Registered number. 01305027

Rolls-Royce Power Engineering plc

Directors' report and financial statements

for the year ended 31 December 2012

Rolls-Royce Power Engineering plc

Company Information

Directors	G Allan R A Dingley (appointed 7 March 2012 & resigned 14 March 2013) R P Curtis M E Green (resigned 24 September 2012) R C Orgill J Smith
Company secretary	D J Goma
Registered number	01305027
Registered office	Moor Lane Derby DE24 8BJ

Rolls-Royce Power Engineering plc

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Rolls-Royce Power Engineering plc

Directors' report
for the year ended 31 December 2012

The directors present their report and the financial statements for the year ended 31 December 2012

Principal activities

The Company designs, manufactures, commissions and services a wide range of advanced engineering products for the marine and energy markets, including the oil and gas industry and power generation

Directors

The directors who served during the year were

G Allan
R A Dingley (appointed 7 March 2012 & resigned 14 March 2013)
R P Curtis
M E Green (resigned 24 September 2012)
R C Orgill
J Smith

Business review

Our market sectors present global growth opportunities

In 2012, the company decreased sales to £1,043 0 million (2011 £1,126 4 million), and profit before tax increased by 14% per cent to £82 6 million (2011 £72 5 million)

We continue to invest in technologies, products, people and capabilities with the objective of broadening and strengthening our product portfolio, improving our efficiency and enhancing the environmental performance of our products In 2012 total investment in research and development amounted to £32 6 million (2011 £33 3 million)

A strong balance sheet

The company ended 2012 with a net cash balance of £113 5 million (2011 £55 2 million) with net assets increasing to £449 6 million (2011 £379 0 million)

Priorities

The Company continued to address four priority areas in 2012
Investment in technology and products
Operational and unit cost reduction
Continued development of aftermarket services
Responding to the challenge of climate change

Future prospects

Each of our businesses offers significant opportunities for organic growth

The supply of integrated power and propulsion systems and the provision of associated aftermarket services remains the key focus of our marine business The forward visibility of the order book together with the actions we are taking to improve productivity and grow aftermarket services have given us a strong platform for future growth

In the energy sector, we see opportunities to strengthen our presence particularly in the aftermarket sector from the increasing installed base

In 2013, we anticipate the aftermarket will continue to grow and will be supported by a continued focus on improvement

Rolls-Royce Power Engineering plc

Directors' report
for the year ended 31 December 2012

Market outlook

The Company operates in two long-term, global markets – marine and energy These markets present a huge opportunity over the next 20 years and have common characteristics All these markets have very high entry barriers and
– offer the opportunity for organic growth,
– feature extraordinarily long programme lives, usually measured in decades,
– can only be addressed through significant investments in technology, infrastructure and capability, and
– create a significant opportunity for extended customer relationships, with revenues from aftermarket services similar in size to original equipment revenues

Marine Highlights	2012	2011
Turnover (£millions)	615	589
Profit before financing costs (£millions)	60	46
Net assets (excluding cash) (£millions)	291	174
Order book (£millions)	1,668	1,254
Employees (numbers)	2,354	2,193

Marine

The marine business operates within Rolls-Royce and is a world leader in the provision of marine power and propulsion systems, offering a wide range of products and services for both naval and commercial sectors Most areas of the marine business again proved very resilient in 2012, despite very difficult economic conditions Order book increased by 33% to £1 7 billion (2012 £1 3 billion) as a result of the £1 billion Core Production Capability (CPC) contract, to produce new reactor cores for the next generation of the UK's nuclear-armed submarines Turnover increased 4% to £615 million (2011 £589 million), driven by work on the CPC and associated contracts, and the Next Generation Nuclear Propulsion Plant (NGNPP)

Profit increased 30% to £60 million (2011 £46 million), principally due to a strong aftermarket performance, including the initial profit from the transfer of the Japanese Spey aftermarket business to Kawasaki Heavy Industries

Energy Highlights	2012	2011
Turnover (£millions)	428	538
Profit before financing costs (£millions)	19	25
Net assets (excluding cash) (£millions)	46	149
Order book (£millions)	313	307
Employees (numbers)	326	315

Energy

There continues to be strong growth in investments in the oil and gas sector Advancements in exploration and extraction technology are sustaining growth of global reserves in oil and gas resources, particularly in the offshore and shale gas markets Investments in deep water production are expected to grow 15% compound annual growth rate (CAGR) over the next 10 years, with Shale Gas growing 10-15% CAGR Liquefied natural gas is expected to grow 5% CAGR which still represents 150 mtpa of new liquefaction capacity over the next 10 years Power demand growth and concerns over energy security and diversity are changing the energy landscape Electricity demand, driven by population and GDP growth, is triggering new investments in generation capacity while grid stability and environmental concerns are promoting a more balanced portfolio of generation capacity These forces make flexible aero-derivative driven gas-fired power generation economically attractive and valuable in providing both energy security and diversity The market is forecasted to grow more than 8% per annum on average over the next 10 years with an estimated £43 billion market value for gas turbine equipment

