganisation of the Group's Civil Aerospace activities announced in 2020, approximately 700 people and all activities carried out at Rolls-Royce's Hucknall site in the UK transferred to ITP Aero in May 2021 along with certain fabrication supply chain activities.

Notes to financial tables and commentary on pages 1-14:

- ¹ Discontinued operations relate to the statutory and underlying results of ITP Aero and are presented net of internal sales and related consolidation adjustments.
- ² 2020 H1 earnings per share has been adjusted to reflect the 2.91 bonus element of the rights issue that was completed on 12 November 2020.
- ³ Organic change at constant translational currency (constant currency) applying FY20 average rates to 2020 H1 and 2021 H1, excluding M&A. All commentary is provided on an organic basis unless otherwise stated.
- ⁴ The underlying results for Civil Aerospace and ITP Aero for 2020 H1 have been restated to reflect the transfer of the Hucknall site with associated fabrications activities from Civil Aerospace to ITP Aero during 2021.
- ⁵ The underlying results for Power Systems for 2020 have been restated to reclassify the Civil Nuclear Instrumentation & Control business as other businesses, consistent with FY20.
- ⁶ Other businesses include the results of the Bergen Engines AS business, the results of the Civil Nuclear Instrumentation & Control business, the results of the North America Civil Nuclear business until the date of disposal on 31 January 2020 and the results of the Knowledge Management System business until the date of disposal on 3 February 2020.
- ⁷ The underlying results of Corporate and inter-segment activities includes the results of the Group's SMR, electrical and UK civil nuclear activities.
- ⁸ M&A includes 2020 Power Systems acquisitions comprising of Kinolt Group S.A and Servowatch Systems Limited (SSL).
- ⁹ Working capital includes inventory, trade receivables, payables and similar assets and liabilities.
- ¹⁰ Net debt includes £57m (2020: £251m) of the fair value of derivatives included in fair value hedges and the element of fair value relating to exchange differences on the underlying principal of derivatives in cash flow hedges.
- ¹¹ Relates to Bergen Engines AS and the Civil Nuclear Instrumentation & Control business which were classified as disposal groups held for sale at 31 December 2020 together with ITP Aero held for sale at 30 June 2021.

Condensed consolidated interim financial statements

Condensed consolidated income statement

For the half-year ended 30 June 2021

	Notes	Half-year to 30 June 2021 £m	Restated Half-year to 30 June 2020 ¹ £m
Continuing operations			
Revenue	2	5,159	5,673
Cost of sales ²		(4,345)	(6,263)
Gross profit/(loss)	2	814	(590)
Commercial and administrative costs	2	(424)	(421)
Research and development costs	2, 3	(390)	(678)
Share of results of joint ventures and associates		38	72
Operating profit/(loss)		38	(1,617)
(Loss)/gain arising on acquisition and disposal of businesses	19	(7)	2
Profit/(loss) before financing and taxation		31	(1,615)
Financing income ³	4	280	23
Financing costs ³	4	(197)	(3,621)
Net financing income/(costs)		83	(3,598)
Profit/(loss) before taxation		114	(5,213)
Taxation	5	280	(48)
Profit/(loss) for the period from continuing operations		394	(5,261)
Discontinued operations			
Profit/(loss) for the period		16	(117)
Costs of disposal of discontinued operations		(17)	-
Loss for the period from discontinued operations	19	(1)	(117)
Profit/(loss) for the period		393	(5,378)
Attributable to:			
Ordinary shareholders		393	(5,380)
Non-controlling interests		-	2
Profit/(loss) for the period		393	(5,378)
Other comprehensive (expense)/income		(145)	683
Total comprehensive income/(expense) for the period		248	(4,695)
Profit/(loss) per ordinary share attributable to ordinary shareholders:			
From continuing operations:			
Basic ⁴		4.73p	(94.03)p
Diluted ⁴		4.72p	(94.03)p
From continuing and discontinued operations:			
Basic ⁴		4.72p	(96.12)p
Diluted ⁴		4.71p	(96.12)p

Underlying earnings per ordinary share are shown in note 6.

¹ The comparative figures have been restated to reflect ITP Aero being classified as a discontinued operation. Further detail can be found in note 19.

² Cost of sales includes a net charge for expected credit losses of £48m (2020: £104m).

³ Included within financing are fair value changes on derivative contracts. Further details can be found in notes 2, 4 and 13.

⁴ The comparative figures for earnings per share have been adjusted to reflect the bonus element of the rights issue that completed on 12 November 2020 - see note 6. Payments to ordinary shareholders in respect of the period are £nil (2020: £nil).

Condensed consolidated statement of comprehensive income

For the half-year ended 30 June 2021

	Notes	Half-year to 30 June 2021 £m	Half-year to 30 June 2020 £m
Profit/(loss) for the period		393	(5,378)
Other comprehensive income (OCI)			
Actuarial movements in post-retirement schemes	16	(12)	393
Share of OCI of joint ventures and associates		(4)	(1)
Related tax movements		16	(130)
Items that will not be reclassified to profit or loss		-	262
Foreign exchange translation differences on foreign operations		(174)	444
Reclassified to income statement on disposal of businesses		-	3
Movement on fair values debited to cash flow hedge reserve		(41)	(6)
Reclassified to income statement from cash flow hedge reserve		38	(19)
Share of OCI of joint ventures and associates		32	(9)
Related tax movements		-	8
Items that may be reclassified to profit or loss		(145)	421
Total other comprehensive (expense)/income		(145)	683
Total comprehensive income/(expense) for the period		248	(4,695)
Attributable to:			
Ordinary shareholders		248	(4,697)
Non-controlling interests		-	2
Total comprehensive income/(expense) for the period		248	(4,695)
Total comprehensive income/(expense) for the period attributable to ordinary shareholders arises from:			
Continuing operations		316	(4,646)
Discontinued operations		(68)	(51)
Total comprehensive income/(expense) for the period attributable to ordinary shareholders		248	(4,697)

Condensed consolidated balance sheet

At 30 June 2021

	Notes	30 June 2021 £m	31 December 2020 £m
ASSETS			
Intangible assets	7	4,063	5,145
Property, plant and equipment	8	3,992	4,515
Right-of-use assets	9	1,266	1,405
Investments – joint ventures and associates		413	394
Investments – other		24	19
Other financial assets	13	537	687
Deferred tax assets		2,062	1,826
Post-retirement scheme surpluses	16	914	907
Non-current assets		13,271	14,898
Inventories		3,673	3,690
Trade receivables and other assets	10	5,068	5,455
Contract assets	12	1,402	1,510
Taxation recoverable		79	117
Other financial assets	13	40	107
Short-term investments		1	–
Cash and cash equivalents		2,915	3,452
Current assets		13,178	14,331
Assets held for sale	19	2,306	288
TOTAL ASSETS		28,755	29,517
LIABILITIES			
Borrowings and lease liabilities	14	(221)	(1,272)
Other financial liabilities	13	(663)	(608)
Trade payables and other liabilities	11	(5,720)	(6,653)
Contract liabilities	12	(3,811)	(4,187)
Current tax liabilities		(96)	(154)
Provisions for liabilities and charges	15	(568)	(826)
Current liabilities		(11,079)	(13,700)
Borrowings and lease liabilities	14	(7,693)	(6,058)
Other financial liabilities	13	(2,462)	(3,046)
Trade payables and other liabilities	11	(1,792)	(1,922)
Contract liabilities	12	(6,427)	(6,245)
Deferred tax liabilities		(392)	(494)
Provisions for liabilities and charges	15	(1,152)	(1,119)
Post-retirement scheme deficits	16	(1,444)	(1,580)
Non-current liabilities		(21,362)	(20,464)
Liabilities associated with assets held for sale	19	(904)	(228)
TOTAL LIABILITIES		(33,345)	(34,392)
NET LIABILITIES		(4,590)	(4,875)
EQUITY			
Called-up share capital		1,674	1,674
Share premium		1,012	1,012
Capital redemption reserve		164	162
Cash flow hedging reserve		(63)	(94)
Merger reserve		650	650
Translation reserve		348	524
Accumulated losses		(8,399)	(8,825)
Equity attributable to ordinary shareholders		(4,614)	(4,897)
Non-controlling interests		24	22
TOTAL EQUITY		(4,590)	(4,875)

Condensed consolidated cash flow statement

For the half-year ended 30 June 2021

	Notes	Half-year to 30 June 2021 £m	Half-year to 30 June 2020 £m
Reconciliation of cash flows from operating activities			
Operating profit/(loss) from continuing operations		38	(1,617)
Operating loss from discontinued operations		(93)	(152)
Operating loss ¹		(55)	(1,769)
Loss on disposal of property, plant and equipment		2	19
Share of results of joint ventures and associates		(38)	(73)
Dividends received from joint ventures and associates		14	28
Amortisation and impairment of intangible assets	7	159	550
Depreciation and impairment of property, plant and equipment	8	243	495
Depreciation and impairment of right-of-use assets	9	128	513
Adjustment of amounts payable under residual value guarantees within lease liabilities ²		(3)	(42)
Impairment of and other movements on investments		2	19
Decrease in provisions		(211)	(130)
Increase in inventories		(219)	(301)
Movement in trade receivables/payables and other assets/liabilities		(136)	(1,925)
Movement in contract assets/liabilities		(178)	642
Financial penalties paid ³		(156)	(135)
Cash flows on other financial assets and liabilities held for operating purposes		(45)	(35)
Interest received		3	12
Net defined benefit post-retirement cost/(credit) recognised in loss before financing	16	26	(116)
Cash funding of defined benefit post-retirement schemes	16	(131)	(38)
Share-based payments		18	1
Net cash outflow from operating activities before taxation		(577)	(2,285)
Taxation paid		(102)	(34)
Net cash outflow from operating activities		(679)	(2,319)
Cash flows from investing activities			
Net movement in unlisted investments		(6)	(14)
Additions of intangible assets	7	(89)	(204)
Disposals of intangible assets	7	2	10
Purchases of property, plant and equipment		(126)	(226)
Disposals of property, plant and equipment		5	1
Disposals of right-of-use assets		-	7
Acquisition of businesses	19	-	(8)
Disposal of businesses	19	(8)	10
Movement in investments in joint ventures and associates and other movements on investments		(2)	(4)
Movement in short-term investments		(1)	-
Net cash outflow from investing activities		(225)	(428)
Cash flows from financing activities			
Repayment of loans ⁴		(942)	(21)
Proceeds from increase in loans ⁴		2,003	2,807
Capital element of lease payments		(147)	(149)
Net cash flow from increase in borrowings and leases		914	2,637
Interest paid		(84)	(38)
Interest element of lease payments		(31)	(39)
Fees paid on undrawn facilities		(35)	-
Cash flows on settlement of excess derivative contracts ⁵	4	(303)	(88)
Movement in short-term investments		-	6
Purchase of ordinary shares		-	(1)
NCl on formation of subsidiary		2	-
Redemption of C Shares		(2)	(90)
Net cash inflow from financing activities		461	2,387
Change in cash and cash equivalents		(443)	(360)
Cash and cash equivalents at 1 January		3,496	4,435
Exchange (losses)/gains on cash and cash equivalents		(75)	156
Cash and cash equivalents at 30 June ⁶		2,978	4,231

Condensed consolidated cash flow statement continued

For the half-year ended 30 June 2021

- ¹ During the period, the Group received £10m (30 June 2020: £17m) from the British Government as part of the UK furlough scheme. This was recognised within operating profit/(loss).
- ² Where the cost of meeting residual value guarantees is less than that previously estimated, as costs have been mitigated or liabilities waived by the lessor, the lease liability has been remeasured. Where the value of this remeasurement exceeds the value of the right-of-use asset, the reduction in the lease liability is credited to cost of sales.
- ³ Relates to penalties paid on agreements with investigating bodies.
- ⁴ Repayment of loans includes repayment of £300m commercial paper under the Covid Corporate Financing Facility (CCFF) and €750m (£639m) loan notes in line with repayment terms. Proceeds from increase in loans includes the draw down of a £2,000m loan (supported by an 80% guarantee from UK Export Finance). Further details are provided in note 15.
- ⁵ During the period, the Group incurred a cash outflow of £303m as a result of settling foreign exchange contracts that were originally in place to sell \$3,297m receipts. Further detail is provided in note 4.
- ⁶ The Group considers overdrafts (repayable on demand) and cash held for sale to be an integral part of its cash management activities and these are included in cash and cash equivalents for the purposes of the cash flow statement.

In deriving the condensed consolidated cash flow statement, movements in balance sheet line items have been adjusted for non-cash items. The cash flow in the period includes the sale of goods and services to joint ventures and associates – see note 18.

