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Stock Report

ROLLS-ROYCE HOLDING PLC
TICKER: RR



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A REPORT BY AP
CAPITAL RESEARCH
Rolls-Royce

Business model and overview

ROLLS-ROYCE HOLDING PLC

Rolls Royce (RR. L PLC) grew from the electrical and mechanical business established by Henry Royce in 1884. Royce built his first motor car in 1904 and met Charles Rolls, whose company sold quality cars in London in May of that year.

Rolls-Royce is the world's leading supplier of marine propulsion equipment. Its products and services range from complete ship design to integrated propulsion, manoeuvring, positioning systems and deck machinery.

Products and Services:

- **Civil Aerospace, 42% (£5,089m) Total Revenue 2020** – The civil aerospace business is a major manufacturer and service provider of aero engines. Rolls-Royce powers more than 35 commercial aircraft types and has over 13,000 engines in service around the world. Demand for their products remains robust and underpins strong performance.
- **Defences, 28% (£3,366m) Total Revenue 2020** – Rolls-Royce defence engages in the development, manufacture, marketing and sale of helicopters, transporters, trainers, tactical aircraft and unmanned aerial vehicles.
- **Power Systems, 22% (£2,745m) Total Revenue 2020** – Rolls-Royce power systems provide pioneering, integrated propulsion and energy solutions. With 'Net Zero at Power Systems'.
- **Nuclear** – Rolls-Royce has been backed by a consortium of private investors and the UK government to develop small nuclear reactors to generate cleaner energy. The creation of the Rolls-Royce small modular reactor business was announced following a £195 million cash injection from private firms and a £219 million grant from the government.

Rolls-Royce Motor Models:

- **Rolls-Royce Phantom** – Launched in 2003 and was the first Rolls-Royce developed and introduced after BMW purchased the right to use the Rolls-Royce name and logo in 1998.

Priced at over £363,600

- **Rolls-Royce Cullinan** – The Cullinan is the first SUV to be launched by Rolls-Royce. It is the brand's first all-wheel-drive (AWD) vehicle. Named after the Cullinan Diamond, the largest gem-quality rough diamond ever discovered.

Priced from £279,100

- **Rolls-Royce Ghost** – The Ghost is a full-sized luxury car manufactured by Rolls-Royce Motor Cars. The car was first produced in 1906 and made its debut in 2020 for the new Ghost extended.

Priced at £258,800



13,000

Engines in service

65%

of Civil Aerospace Revenue
attributed to Large Engine
sales

3,756

Approximate deliveries in 2020
from Rolls-Royce Motors

Management Team + Social Media

ROLLS-ROYCE HOLDING PLC



Warren East CBE: Chief executive officer

Warren East earned a bachelor's degree in engineering science from Wadham College, Oxford. He then went on to earn a Master of Business Administration (MBA) degree from Cranfield School of Management at Cranfield University. In 2014 East became a non-executive director of Rolls-Royce Holdings and chair of the board's technology committee.



Panos Kakoullis: Chief Financial Officer

Panos Kakoullis has over 30 years of industry experience with Deloitte, where he most recently served as Managing Director in the firm's global audit and assurance business. Rolls-Royce named Panos Kakoullis as its new chief financial officer to implement a cost-cutting and simplification programme to cope with the strains of Covid-19.

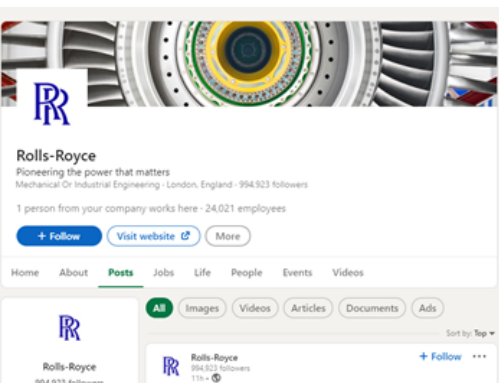


Tom Bell: President - Defence; Chairman & CEO - Rolls-Royce North America

Tom Bell used to be senior vice president of global sales and marketing for defence, space and security at the Boeing company. Before joining Boeing in 2015, Tom was president of Rolls-Royce defence aerospace, having joined as president, customer business, North America in mid-2012. Now Bell serves as President – Defence and President and Chief Executive Officer of Rolls-Royce North America of the Company.

