

Rolls-Royce Holdings plc

LSE: RR. · RR.L

An excellent business at a demanding price — and the question the market is really answering: what return should an investor accept for a long-duration aerospace aftermarket annuity?

REFERENCE PRICE

NBS CENTRAL FAIR VALUE

VALUATION CLASSIFICATION

CONFIDENCE

1,567.04p**c. 1,050p****MODESTLY OVERVALUED****LOW-TO-MODERATE**

An excellent business at a demanding price

Rolls-Royce has been genuinely transformed. Our work finds the Civil Aerospace margin expansion is predominantly structural rather than an accounting artefact, and we broadly accept the operational earnings story. Our disagreement with the market is narrower and more specific: cash conversion, and the return an investor should require.

REFERENCE PRICE	NBS CENTRAL FAIR VALUE	IMPLIED DOWNSIDE	CLASSIFICATION
1,567p 13 Aug 2026 · £130.5bn	c.1,050p triangulated judgement	-33% to central fair value	MODESTLY OVERVALUED confidence: low-to-moderate

BEAR	BASE DCF	NBS CENTRAL	PEER-MULTIPLE REF.	BULL
461p	690p	c.1,050p	1,410p	1,443p

690p is the output of our principal CAPM-based DCF scenario. c.1,050p is our central valuation judgement after triangulating that DCF against alternative required-return assumptions, peer valuation evidence and the observable sector-wide valuation premium. The two are different objects and are kept distinct throughout this report. See p.9.

THESIS

The operational story is real. Group operating margin on the three core divisions has gone from -16.9% in 2020 to 18.3% in FY2025; shareholders' equity has gone from £6.0bn negative at the 2022 trough to £2.8bn positive. We forecast operating profit slightly *above* management's own 2028 target.

What we cannot independently justify is the combination the share price requires: consensus-like cash conversion, a required return near 7.5%, a two-decade growth runway, and a favourable SMR outcome — all at once.

VARIANT PERCEPTION

We are within 1% of consensus on FY2028 revenue and within 1.3% on operating profit, but **16% below on free cash flow** (£4.47bn vs £5.31bn). The entire gap is the assumed rebuild in Civil Aerospace LTSA balance growth. That is a specific, observable and falsifiable disagreement rather than a general scepticism.

WHAT THE MARKET IS PRICING

Our reverse DCF implies a required return of roughly 6.1% on our own cash-flow path. That is not evidence 6.1% is correct — it is a measure of how much duration the market is willing to pay for.

Reaching today's price on our forecasts needs four favourable conditions to hold together: consensus cash conversion, a required return near 7.5%, a growth runway extending to 2045, and the high case for SMR. Any three of the four still leave the shares 12–20% overvalued.

WHY CONFIDENCE IS ONLY LOW-TO-MODERATE

The same discount rate applied to GE Aerospace and Safran would declare much of the high-quality aerospace aftermarket sector 40–60% overvalued. Rolls-Royce is not an outlier within its peer group, and we treat that as a reason for humility about our discount rate rather than confidence about the market's error.

KEY CATALYST

The FY2026 results disclosure of **H2 LTSA balance growth**. H1 2026 delivered £86m against £472m a year earlier, while management's mid-term plan assumes £0.8–1.2bn a year. This single line is the highest-information disclosure in the investment case.

WHAT WOULD CHANGE OUR MIND

Toward positive: H2 2026 LTSA balance growth above c.£400m; credible evidence that the appropriate required return for this asset is 8% or below; Civil core margin reaching 22%+ with contractual improvements already at nil.

Toward negative: shop visits tracking flying hours rather than falling; LTSA balance growth turning negative; Defence margin reverting to 15%.

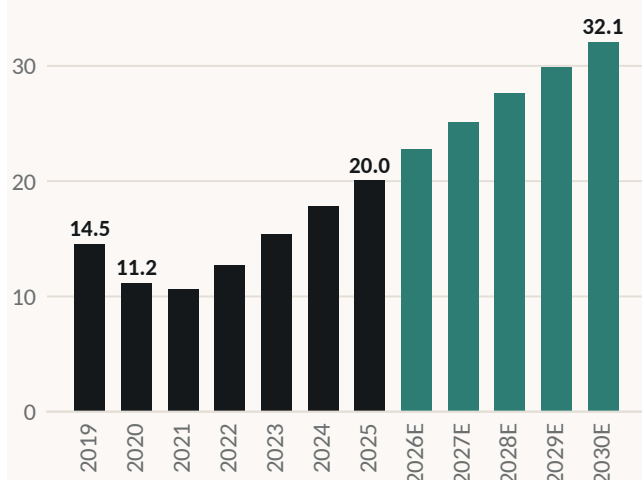
HOW WE GOT HERE

Three of our own hypotheses were tested and abandoned: that recent free cash flow was materially inflated by working capital; that the valuation gap was principally about forecast duration; and that Civil margins were materially accounting-inflated. Only the cash-conversion disagreement survived the evidence. That evolution is documented rather than hidden.

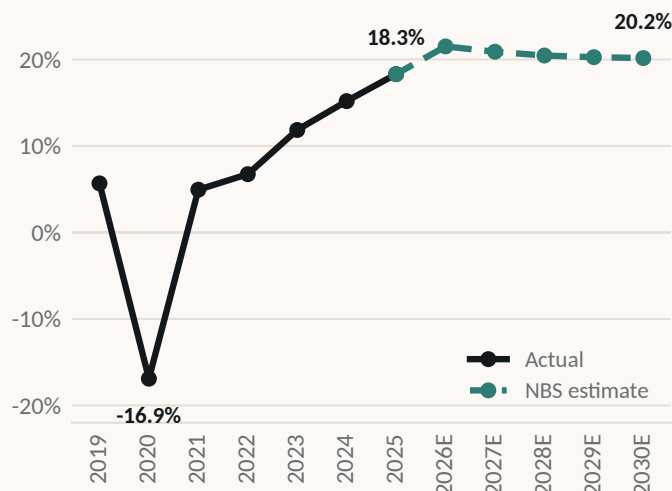
Why historical Rolls-Royce is a poor guide to the business today

Three things changed at once, and each matters for how the company should be valued. Profitability moved from structurally thin to genuinely high. The balance sheet moved from deeply distressed to net cash. And the earnings mix shifted decisively toward a long-duration aftermarket annuity, where cash is collected on flying hours from the moment an engine enters service and the cost of servicing it arrives years later.

Revenue, three core divisions (£bn)



Operating margin, three core divisions



Source: Rolls-Royce FY2019–FY2025 results (underlying basis); LSEG segment data; NBS estimates FY2026E–FY2030E. Chart shows the sum of Civil Aerospace, Defence and Power Systems on a consistent divisional basis; it therefore excludes corporate costs and other businesses and is not directly comparable with group underlying figures.