Turnover in the energy business reduced by 20% to £428 million (2011 £538 million) due to lower original equipment order intake as the vast majority of new unit projects traded through a sister company Profit at £19 million (2011 £25 million) in 2012 is consistent with prior year mainly due to a reduction in general and administrative expenses offset by additional recoverable engine costs of £7m (2011 - £nil)

We continue to enhance customer value through product upgrades for increased power, better efficiency and reliability, lower emissions and greater ease of maintenance

Directors' report
for the year ended 31 December 2012

Results and dividends

The profit for the year, after taxation, amounted to £68,400 thousand (2011 - £63,100 thousand)

No dividends were paid during the year (2011 - £nil) An interim dividend of £40,000 thousand is proposed to be paid in July 2013

Principal risks and uncertainties

Business environment risks

Corporate responsibility

The Company recognises the benefit that is derived from conducting business in an ethically and socially responsible manner This approach extends to the supply of raw materials and components, the provision of a safe and healthy place of work and investment in technologies to reduce the environmental impact of the Company's products and operations Non-compliance by the Company with legislation or other regulatory requirements (for example export controls, use of controlled substances, and anti-bribery and corruption legislation) compromises the ability to conduct business in certain jurisdictions

A failure in any of these areas could damage the Company's reputation and disrupt its business

A group wide training programme exists for the Rolls-Royce Global Code of Business Ethics and a legal and compliance team has been put in place to manage specific issues arising The code sets out the principles and guidelines concerning interaction with our stakeholders

Strategic risks

Aftermarket

Aftermarket revenues contribute over half of the Company's annual sales and are an essential element of the returns the Company expects to make from its investments Any threat to the security of aftermarket revenues through, for example, a failure to provide an operational service which meets customers' expectations, would threaten the Company's level of profitability

The Company is focused on providing a high standard of service to all its customers Increasingly, customers are selecting a broader range of services through long term service agreements, under which the Company assumes a higher level of responsibility for the maintenance and availability of its products in return for a usage based fee The Company deploys customer satisfaction surveys to monitor its service level

Competitive forces

The markets in which Rolls-Royce Power Engineering plc operates are highly competitive The majority of its programmes are long term in nature and access to the key platforms is critical to the success of the business This requires sustained investment in technology, capability and infrastructure, which presents a high barrier to entry However, these factors alone do not protect the Company from competition, such that price competition and technical advances made by competitors could adversely affect the Company's results

The Company has maintained a steady improvement in operational performance, which together with the establishment of long term customer relationships and sustained investment in technology acquisition, allows the Company to respond to competitive pressure

Financial risks

Cash and overdrafts are held at floating rates and the Company is therefore exposed to movements in interest rates

All material cash balances are held in sterling and therefore these balances are not exposed to movements in foreign exchange rates

The Company's credit risk is primarily attributable to its trade receivables The amounts presented in the balance sheet are net of allowances for doubtful receivables In order to maintain liquidity to ensure that sufficient funds are available for on-going operations and future developments, the Company uses a mixture of long term and short term group debt finance

The Company is exposed to a number of foreign currencies The most significant transactional currency exposures are the US dollar and Euro The Company manages its exposure by entering into foreign exchange contracts to mitigate the impact of volatile exchange rates

Operational risks

Performance of supply chain

The Company's strategy is to simplify the external supply chain, forging deeper, strategic relationships with fewer but stronger suppliers

In addition, the Company has a business continuity programme, to manage the risk of a loss of a major capability or facility

IT security

Advances in technology have resulted in more data being transmitted across global communication links, posing an increased security risk

Security systems have been upgraded with the latest technology and Rolls-Royce Power Engineering plc maintains effective communications with other industrial companies and the appropriate government agencies to share information on potential threats

Programme risk

The Company manages complex product programmes with demanding technical requirements against stringent customer schedules This requires the co-ordination of the external supply chain, manufacturing operations, partners and engineering functions Failure to achieve programme goals would have significant financial implications for the Company

The Company employs project management controls on a routine basis

Supplier payment policy

The Company seeks the best possible terms from suppliers and when entering into binding purchasing contracts, gives consideration to quality, delivery, price and terms of payment In the event of disputes, efforts are made to resolve them quickly

The Company had an average payment timescale of 60 days at December 31, 2012 (2011 - 48 days)

Research and development

The Company devotes a substantial amount of time and effort to research and development activities and expenditure for 2012 was £32 6 million (2011 - £33 3 million) and is expected to continue at a similar level for the foreseeable future

