



Rolls-Royce

Rolls-Royce plc
Directors report and financial statements
December 31, 2004



A15
COMPANIES HOUSE

A2LRM6DT

0097
23/06/05

Contents

Report of the directors	1
Directors' responsibilities	3
Independent auditors' report	3
Group profit and loss account	4
Balance sheets	5
Group statement of total recognised gains and losses	6
Group historical cost profits and losses	6
Reconciliations of movements in shareholders' funds	6
Notes to the financial statements	7
Principal subsidiary undertakings	31
Principal joint ventures	33
Joint arrangements that are not entities	34

Rolls-Royce plc

Registered office:
65 Buckingham Gate
London SW1E 6AT

Telephone

020 7222 9020

Company number:

1003142

Report of the directors

Report of the directors

The directors present their annual report and the audited financial statements for the year ended December 31, 2004.

Principal activities

The principal activities of the Group are the supply of power systems and services to four growth markets – civil aerospace, defence, marine and energy. Rolls-Royce has established leading positions in these global markets by investing in technology and capability that can be exploited in each of these sectors.

Results for the year

During the year ended December 31, 2004 the Group achieved a turnover of **£5,939 million** (2003 £5,645 million) and a profit on ordinary activities before taxation of **£306 million** (2003 £180 million).

Further details of the Group's results and on its future developments are contained within the annual report of the parent company Rolls-Royce Group plc.

Dividends

A dividend of £601m was paid to the parent company.

Share capital

No new shares have been issued during the year.

Directors and their interests

The directors who held office during the year are:

Mr Euan Baird
Sir John Rose
Lord Moore of Lower Marsh
Hon Amy L Bondurant
Mr Peter J Byrom
Mr John P Cheffins
Mr Carl-Peter Forster
Mr Colin H Green
Mr James M Guyette
Dr Michael G J W Howse
Sir Robin Nicholson
Mr Simon M Roberston
Mr Andrew B Shilston
Mr Ian C Strachan
Mr Carl G Symon
Prof Sir John Taylor
Sir John Weston

All of the directors shown above are also directors of Rolls-Royce Group plc, the ultimate holding company, and as such are not required to disclose in these financial statements their individual remuneration or their interests in the shares of companies in the Rolls-Royce Group as they are disclosed in the financial statements of Rolls-Royce Group plc.

The closing mid-market price of the ordinary shares of the Company's ultimate parent company Rolls-Royce Group plc at December 31, 2004, was 247p and the range during 2004 was 168p to 269p.

Going concern statement

After making enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

Employment policy

The number of Group employees at the end of the year was **35,400** (2003 35,200).

The Group's employment policies and practices support overall business objectives by motivating and developing employees to meet the requirements of the business and its customers. Policies continue to be reviewed and developed to support the changing needs and international nature of the business.

A strong emphasis is placed on effective worldwide employee communications and each business has its own programme of communication adapted to its particular needs.

The Group consults with employees and employee representatives on a wide range of topics relating to its overall business objectives. Regular meetings are held in each business to discuss opportunities and issues of common interest.

A Company and Union Forum is now held at least twice a year involving senior management and employee representatives from across the Group followed by supporting communication in each business. This process is currently being broadened and a special negotiating body has been established to develop and introduce a Global Council that will cover all employees in the Group worldwide.

The Group has a strong equal opportunities policy and recognises the importance of developing a diverse and inclusive workforce.

The Company's policy, wherever possible, is to provide employment, training and development opportunities for disabled people. It is also committed to supporting employees who become disabled and to helping disabled employees make the best possible use of their skills and potential.

Learning and development

The Group continues to invest in improving individual and business capability by offering development opportunities and training programmes which ensure effective business learning and continuous professional development.

Report of the directors

continued

Payment to suppliers

The Company is guided by the Supply Chain Relationships in Aerospace (SCRIA) initiative. It seeks the best possible terms from suppliers and when entering into binding purchasing contracts, gives consideration to quality, delivery, price and the terms of payment. In the event of disputes, efforts are made to resolve them quickly.

The Company had the equivalent of 57 days purchases outstanding at December 31, 2004, based on the average daily amount invoiced by suppliers during the year.

Auditors

A resolution to reappoint the auditors, KPMG Audit Plc, and to authorise the directors to determine their remuneration, will be proposed at the Annual General Meeting.

By order of the Board



C E Blundell, Company Secretary
February 9, 2005

Directors' responsibilities for the financial statements

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the Group and of the profit or loss for that period.

In preparing those financial statements, the directors are required to:

- i) select suitable accounting policies and then apply them consistently;
- ii) make judgements and estimates that are reasonable and prudent;
- iii) state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- iv) prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company and the Group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Independent auditors' report to the members of Rolls-Royce plc

We have audited the financial statements on pages 4 to 34.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the directors' report and, as described on this page, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Group is not disclosed.

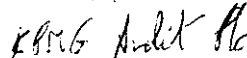
Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at December 31, 2004 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



KPMG Audit Plc

Chartered Accountants, Registered Auditor

London

February 9, 2005

Group profit and loss account for the year ended December 31, 2004

	Notes	2004 £m	2003 £m
Turnover: Group and share of joint ventures		6,229	6,038
Sales to joint ventures		965	936
Less share of joint ventures' turnover		(1,255)	(1,329)
Group turnover	2	5,939	5,645
Cost of sales		(4,812)	(4,714)
Gross profit		1,127	931
Other operating income	3	73	153
Commercial, marketing and product support costs		(302)	(292)
General and administrative costs		(296)	(288)
Research and development (net)*		(282)	(281)
Group operating profit		320	223
Share of operating profit of joint ventures		49	52
Profit on sale or termination of businesses	30	9	6
Loss on sale of fixed assets		(2)	(11)
Profit on ordinary activities before interest	2	376	270
Net interest payable – Group	4	(48)	(66)
– joint ventures		(22)	(24)
Profit on ordinary activities before taxation	3	306	180
Taxation	5	(101)	(64)
Profit on ordinary activities after taxation		205	116
Equity minority interests in subsidiary undertakings		(1)	—
Profit attributable to ordinary shareholders		204	116
Dividends	6	(601)	—
Transferred (from)/to reserves	25	(397)	116
*Research and development (gross)		(601)	(619)

As permitted by the Companies Act 1985, a separate profit and loss account for the Company has not been included in these financial statements. Of the Group profit attributable to ordinary shareholders, a loss of **£30m** (2003 loss of £53m) has been dealt with in the profit and loss account of the Company.

There have been no material acquisitions or material discontinued operations in 2004 or 2003.

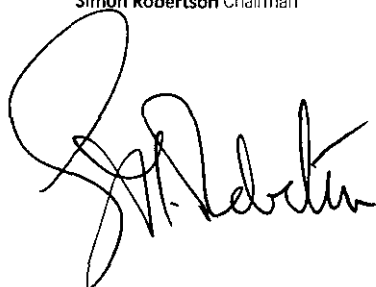
Balance sheets
at December 31, 2004

		Group		Company	
	Notes	2004 £m	2003 £m	2004 £m	2003 £m
Fixed assets					
Intangible assets	8	911	863	141	56
Tangible assets	9	1,626	1,750	869	850
Investments – subsidiary undertakings	10	—	—	1,773	1,472
– joint ventures	11	199	202	55	53
share of gross assets		1,137	1,113		
share of gross liabilities		(943)	(916)		
goodwill		5	5		
– other	12	59	64	48	47
		2,795	2,879	2,886	2,478
Current assets					
Stocks	13	1,081	962	676	572
Debtors – amounts falling due within one year	14	1,357	1,497	1,204	1,668
– amounts falling due after one year	15	1,053	1,109	487	690
Short-term deposits and investments	16	730	174	648	106
Cash at bank and in hand		758	794	425	436
		4,979	4,536	3,440	3,472
Creditors – amounts falling due within one year					
Borrowings	17	(204)	(94)	(328)	(81)
Other creditors	18	(3,420)	(2,707)	(2,967)	(2,525)
Net current assets		1,355	1,735	145	866
Total assets less current liabilities		4,150	4,614	3,031	3,344
Creditors – amounts falling due after one year					
Borrowings	19	(1,364)	(1,197)	(1,290)	(995)
Other creditors	20	(540)	(426)	(293)	(257)
Provisions for liabilities and charges	21	(787)	(795)	(168)	(181)
		1,459	2,196	1,280	1,911
Capital and reserves					
Called-up share capital	24	326	326	326	326
Share premium account	25	631	631	631	631
Revaluation reserve	25	89	96	85	89
Other reserves	25	—	195	167	167
Profit and loss account	25	409	945	71	698
Equity shareholders' funds		1,455	2,193	1,280	1,911
Equity minority interests in subsidiary undertakings		4	3	—	—
		1,459	2,196	1,280	1,911

The financial statements on pages 4 to 34 were approved by the Board on February 9, 2005 and signed on its behalf by:

Simon Robertson Chairman

Andrew Shilston Finance Director




Group statement of total recognised gains and losses for the year ended December 31, 2004

	2004 £m	2003 £m
Profit attributable to the shareholders of Rolls-Royce plc	204	116
Exchange adjustments on foreign currency net investments	(38)	(3)
Total recognised gains for the year	166	113

Group historical cost profits and losses for the year ended December 31, 2004

	2004 £m	2003 £m
Profit on ordinary activities before taxation	306	180
Difference between the historical cost depreciation charge and the actual depreciation charge for the year calculated on the revalued amount	7	4
Historical cost profit on ordinary activities before taxation	313	184
Historical cost transfer (from)/to reserves	(390)	120

Reconciliations of movements in shareholders' funds for the year ended December 31, 2004

	2004 £m	Group 2003 £m	2004 £m	Company 2003 £m
At January 1	2,193	2,035	1,911	1,919
Total recognised gains for the year	166	113	(631)	(53)
Ordinary dividends (net of scrip dividend adjustments)	(601)	45	—	45
Goodwill transferred to the profit and loss account in respect of disposals of businesses	2	—	—	—
Transfer of subsidiary investment to parent company	(305)	—	—	—
At December 31	1,455	2,193	1,280	1,911

Notes to the financial statements

1 Accounting policies

Basis of accounting

The financial statements have been prepared in accordance with applicable accounting standards on the historical cost basis, modified to include the revaluation of land and buildings.

