

Registered number 3543

Vinters Engineering plc

Annual report and financial statements
for the year ended 31 December 2006

**Directors on
30th July 2007:**

**G Allan
B Baker
D R Bale
J Warren**

Secretary :

D J Goma

TUESDAY



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COMPANIES HOUSE

Registered Office : Moor Lane, Derby DE24 8BJ

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Directors' report

The directors present their annual report on the affairs of the company, together with the financial statements and auditors' report, for the year ended 31 December 2006

Business review

Defence Systems

The company is involved in the production, repair and overhaul of power generation, transmission and conversion equipment for military and commercial markets

2006 was a difficult year, with turnover almost 50% of 2005 levels, at £12.4 million. During 2003, 2004 and 2005 Powerfield was the main sub-contractor on a PFI contract supplying high specification generating equipment to the UK MoD. Known as FEPS (Field Electrical Power Supply), the production of this equipment was completed in 2005. Powerfield now has responsibility for maintaining the fleet of generators through the life of the contract to 2021.

The closure of our Crewe facility was completed in November 2006. This facility was primarily a repair and overhaul facility for military vehicle and marine engines. Unfortunately, the company lost the military vehicle contract, with the final overhauls due by the end of 2006, and it was with regret that the company decided to consolidate its activities to one site at Winsford, Cheshire.

The operating loss of the defence systems business was £0.1 million (2005 Profit £1.0 million).

The company is exposed to risks from a failure of the supply chain and has a business continuity programme to manage the risk of a loss of a significant supplier.

Pensions

During the year a revised benefit structure was agreed with the members of the Vickers Group Pension Scheme. Together with the better than expected return on the scheme assets during the year these factors have resulted in a reduction of the deficit before tax from £26.3 million to a net surplus of £19.3 million as at 31 December 2006. The next funding valuation by the actuary as at 5 April 2007 is currently in progress.

Provisions

The company incurs costs in relation to claims for employer-liability claims following the insolvency of an insurance company. The provision at year-end increased from £20 million to £22.6 million. This provision is based on an actuarial report in respect of the potential liability for claims. There was also an additional specific provision at year-end of £10 million relating to a single claim that has been settled post year-end.

Other

A dividend of £25.9m was received during the year from a subsidiary company, Vinters International Limited.

The company has a number of dormant subsidiary companies and during the year seven of these companies were liquidated.

Financial risk management objectives and policies

The Rolls-Royce Group has an established, structured approach to risk management which is detailed in the consolidated accounts of Rolls-Royce Group plc. The company acts in accordance with this policy.

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. All trading of the defence systems business is also denominated in sterling.

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. The main customer of the business is the UK Ministry of Defence and therefore the overall credit risk to the company is low.

In order to maintain liquidity to ensure that sufficient funds are available for ongoing operations and future developments, the company uses a mixture of long-term and short-term group debt finance.

The company had investments of £370 million (2005 £394 million) at year-end, of which £273 million (2005 £273 million) relates to overseas subsidiary companies whose trading currency is not sterling. The company is

Directors' report

Financial risk management objectives and policies (continued)

therefore exposed to movements in foreign exchange rates, mainly the United States Dollar and the Euro. The company regards its interests in overseas subsidiary companies as long-term investments and any currency risk arising through these companies is actively managed as part of the Rolls-Royce Group risk management strategy.

Dividends

A dividend of £ Nil (2005 £ Nil) was paid during the year.

Directors

The directors, who served throughout the year were as follows:

G Allan
B Baker
D Bale
J Warren

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 the equivalent of 8 days (2005 31 days) comparative purchases outstanding at December 31, 2006 based on the average daily amount invoiced by suppliers during the year.

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.

Disclosure of information to auditors

Each of the persons who is a director at the date of approval of this report confirms that:

(1) so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware, and

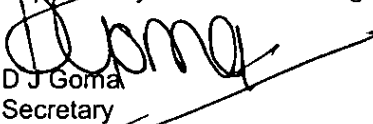
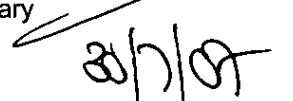
(2) the director has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 234ZA of the Companies Act 1985.

Auditors

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG Audit Plc as auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

Approved by the Board and signed on its behalf by


D J Goma
Secretary


Statement of directors' responsibilities in respect of the directors' report and 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)

The financial statements are required by law to 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, and
- 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 proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities

Independent auditors' report to the members of Vinters Engineering plc

We have audited the financial statements (the "financial statements") of Vinters Engineering plc for the year ended 31 December 2006 which comprise the Profit and Loss Account, the Balance Sheet, the Statement of Total Recognised Gains and Losses, and the related notes. These financial statements have been prepared under the accounting policies set out therein.