Employment policy

The Company and employee representatives continue to work closely together to improve the quality of employee engagement and participation in the development of the business

The Company consults widely over changes to pension arrangements for UK employees The Company's policy on diversity and equality continues to develop in consultation with employee representatives The Company is committed to equal opportunities and to developing a diverse and inclusive workforce

The Company's policy is to provide, wherever possible, employment and 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

The Company actively encourages employee share ownership in the ultimate parent company, Rolls-Royce Holdings plc The Company continues to invest in training and development programmes to ensure that employees have the opportunity to attain the highest level of skills

Employees are encouraged to take responsibility for their personal development and opportunities are available to extend their competency levels using a range of the latest education and training techniques The use of Appraisal Systems and Personal Development Planning continues to grow and opportunities for the Company to share best practice in these and other employee development and training activities are a high priority

Rolls-Royce Power Engineering plc

Directors' report
for the year ended 31 December 2012

Directors' indemnities

The Company has made qualifying third party indemnity provisions for the benefit of its directors which were made during the year and remain in force at the date of this report

Statement as to disclosure of information to auditors

Each of the persons who are directors at the time when this Directors' report is approved has confirmed that

- so far as that director is aware, there is no relevant audit information of which the Company's auditor is unaware, and
- that director has taken all the steps that ought to have been taken as a director in order to be aware of any information needed by the Company's auditor in connection with preparing its report and to establish that the Company's auditor is aware of that information

Auditor

In accordance with Section 489 of the Companies Act 2006, a resolution for the re-appointment of KPMG Audit Plc as auditor of the company is to be proposed at the forthcoming Annual General Meeting

This report was approved by the board and signed on its behalf

G Allan

G Allan
Director
Date 25 June 2013

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE DIRECTORS' REPORT AND THE FINANCIAL STATEMENTS

The directors are responsible for preparing the Directors' report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice) Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgments and estimates that are reasonable and prudent,
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements,
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006 They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities

Independent auditor's report to the members of Rolls-Royce Power Engineering plc

We have audited the financial statements of Rolls-Royce Power Engineering plc for the year ended 31 December 2012, set out on pages 8 to 27 The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice)

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 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 auditor

As explained more fully in the Directors' Responsibilities Statement (page 6), the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www frc org uk/auditscopeukprivate

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2012 and of its profit for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit

AJ Sykes

Anthony Sykes (Senior Statutory Auditor)
for and on behalf of
KPMG Audit Plc, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL
Date 27 June 2013

Rolls-Royce Power Engineering plc

Profit and loss account
for the year ended 31 December 2012

	Note	2012 £000	2011 £000
Turnover	2	1,043,000	1,126,400
Cost of sales		(822,400)	(917,900)
Gross profit		220,600	208,500
General and administrative expenses		(109,100)	(104,600)
Research and development (net)		(32,600)	(33,300)
Total administrative expenses		(141,700)	(137,900)
Operating profit		78,900	70,600
Profit on sale of tangible fixed assets		-	(100)
Profit on ordinary activities before finance charges		78,900	70,500
Loss on disposal of investments		(700)	-
Interest receivable and similar income	3	4,400	3,400
Interest payable and similar charges	4	-	(1,400)
Profit on ordinary activities before taxation		82,600	72,500
Tax on profit on ordinary activities	6	(14,200)	(9,400)
Profit for the financial year	20	68,400	63,100

All amounts relate to continuing operations

There were no recognised gains and losses for 2012 or 2011 other than those included in the Profit and loss account

The notes on pages 10 to 27 form part of these financial statements

Rolls-Royce Power Engineering plc
Registered number 01305027

Balance sheet
as at 31 December 2012

	Note	£000	2012 £000	£000	2011 £000
Fixed assets					
Intangible assets	9		45,700		50,800
Tangible assets	10		29,000		25,200
Investments	11		141,500		142,200
			216,200		218,200
Current assets					
Stocks	12	104,700		94,800	
Debtors amounts falling due after more than one year	13	14,500		24,700	
Debtors amounts falling due within one year	13	768,500		708,000	
Cash at bank and in hand		113,500		55,200	
		1,001,200		882,700	
Creditors amounts falling due within one year	14	(553,700)		(517,700)	
Net current assets			447,500		365,000
Total assets less current liabilities			663,700		583,200
Creditors amounts falling due after more than one year	15		(180,900)		(148,200)
Provisions for liabilities and charges					
Other provisions	18		(33,200)		(56,000)
Net assets			449,600		379,000
Capital and reserves					
Called up share capital	19		379,100		379,100
Share premium account	20		24,100		24,100
Capital redemption reserve	20		4,000		4,000
Revaluation reserve	20		800		800
Profit and loss account	20		41,600		(29,000)
Shareholders' funds	21		449,600		379,000