	Half-year to 30 June 2021 £m	Half-year to 30 June 2020 £m
Reconciliation of movements in cash and cash equivalents to movements in net debt		
Change in cash and cash equivalents	(443)	(360)
Cash flow from increase in borrowings and leases	(914)	(2,637)
Less: settlement of related derivatives included in fair value of swaps below	6	–
Cash flow from decrease/(increase) in short-term investments	1	(6)
Change in net debt resulting from cash flows	(1,350)	(3,003)
New leases and other non-cash adjustments to lease liabilities and borrowings	(17)	18
Exchange gains/(losses) on net debt	2	(2)
Fair value adjustments	144	(302)
Reclassifications	19	–
Movement in net debt	(1,202)	(3,289)
Net debt at 1 January	(3,827)	(1,236)
Net debt at 30 June excluding the fair value of swaps	(5,029)	(4,525)
Fair value of swaps hedging fixed rate borrowings	57	456
Net debt at 30 June	(4,972)	(4,069)

Condensed consolidated cash flow statement continued

For the half-year ended 30 June 2021

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

	At 1 January	Funds flow	Exchange differences	Fair value adjustments	Reclassifications ²	Other movements	At 30 June
	£m	£m	£m	£m	£m	£m	£m
2021							
Cash at bank and in hand	940	(122)	(13)	-	(38)	-	767
Money market funds	669	(527)	-	-	-	-	142
Short-term deposits	1,843	221	(58)	-	-	-	2,006
Cash and cash equivalents (per balance sheet)	3,452	(428)	(71)	-	(38)	-	2,915
Cash and cash equivalents included within assets held for sale	51	(16)	(4)	-	38	-	69
Overdrafts	(7)	1	-	-	-	-	(6)
Cash and cash equivalents (per cash flow statement)	3,496	(443)	(75)	-	-	-	2,978
Short-term investments	-	1	-	-	-	-	1
Other current borrowings	(1,006)	948	1	36	18	-	(3)
Non-current borrowings	(4,274)	(2,003)	45	108	88	(3)	(6,039)
Borrowings included within liabilities held for sale	-	-	-	-	(77)	-	(77)
Lease liabilities	(2,043)	145	31	-	15	(14)	(1,866)
Lease liabilities included within liabilities held for sale	-	2	-	-	(25)	-	(23)
Financial liabilities	(7,323)	(908)	77	144	19	(17)	(8,008)
Net debt excluding fair value of swaps	(3,827)	(1,350)	2	144	19	(17)	(5,029)
Fair value of swaps hedging fixed rate borrowings ¹	251	(6)	(41)	(147)	-	-	57
Net debt	(3,576)	(1,356)	(39)	(3)	19	(17)	(4,972)
<i>Net debt (excluding lease liabilities)</i>	<i>(1,533)</i>						<i>(3,083)</i>
2020							
Cash at bank and in hand	825	110	36	-	-	-	971
Money market funds	1,095	(44)	-	-	-	-	1,051
Short-term deposits	2,523	(426)	120	-	-	-	2,217
Cash and cash equivalents (per balance sheet)	4,443	(360)	156	-	-	-	4,239
Overdrafts	(8)	-	-	-	-	-	(8)
Cash and cash equivalents (per cash flow statement)	4,435	(360)	156	-	-	-	4,231
Short-term investments	6	(6)	-	-	-	-	-
Other current borrowings	(427)	(283)	(3)	(31)	(690)	-	(1,434)
Non-current borrowings	(2,896)	(2,503)	(5)	(271)	690	-	(4,985)
Lease liabilities	(2,354)	149	(150)	-	-	18	(2,337)
Financial liabilities	(5,677)	(2,637)	(158)	(302)	-	18	(8,756)
Net debt excluding fair value of swaps	(1,236)	(3,003)	(2)	(302)	-	18	(4,525)
Fair value of swaps hedging fixed rate borrowings	243	-	-	213	-	-	456
Net debt	(993)	(3,003)	(2)	(89)	-	18	(4,069)
<i>Net funds/(debt) (excluding lease liabilities)</i>	<i>1,361</i>						<i>(1,732)</i>

¹ Fair value of swaps hedging fixed rate borrowings reflects the impact of derivatives on repayments of the principal amount of debt. Net debt therefore includes the fair value of derivatives included in fair value hedges (30 June 2021: £141m, 31 December 2020: £293m) and the element of fair value relating to exchange differences on the underlying principal of derivatives in cash flow hedges (30 June 2021: £(84)m, 31 December 2020: £(42)m).

² Reclassifications include the transfer of ITP Aero to held for sale and fees of £29m paid in previous periods for the £2,000m loan (supported by an 80% guarantee from UK Export Finance) that have been reclassified to borrowings on the draw down of the facility during the current period.

Condensed consolidated statement of changes in equity

For the half-year ended 30 June 2021

	Attributable to ordinary shareholders									
	Share capital	Share premium	Capital redemption reserve	Cash flow hedging reserve	Merger reserve	Translation reserve	Accumulated losses ¹	Total	Non-controlling interests (NCI)	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2021	1,674	1,012	162	(94)	650	524	(8,825)	(4,897)	22	(4,875)
Profit for the period	-	-	-	-	-	-	393	393	-	393
Foreign exchange translation differences on foreign operations	-	-	-	-	-	(174)	-	(174)	-	(174)
Movement on post-retirement schemes	-	-	-	-	-	-	(12)	(12)	-	(12)
Fair value movement on cash flow hedges	-	-	-	(41)	-	-	-	(41)	-	(41)
Reclassified to income statement from cash flow hedge reserve	-	-	-	38	-	-	-	38	-	38
OCI of joint ventures and associates	-	-	-	32	-	-	(4)	28	-	28
Related tax movements	-	-	-	2	-	(2)	16	16	-	16
Total comprehensive income/(expense) for the period	-	-	-	31	-	(176)	393	248	-	248
Issues of ordinary shares	-	-	-	-	-	-	-	-	-	-
Redemption of C Shares ²	-	-	2	-	-	-	(2)	-	-	-
Share-based payments - direct to equity ³	-	-	-	-	-	-	18	18	-	18
NCI on formation of subsidiary	-	-	-	-	-	-	-	-	2	2
Related tax movements	-	-	-	-	-	-	17	17	-	17
Other changes in equity in the period	-	-	2	-	-	-	33	35	2	37
At 30 June 2021	1,674	1,012	164	(63)	650	348	(8,399)	(4,614)	24	(4,590)
At 1 January 2020	386	319	159	(96)	650	397	(5,191)	(3,376)	22	(3,354)
(Loss)/profit for the period	-	-	-	-	-	-	(5,380)	(5,380)	2	(5,378)
Foreign exchange translation differences on foreign operations	-	-	-	-	-	444	-	444	-	444
Reclassified to the income statement on disposal of businesses	-	-	-	-	-	3	-	3	-	3
Movement on post-retirement schemes	-	-	-	-	-	-	393	393	-	393
Fair value movement on cash flow hedges	-	-	-	(6)	-	-	-	(6)	-	(6)
Reclassified to income statement from cash flow hedge reserve	-	-	-	(19)	-	-	-	(19)	-	(19)
OCI of joint ventures and associates	-	-	-	(9)	-	-	(1)	(10)	-	(10)
Related tax movements	-	-	-	6	-	2	(130)	(122)	-	(122)
Total comprehensive income/(expense) for the period	-	-	-	(28)	-	449	(5,118)	(4,697)	2	(4,695)
Arising on issues of ordinary shares	-	-	-	-	-	-	-	-	-	-
Issue of C Shares ²	-	-	(89)	-	-	-	1	(88)	-	(88)
Redemption of C Shares	-	-	91	-	-	-	(91)	-	-	-
Ordinary shares purchased	-	-	-	-	-	-	(1)	(1)	-	(1)
Shares issued to employee share trust	-	-	-	-	-	-	-	-	-	-
Share-based payments - direct to equity ³	-	-	-	-	-	-	1	1	-	1
Related tax movements	-	-	-	-	-	-	13	13	-	13
Other changes in equity in the period	-	-	2	-	-	-	(77)	(75)	-	(75)
At 30 June 2020	386	319	161	(124)	650	846	(10,386)	(8,148)	24	(8,124)

¹ At 30 June 2021, 34,938,153 ordinary shares with a net book value of £78m (30 June 2020: 9,345,059 ordinary shares with a net book value of £80m) were held for the purpose of share-based payment plans and included in accumulated losses. During the period, 4,928,564 ordinary shares with a net book value of £111m (30 June 2020: 3,217,241 ordinary shares with a net book value of £28m) vested in share-based payment plans. During the period, the Company acquired none (30 June 2020: 85,724) of its ordinary shares via reinvestment of dividends received on its own shares and purchased none (30 June 2020: none) of its ordinary shares through purchases on the London Stock Exchange.

² In Rolls-Royce Holdings plc's own Financial Statements, C Shares are issued from the merger reserve. This reserve was created by a scheme of arrangement in 2011. As this reserve is eliminated on consolidation, in the consolidated financial statements, the C Shares are shown as being issued from the capital redemption reserve.

³ Share-based payments – direct to equity is the share-based payment charge for the period less the actual cost of vesting excluding those vesting from own shares and cash received on share-based schemes vesting.

Notes to the interim financial statements

1 Basis of preparation and accounting policies

Reporting entity

Rolls-Royce Holdings plc (the 'Company') is a public company incorporated under the Companies Act 2006 and domiciled in the UK. These condensed consolidated interim financial statements of the Group as at and for the six months ended 30 June 2021 consist of the consolidation of the financial statements of the Group and its subsidiaries (together referred to as the "Group") and include the Group's interest in jointly controlled and associated entities.

The consolidated financial statements of the Group as at and for the year ended 31 December 2020 (Annual Report 2020) are available upon request from the Company Secretary, Rolls-Royce Holdings plc, Kings Place, 90 York Way, London, N1 9FX. The Board of Directors approved the condensed consolidated interim financial statements on 5 August 2021.

Statement of compliance

These condensed consolidated interim financial statements have been prepared on the basis of the policies set out in the 2020 Annual Report and in accordance with UK adopted IAS 34 *Interim Financial Reporting* and the Disclosure Guidance and Transparency Rules sourcebook of the UK's Financial Conduct Authority. They do not include all of the information required for full annual statements and should be read in conjunction with the 2020 Annual Report.

The interim figures up to 30 June 2021 and 2020 are unaudited. The 2020 financial statements, which were prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006 and IFRS adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union, have been reported on by the Group's auditors and delivered to the registrar of companies. There are no differences for the Group in applying each of these accounting frameworks. The report of the auditors was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report, and (iii) did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

The financial statements for the year ending 31 December 2021 will be prepared in accordance with IFRS as adopted by the UK Endorsement Board. This change in basis of preparation is required by UK company law for the purposes of financial reporting as a result of the UK's exit from the EU on 31 January 2020 and the cessation of the transition period on 31 December 2020. This change does not constitute a change in accounting policy, rather a change in framework which is required to group the use of IFRS in company law. There is no impact on the recognition, measurement or disclosure between the two frameworks in the period reported.

Changes to accounting policies

In April 2021 the IFRS Interpretations Committee published its final agenda decision on Configuration and Customisation costs in a Cloud Computing Arrangement. The agenda decision considers how a customer accounts for configuration or customisation costs where an intangible asset is not recognised in a cloud computing arrangement. The agenda decision does not have a material impact on the Group in respect of the current period or prior periods.

During 2021, a transition project, in relation to IBOR reform, to assess and implement changes to systems, processes, risk and valuation models, as well as managing related tax and accounting implications has been initiated. The Group's risk exposure that is directly affected by the interest rate benchmark reform is its portfolio of long-term borrowings of £6.1bn and a number of its foreign exchange contracts. The borrowings are hedged, using interest rate swaps and cross-currency interest rate swaps, for changes in fair value and cash flows attributable to the relevant benchmark interest rate. The Group will be making amendments to the contractual terms of IBOR-referenced floating-rate debt, swaps and foreign exchange contracts, and updating any relevant hedge designations in the second half of the year. A number of the Group's lease liabilities are based on a LIBOR index. These are predominantly referencing USD LIBOR which is not expected to cease until 2023. These contracts will be amended in due course.

Discontinued operations

A discontinued operation is defined in IFRS 5 *Non-current assets held for sale and discontinued operations* as a component of an entity that has been disposed of or is classified as held for sale, represents a separate major line of business or geographical area of operations, is part of a single co-ordinated plan to dispose of such a line of business or is a subsidiary acquired exclusively with a view to resale. The results of discontinued operations are required to be presented separately in the statement of profit or loss with the comparative period restated to show results attributable to continuing operations.

Assets and businesses are classified as held for sale when their carrying amounts are recovered through sale rather than through continuing use.

As at 30 June 2021, the ITP Aero business has been classified as held for sale following activities undertaken in the period to transfer assets (including the Civil Aerospace Hucknall site with associated fabrications activities) within the Group from Civil Aerospace to ITP Aero in preparation for sale. The comparative balance sheet has not been restated. ITP Aero continues to be disclosed as an operating segment of the business in line with IFRS 8 *Operating Segments* and consequently has been classified as a discontinued operation at 30 June 2021. See notes 2 and 19 for more detail. Bergen Engines AS and Civil Nuclear Instrumentation & Control are recognised as disposal groups held for sale but do not meet the criteria of a discontinued operation.

Post balance sheet events

The Group entered into an agreement to sell Bergen Engines on 3 August 2021. Further detail is included in note 19. On 4 August 2021, the Group finalised an amendment to extend a £1bn bank loan facility from a maturity date of 15 October 2022 to a maturity date of 15 January 2024.

1 Basis of preparation and accounting policies continued

Going concern

In assessing the adoption of the going concern basis in the condensed consolidated interim financial statements, the Directors have considered the Group's forecast cash flows and available liquidity over an eighteen-month period to February 2023, taking into account the Group's principal risks and uncertainties.

The COVID-19 pandemic continues to have an impact on the Group due to ongoing global travel restrictions. The speed of vaccination programmes and efficacy of vaccines against different variants of the virus means that uncertainty remains in the short-term over the timing of recovery of demand, in particular in relation to the civil aviation industry. This has been considered by the Directors in assessing the adoption of the going concern basis in the condensed consolidated interim financial statements. Recognising the challenges of reliably estimating and forecasting the timing of recovery of demand, the Directors have considered a base case forecast (reflecting the Directors current expectations of future trading) and a severe but plausible downside forecast (which envisages a "stress" or "downside" situation).

Since the start of the pandemic the Group has taken action to reduce cash expenditure and maintain liquidity. A major restructuring programme was launched in 2020 to reshape and resize the Group to deliver forecast annualised savings of at least £1.3bn by the end of 2022, with a plan to remove at least 9,000 roles across the Group. At 30 June 2021, approximately 8,000 roles had been removed. The Group raised £7.3bn of additional funding during 2020 through a combination of equity and debt and in March 2021, secured a further £1bn term-loan facility, 80% of which is guaranteed by UK Export Finance (UKEF), repayable in March 2026.