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

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the statement of directors' responsibilities on page number 3.

Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

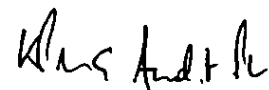
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the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

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

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2006 and of its profit for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements.



KPMG Audit Plc
Chartered Accountants
Registered Auditor
London

31 July 2007

Profit and loss account

For the year ended 31 December 2006

	Notes	2006 £m	Restated* 2005 £m
Turnover	2		
Continuing operations		12 4	24 0
Discontinued operations		-	0 9
		<hr/> 12 4	<hr/> 24 9
Cost of sales	2	(14 1)	(21 8)
Gross (loss)/profit	2	<hr/> (1 7)	<hr/> 3 1
Administrative expenses	2	(21 7)	(2 0)
Operating (loss)/profit		<hr/> (23 4)	<hr/> 1 1
Continuing operations		(23 4)	1 0
Discontinued operations		-	0 1
		<hr/> (23 4)	<hr/> 1 1
Profit on sale of discontinued operations	3	-	0 3
Income from shares in group undertakings		25 9	-
		<hr/> 2 5	<hr/> 1 4
Profit on ordinary activities before finance charges		<hr/> 2 5	<hr/> 1 4
Finance charges (net)	4	5 0	2 5
		<hr/> 7 5	<hr/> 3 9
Profit on ordinary activities before taxation	5	<hr/> 7 5	<hr/> 3 9
Tax on profit on ordinary activities	7	3 6	2 2
		<hr/> 11 1	<hr/> 6 1
Profit on ordinary activities after taxation and profit for the financial year	20	<hr/> 11 1	<hr/> 6 1

*See note 9

Statement of total recognised gains and losses

For the year ended 31 December 2006

	Notes	2006 £m	Restated* 2005 £m
Profit for the financial year		11.1	6.1
Actuarial gains	17	24.9	25.4
Deferred tax on actuarial gains	17	(8.5)	(7.8)
Total recognised gains and losses relating to the year		27.5	23.7
Prior year adjustment (as explained in note 9)		(0.7)	
Total gains and losses recognised since last annual report and financial statements		26.8	

*See note 9

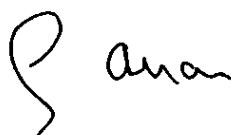
Balance sheet
31 December 2006

	Notes	2006 £m	Restated* 2005 £m
Fixed assets			
Tangible assets	10	5 4	5 5
Investments	11	370 5	393 8
		<u>375 9</u>	<u>399 3</u>
Current assets			
Stocks	12	4 2	6 0
Debtors- due within one year	13	12 5	5 5
Cash at bank and in hand		5 0	4 3
		<u>21 7</u>	<u>15 8</u>
Creditors: Amounts falling due within one year	14	(118 4)	(145 1)
Net current liabilities		<u>(96 7)</u>	<u>(129 3)</u>
Total assets less current liabilities		279 2	270 0
Creditors: Amounts falling due after more than one year	15	(19 1)	(19 1)
Provisions for liabilities and charges	16	(34 0)	(21 6)
Net assets excluding pension asset / (liabilities)		226 1	229 3
Pension asset / (liabilities)	17	12 5	(18 4)
Net assets		<u>238 6</u>	<u>210 9</u>
Capital and reserves			
Called-up share capital	18	171 6	171 6
Share premium account	19	65 1	65 1
Revaluation reserve	19	2 2	2 2
Other reserves	19	8 4	8 4
Profit and loss account	19	(8 7)	(36 4)
Shareholders' funds	20	<u>238 6</u>	<u>210 9</u>

*See note 9

The financial statements on pages 5 to 28 were approved by the board of directors on 30th July 2007 and signed on its behalf by

G Allan
Director



Notes to the financial statements

31 December 2006

1 Significant accounting policies

The principal accounting policies are summarised below

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards, on the historical cost basis except where FRS requires an alternative treatment

The Company is exempt by virtue of section 228 of the Companies Act 1985 from the requirement to prepare group financial statements

As permitted by Financial Reporting Standard 1 "Cash flow statements" (Revised 1996), no cash flow statement has been prepared, as a consolidated cash flow statement has been prepared by the ultimate parent company

The financial statements have been prepared on the going concern basis, notwithstanding net current liabilities of £96.7m, which the directors believe to be appropriate for the following reasons. The company is dependent for its working capital on funds provided to it by Rolls-Royce plc, a parent of the company. Rolls-Royce plc has provided the company with an undertaking that for at least 12 months from the date of approval of these financial statements, it will continue to make available such funds as are needed by the company and in particular will not seek repayment of the amounts currently made available. This should enable the company to continue in operational existence for the foreseeable future by meeting its liabilities as they fall due for payment. As with any company placing reliance on other group entities for financial support, the directors acknowledge that there can be no certainty that this support will continue although, at the date of approval of these financial statements, they have no reason to believe that it will not do so.