The financial statements were approved and authorised for issue by the board and were signed on its behalf on
25 June 2013

G Allan

G Allan
Director

The notes on pages 10 to 27 form part of these financial statements

1. Significant accounting policies

The principal accounting policies are summarised below

1 1 Basis of preparation

These financial statements have been prepared on a going concern basis, under the historical cost convention, and in accordance with applicable accounting standards

The Company is exempt by virtue of section 399 of the Companies Act 2006 from the requirement to prepare group financial statements

The Company is a wholly owned subsidiary of Rolls-Royce plc and is included in the consolidated financial statements of Rolls-Royce plc, which are publicly available Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of FRS1

1 2 Foreign currency translation

Assets and liabilities denominated in foreign currencies are translated into sterling at the rate ruling at the year end Exchange differences arising on foreign exchange transactions and the retranslation of assets and liabilities into sterling at the rate ruling at the year-end are taken into account in determining profit before taxation

1 3 Turnover

Turnover comprises sales to external customers after discounts, 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 are recognised by reference to the stage of completion based on services performed to date The assessment of the stage of completion is dependent on the nature of the contract, but will generally be based on costs incurred to the extent these relate to services performed up to the reporting date, achievement of contractual milestones where appropriate

Linked sales of products and services are treated as a single 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 are considered to form a single project with an overall profit margin Turnover is recognised on the same basis as for other sales of products and services as described above

Provided that the outcome of construction contracts can be assessed with reasonable certainty, the turnover and costs on such contracts are recognised based on stage of completion and the overall contract profitability

Full provision is made for any estimated losses to completion of contracts having regard to the overall substance of the arrangements

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

1 Significant accounting policies (continued)

1 4 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 as internally generated intangible asset only if it meets strict criteria, 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

1 5 Pension costs

Contributions to Rolls-Royce plc group 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

1 6 Share-based payments

The Company, on behalf of its parent Company, provides share-based payment arrangements to certain employees These are equity-settled arrangements and are measured at fair value (excluding the effect of non-market based vesting conditions) at the date of grant The fair value is expensed on a straight-line basis over the vesting period The amount recognised as an expense is adjusted to reflect the actual number of shares or options that will vest, except where additional shares vest as a result of the Total Shareholder Return (TSR) performance condition in the Performance Share Plan The costs of these share-based payments are treated as a capital contribution from the parent Company Any payments made by the Company to its parent Company, in respect of these arrangements, are treated as a return of this capital contribution

The fair values of the share-based payment arrangements are measured as follows
i) ShareSave plans – using the binomial pricing model,
ii) Performance Share Plan – using a pricing model adjusted to reflect non-entitlement to dividends (or equivalent) and the TSR market-based performance condition,
iii) Annual Performance Related Award plan deferred shares and free shares under the Share Incentive Plan – share price on the date of the award

1.7 Financial instruments

FRS 26 requires the classification of financial instruments into separate categories for which the accounting requirement is different The Company has classified its financial instruments as follows

– Derivatives, comprising foreign exchange contracts are classified as held for trading

Financial instruments are recognised at the contract date and initially measured at fair value Their subsequent measurement depends on their classification

– Held for trading instruments are held at fair value Changes in fair value are included in profit and loss

The Company does not apply hedge accounting in respect of forward foreign exchange contracts held to manage the cash flow exposures of forecast transactions denominated in foreign currencies

1 8 Interest

Interest receivable/payable is credited/charged to the profit and loss account using the effective interest method

1 Significant accounting policies (continued)

1 9 Taxation

The tax charge on the profit or loss for the year comprises current and deferred tax

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

1 10 Stocks

Stocks and work in progress are valued at the lower of cost and net realisable value on a first-in, first-out basis Cost comprises direct materials and, where applicable, direct labour costs and those overheads, including depreciation of property, plant and equipment, that have been incurred in bringing the stocks to their present location and condition Net realisable value represents the estimated selling prices less all estimated costs of completion and costs to be incurred in marketing, selling and distribution

1.11 Tangible fixed assets

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

Depreciation is provided on the original cost of purchases since 1996 and on the valuation of properties adopted at 31 December 1996 and is calculated on a straight-line basis to write off the cost, less the estimated residual value, of property, plant and equipment over their estimated useful lives Estimated useful lives are as follows

i) Land and buildings, as advised by the Company's professional advisors
  a) Freehold buildings – 15 to 45 years (average 20 years)
  b) Leasehold buildings – lower of advisors' estimates or period of lease
  c) No depreciation is provided on freehold land
ii) Plant and equipment – 5 to 25 years (average 15 years)
iii) No depreciation is provided on assets in the course of construction

1 12 Investments

Fixed asset investments are shown at cost less provision for impairment Current asset investments are stated at the lower of cost and net realisable value

