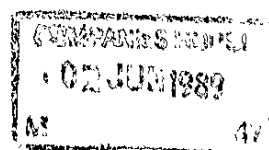
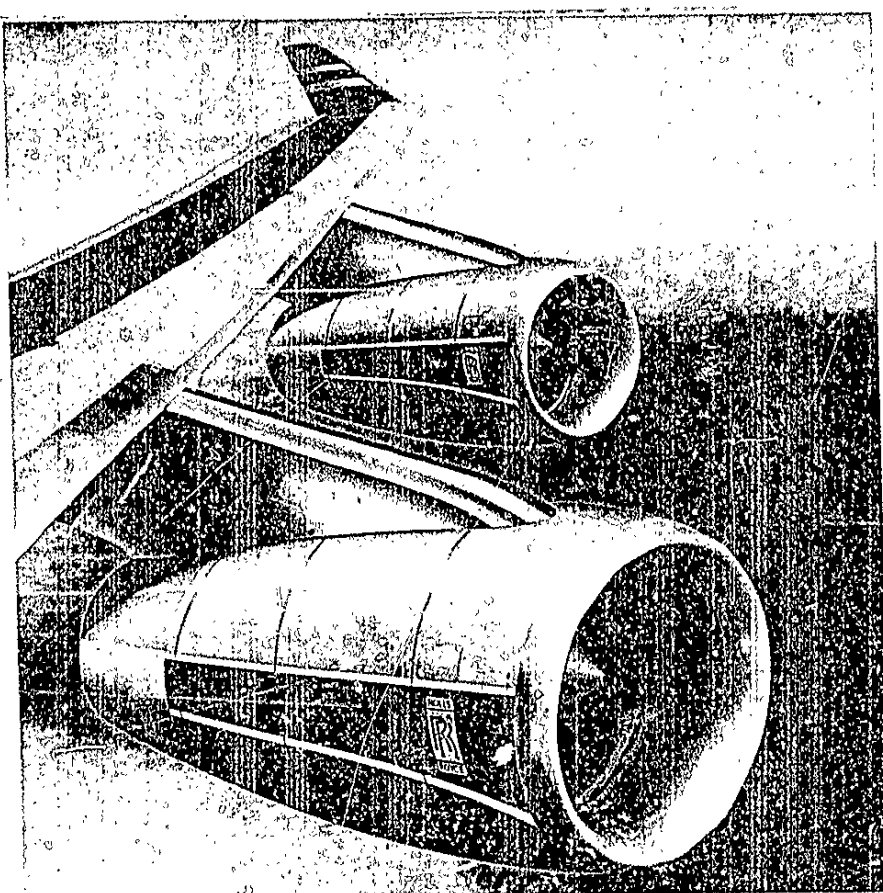




ROLLS-ROYCE plc

Annual Report 1988

COMPANY NUMBER 1003142



COMPANY PROFILE

Rolls-Royce is one of the three major aero engine manufacturers in the western world able to produce a wide range of powerplants up to the highest thrusts for civil and military applications. Founded in 1906, the Company's first aero engines flew in 1915, during World War I.

Today, its products are in operation with more than 310 airlines, 110 armed forces and 700 executive and corporate operators. Over 185 industrial customers use its aero engine derivatives for power generation and gas and oil pumping, while the warships of 25 navies are also powered by Rolls-Royce gas turbines.

In addition, Rolls-Royce and Associates, a subsidiary company, is responsible for the design, supply and support of nuclear steam raising plant for the Royal Navy's nuclear-powered submarine fleet.

In all, over 1,250 customers operate more than 26,000 Rolls-Royce gas turbines. The Group employs 40,400 people worldwide, of whom over 90 per cent work in the United Kingdom.

The Parent Company, Rolls-Royce plc, is organised into three main business groups—Civil, Military and Industrial and Marine—supported by Engineering and Supply Groups.

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GROUP FINANCIAL HIGHLIGHTS

for the year ended December 31, 1988

	1988	1987
	£m	£m
Turnover	1,973	2,059
Operating profit	333	347
Research and development (net)	(149)	(187)
Profit before exceptional item and taxation	197	156
Profit before taxation	168	156
Profit attributable to the shareholders	145	134
Shareholders' funds	949	855
 Earnings per ordinary share—net basis before exceptional item	 21.7p	 18.2p
Dividends per ordinary share	6.3p	5.25p
Average number of ordinary shares in issue	801m	738m
 Average number of employees	 40,900	 42,000

Front cover: Rolls-Royce RB211-524G engines, delivering 58,000 lb take-off thrust, will enter service powering Boeing 747-400 airliners of Cathay Pacific Airways. The -524G has won a significant proportion of the Boeing 747-400 market and has also been selected by British Airways, Qantas, Air New Zealand and International Lease Finance Corporation.

CHAIRMAN'S STATEMENT

For the civil aviation business, 1988 proved to be a record year with all the major aircraft manufacturers receiving significant orders for new equipment from airlines throughout the world. Rolls-Royce benefited from both the higher volume of orders and an increased market share, resulting in a total end-1988 order book (including both civil and military business) of . . . billion, compared with £2.8 billion at the end of 1987.

Turnover in 1988, however, was slightly down at £1,973 million (1987 £2,059 million), partly reflecting a pause between the large order intake during the past two years and delivery of engines, and partly due to some slippage of planned 1988 turnover into 1989.

Operating profit at £333 million was correspondingly lower, the margin on sales at 16.9 per cent being similar to last year. Whilst the profitability of military business continued its improving trend, civil business was adversely affected by the relative weakness of the US dollar throughout most of 1988 and the competitive nature of the market. If the average dollar/sterling conversion rate achieved in 1988 had been similar to that achieved in 1987, operating profit and turnover would have been higher by almost £30 million.

Net research and development expenditure fell from the higher figure of £187 million incurred in 1987 to £149 million, a level within our target of 8 per cent of sales. As last year, no launch aid was received on any of our civil engine programmes; however, levy payments to Her Majesty's Government in respect of past launch support amounted to £19 million.

After crediting net interest of £13 million (for 1987 there was a net charge of £4 million), profit on ordinary activities before exceptional item and taxation amounted to £197 million (1987 £156 million), an increase of 26.3 per cent.

As a direct result of a net reduction in parent company manning levels of 1,900, the 1988 results include an exceptional charge of £29 million for restructuring. The equivalent cost in 1987 was £7 million, which was charged against operating profit.

1988 was the first full year of operations by the Company since its return to the private sector in May 1987, and I believe it is appropriate to review what has been achieved in that relatively short timescale.

The record size of our order book has already been mentioned, yet this includes only a minor proportion of our annual civil spares sales and excludes the value of business arising from the second phase of military aircraft purchases by Saudi Arabia.

Two major project decisions occurred in 1988. Firstly, we launched the world's most powerful civil turbofan engine, the RB211-524L, thus giving the Company product cover in all market sectors, and specifically making a Rolls-Royce engine available for all the new large wide-bodied aircraft on offer by the three major airframe manufacturers. Secondly, the signing of the development contract for the collaborative EJ200 engine (in which Rolls-Royce has a 33 per cent share) for the European Fighter Aircraft is expected to provide continuing work for the Military Engine Group well into the next century.

Productivity has improved generally through manpower reductions in all major areas, whilst in our factory units the time taken to manufacture all the parts for a civil gas turbine engine has reduced dramatically from over 18 months to 12 months. The effect of this has been to reduce inventory against a rising workload, and give us greater flexibility in responding to changes in engine programme requirements from our customers.

Our new approach to the management of research and development is reflected in better value for the money we spend and, through a much closer relationship with manufacturing, has enabled us to launch new engine programmes in a more controlled and cost-effective way.

Cash flow continues to be strong, resulting in a net cash balance of £180 million at the end of 1988. In July the Company issued £150 million Eurobond Notes, the proceeds of which

CHAIRMAN'S STATEMENT



Sir Francis Tombs presents the Chairman's Award for 1988 to Trainee of the Year Jane Grantham, a graduate in Mechanical Engineering, who is based at Rolls-Royce's Bristol facility.

have been re-invested, and in addition there is available the unused £250 million Multi-Option Facility arranged in 1987.

Capital expenditure was at a lower level than in 1987, mainly as a result of slowing down the rate of investment in computing equipment, but it is expected that 1989 spend will increase to the 1987 level.

At this time last year, I reported that the registrar was having great difficulties with our share register, following our successful flotation which attracted over 2,000,000 shareholders, including a large overseas element. I am pleased to say that those problems are now behind us.

It is with great pleasure that I renew my thanks, and those of the Board, to our workforce throughout the world. Their dedicated service underlies our success.

Future Prospects

There seems little sign of any slowing down in the rate of expansion of the civil aviation industry. Our success in increasing the number of airline customers and in offering engines for a wide range of airframes, has inevitably provoked competitive reactions and we continue to implement cost-saving measures to offset those pressures and to allow us to operate with a strong sterling/dollar exchange rate.

With our ability now to offer engines in all market sectors, we are in a stronger world position than ever before to take advantage of the significant business available to us.

Sir Francis Tombs

Sir Francis Tombs
March 21, 1989

GROUP FIVE YEAR REVIEW

for the years ended December 31

PROFIT AND LOSS ACCOUNT

	1988	1987	1986	1985	1984
	£m	£m	£m	£m	£m
Turnover	<u>1,973</u>	<u>2,059</u>	<u>1,802</u>	<u>1,601</u>	<u>1,409</u>
Operating profit	333	347	273	211	162
Research and development (net)	(149)	(187)	(132)	(100)	(101)
Share of losses in related companies	—	—	—	(1)	—
Profit before interest	184	160	141	110	61
Net interest receivable (payable)	13	(4)	(21)	(29)	(35)
Profit before exceptional item and taxation	197	156	120	81	26
Exceptional item—restructuring costs*	(29)	—	—	—	—
Profit on ordinary activities before taxation	168	156	120	81	26
Taxation	(22)	(21)	1	(3)	(6)
Profit on ordinary activities after taxation	146	135	121	78	20
Attributable to minority interests in subsidiaries	(1)	(1)	(1)	(1)	(1)
Profit attributable to the shareholders	145	134	120	77	19
Dividends	(50)	(42)	—	—	—
Retained profit for the year	<u>95</u>	<u>92</u>	<u>120</u>	<u>77</u>	<u>19</u>
Earnings per ordinary share					
Net basis	18.1p	18.2p			
Net basis before exceptional item	21.7p	18.2p			
Nil distribution basis	19.7p	20.1p	18.9p	12.1p	3.0p
Dividends per ordinary share	6.3p	5.25p			

BALANCE SHEET

Fixed assets	473	438	405	383	382
Current assets	<u>1,309</u>	<u>1,106</u>	<u>940</u>	<u>838</u>	<u>800</u>
	1,782	1,544	1,345	1,221	1,182
Liabilities and provisions	(830)	(685)	(833)	(828)	(867)
	<u>952</u>	<u>859</u>	<u>512</u>	<u>393</u>	<u>315</u>
Share capital	160	160	127	127	508
Reserves	<u>789</u>	<u>695</u>	<u>380</u>	<u>262</u>	<u>(198)</u>
Shareholders' funds	949	855	507	389	310
Minority interests in subsidiaries	3	4	5	4	5
	<u>952</u>	<u>859</u>	<u>512</u>	<u>393</u>	<u>315</u>

OTHER FINANCIAL INFORMATION

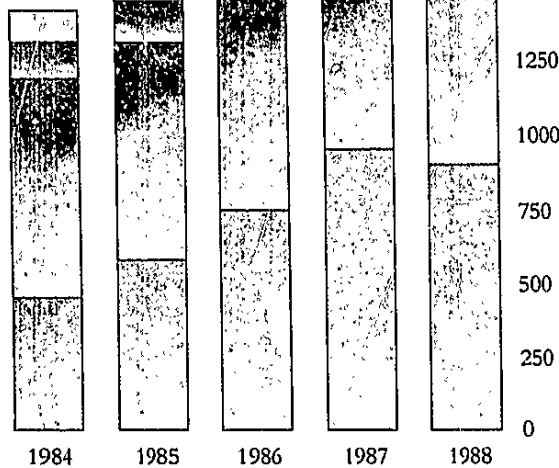
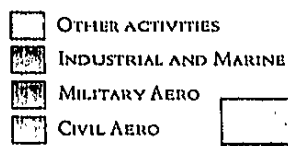
Research and development (gross)	274	294	255	234	227
*Restructuring costs charged against operating profit in previous years		7	3	—	8