As permitted by FRS 1, no cash flow statement has been prepared as a consolidated cash flow statement has been prepared by the ultimate parent company.

Basis of consolidation

The Group financial statements include the financial statements of the Company and all of its subsidiary undertakings made up to December 31, together with the Group's share of the results up to December 31 of:

- i) Joint ventures
A joint venture is an entity in which the Group holds a long-term interest and which is jointly controlled by the Group and one or more other venturers under a contractual arrangement. The results of joint ventures are accounted for using the gross equity method of accounting.
- ii) Joint arrangements that are not entities
The Group has certain contractual arrangements with other participants to engage in joint activities that do not create an entity carrying on a trade or business of its own. The Group includes its share of assets, liabilities and cash flows in such joint arrangements, measured in accordance with the terms of each arrangement, which is usually pro rata to the Group's risk interest in the joint arrangement.

Any subsidiary undertakings, joint ventures and joint arrangements that are not entities, sold or acquired during the year are included up to, or from, the dates of change of control.

Some small adjustments have been made to comparative figures to put them on a consistent basis with the current year.

Purchased goodwill

Goodwill represents the excess of the fair value of the purchase consideration for shares in subsidiary undertakings and joint ventures over the fair value of the Group of the net assets acquired.

- i) To December 31, 1997: Goodwill was written off to reserves in the year of acquisition. The profit or loss on the disposal of a business acquired before December 31, 1997 takes into account the attributable value of purchased goodwill relating to that business.
- ii) From January 1, 1998: Goodwill has been recognised within fixed assets in the year in which it arises and amortised on a straight line basis over its useful economic life, up to a maximum of 20 years.

Revenue recognition

Revenues comprise sales to outside customers after discounts, and excluding value added tax.

Sales of products are recognised when the significant risks and rewards of ownership of the goods are transferred to the customer, the sales price agreed and the receipt of payment can be assured.

Sales of services and long-term contracts are recognised when the outcome of the transaction can be reliably estimated. Revenue is recognised by reference to the stage of completion based on services performed to date as a percentage of the total contractual obligation.

Linked sales of product and services are treated as a single long-term contract where these components have been negotiated as a single commercial package and are so closely interrelated that they do not operate independently of each other and form a single project with an overall profit margin. Revenue is recognised on the same basis as for other long-term contracts as described above.

Provided that the outcome of long-term contracts can be assessed with reasonable certainty, the attributable profit recognised on such contracts is based on stage of completion and the overall contract profitability, after including an appropriate risk factor, which is progressively reduced over the life of the contract.

Full provision is made for any estimated losses to completion of contracts having regard to the overall substance of the arrangements including, if appropriate, related commitments and undertakings given by customers.

Progress payments received, when greater than recorded turnover, are deducted from the value of work in progress except to the extent that payments on account exceed the value of work in progress on any contract where the excess is included in creditors. The amount by which recorded turnover of long-term contracts is in excess of payments on account is classified as 'amounts recoverable on contracts' and is separately disclosed within debtors.

Stock

Stock and work in progress are valued at the lower of cost and net realisable value.

Risk and revenue sharing partnerships

From time to time, the Group enters into arrangements with partners who, in return for a share in future programme revenues or profits, make cash payments which are not refundable (except under certain remote circumstances). Cash sums received, which reimburse the Group for past expenditure, are credited to other operating income. The arrangements may also require partners to undertake development work and/or supply components at their own expense for use in the programme. No accounting entries are recorded where partners undertake such development work or where programme components are supplied by partners because no obligation arises unless and until programme sales are made; instead, payments to partners for their share in the programme are charged to cost of sales as programme revenues arise.

Research and development

The charge to the profit and loss account consists of research and development expenditure incurred in the year, excluding known recoverable costs on contracts, contributions to shared engineering programmes and application engineering. Application engineering expenditure, incurred in the adaptation of existing technology to new products, is capitalised and amortised over the programme life, up to a maximum of ten years, where both the technical and commercial risks are considered to be sufficiently low.

Foreign currencies

Assets and liabilities denominated in foreign currencies are translated into sterling at the rate ruling at the year end or, where applicable, at the estimated sterling equivalent, taking account of future foreign exchange and similar contracts. The trading results of overseas undertakings are translated at the average exchange rates for the year or, where applicable, at the estimated sterling equivalent, taking account of future foreign exchange and similar contracts. Exchange adjustments arising from the retranslation of the opening net investments, and from the translation of the profits or losses at average rates, are taken to reserves. Other exchange differences, including those arising from currency conversions in the usual course of trading, are taken into account in determining profit on ordinary activities before taxation.

Treasury instruments

The accounting treatment of the key instruments used by the Group is as follows:

- i) Gains or losses arising on forward exchange contracts are taken to the profit and loss account in the same period as the underlying transaction.
- ii) Net interest arising on interest rate agreements is taken to the profit and loss account.
- iii) Premiums paid or received on currency options are taken to the profit and loss account when the option expires or matures.
- iv) Gains or losses arising on jet fuel swaps are taken to the profit and loss account in the same period as the underlying transaction.

If the underlying transaction to a hedge ceases to exist, the hedge is terminated and the profits and losses on termination are recognised in the profit and loss account immediately. If the hedge transaction is terminated, the profits and losses on termination are held in the balance sheet and amortised over the life of the original underlying transactions.

Notes to the financial statements

continued

1 Accounting policies continued

Post-retirement benefits

Contributions to Group defined benefit pension schemes are charged to the profit and loss account so as to spread the cost of pensions at a substantially level percentage of payroll costs over employees' service lives.

The cost of providing post-retirement benefits other than pensions is charged to the profit and loss account over the service lives of the relevant employees.

Certification costs and participation fees

Costs incurred in respect of meeting regulatory certification requirements for new civil engine/aircraft combinations and payments made to airframe manufacturers for this, and participation fees, are carried forward in intangible assets to the extent that they can be recovered out of future sales and are charged to the profit and loss account over the programme life, up to a maximum of ten years.

Interest

Interest payable is charged to the profit and loss account as incurred, except where the borrowing finances tangible fixed assets in the course of construction relating to power development projects. Such interest is capitalised until the asset is complete and is then written off by way of depreciation of the relevant asset.

Interest receivable is credited to the profit and loss account as earned.

Taxation

Provision for taxation is made at the current rate and for deferred taxation at the projected rate on all timing differences which have originated, but not reversed at the balance sheet date.

Scrip dividends

The amounts of dividends taken as shares instead of cash under the scrip dividend scheme have been added back to reserves. The nominal value of shares issued under the scheme has been funded out of the share premium account.

Accounting for leases

i) As Lessee

Assets financed by leasing agreements which give rights approximating to ownership (finance leases) have been capitalised at amounts equal to the original cost of the assets to the lessors and depreciation provided on the basis of the Group depreciation policy. The capital elements of future obligations under finance leases are included as liabilities in the balance sheet and the current year's interest element, having been allocated to accounting periods to give a constant periodic rate of charge on the outstanding balance, is charged to the profit and loss account.

The annual payments under all other lease arrangements, known as operating leases, are charged to the profit and loss account on an accruals basis.

ii) As Lessor

Amounts receivable under finance leases are included under debtors and represent the total amount outstanding under lease agreements less unearned income. Finance lease income, having been allocated to accounting periods to give a constant periodic rate of return on the net cash investment, is included in turnover.

Rentals receivable under operating leases are included in turnover on an accruals basis.

Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost or valuation less accumulated depreciation and any provision for impairments in value.

Depreciation is provided on the following basis:

i) Land and buildings

Depreciation is provided on the original cost of purchases since 1996 and on the valuation of properties adopted at December 31, 1996 and is calculated on a straight line basis at rates sufficient to reduce them to their estimated residual value. Estimated lives, as advised by the Group's professional valuers, are:

- a) Freehold buildings – five to 45 years (average 23 years).
- b) Leasehold land and buildings – lower of valuers' estimates or period of lease.