The financial repair is complete

£M UNLESS STATED	FY2019	FY2024	FY2025
Group underlying operating profit	n/a	2,464	3,462
Group underlying operating margin	n/a	13.8%	17.3%
Free cash flow	n/a	2,425	3,270
Net cash / (debt)	(1,258)	475	1,895
Total shareholders' equity	(3,354)	(881)	2,786
Civil Aerospace operating margin	0.5%	16.6%	20.5%

Source: Rolls-Royce results; LSEG (FY2019 balance-sheet items). FY2019 net debt is an NBS calculation — LSEG cash and short-term investments less borrowings including lease liabilities — and is not on Rolls-Royce's current net cash definition. Group underlying figures are not disclosed on today's segmental basis for FY2019.

The economics that now matter

Civil Aerospace is best understood as an installed-base annuity with a thin-margin hardware channel attached. Long-term service agreements bill per engine flying hour; revenue is recognised as servicing costs are incurred. A growing, young fleet therefore generates a structural cash tailwind that decays as the fleet matures.

At 31 December 2025 the net Civil Aerospace LTSA position was a **£10.4bn contract liability** — £11,370m of contract liabilities against £973m of contract assets. That is cash already collected against servicing yet to be performed, and it is the single most important balance in the company.

Two consequences follow. Reported free cash flow is not a clean read on earned economics while the fleet is growing — the question we take up on p.6. And the appropriate required return for such a long-duration stream becomes the central valuation question, which we take up on p.9.

Is the margin real? Mostly, yes

We began this work suspecting that Civil Aerospace margins were flattered by accounting. Rolls-Royce recognises "contractual margin improvements" — revisions to the expected lifetime profitability of long-term service agreements — and in FY2025 these were large. The question was whether the improvement was economic or presentational.

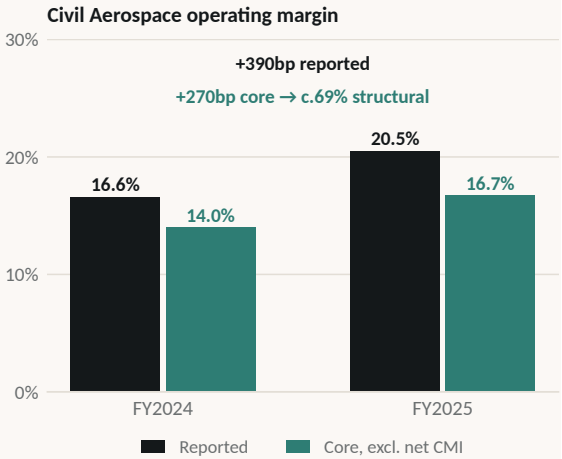
Reported Civil Aerospace margin rose from 16.6% to 20.5%, an increase of 390 basis points. Strip out *all* net contractual margin improvements and the core margin still rose from 14.0% to 16.7% — 270 basis points.

Approximately 69% of the margin expansion is therefore not attributable to contractual margin improvements at all. That is the central finding of this section, and it materially weakened our initial concern.

THE CONTRIBUTION IS FINITE AND VISIBLY DECAYING

£M	FY2024	FY2025	CHANGE
Gross contractual margin improvements	617	553	−10%
Supply-chain and other charges	(382)	(161)	—
Net contractual margin improvements	235	392	+67%
of which contract catch-ups	290	226	−22%
of which onerous provision movement	(55)	166	to release
Total provisions balance	1,994	1,557	−22%
Net CMI as % of Civil operating profit	15.6%	18.4%	—

Source: Rolls-Royce FY2025 results, Civil Aerospace divisional review; NBS calculations for percentages and the core-margin derivation.



Source: Rolls-Royce FY2024 and FY2025 results; core margin is an NBS calculation excluding net contractual margin improvements.

ACCOUNTING TIMING VS ECONOMIC RUN-RATE

A catch-up recognises a change in *lifetime* contract profitability in a single period. The catch-up does not repeat. The improved margin on the renegotiated contract does. So the catch-up line should decay toward nil while the underlying margin steps up — which is exactly how we model it.

WHY WE ULTIMATELY ACCEPT 21–23% AS BROADLY SUSTAINABLE

Every series points to a finite clean-up that is running down: gross improvements are falling, catch-ups are falling, the provisions balance has shrunk by more than a fifth, and the onerous-contract line has flipped from charge to release — the signature of a release phase nearing its end.

But the renegotiated contracts stay renegotiated. Management attributes the improvement to onerous-contract repricing *and* to time-on-wing milestones on the Trent XWB-84, and the second of those is durable economics arriving through the accounting rather than an artefact of it.

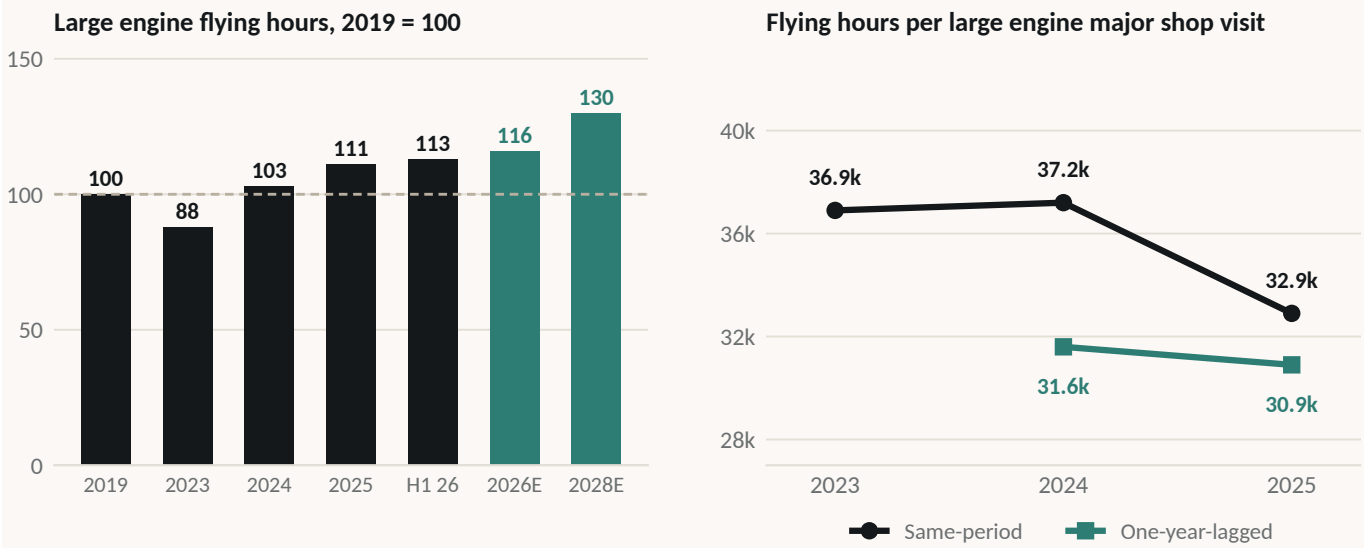
OUR MODELLING TREATMENT

We fade net contractual margin improvements from £392m in FY2025 to £80m by FY2030, while allowing the core margin to rise from 16.7% to 20.8% as repriced contracts enter the run-rate. The result is a Civil margin of 21.9% in FY2028 — inside management's 21–23% target band, in its lower half — fading to 21.3% by FY2030.