Liquidity and borrowings

At 30 June 2021, the Group had liquidity of £7.5bn including cash and cash equivalents of £3.0bn and undrawn facilities of £4.5bn.

On 4 August 2021, the Group finalised an amendment to extend the £1bn bank loan facility (currently undrawn) from a maturity date of 15 October 2022 to a maturity date of 15 January 2024.

The Group's committed borrowing facilities at 30 June 2021 and 28 February 2023 are set out below. None of the facilities are subject to any financial covenants or rating triggers which could accelerate repayment.

(£m)	30 June 2021	28 February 2023
Issued Bond Notes ¹	3,995	3,995
Other loans	81	37
UKEF £2bn loan ² and UKEF £1bn loan (undrawn) ³	3,000	3,000
Revolving Credit Facility (undrawn) ⁴	2,500	2,500
Bank Loan Facility (undrawn) ⁵	1,000	1,000
Total committed borrowing facilities	10,576	10,532

¹ The value of Issued Bond Notes reflects the impact of derivatives on repayments of the principal amount of debt. The bonds mature by May 2028.

² The £2,000m UKEF loan matures in August 2025.

³ The £1,000m UKEF loan maturities in March 2026 (currently undrawn).

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

⁵ The £1,000m Bank Loan Facility matures in January 2024 (currently undrawn).

Taking into account the maturity of borrowing facilities, the Group has committed facilities of at least £10.5bn available throughout the period to 28 February 2023.

Forecasts

The Group's base case forecast assumes the continuation of a steady recovery in customer confidence in the aftermath of the COVID-19 pandemic. Vaccination programmes are rolled out but the efficacy of vaccines over different variants and differing governmental quarantine and testing requirements and travel restrictions are expected to hinder the recovery of demand in the short term, in particular in relation to the civil aviation industry.

The downside forecast assumes that Civil widebody engine flying hours (EFHs) remain at current levels when compared with 2019 EFHs over the 18-month period to February 2023, with recovery subdued due to ongoing infection rates and an increase in new variants of the virus, resulting in caution in opening borders to international travel and no upward trend in EFH until March 2023, resulting in a much slower recovery in demand compared with the base case.

The proceeds of at least £2bn from planned disposals, as announced in August 2020, have not been included when assessing the going concern, although completion of these disposals is anticipated within the eighteen-month period being considered.

Conclusion

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

1 Basis of preparation and accounting policies continued

Climate change

In preparing the condensed consolidated interim financial statements, the Directors have considered the impact of climate change, particularly in the context of the disclosures included in the Strategic Report in the 2020 Annual Report and the stated net zero targets. These considerations did not have a material impact on the financial reporting judgements and estimates, consistent with the assessment that climate change is not expected to have a significant impact on the Group's going concern assessment to February 2023 nor the viability of the Group over the next five years. The following specific points were considered:

- The Group continues to invest in new technologies including hybrid electric solutions in Power Systems, continued development of the more efficient UltraFan aero engine, testing of sustainable aviation fuels, small modular reactors (SMRs) and hybrid and fully electric propulsion.
- The Group continues to invest in onsite renewable energy generation solutions for the Group's facilities and investment is included in the five year forecasts to enable the Group to meet its 2030 target for zero greenhouse gas emissions (scope 1 and 2) from operations and facilities.
- Management has considered the impact of climate change on a number of key estimates within the financial statements, including:
 - the estimates of future cash flows used in impairment assessments of the carrying value of non-current assets (such as programme intangible assets and goodwill);
 - the estimates of future profitability used in assessing the recoverability of deferred tax assets in the UK (see note 5); and
 - the long-term contract accounting assumptions, such as the level of EFHs assumed, which consider the future expectations of consumer and airline customer behaviour (see note 12).

Key areas of judgement and sources of estimation uncertainty

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

Area	Key judgements	Key sources of estimation uncertainty	Sensitivities performed
Revenue recognition and contract assets and liabilities	<p>Whether Civil Aerospace OE and aftermarket contracts should be combined.</p> <p>How performance on long-term aftermarket contracts should be measured.</p> <p>Whether any costs should be treated as wastage.</p> <p>Whether sales of spare engines to joint ventures are at fair value.</p>	<p>Estimates of future revenue and costs of long-term contractual arrangements.</p> <p>Uncertainty remains in the short-term over the timing of recovery of demand, in particular in relation to the civil aviation industry, in the aftermath of the COVID-19 pandemic. Estimates of future revenue within Civil Aerospace are based upon future EFH forecasts, influenced by assumptions over the time period and profile over which the aerospace industry will recover.</p>	<p>Based upon the stage of completion of all widebody LTSA contracts within Civil Aerospace as at 30 June 2021, the following changes in estimate would result in catch-up adjustments being recognised in the period in which the estimates change (at underlying rates):</p> <ul style="list-style-type: none"> - A reduction in forecast EFHs of 15% over the remaining term of the contracts would decrease LTSA income and to a lesser extent costs, resulting in a catch-up adjustment of £100m - £130m. An estimated 90% of this would be expected to be a reduction in revenue with the remainder relating to onerous contracts which would be an increase in cost of sales. - A 5% increase or decrease in shop visit costs over the life of the contracts would lead to a catch-up adjustment of £140m. - A 2% increase or decrease in revenue over the life of the contracts would lead to a catch-up adjustment of £200m.
Risk and revenue sharing arrangements	Determination of the nature of entry fees received.		
Taxation		Estimates are necessary to assess whether it is probable that sufficient suitable taxable profits will arise in the UK to utilise the deferred tax assets. This is largely driven by the Civil Aerospace business and the estimates described above in 'revenue recognition'.	A 5% change in margin in the main Civil Aerospace widebody programmes or a 5% change in the number of shop visits (driven by EFHs which are influenced by a number of factors including climate change) over the remaining life of the programmes, would result in an increase/decrease in the deferred tax asset recognised by around £150m, which equates to around a £1.2bn change in profit.
Business combinations	Identification of acquired assets and liabilities.		
Discontinued operations and assets held for sale	Whether the ITP Aero business meets the criteria to be classified as held for sale and a discontinued operation.		
Research and development	<p>Determination of the point in time where costs incurred on an internal programme development meet the criteria for capitalisation or ceasing capitalisation.</p> <p>Determination of the basis for amortising capitalised development costs.</p>		

Area	Key judgements	Key sources of estimation uncertainty	Sensitivities performed
Leases	Determination of the lease term.	Estimates of the payments required to meet residual value guarantees at the end of engine leases. Amounts due can vary depending on the level of utilisation of the engines, overhaul activity prior to the end of the contract, and decisions taken on whether ongoing access to the assets is required at the end of the lease term.	The lease liability at 30 June 2021 included £339m relating to the cost of meeting these residual value guarantees in the Civil Aerospace business. Up to £13m is payable in the next 12 months, £139m is due over the following four years and the remaining balance after five years.
Impairment of non-current assets	Determination of cash-generating units for assessing impairment of goodwill.	The carrying value of intangible assets (including programme-related intangible assets) is dependent on the estimates of future cash flows which are influenced by assumptions over the recovery of the industries in which the Group operate and the discount rates applied.	<p>A slower than expected recovery in the aftermath of the COVID-19 pandemic could result in a deterioration in future cash flow forecasts that support programme intangible assets. A 5% deterioration in EFHs (and hence future cash flows) across the life of the Civil Aerospace programmes would result in programme intangible assets that have previously been subject to impairment incurring an additional impairment of £50m.</p> <p>For intangible assets where there is existing headroom in the impairment test (and thus no impairment) but where deteriorations in key assumptions over the next 12 months could lead to an impairment, any of the following individual changes in assumptions would cause the recoverable amount of the programme assets to equal the carrying value:</p> <ul style="list-style-type: none"> - A reduction in engine sales that are forecast but not contracted by 64%. - An increase in costs of 8%.
Provisions	Whether any costs should be treated as wastage.	<p>Estimates of the time to resolve the technical issues on the Trent 1000, including the development of the modified HPT blade and estimates to Trent 1000 long-term contracts assessed as onerous.</p> <p>Estimates of the future revenues and costs to fulfil onerous contracts.</p>	<p>A 12-month delay in the availability of the modified HPT blade could lead to a £60m-£100m increase in the Trent 1000 exceptional costs provision.</p> <p>A reduction in Civil Aerospace widebody flying hours of 15% over the remaining term of the contracts and the associated decrease in revenues and costs could lead to a £10m – £15m increase in the provision for contract losses.</p>
Post-retirement benefits		The valuation of the Group's defined benefit pension schemes are based on assumptions determined with independent actuarial advice. The size of the net surplus is sensitive to the actuarial assumptions, which include the discount rate used to determine the present value of the future obligation, longevity, and the number of plan members who take the option to transfer their pension to a lump sum on retirement or who choose to take the Bridging Pension Option.	<p>A reduction in the discount rate from 1.95% to 1.70% could lead to an increase in the defined benefit obligations of the RR UK Pension Fund of approximately £425m. This would be expected to be broadly offset by changes in the value of scheme assets, as the scheme's investment policies are designed to mitigate this risk.</p> <p>A one-year increase in life expectancy from 21.7 years (male aged 65) and from 23.1 years (male aged 45) would increase the defined benefit obligations of the RR UK Pension Fund by approximately £380m.</p> <p>Where applicable, it is assumed that 40% (31 December 2020: 40%) of members of the RR UK Pension Fund will transfer out of the fund on retirement with a share of funds transfer value. An increase of 5% in this assumption would increase the defined benefit obligation by £30m.</p>

2 Analysis by business segment

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

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

For the year ended 31 December 2020, the four divisions set out above were identified as core businesses, with other smaller businesses identified as non-core businesses. From 1 January 2021, the identification of core and non-core businesses has ceased with non-core businesses now included within the category of 'other businesses'. The figures in the segmental analysis are shown in total to include other businesses.

Other businesses include the trading results of the Bergen Engines AS business (the Group signed a sales agreement on 3 August 2021), the results of the Civil Nuclear Instrumentation & Control business (the Group signed a sales agreement on 7 December 2020), the results of the North America Civil Nuclear business until the date of disposal on 31 January 2020 and the results of the Knowledge Management System business until the date of disposal on 3 February 2020. The segmental analysis for 2020 has been restated to reflect the 2021 definition of other businesses.

During the period to 30 June 2021, activity previously managed as part of the Civil Aerospace segment has been transferred to ITP Aero. The activity transferred from Civil Aerospace to ITP Aero relates to the change in ownership of the Hucknall site with associated fabrications activities. This transfers the production of fabrications, combustors and fan outlet guide vanes manufactured in Hucknall from Civil Aerospace to ITP Aero. The segmental analysis for 2020 has been restated to reflect these activities in the ITP Aero segment in line with 2021. As a result of this transfer and the commitment to sell ITP Aero, it has been classified as held for sale at 30 June 2021 and as a discontinued operation for both statutory and underlying results.

Underlying results

The Group presents the financial performance of the businesses in accordance with IFRS 8 and consistently with the basis on which performance is communicated to the Board each month.

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

2 Analysis by business segment continued

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

In the period to 30 June 2021, the Group was a net purchaser (30 June 2020: net purchaser) of USD, with the consequence that the achieved exchange rate GBP:USD of 1.39 (30 June 2020: 1.24) on settled contracts was similar to the average spot rate in the period. In the second half of 2021, the Group expects to return to being a net seller of USD, at an expected achieved exchange rate GBP:USD of 1.59 based on the USD hedge book.

Estimates of future USD cash flows have been determined using the Group's base-case forecast. These USD cash flows have been used to establish the extent of future USD hedge requirements. In 2020, the Group took action to reduce the size of the USD hedge book by \$11.8bn across 2020-2026, resulting in an underlying charge of £1.7bn being recognised within underlying finance costs and the associated cash settlement costs occurring over the period 2020-2026. In the period to 30 June 2021, the Group took the opportunity to further reduce the size of the USD hedge book by an additional \$0.9bn by settling the mark-to market at zero cost. The derivatives relating to this underlying charge have been subsequently excluded from the effective hedge book, and therefore are also excluded from the calculation of the average exchange rate achieved in the current and future periods. This charge was reversed in arriving at statutory performance on the basis that the cumulative fair value changes on these derivative contracts are recognised as they arise.

In the period to 30 June 2021, cash settlement costs of £303m were incurred (30 June 2020: £88m).

Underlying performance excludes the following:

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

Acquisition accounting, business disposals and impairment

These are excluded from underlying results so that the current period and comparative results are directly comparable.

Exceptional items

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

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

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

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

Other items

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

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

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

See page 31 for the reconciliation between underlying performance and statutory performance.

2 Analysis by business segment continued

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

	Civil Aerospace ¹ £m	Power Systems ² £m	Defence £m	Other businesses £m	Corporate and inter- segment ³ £m	Total underlying from continuing operations £m
For the half-year ended 30 June 2021						
Underlying revenue from sale of original equipment	722	718	719	79	1	2,239
Underlying revenue from aftermarket services	1,446	463	1,002	73	4	2,988
Total underlying revenue	2,168	1,181	1,721	152	5	5,227
Gross profit	380	301	395	20	1	1,097
Commercial and administrative costs	(145)	(190)	(79)	(10)	(20)	(444)
Research and development costs	(237)	(69)	(47)	(5)	(28)	(386)
Share of results of joint ventures and associates	41	(1)	–	–	–	40
Underlying operating profit/(loss)	39	41	269	5	(47)	307
For the half-year ended 30 June 2020						
Underlying revenue from sale of original equipment	1,187	804	678	64	(5)	2,728
Underlying revenue from aftermarket services	1,329	410	875	70	(2)	2,682
Total underlying revenue	2,516	1,214	1,553	134	(7)	5,410
Gross (loss)/profit	(1,552)	263	332	9	(17)	(965)
Commercial and administrative costs	(172)	(148)	(76)	(16)	(23)	(435)
Research and development costs	(180)	(82)	(49)	(10)	–	(321)
Share of results of joint ventures and associates	88	–	3	–	–	91
Underlying operating (loss)/profit	(1,816)	33	210	(17)	(40)	(1,630)

¹ The underlying results for Civil Aerospace and ITP Aero (shown as underlying results from discontinued operations below) for 30 June 2020 have been restated to reflect the changes to activity during 2021 as described above.

