NEW BOSS TO SIMPLIFY ROLLS-ROYCE

News / Personalities

Twelve months and 80 signatures: that is what it recently took Rolls-Royce to approve a small change requested by a supplier, symptomatic of a business that had become as complex as the engines it makes to power the world's biggest aircraft.

New chief executive Warren East says the number of sign-offs should be closer to 15, and it's an example of the complexity at the company.

"Virtually every process I look at is over-complicated," East said.

He has met 70 investors in the last six weeks, seeking support after oil and gas customers cut orders for marine engines and some aero engines were retired earlier than expected, exposing poor financial discipline and operational problems.

The share price has nearly halved since May, leading to takeover talk and reports of UK government concern that a key military contractor could fall into foreign hands.

SIMPLICITY AND PACE

East, who became chief executive in July, announced a restructuring last month, under the mantra of "simplicity and pace", aiming to save GBP£150 million - GBP£200 million annually by 2017.

A first step was scrapping a layer of senior management.

"It is going to take four to five years," he said, but hopes to get 80 percent of it done in 18 months to two years.

It is not the first time the engineering powerhouse has taken aim at its own complexity. In the 1990s, the Derwent Project sought radical cuts in lead times and costs.

But East, who built British chip designer ARM into a world-beating supplier to the likes of Apple and was a non-executive director at Rolls before he replaced John Rishton, is making a new effort to tackle management layers and red tape.

East, who likes to hold candid town-hall meetings, says things could get worse before they get better, and does not rule out another profit warning.

Rolls-Royce's fortunes have been entwined with Britain's national interest since it built its first aero-engine for the Royal Air Force in World War One, and it was nationalised in the 1970s after a new turbo-fan engine almost destroyed the company.

It was privatised in 1987, although the government kept a "golden share" that can be used to block a takeover.

Recent press reports said the British government was considering nationalising Roll-Royce's nuclear submarine unit or merging some of its businesses into BAE Systems, Britain's other defence heavyweight, if the company's difficulties worsened.

"Of course it's possible that there's all sorts of people dreaming up lots of strategies for Rolls-Royce," East said, "I can tell you that I've had no hint whatsoever of any reality behind the stories."

MARGINS

Rolls has historically struggled to match the 20 percent level of margins made by its larger US rival GE, which benefits from its exposure to the high-volume narrow-body aircraft market. Before recent woes, Rolls was targeting margins of around 15 percent.

Rolls-Royce is on course to take a 50 percent share of the 250-seat plus twin aisle wide-body aircraft market by 2020, up from 30 percent now.

It has been out of narrow-body jets, which carry up to 200 passengers, since 2011 when it decided to sell out of a multinational alliance making those engines to Pratt & Whitney.

Its former US partner has independently notched up thousands of engine sales for the updated Airbus A320neo, prompting debate over whether Rolls made a blunder.

East is not excluding taking Rolls-Royce back into that market, but says it is not a priority.

"I don't rule out narrow-body in the long term but we have got to get through to make the business model work in the first place with one (wide-body) space," he said.

East also said he was open to possible new developments including a "middle of the market" 240-seater being studied by Boeing and a possible engine upgrade of the Airbus A380.

LIMITED ROOM FOR MANOEUVRE

The arrival of US activist investor ValueAct on the shareholder register in July ramped up expectations of change.

But East, who met the US hedge fund earlier in December, denies reports ValueAct wants to force Rolls to divest its marine unit.

"My thoughts and their thoughts are pretty much completely aligned," he said.

But the share price drop to about 570 pence from a year-high of 1,046 pence in May has raised the prospect of suitors.

Jefferies analyst Sandy Morris believes any suitor would have to offer at least GBP£10 per share for the company.

"There is a tacit acceptance that the business is worth vastly more in 2020 and that by 2025 is worth vastly more again" he said, referring to the growth promised by the new engines on order.

But Rolls-Royce has issued four profit warnings in just over a year and placed the dividend under review and the consensus forecast is now for it to be cut.

On the shop floor at Filton, where the engines for Concorde were once made, pride in the company is undiminished.

Wearing a Rolls-Royce embroidered shirt, Paul Abrahams, value-stream manager said: "You feel the hurt when we have problems and share the success when things go well."

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