Changes in accounting policy

FRS 20 (IFRS 2) Share-based Payment has been adopted for the first time in these financial statements. The effect of the adoption of this standard has increased staff costs in the current year by £0.1m and resulted in a prior period adjustment of £0.1m. Further details regarding the accounting policy are shown below and in note 8.

The company has adopted the amendments to FRS17 Retirement Benefits published in December 2006. The effect of the adoption of this standard is discussed in note 17.

The following new standards relating to financial instruments have been adopted in full in these financial statements:

FRS 23 (IAS 21) The Effects of Changes in Foreign Exchange Rates
FRS 25 (IAS 32) Financial Instruments: Disclosure and Presentation
FRS 26 (IAS 39) Financial Instruments: Measurement

There has been no effect of the adoption of these standards. Further details regarding the specific policies adopted are shown below.

FRS 28 'Corresponding Amounts' has been adopted and corresponding amounts have been shown in the primary financial statements and the notes to the accounts where applicable.

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.

Notes to the financial statements

31 December 2006

1 Significant accounting policies (continued)

Turnover

Turnover consists of amounts invoiced to external customers, net of value added taxes, in respect of deliveries made, or work completed, during the year. In the case of long-term contracts, turnover is based on the estimated sale value of the work completed during the year.

Research and development

Research and development expenditure is written off as incurred.

Pension costs

The Company operates a defined benefit scheme, the assets of which are administered by trustees and are independent of the group's finances. Pensions are accounted for under FRS17 'Post Retirement Benefits'. Obligations are measured at the discounted present value whilst plan assets are recorded at fair value. The service and financing costs are recognised separately in the profit and loss account, service costs are spread systematically over the lives of employees and financing costs are recognised in the periods in which they arise. Actuarial gains and losses are recognised immediately in the statement of total recognised gains and losses.

Share-based payment

The company applied the requirements of FRS 20 (IFRS 2) Share-based Payment from January 1, 2005. In accordance with the transition provisions, FRS 20 has been applied to all grants made after November 7, 2002 that were unvested as of January 1, 2005.

The company issues equity-settled and cash-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value (excluding the effect of non-market based vesting conditions) at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the company's estimate of shares or options that will eventually vest. For cash-settled share-based payments a liability equal to the proportion of the goods or services received is recognised at the current fair value determined at each balance sheet date.

Fair value is measured using the binomial pricing model for the sharesave plans. Fair values of awards made under the Performance Share Plan (PSP) are measured using a pricing model adjusted to reflect non-entitlement to dividends (or equivalent) and the Total Shareholder Return market-based performance condition.

See note 8 for further description of the share-based payment plans.

Financial instruments

FRS 26 requires the classification of financial instruments into separate categories for which the accounting requirement is different. Borrowings have been classified as other liabilities and are held at amortised cost and not revalued.

Interest

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

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.

Notes to the financial statements

31 December 2006

1 Significant accounting policies (continued)

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 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.

Tangible fixed assets

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

Depreciation is provided 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 – five to 45 years (average 23 years)
 - b) Leasehold buildings – lower of advisors' estimates or period of lease
 - c) No depreciation is provided on freehold land
- ii) Plant and equipment – five to 25 years (average 16 years)
- iii) No depreciation is provided on assets in the course of construction

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.

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.

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.

Notes to the financial statements

31 December 2006

2 Segment information

Classes of business

	Defence Systems		Automotive Pressings		Unallocated		Company	
	2006	Restated*	2006	Restated*	2006	Restated*	2006	Restated*
	£	£	£	£	£	£	£	£
Turnover	12 4	24 0	-	0 9	-	-	12 4	24 9
Operating (loss)/profit	(0 1)	1 0	-	0 3	(23 3)	(0 2)	(23 4)	1 1
Other items reported after operating profit	-	-	-	0 3	25 9	-	25 9	0 3
Finance charges (net)							5 0	2 5
Profit on ordinary activities before taxation							7 5	3 9
Segment net assets	13 7	13 8	-	-	224 9	197 1		
Net assets							238 6	210 9