² The underlying results for Power Systems for 30 June 2020 have been restated to reclassify the Civil Nuclear Instrumentation & Control business as Other businesses.

³ The underlying results of Corporate and inter-segment activities include the results of the Group's SMR, electrical and UK nuclear activities. As the Group increases its investment in these important new technologies it is anticipated that the result of these activities will be combined and presented as an additional segment in the full-year financial statements in line with how performance will be reviewed by the entity's Chief Operating Decision Maker.

2 Analysis by business segment continued

Reconciliation to statutory results

	Total underlying from continuing operations £m	Discontinued operations		Total underlying £m	Underlying adjustments and adjustments to FX £m	Discontinued operations ¹ £m	Group statutory results £m
		ITP Aero £m	Inter-segment £m				
For the half-year ended 30 June 2021							
Revenue from sale of original equipment	2,239	271	(139)	2,371	(4)	(132)	2,235
Revenue from aftermarket services	2,988	46	(32)	3,002	(64)	(14)	2,924
Total revenue	5,227	317	(171)	5,373	(68)	(146)	5,159
Gross profit/(loss)	1,097	48	(23)	1,122	(340)	32	814
Commercial and administrative costs	(444)	(26)	–	(470)	3	43	(424)
Research and development costs	(386)	(15)	–	(401)	(7)	18	(390)
Share of results of joint ventures and associates	40	–	–	40	(2)	–	38
Operating profit/(loss)	307	7	(23)	291	(346)	93	38
Loss arising on the acquisition and disposal of businesses	–	–	–	–	(7)	–	(7)
Profit/(loss) before financing and taxation	307	7	(23)	291	(353)	93	31
Net financing	(174)	1	–	(173)	257	(1)	83
Profit/(loss) before taxation	133	8	(23)	118	(96)	92	114
Taxation	(29)	54	4	29	342	(91)	280
Discontinued operations	–	–	–	–	–	(1)	(1)
Profit/(loss) for the period	104	62	(19)	147	246	–	393
Profit for the period from continuing operations				104			394
Profit/(loss) for the period from discontinued operations				43			(1)
Attributable to:							
Ordinary shareholders				147	246	–	393
Non-controlling interests				–	–	–	–
For the half-year ended 30 June 2020							
Revenue from sale of original equipment	2,728	319	(197)	2,850	(36)	(122)	2,692
Revenue from aftermarket services	2,682	79	(50)	2,711	299	(29)	2,981
Total revenue	5,410	398	(247)	5,561	263	(151)	5,673
Gross (loss)/profit	(965)	37	(39)	(967)	280	97	(590)
Commercial and administrative costs	(435)	(23)	–	(458)	15	22	(421)
Research and development costs	(321)	(15)	–	(336)	(376)	34	(678)
Share of results of joint ventures and associates	91	1	–	92	(19)	(1)	72
Operating (loss)/profit	(1,630)	–	(39)	(1,669)	(100)	152	(1,617)
Gain on the disposal of businesses	–	–	–	–	2	–	2
(Loss)/profit before financing and taxation	(1,630)	–	(39)	(1,669)	(98)	152	(1,615)
Net financing	(1,573)	(2)	–	(1,575)	(2,025)	2	(3,598)
(Loss)/profit before taxation	(3,203)	(2)	(39)	(3,244)	(2,123)	154	(5,213)
Taxation	(90)	1	7	(82)	71	(37)	(48)
Discontinued operations	–	–	–	–	–	(117)	(117)
Loss for the period	(3,293)	(1)	(32)	(3,326)	(2,052)	–	(5,378)
Loss for the period from continuing operations				(3,293)			(5,261)
Loss for the period from discontinued operations				(33)			(117)
Attributable to:							
Ordinary shareholders				(3,327)	(2,053)	–	(5,380)
Non-controlling interests				1	1	–	2

¹ Discontinued operations relate to the statutory results of ITP Aero and are presented net of internal sales, internal margin and related consolidation adjustments. Included within the operating loss of £93m is £17m of costs of disposal incurred related to the disposal group.

2 Analysis by business segment continued

Disaggregation of revenue from contracts with customers

Analysis by type and basis of recognition	Civil Aerospace ¹ £m	Power Systems ² £m	Defence £m	Other businesses £m	Corporate and inter-segment £m	Total underlying from continuing operations £m
For the half-year ended 30 June 2021						
Original equipment recognised at a point in time	721	707	301	79	1	1,809
Original equipment recognised over time	1	11	418	–	–	430
Aftermarket services recognised at a point in time	193	404	419	73	4	1,093
Aftermarket services recognised over time	1,197	59	583	–	–	1,839
Total underlying customer contract revenue	2,112	1,181	1,721	152	5	5,171
Other underlying revenue	56	–	–	–	–	56
Total underlying revenue	2,168	1,181	1,721	152	5	5,227

For the half-year ended 30 June 2020						
Original equipment recognised at a point in time	1,187	786	248	64	(5)	2,280
Original equipment recognised over time	–	18	430	–	–	448
Aftermarket services recognised at a point in time	746	351	364	70	(2)	1,529
Aftermarket services recognised over time	477	59	511	–	–	1,047
Total underlying customer contract revenue	2,410	1,214	1,553	134	(7)	5,304
Other underlying revenue	106	–	–	–	–	106
Total underlying revenue	2,516	1,214	1,553	134	(7)	5,410

¹ The underlying results for Civil Aerospace and ITP Aero (shown as underlying results from discontinued operations below) for 30 June 2020 have been restated to reflect the changes to activity during 2021 as described above.

² The underlying results for Power Systems for 30 June 2020 have been restated to reclassify the Civil Nuclear Instrumentation & Control business as Other businesses.

	Total underlying from continuing operations £m	Discontinued operations		Total underlying £m	Underlying adjustments and adjustments to FX £m	Discontinued operations ¹ £m	Group statutory results £m
		ITP Aero £m	Inter-segment £m				
For the half-year ended 30 June 2021							
Original equipment recognised at a point in time	1,809	247	(129)	1,927	(8)	(118)	1,801
Original equipment recognised over time	430	24	(10)	444	1	(14)	431
Aftermarket services recognised at a point in time	1,093	15	(3)	1,105	1	(12)	1,094
Aftermarket services recognised over time	1,839	31	(29)	1,841	(57)	(2)	1,782
Total customer contract revenue	5,171	317	(171)	5,317	(63)	(146)	5,108
Other revenue	56	–	–	56	(5)	–	51
Total revenue	5,227	317	(171)	5,373	(68)	(146)	5,159

For the half-year ended 30 June 2020							
Original equipment recognised at a point in time	2,280	296	(181)	2,395	(36)	(115)	2,244
Original equipment recognised over time	448	23	(16)	455	–	(7)	448
Aftermarket services recognised at a point in time	1,529	48	(39)	1,538	73	(9)	1,602
Aftermarket services recognised over time	1,047	31	(11)	1,067	226	(20)	1,273
Total customer contract revenue	5,304	398	(247)	5,455	263	(151)	5,567
Other revenue	106	–	–	106	–	–	106
Total revenue	5,410	398	(247)	5,561	263	(151)	5,673

¹ Discontinued operations relate to the statutory results of ITP Aero and are presented net of internal sales and related consolidation adjustments.

2 Analysis by business segment continued

Underlying profit adjustments	Half-year to 30 June 2021				Half-year to 30 June 2020				
	Revenue £m	Profit/(loss) before financing £m	Net financing £m	Taxation £m	Revenue £m	(Loss)/profit before financing £m	Net financing £m	Taxation £m	
Total underlying performance	5,373	291	(173)	29	5,561	(1,669)	(1,575)	(82)	
Impact of settled derivative contracts on trading transactions ¹	A	(68)	(297)	164	10	263	664	(669)	(2)
Unrealised fair value changes on derivative contracts held for trading ²	A	–	(4)	66	(1)	–	(4)	(2,729)	191
Unrealised net (gain)/losses on closing future over-hedged position ³	A	–	–	(8)	–	–	–	1,369	(106)
Realised net (gain)/losses on closing future over-hedged position ³	A	–	–	(7)	–	–	–	88	–
Unrealised fair value change to derivative contracts held for financing ⁴	A	–	–	38	(10)	–	–	(88)	–
Exceptional programme credits/(charges) ⁵	B	–	–	–	–	–	498	(21)	–
Impact of discount rate changes ⁶	B	–	–	–	–	–	–	30	–
Exceptional restructuring charge ⁷	B	–	(10)	–	(6)	–	(366)	–	9
Impairments ⁸	C	–	1	–	–	–	(966)	–	125
Other write-offs	C	–	–	–	–	–	(99)	–	39
Effect of acquisition accounting ⁹	C	–	(50)	–	13	–	(66)	–	17
Pension past-service credit ¹⁰	D	–	11	–	(4)	–	248	–	(87)
Other	D	–	3	4	(6)	–	(9)	(5)	1
Included in operating (loss)/profit		(68)	(346)	257	(4)	263	(100)	(2,025)	187
(Loss)/gains arising on the acquisitions and disposals of businesses ¹¹	C	–	(7)	–	–	–	2	–	–
Impact of tax rate change ¹²		–	–	–	346	–	–	–	160
De-recognition of UK losses		–	–	–	–	–	–	–	(276)
Total underlying adjustments		(68)	(353)	257	342	263	(98)	(2,025)	71
Discontinued operations		(146)	93	(1)	(91)	(151)	152	2	(37)
Statutory performance per condensed consolidated income statement		5,159	31	83	280	5,673	(1,615)	(3,598)	(48)

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

¹ The impact of measuring revenues and costs and the impact of valuation of assets and liabilities using the period end exchange rate rather than the achieved rate or the exchange rate that is expected to be achieved by the use of the hedge book reduced statutory revenues by £68m (30 June 2020: increased revenues by £263m) and reduced profit before financing and taxation by £297m (30 June 2020: reduced loss by £664m). Underlying financing excludes the impact of revaluing monetary assets and liabilities at the period end exchange rate.

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

³ In 2020, the Group took action to reduce the size of the USD hedge book by \$11.8bn across 2020-2026, resulting in an underlying charge of £1.7bn at 31 December 2020 (30 June 2020: £1.5bn). In 2021, this estimate was updated to reflect the actual cash cost and resulted in a £15m gain to underlying finance costs in the period to 30 June 2021. Further detail is provided in note 4.

⁴ Includes the losses on hedge ineffectiveness in the year of £2m (30 June 2020: losses of £15m) and net fair value gains of £40m (30 June 2020: losses of £73m) on any interest rate swaps not designated into hedging relationships for accounting purposes.

⁵ In the comparative period at 30 June 2020, the estimated Trent 1000 abnormal wastage costs reduced by £498m as a result of COVID-19, with improvements in the position on contract losses and lower expected costs associated with remediation shop visits and customer disruption.

⁶ During the period to 30 June 2021, the movement in discount rates on onerous contracts has resulted in an immaterial charge which has been recognised in underlying profit.

⁷ During the period to 30 June 2021, the Group recorded an exceptional restructuring charge of £10m which included a charge of £38m associated with initiatives to enable the restructuring which have been charged directly to the income statement. Further details are provided in note 15.

⁸ The Group has assessed the carrying value of its assets. Further details are provided in notes 7, 8 and 9.

⁹ The effect of acquisition accounting includes the amortisation of intangible assets arising on previous acquisitions.

¹⁰ A past service credit of £7m has been recorded following the final details on the additional transitional protections being agreed during the period and £4m as a result of transferring employment of 236 employees in anticipation of a business disposal.

¹¹ (Losses)/gains arising on the acquisitions and disposals of businesses are set out in note 19.

¹² The increase in the UK tax rate from 19% to 25% has been substantively enacted at the balance sheet date. The opening UK deferred tax balances have therefore been re-measured at 25%. This results in a credit to the income statement in 2021 of £328m, with an additional £18m credit arising in discontinued operations. The 2020 tax credit relates to the increase in the UK tax rate from 17% to 19%. Included in the £160m credit in 2020 is £1m that relates to discontinued operations.

2 Analysis by business segment continued

Balance sheet analysis

	Civil Aerospace ¹	Power Systems	Defence	ITP Aero ¹	Total reportable segments	ITP Aero transferred to held for sale ²	Total reportable segments excluding held for sale
At 30 June 2021							
Segment assets	15,673	3,461	3,274	1,931	24,339	(1,859)	22,480
Interests in joint ventures and associates	357	11	45	1	414	(1)	413
Segment liabilities	(20,495)	(1,459)	(2,889)	(958)	(25,801)	538	(25,263)
Net (liabilities)/assets	(4,465)	2,013	430	974	(1,048)	(1,322)	(2,370)
At 31 December 2020							
Segment assets	16,632	3,497	3,116	2,090	25,335	–	25,335
Interests in joint ventures and associates	363	11	19	1	394	–	394
Segment liabilities	(22,331)	(1,358)	(3,085)	(1,036)	(27,810)	–	(27,810)
Net (liabilities)/assets	(5,336)	2,150	50	1,055	(2,081)	–	(2,081)

¹ The financial position for Civil Aerospace and ITP Aero for 31 December 2020 have been restated to reflect the transfer of activity during 2021 as described above.

² ITP Aero segmental net assets transferred to held for sale exclude intercompany balances.