Judgement: current margins are not materially accounting-inflated; the improvement is predominantly structural; the 21–23% range looks sustainable; and we assume the lower half of it long term. This line of enquiry is closed.

The engine of both margin and cash: time on wing

Flying hours drive receipts. Shop visits drive cost. The gap between them — how many hours an engine flies before it needs a major shop visit — is where the aftermarket's economics are decided, and it is the variable on which management has made its boldest quantified claim.



The apparent contradiction, resolved

FY2026 guidance implies 1,480–1,550 total shop visits. The 2028 mid-term assumption implies just **1,300–1,400** — fewer shop visits — while large-engine flying hours rise from 115–120% of 2019 to 130–140%. On its face that looks inconsistent.

It is not. Rolls-Royce states the mechanism directly: mid-term free cash flow "reflects large EFH growth to 130% to 140% of 2019 levels, a higher average normalised EFH rate, the benefits of our time on wing initiatives with shop visits falling to 1,300–1,400 in the mid-term."

So the target embeds an explicit durability step-change. Combining roughly 10% fewer shop visits with roughly 15% more flying hours implies **maintenance intensity improving by approximately 28% in three years**. That single operational claim underpins both the 2028 margin target and the 2028 cash target.

AN HONEST LIMITATION

Testing this properly needs a long history, and the COVID years cannot supply one — the fleet was parked and shop visits deferred. We therefore calibrate on FY2023–FY2025 plus H1 2026. The one-year-lagged relationship between flying hours and major shop visits is markedly more stable than the same-period ratio (31.6k and 30.9k hours per visit against 36.9k / 37.2k / 32.9k), which is economically sensible: a shop visit in one year reflects hours accumulated across several. But two observations are not a test, and we present the lagged form as the better-fitting of two candidates rather than as an established relationship.

WHY IT MATTERS TWICE

Margin. Fewer shop visits per flying hour means lower lifetime servicing cost against the same contractual receipts — which is precisely what drives an upward revision to expected contract profitability, and therefore the catch-ups discussed on p.4.

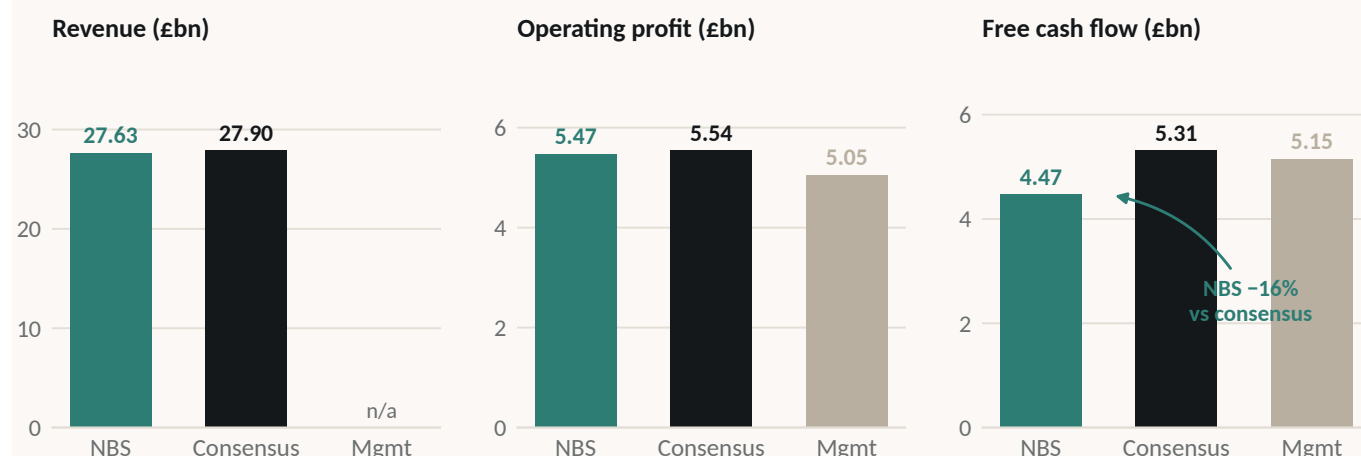
Cash. Deferring shop visits also defers cash cost, extending the period over which flying-hour receipts run ahead of servicing outflows. Durability is therefore the common driver of both the margin story and the LTSA balance story — which is why we treat it as the single most important operational assumption in the model.

CIVIL AEROSPACE KPIS	FY2024	FY2025
Large engine EFH (m)	16.0	17.0
as % of 2019	103%	111%
Total OE deliveries	529	483
Total LTSA shop visits	1,313	1,440
large engine major	430	517
LTSA flying-hour receipts (£bn)	5.5	6.0
Implied receipts per large EFH	£344	£353

Source: Rolls-Royce FY2024 and FY2025 results. Receipts per flying hour is an NBS calculation; the disclosed receipts figure is not explicitly scoped to large engines, so the level is indicative while the trend is robust.

We agree on profit. We disagree on cash.

This is the one place where our forecast departs materially from the market's, and it departs in a way that a single disclosure can settle.



Source: NBS estimates; Rolls-Royce published analyst consensus (July 2026, 13 contributors); Rolls-Royce mid-term targets stated at the FY2025 results and reiterated at H1 2026. Management's 2028 figures are the midpoints of £4.9–5.2bn and £5.0–5.3bn; no revenue target is published.

FY2028E	NBS	CONSENSUS	MANAGEMENT TARGET	NBS VS CONSENSUS
Revenue (£m)	27,634	27,896	not published	-0.9%
Underlying operating profit (£m)	5,470	5,544	4,900–5,200	-1.3%
Free cash flow (£m)	4,471	5,314	5,000–5,300	-15.9%
Free cash flow / operating profit	82%	96%	c. 95%	-14pp

Consensus predates the 30 July 2026 guidance raise: consensus FY2026 operating profit of £4,198m sits below the raised FY2026 guidance range of £4.7–4.9bn. FY2027–28 are likely also to be revised upward. This does not affect our conclusion, because our differentiated view is on cash — where consensus sits above us.

The whole difference is one line

Civil Aerospace LTSA balance growth, net of risk-and-revenue-sharing arrangements, was £1.1bn in FY2023, £691m in FY2024 and £572m in FY2025. In the first half of 2026 it was **£86m**, against £472m in the comparable half. Management's mid-term plan assumes £0.8–1.2bn a year.