No depreciation is provided in respect of freehold land.

ii) Plant and equipment

Depreciation is provided on the original cost of plant and equipment and is calculated on a straight line basis at rates sufficient to reduce them to their estimated residual value. Estimated lives are in the range five to 25 years (average 15 years).

iii) Aircraft and engines

Depreciation is provided on the original cost of aircraft and engines and is calculated on a straight line basis at rates sufficient to reduce them to their estimated residual value. Estimated lives are in the range five to 20 years (average 13 years).

iv) In course of construction

No depreciation is provided on assets in the course of construction.

Notes to the financial statements

continued

2 Segmental analysis

	Group turnover		Profit before interest		Net assets ¹	
	2004 £m	Restated 2003 £m	2004 £m	Restated 2003 £m	2004 £m	Restated 2003 £m
Analysis by business:						
Civil aerospace	3,040	2,694	165	82	665	1,128
Defence	1,374	1,398	155	132	(129)	81
Marine	963	1,003	40	39	437	584
Energy	489	508	8	23	330	351
Financial services ³	73	42	8	(6)	236	375
	5,939	5,645	376	270	1,539	2,519
Geographical analysis by origin:						
United Kingdom	3,785	3,467	129	76	741	1,497
Other	2,154	2,178	247	194	798	1,022
	5,939	5,645	376	270	1,539	2,519 ⁴
Geographical analysis by destination:						
United Kingdom	915	1,006				
Rest of Europe	954	919				
USA	1,944	2,061				
Canada	205	129				
Asia	1,290	1,047				
Africa	196	110				
Australasia	85	70				
Other	350	303				
	5,939	5,645				
Exports from United Kingdom	2,919	2,434				
Sales to overseas subsidiaries	(297)	(247)				
Sales by overseas subsidiaries	2,393	2,425				
Sales by overseas joint arrangements	9	27				
Total overseas	5,024	4,639				

¹ Net assets exclude net debt of £80m (2003 net debt of £323m).

² 2003 restated for the transfer of the Diesels business from Energy to Marine.

³ The turnover of financial services businesses including share of joint ventures is £130m (2003 £127m).

⁴ 2003 has been re-presented to more accurately reflect a reclassification of inter-company eliminations.

The analysis of underlying profit before interest, the profit and loss account exceptional items and the reconciliation to underlying profit before taxation are as follows:

	2004			Restated 2003 ¹			
	Underlying profit before interest £m	Non-trading items £m	Profit before interest £m	Underlying profit before interest £m	Exceptional items £m	Other non-trading items £m	Profit before interest £m
Civil aerospace	170	(5)	165	131	(34)	(15)	82
Defence	155	—	155	147	(11)	(4)	132
Marine	67	(27)	40	78	(7)	(32)	39
Energy	14	(6)	8	23	(1)	1	23
Financial services	9	(1)	8	(4)	(1)	(1)	(6)
	415	(39)²	376	375	(54)³	(51)²	270
Interest	(70)			(90)			
Underlying profit before taxation	345			285			

¹ 2003 restated for the transfer of the Diesels business from Energy to Marine.

² Comprising amortisation of goodwill £47m (2003 £48m), profit on sale of businesses £9m (2003 £6m) and loss on sale of fixed assets £1m (2003 £9m).

³ Rationalisation costs see note 3.

Notes to the financial statements

continued

3 Profit on ordinary activities before taxation

	2004 £m	2003 £m
After crediting		
Risk and revenue sharing partnerships receipts – credited to other operating income	73	153
Operating lease rentals receivable	37	24
After charging		
Exceptional items– rationalisation costs ¹	—	54
Amortisation of goodwill	47	48
Amortisation of certification costs	15	15
Depreciation of owned tangible fixed assets ²	211	209
Depreciation of tangible fixed assets held under finance leases ²	12	14
Operating lease rentals payable – hire of plant and equipment	55	58
– hire of other assets	17	19
Risk and revenue sharing partnerships payments – included in cost of sales	240	179

Auditors' fees were as follows during the year:

Audit 2004 – Group	£3.1m (2003 £3.1m) including Company £0.7m (2003 £0.7m)
Other 2004 – United Kingdom	£0.9m (2003 £1.2m)
– Rest of World	£0.6m (2003 £0.8m)

¹ Rationalisation costs in 2003 relate to termination of employment, site decommissioning and relocation and related disruption to operations, including accelerated depreciation of plant and machinery.

² Including appropriate amounts charged to stocks.

4 Net interest payable

	2004 £m	2003 £m
Interest payable on:		
Bank loans and overdrafts	(28)	(35)
Other borrowings	(75)	(52)
Finance leases	(3)	(5)
	(106)	(92)
Interest receivable	58	26
	(48)	(66)

Notes to the financial statements

continued

5 Taxation

	UK		Overseas		Total	
	2004 £m	2003 £m	2004 £m	2003 £m	2004 £m	2003 £m
Current tax						
Current tax charge/(credit) for the period	52	22	70	55	122	77
Less double tax relief	(48)	(17)	—	—	(48)	(17)
	4	5	70	55	74	60
Adjustments in respect of prior periods	1	(10)	—	(14)	1	(24)
Joint ventures	3	4	3	4	6	8
	8	(1)	73	45	81	44
Deferred tax						
Deferred tax (credit)/charge for the period	13	(3)	12	(6)	25	(9)
Adjustments in respect of prior periods	(12)	14	4	13	(8)	27
Joint ventures	3	2	—	—	3	2
	12	12	89	52	101	64
Tax reconciliation						
Profit on ordinary activities before taxation					306	180
Nominal tax charge at UK corporation tax rate 30% (2003 30%)					92	54
UK R&D tax credit					(13)	(12)
Goodwill not deductible for tax purposes					14	13
Fixed asset timing differences					(12)	(4)
Other timing differences					(16)	10
Other items					15	7
Adjustments in respect of prior periods					1	(24)
					81	44

6 Dividends – ordinary shares

	2004 £m	2003 £m
Paid to parent company	601	—

Notes to the financial statements

continued

7 Employee information

	2004 Number	2003 Number
Average weekly number of Group employees during the year		
United Kingdom	21,000	21,700
Overseas	14,200	14,400
	35,200	36,100
Civil aerospace	19,900	20,400
Defence	5,100	5,000
Marine	7,200	7,300 ¹
Energy	2,900	3,300 ¹
Financial services	100	100
	35,200	36,100
	£m	£m
Group employment costs		
Wages and salaries	1,297	1,316
Social security costs	128	132
Pensions and other post-retirement benefits (note 29)	138	112
	1,563	1,560

¹ Restated for the transfer of the Diesels business from Energy to Marine.

Emoluments of directors

Emoluments of directors of the Company are summarised below. Further details are given in the directors' remuneration report within the Annual Report of Rolls-Royce Group plc.

	Highest paid director ¹ £000	2004 Other directors £000	Highest paid director ¹ £000	2003 Other directors £000
Aggregate emoluments	1,075	3,554	904	3,235
Aggregate amount relating to long-term incentive plans	210	490	138	389
Aggregate value of Company contributions to Company defined contribution pension schemes		325		338
Accrued pension for highest paid director	384		335	
Gains realised on exercise of share options		62		

	2004 Number	2003 Number
Number of directors with accruing retirement benefits:		
Defined contribution schemes ²	2	2
Defined benefit schemes	6	6
Number of directors exercising share options	2	—
Number of directors receiving shares as part of long-term incentive schemes	6	6

¹ Member of defined benefit scheme.

² Two directors were members of both defined contribution and defined benefit schemes (2003 two directors).

