AA Intermediate Co Ltd - Investor Report

This is the Investor Report for the year ended 31 January 2020 which we are required to deliver pursuant to paragraph 6 of Part A of Schedule 3 of the Common Terms Agreement.

All figures in the commentary below are as per the AA Intermediate Co Limited statutory accounts, post adoption of new IFRS accountings standards such as IFRS 16 and IFRS 9. We note that the ratios below the commentary in respect of the Group's debt covenants are calculated after reversing the impact of such GAAP changes as required by the covenant documents.

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 3.4 million breakdowns in the year ended 31 January 2020, and the AA remains the market leader with c. 40% of the Consumer market, c. 50% of the manufacturer segment, over 60% of the UK's largest fleet and leasing companies and around half of the AVA banking segment.

- Trading EBITDA increased by 2% to £343 million in the twelve months ended 31 January 2020 (2019: £337 million).

- Trading EBITDA margins remained steady at 35% in the twelve months ended 31 January 2020 (2019: 35%).

- Cash flow from operating activities before tax and exceptional items of £336 million (cash conversion: 98%) for the year ended 31 January 2020 and £289 million (cash conversion 86%) for the year ended 31 January 2019.

- Total Net Debt to EBITDA of 8.0 x and Total Class A Net Debt to EBITDA at 6.2 x as at 31 January 2020.

Further information is available at www.theaaplc.com/investors and within the AA plc Annual Report and Financial Statements.

Regulatory and business update

As reported in the prior year financial statements, the former Executive Chairman, Bob Mackenzie, who was dismissed for gross misconduct on 1 August 2017, had on 6 March 2018 issued a claim for substantial damages against AA plc, its subsidiary (Automobile Association Developments Limited) (together, 'the Companies') and personally against a number of their directors (existing and former) and the former Company Secretary.
In November 2018, Mr Mackenzie's claim against all the directors and the former Company Secretary was dismissed in full and he was ordered to pay their costs to be assessed by the Court if not agreed. The majority of Mr Mackenzie's claim arises from his exclusion from a share option scheme which, in any event, lapsed for all participants without any payment in June 2019. However, Mr Mackenzie has now issued an amended claim which includes a new claim for personal injury allegedly suffered as a result of stress arising from his role as CEO and Chairman. The Companies have filed a full defence in relation

to Mr Mackenzie's amended claim. After further discussion with external counsel the Companies decided to apply for a strike-out application in relation to the entirety of Mr Mackenzie's claims against them. This application was filed in May and the Companies are awaiting a court date for this application. The Board assumes for the purpose of these financial statements that Mr Mackenzie will proceed with the claim against the Companies but maintains that it is not necessary for the Group to make a financial provision as it expects the defence will prevail.

The insurance industry has seen significant activity from the FCA in the areas of pricing practices, vulnerable customers and affordability in consumer credit. The AA has worked collaboratively with the FCA in responding to the 'Dear CEO' letters and data requests sent out to intermediaries and insurers and has been proactive in advising the FCA of any issues identified in the course of the year, none of which has been material. It has also engaged proactively on the FCA's interim report on pricing practices published in October 2019. Given recent political events, the AA continues to monitor the potential impact of Brexit on the AA's business and operations, which has previously been assessed as being minimal.

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 and up to the date of approval of the financial statements:

Martin Clarke – Chief Financial Officer, resigned 29 April 2019

Gillian Pritchard – Director, resigned 1 August 2019

Mark Strickland – Director, resigned 6 January 2020

Marianne Neville – Director, appointed 1 August 2019

Kevin Dangerfield – Director, appointed 6 January 2020

Capital Expenditure

Capital Expenditure (excluding Maintenance Capital Expenditure) in the period to 31 January 2020 included growth capital expenditure of £25m related to our Roadside and Insurance business and £11m related to digital projects.

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

Financing

On 8 February 2019, the Group drew down £15m of its working capital facility. This was repaid on 22 March 2019.

On 23 December 2019, the Group completed the purchase of £3m of Class A5 notes in AA Bond Co Limited for cash consideration of £3m. These notes were purchased within the WBS by AA Bond Co Limited and were therefore subsequently cancelled.

On 5 February 2020, the Group issued £325m of Class A8 notes at an interest rate of 5.50% in exchange for £325m of Class A5 notes. This refinancing transaction is an event after the reporting period and will be accounted for in the 2021 financial year.

Acquisitions or Disposals

On 1 February 2019, the Group completed the purchase of the entire share capital of Prestige Motor Care Holdings Limited and its three wholly owned subsidiaries Prestige Fleet Servicing Limited, Prestige Car Servicing Limited and Prestige Motor Care Limited for cash consideration of £11m.

On acquisition, assets and liabilities acquired included £3m cash and £2m trade and other payables. Goodwill of £10m was initially recognised but was subsequently reallocated within the permitted measurement period, comprising additions of £11m to customer relationships, £1m to software and £2m to deferred tax liabilities. At the point of acquisition, the combined fair value of net assets acquired was therefore £11m, which resulted in £nil goodwill being recognised. The net outflow of cash to acquire these subsidiaries was £8m.

Prestige Motor Care Holdings Limited and its subsidiaries generated a combined revenue of £18m for the year ended 31 January 2020.

On 29 March 2019, the Group completed the sale of 51% of the share capital of AA Media Limited.

Current Hedge Position

The Holdco Group has a forward starting interest rate swap in place which can be used in order to fully hedge its interest rate exposure in relation to its Authorised Credit Facilities, should it be required.

Class A 'basket' reset

As noted in the prior year, as permitted by the WBS programme, we have reset both the Minimum Capital Maintenance Spend Amount to £35 million (from £25 million) and the Maximum Finance Lease Amount to £150 million (Indexed) (from £60 million (Indexed)). This applies for the 5 financial years ending 31 January 2023.

Ratios

We confirm that in respect of this investor report dated 23 June 2020, 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 2020 is more than 1.35; we set out the calculation below:

	Year to January 2020 £m
Operating profit before tax	105
Add back:	
Debt interest payable	129
Interest payable under finance leases	4
Amortisation of debt issue costs	11
Contingent consideration finance cost	1
Change in fair value of contingent consideration	(9)
Non-cash interest expense attributable to movement in mark-to-market hedging obliga	1
Finance costs in respect of pensions	5
Exceptional items	4
Depreciation and amortisation	82
Difference between the pension service cost and employer cash contributions	4
Share-based payments	4
Less interest receivable	(1)
Class A Maintenance EBITDA	340
Less	
Cash tax paid	(10)
Change in working capital	43
Minimum capital maintenance spend	(35)
Payments for onerous lease	(1)
Class A Free cash flow	337
Class A total debt service charge	98
Class A FCF DSCR	3.4

- 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 2020 was £Nil.

- 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 £Nil, 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-20 £m
Class A Debt:		
	Class A2 notes	500
	Class A3 notes	200
	Class A5 notes	697
	Class A6 notes	250
	Class A7 notes	550
Less:	Cash and Cash Equivalent Investments	(102)
Total Class A Net Debt		2,095
	Permitted Investor payment	(225)
Max Class A Net Debt		1,870
Class A Maintenance EBITDA		340
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 £105 million, £105 million has been added to Retained Excess Cash flow.
- No dividend payment 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 £196 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 2020:
  - 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,

Kevin Dangerfield
Director
For and on behalf of Automobile Association Developments Limited as Holdco Group Agent
23 June 2020