1 Significant accounting policies (continued)

1 13 Leases

i) As Lessee
Assets financed by leasing agreements which give rights approximating to ownership (finance leases) have been capitalised at their fair value and depreciation is provided on the basis of the Company 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 liability, 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 a straight-line basis

ii) As Lessor
Amounts receivable under finance leases are included within debtors and represent the total amount outstanding under the 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 investment, is included in turnover

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

1 14 Provisions

Provisions are recognised when the Company has a present obligation as a result of a past event, and it is probable that the Company will be required to settle that obligation Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material

1 15 Related party transactions

The company has taken advantage of the exemption in FRS 8 not to disclose related party transactions with other group companies

2 Segment informatıon

A geographıcal analysıs of turnover ıs as follows

	2012 £000	2011 £000
Unıted Kıngdom	643,500	648,500
Rest of Europe	64,500	142,800
North Amerıca	195,800	189,100
Mıddle East and Asıa	88,500	79,900
Central and South Amerıca	13,700	24,600
Afrıca	33,400	37,500
Australasıa and Pacıfic	3,600	4,000
	1,043,000	1,126,400

An actıvıty analysıs ıs as follows

	Turnover 2012 £000	Turnover 2011 £000	Profit on ordınary actıvıties before finance ıncome 2012 £000	Profit on ordınary actıvıties before finance ıncome 2011 £000	Net assets * 2012 £000	Net assets * 2011 £000
Energy	427,800	537,800	18,800	25,000	45,600	149,300
Marıne	615,200	588,600	60,100	45,500	290,500	174,400
Total	1,043,000	1,126,400	78,900	70,500	336,100	323,700

* Net assets exclude net cash of £113 5m (2011 - £55 2m)

3 Interest receıvable

	2012 £000	2011 £000
Interest receıvable and sımılar ıncome	100	400
Foreıgn exchange gaıns	2,600	3,000
Faır value gaıns on foreıgn currency contracts	1,700	-
	4,400	3,400

4. Interest payable

	2012 £000	2011 £000
Faır value losses on foreıgn exchange contracts	-	1,400

5 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging

	2012 £000	2011 £000
Amortisation of owned intangible fixed assets	5,300	6,400
Depreciation of owned tangible fixed assets	4,500	4,300
Operating lease rentals		
- other	1,200	1,300
Research and development (net)	32,600	33,300
Auditor's remuneration - fees for the audit of the Company	300	200

Fees paid to the Company's auditor, KPMG Audit plc, and its associates for services other than the statutory audit of the Company are not disclosed in Rolls-Royce Power Engineering plc's accounts since the consolidated accounts of Rolls-Royce Power Engineering plc's ultimate parent, Rolls-Royce Holdings plc, are required to disclose non-audit fees on a consolidated basis

6 Tax on profit on ordinary activities

	2012 £000	2011 £000
Current tax (see note below)		
UK corporation tax charge on profit for the year	14,200	8,800
Overseas tax	600	100
Total current tax	14,800	8,900
Deferred tax - origination and reversal of timing differences		
In respect of year	(800)	400
In respect of prior periods	300	100
In respect of change in tax rate	(100)	-
Total deferred tax (see note 17)	(600)	500
Tax on profit on ordinary activities	14,200	9,400

6 Tax on profit on ordinary activities (continued)

Factors affecting tax charge for the year

The tax assessed for the year is lower than (2011 - lower than) the standard rate of corporation tax in the UK of 24 5% (2011 - 26 5%) The differences are explained below

	2012 £000	2011 £000
Profit on ordinary activities before tax	82,600	72,500
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 24 5% (2011 - 26 5%)	20,200	19,200
Effects of		
Expenses not deductible for tax purposes	700	200
Depreciation in excess of capital allowances	600	300
Other timing differences for the period	200	(700)
Income not taxable	(1,900)	(400)
Research and development tax credit	(5,000)	(9,700)
Current tax charge for period (see note above)	14,800	8,900

Factors that may affect future tax charges

The 2013 Budget announced that the UK corporation tax rate will reduce to 20 per cent by 2015 The reductions to 24 per cent effective from April 1, 2012 and 23 per cent effective from April 1, 2013 were substantively enacted on March 26, 2012 and July 3, 2012 respectively As the rate change to 23 per cent was substantively enacted prior to the year end, the closing deferred tax asset has been restated accordingly and the credit has been recognised in the P&L Had the further tax rate changes been substantively enacted on or before the balance sheet date it would have had the effect of reducing the closing deferred tax asset as at 31 December 2012 by £54,000

Rolls-Royce Power Engineering plc

Notes to the financial statements
for the year ended 31 December 2012

7 Share-based payments

Share-based payment plans in operation during the year

During the year, the company participated in the following share-based payment plans operated by Rolls-Royce Holdings plc

Performance Share Plan (PSP)