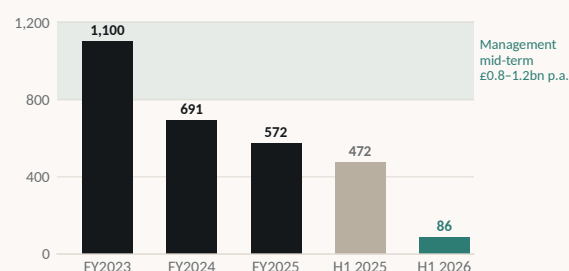
WHY WE ARE CAUTIOUS

Reaching £1.0bn by FY2028 from an £86m half requires the tailwind to grow roughly twelve-fold in two and a half years. Rolls-Royce's own explanation for the H1 slowdown is that receipts grew 13% while recognised LTSA revenue grew faster still, helped by higher LTSA margins and contract catch-ups. If catch-up recognition is itself finite — as p.4 argues — then the mechanism that compressed the balance build in H1 2026 does not obviously reverse.

WHY MANAGEMENT MAY STILL BE RIGHT

The counter-argument is mechanical and serious. New engines generate flying-hour receipts from entry into service but do not require a major shop visit for years. A delivery ramp from 483 engines in FY2025 toward 650–750 by 2028 therefore rebuilds the balance almost automatically, provided deliveries arrive. Our own model has deliveries rising to 680 in FY2028. If the age-mix effect dominates the recognition effect, management's range is attainable and we are wrong.

Civil LTSA balance growth, net of RRSAs (£m)



Source: Rolls-Royce FY2023–FY2025 results and H1 2025 / H1 2026 results; mid-term band per FY2025 results.

THE FALSIFICATION CONDITION

We set this out explicitly so the claim can be judged rather than argued.

H2 FY2026 LTSA balance growth above approximately £400m — implying a full-year figure near £0.5bn and a credible path to £0.8bn+ — would materially weaken and in our view falsify our cash-conversion thesis. We would concede the point and our fair value would rise toward the upper part of our range. Conversely a second consecutive sub-£200m half would strengthen it considerably.

Base-case forecasts, FY2024A–FY2030E

Our forecasts are built from operating drivers rather than extrapolated growth rates. Civil Aerospace services revenue is driven by large-engine flying hours multiplied by a realised revenue-per-flying-hour rate; original-equipment revenue by deliveries and revenue per delivery. Defence is a backlog-conversion model; Power Systems an order-intake model. Management guidance is used as a reference point and constraint, never as the forecast.

£M UNLESS STATED	FY2024A	FY2025A	FY2026E	FY2027E	FY2028E	FY2029E	FY2030E
Civil Aerospace revenue	9,040	10,382	12,120	13,313	14,813	16,025	17,219
Defence revenue	4,522	4,772	5,154	5,566	6,011	6,432	6,818
Power Systems revenue	4,271	4,892	5,528	6,191	6,810	7,423	8,017
Group underlying revenue	17,848	20,059	22,801	25,071	27,634	29,880	32,055
Civil Aerospace operating profit	1,505	2,130	2,836	3,003	3,237	3,447	3,662
Civil operating margin	16.6%	20.5%	23.4%	22.6%	21.9%	21.5%	21.3%
Defence operating profit	644	689	948	974	1,022	1,093	1,159
Defence operating margin	14.2%	14.4%	18.4%	17.5%	17.0%	17.0%	17.0%
Power Systems operating profit	560	852	1,122	1,269	1,396	1,522	1,644
Power Systems operating margin	13.1%	17.4%	20.3%	20.5%	20.5%	20.5%	20.5%
All Other and corporate	(246)	(209)	(170)	(180)	(185)	(165)	(140)
Group underlying operating profit	2,464	3,462	4,737	5,066	5,470	5,897	6,324
Group operating margin	13.8%	17.3%	20.8%	20.2%	19.8%	19.7%	19.7%
LTSA + RRSA balance growth	691	572	250	500	700	800	850
Cash tax	(381)	(555)	(805)	(963)	(1,149)	(1,297)	(1,455)
Capital expenditure	(876)	(978)	(1,100)	(1,200)	(1,300)	(1,350)	(1,400)
Free cash flow	2,425	3,270	3,804	4,103	4,471	4,900	5,270
as % of operating profit	98%	94%	80%	81%	82%	83%	83%
Free cash flow per share (p)	—	—	45.6	50.2	56.0	62.8	69.2
Closing net cash	475	1,895	2,239	2,840	3,673	4,707	5,892

Source: Rolls-Royce FY2024 and FY2025 results (FY2024A, FY2025A columns); all FY2026E–FY2030E figures are NBS estimates. "All Other and corporate" for FY2024 combines All Other Businesses with corporate and inter-segment items. Free cash flow is on Rolls-Royce's definition: struck after cash tax, interest paid and received, capital expenditure and lease capital payments, and before dividends, buybacks and acquisitions. Per-share figures use NBS forecast average share counts reflecting the announced £7–9bn 2026–28 buyback programme.

WHERE WE SIT AGAINST GUIDANCE

Our FY2026 operating profit of £4,737m sits at the lower end of the £4.7–4.9bn guidance range and our FY2026 free cash flow of £3,804m at the bottom of £3.8–4.0bn. By FY2028 we are 8.3% *above* the profit target and 13.2% *below* the cash target. That asymmetry is deliberate and is the core of our view.

AN OBSERVATION ON THE TARGETS THEMSELVES

The 2028 operating profit target of £4.9–5.2bn is only 2–4% above the *raised* FY2026 guidance of £4.7–4.9bn — roughly 1–2% a year, while flying hours are guided from 115–120% to 130–140% of 2019. The targets were set in February 2026 and reiterated rather than reset in July. On the profit line they read to us as a floor rather than a forecast.

Why the DCF prints so far below the share price

We value Rolls-Royce's own free cash flow measure — an equity flow, struck after interest and tax — discounted at the cost of equity, in three explicit phases: a driver-built forecast to FY2030, an explicit fade to FY2035, and an extended Civil Aerospace duration phase to FY2040 before terminal economics apply. Building the long-duration phases explicitly cut terminal value from 73% of equity value in an earlier single-stage structure to 32%.

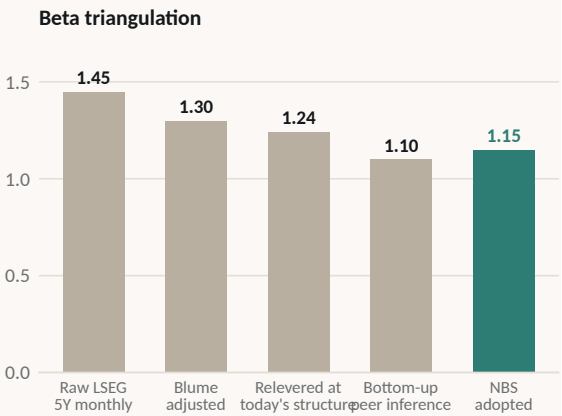
DISCOUNT RATE BUILD	
Risk-free rate — UK 10-year gilt yield	5.02%
Equity risk premium (NBS assumption)	5.00%
NBS adopted beta	1.15
Cost of equity	10.77%
Pre-tax cost of debt (assumption)	5.75%
Debt weighting	3.2%
WACC	10.57%
Terminal growth rate	2.50%

Source: share price, shares outstanding, UK 10-year gilt yield and the raw beta are LSEG data as at 13 August 2026. The equity risk premium, cost of debt and terminal growth are NBS assumptions.

