AA Intermediate Co Ltd - Investor Report

This is the Investor Report for the year ended 31 January 2017 which we are required to deliver pursuant to paragraph 6 of Part A of Schedule 3 of the Common Terms Agreement.

General Overview

The business is characterised by stable and predictable revenue streams, strong operating margins and high cash conversion.

The business is focused on delivering the highest possible standards of customer service, quality products, stable and predictable profits, strong operating margins and high cash conversion. The Group continued to demonstrate all of these qualities in the financial year:

- We attended 3.6 million breakdowns in the year ended 31 January 2017, and the AA has been awarded 'Which?' recommended provider status for both consumer and AA-provided manufacture breakdown cover for the 11th year in a row.

- EBITDA including discontinued operations decreased by 1% to £414 million in the twelve months ended 31 January 2017 (2016: £417 million). On a continuing basis, EBITDA increased by 1% to £406 million in the twelve months ended 31 January 2017 (2016: £404 million).

- EBITDA margins remained flat in the twelve months ended 31 January 2017 at 43% (2016: 43%).

- Cash flow from operating activities before tax and exceptional items of £412 million (cash conversion: 93%) for the year ended 31 January 2016 and £417 million (cash conversion 99%) for the year ended 31 January 2016.

- Total Net Debt to EBITDA of 6.7 x and Total Class A Net Debt to EBITDA at 5.2 x as at 31 January 2017.

Further information is available at www.theAA.com/investor-relations and within the AA plc Annual Report and Financial Statements.

Regulatory and business update

The Government has confirmed that, from 1 April 2017, it will cap the amount of UK tax relief for interest to 30% of taxable earnings before interest, depreciation and amortisation (EBITDA) calculated across the UK group. Alternatively, groups may elect for the interest restriction to be based on the net interest to EBITDA ratio for the worldwide group. The AA is expected to be affected by these restrictions and it is likely that we will apply the group rule. As the AA is predominantly UK based, the impact of these rules is not expected to be significant. Legislation enacting the interest cap was dropped from the 2017 Finance Act but is expected to be enacted later in the year.

On 11 August 2016, the Group completed the sale of AA Ireland. As part of the transaction, the AA Ireland pension scheme, which is closed to future accrual was transferred to AA Corporation Limited, a UK subsidiary of the Group and will continue to be the responsibility of the Group.

Proceeds, net of fees were £130 million and allowed £106 million of the Senior Term Facility to be repaid on 31 August 2016. Under the terms of our borrowings, we have held back £24 million from the net proceeds in ring-fenced available cash to be used for potential future acquisitions. Any amounts not committed within 12 months from the AA Ireland completion date must be used to repay either Class A notes or the Senior Term Facility.

We are aware that there is some duplication of roadside assistance cover taken by a limited number of business-to-business customers who are also personal Members. While some may be unaware that they have more than one form of cover, others choose to maintain this in order to take advantage of the additional benefits personal Membership provides. Through the programme of data review for the new Customer Relationship Management systems, we identified a group of our banking partners' customers for whom the benefit of holding both forms of cover is not clear. We proposed a programme of remediation for them which has the support of the regulatory authority. We have provided £10 million for our estimate of the costs.

There have been no other new significant regulatory and business developments (including any highly publicised incidents) other than as described in the Annual Financial Statements.

There have been no other significant announcements/publications by the government relating to Permitted Business.

The following changes to office holders occurred during the year:

Gillian Pritchard – Director, appointed 30 April 2016

Rob Scott – Director, resigned 30 April 2016

Capital Expenditure

Capital Expenditure (excluding Maintenance Capital Expenditure) in the period to 31 January 2017 included £41 million relating to the IT transformation project.

There has been no other Capital Expenditure (excluding Maintenance Capital Expenditure) in an amount exceeding £5 million (Indexed) during the period.

Financing

On the 6 December 2016, the Group issued £700 million Class A5 notes at an interest rate of 2.88%. Holders of £300 million of A1 notes and £195 million of A4 notes exchanged their A notes for the new A5 notes. From the remaining proceeds, the Group tendered £165 million of Class B2 notes. The refinancing was completed at a premium of £30 million and with issue costs of £8 million.

Acquisitions or Disposals

As noted above, during the year ended 31 January 2017, the Group disposed of its Irish business resulting in a profit of £77 million.

Current Hedge Position

The Holdco Group has fully hedged its interest rate exposure in relation to its Authorised Credit Facilities.