This plan involves the award of shares to participants subject to performance conditions Vesting of the performance shares is based on the achievement of both non-market based conditions (EPS and cash flow per share) and a market based performance condition (Total Shareholder Return - TSR) over a three-year period

ShareSave share option plan (ShareSave)

Based on a three or five year monthly savings contract, eligible employees are granted share options with an exercise price of up to 20 per cent below the share price when the contract is entered into Vesting of the options is not subject to the achievement of a performance target The plan is HM Revenue & Customs approved

Annual Performance Related Award (APRA) plan deferred shares

A proportion of the APRA annual incentive scheme is delivered in the form of a deferred share award The release of deferred share awards is not dependent on the achievement of any further performance conditions other than that participants remain employed by the group for two years from the date of the award in order to retain the full number of shares During the two year deferral period, participants are entitled to receive dividends, or equivalent, on the deferred shares

Movements in the Company's share-based payment plans during the year

	ShareSave Number Thousands	ShareSave Weighted average exercise price Pence	PSP Number Thousands	APRA Number Thousands
Outstanding at 1 January 2011	2,866	377	1,158	220
Granted	887	525	77	116
Additional entitlements arising from TSR performance	-	-	417	-
Forfeited	(84)	384	-	-
Exercised	(1,042)	341	(751)	(146)
Outstanding at 31 December 2011	2,627	441	901	190
Granted	-	-	63	159
Additional entitlements arising from TSR performance	-	-	907	-
Forfeited	(35)	450	-	-
Exercised	(7)	409	(1,633)	(74)
Outstanding at 31 December 2012	2,585	441	238	275

As share options are exercised throughout the year, the weighted average share price during the year of 836p (2011 - 642p) is representative of the weighted average share price at the date of exercise

Share options outstanding

	ShareSave Number Thousands	ShareSave Weighted average remaining contractual life Years
At 31 December 2011		
300p - 399p	1,038	2 4
400p - 499p	703	1 1
500p - 599p	886	4 4
	2,627	2 7
At 31 December 2012		
300p - 399p	1,021	1 4
400p - 499p	694	0 1
500p - 599p	870	3 4
	2,585	1 7

The range of exercise prices of options outstanding at December 31, 2012 was between 387p and 525p (2011 - 387p and 525p)

Fair values of share-based payment plans

The weighted average fair values per share of equity-settled share-based payment plans granted during the year, estimated at the date of grant are as follows

	2012 (pence)	2011 (pence)
PSP - 25% TSR uplift	885	662
PSP - 50% TSR uplift	985	737
ShareSave - 3 year grant	n/a	210
ShareSave - 5 year grant	n/a	238
APRA	809	612

In estimating these fair values, the following assumptions were used

	PSP 2012	PSP 2011	ShareSave 2011
Weighted average share price	809p	612p	691p
Exercise price	n/a	n/a	525p
Expected dividends	16 5p	15 4p	16 0p
Expected volatility	31%	32%	30%
Correlation	39%	36%	n/a
Expected life - PSP	3 years	3 years	n/a
Expected life - 3 year ShareSave	n/a	n/a	3 3 - 3 8 years
Expected life - 5 year ShareSave	n/a	n/a	5 3 -5 8 years
Risk free interest rate	0 6%	1 9%	1 9%

Expected volatility is based on the historical volatility of Rolls-Royce Holdings plc's share price over the seven years prior to the grant or award date Expected dividends are based on Rolls-Royce Holdings plc's payments to shareholders in respect of the previous year

PSP

The fair value of shares awarded under the PSP is calculated using a pricing model that takes account of the non-entitlement to dividends (or equivalent) during the vesting period and the market-based performance condition, based on expectations about volatility and the correlation of share price returns in the group of FTSE 100 companies, which incorporates into the valuation the interdependency between share price performance and TSR vesting This adjustment increases the fair value of the award relative to the share price at the date of grant

ShareSave

The fair value of the options granted under the ShareSave plan is calculated using a binomial pricing model that assumes that participants will exercise their options at the beginning of the six month window if the share price is greater than the exercise price Otherwise it assumes that options are held until the expiration of their contractual term This results in an expected life that falls somewhere between the start and end of the exercise window

APRA

The fair value of shares awarded under APRA is calculated as the share price on the date of the award, excluding expected dividends

8 Staff costs and directors remuneration

Staff costs were as follows

	2012 £000	2011 £000
Wages and salaries	139,000	121,000
Social security costs	13,600	11,900
Pensions and other post-retirement benefits	15,600	14,100
Share-based payments	2,900	2,700
	171,100	149,700

The average monthly number of employees, including the directors, during the year was as follows

	2012 No	2011 No
Energy	326	315
Marine	2,354	2,193
	2,680	2,508

No remuneration has been received by the directors in respect of their services to the Company (2011 £Nil)