Social Media

Rolls Royce uses its social media platform. For instance, they use LinkedIn to keep followers informed and updated on implementing new things to help encourage a carbon-neutral future. Unlike other aero-engine manufacturing businesses, Rolls Royce keeps their followers up to date on their actions to reach their target.



147K

INSTAGRAM
FOLLOWERS

17.7K

TWITTER
FOLLOWERS

994K

LINKEDIN
FOLLOWERS

Financials + Institutions

ROLLS-ROYCE HOLDING PLC

Revenue steadily increased over the past five years until the pandemic hit, which fell 29% year-over-year in 2020. This drop in revenue was caused by the commercial aviation industry ceasing flights due to travel bans imposed from the lockdown. This pandemic affected Rolls-Royce's civil aerospace revenue, which account's for 42% of total revenue. These include the sale of their Trent engine range and the maintenance of these engines to its customers. Gross profit has steadily declined over the past five years from 24% to -2%. Competition is affecting Rolls-Royce's margin as they continually invest in R&D to gain a competitive edge. As operating expenses continue to increase, its net income continues to fall, widening its loss. This impacts the company's retained earnings as continual net losses will require the company to use its retained earnings to finance its operations. Since they have now accumulated debt on their balance sheet, this can be a concern to investors because they would have to issue more shares, issue more corporate debt or reduce investment into working capital to finance their operations. Rolls-Royce is a highly leveraged company with a D/E ratio peaking at 31.28 in 2018. Also, we notice the rise in short term debt, which has been growing 19% on average over the past five years. This leveraged position is not benefiting them due to declining gross profit and declining net income, while revenue grows on average 3.8% annually, excluding 2020.

Rolls-Royce's ran into financial issues in 2020 because they burned through £4.2bn in cash to fund their general operation. They had to raise £2bn in equity and £5.3bn in debt to increase their liquidity and strengthen their balance sheet to survive the issues faced by the pandemic.

Overall, the company needs to strengthen their balance sheet as they are accumulating a lot of short term debt over the years. However, their margins do not justify Rolls-Royce benefiting from being highly leveraged. This is shown by the accumulated deficit and a widening of their net income. If the company doesn't fix their costs structure in the short term, the company could exhibit financial stress. That is if the travel industry continues to be hindered.

(£m)	2020	2019	2018	2017	2016	2015
Revenue	11,824	16,587	15,729	16,307	14,955	13,725
COGS	12,034	15,645	14,531	13,134	11,907	10,459
Gross Profit/Loss	-210	942	1,198	3,173	3,048	3,266
SGA	808	1,128	1,595	1,222	2,208	1,059
Operating Income	-2,081	-852	-1,161	1,287	44	1,499
Net income	-3,169	-713	-2,393	4,208	-4,032	84
Retained Earnings/Deficit	-8,825	-5,191	-2,991	-343	445	4,457
Cash and Cash Equivalents	3,452	4,443	4,974	2,953	2,771	3,176
Borrowings and lease liabilities Long term	1,272	775	858	82	172	419
Borrowings and lease liabilities Short term	6,058	4,910	3,804	3,406	3,185	2,883

Financial Ratios	2020	2019	2018	2017	2016	2015
Gross Profit Margin	-2%	6%	8%	19%	20%	24%
SGA/Gross Profit	-385%	120%	133%	39%	72%	32%
Operating Margin	-18%	-5%	-7%	8%	0%	11%
Revenue YoY	-29%	5%	-4%	9%	9%	0%
Net Profit Margin	-27%	-4%	-15%	26%	-27%	1%
Debt/Equity	7.05	10.62	31.28	3.86	12.70	3.45
Current Ratio	1.05	1.07	1.08	1.34	1.35	1.48