	2006			2005 (Restated*)		
	Continuing operations	Discontinued operations	Total	Continuing operations	Discontinued operations	Total
	£	£	£	£	£	£
Cost of sales	14 1	-	14 1	20 8	1 0	21 8
Gross (loss)/profit	(1 7)	-	(1 7)	3 2	(0 1)	3 1
Other operating expenses/(income) (net)	21 7	-	21 7	2 2	(0 2)	2 0

*See note 9

All turnover by origin/destination was from/to the United Kingdom

Notes to the financial statements

31 December 2006

3 Exceptional items reported after operating profit

	2006 £m	2005 £m
Profit on sale of discontinued operations	-	0.3

The profit on sale in the prior year relates to the disposal of the business and assets of Vickers Pressings Limited

4 Finance charges (net)

	2006 £m	2005 £m
Interest receivable and similar income	-	0.6
Interest payable and similar charges	(1.3)	(1.0)
Net interest receivable / (payable)	(1.3)	(0.4)
Finance charges on post retirement benefits		
Expected return on pension scheme assets	32.1	29.2
Interest on pension scheme liabilities	(25.8)	(26.3)
Net other finance charges	6.3	2.9
Finance charges (net)	5.0	2.5

Notes to the financial statements

31 December 2006

5 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging (crediting)

	2006 £m	2005 £m
Depreciation of tangible fixed assets		
- owned	0.4	0.5
Research and development - current year expenditure	0.5	0.4
Auditors' remuneration – fees for the audit of the company	0.1	0.1
	<hr/>	<hr/>

6 Staff costs and directors remuneration

The average monthly number of employees (including executive directors) was

	2006 Number	2005 Number
Defence aerospace	110	130
	<hr/>	<hr/>

	2006 £m	Restated* 2005 £m
Their aggregate remuneration comprised		
Wages and salaries	3.4	4.1
Social security costs	0.2	0.3
Share based payments	0.1	0.1
Other pension costs (see note 17)	1.9	2.4
	<hr/>	<hr/>
	5.6	6.9
	<hr/>	<hr/>

No remuneration has been received by the directors in respect of their services to the Company (2005 £Nil)

* See note 9

Notes to the financial statements

31 December 2006

7 Tax on profit on ordinary activities

The tax credit comprises

	2006 £m	2005 £m
Current tax		
UK corporation tax – group relief payable	(9 8)	(2 3)
Adjustments in respect of prior years		
- UK corporation tax – group relief payable	-	(3 5)
Total current tax	<u>(9 8)</u>	<u>(5 8)</u>
Deferred tax		
Origination and reversal of timing differences	6 2	3 6
Total deferred tax	<u>6 2</u>	<u>3 6</u>
Total tax on profit on ordinary activities	<u>(3 6)</u>	<u>(2 2)</u>

The differences between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows

	2006 £m	Restated* 2005 £m
Profit on ordinary activities before tax	<u>7 5</u>	<u>3 9</u>
Tax on profit on ordinary activities at standard UK corporation tax rate of 30% (2005 - 30%)	2 2	1 2
Effects of		
Expenses not deductible for tax purposes	1 9	0 1
Income not taxable	(7 8)	-
Capital allowances in excess of depreciation	0 1	-
Other timing differences	(6 2)	(3 6)
Adjustments to tax charge in respect of previous periods	-	(3 5)
Current tax charge for period	<u>(9 8)</u>	<u>(5 8)</u>

* See note 9

Notes to the financial statements

31 December 2006

8 Share based payments

Share-based payment schemes in operation during the period

The Company participated in the following share-based payment schemes of Rolls-Royce Group plc in operation during the year

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)

Sharesave share option scheme

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 scheme is HM Revenue & Customs approved.

Annual Performance Related Award (APRA) plan

Deferred shares awarded as part of the APRA plan. One third of the value of any annual bonus 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 an employee of 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 on the deferred shares.

Share Incentive Plan (SIP)

This is the 'Free Share' element of the Share Incentive Plan. Eligible employees receive shares with a value of up to one week's salary. There are no conditions attached to the shares.

In accordance with the transitional provisions of FRS 20, the Company has recognised an expense in respect of all grants under these plans made after November 7, 2002 and unvested at January 1, 2005.

The Company recognised a total expense of £0.1m in 2006 (£0.1m in 2005).

The movements in awards under the various share schemes is shown in the tables below.