9 Intangible fixed assets

	Development expenditure £000	Other £000	Total £000
Cost			
At 1 January 2012	60,000	5,500	65,500
Additions	-	200	200
At 31 December 2012	60,000	5,700	65,700
Accumulated amortisation			
At 1 January 2012	12,000	2,700	14,700
Charge for the year	4,000	1,300	5,300
At 31 December 2012	16,000	4,000	20,000
Net book value			
At 31 December 2012	44,000	1,700	45,700
At 31 December 2011	48,000	2,800	50,800

Other intangibles relate to licence fees and are amortised over 10 years

Rolls-Royce Power Engineering plc

Notes to the financial statements
for the year ended 31 December 2012

10 Tangible fixed assets

	Land and buildings Freehold £000	S/Term Leasehold Property £000	Plant & machinery £000	Assets in course of construction £000	Total £000
Cost					
At 1 January 2012	12,600	-	57,300	4,400	74,300
Additions	-	200	700	7,400	8,300
Transfers intra group	-	-	100	-	100
Disposals	-	-	(500)	-	(500)
Transfers	500	700	1,200	(2,400)	-
At 31 December 2012	13,100	900	58,800	9,400	82,200
Depreciation					
At 1 January 2012	6,200	-	42,900	-	49,100
Charge for the year	300	-	4,200	-	4,500
Transfers intra group	-	-	100	-	100
Disposals	-	-	(500)	-	(500)
At 31 December 2012	6,500	-	46,700	-	53,200
Net book value					
At 31 December 2012	6,600	900	12,100	9,400	29,000
At 31 December 2011	6,400	-	14,400	4,400	25,200

The net book value of land, which is not being depreciated, is £0 8m (2011 - £0 8m)

11 Fixed asset investments

	Subsidiary undertakings £000	Joint ventures £000	Unlisted investments £000	Total £000
Cost or valuation				
At 1 January 2012	141,500	100	700	142,300
Disposals	-	-	(700)	(700)
At 31 December 2012	141,500	100	-	141,600
Impairment				
At 1 January 2012 and 31 December 2012	-	100	-	100
Net book value				
At 31 December 2012	141,500	-	-	141,500
At 31 December 2011	141,500	-	700	142,200

Notes to the financial statements
for the year ended 31 December 2012

11 Fixed asset investments (continued)

Subsidiary undertakings

The following were subsidiary undertakings of the Company

Name	Holding
Allen Power Engineering Limited *	100%
Michell Bearings **	100%
Rolls-Royce Industrial Power (India) Limited ***	100%
Rolls-Royce Industrial Power (Overseas Projects) Limited	100%
Rolls-Royce Industrial Power Engineering (Overseas Projects) Limited	100%
Rolls-Royce Marine Electrical Systems Limited	100%

* The principal wholly owned UK subsidiary undertaking trade as an agent of the Company
** Michell Bearings is a trading division of the Company
*** Financial year ends 31st March

Other investments relate to non-listed trade investments

12 Stocks

	2012 £000	2011 £000
Raw materials and consumables	1,000	1,400
Work in progress	10,700	14,000
Finished goods and goods for resale	86,600	74,000
Long term contract balances	6,400	5,400
	104,700	94,800

There is no material difference between the balance sheet value of stocks and their replacement cost

Long term contract balances consist of

	2012 £000	2011 £000
Long term contracts work in progress	4,800	3,600
Payments on account	1,600	1,800
	6,400	5,400

Rolls-Royce Power Engineering plc

Notes to the financial statements
for the year ended 31 December 2012

13 Debtors

	2012 £000	2011 £000
Amounts falling due after more than one year		
Trade debtors	-	500
Amounts owed by group undertakings	1,600	6,100
Other financial assets (note 16)	300	500
Other debtors	12,000	17,600
Deferred tax asset (see note 17)	600	-
	14,500	24,700

	2012 £000	2011 £000
Amounts falling due within one year		
Trade debtors	68,400	74,100
Amounts recoverable on contracts	59,000	40,700
Amounts owed by group undertakings	631,000	588,100
Other financial assets (note 16)	1,100	700
Other debtors	5,200	-
Prepayments and accrued income	3,800	4,400
	768,500	708,000

14 Creditors Amounts falling due within one year

	2012 £000	2011 £000
Bank and other borrowings	1,500	1,200
Payments received on account	126,000	116,400
Trade creditors	45,200	38,900
Amounts owed to group undertakings	212,100	203,000
Other taxation and social security	4,700	4,000
Other financial liabilities (note 16)	600	1,000
Other creditors	48,700	47,000
Accruals and deferred income	114,900	106,200
	553,700	517,700