Top 5 Institutional Holders

Shareholder	Holding Shares
American Funds Growth Fund of America	290,108,238
American Funds Investment Company of America	225,937,640
American Funds EuroPacific Growth Fund	203,695,191
Causeway International Value Fund	152,337,239
Fidelity Funds SICAV - Global Technology Fund	135,470,974

-£0.53

2020 EPS

4.39

P/E ratio TTM

40.4

EV/EBITDA

Competitors

ROLLS-ROYCE HOLDING PLC

BAE SYSTEMS

BAE Systems Plc £17.80bn market cap Revenue: £19.3bn

BAE Systems manufactures components for the defence sector for aircraft, marine ships and land vehicles. They also develop systems to enhance the capabilities of the military. The services they provide are Cyber Security, Intelligent Autonomous Systems and Digital and Data analysis. The UK provides 45% of their sales, with the Ministry of Defence providing 20% of the business. Comparable to Roll-Royce, which serves 5.4%.



GE Digital

GE: Market cap: \$112.26B

GE Digital is a subsidiary of the American conglomerate corporation General Electric, providing software services to industrial companies. GE serves various large companies. An example of their competitive advantages is their Proficy Manufacturing Execution Systems, which helps to achieve improved efficiency on manufacturing operations. Qantas Airlines have partnered with GE to develop a flight analytical tool called Flightpulse. Pilots use this tool to analyse flight data to provide them with the optimal route that helps to reduce the amount of fuel they burn.

MEGGITT

Meggitt Plc: Revenue: £1,684m, Market Cap: £5.82B

Meggitt, an engineering group, designs and manufactures components and sub-systems for the three core sectors they operate in: Aerospace, Defence and Global Energy. They provide braking systems for commercial, business and defence aircraft, engine composite components, and maintenance to their customers. Civil Aerospace accounts for 43% of Meggitt's revenue, Defence accounts for 46% of revenue, and Global Energy accounts for 11%.

£486M

Meggitt: Paid to shareholders in dividends over the past five years

5.4%

Rolls-Royce: Business supplied to the Ministry of Defence

£11.5BN

Rolls-Royce Market Cap

SWOT Analysis

ROLLS-ROYCE HOLDING PLC

Strengths

- One of the top strengths of Rolls-Royce is its brand perception. Over the years, they have produced a strong brand image in terms of engineering, quality, and design. In terms of design, Rolls-Royce cars have perfected the art of luxury design for interiors and the exterior, chassis, and engine. The elegant and supreme brand has a niche target audience owned mainly by the elite of society.
- Another strength of the company is their business structure. Its business operation has been dissected into five main categories: Civil Aerospace, Defence Aerospace, Power System, and Marine and Nuclear. With these divisions, it helps improve the company's financial performance to meet customers' needs better. Approximately half of Rolls-Royce's revenue is derived from the civil aerospace division.

Weaknesses

- The UK's Serious Fraud Office (SFO) questioned the moral conduct of Rolls-Royce after being involved in a bribery scandal. The company was said to have bribed authorities to win contracts, which led to them paying £671 million to settle corruption cases with UK and US authorities.
- Rolls-Royce has a high negative debt-equity ratio meaning the company is highly leveraged and is investing in risky projects. This demonstrates that the company has a weak risk management system; therefore, it will be harder to finance more projects.

Opportunities

- Rolls-Royce has the opportunity to manage risks better. Throughout the years, the company has bought and formed partnerships with many others, for example, Allison Engine, Vickers Plc, North Engineering Industries etc. Rolls-Royce needs to develop good alliances, acquire joint ventures, form partnerships, and mitigate risky unprofitable projects under their current high debt-equity ratio.
- The technology advancements in the automobile industry are increasing, for example, self-driven cars. Other companies are also introducing New-age technologies like machine learning and data connectivity; therefore, this creates an opportunity for the luxury cars produced by Rolls Royce.

Threats

- Brexit has posed several issues for the company regarding redundancies, taxes, supply chain, etc., thus also impacting the country's economy. As a result of these restrictions imposed, the growing costs of raw materials and fuel add to the company's overall increased costs.
- The world is now shifting to more sustainable transportation options such as electric vehicles, hybrids, and fuel cell-powered hydrogen cars. With the pandemic's effects on Rolls-Royce's balance sheet, they may struggle to finance their R&D into sustainable technology.