	Number of shares awarded	
	2006	2005
PSP	Thousands	Thousands
Outstanding at January 1	-	-
Awarded during the year	5	-
Forfeited during the year	-	-
Vested during the year	-	-
Outstanding at December 31	5	-

8 Share based payments (continued)

	2006		2005	
	Number of share options Thousands	Weighted average exercise price Pence	Number of share options Thousands	Weighted average exercise price Pence
Sharesave				
Outstanding at January 1	483	158p	434	130p
Granted during the year	-	-	49	298p
Forfeited during the year	-	168p	-	138p
Exercised during the year	(135)	140p	-	140p
Outstanding at December 31	348	153p	483	158p
Exercisable at December 31	11	141p	-	-

	Number of shares awarded	
	2006	2005
	Thousands	Thousands
Deferred shares under APRA		
Outstanding at January 1	-	-
Awarded during the year	1	-
Forfeited during the year	-	-
Vested during the year	-	-
Outstanding at December 31	1	-

	Number of shares awarded	
	2006	2005
	Thousands	Thousands
Free shares under SIP		
Awarded during the year	4	4

Options were exercised on a regular basis during the year. The average share price during the year was 439p (2005 310p)

Fair values

The weighted average fair values for PSP awards, ShareSave grants, APRA deferred share awards, and SIP Free Share awards made during the year are as follows

	2006	2005
	Pence	Pence
PSP	494p	282p
ShareSave - 3 year	-	131p
ShareSave - 5 year	-	154p
APRA deferred share awards	448p	260p
SIP Free Share awards	462p	257p

Details of the assumptions used in the calculation of these fair values are set out below. Expected volatility was based on the historical volatility of Rolls-Royce Group plc's share price over the seven years prior to the grant or award date. Expected dividends were based on payments to shareholders over the five years prior to the grant or award date.

Notes to the financial statements

31 December 2006

8 Share based payments (continued)

PSP awards

The fair value of the shares awarded under the PSP are calculated using the market value of the shares at the time of the award, adjusted to take into account non-entitlement to dividends during the vesting period and the TSR performance condition. The PSP fair values were calculated using the following assumptions

	2006	2005
Weighted average share price	444p	262p
Expected dividends	7.92p	7.81p
Volatility	32%	34%
Correlation	19%	19%
Expected life	3 years	3 years
Risk free interest rate	4.3%	4.9%

The PSP has a TSR market-based performance condition, such that Rolls-Royce Group plc's TSR over the performance period will be compared with the TSR of the companies constituting the FTSE 100 index on the date of grant. If Rolls-Royce Group plc's TSR exceeds the median TSR of the FTSE 100, the number of shares that vest will be increased by 25 per cent. The fair value of an award of shares under the PSP has been adjusted to take into account this market-based performance condition using a pricing model based on expectations about volatility and the correlation of share price returns in the group of FTSE 100 companies and which incorporates into the valuation the interdependency between share price performance and TSR vesting. This adjustment increases the fair value relative to the share price at the date of grant.

ShareSave awards

The fair value of options granted under the ShareSave plan are calculated using a binomial pricing model with the following assumptions (no options were granted in 2006)

	2005
Weighted average share price	351p
Exercise price	298p
Volatility	40%
Expected dividends	7.86p
Expected life ¹ - 3 year ShareSave	3.3-3.8 years
- 5 year ShareSave	5.3-5.8 years
Close periods	
From January 1	6 weeks
From July 1	1 month
Risk free interest rate	4.4%

¹ The binomial pricing model assumes that participants will exercise 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.

Deferred shares under APRA and Free Shares under SIP

The fair value of shares awarded under these plans is calculated as the share price on the date of award.

Notes to the financial statements

31 December 2006

8 Share based payments (continued)

Fair values of options granted in 2003 and 2004

The charge under FRS 20 for the current period includes a charge for options granted under the PSP, APRA and ShareSave plans during the years ended December 31, 2003 and 2004 with the following grant date fair values

	2004	2003
Sharesave - 3 year	-	61p
Sharesave - 5 year	-	71p
APRA	220p	-

These fair values were calculated using the models described above with the following assumptions

	ShareSave
Weighted average share price	173p
Weighted average exercise price	142p
Volatility	43%
Expected dividends	7 61p
Expected life	
- 3 year ShareSave	3 15-3 65 years
- 5 year ShareSave	5 15-5 65 years
Correlation	
Close periods	
From January 1	6 weeks
From July 1	1 month
Risk free interest rate	4 6%

¹ For the ShareSave options, the binomial pricing model assumes that participants will exercise 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.

Notes to the financial statements

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9 Prior year adjustment

The company adopted FRS 20 from 1 January 2006, with comparative figures for 2005 being adjusted. FRS 20 requires a fair value charge to be made in respect of share-based payments. Further details regarding the charges are included in note 8.

The Company has adopted the amendments to FRS 17 published in December 2006. These amendments bring the disclosures into line with International Accounting Standard 19 and change the valuation of scheme assets to a bid price basis (previously valued on a mid-market price basis). The corresponding amounts have been restated accordingly. Further details are included in note 17.