THE BETA PROBLEM

The raw LSEG "5Y Monthly Beta" is 1.45. That window runs from roughly August 2021 to August 2026 — a period in which Rolls-Royce carried some £4.5bn of net debt against a market capitalisation that began near £8bn, with negative shareholders' equity and extreme operational leverage to the reopening of long-haul aviation. It is a measurement of a company that no longer exists in that form.

We therefore triangulate rather than adopt. A Blume adjustment gives 1.30. Unlevering at the leverage prevailing over the measurement window and relevering at today's net-cash structure gives 1.24. A bottom-up aerospace and defence peer range sits around 1.00–1.20. We adopt **1.15**, with a defensible range of 1.05–1.30, and we do not claim greater precision than that. The benchmark index and adjustment methodology behind the supplied figure were not available to us; that limitation is recorded rather than assumed away.



Source: LSEG (raw beta); NBS calculations and judgement for the adjusted, relevered and adopted figures. The peer inference is an NBS estimate and is not independently sourced.

VALUATION OUTPUT	CORE, EX-SMR
PV of FY2026–35 free cash flow (£m)	28,762
PV of FY2036–40 phase (£m)	8,171
PV of terminal value beyond FY2040 (£m)	17,386
Core equity value (£m)	54,320
terminal value as % of core	32%
Core value per share	652p
plus SMR optionality (p.11)	37p
Base DCF value per share	690p

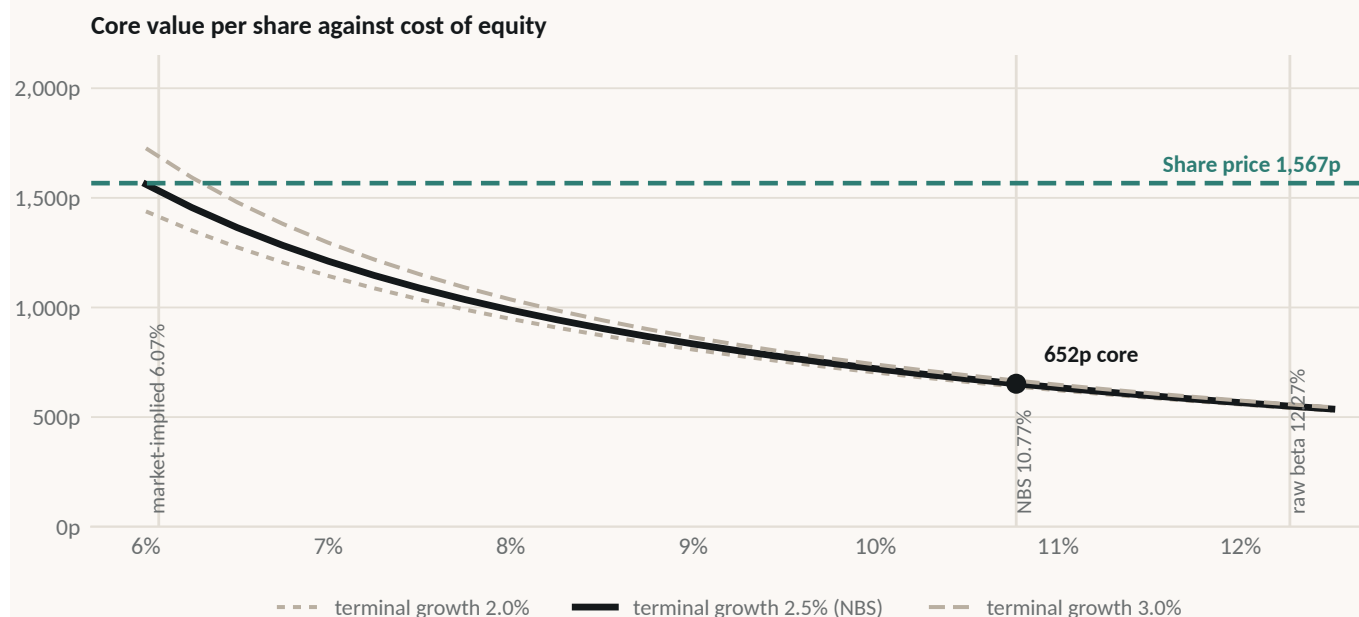
Source: NBS model. Value per share uses 8,330m shares outstanding — the current count, since the buyback is funded from the free cash flow already being discounted.

THE CROSS-CHECK

An independent unlevered DCF at WACC, with a full enterprise-to-equity bridge, gives **677p** of core value against the equity-flow method's 652p — a 3.8% difference. That is the expected result for a company financed roughly 97% by equity, where WACC sits only 20bp below the cost of equity. The residual reflects the bridge items, principally the £606m pension deficit. No adjustment was made to force agreement.

The question is not the forecast. It is the required return.

Our DCF says 690p. Applying Safran's trading multiple to our own next-year earnings says roughly 1,410p. The two methods differ by more than a factor of two, and that disagreement is the most important thing in this report.



Source: NBS model. Core value excludes SMR optionality. The market-implied cost of equity of 6.07% is solved from the current share price less our probability-weighted SMR value, on our own base-case cash-flow path.

Why we do not simply declare the market wrong

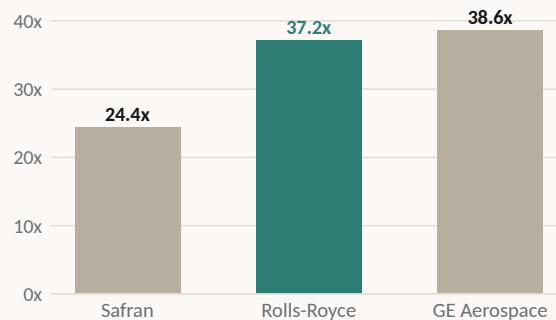
Valuation is extraordinarily sensitive to the discount rate here, because the cash flows are long-dated. Moving the cost of equity from 10.77% to 9.00% adds 28% to core value; the raw 1.45 beta removes 16%. By comparison, doubling the length of the fade period adds under 5% and lifting terminal growth by 50bp adds barely 2%.

So the honest statement is that the valuation is a required-return question first and a cash-conversion question second. And on the required return, neither extreme is credible. A CAPM cost of equity of 10.77% produces a fair value implying about 9.6x FY2028E EV/EBIT for a growing, net-cash, 20%-margin aftermarket annuity. Solving the other way, the share price implies a cost of equity of 6.07% and a beta of about 0.22 — a bond-like figure for a cyclical industrial.