£448M

Operating Profit from
Defence segment

£4.2BN

Cash outflow due to the drop in activity
from their Civil Aerospace division

2050

Achieve Net Zero
Carbon emissions

Technical Analysis

ROLLS-ROYCE HOLDING PLC



Rolls-Royce pre-Covid was trading at 240p. Following the announcement of a lockdown in the UK, the share price collapsed 61% to a low of 85p. The pandemic affected all global markets, with the aviation industry suffering the most because of a halt in travel. The stock found its support around 87p and started ranging between 87p and 135p before collapsing to a 17-year low of 39p. Following this, the stock rebounded 258% over the next two months, testing the 135p level. This rally in price was due to prospects of a vaccine, immense buying volume which followed and some optimism regarding Rolls-Royce financing plan, pushing the stock higher to test the key resistance level, 135p.

From a YTD perspective, Rolls-Royce share price has been consolidating into a wedge for the majority of this year. Since hitting a key resistance level of 135p on 03.12.20, the stock has been bearish, creating a series of lower highs and lower lows. Following the bullish rally at the second half of 2020, the price has created a bullish flag that broke out in 20.09.21 after announcing that Rolls-Royce North America has signed a new contract with the US Air Forces to supply parts for its B-52 bomber jets. Other reasons for a strong rally is the optimism around easing travel restrictions as the UK moved more countries to its amber list and the sale of ITP Aero for £1.3bn to Bain Capital private equity group.

The stock seemed to be retesting the broken resistance; however, with the fears of the Omicron variant emerging, the price fell back into its range, signifying a false breakout. Until concerns about the new variant subside and potential strengthening of Rolls-Royce's balance sheet, could we see the price break above 135p again and rally to 175p to fill in the inefficient gap.

86.59

52-Week Low

137.19

50-day Moving
Average

8.2B

Public Float

Final Thoughts

ROLLS-ROYCE HOLDING PLC

Aarti Patel

Rolls-Royce is a well-established automobile company. Rolls-Royce managed to cut costs and deal with the situation very well despite the pressure that the COVID-19 pandemic had placed on the company. I believe this is the best time to invest in the stock since Rolls Royce has the potential to come out of this pandemic in a good position, according to their balance sheet. The current share price of Rolls Royce is 143.28p. I recommend this as a Moderate Buy with a 1-year median price target of 120.00, a high estimate of 162.00 and a low estimate of 52.00.

Tiffany Omenyi

Rolls-Royce is an established company known to many UK investors. The company has now secured backing from private investors and the UK government to develop small nuclear reactors to help generate cleaner energy. This news, coupled with the impression that Rolls Royce is gaining from the pandemic recovery, could convince investors that this is a good moment to invest in the company with the potential new stream of income. To conclude, I believe that this is a good time to invest in this firm and with the current share price of Rolls-Royce being 143.28p. I would also recommend this as a Moderate Buy stock with a 1-year median price target of 120.00, having a high estimate of 162.00 and a low estimate of 52.00.

Avish Patel

Rolls-Royce has had a rough patch with the air travel restrictions over the past year, as they generate revenue servicing when their engines are flying. The company had to source £7.3bn after burning through £4.2bn, announce 9,000 job cuts and sell some of their assets to remain afloat. Despite this mishap, the prospects envisioned by the CEO looks promising as they look to innovate new technologies to reach their goal of 'Net Carbon Zero by 2020'. For example, the 'Spirit of Innovation' recently broke a speed over 300mph as the first all-electric plane.

Rolls-Royce's majority of revenue comes from the civil aerospace division. Once air travel restrictions ease and the fear of Covid subsides, Roll-Royce will be able to rebound from its pandemic lows. Providing that the company focuses on fixing their capital expenditure and operations, they will recover back to being a profitable company. Overall, I would recommend this stock as a HOLD based on the company's current financial position. My 1-year median price target is 125p, a high estimate of 175p, and a low estimate of 90p.



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ROLLS-ROYCE HOLDING PLC

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