The impact arising from these changes are summarised as follows:

	Year ended 31 December 2005 £m	
Profit and loss account		
Adoption of FRS 20 Share based payment		(0.1)
Adjustment to profit before taxation		(0.1)
Net assets	At 1 January 2005 £m	At 31 December 2005 £m
Adoption of the amendments to FRS 17 Retirement Benefits	(1.3)	(1.3)
Related taxation effect	0.4	0.4
Adoption of FRS20 Share based payment	-	0.2
Adjustment to net assets	(0.9)	(0.7)

Notes to the financial statements
31 December 2006

10 Tangible fixed assets

	Land and buildings		Plant and machinery	Assets under construction	Total
	Freehold	Long leasehold £m	£m	£m	£m
Cost or valuation					
At 1 January 2006	4.5	1.1	3.2	-	8.8
Additions	-	-	0.1	0.2	0.3
At 31 December 2006	<u>4.5</u>	<u>1.1</u>	<u>3.3</u>	<u>0.2</u>	<u>9.1</u>
Depreciation					
At 1 January 2006	0.8	0.6	1.9	-	3.3
Charge for the year	0.1	-	0.3	-	0.4
At 31 December 2006	<u>0.9</u>	<u>0.6</u>	<u>2.2</u>	<u>-</u>	<u>3.7</u>
Net book value					
At 31 December 2006	<u>3.6</u>	<u>0.5</u>	<u>1.1</u>	<u>0.2</u>	<u>5.4</u>
At 31 December 2005	<u>3.7</u>	<u>0.5</u>	<u>1.3</u>	<u>-</u>	<u>5.5</u>

The cost of non-depreciable land included above is £0.3m (2005: £0.3m)

Land and buildings

	2006 £m	2005 £m
Land and buildings at cost or valuation comprise		
Cost	4.1	4.1
Valuation	<u>1.5</u>	<u>1.5</u>
	<u>5.6</u>	<u>5.6</u>

11 Fixed asset investments

	2006 £m	2005 £m
Subsidiary undertakings	<u>370 5</u>	<u>393 8</u>
Subsidiary undertakings		
		£m
Cost		
At 1 January 2006		565 9
Disposals on liquidation		<u>(27 0)</u>
At 31 December 2006		<u>538 9</u>
Provisions for impairment		
At 1 January 2006		(172 1)
Disposals on liquidation		<u>3 7</u>
At 31 December 2006		<u>(168 4)</u>
Net book value		<u>370 5</u>

Principal investments

The company has investments in the following subsidiary undertakings. To avoid a statement of excessive length, details of investments which are not significant have been omitted.

Principal investments

The company has investments in the following subsidiary undertakings

	Country of incorporation or principal business address	Principal activity
Vinters International Limited	UK	Holding Company
Powerfield Specialist Engines Limited	UK	Defence Systems
Powerfield Limited	UK	Defence Systems
Ross Ceramics Limited	UK	Turbine Components
Rolls-Royce AB *	Sweden	Marine
Rolls-Royce OY AB *	Finland	Marine
Rolls-Royce Marine AS *	Norway	Marine
Ulstein Turbine AS *	Norway	Marine

The whole of the share capital of each of the companies shown is held by Vinters Engineering plc or, where indicated by an asterisk, by one of its wholly-owned subsidiary undertakings.

Notes to the financial statements

31 December 2006

12 Stocks

	2006 £m	2005 £m
Raw materials and consumables	3 0	0 6
Work in progress	1 2	5 4
	<u>4 2</u>	<u>6 0</u>

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

13 Debtors

	2006 £m	2005 £m
Amounts falling due within one year		
Trade debtors	2 4	2 6
Amounts owed by group undertakings	9 8	2 9
Prepayments and accrued income	0 3	-
	<u>12 5</u>	<u>5 5</u>

14 Creditors. Amounts falling due within one year

	2006 £m	2005 £m
Bank loans and overdrafts	16 5	25 0
Trade creditors	0 3	1 7
Amounts owed to subsidiary undertakings	100 2	117 4
Amounts owed to group undertakings	0 3	0 2
Other taxation and social security	0 1	-
Other creditors	0 6	0 3
Accruals and deferred income	0 4	0 5
	<u>118 4</u>	<u>145 1</u>