GROUP FIVE YEAR REVIEW

for the years ended December 31

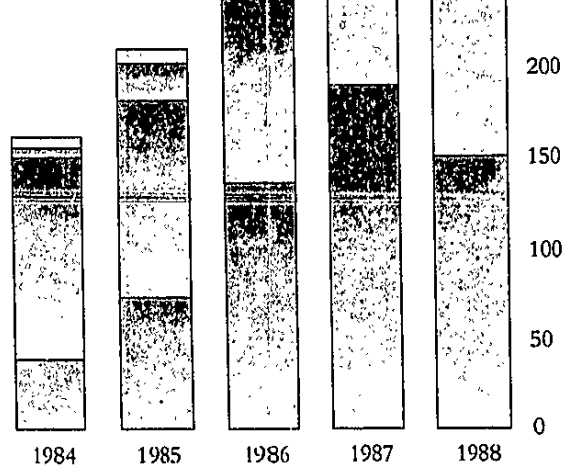
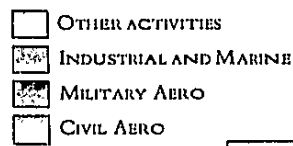
Turnover

£m



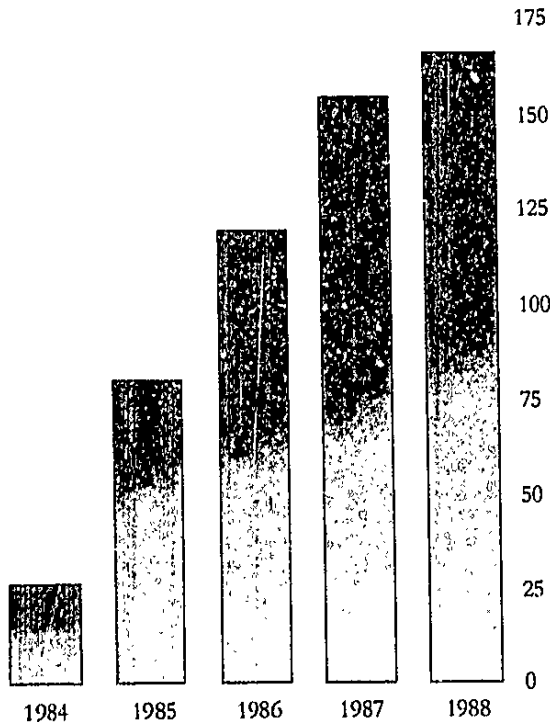
Operating profit

£m



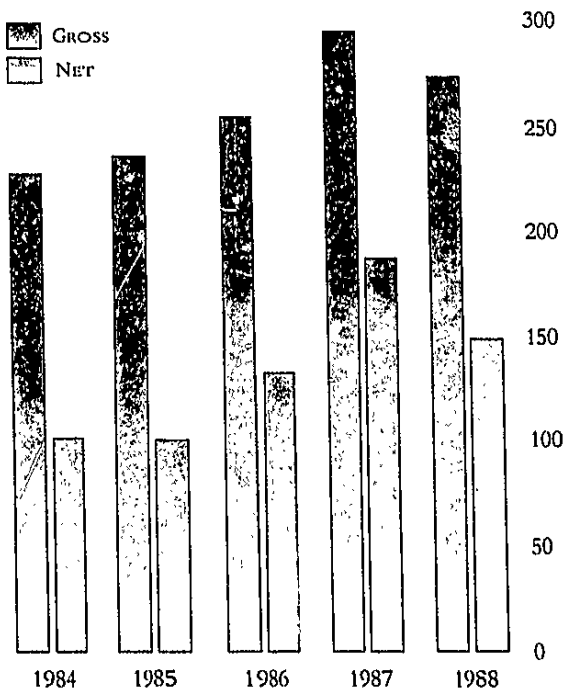
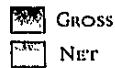
Profit before taxation

£m



Research and development

£m



REPORT OF THE DIRECTORS

The directors present their report together with the audited accounts for the year ended December 31, 1988.

Principal activities

The Company's principal business is the design, development, manufacture, sale and support of gas turbine engines and ancillary equipment for aircraft and for industrial and marine applications. Its subsidiary companies include Rolls-Royce and Associates Limited which designs, develops, procures and supports nuclear steam raising plant for naval purposes. Other subsidiary companies are mainly involved in the manufacture of aerospace and related products and in providing sales and service support of the Company's products overseas.

Results for the year

Profit before taxation was £168m (1987 £156m) and, subject to approval of the recommended final dividend, the retained profit for the year of £95m has been added to reserves. The directors recommend the payment of a final dividend of 4.2p per share which, with the interim dividend of 2.1p per share paid on December 5, 1988, will make a total dividend of 6.3p per share for the year (1987 5.25p). The final dividend, if approved, will be paid on June 5, 1989 to shareholders registered on April 21, 1989.

A review of the year's operations, research and development activities and future prospects is contained in the Chairman's Statement and in the Review of Activities.

Employment

The number of Group employees at the end of the year was 40,400 (1987 41,600), which includes employees previously of Foster Wheeler Power Products Limited part of whose business was acquired during the year.

The Company's policy continues to be to provide, wherever possible, employment opportunities for disabled people, to care for employees who become disabled and to make the best possible use of their skills and potential;

it also operates an equal opportunities policy.

In 1988 industrial accidents remained at a level well below the average for similar UK manufacturing companies. Rolls-Royce has a continuing programme to assess potential health hazards; this is supported where necessary by environmental measurement. Workforce involvement in health and safety issues is encouraged through safety representatives and the Safety Committee structure.

Training in support of the business objectives is a vital activity. This was recognised nationally in 1988 when one of the Company's Management Skills courses received a National Training Award and a Patron's Special Award.

The training of young people continued in 1988 with 530 school, college and university leavers joining Rolls-Royce as trainees. The Company had 1,450 trainees engaged in a wide range of training and personal development activities. Adult training programmes were developed to meet an ever increasing demand for training aimed at improving the effectiveness of the people in the business. Over 14,000 employees attended further education and training programmes in 1988.

Across the Company there exist various forms of communication, each adapted to the particular needs of individual sites. The Company continues its commitment to consultation with employees and their elected representatives on a comprehensive range of topics related to its overall business objectives. Joint meetings of management and employee representatives are held regularly at every site to discuss problems and opportunities. In 1988 Rolls-Royce again held a central forum, attended by the most senior members of management and representatives of Staff and Works employees from all sites.

Directors

The directors listed on page 8 were in office throughout 1988 apart from Dr G. R. Higginson, appointed April 1, 1988; Mr F. Turner, appointed September 15, 1988 and Mr P. F. Macfarlane,

REPORT OF THE DIRECTORS

whose appointment is with effect from March 21, 1989.

Sir Arnold Hall resigned from the Board on May 24, 1988 and Mr J. A. Rigg, having reached retirement age for executive directors, has resigned with effect from March 31, 1989.

The directors retiring by rotation at the Annual General Meeting on May 23, 1989, in accordance with Article 79 of the Company's Articles of Association, are Sir Douglas Lowe, Sir Ralph Robins and Sir Francis Tombs who, being eligible, offer themselves for re-election. Mr P. F. Macfarlane and Mr F. Turner retire in accordance with Article 84 and, being eligible, offer themselves for re-election.

Sir Francis Tombs' service agreement expires on January 31, 1990, Sir Ralph Robins has an agreement terminable by the Company upon not less than 36 months' notice and Mr P. F. Macfarlane and Mr F. Turner have agreements terminable by the Company upon not less than 24 months' notice.

The Board is not aware of any contract of significance in relation to the Company or its subsidiaries in which a director has, or has had, a material interest.

Directors' share interests are given in note 22 to the accounts.

Fixed assets

Expenditure on tangible fixed assets during the year amounted to £65m (1987 £82m), mainly in respect of gas turbine manufacturing and engineering facilities and supporting computer equipment.

The professional valuation of the Company's land and buildings at December 31, 1985 has been updated to the end of 1988 and suggests a value approximately £35m greater than the figure shown in the accounts.

Details of investments in subsidiary and related companies and in trade investments are given in notes 11, 12 and 13 to the accounts.

Donations

Charitable donations amounted to £86,100

(1987 £54,600). No political donations were made by the Company or its subsidiaries.

Close company status

The close company provisions of the Income and Corporation Taxes Act 1988 do not apply to the Company.

Share capital

Details of the share capital and employee share schemes are given in note 22 to the accounts.

At the Annual General Meeting a resolution will be proposed to give the directors authority, for a limited period, to allot shares for cash both by way of rights issues and, in respect of a limited number of ordinary shares, to people other than existing ordinary shareholders.

In addition, in order to keep the Sharesave Scheme in line with best practice, a resolution is being proposed, incorporating provisions introduced by the Finance Act 1987, to permit employees to exchange their options in the event of a change of control of Rolls-Royce.

A resolution will also be proposed to remove the 5 per cent limit which applies until April 5, 1992 on shares under the Sharesave and Executive Share Option Schemes thus allowing more shares to be offered within the 10 per cent limit.

Information on these proposed resolutions is given in the Notice of Annual General Meeting (Explanatory Notes) on page 37 of this Report.

At March 21, 1989 no person had notified the Company of an interest of 5 per cent or more in the issued share capital of the Company.

Auditors

A resolution to re-appoint the auditors, Coopers & Lybrand, and to authorise the directors to approve their remuneration will be proposed at the Annual General Meeting.

By order of the Board


Anthony Warrington

Secretary

March 21, 1989

BOARD OF DIRECTORS as at March 21, 1989

Sir Francis Tombs, BSc (Econ), F Eng*
CHAIRMAN

Elected to the Board in 1982 and appointed Chairman in 1985. He is also Chairman of T&N PLC and a Non-Executive Director of N M Rothschild & Sons Limited and Shell UK Limited. Age 64.



Sir Ralph Robins, BSc (Eng), F Eng
MANAGING DIRECTOR

Elected to the Board in 1982 and appointed Managing Director in 1984. He joined Rolls-Royce in 1955 and his appointments have included Director-Civil Engines. He is a Non-Executive Director of Standard Chartered PLC and ASW Holdings PLC. Age 56.

Dr Gordon R. Higginson, BSc (Eng), PhD
NON-EXECUTIVE DIRECTOR

Elected to the Board in 1988. He is Vice-Chancellor of the University of Southampton. Age 59.



Sir Robin Nicholson, FRSE, F Eng
NON-EXECUTIVE DIRECTOR

Elected to the Board in 1986. He is an Executive Director of Pilkington plc and a Non-Executive Director of The British Petroleum Company plc. Age 54.

James O. Keir, C Eng
DIRECTOR-SUPPLY

Elected to the Board in 1984. He joined Rolls-Royce in 1961 and his appointments have included Project Director RB211-524 and Director-Civil Engines. Age 49.



James A. Rigg, CBE, FCA*
DIRECTOR-FINANCE

Elected to the Board in 1982, he will retire on March 31, 1989. He joined Rolls-Royce in 1953 and is a Non-Executive Director of Williams Holdings PLC. Age 62.

Air Chief Marshal Sir Douglas Lowe, GCB, DFC, AFC, CRAes*
NON-EXECUTIVE DIRECTOR

Elected to the Board in 1984. He has been Chief of Defence Procurement with the Ministry of Defence and is Chairman of Band III Holdings Limited. Age 67.



Sir Philip Shelbourne, MA*
NON-EXECUTIVE DIRECTOR

Elected to the Board in 1986. He is Chairman of Henry Ansbacher Holdings PLC. Age 64.

Peter F. Macfarlane, FCA, FCT

DIRECTOR-FINANCE from April 1, 1989
Elected to the Board March 21, 1989. He joined Rolls-Royce in 1979 and his appointments have included Group Treasurer, Director of Industrial and Marine and Director of Corporate Development. Age 50.



Frank Turner, BSc (Eng), F Eng
DIRECTOR-CIVIL ENGINES

Elected to the Board in 1988. He joined Rolls-Royce in 1959 and his appointments have included Director of Manufacturing Engineering and Director of Industrial and Marine. Age 45.