Notes to the financial statements

continued

8 Intangible fixed assets

	Group			Company	
	Goodwill £m	Certification costs and participation fees £m	Application engineering £m	Total £m	Certification costs £m
Cost					
At January 1, 2004	960	175	43	1,178	169
Exchange adjustments	3	—	—	3	—
Additions	—	99	11	110	99
Disposals	(4)	—	—	(4)	—
At December 31, 2004	959	274	54	1,287	268
Accumulated amortisation					
At January 1, 2004	201	114	—	315	113
Exchange adjustments	3	—	—	3	—
Provided during the year	47	15	—	62	14
Disposals	(4)	—	—	(4)	—
At December 31, 2004	247	129	—	376	127
Net book value at December 31, 2004	712	145	54	911	141
Net book value at December 31, 2003	759	61	43	863	56

Notes to the financial statements

continued

9 Tangible fixed assets

	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m	In course of construction £m	Total £m
Group					
Cost or valuation:					
At January 1, 2004	522	1,949	256	156	2,883
Exchange adjustments	(1)	(17)	(10)	(3)	(31)
Additions at cost	10	56	6	119	191
On disposals of businesses	(1)	(6)	—	—	(7)
Reclassifications	11	86	—	(97)	—
Disposals/write-offs	(6)	(100)	(102)	—	(208)
At December 31, 2004	535	1,968	150	175	2,828
Accumulated depreciation:					
At January 1, 2004	96	941	96	—	1,133
Exchange adjustments	—	(10)	(3)	—	(13)
Provided during year ¹	20	176	27	—	223
On disposals of businesses	—	(4)	—	—	(4)
Disposals/write-offs	(1)	(79)	(57)	—	(137)
At December 31, 2004	115	1,024	63	—	1,202
Net book value at December 31, 2004	420	944	87	175	1,626
Net book value at December 31, 2003	426	1,008	160	156	1,750
Company					
Cost or valuation:					
At January 1, 2004	279	1,157	—	48	1,484
Additions at cost	6	34	—	94	134
Reclassifications	3	22	—	(25)	—
Disposals/write-offs	(3)	(51)	—	—	(54)
At December 31, 2004	285	1,162	—	117	1,564
Accumulated depreciation:					
At January 1, 2004	65	569	—	—	634
Provided during year	11	95	—	—	106
Disposals/write-offs	—	(45)	—	—	(45)
At December 31, 2004	76	619	—	—	695
Net book value at December 31, 2004	209	543	—	117	869
Net book value at December 31, 2003	214	588	—	48	850

¹ Includes impairment charges of £18m for plant and equipment, £1m for land and buildings, and £14m relating to the write-down of aircraft to values provided by independent aircraft appraisers.

Notes to the financial statements

continued

9 Tangible fixed assets continued

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Tangible fixed assets include:				
Net book value of finance leased assets	48	105	44	55
Assets held for use in operating leases:				
Cost	131	233	—	—
Depreciation	(49)	(82)	—	—
Net book value	82	151	—	—
Non-depreciable land	97	98	58	58
Land and buildings at cost or valuation comprise:				
Cost	311	296	93	87
Valuation at December 31, 1985	1	1	—	—
Valuation at December 31, 1996 ¹	223	225	192	192
	535	522	285	279
Land and buildings at net book value comprise:				
Freehold	388	395	200	207
Long leasehold	16	16	8	6
Short leasehold	16	15	1	1
	420	426	209	214
On a historical cost basis the net book value of land and buildings would have been as follows:				
Cost	519	506	267	261
Depreciation	(188)	(176)	(143)	(136)
	331	330	124	125
Capitalised interest included in net book value of assets in course of construction	2	2	—	—
Capital expenditure commitments – contracted but not provided for	86	22	84	20

The Group has followed the transitional provisions of FRS 15 'Tangible fixed assets', to retain the book value of land and buildings, certain of which were revalued in 1996 (see ¹ below).

¹ Group properties were revalued at December 31, 1996 as follows:

- Specialised properties, including certain of the Group's major manufacturing sites, were revalued on a depreciated replacement cost basis.
- Non-specialised properties were revalued by reference to their existing use value.
- Properties surplus to the Group's requirements were revalued on an open market value basis.

In the United Kingdom the revaluation was carried out by Gerald Eve, Chartered Surveyors, Fuller Peiser, Chartered Surveyors and Storey Sons & Parker, Chartered Surveyors, in accordance with the appraisal and valuation manual of the Royal Institution of Chartered Surveyors. Overseas properties were valued principally by independent local valuers.

Notes to the financial statements

continued

10 Investments – subsidiary undertakings

	Shares £m
Company	
Cost:	
At January 1, 2004	1,472
Additions	613
Disposals/write-offs	(312)
At December 31, 2004	1,773

The principal subsidiary undertakings are listed on pages 31 and 32.

11 Investments – joint ventures

	Shares at cost £m	Share of post acquisition reserves £m	Loans £m	Total £m
Group				
At January 1, 2004	128	68	6	202 ¹
Exchange adjustments	(4)	(4)	—	(8)
Additions	1	—	1	2
Share of retained profit	—	3	—	3
At December 31, 2004	125	67	7	199 ¹
Company				
At January 1, 2004	53	—	—	53
Additions	1	—	1	2
At December 31, 2004	54	—	1	55

The principal joint ventures are listed on pages 33 and 34.

¹ Investments in joint ventures are represented by:

	2004 £m	2003 £m
Share of aggregate assets:		
Fixed	662	676
Current	475	437
Share of aggregate liabilities: ²		
Due within one year	(422)	(367)
Due after one year	(521)	(549)
Goodwill	5	5
	199	202

² Includes borrowings of (518) (520)

Notes to the financial statements

continued

12 Investments – other

	Unlisted investments at cost £m	Parent company shares held under trust ¹ £m	Total £m
Group			
At January 1, 2004	63	1	64
Additions	—	14	14
Amortisation/disposals	(6)	(13)	(19)
At December 31, 2004	57	2	59
Company			
At January 1, 2004	46	1	47
Additions	—	14	14
Amortisation/disposals	—	(13)	(13)
At December 31, 2004	46	2	48

¹ Shares in the parent company are held in two trusts:

i) In respect of the employee share schemes. The shares held by this independently managed trust were purchased on the open market:

		£m
May 5, 2004	37,130 at £1.95 per share	0.1
October 22, 2004	400,000 at £1.98 per share	0.8

At December 31, 2004, the shares held had a market value of £1.1m. In accordance with UITF 17 'Employee share schemes', the Company is required to amortise the cost of likely awards over each separate performance measurement period and to include this charge as part of the cost of 'wages and salaries'. The UITF is a committee of the Accounting Standards Board.

ii) In respect of a Qualifying Employee Share Trust (QUEST), which provides employees with shares under Inland Revenue approved Save As You Earn (SAYE) share schemes. As permitted by UITF 17, no amortisation charge has been made. At December 31, 2004, a total of 410,747 of these shares had still not been allocated to option holders, their market value being £1.0m. These outstanding allocations are expected to occur in 2005.

Both trusts have waived their voting rights, and their costs of administration have been charged to the Company's profit and loss account.

13 Stocks

	2004 £m	Group 2003 £m	2004 £m	Company 2003 £m
Raw materials	147	156	14	17
Work in progress	423	369	226	152
Long-term contracts work in progress	148	117	74	75
Finished goods	615	596	448	460
Payments on account	63	29	39	44
	1,396	1,267	801	748
Progress payments received against:				
Long-term contracts	(178)	(142)	(87)	(107)
Other stocks	(137)	(163)	(38)	(69)
	1,081	962	676	572

Notes to the financial statements

continued

14 Debtors – amounts falling due within one year

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Trade debtors	742	956	244	413
Amounts recoverable on contracts	91	94	21	14
Amounts owed by – subsidiary undertakings	—	—	540	934
– joint ventures	202	162	194	151
Corporate taxation	2	1	—	—
Deferred tax assets (note 22)	—	23	—	—
Other debtors	187	115	97	40
Prepayments and accrued income	133	146	108	116
	1,357	1,497	1,204	1,668

15 Debtors – amounts falling due after one year

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Trade debtors	14	61	9	59
Amounts recoverable on contracts	534	533	312	421
Amounts owed by – subsidiary undertakings	—	—	21	76
– joint ventures	37	47	21	30
Deferred tax assets (note 22)	96	94	—	—
Other debtors	58	53	26	6
Prepayments and accrued income	51	82	51	79
Prepaid pension contributions	263	239	47	19
	1,053	1,109	487	690

16 Short-term deposits and investments

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Short-term deposits	694	135	648	106
Investments – government securities and corporate bonds	36	39	—	—
	730	174	648	106

17 Borrowings – amounts falling due within one year

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Overdrafts	13	20	143	73
Bank loans	2	58	—	—
Other loans	—	1	—	—
Obligations under finance leases	12	15	8	8
4½% Notes 2005 ¹	177	—	177	—
	204	94	328	81

¹ The Company has borrowed €256m in order to provide a loan for general purposes. This note is the subject of currency swap agreements under which counterparties have undertaken to pay amounts at fixed rates of interest and exchange in consideration for amounts payable by the subsidiary at variable rates of interest at fixed exchange rates.

Notes to the financial statements

continued

18 Other creditors – amounts falling due within one year

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Payments received on account	277	332	154	216
Trade creditors	572	476	302	237
Amounts owed to – subsidiary undertakings	—	—	562	867
– joint ventures	110	113	107	108
– parent and its subsidiaries	850	—	850	—
Corporate taxation	176	185	120	74
Other taxation and social security	71	56	45	29
Other creditors	612	604	535	509
Accruals and deferred income	752	941	292	485
	3,420	2,707	2,967	2,525

19 Borrowings – amounts falling due after one year

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Unsecured				
Bank loans	73	115	—	—
4½% Notes 2005	—	177	—	177
6¾% Notes 2007 ¹	310	310	310	310
7¾% Notes 2016	200	200	200	200
5.84% Notes 2010 ²	97	104	97	104
6.38% Notes 2013 ²	120	128	120	128
6.55% Notes 2015 ²	43	47	43	47
4½% Notes 2011 ¹	500	—	500	—
Other loan 2009 (interest rate nil)	1	2	—	—
Secured				
Bank loans	—	3	—	—
Obligations under finance leases payable: ³				
Between one and two years	6	39	6	8
Between two and five years	14	27	14	19
After five years	—	3	—	2
Zero-coupon bonds 2005/2007 (including 9.0% interest accretion) ⁴	—	42	—	—
	1,364	1,197	1,290	995
Repayable				
Between one and two years – by instalments	9	27	6	8
– otherwise	65	239	—	177
Between two and five years – by instalments	19	50	14	19
– otherwise	310	389	310	310
After five years – by instalments	1	13	—	2
– otherwise	960	479	960	479
	1,364	1,197	1,290	995

¹ The Company has borrowed €1,250m in order to provide a loan for general Group purposes. These notes are the subject of currency swap agreements under which counterparties have undertaken to pay amounts at fixed rates of interest and exchange in consideration for amounts payable by the Company at variable rates of interest and at fixed exchange rates.