Notes to the financial statements

31 December 2006

15 Creditors Amounts falling due after more than one year

	2006 £m	2005 £m
Amounts owed to subsidiary undertakings	<u>19 1</u>	<u>19 1</u>

16 Provisions for liabilities and charges

	Disposals £m	Deferred Taxation £m	Total £m
At 1 January 2006	20 7	1 1	21 8
Prior year adjustment (see note 9)	-	(0 2)	(0 2)
At 1 January 2006 (as restated)	<u>20 7</u>	<u>0 9</u>	<u>21 6</u>
Charged to profit and loss account	14 0	(0 1)	13 9
Utilised in year	<u>(1 5)</u>	<u>-</u>	<u>(1 5)</u>
At 31 December 2006	<u>33 2</u>	<u>0 8</u>	<u>34 0</u>

The provisions above relate to a number of liabilities which are long term in nature and the timing of their utilisation is uncertain

Deferred tax

Deferred tax is provided as follows

	2006 £m	Restated* 2005 £m
Accelerated capital allowances	1 0	1 1
Other timing differences	<u>(0 2)</u>	<u>(0 2)</u>
	<u>0 8</u>	<u>0 9</u>

The potential liability for taxation, which has not been provided in the amounts shown above because such tax would become payable only if the properties were sold without it being possible to claim rollover relief is

Capital gains on revaluation of properties and rolled-over gains	<u>0 7</u>	<u>0 7</u>
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* See note 9

Notes to the financial statements

31 December 2006

17 Pensions

The Company's pension scheme is a funded defined benefit type and the assets of the scheme are held in a separate trustee administered fund. Employees are entitled to retirement benefits based on their final salaries and length of service.

The valuation of the scheme is based on the most recent funding valuation, updated by the scheme actuary to 31 December 2006. The most recent full funding valuation of the scheme was at 31 March 2004.

In 2006, the Company has adopted the amendments to FRS 17 published in December 2006. These amendments bring the disclosures into line with International Accounting Standard 19 and change the valuation of scheme assets to a bid price basis (previously valued on a mid-market price basis). The corresponding amounts have been restated accordingly. The net result of these amendments is the recognition of additional actuarial losses of £1.3m, which relates to years prior to 2005.

The principal actuarial assumptions were as follows:

	2006 %	2005 %
Rate of increase in salaries	4.4	4.4
Rate of increase in pensions in payment and deferment	2.9	2.6
Discount rate	5.1	4.7
Inflation assumption	2.9	2.9

The mortality assumptions adopted for the pension schemes are derived from the PA92 actuarial tables published by the Institute of Actuaries.

Other demographic assumptions have been set on advice from the Actuary, having regard to the latest trends in scheme experience and other relevant data. The assumptions are reviewed and updated as necessary as part of the periodic actuarial valuation of the schemes.

Actuarial gains of £24.9m (2005: £25.4m) have been reported in the statement of total recognised gains and losses. Cumulative actuarial losses from January 1, 2002 reported in the statement of recognised income and expense are £66.4m (2005: £91.3m).

Amounts recognised in the balance sheet

	2006 £m	Restated* 2005 £m
Present value of funded obligations	(552.5)	(559.9)
Fair value of scheme assets	571.8	533.6
Surplus / (Deficit)	19.3	(26.3)
Related deferred tax (liability) / asset	(6.8)	7.9
Net surplus / (liability)	12.5	(18.4)

Notes to the financial statements

31 December 2006

17 Pensions (continued)

Changes in present value of defined benefit obligations

	2006 £m	2005 £m
At January 1	(559 9)	(512 6)
Current service cost	(4 7)	(4 6)
Finance cost	(25 8)	(26 3)
Contributions	(0 8)	(0 8)
Net benefits paid out	20 1	21 3
Actuarial gain/(loss)	18 6	(36 9)
At December 31	<u>(552 5)</u>	<u>(559 9)</u>

Current service cost and contributions include £2 8m (2005 £2 2m) incurred by other subsidiary companies

Changes in fair value of scheme assets

	2006 £m	Restated* 2005 £m
At January 1 (as previously reported)	534 9	450 2
Adoption of amendments to FRS17	<u>(1 3)</u>	<u>(1 3)</u>
At January 1 (restated)	533 6	448 9
Expected return on assets	32 1	29 2
Contributions by employer	19 1	13 7
Contributions by employees	0 8	0 8
Benefits paid out	(20 1)	(21 3)
Actuarial gain/(loss)	<u>6 3</u>	<u>62 3</u>
At December 31	<u>571 8</u>	<u>533 6</u>
Actual return on plan assets	38 4	91 5

Notes to the financial statements

31 December 2006

17 Pensions (continued)

The fair value of the scheme assets and the expected rates of return at December 31 were as follows

	Expected rate of return %	2006 Market value £m	Expected rate of return %	Restated* 2005 Market value £m
Equities	7.5	349.5	7.1	327.8
Sovereign debt	4.9	154.5	4.5	121.8
Corporate bonds	4.5	92.4	4.1	70.9
Other	5.0	(24.6)	4.3	13.1
		<u>571.8</u>		<u>533.6</u>

The scheme assets do not include any financial instruments of the Vinters Engineering plc group, nor any property occupied by, or other assets used by, the group

The expected rate of return on individual categories of scheme assets are determined by reference to gilt yields. The expectation is that the return from equities and corporate bonds will exceed the return from gilts by 3% per annum and 0.45% per annum respectively. The overall expected rate of return is calculated by weighting the individual returns expected from each asset class in accordance with the actual asset balance in the schemes investment portfolio.