Stewart C. Miller, BSc (Eng), F Eng
DIRECTOR-ENGINEERING

Elected to the Board in 1985. He joined Rolls-Royce in 1954 and his appointments have included Head of Project RB211-535 and Director of Advanced Engineering. Age 54.



John D. Wragg, BSc (Eng), C Eng
DIRECTOR-MILITARY ENGINES

Elected to the Board in 1984. He joined The Bristol Aeroplane Company Limited in 1952 and within Rolls-Royce his appointments have included Director-Corporate Engineering. Age 60.

Harold G. Mourgue, FCA*
NON-EXECUTIVE DIRECTOR

Elected to the Board in 1985. He is also a Non-Executive Director of T&N PLC and Thames Television PLC. Age 61.



SECRETARY

Anthony Warrington, BSc (Econ)
Appointed 1980. He joined Rolls-Royce in 1978, initially on secondment, having been Under-Secretary, Air Division, Department of Industry since 1973. Age 59.

* Member of Audit Committee

REVIEW OF ACTIVITIES

Introduction

Most of the Company's personnel and facilities are based in the United Kingdom. However, in addition to its manufacturing subsidiaries in Canada and Brazil, Rolls-Royce co-operates with companies in more than 20 countries on gas turbine development, manufacture and maintenance.

The Company has business in most countries and extensive customer support is provided by a worldwide network of over 250 representatives, together with overseas operating subsidiaries.

In recent years overseas revenues have accounted for more than 70 per cent of total sales and in April 1988 the Company was named among the recipients of the Queen's Award for Export Achievement for the seventh time.

In August the Prime Minister, the Rt Hon Margaret Thatcher FRS, MP officially opened Turbine Components Australia Pty. Limited (TCA) while at the start of the following month the latest addition to the RB211 family, the -524L, was unveiled by Sir Frank Whittle OM, FRS.

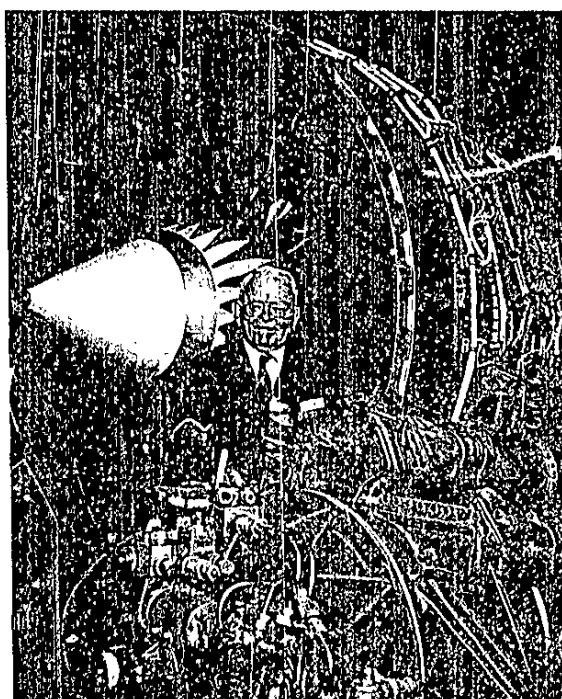


Above: Rolls-Royce Managing Director Sir Ralph Robins (right) receives the Queen's Award for Export Achievement from the Lord Lieutenant of Greater London, Field Marshal the Lord Bramall.



Above right: Prime Minister Margaret Thatcher is briefed on turbine blade manufacture by Mr Robert Hill, Technical Manager, TCA during the official opening of the plant, in which Rolls-Royce has a 50 per cent interest. Based in Perth, Western Australia TCA produces turbine blade castings for Rolls-Royce RB211 and Tay turbfans.

Right: Sir Frank Whittle, 'the father of the jet engine', is pictured after the unveiling of the RB211-524L at the 1988 Farnborough Air Show. Also on the Rolls-Royce stand was one of Sir Frank's most advanced engines, the W2/700, seen here in the foreground.



REVIEW OF ACTIVITIES

Civil Engines

During 1988 the world's airlines ordered new civil aircraft in record numbers and Rolls-Royce's market share of the associated engine business doubled to almost 18 per cent compared with 1987.

The Company continued to widen its RB211 engine family to achieve the maximum number of aircraft applications. The RB211 further consolidated its reputation for reliability and during the year the engine's operating experience exceeded 30 million hours since its introduction in 1972.

Orders for the Boeing 757 airliner increased significantly during the year and the RB211-535E4 won an overwhelming share of the engine selections for this aircraft. The reliability of the -535 series continues to be outstanding and contributed to it being specified by several new customers. These included American Airlines, which ordered 50 aircraft plus options for 50 more. By the end of 1988, 241 of the 405 B757s on firm order had been specified with Rolls-Royce engines by three-quarters of the customers for the strong-selling twinjet.

The latest version of the RB211 to fly, the -524G, was certificated in March 1988. It enters service in 1989 in Boeing 747-400 airliners ordered by Cathay Pacific, British Airways, Qantas, Air New Zealand and International Lease Finance Corporation (ILFC). The higher-thrust -524H is due to go into service with British Airways at the end of 1989 in the wide-bodied Boeing 767-300 twinjet and has also been selected by two aircraft leasing companies, Ansett Worldwide Aviation Services and ILFC.

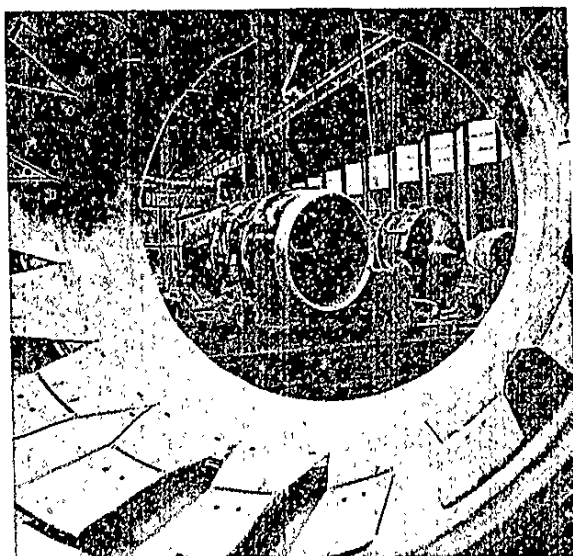
The world's most powerful turbofan, the RB211-524L, was launched in 1988, in conjunction with risk and revenue sharing partners, to power McDonnell Douglas MD-11, Airbus A330 and Boeing 747/767 airliners. Engines of its thrust class are expected to account for the major part of the future market for civil engines. At the start of 1989, Air Europe became the launch customer for this engine with an order for six MD-11s (with options for a further 12

aircraft)-the first Rolls-Royce engine to power a Douglas civil aircraft for almost 25 years.

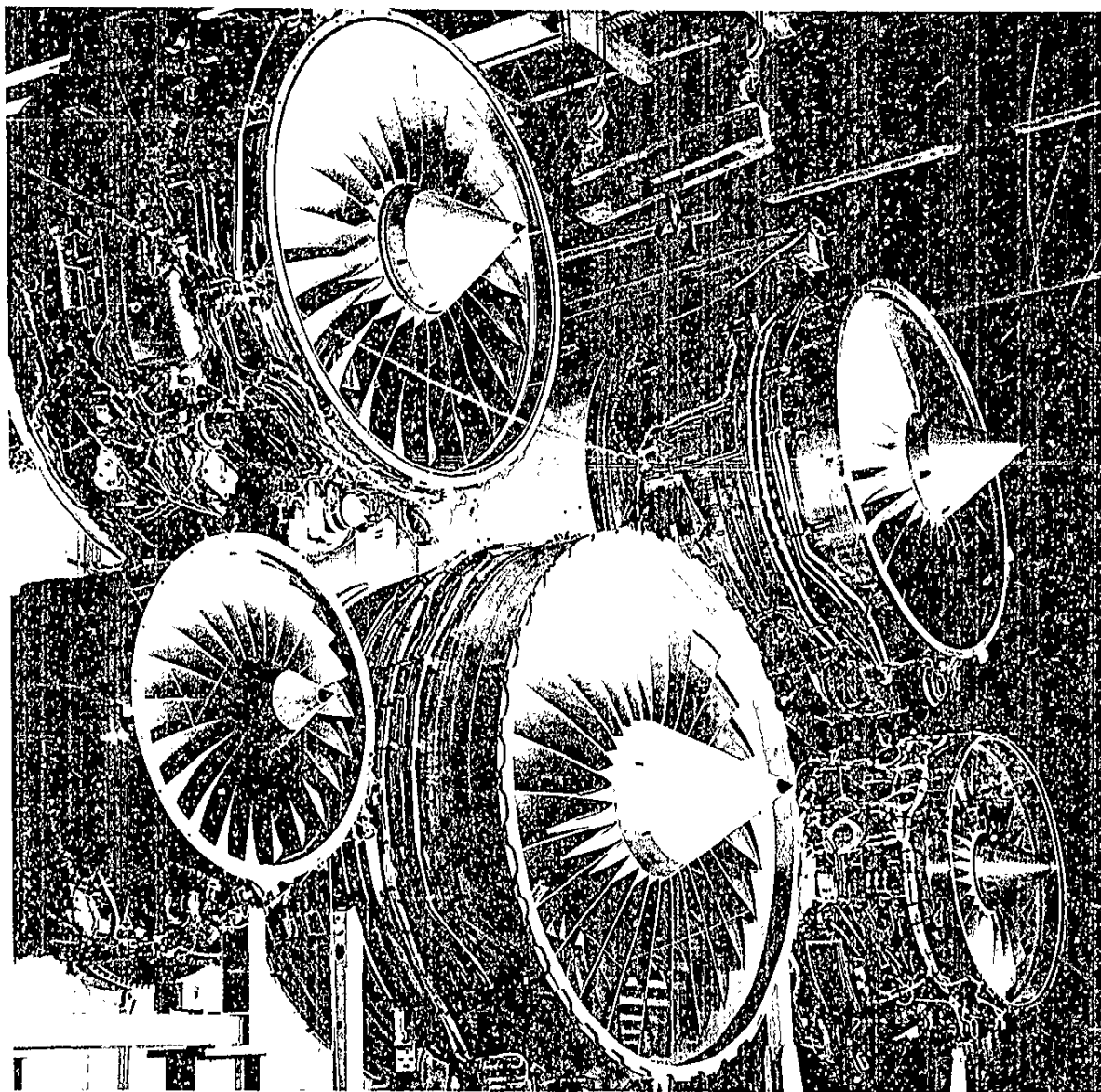
Orders for Tay engines totalled 620 at the end of 1988 and nearly 300 had been delivered. The Tay-powered Fokker 100 entered service with Swissair during the year and the higher-thrust Tay 650 for USAir was certificated in June, 10 weeks ahead of schedule. The first Fokker 100 with this engine will be delivered in mid-1989.

The Tay 670, which will provide 18,000 lb take-off thrust, was launched in September 1988. It is targeted at re-engining McDonnell Douglas DC-9, Boeing 727 and 737 aircraft and will achieve reduced noise levels, thus meeting expected environmental legislation; it will also improve the overall performance and economics of these airplanes.

Rolls-Royce is a major partner in the IAE International Aero Engines V2500 programme. This engine was certificated in June and enters airline service on the Airbus A320 in the second quarter of 1989. Flight certification on the Airbus A320 progressed very smoothly, drawing praise for the engine's reliability, handling, performance and quietness. In January 1989, the US airline Braniff Inc. placed an order for 50 V2500-powered A320s, taking options on a further 50, bringing the potential business to date for this airframe/engine combination to 170 airplanes.



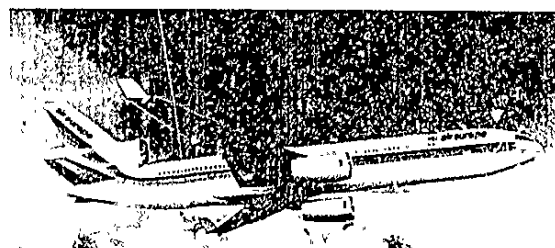
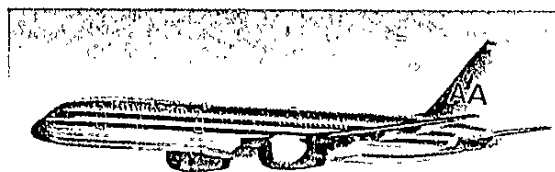
REVIEW OF ACTIVITIES



Above: Civil engine product range, delivering thrusts from 12,500 lb to over 80,000 lb. Clockwise, from far left: the Tay, RB211-535E4, RB211-524G/H, V2500 and RB211-524L turbofans.