² The Company has borrowed US\$500m in the US Private Placement market. This borrowing is the subject of interest rate swap agreements under which the Group has undertaken to pay floating rates of interest. The borrowing forms part of a net asset hedging arrangement.

³ Obligations under finance leases are secured by related leased assets.

⁴ Secured on aircraft financed by joint arrangements. Repayment of the zero-coupon bonds is also guaranteed by the Company.

Notes to the financial statements

continued

20 Other creditors – amounts falling due after one year

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Payments received on account	118	120	107	120
Amounts owed to – subsidiary undertakings	—	—	—	—
– joint ventures	25	25	—	—
Other creditors	128	51	108	46
Accruals and deferred income	269	230	78	91
	540	426	293	257

21 Provisions for liabilities and charges

	At January 1, 2004 £m	Exchange adjustments £m	Unused amounts reversed £m	Charged to profit and loss account £m	Utilised £m	At December 31, 2004 £m
Group						
Post-employment, pensions and other post-retirement benefits	160	(9)	—	17	(9)	159
Deferred taxation (note 22)	214	—	(17)	14	—	211
Warranty/guarantees	187	(1)	(3)	48	(60)	171
Contract loss	68	(1)	(1)	16	(34)	48
Customer financing	92	—	—	51	(27)	116
Insurance	25	—	—	18	(5)	38
Restructuring and rationalisation	22	—	(1)	4	(9)	16
Other	27	(1)	—	10	(8)	28
	795	(12)	(22)	178	(152)	787
Company						
Deferred taxation (note 22)	70	—	(14)	—	—	56
Warranty/guarantees	39	—	—	8	(11)	36
Contract loss	1	—	—	1	(1)	1
Customer financing	57	—	—	45	(39)	63
Restructuring and rationalisation	13	—	(1)	3	(5)	10
Other	1	—	—	1	—	2
	181	—	(15)	58	(56)	168

Post-employment, pensions and other post-retirement provisions are long term in nature and the timing of their utilisation is uncertain.

Warranty provisions primarily relate to products sold and generally cover a period of up to three years.

Provisions for contract loss and restructuring are generally expected to be utilised within one year.

Customer financing provisions cover guarantees provided for asset values and/or financing as described in note 27. Timing of utilisation is uncertain.

Insurance provisions relate to the Group's captive insurance business with timing of utilisation being uncertain.

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

Notes to the financial statements

continued

22 Deferred taxation

	Group £m	Company £m
At January 1, 2004	(97)	(70)
Amount charged to profit and loss account	(17)	14
Exchange movements	(1)	—
At December 31, 2004	(115)	(56)

There are other deferred tax assets totalling **£126m** (2003 £119m) that have not been recognised on the basis that their future economic benefit is uncertain.

The undistributed profits of overseas subsidiary undertakings and joint ventures may be liable to overseas taxes and/or United Kingdom tax (after allowing for double tax relief) if remitted as dividends to the UK. No deferred tax has been provided as there are currently no commitments to pay such dividends.

The analysis of the deferred tax position is as follows:

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Fixed asset timing differences	(131)	(123)	(109)	(108)
Other timing differences	(90)	(72)	(33)	(41)
Losses	26	8	25	8
Advance corporation tax	80	90	61	71
	(115)	(97)	(56)	(70)
Included in:				
Provisions	(211)	(214)	(56)	(70)
Debtors	96	117	—	—
	(115)	(97)	(56)	(70)

The above figures exclude taxation payable on capital gains which might arise from the sale of fixed assets at the values at which they are stated in the Group's balance sheet.

Notes to the financial statements

continued

23 Financial instruments

The following disclosures provide information regarding the effect of financial instruments on the financial assets and liabilities of the Group, excluding short-term debtors and creditors where permitted by FRS 13.

Funding and interest rates

	2004			
	Sterling £m	US Dollar £m	Euro £m	Other £m
Financial assets				
Cash at bank and in hand ¹	200	418	45	95
Short-term deposits ²	652	34	3	5
Government securities and corporate bonds ³	34	2	—	—
Unlisted fixed asset investments ⁴	47	3	2	5
Debtors – amounts falling due after one year ⁴	41	36	13	19
	974	493	63	124

Financial liabilities ⁵				
Floating-rate borrowings ⁶	(714)	(180)	(8)	(5)
Fixed-rate borrowings	(508)	(87)	—	(65)
Borrowings on which no interest is paid ⁷	—	—	—	(1)
Other creditors – amounts falling due after one year ⁴	(42)	(31)	(1)	(12)
	(1,264)	(298)	(9)	(83)

	2003			
	Sterling £m	US Dollar £m	Euro £m	Other £m
Financial assets				
Cash at bank and in hand ¹	139	497	34	124
Short-term deposits ²	108	—	—	27
Government securities and corporate bonds ³	39	—	—	—
Unlisted fixed asset investments ⁴	47	9	2	5
Debtors – amounts falling due after one year ⁴	87	59	13	2
	420	565	49	158

Financial liabilities ⁵				
Floating-rate borrowings ⁶	—	(290)	(8)	(12)
Fixed-rate borrowings	(729)	(130)	(2)	(118)
Borrowings on which no interest is paid ⁷	—	—	—	(2)
Other creditors – amounts falling due after one year ⁴	(32)	(43)	—	—
	(761)	(463)	(10)	(132)

Notes

¹ Cash at bank and in hand comprises bank balances and deposits placed on money markets overnight.

² Short-term deposits are deposits placed on money markets for periods ranging from two nights up to one month.

³ Interest on the securities and bonds are at fixed rates. The weighted average interest rate on the sterling securities is **5.8%** (2003 5.0%).
The weighted average time for these securities is **2.5 years** (2003 2.5 years).

⁴ These amounts do not incur or accrue interest.

⁵ Financial liabilities are stated after taking into account the various interest rate and currency swaps entered into by the Group.

⁶ Floating-rate financial liabilities comprise borrowings bearing interest at rates fixed in advance for periods ranging from one to six months based on the applicable LIBOR rate.

⁷ The weighted average period for borrowings on which no interest is paid is **five years** (2003 six years).

Notes to the financial statements

continued

23 Financial instruments continued

The analysis of fixed-rate borrowings is as follows:

	2004			2003		
	Total £m	Weighted average interest rate at which fixed %	Weighted average period for which rate is fixed Months	Total £m	Weighted average interest rate at which fixed %	Weighted average period for which rate is fixed Months
Currency						
Sterling	508	6.9	15	729	6.7	15
US Dollar	87	6.5	43	130	7.2	38
Other	65	5.4	15	120	5.4	22

The maturity profile of the Group's financial liabilities is as follows:

	2004 £m	2003 £m
In one year or less, or on demand	204	94
In more than one year but not more than two years	117	304
In more than two years but not more than five years	372	476
In more than five years	961	492
	1,654	1,366

Borrowing facilities

The Group has various borrowing facilities available to it. The undrawn committed facilities available at December 31, 2004 were as follows:

	2004 £m	2003 £m
Expiring within one year	—	91
Expiring in one to two years	—	67
Expiring thereafter	250	853
	250	1,011

Exchange risk management

The table below shows the Group's currency exposures at December 31, 2004 on currency transactions that give rise to the net currency gains and losses recognised in the profit and loss account. Such exposures comprise the net monetary assets and liabilities of the Group at December 31, 2004 that are not denominated in the functional currency of the operating company involved. The exposures are stated after taking into account the effects of currency swaps and forward foreign exchange contracts.