Ratios

We confirm that in respect of this investor report dated 21 June 2017, by reference to the most recent Financial Statements that we are obliged to deliver to you in accordance with paragraph 1 (*Financial Statements*) of Part A (*Information Covenants*) of Schedule 3 (*Holdco Group Covenants*) of the Common Terms Agreement:

- the Class A FCF DSCR as at 31 January 2017 is more than 1.35; we set out the calculation below:

	Year to January 2017 £m
Operating profit before tax	188
Add back:	
Debt interest payable	147
Penalty interest payable	2
Interest payable under finance leases	8
Amortisation of debt issue costs	9
Transfer from cash flow hedge reserve	6
Finance costs in respect of pensions	10
Exceptional items	35
Depreciation and amortisation	67
Difference between the pension service cost and employer cash contributions	8
Profit on disposal of Irish business segment	(77)
Share-based payments	12
Less interest receivable	(1)
Class A Maintenance EBITDA	414
Less	
Cash tax paid	(23)
Change in working capital	(13)
Dividend received from joint ventures and associates	(1)
Minimum capital maintenance spend	(25)
Payments for onerous lease	(1)
Class A Free cash flow	351
Class A total debt service charge	106
Class A FCF DSCR	3.3

- the amount of Additional Financial Indebtedness raised since the date of the immediately preceding Investor report and included for the Test Period ending 31 January 2017 was £700 million and the Class A FCF DSCR was 3.5 and the ratio of Total Class A Net Debt to EBITDA was 5.2 in each case calculated on a pro forma basis as provided for in the definition of Additional Financial Indebtedness.

	Year to July 2016 £m
Operating profit before tax	133
Add back:	
Debt interest payable	150
Discontinued operations - AA Ireland	7
Interest payable under finance leases	7
Amortisation of debt issue costs	4
Finance costs in respect of pensions	11
Exceptional items	32
Depreciation and amortisation	57
Difference between the pension service cost and employer cash contributions	9
Share-based payments	9
Class A Maintenance EBITDA	419
Less	
Cash tax paid	(13)
Change in working capital	(17)
Minimum capital maintenance spend	(25)
Payments for onerous lease	(4)
Class A Free cash flow	360
Class A total debt service charge	102
Class A FCF DSCR	3.5

		Year to July 2016 £m
Class A Debt:		
	Senior term facility	348
	Class A1 notes	175
	Class A2 notes	500
	Class A3 notes	500
	Class A4 notes	55
	Class A5 notes	700
	Working Capital Facility (utilised as guarantee)	7
Less:	Cash and Cash Equivalent Investments	(122)
Total Class A Net Debt		2,163
Class A Maintenance EBITDA		419
Ratio of Class A Net DEBT to EBITDA		5.2

- the maximum amount of Permitted Investor Payments that may be made in the 90 days following the date of required delivery of this Compliance Certificate is £127 million, and the ratio of Total Class A Net Debt as at the most recent Test Date to EBITDA in respect of the Test Period ending on that Test Date calculated pro forma for any payment of such maximum amount would be 5.5:1. The calculation is set out below:

		Year to Jan-17 £m
Class A Debt:		
	Senior term facility	348
	Class A1 notes	175
	Class A2 notes	500
	Class A3 notes	500
	Class A4 notes	55
	Class A5 notes	700
	Working Capital Facility (utilised as guarantee)	8
Less:	Cash and Cash Equivalent Investments	(136)
Total Class A Net Debt		2,150
	Permitted Investor payment	127
Max Class A Net Debt		2,277
Class A Maintenance EBITDA		414
Ratio of Class A Net DEBT to EBITDA		5.5

- We confirm that the Class A FCF DSCR Ratio has been calculated in respect of the Test Dates for which it is required to be calculated under the Common Terms Agreement.

We confirm that:

- no CTA Default or Trigger Event has occurred and is continuing.
- the Holdco Group is in compliance with the Hedging Policy.
- as excess cashflow for the year is an inflow of £66 million, £66 million has been added to Retained Excess Cash flow.
- a dividend payment of £60 million has been made out of Retained Excess Cashflow in the period since the date of the most recent Compliance Certificate;
- therefore the amount of Retained Excess Cashflow as at the date of this Compliance Certificate is £171 million; there have not been other payments made out of Retained Excess Cashflow
- we are in compliance with the Obligor Coverage Test.
- below is a list of the Material Companies as at 31 January 2017:
    - Automobile Association Developments Limited
    - Automobile Association Insurance Services Limited
    - AA Corporation Limited

- the statements set out in this Investor Report are accurate in all material respects.

Yours faithfully,

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Director

For and on behalf of
Automobile Association Developments Limited as Holdco Group Agent

22 June 2017