Left: In May 1988, British Airways completed a two-year programme modifying 60 RB211-524C2 engines to -524D4 Upgrade standard for 12 of its fleet of Boeing 747 236 aircraft. As a result, the airline has achieved significant fuel savings and greatly enhanced these airplanes' payload/range performance. The -524's inherent retrofit capability is a major advantage for customers, such as British Airways, with a predominantly Rolls-Royce powered wide-body fleet.

Right: Two major breakthroughs for the RB211 family - (above) American Airlines' order for up to 100 -535E4 powered Boeing 757 airliners and (below) launch customer Air Europe has specified the -524L for its MD-11 trijet fleet.



REVIEW OF ACTIVITIES

Military engines

The signing in November of the development contract for the new Eurojet EJ200 engine was a major milestone in 1988. The airframe development contract has also been placed and is expected to lead to the procurement of 800 European Fighter Aircraft (EFA) requiring some 1,800 EJ200 engines. Rolls-Royce has a 33 per cent share in this project. The first design verification engine made its initial run before the end of the year as the result of excellent progress made by the Eurojet team of companies.

The UK Ministry of Defence (MoD) announced in late 1988 that 41 more Tornado aircraft were to be ordered for the Royal Air Force; this will lead to additional orders for the Turbo-Union RB199 engine. Saudi Arabia and Oman also placed firm orders for this engine/airframe combination in 1988. Total orders now exceed 2,400 engines, over 2,000 of which have been produced. Service experience with the RB199 passed one million hours during the year.

The US Government sanctioned a three-year purchase of a further 72 Pegasus-powered Harrier II aircraft for the Marine Corps (USMC). It includes aircraft powered by the new Pegasus 11-61, a 23,800 lb increased-thrust version which first ran in 1988 and will be delivered in 1990. This brings to over 380 the total USMC order for all Harrier aircraft.

The T45A Goshawk trainer for the US Navy made its first flight during the year. It is powered by the F405 Adour engine for which initial production orders have now been received. The Adour has accumulated over three million hours of flying experience worldwide in Jaguar, Hawk and Japanese T-2/F-1 aircraft.

There was good progress too, on the Spey 807 for the Italian/Brazilian AMX close combat aircraft. The first Italian production aircraft flew in May 1988 and the first Brazilian-built engine was prepared for despatch early in 1989.

The Rolls-Royce Turbomeca RTM322 turbo-shaft was selected by the MoD for its potential purchase of EH101 helicopters. The MoD has

awarded the engine a provisional technical certificate and production RTM322s will be available from 1990. Marketing activity is also aimed at military customers in Canada, the Middle East, Europe and the United States.

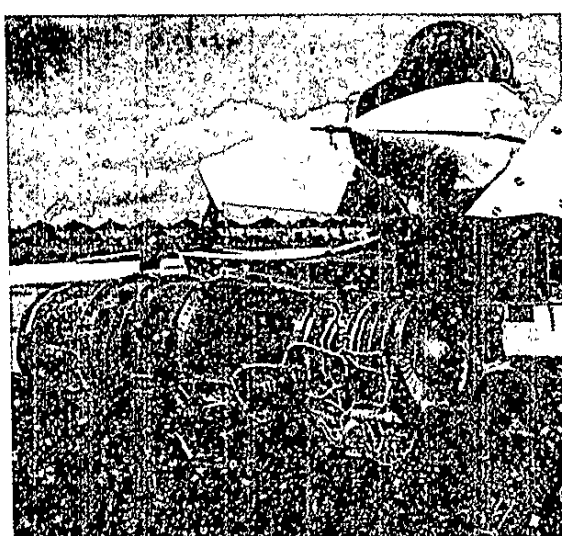
Sales of the Gem engine continued during 1988 in Lynx and Agusta A129 helicopters; orders were announced by South Korea and Italy. Work also continued on the new MTR390 helicopter engine which is being developed jointly by Rolls-Royce, MTU and Turbomeca. Test flying is scheduled for 1990, with engine certification in 1993.

Industrial and marine

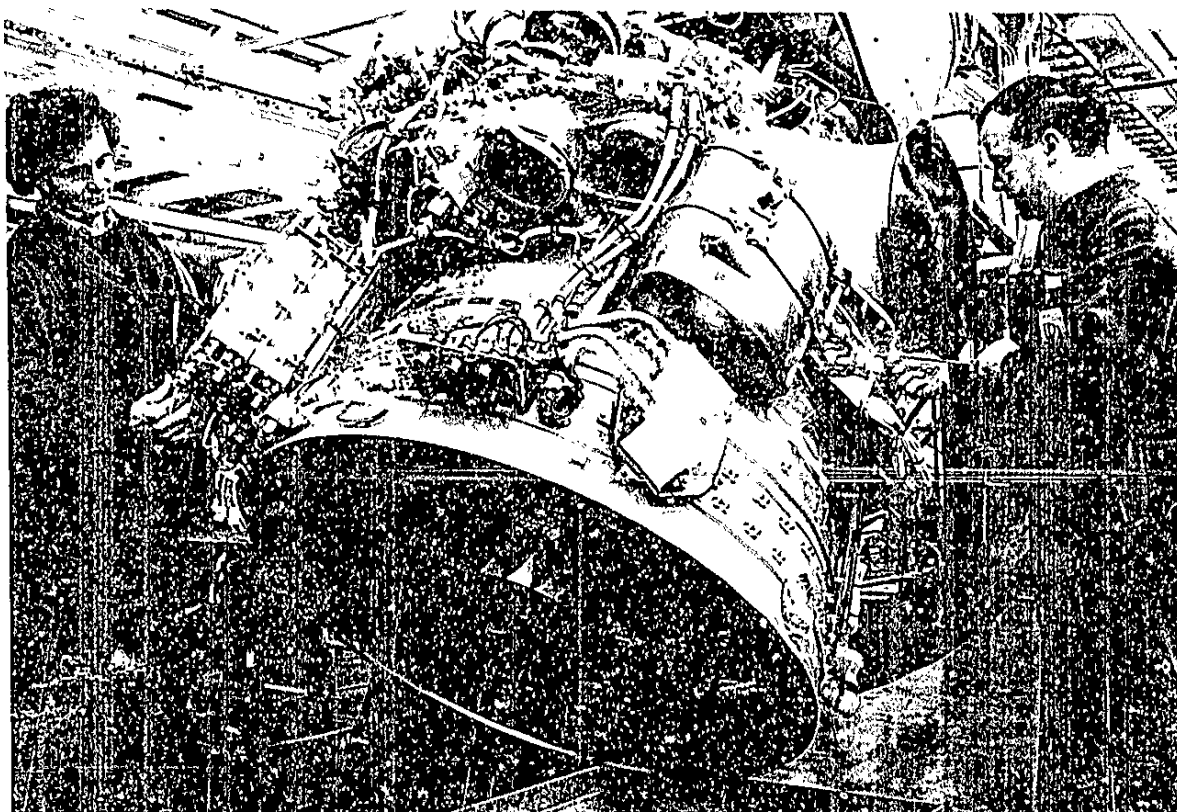
There was a rapid upturn in demand from gas and oil customers in 1988 and record orders were placed for the industrial RB211. These came mainly through the joint-venture company Cooper Rolls. A technical collaboration agreement was signed with Asca Brown Boveri, a world leader in electrical power generation.

Development of a more powerful marine Spey is proceeding to plan and it completed a test run simulating 10 years of service life. It will be installed in HMS Brave for sea trials early in 1990.

The 2,000th RB199 production engine is pictured in front of the Experimental Aircraft Programme (EAP) demonstrator for Europe's new agile fighter.



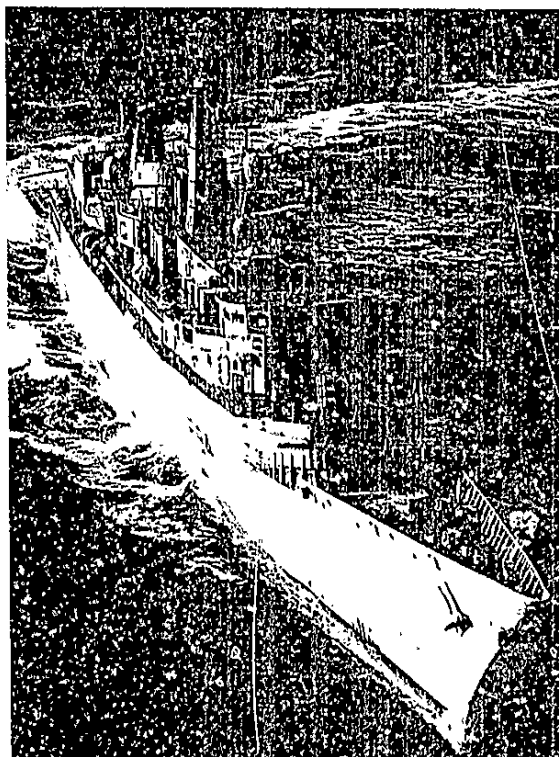
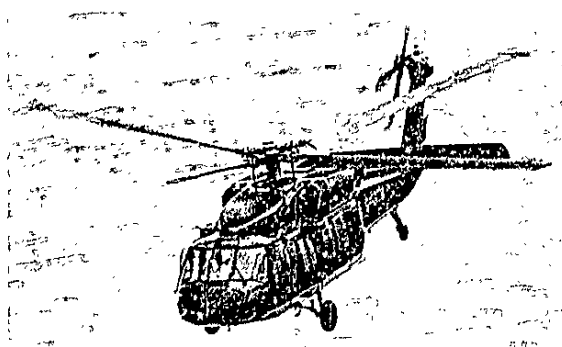
REVIEW OF ACTIVITIES



Top: The new Pegasus 11-61 being prepared for its first test run.

Above: The F405 Adour-powered T45A Goshawk trainer, which made its first flight in 1988.

Below: Flight trials of the RTM322 turboshaft continued during 1988.



Sea trials of a more powerful marine Spey, to be installed in HMS Brave, begin early in 1990.

REVIEW OF ACTIVITIES

Engineering research and development

Advanced engineering programmes provide the technology for existing engines to be developed to their full potential and for new designs to be based on the latest proven technical advances. Good progress with the Pegasus 11-61 and EJ200 engines following the XG15 and XG40 demonstrator programmes illustrates this well.

The RB211-524L project is benefiting from advanced engineering programmes covering compressor and turbine technology. The result will be improved fuel consumption and an extensive thrust capability ensuring that the -524L engine will be suitable for the next generation of wide body airliners requiring thrusts ranging from 65,000 lb to over 80,000 lb.