Functional currency of Group operation	2004				2003			
	Net foreign currency monetary assets/(liabilities)				Net foreign currency monetary assets/(liabilities)			
	Sterling £m	US Dollar £m	Euro £m	Other £m	Sterling £m	US Dollar £m	Euro £m	Other £m
Sterling	—	—	1	—	—	(3)	—	3
US Dollar	—	—	—	1	—	—	—	—
Euro	—	1	—	—	(3)	—	—	1
Other	1	4	(1)	4	(2)	2	3	1

Notes to the financial statements

continued

23 Financial instruments continued

Fair values of financial assets and financial liabilities

The estimated fair value of the Group's financial instruments are summarised below:

	2004		2003	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Unlisted fixed asset investments	57	57	63	63
Cash at bank and in hand	758	758	794	794
Short-term deposits and investments	730	730	174	176
Short-term debt	(204)	(211)	(94)	(92)
Long-term debt	(1,364)	(1,569)	(1,197)	(1,342)
Other creditors – amounts falling due after one year	(86)	(82)	(75)	(72)
Debtors – amounts falling due after one year	109	104	161	154
Derivatives used to hedge the interest, currency and commodity exposure of the business:				
Jet fuel swaps	—	9	—	6
Interest rate swaps	23	129	(27)	(1)
Forward foreign currency contracts	—	986	—	724
Forward purchase of shares to meet share option commitments	—	40	—	(10)

Where available, market values have been used to determine current values. Where market values are not available, fair values have been calculated by discounting expected future cash flows at prevailing interest and exchange rates.

Cash at bank and in hand, short-term deposits and short-term borrowings:

The book value approximates to fair value either due to the short-term maturity of the instruments or because the interest rate of investments is reset after periods not greater than six months.

Derivatives:

The fair value of derivatives is the estimated amount, based on current market rates, which the Group would expect to pay or receive were it to terminate the derivatives at the balance sheet date.

Hedges of future transactions

The Group's policy is to hedge the following exposures:

Interest rate risk – using interest swaps

Currency exposures on future forecast sales – using forward foreign currency contracts, currency swaps and currency options

Commodity price risk – using jet fuel swaps

Gains and losses on instruments used for hedging are dealt with as outlined in the accounting policies on pages 7 and 8.

Unrecognised gains and losses on instruments used for hedging, and the movements therein, are as follows:

	2004			2003		
	Gains £m	(Losses) £m	Total net gains/(losses) £m	Gains £m	(Losses) £m	Total net gains/(losses) £m
Unrecognised gains and losses on hedges at January 1, 2004	980	(234)	746	390	(331)	59
Gains and losses arising in previous year that were recognised in 2004	(280)	90	(190)	(199)	143	(56)
Gains and losses arising in previous year that were not recognised in 2004	700	(144)	556	191	(188)	3
Gains and losses arising in 2004 that were not recognised in 2004	618	(33)	585	789	(46)	743
Unrecognised gains and losses on hedges at December 31, 2004 of which:	1,318	(177)	1,141	980	(234)	746
Gains and losses expected to be recognised in 2005	564	(123)	441	260	(129)	131
Gains and losses expected to be recognised thereafter	754	(54)	700	720	(105)	615

Notes to the financial statements

continued

24 Share capital

	Equity ordinary shares of 20p each	Nominal value £m
Authorised		
At January 1 and December 31, 2004	2,000,000,000	400
Issued and fully paid		
At January 1 and December 31, 2004	1,630,996,508	326

On June 23, 2003 Rolls-Royce plc had 1,630,996,508 shares in issue with an aggregate nominal value of £326m. On this date, under a scheme of arrangement between Rolls-Royce plc and its shareholders under Section 425 of the Companies Act 1985, and as sanctioned by the High Court, all the issued shares in the Company were cancelled and the same number of new shares were issued to Rolls-Royce Group plc the new holding company of the Rolls-Royce Group in consideration for the allotment to shareholders of one ordinary share in Rolls-Royce Group plc for each ordinary share in Rolls-Royce plc held on the record date (June 20, 2003).

As a result of the scheme of arrangement, holders of options over ordinary shares in Rolls-Royce plc under the sharesave schemes and the executive option schemes were permitted to exchange their options for options over an equivalent number of ordinary shares in Rolls-Royce Group plc.

Notes to the financial statements

continued

25 Reserves

	Share premium £m	Non-distributable Revaluation reserve £m	Other reserves £m	Profit and loss account £m
Group				
At January 1, 2004	631	96	195	945
Exchange adjustments	—	—	—	(38)
Transfers between reserves	—	(7)	—	7
Write-back of purchased goodwill	—	—	2	—
Transfer of subsidiary investment to parent company ¹	—	—	(197)	(108)
Retained profit for the year	—	—	—	(397)
At December 31, 2004	631	89	—	409
Company				
At January 1, 2004	631	89	167	698
Transfers between reserves	—	(4)	—	4
Retained loss for the year	—	—	—	(631)
At December 31, 2004	631	85	167	71

¹ Elimination of consolidation reserves relating to subsidiary investment which has been transferred to parent company.

The cumulative amount of goodwill, arising on the acquisition of undertakings still in the Group at December 31, 2004, written off against other reserves amounts to **£370m** (2003 £372m). The continuance of this basis, in respect of pre-1998 acquisitions, is permitted under the transitional arrangements of FRS 10.

26 Operating lease annual commitments

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Leases of land and buildings which expire:				
Within one year	2	2	—	—
Between one and five years	4	3	—	—
After five years	10	9	6	6
Other leases which expire:				
Within one year	2	4	1	2
Between one and five years	21	7	1	2
After five years	35	42	—	—

Notes to the financial statements

continued

27 Contingent liabilities

In connection with the sale of its products, on some occasions the Group and Company enter into individually and collectively significant long-term contingent obligations. These can involve, inter alia, guaranteeing financing for customers, guaranteeing a proportion of the values of both engine and airframe, entering into leasing transactions, commitments to purchase aircraft and in certain circumstances could involve the Group and Company assuming certain of its customers' entitlements and related borrowing or cash flow obligations until the value of the security can be realised.

At the date these accounts are approved, the directors regard the possibility that there will be any significant loss arising from these contingencies, which cover a number of customers over a long period of time, as remote. In determining this, and the values below, the directors have taken account of advice, principally from Airclaims Limited, professional aircraft appraisers, who base their calculations on a current and future fair market value basis assuming an arms-length transaction between a willing seller and a willing buyer.

At December 31, 2004, the total gross contingent liabilities relating to financing arrangements on all delivered aircraft, less insurance arrangements and relevant provisions amounted to **£999m** (2003 £1,090m), of which **£12m** (2003 £39m) related to sales finance support to joint ventures. Taking into account the net realisable value of the relevant security, the net contingent liabilities in respect of financing arrangements on all delivered aircraft amounted to **£189m** (2003 £184m). Sensitivity calculations are complex, but, for example, if the value of the relevant security was reduced by 20%, a net contingent liability of approximately **£277m** (2003 £262m) would result. There are also net contingent liabilities in respect of undelivered aircraft but it is not considered practicable to estimate these as deliveries can be many years in the future and the related financing will only be put in place at the appropriate time.

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

In addition to the guarantees referred to in note 19 and above at December 31, 2004, there were other Company guarantees in respect of financial obligations of subsidiary undertakings **£66m** (2003 £83m), and in respect of joint ventures **£26m** (2003 £19m).

28 Related party transactions

The Company is a wholly owned subsidiary of Rolls-Royce Group plc and therefore has taken advantage of the exemption in FRS 8 not to disclose related party transactions with its parent company and other group companies.

29 Post-retirement benefits

Pensions

The Group's pension schemes are mainly of the defined benefit type and the assets of the schemes are held in separate trustee administered funds.

The pension cost relating to the UK schemes is assessed in accordance with SSAP 24 'Accounting for Pension Costs', based on the advice of independent qualified actuaries using the projected unit method. The latest actuarial valuations of the principal schemes were as at March 31, 2004 (for the Vickers Group Pension Scheme), April 5, 2004 (for the Rolls-Royce Group Pension Scheme), and March 31, 2003 (for the Rolls-Royce Pension Fund). The principal assumptions used were that in the long term the average returns on investments would be 2% per annum higher than the average increase in pay and 3.6% per annum higher than the average increase in pensions. Assets were valued on a market related basis.

The pension cost relating to overseas schemes is calculated in accordance with local best practice and regulations.

The total pension cost for the Group was **£123m** (2003 £95m) of which **£25m** (2003 £23m) relates to overseas schemes.

The aggregate of the market values of the UK schemes at the dates of the latest actuarial valuations was £3,804m. The actuarial value of the assets of the principal schemes represented respectively 92% (for the Rolls-Royce Pension Fund), 79% (for the Vickers Group Pension Scheme) and 89% (for the Rolls-Royce Group Pension Scheme) of the value of the projected accrued liabilities.

The difference between the value of the assets and the value of the projected accrued liabilities of the three principal schemes (after allowing for expected future increases in earnings and pension increases) is being amortised over periods of between 8.5 and 12 years, being the average expected remaining service lives of the pensionable employees.

Prepayments of **£263m** (2003 £239m) are included in debtors and accruals of **£22m** (2003 £29m) are included in provisions for liabilities and charges, being the differences between the accumulated amounts paid into the pension funds and the accumulated pension costs.

Post-retirement benefits other than pensions

In the USA, and to a lesser extent in some other countries, the Group's employment practices include the provision of healthcare and life insurance benefits for retired employees. In the USA, 540 retired employees currently benefit from these provisions and it is estimated that 4,385 current employees will be eligible on retirement.