THE PEER SANITY CHECK

Rolls-Royce does not trade in isolation. On last-twelve-months EV/EBIT it sits at roughly 37x — essentially level with GE Aerospace and at a substantial premium to Safran. The same CAPM framework applied to those two companies would declare much of the high-quality aerospace aftermarket sector 40–60% overvalued. When a model reaches that conclusion about an entire peer group, the discount rate deserves more scepticism than the market does. Rolls-Royce is not an outlier within its sector — and that, rather than any single forecast line, is why our confidence is only low-to-moderate.

EV/EBIT, last twelve months



Source: third-party market data, last-twelve-months basis — Safran as at 17 August 2026, GE Aerospace as at 12 August 2026. Rolls-Royce is an NBS calculation: enterprise value of £128.6bn (market capitalisation less £1,895m of lease-inclusive net cash) over FY2025 underlying operating profit of £3,462m. Trailing multiples only; not comparable with the forward multiples cited below.

ROLLS-ROYCE MULTIPLES

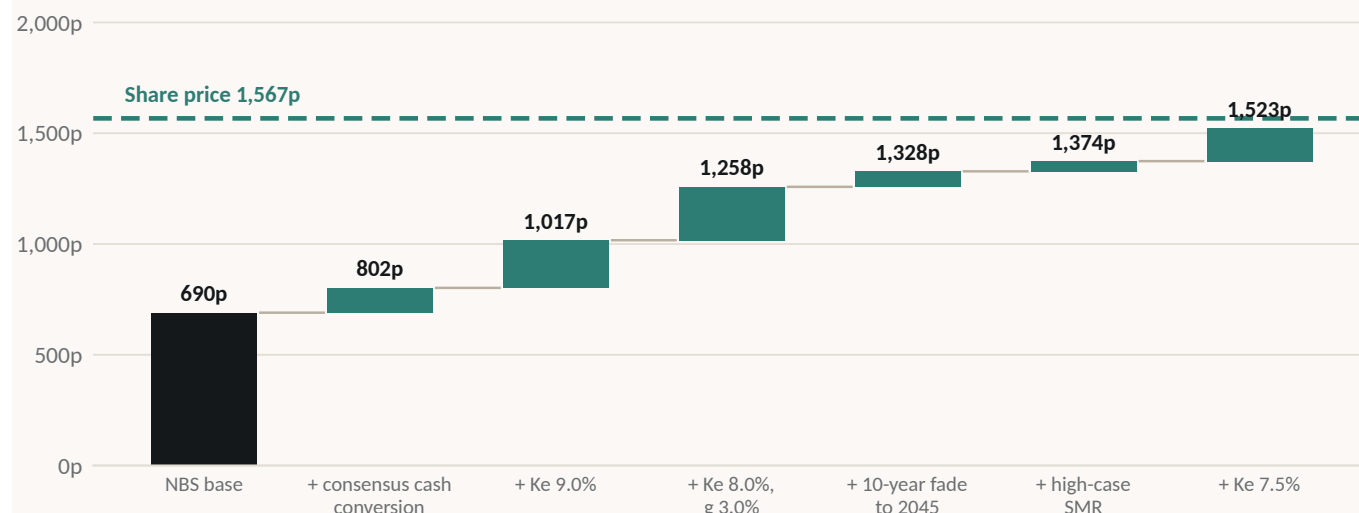
EV/EBIT, FY2025 actual	37.2x
EV/EBIT, NBS FY2026E	27.2x
EV/EBIT, NBS FY2028E	23.5x
P/E, consensus FY2026E	41.1x
P/E, consensus FY2028E	30.0x
FCF yield, NBS FY2028E	3.4%

Source: NBS calculations; EPS from Rolls-Royce published consensus (July 2026).

What 1,567p requires an investor to believe

Single-variable reverse-DCF solutions are arithmetic boundary tests, not expectations: no investor believes Rolls-Royce will earn a 54% operating margin. The useful exercise is to build the price out of economically coherent conditions and see how many must hold at once.

What must be believed to reach 1,567p — cumulative build



Source: NBS model. Each step is cumulative on the step before it. All valuations include the corresponding SMR treatment. Ke denotes cost of equity; g denotes terminal growth.

Four conditions, and they must hold together

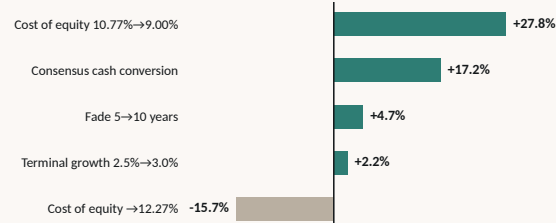
Starting from our base of 690p, reaching 1,567p requires:

- **Consensus-like cash conversion** — 96% of operating profit rather than our 82%, i.e. management's £0.8–1.2bn mid-term LTSA assumption is delivered. Worth +112p.
- **A required return near the market-implied level** — the single largest lever. Moving from 10.77% to 9.00% adds 215p; going further to 8.00% with 3.0% terminal growth adds another 241p.
- **A long explicit growth duration** — extending the fade from five years to ten, to 2045. Worth only +70p, which is the surprise in this analysis.
- **A favourable SMR outcome** — the high case rather than a probability weighting. Worth +46p.

On our numbers those four take us to 1,374p. Reaching 1,567p needs the required return to fall to roughly 7.5%. Any three of the four leave the shares 12–20% overvalued. **It is the conjunction, not any single heroic assumption, that the price demands.**

Expressed operationally the package is not absurd: flying hours above 140% of 2019 by 2030, Civil margins held at the top of the 21–23% range, the durability programme delivering 1,300–1,400 shop visits on a materially larger fleet, Power Systems compounding at high single digits, Defence holding above its target band. Those things are achievable. The binding constraint is the discount rate.

Impact on core value per share



Source: NBS model. Change in core value per share from the base case of 652p, one assumption at a time.

A HYPOTHESIS WE TESTED AND DROPPED

We expected forecast duration to explain much of the gap: that a five-year explicit forecast plus a terminal value understated a 25-year installed-base annuity. So we built it — an explicit fade to FY2035 and a further Civil duration phase to FY2040. It added roughly 5% to value and cut terminal value's share from 73% to 32%. The structure improved; the conclusion did not change. **Duration is not the answer**, and saying so is more useful than quietly dropping the question.

Real optionality, but not the explanation

Rolls-Royce holds 57.8% of Rolls-Royce SMR and does not consolidate it, having relinquished control in March 2025 when ČEZ Group invested. It is equity-accounted, so it contributes losses to reported results and no revenue. Because it is structurally outside the operating divisions, it belongs in a sum-of-the-parts rather than inside the operating DCF.

