AA Intermediate Co Ltd - Investor Report

This is the Investor Report for the year ended 31 January 2019 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 3.7 million breakdowns in the year ended 31 January 2019, 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 decreased by 14% to £337 million in the twelve months ended 31 January 2019 (2018: £393 million).

- Trading EBITDA margins decreased to 35% in the twelve months ended 31 January 2019 (2018: 42%) due to planned strategic expenditure.

- Cash flow from operating activities before tax and exceptional items of £289 million (cash conversion: 86%) for the year ended 31 January 2019 and £367 million (cash conversion 93%) for the year ended 31 January 2018.

- Total Net Debt to EBITDA of 8.3 x and Total Class A Net Debt to EBITDA at 6.5 x as at 31 January 2019.

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 accounts, 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. Mr Mackenzie's claim against the Companies has not progressed materially, nor has he provided the Companies with full details of his alleged loss. The Companies continue to maintain their counterclaim for the reimbursement of previous bonuses paid to Mr Mackenzie. 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 new corporate interest restriction legislation was introduced with effect from 1 April 2017. As the majority of the Group activity is taxed within the UK, these restrictions have not had a significant impact on the deductibility of the Group's interest.

In addition to commencing preparation for the Senior Managers and Certification Regime (SMCR), the Group, along with other UK insurers brokers and aggregators, has responded to the FCA's market study on pricing practices announced in October 2018 and industry data requests.

Implementation of Insurance Distribution Directive (IDD) and General Data Protection Regulation (GDPR) requirements has seen a significant change to business processes.

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:

Martin Clarke – Chief Financial Officer, resigned 29 April 2019

Mark Millar – Company Secretary and Director, resigned 17 April 2018

Catherine Free – Company Secretary, appointed 17 April 2019, resigned 30 January 2019

Nadia Hoosen – Company Secretary, appointed 30 January 2019

Capital Expenditure

Capital Expenditure (excluding Maintenance Capital Expenditure) in the period to 31 January 2019 included £30 million relating to the IT transformation project, £13m related to growth capital expenditure across our Roadside and Insurance business and £22m relating to finance lease capital payments net of proceeds from the sale of fixed assets.

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

Financing

On 17 July 2018, the Group issued £550m of Class A7 notes at an interest rate of 4.88%. £8m of costs associated with the issue of the A7 notes were capitalised. This consisted of £2m of premium and £6m of new issue fees.

From the proceeds of the Class A7 notes, the Group repaid £300m of Class A3 notes incurring a penalty of £15m and the £250m Senior Term Facility (STF). In line with the Group accounting policy, this was accounted for as an extinguishment of debt and therefore issue costs associated with the Class A3 notes and the STF have been written off totalling £3m.

On 17 July 2018, the Group also entered into a new undrawn £200m forward starting Senior Term Facility due in July 2023 in order to secure committed funding to be able to redeem the £200m of Class A3 notes left outstanding at their effective maturity on 31 July 2020. In addition, a new working capital facility of £60m (together with a £15m accordion facility), was put in place to replace the previous £75m working capital facility, with a maturity to 31 July 2023 and with the same margin as the previous facility. In line with group policy the fees associated with this of £3m were written off, as both facilities were undrawn.

Following the repayment of the STF, all but one of the outstanding interest rate swaps scheduled to conclude after 31 July 2018 were settled for £7m. One future dated interest rate swap was left in place to cover the undrawn STF. Following the settlement of the interest rate swaps and the repayment of the original STF, there is no longer an interest rate hedge on the original STF so the cash flow hedge reserve was released back through other comprehensive income.

On 30 July 2018, the Group drew down £15m of the working capital facility. This was repaid on 29 August 2018.

Acquisitions or Disposals

On 1 March 2018 the Group completed the purchase of the entire share capital of Used Car Sites Limited. A payment of £12 million was made to the former owners and £3 million was paid into an escrow account and is payable to the former owners subject to certain conditions being met. This transaction left a remaining balance of £11 million provisional deferred consideration which is due in more than one year.

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 29 March 2019, the Group completed the sale of 51% of the share capital of AA Media Limited for cash consideration of £1m.

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 the new STF be drawn.

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 next 5 financial years starting for the year ending 31 January 2019.

Ratios

We confirm that in respect of this investor report dated 25 June 2019, 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 2019 is more than 1.35; we set out the calculation below:

	Year to January 2019 £m
Operating profit before tax	50
Add back:	
Debt interest payable	127
Penalty interest payable	15
Interest payable under finance leases	4
Amortisation of debt issue costs	21
Transfer from cash flow hedge reserve	(8)
Finance costs in respect of pensions	6
Contingent consideration finance cost	2
Change in fair value of contingent consideration	(1)
Exceptional items	18
Depreciation and amortisation	72
Difference between the pension service cost and employer cash contributions	27
Profit on disposal of Irish business segment	-
Share-based payments	4
Less interest receivable	-
Class A Maintenance EBITDA	337
Less	
Cash tax paid	(15)
Change in working capital	(24)
Dividend received from joint ventures and associates	-
Minimum capital maintenance spend	(35)
Payments for restructuring and other provisions	(10)
Payments for onerous lease	(2)
Class A Free cash flow	251
Class A total debt service charge	96
Class A FCF DSCR	2.6

- 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 2019 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-19 £m
Class A Debt:		
	Senior term facility	-
	Class A1 notes	-
	Class A2 notes	500
	Class A3 notes	200
	Class A4 notes	-
	Class A5 notes	700
	Class A6 notes	250
	Class A7 notes	550
	Working Capital Facility (utilised as guarantee)	4
Less:	Cash and Cash Equivalent Investments	(20)
Total Class A Net Debt		2,184
	Permitted Investor payment	(330)
Max Class A Net Debt		1,854
Class A Maintenance EBITDA		337
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 £nil, £nil 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 £91 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 2019:
    - 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,

M.W. Strickland

Mark Strickland
Director
For and on behalf of Automobile Association Developments Limited as Holdco Group Agent
25 June 2019