The cost of post-retirement benefits other than pensions for the Group was **£15m** (2003 £17m). Provisions for the benefit obligations at December 31, 2004 amounted to **£124m** (2003 £119m) and are included in provisions for liabilities and charges. There were no plan assets at either December 31, 2004 or December 31, 2003. The future costs of benefits are assessed in accordance with the advice of independent qualified actuaries and are based on a weighted average discount rate of 5.8% and a weighted average assumed healthcare costs trend rate of 8% grading down to 5% over seven years.

Notes to the financial statements

continued

29 Post-retirement benefits continued

FRS 17 disclosures

The full implementation of FRS 17 'Retirement Benefits' has been deferred, however certain disclosures are required which are included below.

The valuations with respect to UK schemes have been based on the most recent actuarial valuation (as noted above) and updated by the scheme actuary to December 31, 2003 taking account of the requirements of FRS 17. For the material overseas defined benefit schemes the last formal actuarial valuations have been updated to December 31, 2003 by a qualified actuary taking account of the requirements of FRS 17.

The principal actuarial assumptions were as follows:

	2004		2003		2002	
	UK schemes %	Overseas schemes % ¹	UK schemes %	Overseas schemes % ¹	UK schemes %	Overseas schemes % ¹
Rate of increase in salaries	4.4	2.4	4.3	2.8	3.8	2.9
Rate of increase of pensions in payment and deferment	2.6	0.2	2.6	0.2	2.3	0.4
Discount rate	5.3	5.7	5.4	6.1	5.5	6.6
Inflation assumption	2.9	2.8	2.8	2.7	2.3	2.9

¹ Weighted average percentage.

The assets in the principal schemes and the expected rates of return at December 31 were as follows:

	2004 Group				2004 Company	
	UK schemes		Overseas schemes			
	Expected long-term rate of return %	Market value £m	Expected long-term rate of return %	Market value £m	Expected long-term rate of return %	Market value £m
Equities	7.6	3,007	8.3	99	7.6	2,234
Sovereign debt	4.6	699	—	—	4.6	441
Corporate bonds	5.1	644	5.6	58	5.1	452
Other	5.3	188	6.8	14	5.4	164
Total market value of assets	—	4,538	—	171	—	3,291
Present value of scheme liabilities	—	(5,688)	—	(419)	—	(4,321)
Deficit in the schemes	—	(1,150)	—	(248) ¹	—	(1,030)
Related deferred tax asset	—	345	—	77	—	309
Net pension liability	—	(805)	—	(171)	—	(721)

	2003 Group				2003 Company	
	UK schemes		Overseas schemes			
	Expected long-term rate of return %	Market value £m	Expected long-term rate of return %	Market value £m	Expected long-term rate of return %	Market value £m
Equities	8.3	2,884	8.3	86	8.3	2,073
Sovereign debt	4.8	692	—	—	4.8	449
Corporate bonds	5.1	580	5.7	49	5.1	426
Other	5.4	116	6.7	13	5.4	101
Total market value of assets	—	4,272	—	148	—	3,049
Present value of scheme liabilities	—	(5,493)	—	(383)	—	(4,105)
Deficit in the schemes	—	(1,221)	—	(235) ¹	—	(1,056)
Related deferred tax asset	—	366	—	79	—	317
Net pension liability	—	(855)	—	(156)	—	(739)

	2002 Group				2002 Company	
	UK schemes		Overseas schemes			
	Expected long-term rate of return %	Market value £m	Expected long-term rate of return %	Market value £m	Expected long-term rate of return %	Market value £m
Equities	8.0	2,524	9.4	63	8.0	1,794
Sovereign debt	4.4	644	—	—	4.4	404
Corporate bonds	5.0	492	6.5	45	5.0	371
Other	5.9	144	6.5	9	6.2	125
Total market value of assets	—	3,804	—	117	—	2,694
Present value of scheme liabilities	—	(5,400)	—	(360)	—	(4,127)
Deficit in the schemes	—	(1,596)	—	(243) ¹	—	(1,433)
Related deferred tax asset	—	479	—	85	—	430
Net pension liability	—	(1,117)	—	(158)	—	(1,003)

¹ Provisions of **£159m** (2003 £160m, 2002 £158m) exist primarily for overseas post-employment benefits and pensions (see note 21).

Notes to the financial statements

continued

29 Post-retirement benefits continued

Amounts charged to profit and loss account

	2004		Group 2003		Company	
	UK schemes £m	Overseas schemes £m	UK schemes £m	Overseas schemes £m	2004 £m	2003 £m
Operating profit						
Current service charge	75	19	81	19	59	65
Gain resulting from curtailment ¹	(2)	—	(567)	—	—	(567)
	73	19	(486)	19	59	(502)
Finance income						
Expected return on pension scheme assets	(303)	(11)	(257)	(10)	(218)	(184)
Interest on pension scheme liabilities	292	23	292	25	219	224
	(11)	12	35	15	1	40
Total charge/(credit)	62	31	(451)	34	60	(462)

¹ Results from agreed benefit reductions.

Movement in scheme deficits during the year

	2004		Group 2003		Company	
	UK schemes £m	Overseas schemes £m	UK schemes £m	Overseas schemes £m	2004 £m	2003 £m
At January 1	(1,221)	(235)	(1,596)	(243)	(1,056)	(1,433)
Exchange adjustments	—	14	—	18	—	—
Current service cost	(75)	(19)	(81)	(19)	(59)	(65)
Curtailment	2	—	567	—	—	567
Contributions	111	29	101	27	107	98
Finance income	11	(12)	(35)	(15)	(1)	(40)
Actuarial loss	22	(25)	(177)	(3)	(21)	(183)
At December 31	(1,150)	(248)	(1,221)	(235)	(1,030)	(1,056)

History of experience gains and losses and amount recognised in statement of total recognised gains and losses

	2004		Group 2003		Company	
	UK schemes £m	Overseas schemes £m	UK schemes £m	Overseas schemes £m	2004 £m	2003 £m
Difference between the expected and actual return on scheme assets						
Amount	130	2	350	10	92	253
Percentage of scheme assets	3%	1%	8%	7%	3%	8%
Experience gains and losses on scheme liabilities						
Amount	59	10	(147)	14	1	(157)
Percentage of the present value of scheme liabilities	1%	2%	(3%)	4%	0%	(4%)
Effect of changes in assumptions underlying the present value of scheme liabilities						
Amount	(167)	(37)	(380)	(27)	(114)	(279)
Percentage of the present value of scheme liabilities	(3%)	(9%)	(7%)	(7%)	(3%)	(7%)
Exchange adjustments	—	14	—	18	—	—
Total amount recognised in the statement of total recognised gains and losses						
Amount	22	(11)	(177)	15	(21)	(183)
Percentage of the present value of scheme liabilities	0%	(3%)	(3%)	4%	0%	(4%)

Notes to the financial statements

continued

29 Post-retirement benefits continued

Net assets

If the above net pensions liabilities had been recognised in the financial statements, the net assets and profit and loss reserve would be as follows:

	Group			Company		
	2004 £m	2003 £m	2002 £m	2004 £m	2003 £m	2002 £m
Net assets per balance sheet	1,459	2,196	2,037	1,280	1,911	1,919
Net pension liability	(976)	(1,011)	(1,275)	(721)	(739)	(1,003)
Pension prepayment: ¹	(186)	(168)	(143)	(33)	(13)	(6)
Provisions for pensions and other post retirement benefits ²	107	104	101	—	—	—
Total FRS 17 pension adjustment	(1,055)	(1,075)	(1,317)	(754)	(752)	(1,009)
Net assets under FRS 17	404	1,121	720	526	1,159	910

¹ Pension prepayment currently recorded: Group £263m (2003 £239m, 2002 £204m) less related deferred tax liability of £77m (2003 £71m, 2002 £61m);

Company £47m (2003 £19m, 2002 £9m) less related deferred tax liability of £14m (2003 £6m, 2002 £3m).

² Provisions currently recorded £159m (2003 £160m, 2002 £158m) less related deferred tax asset of £52m (2003 £56m, 2002 £57m).

Profit and loss reserve

	Group			Company		
	2004 £m	2003 £m	2002 £m	2004 £m	2003 £m	2002 £m
Profit and loss reserve	409	945	783	71	698	702
Total FRS 17 pension adjustment	(1,055)	(1,075)	(1,317)	(754)	(752)	(1,009)
Profit and loss reserve under FRS 17	(646)	(130)	(534)	(683)	(54)	(307)

30 Disposal or termination of businesses

During the year the Group disposed of its interests in Rolls-Royce Gear Systems Inc., as summarised below:

	Total £m
Tangible fixed assets	3
Stocks	2
Debtors	5
Creditors	(4)
Net assets	6
Related goodwill	2
	8
Profit on sale or termination of businesses	9
Disposal proceeds less costs	17

31 Ultimate holding company

The ultimate holding company is Rolls-Royce Group plc, incorporated in Great Britain. The financial statements for Rolls-Royce Group plc may be obtained from the Company Secretary, Rolls-Royce Group plc, 65 Buckingham Gate, London SW1E 6AT.