OBSERVABLE EVIDENCE

DATE	EVENT
Mar 2025	ČEZ investment; RR diluted 70.5% → 61.7%. Retained holding recognised at fair value of £732m, implying roughly £1.19bn for 100%
Jun 2025	Selected as the UK's SMR technology following the Great British Energy – Nuclear competition
Jul 2025	Second ČEZ investment; RR diluted to 55.3%
Dec 2025	RR invests further, raising its stake to 57.8% — evidence of continuing funding calls
Apr 2026	Contract signed with Great British Energy – Nuclear for the first three UK units (at least 1.4GWe); £2.6bn allocated in the 2025 Spending Review; National Wealth Fund committing up to £599m; up to six further units planned in Czechia. Programme remains pre final investment decision

Source: Rolls-Royce FY2025 results (note 25, business disposals); World Nuclear News; UK Government announcement of the Great British Energy – Nuclear contract, 13 April 2026.

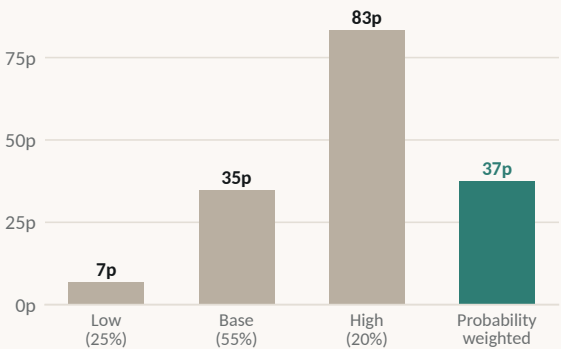
The March 2025 fair value is the only hard equity-value observation. A National Wealth Fund commitment of up to £599m alongside a signed three-unit contract is not consistent with a business still worth £1.2bn in total, so a materially higher valuation is implied — but no figure is disclosed, and the step-up in our base case is an inference rather than an observation.

HOW WE TREAT IT IN THE VALUATION

SMR sits outside the discounted cash flow entirely. Our core operating value of 652p per share ascribes it nothing; the 37p is added afterwards to give the 690p base case. That separation is deliberate, so a reader who disagrees with our probability weighting can substitute their own figure without disturbing the operating analysis.

It also means the DCF is a conservative floor in one specific respect. Management expects Rolls-Royce SMR to be profitable and free cash flow positive by 2030, and none of that appears in our operating forecast — no revenue, no margin, no cash. What does appear is the drag: equity-accounted losses within All Other Businesses.

Value of RR's 57.8% SMR stake, per share



Source: NBS probability-weighted valuation. Case values for 100% of Rolls-Royce SMR are NBS assumptions; Rolls-Royce's share is taken at 57.8%.

CASE	100% (€M)	RR SHARE	PROB.
Low — stalls pre-FID	1,000	578	25%
Base — 3 UK + up to 6 Czech units	5,000	2,890	55%
High — global leader, 20+ units	12,000	6,936	20%
Probability-weighted	—	3,121	100%

CONCLUSION

Roughly **£3.1bn attributable, 37p per share, 2.4% of the current price**. Even the high case is about 83p, or 5%. SMR is genuine optionality and we carry it in our fair value — but it cannot explain the gap between a conventional discounted cash flow and the share price. We have not deducted future equity injections; the December 2025 top-up shows funding calls are live, and a further £0.5bn would reduce the figure by about 6p.

What we are watching, and what would move fair value

Each item below is tied to a specific line in our model, with an indication of its effect on core value per share. A generic aerospace risk list would be of no use to anybody.

RISKS, RANKED BY CAPACITY TO MOVE FAIR VALUE

#	RISK	MODEL LINE	EFFECT ON CORE VALUE
1	Market re-rates toward a CAPM-consistent required return as rates stay high or sector multiples compress	Cost of equity	-22% on Ke 9.0%→10.77%
2	The time-on-wing programme fails to reduce shop visits to 1,300–1,400 on a larger fleet	Maintenance intensity; Civil core margin	c.-20% at 18% core margin
3	LTSA cash generation stays near the H1 2026 run-rate rather than rebuilding	LTSA + RRSA growth	already in base; Bear takes it lower
4	Widebody delivery rates disappoint, capping flying-hour growth — airframer supply chain, not demand	Flying-hour index	c.-7% at 130% of 2019 by 2030
5	Defence margin reverts into its 14–16% target band as international mix normalises	Defence margin	c.-6% at 15.0% terminal
6	The data-centre power capital expenditure cycle turns	Power Systems growth and margin	c.-5%
7	Sterling strength; mid-term targets assume \$1.33/£ and a US\$21bn hedge book defers rather than removes the exposure	Not separately modelled	logged

Source: NBS model sensitivities. Effects are indicative single-variable impacts on core value per share, not additive.

CATALYSTS

#	CATALYST	WHY IT MATTERS
1	FY2026 results — H2 LTSA balance growth	The single highest-information disclosure. Adopting consensus conversion is worth +17% to core value
2	Mid-term targets reset upward at the FY2026 results	Would confirm our profit view and lift a consensus that still predates the July guidance raise
3	SMR final investment decision and a first export order beyond Czechia	Worth about 46p moving from probability-weighted to the high case
4	Buyback extended beyond the £7–9bn 2026–28 programme	Per-share accretive, enterprise-value neutral. Second-order

WHAT WOULD CHANGE OUR MIND

Toward a more positive view

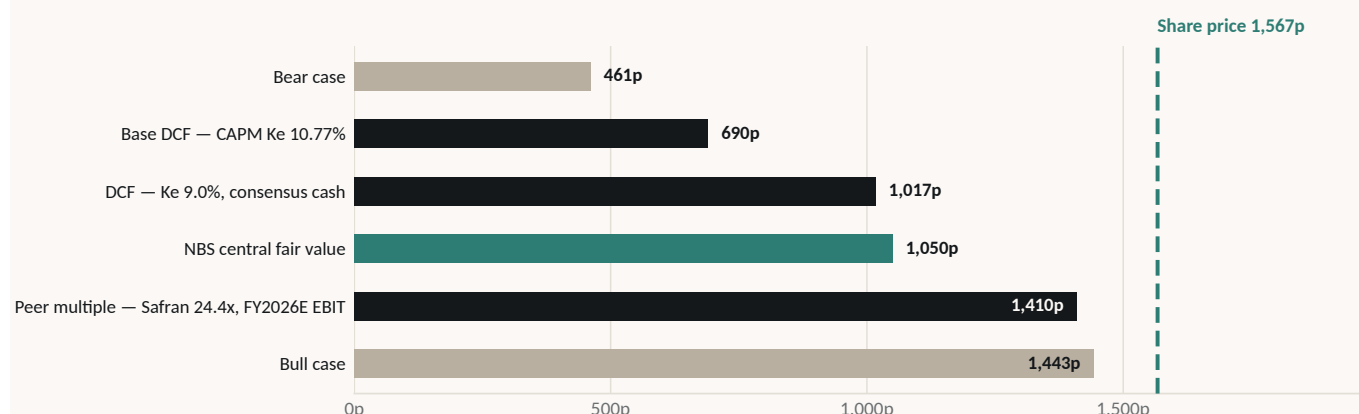
- H2 2026 LTSA balance growth above approximately £400m. This is the specific falsification test of the one view we hold against consensus, and we would concede it.
- Credible evidence that the appropriate required return for a widebody aftermarket annuity is 8% or below — a sourced adjusted beta, a bottom-up peer beta below 1.0, or sector multiples sustained through a full rate cycle. This alone moves our fair value from 690p toward 1,258p.
- Civil core margin, excluding contractual improvements, reaching 22% or more while the improvement line is already near nil.

