AA Intermediate Co Ltd - Investor Report

This is the Investor Report for the year ended 31 January 2018 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 2018, and the AA remains the market leader with c. 40% of the Consumer market, c. 65% 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 including discontinued operations decreased by 5% to £393 million in the twelve months ended 31 January 2018 (2017: £414 million). On a continuing basis, EBITDA decreased by 3% to £393 million in the twelve months ended 31 January 2018 (2017: £406 million).

- Trading EBITDA margins decreased slightly to 42% in the twelve months ended 31 January 2018 (2017: 43%).

- Cash flow from continuing operating activities before tax and exceptional items of £367 million (cash conversion: 93%) for the year ended 31 January 2018 and £374 million (cash conversion 92%) for the year ended 31 January 2017.

- Total Net Debt to EBITDA of 7.1 x and Total Class A Net Debt to EBITDA at 5.47 x as at 31 January 2018.

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

Regulatory and business update

As part of the UK government's implementation of OECD proposals, Finance (No 2) Act 2017 was enacted and introduced new restrictions on interest deductions with effect from 1 April 2017. Broadly, under these new rules, there is a cap on interest deductions by means of a fixed ratio rule based on 30 per cent of a group's UK tax-related EBITDA, and an elective worldwide group ratio rule which will enable certain groups to deduct interest that would otherwise be disallowed under the fixed ratio rule.

These new rules may have an effect on the ability of the AA plc group to claim deductions for part of its interest expenses. However, as the AA is predominantly UK based and will elect to use the group ratio rule, the impact on the group's effective tax rate is not expected to be significant.

In the previous financial year, we became aware that there was some duplication of roadside assistance cover taken by a limited number of business-to-business customers who were personal Members and held AVAs (Added Value Accounts) with our banking partners. While some were unaware that they

had duplicate cover, others chose to maintain this to receive the benefits of Membership. Through the review of data for the new Customer Relationship Management systems, we identified a group of customers for whom the benefit of holding both forms of cover were not clear. We proposed a programme of remediation for them which has the support of the regulatory authority. We provided a total of £10 million for our estimate of the refunds due of which £7 million was expected to relate to premiums previously paid for breakdown cover and £3 million for interest payable on those premiums. During the period £5 million has been paid out relating to premiums and £3 million relating to interest, £1m has been released and we expect to pay out the remaining amount during the financial year ended 31 January 2019.

On 7 March 2018, the Group received notification that former Executive Chairman, Bob Mackenzie, who was dismissed for gross misconduct on 1 August 2017, had on 6 March 2018 issued a Claim Form in the High Court, Chancery Division against AA plc, its subsidiary Automobile Association Developments Limited and personally against a number of their directors and the Company Secretary. The Claim Form seeks a permanent injunction to retain his MVP shares and up to £225 million in damages. The Group has not made a provision for these amounts in its financial statements as the Group expects to be successful in rigorously defending these claims. However, the Group will incur legal costs of approximately £1 million to defend these claims during the next two financial years which it would seek to recover from Bob Mackenzie when the litigation concludes.

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:

Mark Strickland – Director, appointed 7 August 2017

Mark Millar - Director, resigned 17 April 2018

Bob Mackenzie – Director, dismissed 1 August 2017

Mark Millar – Company Secretary, resigned 17 April 2018

Catherine Hammond – Company Secretary, appointed 17 April 2018

Capital Expenditure

Capital Expenditure (excluding Maintenance Capital Expenditure) in the period to 31 January 2018 included £34 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 13 July 2017, the Group issued £250 million of Class A6 notes at an interest rate of 2.75%. £4 million of costs associated with the issue of the A6 notes were capitalised. This consisted of £1 million of premium and £3 million of new issue fees.

From the proceeds of the A6 notes, the Group repaid the remaining £175 million of A1 notes incurring an interest penalty of £7 million and £55 million of A4 notes incurring an interest penalty of £3 million. In line with the Group accounting policy, this was accounted for as an extinguishment of debt and therefore issue costs associated with the A1 and A4 notes have been written off but totalled under £1 million.

Following the sale of the Irish business during the prior year, we held back £24 million from the net proceeds in ring-fenced available cash to be used for potential future acquisitions or repayment of debt. On 13 July 2017 the £24 million was used as part of a repayment of £98 million of the Senior Term Facility. This was treated as an extinguishment of debt and therefore the issue costs of just under £1m associated with the repayment were written off. The balance of the STF was renegotiated and its maturity extended to 31 July 2021. This was treated as a modification and therefore the fees associated with this, which were under £1m, were capitalised.

On the 13 July 2017 the working capital facility was reduced from £150 million to £75 million. The fees associated with this were under £1 million.

Acquisitions or Disposals

On 1 October 2017 the company assumed control of Used Car Sites Limited (trading as AA Cars), a used car sales platform for a provisional consideration of £26 million. At the point of acquisition Used Car Sites Limited had receivables of £1.8 million, cash of £1.8 million and payables of £2.4 million. Used Car Sites Limited made a profit before tax of £nil for the year to 30 September 2017 and a profit before tax of £1 million for the period 1 October 2017 to 31 January 2018.

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.

Current Hedge Position

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

Class A 'basket' reset

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 22 June 2018, 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 2018 is more than 1.35; we set out the calculation below:

	Year to January 2018 £m
Operating profit before tax	147
Add back:	
Debt interest payable	132
Penalty interest payable	10
Interest payable under finance leases	6
Amortisation of debt issue costs	11
Transfer from cash flow hedge reserve	(2)
Finance costs in respect of pensions	10
Exceptional items	29
Depreciation and amortisation	68
Difference between the pension service cost and employer cash contributions	(24)
Share-based payments	7
Less interest receivable	(1)
Class A Maintenance EBITDA	393
Less	
Cash tax paid	(23)
Change in working capital	(6)
Minimum capital maintenance spend	(25)
Payments for restructuring and other provisions	(10)
Payments for onerous lease	(2)
Class A Free cash flow	327
Class A total debt service charge	99
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 2018 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 £6 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:

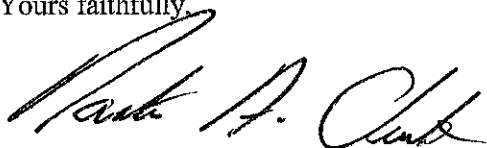
		Year to Jan-18 £m
Class A Debt:		
	Senior term facility	250
	Class A2 notes	500
	Class A3 notes	500
	Class A5 notes	700
	Class A6 notes	250
	Working Capital Facility (utilised as guarantee)	5
Less:	Cash and Cash Equivalent Investments	(50)
Total Class A Net Debt		2,155
	Permitted Investor payment	6
Max Class A Net Debt		2,162
Class A Maintenance EBITDA		393
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.
- 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 £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 2018:
    - 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,



Martin Clarke
Director
For and on behalf of Automobile Association Developments Limited as Holdco Group Agent
22 June 2018