Principal subsidiary undertakings at December 31, 2004

Incorporated within the UK

Civil aerospace

Rolls E.L. Turboprops Limited	Engine support services/holding company
Rolls-Royce General Partner Limited ¹	Management company
Rolls-Royce Total Care Services Limited	Aftermarket support services

Marine systems

Rolls-Royce Marine Electrical Systems Limited ²	Marine electrical systems
Rolls-Royce Marine Power Operations Limited	Nuclear submarine propulsion systems

Energy

Rolls-Royce Fuel Cell Systems Limited ³	Development of fuel cell systems
--	----------------------------------

Financial services and corporate

Rolls-Royce Aircraft Management Limited	Sales finance and other financial services
Rolls-Royce Capital Limited ³	Sales finance and other financial services
Rolls-Royce International Limited	International support and commercial information services
Rolls-Royce Leasing Limited	Engine leasing
Rolls-Royce Overseas Holdings Limited	Holding company
Rolls-Royce Overseas Investments Limited ⁴	Holding company
Rolls-Royce Power Engineering plc	Power generation and marine systems
Rolls-Royce Power Ventures Limited	Provision of project development capabilities
Vinters Engineering plc ⁵	Holding company
Vinters plc	Holding company

¹ The interest is held by Rolls-Royce Supplies Limited.

² The interest is held by Rolls-Royce Power Engineering plc.

³ This subsidiary acts as an agent of Rolls-Royce plc.

⁴ The interest is held by Rolls-Royce Overseas Holdings Limited.

⁵ The interest is held by Vinters plc.

The above companies operate principally in the UK and the effective Group interest is 100%.

Principal subsidiary undertakings at December 31, 2004 continued

Incorporated overseas

Civil aerospace

Brazil	Rolls-Royce Brasil Limitada	Repair and overhaul
France	Rolls-Royce Technical Support SARL ¹	Project support
Germany	Rolls-Royce Deutschland Ltd & Co KG ²	BR700 series engine development and manufacture
Italy	Europea Microfusioni Aerospaziali S.p.A.	Manufacture of castings
USA	Rolls-Royce Corporation ³	Design, development and manufacture of gas turbine engines
USA	Rolls-Royce Engine Services – Oakland Inc. ⁴	Repair and overhaul

Marine systems

Finland	Rolls-Royce OY AB ⁵	Manufacture of winches and propeller systems
Norway	Rolls-Royce Marine AS ⁵	Design and manufacture of ship equipment/holding company
Norway	Ulstein Holding AS ⁶	Holding company
Sweden	Kamewa Holding AB ⁵	Holding company
Sweden	Rolls-Royce AB ⁷	Manufacture of propeller systems
USA	Rolls-Royce Commercial Marine Inc. ⁴	Aftermarket support services
USA	Rolls-Royce Naval Marine Inc. ⁴	Design and manufacture of ship propellers
USA	Syncrolift Inc. ⁴	Shiplift systems

Energy

Canada	Rolls-Royce Canada Limited ⁸	Industrial gas turbines and aero engine sales, service and overhaul
India	Rolls-Royce Energy Systems India Private Limited ¹	Project management and customer support
Singapore	Rolls-Royce Pte Limited ¹	Engine and turbine compression systems, spares
USA	Rolls-Royce Energy Systems Inc. ⁴	Turbine generator packages

Financial services and corporate

Canada	Rolls-Royce Holdings Canada Inc.	Holding company
Guernsey	Nightingale Insurance Limited ¹	Insurance services
USA	Rolls-Royce North America (USA) Holdings Co. ⁹	Holding company
USA	Rolls-Royce North America Holdings Inc. ¹⁰	Holding company
USA	Rolls-Royce Capital Inc. ¹¹	Financial services

¹ The interests are held by Rolls-Royce Overseas Holdings Limited.

² The interest is held as follows: 49.5% Rolls-Royce Erste Beteiligungs GmbH, 50.5% Rolls-Royce Zweite Beteiligungs GmbH.

³ The interest is held by Rolls-Royce Asset Management Inc.

⁴ The interests are held by Rolls-Royce North America Ventures I Inc.

⁵ The interests are held by Vinters International Limited.

⁶ The interest is held by Rolls-Royce Marine AS.

⁷ The interest is held by Kamewa Holding AB.

⁸ The interest is held by Rolls-Royce Holdings Canada Inc.

⁹ The interest is held by Rolls-Royce Overseas Investments Limited.

¹⁰ The interest is held by Rolls-Royce North America (USA) Holdings Co.

¹¹ The interest is held by Rolls-Royce North America Ventures II Inc.

The above companies operate principally in the country of their incorporation.

The effective Group interest is 100%, other than Europea Microfusioni Aerospaziali S.p.A. which is 51%.

A list of all subsidiary undertakings will be included in the Company's annual return to Companies House.

Principal joint ventures at December 31, 2004

Incorporated within the UK

	Class	% of class held	% of total equity held
Civil aerospace			
TRT Limited	A Ordinary	—	49.5
Turbine blade repair services	B Ordinary	100	
Turbine Surface Technologies Limited	A Ordinary	—	50
Turbine surface coatings	B Ordinary	100	
Defence			
Airtanker Holdings Limited	Ordinary	20	20
Holding company			
Rolls-Royce Snecma Limited (UK & France)	A Shares	—	50
Engine collaboration	B Shares	100	
Rolls-Royce Turbomeca Limited (UK & France)	A Shares	—	50
Adour and RTM322 engines collaboration	B Shares	100	
Turbo-Union Limited (UK, Germany & Italy)	Ordinary	40	40
RB199 engine collaboration	A Shares	37.5	
Energy			
Genistics Holdings Limited	A Ordinary	100	50
Holding company of Genistics Limited	B Ordinary	—	
Rolls Wood Group (Repair and Overhauls) Limited	A Ordinary	100	50
Repair and overhaul	B Ordinary	—	
Financial services and corporate			
Alpha Partners Leasing Limited	A Ordinary	100	50
Engine leasing	B Ordinary	—	

Incorporated overseas

	Class	% of class held	% of total equity held
Civil aerospace			
China	Ordinary	49	49
Hong Kong	Ordinary	45	45
Israel	A Ordinary	50	50
	B Ordinary	50	
Saudi Arabia	Ordinary	16.7	16.7
Singapore	Common	50	50
Singapore	Ordinary	30	30
Spain	Ordinary	46.9	46.9
Switzerland	A Shares	100	32.5
	B Shares	—	
	C Shares	—	
	D shares	—	
USA	Partnership	50	—
USA	Partnership	50	—
USA	Common	15	15

Principal joint ventures at December 31, 2004 continued

Incorporated overseas continued

		Class	% of class held	% of total equity held
Defence				
Germany	EPI Europrop International GmbH (Germany) (effective interest 35.5%) A400M engine collaboration	Ordinary	28	28
Germany	EUROJET Turbo GmbH (UK, Germany, Italy & Spain) (effective interest 39%) EJ200 engine collaboration	Ordinary	33	33
Germany	MTU, Turbomeca, Rolls-Royce GmbH (UK, France & Germany) MTR390 engine collaboration	Ordinary	33.3	33.3
Financial services and corporate				
Isle of Man	Pembroke Group Limited ⁶ (Eire) Aircraft leasing	Ordinary	50	50
USA	Alpha Leasing (US) LLC ⁷ Engine leasing	Partnership	50	—
USA	Alpha Leasing (US) (No. 2) LLC ⁷ Engine leasing	Partnership	50	—
USA	Exostar LLC ⁸ B2B exchange	Partnership	17.6	—
USA	Rolls-Royce & Partners Finance (US) LLC ⁷ Engine leasing	Partnership	50	—

Unincorporated overseas

Civil aerospace

USA	Light Helicopter Turbine Engine Company (LHTEC) Rolls-Royce Corporation has a 50% interest in this unincorporated partnership which was formed to develop and market jointly the T800 engine.
-----	--

¹ The interests are held by Rolls-Royce Overseas Holdings Limited.

² The interest is held by Middle East Equity Partners Limited.

³ The partner is Rolls-Royce Control Systems Holdings Co.

⁴ The partner is Rolls-Royce Engine Services Holdings Co.

⁵ The interest is held by Rolls E.L. Turbopfans Limited.

⁶ The interest is held by Larten Limited.

⁷ The partner is Rolls-Royce Finance Holdings Co.

⁸ The partner is Rolls-Royce Investment Co.

The countries of principal operations are stated in brackets after the name of the company.

Joint arrangements that are not entities at December 31, 2004

		Class	% of class held	% of total equity held
Jersey	RS Leasing Limited ¹ Aircraft leasing	A Ordinary B Ordinary	100 —	50

¹ The interest is held by Rolls-Royce Leasing Limited.



Rolls-Royce®

© 2005 Rolls-Royce plc

Rolls-Royce plc
65 Buckingham Gate
London SW1E 6AT

www.rolls-royce.com