Toward a more negative view

- Shop visits tracking flying hours rather than falling — the durability claim failing in the data.
- LTSA balance growth turning negative as the fleet matures faster than the delivery ramp rebuilds it.
- Defence margin reverting to 15%, with the H1 2026 strength revealed as mix or phasing rather than structural improvement.

An excellent business, priced for a return we cannot justify

The disagreement is not about whether Rolls-Royce is a good company. It is about what return an investor should require for a long-duration aerospace aftermarket annuity — and whether the cash conversion the market assumes will actually arrive.



Source: NBS model. The peer-multiple reference applies Safran's trailing EV/EBIT multiple to NBS FY2026E operating profit and is a cross-check, not a target.

WHAT WE ACCEPT

The transformation is real. Operating margin on the three core divisions has moved from -16.9% in 2020 to 18.3% in FY2025. Shareholders' equity has gone from £6.0bn negative at the 2022 trough to £2.8bn positive, with net cash of £1.9bn. Civil Aerospace margin expansion is predominantly structural: roughly 69% of it survives the removal of every contractual margin improvement, and we accept 21–23% as broadly sustainable.

We are also comfortable being *above* management on profit. The 2028 operating profit target sits only 2–4% above the raised FY2026 guidance while flying hours are guided materially higher; on that line the target reads as a floor, and our FY2028 estimate is 8.3% above it.

WHAT WE DO NOT ACCEPT

Two things. First, that free cash flow converts at 96% of operating profit by FY2028. That requires Civil LTSA balance growth of around £1bn a year after a half that delivered £86m. Second, that a required return of roughly 7.5% is the right hurdle for these cash flows. Our triangulated cost of equity is 10.77%, with a defensible range of 10.25–11.50%.

Requiring both — plus a two-decade growth runway and a favourable SMR outcome — is what 1,567p asks of an investor. We cannot independently justify all four at once.

VALUATION SUMMARY

Bear case	461p
Base DCF, CAPM cost of equity 10.77%	690p
DCF at Ke 9.0%, consensus cash conversion	1,017p
NBS central fair value (judgement)	c.1,050p
Peer-multiple reference	1,410p
Bull case	1,443p
Reference share price	1,567p
Implied downside to central fair value	-33%

Source: NBS model. Central fair value is a judgement across three anchors, not a probability weighting and not derived from the share price.

CLASSIFICATION

MODESTLY OVERVALUED

Confidence: **low-to-moderate**. The classification would be *materially overvalued* if a CAPM-derived cost of equity is the right hurdle, and *fairly valued* if the market's implied hurdle is. We cannot resolve that question with the evidence available, and we prefer to disclose the width of the range than to hide it inside a single number.

Three of our own hypotheses did not survive this work. We began believing recent free cash flow was materially inflated by a working-capital tailwind; free cash flow excluding that tailwind grew 69% in H1 2026, and the hypothesis failed. We then believed the valuation gap was principally about forecast duration; we built the long-duration phases explicitly and it added around 5%. We suspected Civil margins were materially accounting-inflated; roughly 69% of the expansion proved structural.

One disagreement survived, and it is narrow, specific and testable. The FY2026 results will disclose second-half Civil LTSA balance growth. Above approximately £400m and our cash thesis is wrong, on our own stated terms. Below £200m and it strengthens considerably. **We would rather be judged on that number than on a target price.**

Sensitivity, sources and method

CORE VALUE PER SHARE (P) — COST OF EQUITY AGAINST TERMINAL GROWTH

KE \ G	2.0%	2.5%	3.0%	3.5%
8.00%	948	988	1,036	1,095
9.00%	808	834	864	899
10.00%	703	721	740	763
10.77% (NBS)	639	652	667	683
11.50%	588	598	609	622
12.27% (raw beta)	542	550	558	568

Source: NBS model. Core value excludes SMR optionality of 37p.

METHOD

Historical financials come from Rolls-Royce's published results on an underlying basis for segmental and operating figures, cross-checked against an LSEG statutory export. Where the two differ, Rolls-Royce's definitions govern and the difference is recorded. Free cash flow follows Rolls-Royce's own definition throughout, so our estimates are directly comparable with company guidance and consensus. The forecast runs FY2026E–FY2030E on operating drivers, FY2031E–FY2035E on an explicit fade in which the LTSA working-capital tailwind is deliberately extinguished as the fleet matures, and FY2036E–FY2040E as an extended Civil Aerospace duration phase before terminal economics apply. Valuation is primarily an equity-flow DCF at the cost of equity, cross-checked by an unlevered DCF at WACC with an explicit enterprise-to-equity bridge, and sense-checked against peer multiples. All NBS estimates and derived metrics are labelled as such wherever they appear: company-reported figures are never presented as NBS estimates, and NBS calculations never as company-reported.

SOURCE REGISTER

SOURCE	USED FOR
RR FY2025 results, 26 Feb 2026 (incl. notes)	Historicals, contract balances, KPIs, FCF bridge, net cash, SMR note, targets
RR H1 2026 results, 30 Jul 2026	Current trading, raised FY2026 guidance, H1 KPIs and LTSA movement
RR FY2024 results, 27 Feb 2025	FY2023–24 comparatives and KPIs
RR published analyst consensus, Jul 2026 (13 contributors)	Consensus revenue, operating profit, FCF and EPS
LSEG Workspace	Statutory history FY2016–25, segment data, price and share count, gilt yield, raw beta
UK Government / GBN, Apr 2026; World Nuclear News	SMR milestones and funding
Third-party market data providers	Peer trailing multiples, dated in situ

SCENARIO CONSTRUCTION

Bear (461p) — Ke 11.5%, g 2.0%. Renegotiation exhausts; time-on-wing gains do not arrive; shop visits track flying hours; Civil core margin stalls near 18%; Defence reverts into its band; the data-centre cycle cools. Free cash flow plateaus near £4.1bn. SMR low case only.

Base (690p) — Ke 10.77%, g 2.5%. Most of the margin gain is durable; contractual improvements decay to nil by 2030; durability improves but less than targeted; LTSA growth reaches £700m not £1bn. Free cash flow £5.6bn by 2035. SMR at 37p.

Bull (1,443p) — Ke 8.5%, g 3.0%. Durability delivers in full; consensus cash conversion achieved; pricing persists through the renewal cycle; a ten-year runway to 2045; SMR high case.

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