Reconciliation to the balance sheet

	30 June 2021 £m	31 December 2020 £m
Reportable segment assets excluding held for sale	22,480	25,335
Other businesses	5	7
Corporate and inter-segment	(2,566)	(3,102)
Interests in joint ventures and associates	413	394
Assets held for sale ¹	2,306	288
Cash and cash equivalents	2,915	3,452
Short-term investments	1	–
Fair value of swaps hedging fixed rate borrowings	146	293
Deferred and income tax assets	2,141	1,943
Post-retirement scheme surpluses	914	907
Total assets	28,755	29,517
Reportable segment liabilities excluding held for sale	(25,263)	(27,810)
Other businesses	(6)	(5)
Corporate and inter-segment	2,763	3,251
Liabilities associated with assets held for sale ¹	(904)	(228)
Borrowings and lease liabilities	(7,914)	(7,330)
Fair value of swaps hedging fixed rate borrowings	(89)	(42)
Deferred and income tax liabilities	(488)	(648)
Post-retirement scheme deficits	(1,444)	(1,580)
Total liabilities	(33,345)	(34,392)
Net liabilities	(4,590)	(4,875)

¹ As at 30 June 2021, assets and liabilities relating to ITP Aero, Bergen Engines AS and Civil Nuclear Instrumentation & Control have been classified as held for sale. For further details see note 19.

3 Research and development

	Half-year to 30 June 2021 £m	Restated Half-year to 30 June 2020 £m
Gross research and development costs	(549)	(580)
Contributions and fees ¹	153	138
Expenditure in the period	(396)	(442)
Capitalised as intangible assets	41	150
Amortisation and impairment of capitalised costs ²	(35)	(386)
Net cost recognised in the income statement	(390)	(678)
Underlying adjustments relating to the effects of acquisition accounting, impairment and foreign exchange ³	7	376
Discontinued operations	(18)	(34)
Net underlying cost recognised in the income statement	(401)	(336)

¹ Includes government funding.

² See note 7 for analysis of amortisation and impairment. During the period, amortisation of £5m has been incurred within the disposal group recognised as a discontinued operation.

³ During the period to 30 June 2021, no impairment of research and development was recorded. In the comparative period to 30 June 2020, impairment charges of £351m were recorded, relating to the financial and operational impact of COVID-19.

4 Net financing

	Half-year to 30 June 2021		Restated Half-year to 30 June 2020	
	Per consolidated income statement £m	Underlying financing ¹ £m	Per consolidated income statement £m	Underlying financing ¹ £m
Interest receivable	3	3	10	11
Net fair value gains on foreign currency contracts	25	–	–	–
Net fair value gains on non-hedge accounted interest rate swaps ²	40	–	–	–
Net fair value gains on commodity contracts	41	–	–	–
Financing on post-retirement scheme surpluses	7	–	13	–
Net foreign exchange gains	164	–	–	–
Realised net gains on closing over-hedged position ³	–	7	–	–
Unrealised net gains on closing over-hedged position ³	–	8	–	–
Financing income	280	18	23	11
Interest payable	(106)	(112)	(79)	(74)
Net fair value losses on foreign currency contracts	–	–	(2,631)	–
Net fair value losses on non-hedge accounted interest rate swaps ²	–	–	(73)	–
Unrealised net losses on closing future over-hedged position	–	–	–	(1,369)
Realised net losses on closing over-hedged position	–	–	–	(88)
Financial charge relating to financial RRSAs	–	–	(1)	(1)
Net fair value losses on commodity contracts	–	–	(98)	–
Financing on post-retirement scheme deficits	(10)	–	(14)	–
Net foreign exchange losses	–	–	(669)	–
Fees on undrawn facilities	(35)	(35)	(9)	(9)
Other financing charges	(46)	(44)	(47)	(45)
Financing costs	(197)	(191)	(3,621)	(1,586)
Net financing income/(costs)	83	(173)	(3,598)	(1,575)
Analysed as:				
Net interest payable	(103)	(109)	(69)	(63)
Net fair value gains/(losses) on derivative contracts	106	15	(2,802)	(1,457)
Net post-retirement scheme financing	(3)	–	(1)	–
Net foreign exchange gains/(losses)	164	–	(669)	–
Net other financing	(81)	(79)	(57)	(55)
Net financing income/(costs)	83	(173)	(3,598)	(1,575)

¹ See note 2 for definition of underlying results.

² The condensed consolidated income statement shows the net fair value gain/(loss) on any interest rate swaps not designated into hedging relationships for accounting purposes. Underlying financing reclassifies the interest payable (30 June 2020: payable) on these interest rate swaps from fair value movement to interest payable.

³ The £15m gain recognised relates to the actual cost of the reduction in the size of the USD hedge book in the period. For further detail, see below.

In 2020, in response to the deterioration in the medium-term outlook caused by COVID-19 and the related reduction in anticipated net US Dollar cash inflows, the Group took action to reduce the size of the US Dollar hedge book by \$11.8bn by transacting offsetting foreign exchange contracts across 2020-2026. An underlying charge of £1,689m relating to the total \$11.8bn reduction in the size of the US Dollar hedge book was included within underlying financing costs in 2020.

In 2021, this estimate was updated to reflect the actual cash cost of £1,674m resulting in a £15m credit included within underlying financing costs.

The cash settlement costs of £1,674m will occur over the period 2020-2026, £186m was incurred in 2020 and £303m was incurred in the period to 30 June 2021. The Group estimates that future cash outflows of £149m will occur in the remainder of 2021, £326m in 2022, and £710m spread over 2023 to 2026.

The Group also took action to reduce the size of the US Dollar hedge book by an additional \$0.9bn by settling the mark-to market at zero cost.

5 Taxation

The income tax expense has been calculated by applying the annual effective tax rate for each jurisdiction to the half-year profits of each jurisdiction.

The tax credit for the half-year is £280m on a statutory profit before taxation of £114m (30 June 2020: tax charge of £48m on a statutory loss before taxation of £5,213m), giving a statutory rate of (245.6%) (30 June 2020: (0.9%)). The key driver of the tax credit in 2021 is the impact of the increase in the UK tax rate. The key driver of the tax charge in 2020 is the non-recognition of deferred tax on UK losses arising in the year, partially offset by the credit arising on the change in the UK tax rate. Additionally, in 2020 some of the deferred tax asset relating to UK losses previously recognised has been derecognised.

Tax reconciliation – continuing operations:

	Half-year to 30 June 2021		Restated Half-year to 30 June 2020	
	£m	Tax rate	£m	Tax rate
Profit/(loss) before taxation	114		(5,213)	
Nominal tax charge/(credit) at UK corporation tax rate of 19%	22	19.0%	(990)	19.0%
Tax losses in year not recognised in deferred tax ¹	(7)	(6.1%)	707	(13.6%)
Derecognition of deferred tax	–	0.0%	433	(8.3%)
Increase in deferred taxes resulting from change in UK tax rate	(328)	(287.6%)	(159)	3.1%
Other	33	29.1%	57	(1.1%)
Statutory tax (credit)/charge and rate	(280)	(245.6%)	48	(0.9%)
Analysis of statutory tax (credit)/charge:				
Underlying items	(29)		82	
Non-underlying items (see note 2)	(342)		(71)	
Discontinued operations (see note 19)	91		37	
	(280)		48	

¹ Includes UK losses not recognised and movement on unrecognised deferred tax assets relating to foreign exchange and commodity financial assets and liabilities.

Deferred tax assets are recognised to the extent it is probable that future taxable profits will be available against which to recover the asset. Where necessary, this is based on management's assumptions relating to the amounts and timing of future taxable profits. The Board continually reassesses the appropriateness of recovering deferred tax assets relating to losses and other tax credits, which includes a consideration of the level of future profits and the time period over which they are recovered.

Sensitivity analyses are also performed as part of the assessment. At 30 June 2021, sensitivity analyses showed that either a 5% reduction in margins across all applicable Civil widebody programmes or a 5% reduction in shop visit volumes, which could be driven by fewer flying hours as a result of climate change, would result in a decrease in the deferred tax asset in respect of UK losses by around £150m, which equates to around a £1.2bn reduction in profit.

As a consequence of the impact of COVID-19 on existing Civil Aerospace widebody engine programmes, taking into account the sensitivity analyses performed, and in light of the inherent uncertainty in estimating such long-term forecasts, the Group has not recognised any deferred tax assets in respect of 2021 UK losses.

Deferred tax assets arising on additional unrealised losses on derivative contracts that remain hedged have also been assessed resulting in a net increase in the deferred tax asset of £43m, mainly driven by the change in UK corporate tax rate.

Both of these assessments are in line with the approach set out in note 5 of the 2020 Annual Report, and also take into account a 25% probability of there being a severe but plausible downside scenario in relation to the commercial aviation industry. The Spring Budget 2021 announced that the UK corporation tax rate will increase from 19% to 25% from 1 April 2023. The tax rate increase was substantively enacted on 24 May 2021. The prior year UK deferred tax assets and liabilities were calculated at 19%, as this was the enacted rate at the 2020 balance sheet date. As the 25% rate has been substantively enacted before 30 June 2021, the UK deferred tax assets and liabilities have been remeasured at 25%.

The resulting credits or charges have been recognised in the income statement except to the extent that they relate to items previously credited or charged to equity. Accordingly, in 2021, £328m has been credited to the income statement and £18m has been credited directly to equity.

The unrecognised deferred tax assets on UK losses, foreign exchange financial assets and liabilities and other deductible temporary differences have increased by £373m, £116m, and £11m respectively due to the increase in the UK tax rate to 25%.

6 Earnings per ordinary share

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

In the current period, the potentially dilutive share options element has been assessed as 18 million shares. Where a continuing loss is recognised, the effect of potentially dilutive ordinary shares is anti-dilutive.

	Half-year to 30 June 2021			Half-year to 30 June 2020		
	Basic	Potentially dilutive share options	Diluted	Basic	Potentially dilutive share options	Diluted
Profit/(loss) attributable to ordinary shareholders (£m):						
Continuing operations	394		394	(5,263)		(5,263)
Discontinued operations	(1)		(1)	(117)		(117)
	393		393	(5,380)		(5,380)
Weighted average number of ordinary shares (millions)	8,331	18	8,349	5,597	-	5,597
EPS (pence):						
Continuing operations	4.73	(0.01)	4.72	(94.03)	-	(94.03)
Discontinued operations	(0.01)	-	(0.01)	(2.09)	-	(2.09)
	4.72	(0.01)	4.71	(96.12)	-	(96.12)

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

	Half-year to 30 June 2021		Half-year to 30 June 2020	
	Pence	£m	Pence	£m
Underlying EPS / Underlying profit/(loss) attributable to ordinary shareholders	1.76	147	(59.44)	(3,327)
Total underlying adjustments to profit/(loss) before tax (note 2)	(1.15)	(96)	(37.93)	(2,123)
Related tax effects	4.11	342	1.27	71
Related NCI effects	-	-	(0.02)	(1)
EPS / profit/(loss) attributable to ordinary shareholders	4.72	393	(96.12)	(5,380)
Diluted underlying EPS	1.76		(59.44)	

Basic and diluted earnings per share figures for the comparative period have been restated and adjusted for the bonus factor of 2.91 to reflect the bonus element of the November 2020 rights issue, in accordance with IAS 33 *Earnings per Share*. Amounts as originally stated at 30 June 2020 were (280.06)p basic and diluted earnings per share and (173.19)p basic and diluted underlying earnings per share.

7 Intangible assets

	Goodwill £m	Certification costs £m	Development expenditure £m	Customer relationships £m	Software ³ £m	Other £m	Total £m
Cost:							
At 1 January 2021	1,112	963	3,564	1,403	968	893	8,903
Additions	–	1	42	–	28	18	89
Transferred to assets held for sale ¹	–	(6)	(179)	(868)	(15)	(59)	(1,127)
Disposals	–	(22)	–	–	(3)	(1)	(26)
Reclassifications	–	–	–	–	6	(6)	–
Reclassifications from PPE	–	–	–	–	6	–	6
Exchange differences	(41)	(2)	(72)	(58)	(5)	(26)	(204)
At 30 June 2021	1,071	934	3,355	477	985	819	7,641
Accumulated amortisation and impairment:							
At 1 January 2021	38	429	1,803	478	607	403	3,758
Charge for the period ²	–	11	40	42	47	14	154
Impairment	–	–	–	–	–	5	5
Transferred to assets held for sale ¹	–	(4)	(51)	(176)	(10)	–	(241)
Disposals	–	(21)	–	–	(2)	(1)	(24)
Reclassifications	–	–	(1)	–	–	1	–
Reclassifications from PPE	–	–	–	–	6	–	6
Exchange differences	–	(1)	(48)	(17)	(3)	(11)	(80)
At 30 June 2021	38	414	1,743	327	645	411	3,578
Net book value:							
30 June 2021	1,033	520	1,612	150	340	408	4,063
1 January 2021	1,074	534	1,761	925	361	490	5,145

¹ Bergen Engines AS, the Civil Nuclear Instrumentation & Control business and ITP Aero have been classified as disposal groups held for sale at 30 June 2021. Bergen Engines AS and the Civil Nuclear Instrumentation & Control business were classified as held for sale at 31 December 2020 - see note 19.

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

³ Includes £103m (31 December 2020: £110m) of software under course of construction which is not amortised.

Intangible assets have been reviewed for impairment in accordance with IAS 36 *Impairment of Assets*. Assessments have considered potential triggers of impairment such as external factors including climate change, significant changes with an adverse effect on a programme and by analysing latest management forecasts against those prepared in 2020 to identify any deterioration in performance. Where a trigger event has been identified, an impairment test has been carried out. Where an impairment was required the test was performed on the following basis:

- The carrying values have been assessed by reference to value in use. These have been estimated using cash flows from the most recent forecasts prepared by 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 based on estimates of market share, trading assumptions and long-term economic forecasts. The uncertainty over the recovery from COVID-19 has been modelled by including downside forecasts at an appropriate weighting taking into account the business segment being considered.

There have been no individually material impairment charges or reversals recognised in the period.