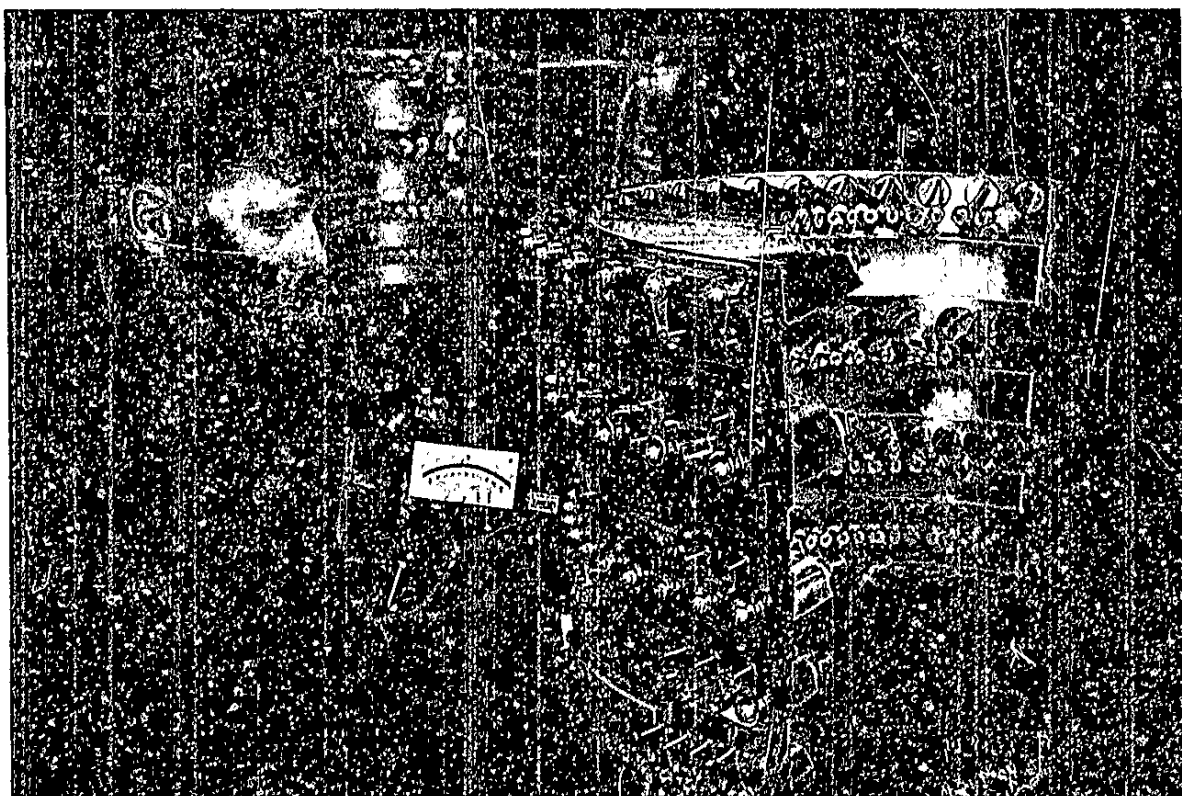
The company is engaged in a long-term ASTOVL (advanced short take-off and vertical landing) programme to define technology for a high performance combat aircraft. Basic studies of four propulsion concepts were completed in 1988 under this UK-US initiative and a technical collaboration agreement was signed with Pratt & Whitney.

The V2500 programme has successfully taken Rolls-Royce compressor development to new standards of performance, materials and mechanical design. This technology contributed to the excellent performance of the powerplant during its certification and flight-test programmes and is now finding applications in other engines.

In April 1988, the Company received the Queen's Award for Technological Achievement for the sixth time – on this occasion for the development of the Tay turbofan.

This powerplant is an excellent example of the benefits gained from the derivative approach to engine design. It has the service-proven Spey core with a low-pressure system based on RB211 technology. Its lightweight wide-chord fan gives increased service life and its composite bypass duct saves both weight and manufacturing cost.

Development work on the V2500 compressor has contributed to a successful flight test programme on the Airbus A320 airliner.



REVIEW OF ACTIVITIES

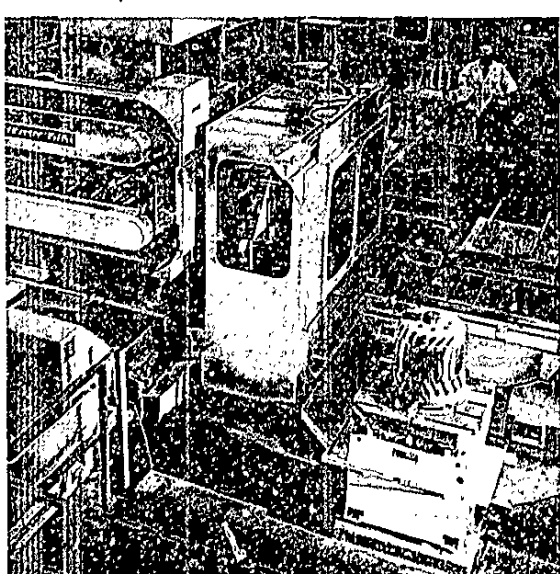
Manufacturing

A major initiative was launched in 1988 to organize the Company's manufacturing resources into smaller shop-floor units or cells. This will reduce lead times and inventories so that a faster response can be made to customer needs. Such cells at Coventry, Leavesden and Hucknall are already cutting significantly the production timescales for making parts.

As part of a substantial investment programme, by the end of 1988 over £6 million had been invested in new electro-chemical and electro-discharge machines to drill holes in advanced turbine blades. At Sunderland, a new manufacturing cell comprising five machining centres, a co-ordinate measuring machine and a pallet transfer system will produce titanium fan discs for all the Company's wide-chord fan engines.

Future high-performance engines will require ceramic materials which can operate at much higher temperatures than metal superalloys. A special Rolls-Royce unit will develop techniques for the design and manufacture of ceramic engine components. It will be based at Warwick University's advanced technology centre and begins its work in mid-1989.

A new cell for the manufacture of wide-chord fan discs is part of a significant investment programme at Rolls-Royce's Sunderland plant.



Nuclear

Rolls-Royce and Associates Limited continued its work for Britain's naval nuclear propulsion programme. Initial trials were completed in 1988 on the advanced propulsion system for the next generation of Royal Navy nuclear submarines.

A full series of tests was also made on the facility for investigating the effect of coolant loss on pressurised water reactors. Other opportunities were also pursued to gain commercial nuclear business from customers in the United Kingdom, Europe and America.

The nuclear business of Foster Wheeler Power Products Limited, based in Hartlepool and London, was acquired on April 1, 1988, to enhance Rolls-Royce's contribution to the UK naval nuclear propulsion programme. Since January 1, 1989 the business has been operated as a wholly-owned subsidiary, Rolls-Royce Power and Process (Hartlepool) Limited.

Engine repair

Competition was fierce in 1988, but Rolls-Royce won major repair contracts from British Airways, USAir and the MoD. Further consolidation of operations was achieved with the transfer of Adour repair work to the East Kilbride Airmotive.

A new braze facility for repairing turbine components began production and a joint-venture company was formed to exploit the technology involved.

New ventures

Rolls-Royce Business Ventures Limited has been formed to exploit company technology in a range of new product areas. An example of this was the start of trading of Stresswave Technology Limited, a subsidiary formed to develop a new sensor with a large potential market in the manufacturing, security, automotive and other fields.

Reflex Manufacturing Systems Limited is developing computer-based manufacturing control systems, initially for the Company's factories and later for external sale.

GROUP PROFIT AND LOSS ACCOUNT

for the year ended December 31, 1988

		1988	1987
	<i>Notes</i>	£m	£m
Turnover	2	1,973	2,059
Cost of sales		(1,469)	(1,528)
Gross profit		504	531
Commercial, marketing and product support costs		(81)	(89)
General and administrative costs		(90)	(95)
Operating profit	2	333	347
Research and development (net)		(149)	(187)
Profit before interest		184	160
Net interest receivable (payable)	3	13	(4)
Profit on ordinary activities before exceptional item and taxation		197	156
Exceptional item—restructuring costs*		(29)	—
Profit on ordinary activities before taxation	4	168	156
Taxation	7	(22)	(21)
Profit on ordinary activities after taxation		146	135
Attributable to minority interests in subsidiaries		(1)	(1)
Profit attributable to the shareholders of Rolls-Royce plc		145	134
Dividends	8	(50)	(42)
Retained profit for the year	23	95	92
*Restructuring costs charged against operating profit			7
Earnings per ordinary share	9		
Net basis		18.1p	18.2p
Net basis before exceptional item		21.7p	18.2p
Nil distribution basis		19.7p	20.1p

As permitted by the Companies Act 1985, a separate profit and loss account for the Company has not been included in these accounts. £107m (1987 £110m) of the Group profit attributable to the shareholders of Rolls-Royce plc has been dealt with in the profit and loss account of the Company.

The notes on pages 19 to 30 form part of these accounts

BALANCE SHEETS

at December 31, 1988

		Group		Company	
	Notes	1988 £m	1987 £m	1988 £m	1987 £m
Fixed assets					
Tangible assets	10	459	438	401	374
Investments—subsidiary companies	11	—	—	30	25
—related companies	12	2	—	2	—
—trade	13	12	—	12	—
		<u>473</u>	<u>438</u>	<u>445</u>	<u>399</u>
Current assets					
Stocks	14	559	623	538	585
Debtors	15	409	329	682	637
Cash at bank and in hand		341	154	308	130
		<u>1,309</u>	<u>1,106</u>	<u>1,528</u>	<u>1,352</u>
Creditors—amounts falling due within one year					
Borrowings	16	(6)	(8)	—	—
Other creditors	17	(473)	(443)	(515)	(476)
Net current assets		<u>830</u>	<u>655</u>	<u>1,013</u>	<u>876</u>
Total assets less current liabilities		<u>1,303</u>	<u>1,093</u>	<u>1,458</u>	<u>1,275</u>
Creditors—amounts falling due after one year					
Borrowings	18	(155)	(9)	(151)	(1)
Other creditors	19	(83)	(118)	(352)	(387)
Provisions for liabilities and charges					
Deferred taxation	20	(1)	(1)	—	—
Other provisions	21	(112)	(106)	(102)	(91)
		<u>952</u>	<u>859</u>	<u>853</u>	<u>796</u>
Capital and reserves					
Called up share capital	22	160	160	160	160
Share premium account	23	241	241	241	241
Revaluation reserve	23	138	141	133	136
Other reserves	23	9	10	8	9
Profit and loss account	23	401	303	311	250
Shareholders' funds		<u>949</u>	<u>855</u>	<u>853</u>	<u>796</u>
Minority interests in subsidiaries		<u>3</u>	<u>4</u>	<u>—</u>	<u>—</u>
		<u>952</u>	<u>859</u>	<u>853</u>	<u>796</u>

Francis Tombs
J. A. Rigg

} Directors

Francis Tombs
J. A. Rigg

March 21, 1989

The notes on pages 19 to 30 form part of these accounts

GROUP STATEMENT OF SOURCE AND APPLICATION OF FUNDS

for the year ended December 31, 1988

	1988 £m	1987 £m
Source of funds		
Profit on ordinary activities before taxation	168	156
Adjustments for items not involving the movement of funds:		
Depreciation of tangible fixed assets	43	41
Increase (decrease) in other provisions for liabilities and charges	6	(6)
Funds generated from operations	<u>217</u>	<u>191</u>
Issue of shares for cash, less issue expenses	—	274
Exchange adjustments	(4)	(12)
Disposals of tangible fixed assets	4	2
(Decrease) increase in creditors falling due after one year	(35)	15
	<u>182</u>	<u>470</u>
Application of funds		
Capital expenditure	(65)	(82)
Investments	(14)	—
Taxation paid	(18)	(6)
Dividends paid	(45)	(14)
Miscellaneous items	(2)	(2)
	<u>38</u>	<u>366</u>
Changes in net current assets		
Increase in current creditors excluding corporate taxation and proposed dividend	21	33
Decrease (increase) in stocks, net of progress payments	64	(19)
(Increase) in debtors	(80)	(14)
Changes in net liquid assets and loans	<u>43</u>	<u>366</u>
Represented by:		
Increase in cash balances	187	133
(Increase) decrease in borrowings:		
Amounts falling due within one year	2	163
Amounts falling due after one year	(146)	70
	<u>43</u>	<u>366</u>

NOTES TO THE ACCOUNTS

1. ACCOUNTING POLICIES

Basis of accounting

The accounts have been prepared on the historical cost basis, modified to include the revaluation of land and buildings at December 31, 1985.

Basis of consolidation

The Group accounts include the accounts of the Company and all of its subsidiaries made up to December 31.

The Group's share of the results of related companies up to December 31 is included in the Group accounts on the basis of either audited accounts or, where these are not available, unaudited management accounts.

Any provisions for diminution in value of the Company's investment in subsidiary or related companies are made in the Company's profit and loss account.

Turnover and trading profit

Turnover excludes value added tax and comprises:

- (i) Amounts invoiced to customers in respect of deliveries made, work completed or services rendered during the year.
- (ii) Estimated sales values, where prices have not been agreed with customers.
- (iii) Income from licences and management fees.

Trading profit is taken at the time of sale; in the case of long-term contracts, profit is arrived at by reference to the estimated overall contract profitability.

Foreign currencies

Company accounts

- (i) Transactions in currencies other than sterling are translated at the average achieved exchange rate for the year, taking account of maturing foreign exchange contracts.
- (ii) Assets and liabilities in foreign currencies are translated into sterling on the following bases:
 - (a) Intra-group balances at the exchange rates ruling at the year end.
 - (b) Other assets and liabilities at the estimated sterling equivalent, taking account of future foreign exchange contracts.
- (iii) Differences on exchange are charged or credited in determining profit on ordinary activities before taxation.