15 Creditors Amounts falling due after more than one year

	2012 £000	2011 £000
Amounts owed to group undertakings	146,300	146,300
Accruals and deferred income	25,100	-
Other financial liabilities (note 16)	1,200	1,900
Other creditors	8,300	-
	180,900	148,200

Notes to the financial statements
for the year ended 31 December 2012

16 Other financial assets and liabilities

Details of the Company's policies on the use of financial instruments are given on page 11

The fair values of derivative financial instruments held by the Company are as follows

	Foreign exchange contracts £000
At December 31, 2011	
Assets - amounts falling due within one year	700
Assets - amounts falling due after one year	500
Liabilities - amounts falling due within one year	(1,000)
Liabilities - amounts falling due after one year	(1,900)
	(1,700)
At December 31, 2012	
Assets - amounts falling due within one year	1,100
Assets - amounts falling due after one year	300
Liabilities - amounts falling due within one year	(600)
Liabilities - amounts falling due after one year	(1,200)
	(400)

The Company uses various financial instruments to manage its exposure to movements in foreign exchange rates

Movements in the fair value of foreign exchange financial instruments were as follows

	Foreign exchange contracts £000
At January 1, 2011	(3,800)
Contracts settled	(1,300)
Movements in derivatives contracts	3,400
At January 1, 2012	(1,700)
Contracts settled	(1,300)
Movements in derivative contracts	2,600
At December 31, 2012	(400)

17 Deferred tax

	2012 £000	2011 £000
Asset at 1 January	-	500
Charged to profit and loss account	600	(500)
Asset at 31 December	600	-

The deferred taxation balance is made up as follows

	2012 £000	2011 £000
Accelerated capital allowances	2,300	2,800
Other timing differences	(1,000)	(700)
Advance Corporation tax	(1,900)	(2,100)
	(600)	-

18 Provisions for liabilities and charges

	Warranties and guarantees £000	Contract loss £000	Other £000	Total £000
Balance as at 1 January 2012	27,400	27,800	800	56,000
Charged to profit and loss account	3,200	3,000	-	6,200
Utilised in year	(5,400)	(10,000)	-	(15,400)
Released unused	(7,400)	(6,200)	-	(13,600)
Balance at 31 December 2012	17,800	14,600	800	33,200

Warranties and guarantees

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

Contract loss

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

Other

Other provisions comprise numerous liabilities with varying expected utilisation rates

19 Share capital

	2012 £000	2011 £000
Allotted, called up and fully paid		
1,516,398,058 Ordinary shares of £0 25 each	379,100	379,100

20. Reserves

	Share premium account £000	Capital redempt'n reserve £000	Revaluation reserve £000	Profit and loss account £000
At 1 January 2012	24,100	4,000	800	(29,000)
Profit for the financial year	-	-	-	68,400
Share based payments	-	-	-	2,200
At 31 December 2012	24,100	4,000	800	41,600

21 Reconciliation of movement in shareholders' funds

	2012 £000	2011 £000
Opening shareholders' funds	379,000	314,900
Profit for the financial year	68,400	63,100
Share based payments	2,200	1,000
Closing shareholders' funds	449,600	379,000

22 Financial commitments

At 31 December 2012 the Company had annual commitments under non-cancellable operating leases as follows

	Land and buildings		Other	
	2012 £000	2011 £000	2012 £000	2011 £000
Expiry date·				
Within 1 year	-	100	200	200
Between 2 and 5 years	200	-	800	700
After more than 5 years	400	-	-	-
Total	600	100	1,000	900

Leases of land and buildings are typically subject to rent reviews at specified intervals and provide for the lessee to pay all insurance, maintenance and repair costs

23 Pension arrangements

The company is a participating employer of The Rolls-Royce Pension Fund, the Rolls-Royce Group Pension Scheme, the Vickers Group Pension Scheme and the Rolls-Royce Ancillary Benefits Plan, which are multi-employer defined benefit schemes The assets of the schemes are held in separate funds administered by trustees and invested by them independently of the finances of the Group The schemes are funded by annual contributions from the company and scheme members

The employer is unable to identify the share of the underlying assets and liabilities of the schemes and in accordance with FRS17 Retirement Benefits, has accounted for contributions as if the schemes were defined contribution schemes

On this basis, the amount of employer contributions for 2012 was £15 6m (2011 £14 1m)

The FRS 17 disclosure relating to the schemes is given in the group financial statements of Rolls-Royce plc

24 Ultimate Parent Company

The Company is a subsidiary undertaking of Rolls-Royce plc, incorporated in Great Britain

The largest group in which the results of the Company are consolidated is that headed by Rolls-Royce Holdings plc The smallest group in which the results of the Company are consolidated is that headed by Rolls-Royce plc, incorporated in Great Britain

The consolidated accounts of these groups are available to the public and may be obtained from 65 Buckingham Gate, London, SW1E 6AT