8 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 2021	1,994	5,442	1,025	451	8,912
Additions	4	27	–	64	95
Transferred to assets held for sale ¹	(122)	(301)	(22)	(8)	(453)
Disposals/write-offs	(11)	(96)	(1)	–	(108)
Reclassifications ²	91	102	–	(193)	–
Reclassifications to intangible assets ²	–	(6)	–	–	(6)
Exchange differences	(32)	(83)	(5)	(4)	(124)
At 30 June 2021	1,924	5,085	997	310	8,316

Accumulated depreciation and impairment:

At 1 January 2021	679	3,336	374	8	4,397
Charge for the period ³	36	176	27	–	239
Impairment ⁴	(1)	(1)	–	2	–
Transferred to assets held for sale ¹	(22)	(123)	(5)	–	(150)
Disposals/write-offs	(5)	(92)	–	–	(97)
Reclassifications ²	(13)	12	–	1	–
Reclassifications to intangible assets ²	–	(6)	–	–	(6)
Exchange differences	(9)	(49)	(1)	–	(59)
At 30 June 2021	665	3,253	395	11	4,324

Net book value at:

30 June 2021	1,259	1,832	602	299	3,992
1 January 2021	1,315	2,106	651	443	4,515

¹ Bergen Engines AS, the Civil Nuclear Instrumentation & Control business and ITP Aero have been classified as disposal groups held for sale at 30 June 2021. Bergen Engines AS and the Civil Nuclear Instrumentation & Control business were classified as held for sale at 31 December 2020 - see note 19.

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

³ Depreciation is charged to cost of sales and commercial and administrative costs or included in the cost of inventory as appropriate.

⁴ The carrying values of tangible assets have been assessed during the period in line with IAS 36. As a result of this assessment, there are no individually material impairment charges or reversals in the period.

9 Right-of-use assets

	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m	Total £m
Cost:				
At 1 January 2021	447	150	1,833	2,430
Additions/modification of leases	9	4	(3)	10
Transferred to assets held for sale ¹	(16)	(2)	–	(18)
Disposals	(8)	(4)	–	(12)
Exchange differences	(6)	(3)	(3)	(12)
At 30 June 2021	426	145	1,827	2,398

Accumulated depreciation and impairment:

At 1 January 2021	159	60	806	1,025
Charge for the period	22	15	100	137
Impairment ²	(3)	(6)	–	(9)
Transferred to assets held for sale ¹	(4)	(1)	–	(5)
Disposals	(8)	(4)	–	(12)
Exchange differences	(2)	(1)	(1)	(4)
At 30 June 2021	164	63	905	1,132

Net book value at:

30 June 2021	262	82	922	1,266
1 January 2021	288	90	1,027	1,405

¹ Bergen Engines AS, the Civil Nuclear Instrumentation & Control business and ITP Aero have been classified as disposal groups held for sale at 30 June 2021. Bergen Engines AS and the Civil Nuclear Instrumentation & Control business were classified as held for sale at 31 December 2020 - see note 19.

² The carrying values of right-of-use assets have been assessed during the period in line with IAS 36. As a result of this assessment, an impairment reversal of £9m has been recognised through non-underlying profit. The reversal relates to an element of the non-underlying impairments recorded in 2020 in Civil Aerospace for site rationalisation where there has been a subsequent change in strategy to continue production on that site.

10 Trade receivables and other assets

	Current		Non-current		Total	
	30 June	31 December	30 June	31 December	30 June	31 December
	2021	2020	2021	2020	2021	2020
	£m	£m	£m	£m	£m	£m
Trade receivables	2,347	2,479	–	–	2,347	2,479
Receivables due on risk and revenue sharing arrangements (RRSAs)	716	603	13	82	729	685
Amounts owed by joint ventures and associates	456	486	13	16	469	502
Costs to obtain contracts with customers	16	12	44	50	60	62
Other taxation and social security receivable	178	225	22	6	200	231
Other receivables ¹	554	639	19	20	573	659
Prepayments	339	412	351	425	690	837
	4,606	4,856	462	599	5,068	5,455

¹ Other receivables include unbilled recoveries relating to overhaul activity.

The expected credit losses for trade receivables and other assets has increased by £29m to £281m (31 December 2020: £252m). This increase is mainly driven by the Civil Aerospace business of £27m, of which £14m relates to specific customers and £13m relates to updates to the recoverability of other receivables.

The Group's expected credit loss provision movements are as follows:

	Half-year to	Year-ended
	30 June	31 December
	2021	2020
	£m	£m
At 1 January	(252)	(138)
Increases in loss allowance recognised in the income statement during the period	(81)	(119)
Loss allowance utilised	15	5
Releases of loss allowance previously provided	33	13
Other net movements	2	(13)
Transferred to held for sale	2	–
At 30 June	(281)	(252)

11 Trade payables and other liabilities

	Current		Non-current		Total	
	30 June	31 December	30 June	31 December	30 June	31 December
	2021	2020	2021	2020	2021	2020
	£m	£m	£m	£m	£m	£m
Trade payables	1,247	1,418	–	–	1,247	1,418
Payables due on RRSAs	500	697	–	–	500	697
Amounts owed to joint ventures and associates	657	583	–	–	657	583
Customer concession credits	1,254	1,536	557	514	1,811	2,050
Warranty credits	123	173	228	196	351	369
Accruals	1,069	1,322	110	117	1,179	1,439
Deferred receipts from RRSA workshare partners	26	17	491	507	517	524
Government grants	11	16	56	66	67	82
Other taxation and social security	117	127	6	7	123	134
Other payables ¹	716	764	344	515	1,060	1,279
	5,720	6,653	1,792	1,922	7,512	8,575

¹ Other payables includes financial penalties from agreements with investigating bodies, parts purchase obligations, payroll liabilities, HMG levies and deferred consideration for recent acquisitions.

The Group's payment terms with suppliers vary on the products and services being sourced, the competitive global markets the Group operates in and other commercial aspects of suppliers' relationships. Industry average payment terms vary between 90-120 days. The Group offers reduced payment terms for smaller suppliers, so that they are paid in 30 days. In line with aerospace industry practice, the Group offers a supply chain financing (SCF) programme in partnership with banks to enable suppliers, including joint ventures, who are on standard 75-day payment terms to receive their payments sooner. The SCF programme is available to suppliers at their discretion and does not change rights and obligations with suppliers nor the timing of payment of suppliers. At 30 June 2021, suppliers had drawn £449m under the SCF scheme (31 December 2020: £582m).

12 Contract assets and liabilities

	Current		Non-current ¹		Total	
	30 June	31 December	30 June	31 December	30 June	31 December
	2021	2020	2021	2020	2021	2020
	£m	£m	£m	£m	£m	£m
Contract assets						
Contract assets with customers	496	416	651	660	1,147	1,076
Participation fee contract assets	24	48	231	386	255	434
	520	464	882	1,046	1,402	1,510

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

Contract assets with customers include £847m (31 December 2020: £726m) of Civil Aerospace LTSA assets, with most of the remaining balance relating to Defence. The main drivers of the increase in the Group balance are: recognition of revenue relating to performance obligations satisfied in previous years of £31m in Civil Aerospace (as the level of variable consideration that will be received has increased as uncertainty has reduced following commercial negotiations); and revenue recognised in Civil Aerospace in the period exceeding amounts billed by £41m. No impairment losses in relation to these contract assets (31 December 2020: none) have arisen during the period to 30 June 2021.

Participation fee contract assets have reduced by £179m (31 December 2020: reduced by £165m) due to ITP Aero being reclassified as a disposal group held for sale which had an impact of £153m, amortisation exceeding additions by £12m and foreign exchange on consolidation of overseas entities of £14m. No impairment losses of participation fee contract assets (31 December 2020: none) have arisen during the period to 30 June 2021.

	Current		Non-current		Total	
	30 June	31 December	30 June	31 December	30 June	31 December
	2021	2020	2021	2020	2021	2020
	£m	£m	£m	£m	£m	£m
Contract liabilities	3,811	4,187	6,427	6,245	10,238	10,432

Contract liabilities have decreased by £194m. The main driver of the change in the Group balance is a result of ITP Aero contract liabilities being reclassified as a disposal group held for sale having an impact of £173m.

Civil Aerospace contract liabilities have increased by £15m. This consists of an increase in relation to LTSA liabilities of £54m to £6,895m (31 December 2020: £6,841m), offset by the utilisation of deposits. LTSA revenue billed has been ahead of revenue recognised in the period and together with foreign exchange movements have increased the LTSA liabilities by £183m, offset by £129m of LTSA revenue recognised relating to performance obligations satisfied in previous years, which were principally driven by improved shop visit cost expectations in Business Aviation and the impact of specific customer negotiations with airlines.

13 Financial assets and liabilities

Carrying value of other financial assets and liabilities

	Derivatives				Financial RRSAs	Other	C Shares	Total
	Foreign exchange contracts	Commodity contracts	Interest rate contracts ¹	Total derivatives				
	£m	£m	£m	£m	£m	£m	£m	£m
At 30 June 2021								
Non-current assets	361	9	152	522	–	15	–	537
Current assets	16	11	1	28	–	12	–	40
Assets	377	20	153	550	–	27	–	577
Current liabilities	(607)	(1)	(1)	(609)	(1)	(27)	(26)	(663)
Non-current liabilities	(2,293)	(1)	(117)	(2,411)	(6)	(45)	–	(2,462)
Liabilities	(2,900)	(2)	(118)	(3,020)	(7)	(72)	(26)	(3,125)
	(2,523)	18	35	(2,470)	(7)	(45)	(26)	(2,548)

At 31 December 2020

Non-current assets	396	18	258	672	–	15	–	687
Current assets	45	7	42	94	–	13	–	107
Assets	441	25	300	766	–	28	–	794
Current liabilities	(522)	(17)	(11)	(550)	(5)	(25)	(28)	(608)
Non-current liabilities	(2,790)	(19)	(113)	(2,922)	(76)	(48)	–	(3,046)
Liabilities	(3,312)	(36)	(124)	(3,472)	(81)	(73)	(28)	(3,654)
	(2,871)	(11)	176	(2,706)	(81)	(45)	(28)	(2,860)

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

13 Financial assets and liabilities continued

Derivative financial instruments

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

	Half-year to 30 June 2021					Year-ended 31 December 2020
	Foreign exchange instruments	Commodity contracts	Interest rate instruments – hedge accounted ²	Interest rate instruments – non-hedge accounted	Total	Total
	£m	£m	£m	£m	£m	£m
At 1 January	(2,871)	(11)	233	(57)	(2,706)	(2,849)
Movements in fair value hedges	–	–	(129)	–	(129)	139
Movements in cash flow hedges	(13)	4	(38)	–	(47)	(36)
Movements in other derivative contracts ¹	25	41	–	40	106	(160)
Contracts settled	348	(1)	(21)	7	333	200
Reclassification to held for sale	(12)	(15)	–	–	(27)	–
At period/year end	(2,523)	18	45	(10)	(2,470)	(2,706)

¹ Included in net financing.

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

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

	Financial RRSAs		Other liabilities		Other assets	
	Half-year to 30 June 2021	Year-ended 31 December 2020	Half-year to 30 June 2021	Year-ended 31 December 2020	Half-year to 30 June 2021	Year-ended 31 December 2020
	£m	£m	£m	£m	£m	£m
At 1 January	(81)	(110)	(73)	(72)	15	16
Exchange adjustments included in OCI	3	(6)	3	(2)	–	–
Additions	–	–	(2)	(17)	–	–
Financing charge ¹	–	(3)	–	(13)	–	–
Excluded from underlying profit:						
Changes in forecast payments ¹	–	(3)	–	–	–	–
Exchange adjustments ¹	–	–	–	–	–	–
Cash paid	2	39	–	18	–	(1)
Other	–	–	–	13	–	–
Reclassification to held for sale	69	2	–	–	–	–
At period/year end	(7)	(81)	(72)	(73)	15	15

¹ Included in financing.

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

	Half-year to 30 June 2021		Year-ended 31 December 2020	
	Book value	Fair value	Book value	Fair value
	£m	£m	£m	£m
Borrowings – Level 1	(4,057)	(4,070)	(4,886)	(4,814)
Borrowings – Level 2	(1,991)	(2,071)	(401)	(403)
Financial RRSAs – Level 3	(7)	(10)	(81)	(89)

Fair values

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

- Non-current investments – other comprise unconsolidated companies and are measured at fair value.
- Money market funds, included within cash and cash equivalents, are valued using Level 1 methodology. Fair values are assumed to approximately equal cost either due to the short-term maturity of the instruments or because the interest rate of the investments is reset after periods not exceeding six months.
- The fair values of held to collect trade receivables and similar items, trade payables and other similar items, other non-derivative financial assets and liabilities, short-term investments and cash and cash equivalents are assumed to approximate to cost either due to the short-term maturity of the instruments or because the interest rate of the investments is reset after periods not exceeding six months.
- Fair values of derivative financial assets and liabilities and trade receivable held to collect or sell (30 June 2021: £111m; 31 December 2020: £938m) are estimated by discounting expected future contractual cash flows using prevailing interest rate curves or cost of borrowing, as appropriate. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. These financial instruments are included on the balance sheet at fair value, derived from observable market prices (Level 2 as defined by IFRS 13 *Fair Value Measurement*). During the period to 30 June 2021, the Group reassessed which trade receivables are held to collect or sell. The Group's intent is to no longer utilise invoice discounting and consequently, balances are generally not classified as held to collect or sell. A small amount of invoice discounting has continued within Power Systems at the request and cost of the customer.
- Borrowings are carried at amortised cost. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. The fair value of borrowings is estimated using quoted prices (Level 1 as defined by IFRS 13) or by discounting contractual future cash flows (Level 2 as defined by IFRS 13).
- The fair values of RRSAs and other liabilities are estimated by discounting expected future cash flows. The contractual cash flows are based on future trading activity, which is estimated based on latest forecasts (Level 3 as defined by IFRS 13).
- Other assets are included on the balance sheet at fair value, derived from observable market prices or latest forecast (Level 2/3 as defined by IFRS 13). At 30 June 2021, Level 3 assets totalled £15m (31 December 2020: £15m).
- The fair value of lease liabilities are estimated by discounting future contractual cash flows using either the interest rate implicit in the lease or the Group's incremental cost of borrowing (Level 2 as defined by IFRS 13).