Group accounts

- (i) Assets and liabilities of overseas subsidiary and related companies are translated into sterling at the exchange rates ruling at the year end.
- (ii) The trading results of overseas subsidiary and related companies are translated at the average exchange rates for the year.
- (iii) On consolidation, differences on exchange arising from the retranslation of the opening net investment in overseas subsidiary and related companies, and from the translation of the profits or losses of those companies at average rate, are taken to reserves.

Research and development

The charge to the profit and loss account consists of total research and development expenditure incurred in the year less costs recoverable on contracts, contributions to shared engineering programmes and any launch aid received under the provisions of the 1982 Civil Aviation Act.

NOTES TO THE ACCOUNTS

1. ACCOUNTING POLICIES (CONTINUED)

Taxation

Provision is made at the rate for the year for United Kingdom corporation tax, for overseas taxation on profits of overseas subsidiaries and for deferred taxation on all timing differences where a liability is expected to arise in the foreseeable future. Advance corporation tax which is not recoverable in the immediate future by offset against United Kingdom corporation tax liabilities is included in the taxation charge for the year.

Stocks

Stocks are valued at cost of materials, labour and relevant manufacturing overheads, less provisions for obsolete and surplus items and, where necessary, provisions to reduce cost to estimated realisable value. Progress payments received are deducted from stocks up to the limit of the relevant work in progress. Other advance payments and deposits are included in creditors.

The requirements of the 1988 revision of Statement of Standard Accounting Practice No. 9 have been implemented. The effect on the accounts is not material.

Accounting for leases

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 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 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. Rentals receivable as lessor under operating leases are included in turnover for the year on an accruals basis.

Depreciation

(i) Properties

Depreciation is provided on the valuation of properties adopted at December 31, 1985 and on the original cost of purchases since 1985 and is calculated on the straight line basis over estimated lives advised by the Group's professional valuers. Depreciation is not provided on freehold land.

The estimated lives are:

(a) Freehold buildings – 10 to 45 years.

(b) Leasehold land and buildings – lower of valuers' estimates or period of lease.

(ii) Plant and equipment

Depreciation is provided on the original cost of plant and equipment and is calculated on the straight line basis over estimated lives in the range 5 to 25 years.

NOTES TO THE ACCOUNTS

2. TURNOVER AND OPERATING PROFIT

	1988				1987			
	United Kingdom £m	Overseas £m	Total £m	%	United Kingdom £m	Overseas £m	Total £m	%
Turnover								
Civil Aero	104	800	904	46	153	800	953	46
Military Aero	206	572	778	40	228	592	820	40
Industrial and Marine	52	71	123	6	44	92	136	7
Other activities	127	41	168	8	118	32	150	7
	<u>489</u>	<u>1,484</u>	<u>1,973</u>		<u>543</u>	<u>1,516</u>	<u>2,059</u>	
	25%	75%	100		26%	74%	100	

Geographical analysis by destination:

North America	728	733
Europe	414	409
Asia	248	286
Australasia	27	29
Africa	21	21
Other countries	46	38
	<u>1,484</u>	<u>1,516</u>

Exports from the United Kingdom:

Direct	1,140	1,148
Indirect	272	286
	<u>1,412</u>	<u>1,434</u>
Sales by overseas subsidiaries	146	145
Company sales to overseas subsidiaries	(74)	(63)
	<u>1,484</u>	<u>1,516</u>

	1988		1987	
	£m	% on Turnover	£m	% on Turnover
Operating profit				
Civil Aero	152	17	194	20
Military Aero	150	19	133	16
Industrial and Marine	21	17	11	8
Other activities	10	6	9	6
	<u>333</u>	17	<u>347</u>	17

3. NET INTEREST RECEIVABLE (PAYABLE)

	1988 £m	1987 £m
Interest receivable	26	9
Interest (payable) on:		
Borrowings repayable within five years—by instalments	(1)	(2)
—otherwise than by instalments	(9)	(7)
Finance leases	(3)	(4)
	<u>13</u>	<u>(4)</u>

NOTES TO THE ACCOUNTS

4. PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

	1988 £m	1987 £m
After charging		
Depreciation of owned tangible fixed assets	33	29
Depreciation of tangible fixed assets held under finance leases	10	12
Operating lease rentals payable – Hire of plant and equipment	10	10
– Hire of other assets	4	6
Auditors' remuneration 1988 £0.7m (1987 £0.7m)		

After crediting

Operating lease rentals receivable	5	4
Release of provision for termination charges associated with the disposal of an overseas facility	3	(2)

5. EMOLUMENTS OF DIRECTORS AND SENIOR EMPLOYEES

	£	£
The emoluments of directors, charged before arriving at operating profit, were:		
Fees	51,480	46,250
Other emoluments, including pension contributions	851,252	706,892
Ex gratia payment to a former director	—	25,000

The emoluments, excluding pension contributions, of directors and senior employees working wholly or mainly in the United Kingdom were:

Chairman	103,200	86,250
Highest paid director	168,330	129,890
Other directors:		

£	Number	Number
Nil to 5,000	1	—
5,001 to 10,000	5	5
10,001 to 25,000	1	—
25,001 to 75,000	—	1
75,001 to 80,000	—	2
80,001 to 85,000	2	1
85,001 to 90,000	—	1
90,001 to 95,000	1	—
95,001 to 100,000	1	—

Senior employees:

30,001 to 35,000	86	76
35,001 to 40,000	43	29
40,001 to 45,000	24	12
45,001 to 50,000	14	13
50,001 to 55,000	8	10
55,001 to 60,000	5	6
60,001 to 65,000	2	3
65,001 to 70,000	7	2
70,001 to 75,000	2	1
75,001 to 80,000	1	—

NOTES TO THE ACCOUNTS

6. EMPLOYEE INFORMATION

	1988	1987
Average weekly number of Group employees during the year		
United Kingdom	37,800	38,900
Overseas	3,100	3,100
	<u>40,900</u>	<u>42,000</u>
	£m	£m
Group employment costs		
Wages and salaries	531	523
Social security costs	42	40
Other pension costs	44	43
	<u>617</u>	<u>606</u>

7. TAXATION

United Kingdom – corporation tax at 35%	3	3
– advance corporation tax written off	13	14
Overseas – current	6	4
	<u>22</u>	<u>21</u>

Both years' corporation tax charges have been reduced by the utilisation of tax losses brought forward.

8. DIVIDENDS – ORDINARY SHARES

Interim paid 2.1p (1987 1.75p) per share	17	14
Final proposed 4.2p (1987 3.5p) per share	33	28
	<u>50</u>	<u>42</u>

9. EARNINGS PER ORDINARY SHARE

Earnings per ordinary share on the net basis are calculated by dividing the profit attributable to the shareholders of Rolls-Royce plc of £145m (1987 £134m) by 801 million (1987 738 million) ordinary shares, being the average number of ordinary shares in issue during the year.

Earnings per ordinary share before exceptional item are calculated as for the net basis but after adding to profit the exceptional item of £29m (1987 nil).

Earnings per ordinary share on a nil distribution basis are calculated as for the net basis but after adding to profit £13m (1987 £14m), being the irrecoverable advance corporation tax attributable to dividends paid and proposed.

A fully diluted earnings per ordinary share figure based on outstanding share options is not provided as the effect on the earnings per ordinary share is not material.

NOTES TO THE ACCOUNTS

10. TANGIBLE FIXED ASSETS

	Land & buildings £m	Group Plant & equipment £m	Total £m	Land & buildings £m	Company Plant & equipment £m	Total £m
Cost or valuation:						
At January 1, 1988	209	616	825	187	490	677
Exchange adjustments	2	3	5	—	—	—
Additions at cost	9	56	65	8	55	63
Disposals	—	(20)	(20)	—	(11)	(11)
At December 31, 1988	<u>220</u>	<u>655</u>	<u>875</u>	<u>195</u>	<u>534</u>	<u>729</u>
Depreciation:						
At January 1, 1988	16	371	387	12	291	303
Exchange adjustments	—	2	2	—	—	—
Provided during year	8	35	43	7	25	32
Disposals	—	(16)	(16)	—	(7)	(7)
At December 31, 1988	<u>24</u>	<u>392</u>	<u>416</u>	<u>19</u>	<u>309</u>	<u>328</u>
Net book value at December 31, 1988	<u>196</u>	<u>263</u>	<u>459</u>	<u>176</u>	<u>225</u>	<u>401</u>
Net book value at December 31, 1987	<u>193</u>	<u>245</u>	<u>438</u>	<u>175</u>	<u>199</u>	<u>374</u>

Included in the above are:

	Group		Company	
	1988 £m	1987 £m	1988 £m	1987 £m
Net book value of finance leased plant and equipment	<u>36</u>	<u>45</u>	<u>223</u>	<u>199</u>
Assets held for use in operating leases:				
Cost	54	56	—	—
Depreciation	<u>(33)</u>	<u>(33)</u>	<u>—</u>	<u>—</u>
Net book value	<u>21</u>	<u>23</u>	<u>—</u>	<u>—</u>
Original cost of assets fully written off but still in use	<u>142</u>	<u>146</u>	<u>137</u>	<u>142</u>
Land and buildings at cost or valuation comprise:				
Valuation at December 31, 1985	189	187	174	174
Cost	<u>31</u>	<u>22</u>	<u>21</u>	<u>13</u>
	<u>220</u>	<u>209</u>	<u>195</u>	<u>187</u>
Land and buildings at net book value comprise:				
Freehold	182	179	165	164
Long leasehold	11	11	8	8
Short leasehold	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>
	<u>196</u>	<u>193</u>	<u>176</u>	<u>175</u>
On an historical cost basis the net book value of land and buildings would have been as follows:				
Cost	143	132	116	108
Depreciation	<u>(85)</u>	<u>(80)</u>	<u>(73)</u>	<u>(69)</u>
Net book value	<u>58</u>	<u>52</u>	<u>43</u>	<u>39</u>

NOTES TO THE ACCOUNTS

11. INVESTMENTS – SUBSIDIARY COMPANIES

	Group		Company	
	1988	1987	1988	1987
	£m	£m	£m	£m
Shares at cost:				
At January 1			28	27
Additions during year			4	1
At December 31			<u>32</u>	<u>28</u>
Provision for diminution in value:				
At January 1			(3)	(4)
Credit for year			1	1
At December 31			<u>(2)</u>	<u>(3)</u>
Net book value at December 31			<u>30</u>	<u>25</u>

The principal subsidiary companies are listed on pages 32 and 33.

12. INVESTMENTS – RELATED COMPANIES

Shares at cost:				
At January 1	1	1	1	1
Additions during year	<u>2</u>	<u>—</u>	<u>2</u>	<u>—</u>
	3	1	3	1
Provision for share of post-acquisition losses	<u>(1)</u>	<u>(1)</u>	<u>(1)</u>	<u>(1)</u>
Net book value at December 31	<u>2</u>	<u>—</u>	<u>2</u>	<u>—</u>

The principal related companies are listed on page 34.

13. INVESTMENTS – TRADE

Shares listed on UK Stock Exchange—at cost	<u>12</u>	<u>—</u>	<u>12</u>	<u>—</u>
—at market value	<u>13</u>	<u>—</u>	<u>13</u>	<u>—</u>

The Company holds as a trade investment 4.7% of the ordinary share capital of Northern Engineering Industries plc.

14. STOCKS

Raw materials	67	73	58	63
Work in progress, jigs and tools	386	425	376	396
Finished parts and engines	388	408	383	400
Payments on account	<u>25</u>	<u>22</u>	<u>28</u>	<u>31</u>
	866	928	845	890
Progress payments against stocks	<u>(307)</u>	<u>(305)</u>	<u>(307)</u>	<u>(305)</u>
	<u>559</u>	<u>623</u>	<u>538</u>	<u>585</u>

The replacement cost of stocks is not considered to be materially different from the historical cost value.