History of plans

The history of the plans for the current and prior years is as follows

	2006 £m	Restated* 2005 £m	Restated* 2004 £m	2003 £m	2002 £m
Present value of defined benefit obligation	(552.5)	(559.9)	(512.6)	(566.7)	(504.8)
Fair value of scheme assets	571.8	533.6	448.9	468.3	410.5
Asset / (Deficit)	<u>19.3</u>	<u>(26.3)</u>	<u>(63.7)</u>	<u>(98.4)</u>	<u>(94.3)</u>
Actuarial gains/(losses) on scheme assets	6.3	62.3	11.5	48.7	(129.8)
Experience losses on scheme liabilities	18.6	(36.9)	22.3	(48.6)	(20.9)
Total amount recognised in the statement of total recognised gains and losses	<u>24.9</u>	<u>25.4</u>	<u>33.8</u>	<u>0.1</u>	<u>(150.7)</u>

The Company has adopted the amendments to FRS 17 published in November 2006. In accordance with the transitional provisions of the amendments to FRS 17, the corresponding amounts for 2002 and 2003 above have not been restated to reflect the change in basis of valuation of scheme assets from mid-market to bid prices.

The Company expects to contribute approximately £19m to its defined benefit scheme in 2007.

*See note 9

Notes to the financial statements

31 December 2006

18 Share capital

	2006 £m	2005 £m
<i>Authorised</i>		
457,000,000 ordinary shares of 50p each	<u>228.5</u>	<u>228.5</u>
<i>Allotted, called-up and fully-paid</i>		
343,297,724 ordinary shares of 50p each	<u>171.6</u>	<u>171.6</u>

19 Reserves

	Revaluation reserve £m	Share premium account £m	Profit and loss account £m	Other reserves £m	Total £m
At 1 January 2006 (as previously stated)	2.2	65.1	(35.7)	8.4	40.0
Prior year adjustment (see note 9)	-	-	(0.7)	-	(0.7)
At 1 January 2006 (as restated)	<u>2.2</u>	<u>65.1</u>	<u>(36.4)</u>	<u>8.4</u>	<u>39.3</u>
Profit for the financial year	-	-	11.1	-	11.1
Other recognised gains and losses relating to the year (net)	-	-	16.4	-	16.4
Share based payments	-	-	0.2	-	0.2
At 31 December 2006	<u>2.2</u>	<u>65.1</u>	<u>(8.7)</u>	<u>8.4</u>	<u>67.0</u>

20 Reconciliation of movements in shareholders' funds

	2006 £m	2005 £m
Opening shareholders' funds as previously stated	211.6	187.8
Prior year adjustment (see note 9)	<u>(0.7)</u>	<u>(0.9)</u>
Opening shareholders' funds as restated	<u>210.9</u>	<u>186.9</u>
Profit for the financial year	11.1	6.1
Other recognised gains and losses relating to the year (net)	16.4	17.6
Share based payments	<u>0.2</u>	<u>0.3</u>
Closing shareholders' funds	<u>238.6</u>	<u>210.9</u>

Notes to the financial statements

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21 Financial commitments

Annual commitments under non-cancellable operating leases are as follows

	2006 Land and buildings £m	2005 Land and buildings £m
Expiry date		
- between two and five years	0.1	-
- after five years	0.7	0.8
	<u>0.8</u>	<u>0.8</u>

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

22 Contingent liabilities

Guarantees and contingencies arising in the ordinary course of business are not expected to result in any material financial loss to the Company

There are lawsuits outstanding against the Company for damages in respect of certain transactions. The directors have been advised that there are good defences in all material actions and do not believe that the Company is likely to suffer any material loss in excess of the amounts provided.

23 Related party transactions

The Company has taken advantage of the exemption in Financial Reporting Standard 8 not to disclose related party transactions with other group companies.

24 Ultimate Parent Company

The Company is a subsidiary undertaking of Rolls-Royce Group plc, incorporated in Great Britain. The largest group in which the results of the Company are consolidated is that headed by Rolls-Royce Group 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.