In 2019, the Group adopted the 'Amendments to IFRS 9, IAS 39 and IFRS 7 *Interest Rate Benchmark Reform*' issued in September 2019. In calculating the change in fair value attributable to the hedged risk for the fixed-rate borrowings, the Group has made the following assumptions that reflect its current expectations:

- The Group has assumed that pre-existing fallback provisions in the borrowings do not apply to IBOR reform;
- Borrowings move to a risk free rate during 2022, and the spread will be similar to the spread included in the interest rate swaps used as hedging instruments; and
- No other changes to the terms of the hedged borrowings are anticipated.

14 Borrowings and lease liabilities

	Current		Non-current		Total	
	30 June 2021 £m	31 December 2020 £m	30 June 2021 £m	31 December 2020 £m	30 June 2021 £m	31 December 2020 £m
Unsecured						
Overdrafts	6	7	–	–	6	7
Bank loans ¹	3	9	1,972	10	1,975	19
Commercial paper ²	–	300	–	–	–	300
Loan notes ³	–	680	4,057	4,206	4,057	4,886
Other loans	–	17	10	58	10	75
Total unsecured	9	1,013	6,039	4,274	6,048	5,287
Lease liabilities	212	259	1,654	1,784	1,866	2,043
Total borrowings and lease liabilities	221	1,272	7,693	6,058	7,914	7,330

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

¹ On the 15 June 2021, the Group drew down the £2,000m loan maturing in 2025 (supported by an 80% guarantee from UK Export Finance).

² On the 27 April 2020, the Group issued commercial paper of £300m to the Covid Corporate Financing Facility (CCFF), a fund operated by the Bank of England on behalf of HM Treasury. These borrowings were repaid on 17 March 2021.

³ On the 18 June 2021, the Group repaid €750m (£639m) loan notes in line with repayment terms.

During the period, the Group entered into a new £1,000m loan maturing in 2026 (supported by an 80% guarantee from UK Export Finance and available to draw until March 2025). This facility was undrawn at 30 June 2021.

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

15 Provisions

	At 1 January 2021 £m	Charged to income statement ¹ £m	Reversed £m	Utilised £m	Transferred to held for sale £m	Exchange differences £m	At 30 June 2021 £m
Trent 1000 exceptional costs	321	24	–	(148)	–	–	197
Contract losses	808	84	(30)	(16)	(13)	(4)	829
Restructuring	236	3	(28)	(59)	(5)	(3)	144
Warranties and guarantees	327	50	(3)	(43)	(11)	(12)	308
Customer financing	17	–	–	–	–	–	17
Insurance	60	10	(16)	(5)	–	–	49
Tax related interest and penalties	33	–	–	–	–	–	33
Employer liability claims	50	1	–	(1)	(1)	–	49
Other	93	14	(1)	(9)	–	(3)	94
	1,945	186	(78)	(281)	(30)	(22)	1,720
Current liabilities	826						568
Non-current liabilities	1,119						1,152

¹ The charge to the income statement includes £16m in underlying profit/(loss) as a result of the unwinding of the discounting of provisions previously recognised.

Trent 1000 exceptional costs

In November 2019, the Group announced the outcome of testing and a thorough technical and financial review of the Trent 1000 TEN programme, following technical issues which were identified in 2019, resulting in a revised timeline and a more conservative estimate of durability for the improved HP turbine blade for the TEN variant. In the period, the Group has utilised £148m of the Trent 1000 exceptional costs provision. This represents customer disruption costs settled in cash and credit notes, and remediation shop visit costs. The remaining provision is expected to be utilised over the period 2021 to 2023.

15 Provisions continued

Contract losses

Provisions for contract losses are recorded when the direct costs to fulfil a contract are assessed as being greater than the expected revenue. In the period, additional contract losses for the Group of £84m have been recognised as a result of a change in future cost estimates. The Group continues to monitor the contract loss provision for changes in the market and revises the provision as required. Provisions for contract losses are expected to be utilised over the term of the customer contracts, typically within 10–15 years.

Restructuring

In May 2020, the Group announced a fundamental restructuring programme in response to the financial and operational impact caused by COVID-19 with a plan to remove 9,000 roles across the Group. During the period, £59m of the provision was utilised as part of these plans and £28m of the provision released following reassessment of the anticipated cost per role. The provision is expected to be utilised by the end of 2022.

Customer financing

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

In addition to the provisions recognised, the Group has contingent liabilities for customer financing arrangements where the payment is not probable as described below. In connection with the sale of its products the Group will, on some occasions, provide financing support for its customers, generally in respect of civil aircraft. The Group's commitments relating to these financing arrangements are spread over many years, relate to a number of customers and a broad product portfolio and are generally secured on the asset subject to the financing. These include commitments of \$1.8bn (31 December 2020: \$1.9bn) (on a discounted basis) to provide facilities to enable customers to purchase aircraft (of which approximately \$307m could be called during 2021). These facilities may only be used if the customer is unable to obtain financing elsewhere and are priced at a premium to the market rate. Significant events impacting the international aircraft financing market, including the COVID-19 pandemic, the failure by customers to meet their obligations under such financing agreements, or inadequate provisions for customer financing liabilities may adversely affect the Group's financial position.

Commitments on delivered aircraft in excess of the amounts provided are shown in the table below. These are reported on a discounted basis at the Group's borrowing rate to better reflect the time span over which these exposures could arise. These amounts do not represent values that are expected to crystallise. The commitments are denominated in USD. 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.

	At 30 June 2021		At 31 December 2020	
	£m	\$m	£m	\$m
Gross commitments	31	43	38	52
Value of security	(10)	(14)	(14)	(19)
Guarantees	(2)	(2)	(5)	(6)
Net commitments	19	27	19	27
Net commitments with security reduced by 20% ¹	21	29	22	30

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

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

The net post-retirement scheme deficit as at 30 June 2021 is calculated on a year to date basis, using the latest valuation as at 31 December 2020, updated to 30 June 2021 for the principal schemes.

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

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

	UK schemes £m	Overseas schemes £m	Total £m
At 1 January 2021	883	(1,569)	(686)
Exchange adjustments	–	54	54
Current service cost and administrative expenses	(4)	(33)	(37)
Past service credit	11	–	11
Financing recognised in the income statement	7	(10)	(3)
Contributions by employer	99	32	131
Actuarial gains recognised in OCI ¹	501	142	643
Returns on plan assets excluding financing recognised in OCI ¹	(609)	(46)	(655)
Transfers	–	(1)	(1)
At 30 June 2021	888	(1,431)	(543)
Post-retirement scheme surpluses – included in non-current assets ²	888	26	914
Post-retirement scheme deficits – included in non-current liabilities	–	(1,444)	(1,444)
Post-retirement scheme deficits – included in liabilities held for sale	–	(13)	(13)
	888	(1,431)	(543)

¹ The UK scheme recognised a net loss of £108m in OCI in the period to 30 June 2021 which has been driven by a higher discount rate offset by returns on plan assets.

² The surplus in the Rolls-Royce UK Pension Fund (RRUKPF) is recognised as, on ultimate wind-up when there are no longer any remaining members, any surplus would be returned to the Group, which has the power to prevent the surplus being used for other purposes in advance of this event.

Changes to UK defined benefit scheme

On the 29 July 2020, the Group announced a consultation with the active members of the UK scheme on a proposal to close the scheme to future accrual on 31 December 2020. As at 31 December 2020, a non-underlying past-service credit of £67m was recognised. Following the confirmation of the scheme closure, the Group held discussions with the employees' representatives and the Trustee regarding additional transitional protections that could be granted from the scheme. At 30 June 2021, £7m has been recognised as a non-underlying past service credit which relates to the differences between the final details agreed and the obligation estimated at 31 December 2020.

In the period to 30 June 2021, 236 employed deferred members have transferred employment in anticipation of a business disposal. As a consequence of this, a £4m non-underlying past service credit has been recognised.

Sensitivities

A reduction in the discount rate from 1.95% to 1.70% could lead to an increase in the defined benefit obligations of the RR UK Pension Fund of approximately £425m. This would be expected to be broadly offset by changes in the value of scheme assets, as the scheme's investment policies are designed to mitigate this risk.

A one-year increase in life expectancy from 21.7 years (male aged 65) and from 23.1 years (male aged 45) would increase the defined benefit obligations of the RR UK Pension Fund by approximately £380m.

Where applicable, it is assumed that 40% (31 December 2020: 40%) of members of the RR UK Pension Fund will transfer out of the fund on retirement with a share of funds transfer value. An increase of 5% in this assumption would increase the defined benefit obligation by £30m.

17 Contingent liabilities

Contingent liabilities in respect of customer financing commitments are described in note 15.

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

Contingent liabilities exist in respect of guarantees provided by the Group in the ordinary course of business for product delivery, commitments made for future service demand in respect of maintenance, repair and overhaul, and performance and reliability. The Group has, in the normal course of business, entered into arrangements in respect of export finance, performance bonds, countertrade obligations and minor miscellaneous items. Various Group undertakings are parties to legal actions and claims (including with tax authorities) 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.

18 Related parties

	Half-year to 30 June 2021 £m	Half-year to 30 June 2020 £m
Sales of goods and services to joint ventures and associates	1,434	2,171
Purchases of goods and services from joint ventures and associates	(1,772)	(2,514)

¹ Sales of goods and services to joint ventures and associates and purchases of goods and services from joint ventures and associates are included at the average exchange rate, consistent with the statutory income statement. In prior periods these have been included at the achieved rate on settled derivative contracts, consistent with note 2.

Included in sales of goods and services to joint ventures and associates are sales of spare engines amounting to £6m (30 June 2020: £20m). Profit recognised in the period on such sales amounted to £13m (30 June 2020: £30m), including profit on current period sales and recognition of profit deferred on similar sales in previous periods. On an underlying basis (at actual achieved rates on settled derivative transactions), the amounts were £13m (30 June 2020: £31m).

19 Disposals, businesses held for sale and discontinued operations

Disposals

Disposal completed in prior periods

On 1 June 2018, the Group sold its L'Orange business, part of Rolls-Royce Power Systems, to Woodward Inc. for €673m. Under the sale agreement, the cash consideration may be adjusted by up to +/-€44m, based on L'Orange aftermarket sales over the five-year period to 31 May 2023. This is reviewed at each reporting date over the adjustment period. A liability of €28m (31 December 2020: €29m) is recognised for amounts that are expected to be payable in relation to the years 2021–2023. Cash of €9m has been paid during the period with an increase in the liability of €8m (£7m) reflected as an adjustment to the sales proceeds. The maximum adjustment to sales proceeds has now been provided for in all future years to 2023.

Businesses held for sale

On 28 February 2020, the Group announced the decision to carry out a strategic review of Bergen Engines AS, the Group's medium-speed gas and diesel engine business. Bergen formed part of the Power Systems business and from 31 December 2020 it has been classified as held for sale. After the termination of the sale with TMH Group in March 2021, the sales process recommenced, and on 3 August 2021 the Group signed an agreement to sell Bergen to global engineering group Langley Holdings plc for an enterprise value of €63m. The agreement is subject to the satisfaction of certain closing conditions and the Norwegian government have been notified of the proposed sale. Effective completion is scheduled for 31 December 2021. Bergen has been assessed for impairment in line with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* with reference to its fair value less costs to sell. An impairment of £8m has been recognised of which £5m has been charged to non-underlying profit. As at 30 June 2021, Bergen had an additional £27m of cash which, as part of bank pooling arrangements, was held by another Group company and consequently is not included in the disposal group as the resulting intra-group balances are eliminated on consolidation. On completion, it is expected that €40m of cash will be retained by Rolls-Royce and any remaining amount will be included in the disposal group.

19 Businesses held for sale and discontinued operations continued

On 7 December 2020, the Group signed an agreement for the sale of Civil Nuclear Instrumentation & Control business to Framatome. Consequently, in accordance with IFRS 5, the business has been classified as held for sale at 30 June 2021 and its carrying value assessed against the anticipated proceeds and disposal costs. The sale is expected to complete in the second half of the year.

On 27 August 2020, the Group announced its intention to sell ITP Aero. During the period to 30 June 2021, the Hucknall site with associated fabrications activities, that were previously reported as part of the Civil Aerospace segment, have been transferred to ITP Aero (see note 2 for more detail) and other preparatory work has been performed such that as at 30 June 2021 ITP Aero was available for immediate sale in its present condition and there is an active programme to locate a buyer and complete the planned sale, as such, the business has been classified as a disposal group held for sale. The assets of ITP Aero have been assessed for impairment in line with the requirements of IFRS 5 and no impairment has been recognised. ITP Aero had an additional £315m of cash which was held by another Group company at 30 June 2021 and consequently is not included in the disposal group as the resulting intra-group balances are eliminated on consolidation. On completion, such cash is expected to be included in the disposal group.

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

	ITP Aero £m	Bergen £m	Civil Nuclear £m	Total £m
Intangible assets	886	–	16	902
Property, plant and equipment	303	–	6	309
Right-of-use assets	13	–	7	20
Investment in associates and joint ventures	1	–	–	1
Deferred tax assets	222	2	4	228
Inventory	237	91	15	343
Trade receivables and other assets	345	52	37	434
Cash and cash equivalents	38	27	4	69
Assets held for sale	2,045	172	89	2,306
Trade payables and other liabilities	(487)	(93)	(71)	(651)
Provisions for liabilities and charges	(30)	(12)	(4)	(46)
Borrowings and lease liabilities	(92)	(3)	(5)	(100)
Deferred tax liabilities	(92)	(2)	–	(94)
Post-retirement scheme deficits	–	–	(13)	(13)
Liabilities associated with assets held for sale	(701)	(110)	(93)	(904)
Net assets/(liabilities) held for sale	1,344	62	(4)	1,402

Discontinued operations

ITP Aero represents a separate major line of business and has been managed as a separate operating segment up to 30 June 2021 (see note 2). For the period ended 30 June 2021, following ITP Aero being classified as a disposal group held for sale and in line with IFRS 5, ITP Aero has been classified as a discontinued operation.