NOTES TO THE ACCOUNTS

15. DEBTORS

	Group		Company	
	1988	1987	1988	1987
	£m	£m	£m	£m
Amounts falling due within one year				
Trade debtors	323	247	255	207
Amounts owed by—subsidiary companies	—	—	26	19
—related companies	39	32	39	32
Other debtors	8	4	7	2
Prepayments and accrued income	25	15	24	13
	<u>395</u>	<u>298</u>	<u>351</u>	<u>273</u>
Amounts falling due after one year				
Trade debtors	12	12	6	6
Amounts owed by—subsidiary companies	—	—	323	339
—related companies	1	5	1	5
Prepayments and accrued income	1	14	1	14
	<u>14</u>	<u>31</u>	<u>331</u>	<u>364</u>
Total debtors	<u>409</u>	<u>329</u>	<u>682</u>	<u>637</u>

16. BORROWINGS – AMOUNTS FALLING DUE WITHIN ONE YEAR

Bank loans and overdrafts	3	4	—	—
Other loans	3	4	—	—
	<u>6</u>	<u>8</u>	<u>—</u>	<u>—</u>

17. OTHER CREDITORS – AMOUNTS FALLING DUE WITHIN ONE YEAR

Trade creditors	177	172	158	151
Amounts owed to—subsidiary companies	—	—	29	20
—related companies	14	8	14	8
Payments received on account	80	94	78	92
Corporate taxation	22	18	17	16
Other taxation and social security	13	19	12	18
Other creditors	107	77	99	72
Accruals and deferred income	15	13	14	12
Proposed dividend	33	28	33	28
Capital obligations under finance leases	12	14	61	59
	<u>473</u>	<u>443</u>	<u>515</u>	<u>476</u>

Company capital obligations under finance leases include £54m (1987 £51m) owed to a subsidiary.

NOTES TO THE ACCOUNTS

18. BORROWINGS – AMOUNTS FALLING DUE AFTER ONE YEAR

	Group		Company	
	1988	1987	1988	1987
	£m	£m	£m	£m
Unsecured				
9½% Notes 1993 (see note below)	150	—	150	—
Bank loans repayable 1990 (interest rate 9.8%)	2	3	—	—
Other loans repayable 1990-1995 (interest rates nil and 11.6%)	2	5	—	—
Secured by charges on related buildings				
Loan repayable 1990-1994 (interest rates 8.8% and 10.5%)	1	1	1	1
	<u>155</u>	<u>9</u>	<u>151</u>	<u>1</u>
Repayable:				
Between one and two years—by instalments	3	5	—	—
Between two and five years—by instalments	2	4	1	1
—otherwise than by instalments	150	—	150	—
	<u>155</u>	<u>9</u>	<u>151</u>	<u>1</u>

The 9½% Notes 1993 are the subject of interest swap agreements under which counterparties have undertaken to pay amounts at fixed rates of interest in consideration for amounts payable by the Company at variable rates of interest, which at December 31, 1988 averaged 11.3%.

19. OTHER CREDITORS – AMOUNTS FALLING DUE AFTER ONE YEAR

Payments received on account	53	70	53	70
Accruals and deferred income	19	24	19	24
Capital obligations under finance leases payable:				
Between one and two years	8	12	59	58
Between two and five years	3	12	150	151
After five years	—	—	71	84
	<u>83</u>	<u>118</u>	<u>352</u>	<u>387</u>

Company capital obligations under finance leases include £275m (1987 £283m) owed to a subsidiary.

20. PROVISIONS FOR LIABILITIES AND CHARGES – DEFERRED TAXATION

Provision:				
Fixed asset timing differences	1	1	—	—
Full potential liability:				
Fixed asset timing differences	21	13	—	—

The effect of the provisions in the 1988 Finance Act has been to eliminate any potential liability on the revaluation of land and buildings (1987 £27m).

At December 31, 1988 the Company has tax losses of approximately £500m (1987 £600m), which are available for relief against future trading profits of the Company, and recoverable advance corporation tax of £27m (1987 £14m).

NOTES TO THE ACCOUNTS

21. OTHER PROVISIONS FOR LIABILITIES AND CHARGES

	Group		Company	
	1988	1987	1988	1987
	£m	£m	£m	£m
Movements on other provisions were:				
At January 1	106	112	91	97
Net charge to profit and loss account	30	26	31	22
Utilised	(24)	(32)	(20)	(28)
At December 31	<u>112</u>	<u>106</u>	<u>102</u>	<u>91</u>

Other provisions include, principally, warranty relating to sales up to the year end and estimated future losses on current contracts.

22. SHARE CAPITAL

	Special share of £1	Ordinary shares of 20p each	Nominal value £m
Authorised			
At January 1 and December 31, 1988	<u>1</u>	<u>1,050,000,000</u>	<u>210</u>
Issued and fully paid			
At January 1, 1988	1	801,470,588	160
Exercise of share options by an employee	—	10	—
At December 31, 1988	<u>1</u>	<u>801,470,598</u>	<u>160</u>

Subject to the provisions of the Companies Act 1985, the special rights redeemable preference share (special share) may be redeemed by the Treasury Solicitor at par at any time.

The Company has established the following employee share schemes:

- (i) Under the Free and Matching Offer Share Scheme 9,447,482 ordinary shares of the Company were held in trust at December 31, 1988 on behalf of 35,893 employees who were beneficially entitled to the shares under special arrangements made in May 1987.

- (ii) At December 31, 1988 the following ordinary shares were subject to options:

	Date of grant	Number of shares	Option price per 20p share	Normal dates of exercise
Executive Share Option Scheme	1987	2,382,700	205p	1990
	1988	986,590	113p	1991
Sharesave Scheme	1987	15,037,776	185p	1992-1994
	1988	15,221,865	112p	1993-1995

- (a) Under the terms of the Executive Share Option Scheme the Board has granted options to purchase ordinary shares in the Company to 46 directors and senior executives.
- (b) Under the terms of the Sharesave Scheme the Board may grant options to purchase ordinary shares in the Company each year to those employees who enter into an Inland Revenue approved Save As You Earn (SAYE) savings contract for a period of either 5 or 7 years.

NOTES TO THE ACCOUNTS

22. SHARE CAPITAL (CONTINUED)

The beneficial, including family, interests in the ordinary share capital of the Company of the persons who were directors on December 31, 1988 were as follows:

	Holdings		Options under Executive Share Option Scheme	
	Dec. 31	Jan. 1*	Dec. 31	Jan. 1*
Sir Francis Tombs	36,811	21,811	199,450	146,300
Dr G. R. Higginson	—	—	—	—
Mr J. O. Keir	1,510	1,510	86,500	79,200
Sir Douglas Lowe	4,000	4,000	—	—
Mr S. C. Miller	1,518	1,518	113,700	95,100
Mr H. G. Mourgue	4,750	4,750	—	—
Sir Robin Nicholson	4,750	4,750	—	—
Mr J. A. Rigg	6,045	6,045	136,500	136,500
Sir Ralph Robins	6,041	6,041	342,200	253,600
Sir Philip Shelbourne	4,750	4,750	—	—
Mr F. Turner	4,186	4,186	72,950	72,950
Mr J. D. Wragg	1,521	1,521	178,200	146,300

*or date of appointment if later.

Mr Turner also has options to subscribe for 4,350 shares under the Sharesave Scheme. There has been no change in the interests set out above between December 31, 1988 and March 21, 1989.

23. RESERVES

	Non-distributable			Profit and loss account £m
	Share premium £m	Revaluation reserve £m	Other reserves £m	
Group				
At January 1, 1988	241	141	10	303
Exchange adjustments	—	—	—	(1)
Transfers between reserves	—	(3)	(1)	4
Retained profit for the year	—	—	—	95
At December 31, 1988	241	138	9	401
Company				
At January 1, 1988	241	136	9	250
Transfers between reserves	—	(3)	(1)	4
Retained profit for the year	—	—	—	57
At December 31, 1988	241	133	8	311

The undistributed profits of overseas subsidiary and related companies may be liable to overseas taxes and/or United Kingdom tax (after allowing for double tax relief) if remitted as dividends to the UK.

24. CAPITAL EXPENDITURE COMMITMENTS

	Group		Company	
	1988 £m	1987 £m	1988 £m	1987 £m
Contracted but not provided	26	19	23	16
Authorised but not yet contracted	15	23	14	21

NOTES TO THE ACCOUNTS

25. OPERATING LEASE ANNUAL COMMITMENTS

	Group		Company	
	1988	1987	1988	1987
	£m	£m	£m	£m
Leases of land and buildings which expire:				
Within one year	—	1	—	—
Between one and five years	2	3	1	1
After five years	2	3	2	2
Other leases which expire:				
Within one year	2	2	1	1
Between one and five years	2	1	1	—
After five years	1	2	—	1

26. CONTINGENT LIABILITIES

Countertrade obligations, recourse under supplier credit arrangements subject to ECGD insurance cover, recourse on discounted promissory notes and minor miscellaneous items	5	4	3	4
Guarantees under sales financing arrangements with customers, after taking into account the estimated realisable value of any underlying security	1	1	1	1
Together with other companies involved in a collaborative agreement, the Company has provided a joint and several guarantee to a lessor. The Company's share, after taking into account the estimated realisable value of the underlying security and recourse amongst the collaborating companies in accordance with the terms of relevant agreements	2	3	2	3
Guarantees in respect of financial obligations of subsidiaries	—	—	52	95

In the opinion of the directors, no significant losses are likely to arise in respect of the above.

Contingent liabilities exist in respect of certain arrangements to secure engine deliveries and under performance and reliability guarantees, entered into in the ordinary course of business. In the opinion of the directors, any claims under such arrangements and guarantees, after allowing for provisions already made, will not be significant in relation to the Group's future activities.

27. PENSION FUNDING

The pension schemes for the majority of employees of the Company and its United Kingdom subsidiaries are of the defined benefits type and are administered by Trustees; the assets of the schemes are invested by them independently of the finances of the Group. The schemes are funded by annual contributions both from the Company or its UK subsidiaries, which are charged against profits for the year, and from members. Based upon actuarial valuations carried out not less than once every three years, the joint contributions provide for benefit entitlements in respect of pensionable service with the Company and its UK subsidiaries. The actuaries have confirmed, following the latest valuations as at March 31, 1988, that the present contribution rates are adequate to meet the benefits provided under the rules of the schemes. If the schemes had been discontinued at the valuation date, the existing assets would have more than covered the accrued benefits of contributing members as well as pensions in payment and other benefits for former contributors.

Pension arrangements for employees of overseas subsidiaries are managed and funded in accordance with local requirements and professional advice.

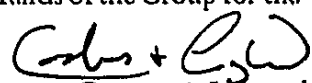
REPORT OF THE AUDITORS

To the members of Rolls-Royce plc

We have audited the accounts on pages 16 to 30 in accordance with approved Auditing Standards.

In our opinion the accounts give a true and fair view of the state of affairs of the Company and the Group at December 31, 1988 and of the profit and source and application of funds of the Group for the year then ended and comply with the Companies Act 1985.

London
March 21, 1989


Coopers & Lybrand
Chartered Accountants

PRINCIPAL SUBSIDIARY COMPANIES at December 31, 1988

	Class	Issued share capital Percentage held by Rolls-Royce plc	Percentage of total equity held by Rolls-Royce plc
REGISTERED IN ENGLAND:			
Deeside Titanium Limited <i>Production of titanium granules</i>	Ordinary	82½	82½
Reflex Manufacturing Systems Limited <i>Software house</i>	Ordinary	100	100
Rolls-Royce and Associates Limited <i>Design, development, procurement and support of nuclear steam raising plant for naval purposes</i>	A Shares B Shares	69 100	76½*
Rolls-Royce Business Ventures Limited <i>Exploitation of Rolls-Royce technology</i>	Ordinary	100	100
Rolls-Royce (China) Limited <i>Commercial information and liaison</i>	Ordinary	100	100
Rolls-Royce (Far East) Limited <i>Commercial information and marketing and service support</i>	Ordinary	100	100
Rolls-Royce (France) Limited <i>Commercial information and marketing support</i>	Ordinary	100	100
Rolls-Royce India Limited <i>Commercial information and marketing and service support</i>	Ordinary	100	100
Rolls-Royce Leasing Limited <i>Leasing of aero and industrial gas turbine engines</i>	Ordinary Preference	100 100	100**
Rolls-Royce MatEval Limited <i>Design and manufacture of ultrasonic inspection systems</i>	Ordinary	100	100
Rolls-Royce Plant Leasing Limited <i>Leasing of plant and equipment</i>	Ordinary	100	100
Rolls-Royce Power and Process (Hartlepool) Limited <i>Manufacture of equipment for energy industries</i>	Ordinary	100	100
Sawley Packaging Company Limited <i>Military and commercial packaging specialists</i>	Ordinary	100	100
Sinfin Freight Forwarding Limited <i>Freight forwarding</i>	Ordinary	100	100
Stresswave Technology Limited <i>Development of intelligent sensors</i>	Ordinary	100	100

* During 1988 Rolls-Royce plc increased its investment in the total equity from 53% to 76½% and it has agreed to purchase the remaining 23½% during 1989

** The interest in the preference shares is held by Rolls-Royce of Australia Pty. Limited

Except where otherwise indicated by their name the above companies operate principally in Great Britain.

PRINCIPAL SUBSIDIARY COMPANIES at December 31, 1988

		Class	Issued share capital Percentage held by Rolls-Royce plc	Percentage of total equity held by Rolls-Royce plc
INCORPORATED OVERSEAS:				
Australia	– Rolls-Royce of Australia Pty. Limited <i>Marketing and support services</i>	Ordinary	100	100
Brazil	– Motores Rolls-Royce Limitada <i>Repair and overhaul; component manufacture</i>	Quota	100	100
Canada	– Rolls-Royce Industries Canada Inc <i>Intermediate holding company</i>	Common	100	100
	– Bristol Aerospace Limited <i>Repair and overhaul; assembly of rocket motors and manufacture of components and propellants</i>	Common	100	100*
	– Rolls-Royce (Canada) Limited <i>Sales, service and overhaul of aero engines; manufacture of industrial gas turbines</i>	Common Preferred	100 100 }	100*
Guernsey	– Nightingale Insurance Limited <i>Insurance underwriting</i>	Ordinary	100	100
Saudi Arabia	– Rolls-Royce International Turbines (Saudi Arabia) Limited <i>Operation and maintenance of electrical generating plant</i>	Ordinary	51	51
USA	– Rolls-Royce Holdings Inc <i>Intermediate holding company</i>	Common	100	100
	– Rolls-Royce Inc <i>Engineering research; aero engine marketing and product support</i>	Common	100	100**
	– Rolls-Royce Capital Inc <i>Financing company</i>	Common	100	100**
	– Rolls-Royce Credit Corporation <i>Financing company</i>	Common	100	100**

* The interests are held by Rolls-Royce Industries Canada Inc

** The interests are held by Rolls-Royce Holdings Inc

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

PRINCIPAL RELATED COMPANIES at December 31, 1988

		Issued share capital†	Percentage held by Rolls-Royce plc	Percentage of total equity held by Rolls-Royce plc
	Class	Total £		
REGISTERED IN ENGLAND:				
Cooper Rolls Limited (England) <i>Sale of mechanical drive units</i>	Ordinary	1,000	50	50*
Rolls-Royce Turbomeca Limited (England and France) <i>Management of collaboration for Adour, RTM 322 and other engines</i>	A Shares	50	—	50
	B Shares	50	100	
Turbo-Union Limited (England, Germany and Italy) <i>Management of collaboration for RB199 engine</i>	Ordinary	992	40	40
	A Shares	16	37½	
INCORPORATED OVERSEAS:				
Australia:				
Turbine Components Australia Pty. Limited (Australia) <i>Manufacture of investment castings</i>	A Shares	AS 2,500,001	100	50
	B Shares	2,500,001	—	
Canada:				
Cooper, Rolls Corporation (Canada) <i>Sale and marketing of mechanical drive units</i>	Common	Can\$ 20,000	50	50**
Germany:				
EUROJET Turbo GmbH (England, Germany, Italy and Spain) <i>Management of collaboration for EJ200 engine</i>	Ordinary	DM 100,000	33	33
Switzerland:				
IAE International Aero Engines AG (England, Germany, Italy, Japan and USA) <i>Management of collaboration for V2500 engine</i>	A shares	S Fr 300,000	100	30
	B shares	300,000	—	
	C shares	199,000	—	
	D shares	121,000	—	
	E shares	80,000	—	
USA:				
Cooper Rolls Inc (Europe and North America) <i>Sale and marketing of mechanical drive units</i>	Common	US\$ 200,000	50	50

† At date of latest available audited accounts

* The interest is held through Cooper Rolls Inc

**The interest is held by Rolls-Royce Industries Canada Inc

The countries of principal operations are stated in brackets after each company's name.

SHAREHOLDER INFORMATION

FINANCIAL CALENDAR

Ex-dividend date for final dividend	April 3, 1989
Qualifying date for final dividend	April 21, 1989
Annual General Meeting	May 23, 1989
Payment of final dividend	June 5, 1989
Press advertisement of 1989 Interim Results	September 15, 1989
Ex-dividend date for interim dividend	October 2, 1989
Qualifying date for interim dividend	October 20, 1989
Payment of interim dividend	December 4, 1989
Financial year end	December 31, 1989
Press advertisement of 1989 Preliminary Results	March, 1990
1989 Annual Report published	April, 1990

ANALYSIS OF ORDINARY SHAREHOLDERS AT DECEMBER 31, 1988

Size of holding	Number of holdings	% of total holdings	% of total shares
1-150	612,545	72.32	11.43
151-1,000	210,226	24.82	8.28
1,001-10,000	22,491	2.66	6.88
10,001-100,000	1,099	0.13	5.00
100,001-1,000,000	474	0.06	20.34
1,000,001 and over	115	0.01	48.07
	<u>846,950</u>	<u>100.00</u>	<u>100.00</u>

Registered Office:
65 Buckingham Gate
London
SW1E 6AT
Telephone: 01-222 9020

Registrar:
National Westminster Bank PLC
Registrar's Department
PO Box 82
Caxton House
Redcliffe Way
Bristol
BS99 7NH
Telephone: 0272-306600

NOTICE OF ANNUAL GENERAL MEETING

Notice is hereby given that the Annual General Meeting of Rolls-Royce plc will be held at The Royal Albert Hall, Kensington Gore, London SW7 on Tuesday May 23, 1989 at 11.00 am to transact the following business:

1. To receive the Report of the Directors and the audited accounts for the year ended December 31, 1988 and to declare a dividend.
2. To re-elect Sir Douglas Lowe as a director.
3. To re-elect Mr P.F. Macfarlane as a director.
4. To re-elect Sir Ralph Robins as a director.
5. To re-elect Sir Francis Tombs as a director.
6. To re-elect Mr F. Turner as a director.
7. To re-appoint Coopers & Lybrand as auditors and authorise the directors to determine their remuneration.
8. To consider and, if thought fit, pass the following Resolution as a Special Resolution:
THAT the directors be empowered, pursuant to Section 95 of the Companies Act 1985, to allot equity securities (as defined in Section 94 of that Act) wholly for cash as if Section 89(1) of that Act did not apply to any such allotment, provided that this power shall be limited to:
 - (i) the allotment of equity securities in connection with an offer by way of rights in favour of the holders of ordinary shares where the equity securities respectively attributable to the interests of all holders of ordinary shares are proportionate (as nearly as may be) to the respective numbers of ordinary shares held by them, provided that the directors may make such arrangements as they consider necessary or expedient in relation to fractional entitlements, or as a result of legal or practical problems arising under the laws of any territory or the requirements of any regulatory body or stock exchange; and
 - (ii) the allotment of equity securities (otherwise than pursuant to sub-paragraph (i) above) up to an aggregate nominal amount equal to £8,014,706 being 40,073,530 ordinary shares of 20p each; and shall expire on the earlier of August 22, 1990 and the conclusion of the next Annual General Meeting of the Company after the date on which this Resolution is passed, save that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the directors may allot equity securities in pursuance of such an offer or agreement notwithstanding that the power conferred hereby has expired.
9. To consider and, if thought fit, pass the following Resolution as an Ordinary Resolution:
THAT, subject to the approval of the Inland Revenue, the directors be authorised to amend the Rolls-Royce Sharesave Scheme to permit the exchange of options for new options in a company that acquires the Company by an offer or scheme of arrangement.
10. To consider and, if thought fit, pass the following Resolution as an Ordinary Resolution:
THAT the directors be authorised to amend the Rolls-Royce Sharesave and Executive Share Option Schemes to remove the limit of five per cent on shares under the schemes applying in the period to April 5, 1992.

By order of the Board

Anthony Warrington
Secretary
April 20, 1989

NOTES:

- (1) A member entitled to attend and vote at the meeting is entitled to appoint one or more proxies to attend and, on a poll, vote instead of him or her. A proxy need not be a member of the Company. Appointment of a proxy will not preclude a member from attending and voting at the meeting should he/she subsequently decide to do so.
- (2) To be effective, forms of proxy must be lodged with the Registrar not less than 48 hours before the time fixed for holding the meeting. The address of the Registrar is given on page 35 of this Report.
- (3) The register of directors' interests in shares of the Company, copies of the directors' contracts of service, the rules of the Sharesave and Executive Share Option Schemes and the proposed amendments thereto will be available for inspection during normal business hours at the Company's registered office from the date of this notice until the date of the meeting and at the place of the meeting from 10.00 am until its conclusion.

NOTICE OF ANNUAL GENERAL MEETING

Explanatory Notes

The Annual General Meeting is a meeting of shareholders which the Company is required to hold each year. There are 10 resolutions before the meeting which shareholders will be asked to approve. Resolutions 1 to 7 relate to 'ordinary business' which has to be dealt with every year and Resolutions 8 to 10 relate to 'special business' which also requires shareholders' approval.

ORDINARY BUSINESS

Resolution 1: To receive report and accounts and declare a dividend.

The directors of the Company are required to present to the meeting the Report of the Directors and the audited accounts for the preceding financial year.

An interim dividend, which the directors are empowered to authorise, was paid on December 5, 1988. However, the declaration of a final dividend must be authorised by the shareholders and cannot exceed the amount recommended by the directors in their report on page 6. Approval of the meeting will permit this to be paid on June 5, 1989.

Resolutions 2 to 6: Re-election of directors.

Under the Company's Articles of Association a proportion of the directors are required to retire by rotation each year and they are entitled to seek re-election.

The three directors who retire by rotation this year, Sir Douglas Lowe, Sir Ralph Robins and Sir Francis Tombs, seek re-election. Resolutions 2, 4 and 5 propose their re-election as directors.

The Articles of Association also require directors appointed by the Board to retire and seek re-election at the first Annual General Meeting next following their appointment. Since the previous Annual General Meeting Mr P.F. Macfarlane and Mr F. Turner have joined the Board and will seek re-election under Resolutions 3 and 6 respectively.

Details of the directors seeking re-election to the Board are shown on pages 7 and 8.

Resolution 7: Re-appointment and remuneration of auditors.

The continuation of the auditors in office is subject to their re-appointment at the meeting at which the accounts are presented. Resolution 7 proposes the re-appointment of Coopers & Lybrand and that the directors be authorised to determine the remuneration to be paid to them.

SPECIAL BUSINESS

Resolution 8: Limited authority to allot shares.

Any shares to be issued for cash must in general be offered first to shareholders in proportion to their existing shareholdings. This is known as 'pre-emption rights'.

Resolution 8 is a special resolution renewing an existing authority, which expires at the conclusion of the 1989 Annual General Meeting, to disapply to a limited extent the statutory pre-emption rights of shareholders in respect of cash issues. This would enable the directors, over the period until the 1990 Annual General Meeting or August 22, 1990 if earlier, to allot equity securities for cash, other than to existing shareholders, up to a maximum nominal amount of £8,014,706 representing 5 per cent of the Company's issued share capital. This is in accordance with Stock Exchange guidelines.

The directors consider that this limited disapplication of Section 89 of the Companies Act 1985 will provide a desirable degree of flexibility to take advantage of business opportunities as they arise.

Resolution 9: Amendment to Sharesave Scheme rules.†

Resolution 9 will, if passed, permit the exchange of options for new options in a company that acquires the Company by an offer or scheme of arrangement.

Resolution 10: Increase in limit on Sharesave and Executive Share Option Schemes.†

Resolution 10 will, if passed, allow the removal of the limit of five per cent on the number of shares in the schemes which in aggregate can be subscribed for, or placed under option, in the period to April 5, 1992, while leaving unchanged the overall limit of ten per cent.

† The proposed amendments to the Rolls-Royce Sharesave and the Executive Share Option Schemes' rules will be contained in documents produced at the meeting, marked 'SAYESO' and 'EXECESO' respectively and signed by the Chairman for the purposes of identification; the directors will be authorised to amend the schemes, subject to such alterations as may be required to obtain Inland Revenue approval.