The financial performance and cash flow information presented reflects the operations for the period that have been classified as discontinued operations.

	Half-year to 30 June 2021 £m	Half-year to 30 June 2020 £m
Revenue	146	151
Operating loss ¹	(76)	(152)
Loss before taxation ¹	(75)	(154)
Income tax credit ¹	91	37
Profit/(loss) for the period from discontinued operations on ordinary activities	16	(117)
Costs on disposal of discontinued operations	(17)	–
Loss for the period from discontinued operations	(1)	(117)
Net cash inflow from operating activities ²	4	8
Net cash outflow from investing activities	(12)	(13)
Net cash outflow from financing activities	(1)	(9)
Exchange gains/losses	3	(5)
Net change in cash and cash equivalents	(6)	(19)

¹ Profit/(loss) from discontinued operations on ordinary activities is presented net of internal margin, related consolidation adjustments and amortisation of intangible assets arising on previous acquisition. The tax credit in 2021 includes a credit relating to the recognition of a deferred tax asset on losses. In the period to 30 June 2020, results included a number of write-offs and programme impairments.

² Cash flows from operating activities include £17m costs of disposal paid during the period to 30 June 2021 that were not a movement in the cash balance of the disposal group.

20 Derivation of summary funds flow statement from statutory cash flow statement

	Half-year to 30 June 2021		Half-year to 30 June 2020		Source
	£m	£m	£m	£m	
Underlying operating profit/(loss) from continuing operations	307		(1,630)		Note 2
Underlying operating loss from discontinued operations	(16)		(39)		Note 2
Underlying operating profit/(loss) (see note 2)		291		(1,669)	Note 2
Amortisation and impairment of intangible assets	159		550		Cash flow statement (CFS)
Depreciation and impairment of property, plant and equipment	243		495		CFS
Depreciation and impairment of right-of-use assets	128		513		CFS
Adjustment to residual value guarantees in lease liabilities	(3)		(42)		CFS
Impairment of joint ventures	2		15		Note 13
Reversal of non-underlying impairments of non-current assets	1		(966)		Reversal of underlying adjustment (note 2)
Acquisition accounting	(50)		(66)		Reversal of underlying adjustment (note 2)
Depreciation and amortisation		480		499	
Additions of intangible assets		(71)		(176)	CFS less exceptional restructuring (see below)
Purchases of property, plant and equipment		(124)		(221)	CFS
Lease payments (capital plus interest)		(171)		(190)	CFS (capital and interest payments adjusted for foreign exchange (FX))
Increase in inventories		(219)		(301)	CFS
Movement in receivables/payables	(223)		(1,313)		CFS adjusted for the impact of exceptional programme charges and exceptional restructuring shown on the basis of the FX rate achieved on settled derivative contracts
Movement in contract balances	(88)		(150)		CFS adjusted for the impact of exceptional programme charges and FX and excluding Civil LTSA (shown separately below)
Underlying movement in Civil Aerospace LTSA contract balances	(108)		788		Movement in Civil LTSA balances within movement of contract balances in CFS less impact of FX
Revaluation of trading assets (excluding exceptional items)	(154)		(152)		Adjustment to reflect the impact of the FX contracts held on receivables/payables
Realised derivatives in financing	45		74		Realised cash flows on FX contracts not included in underlying operating profit less cash flows on settlement of excess derivative contracts
Movement on receivables/payables/contract balances		(528)		(753)	
Movement on provisions		(136)		132	CFS adjusted for the impact of exceptional programme charges and anticipated recoveries, exceptional restructuring and FX contracts held
Net interest received and paid		(81)		(26)	CFS
Fees paid on undrawn facilities		(35)		-	CFS
Cash flows on settlement of excess derivative contracts		(303)		(88)	CFS
Cash flows on financial instruments net of realised losses included in operating profit		(52)		(33)	Cash flows on other financial instruments (CFS) not allocated to lease payments or exceptional programme expenditure adjusted for the impact of FX not held for trading
Other		(6)		(35)	Principally disposals of non-current assets, joint venture trading and the effect of share-based payments
Trading cash flow		(955)		(2,861)	
Underlying operating profit charge in excess of contributions to defined benefit schemes		(94)		94	CFS
Tax		(102)		(34)	CFS
Group free cash flow		(1,151)		(2,801)	
<i>Free cash flow from continuing operations</i>		(1,174)		(2,862)	
<i>Free cash flow from discontinued operations</i>		23		61	
Shareholder payments		(2)		(90)	CFS (includes dividends to NCI)
Acquisition of businesses		-		(8)	CFS
Disposal of businesses		(8)		10	CFS
Exceptional restructuring costs		(134)		(87)	£114m related to severance costs and £20m capital expenditure (30 June 2020: £54m and £33m respectively)
DPA payments		(156)		(135)	CFS
Difference in fair values of derivative contracts held for financing		(3)		(89)	CFS
Payments of lease principal less new leases and other non-cash adjustments to lease liabilities		154		167	CFS adjusted for the impact of FX
Foreign exchange		(70)		(2)	CFS less allocation to leases above
Other		(26)		(41)	Cash outflow on M&A spend and timing of cash flows on a prior period disposal. See below.
Change in net debt		(1,396)		(3,076)	
Change in net debt		(1,396)		(3,076)	
Non-cash lease impact		(154)		(167)	
Reclassification of other financial liabilities to borrowings		-		150	
Change in net debt excluding lease liabilities		(1,550)		(3,093)	

20 Derivation of summary funds flow statement from statutory cash flow statement continued

The information for the period ended 30 June 2020 has been re-presented to be on a comparable basis with the presentation adopted at the period ended 30 June 2021. There is no change to trading or free cash flow. In summary, foreign exchange transactions have been represented within line items to be consistent with presentation throughout the financial statements.

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

The table below shows a reconciliation of free cash flow to the change in cash and cash equivalents presented in the condensed consolidated cash flow statement on page 19.

	Half-year to 30 June 2021		Half-year to 30 June 2020		Source
	£m	£m	£m	£m	
Change in cash and cash equivalents	(443)		(360)		CFS
Net cash flow from changes in borrowings and lease liabilities	(914)		(2,637)		CFS
Movement in short-term investments	1		(6)		CFS
Movement in net debt from cash flows	(1,356)		(3,003)		
Exclude: Capital element of lease repayments	(147)		(149)		CFS
Movement in net debt from cash flows (excluding lease liabilities)		(1,503)		(3,152)	
Returns to shareholders		2		90	CFS
Acquisition of businesses	-		8		CFS
Disposal of businesses	8		(10)		CFS
Other acquisitions and disposals	22		-		£22m related to costs incurred on central M&A activity
Changes in group structure		30		(2)	
Penalties paid on agreements with investigating bodies		156		135	CFS
Exceptional restructuring costs		134		87	£114m related to severance costs and £20m capital expenditure (30 June 2020: £54m and £33m respectively)
Other		30		41	Timing of cash flows on a prior period disposal where the Group retains the responsibility for collecting cash before passing it on to the acquirer and other smaller items
Group free cash flow		(1,151)		(2,801)	

Principal risks and uncertainties

Our risk management system is described on pages 46 and 47 of our 2020 Annual Report as a continuous process that requires risk owners to constantly reassess risks and include learning from incidents to drive improvements in our control environment.

We continue to review our principal risks and how we manage them to reflect the evolving nature of the COVID-19 pandemic. The principal risks facing the Group for the remaining six months of the financial year are reported on pages 47 to 51 of our Annual Report 2020 and are summarised below:

Safety

Failure to: i) meet the expectations of our customers to provide safe products; or ii) create a place to work which minimises the risk of harm to our people, those who work with us, and the environment, would adversely affect our reputation and long-term sustainability.

Climate change

We recognise the urgency of the climate challenge and have committed to net zero carbon by 2050. The principal risk to meeting these commitments is the need to transition our products and services to a lower carbon economy. Failure to transition from carbon-intensive products and services at pace could impact our ability to win future business; achieve operating results; attract and retain talent; secure access to funding; realise future growth opportunities; or force government intervention to limit emissions.

Compliance

Non-compliance by the Group with legislation, the terms of DPAs or other regulatory requirements in the heavily regulated environment in which we operate (for example, export controls; data privacy; use of controlled chemicals and substances; anti-bribery and corruption; and tax and customs legislation). This could affect our ability to conduct business in certain jurisdictions and would potentially expose the Group to: reputational damage; financial penalties; debarment from government contracts for a period of time; and suspension of export privileges (including export credit financing), each of which could have a material adverse effect.

Cyber threat

An attempt to cause harm to the Group, its customers, suppliers and partners through the unauthorised access, manipulation, corruption, or destruction of data, systems or products through cyberspace.

Financial shock

The Group is exposed to a number of financial risks, some of which are of a macroeconomic nature (for example, foreign currency, oil price, interest rates) and some of which are more specific to the Group (for example, liquidity and credit risks). Significant extraneous market events could also materially damage the Group's competitiveness and/or creditworthiness and our ability to access funding. This would affect operational results or the outcomes of financial transactions.

Restructuring

Failure to deliver our restructuring, including changing our behaviours could result in: missed opportunities; dissatisfied customers; disengaged employees; ineffective use of our scarce resources; and increasing the likelihood of other principal risks occurring. This could lead to a business that is overly dependent on a small number of products and customers; failure to achieve our vision; non-delivery of financial targets; and not meeting investor expectations.

Business continuity

The major disruption of the Group's operations, which results in our failure to meet agreed customer commitments and damages our prospects of winning future orders. Disruption could be caused by a range of events, for example: extreme weather or natural hazards (for example earthquakes, floods); political events; financial insolvency of a critical supplier; scarcity of materials; loss of data; fire; or infectious disease. The consequences of these events could have an adverse impact on our people, our internal facilities or our external supply chain.

Competitive environment

Existing competitors: the presence of competitors in the majority of our markets means that the Group is susceptible to significant price pressure for original equipment or services. Our main competitors have access to significant government funding programmes as well as the ability to invest heavily in technology and industrial capability.

Existing products: failure to achieve cost reduction, contracted technical specification, product (or component) life or falling significantly short of customer expectations, would have potentially significant adverse financial and reputational consequences, including the risk of impairment of the carrying value of the Group's intangible assets and the impact of potential litigation.

New programmes: failure to deliver an NPI project on time, within budget, to technical specification or falling significantly short of customer expectations would have potentially significant adverse financial and reputational consequences.

Disruptive technologies (or new entrants with alternative business models): could reduce our ability to sustainably win future business, achieve operating results and realise future growth opportunities.

Market shock

The Group is exposed to a number of market risks, some of which are of a macroeconomic nature (e.g. economic growth rates) and some of which are more specific to the Group (for example, reduction in air travel or defence spending, or disruption to other customer operations). A large proportion of our business is reliant on the civil aviation industry, which is cyclical in nature.

Demand for our products and services could be adversely affected by factors such as current and predicted air traffic, fuel prices and age/replacement rates of customer fleets.

Political risk

Geopolitical factors that lead to an unfavourable business climate and significant tensions between major trading parties or blocs which could impact the Group's operations. Examples include: changes in key political relationships; explicit trade protectionism, differing tax or regulatory regimes, potential for conflict or broader political issues; and heightened political tensions.

Talent and capability

Inability to identify, attract, retain and apply the critical capabilities and skills needed in appropriate numbers to effectively organise, deploy and incentivise our people would threaten the delivery of our strategies.

Payments to shareholders

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

Shareholders wishing to redeem their existing C Shares must lodge instructions with the Registrar to arrive no later than 5.00pm on 1 December 2021 (CREST holders must submit their election in CREST by 2.55pm). The payment of C Share redemption monies will be made on 5 January 2022 and the CRIP purchase will begin as soon as practicable after 6 January 2022.

Statement of Directors' responsibilities

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

- the condensed consolidated interim financial statements have been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the UK;
- 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 interim 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 11 March 2021 are listed in its Annual Report 2020 on pages 64 to 66. Subsequently, Stephen Daintith resigned as a Director on 19 March 2021 and Frank Chapman, Lewis Booth and Jasmin Staiblin resigned on 13 May 2021. Panos Kakoullis was appointed as a Director on 3 May 2021 and Anita Frew was appointed on 1 July 2021.

By order of the Board

Warren East
Chief Executive

Panos Kakoullis
Chief Financial Officer

5 August 2021

5 August 2021

Independent review report to Rolls-Royce Holdings plc

Report on the condensed consolidated interim financial statements

Our conclusion

We have reviewed Rolls-Royce Holdings plc's condensed consolidated interim financial statements (the "interim financial statements") in the 2021 Half Year Results of Rolls-Royce Holdings plc for the 6 month period ended 30 June 2021 (the "period").

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 UK adopted International Accounting Standard 34, 'Interim Financial Reporting' 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 2021;
- the Condensed consolidated income statement and Condensed consolidated statement of comprehensive income for the period then ended;
- the Condensed consolidated cash flow statement for the period then ended;
- the Condensed consolidated statement of changes in equity for the period then ended; and
- the explanatory notes to the interim financial statements.

The interim financial statements included in the 2021 Half Year Results of Rolls-Royce Holdings plc have been prepared in accordance with UK adopted International Accounting Standard 34, 'Interim Financial Reporting' and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

Responsibilities for the interim financial statements and the review

Our responsibilities and those of the directors

The 2021 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 2021 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 2021 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 2021 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

5 August 2021