



AA INTERMEDIATE CO LIMITED

INTERIM REPORT

FOR THE SIX MONTHS ENDED 31 JULY 2017

Management discussion and analysis

Introduction

The directors present the condensed financial statements of AA Intermediate Co Limited (“the Company”) and its subsidiary undertakings (together “the Group”) for the period ended 31 July 2017. The Company is an Obligor and a parent company of each of the other Obligors that provide security and guarantees under the financing arrangements entered into by the AA on 2 July 2013. The Company’s immediate parent is AA Mid Co Limited. There is no material difference in the financial conditions and results of operations between the AA Intermediate Co Limited group and the AA Mid Co Limited group.

Principal activity and review of business developments

The Group provides AA branded goods and services across the UK. The AA’s principal activity is the provision of Roadside Assistance to both its personal Members and business customers (which in aggregate makes up 79% of Group Trading Revenue).

The other business segments that the AA operates in the UK are Insurance Services and Driving Services. The AA business strategy includes cross-selling Insurance Services to its Membership utilising its marketing database and multiple points of contact with its customers.

The AA is focused on delivering the highest possible standards of customer service, quality products, stable and predictable profits, strong operating margins and continued strong cash generation. The Group continued to demonstrate all of these qualities during the six-month period.

Key operating measures

We use several key operating measures to track the financial and operating performance of our business.

	July 2017	July 2016
Roadside Assistance		
Paid personal Members ¹ (000s)	3,325	3,321
Average income per paid personal Member ¹ (£)	156	157
Business customers ¹ (000s)	10,016	10,179
Average income per business customer ¹ (£)	20	19
Number of breakdowns (000s)	1,761	1,759
¹ Last 12 months		
Insurance Services		
Policy numbers in force ¹ (000s)	1,845	1,962
Average income per policy ² (£)	72	67
¹ Last 12 months includes Home Services, but not Financial Services		
² Average income per policy includes Financial Services revenue		
Driving services		
Number of driving instructors	2,669	2,516

Management discussion and analysis (continued)

Key operating measures (continued)

Paid personal Members increased 0.1% year on year to 3,325,000 (H1 2017: 3,321,000) although just down 0.3% on the last six-month period (2017 year end: 3,335,000). Last year's membership number included an additional 70,000 who paid for membership, having received free membership in the previous year. We are no longer benefiting from these free-to-paid renewals since reducing free membership in December 2015. However, the growth in new members has offset this.

In the business-to-business segment, the 2% reduction in business customers was anticipated due to the continuing decline in Added Value Accounts which have reduced substantially in recent years across the banking sector. This was partially offset by an increase in manufacturers' new vehicle numbers. We have retained or extended a number of key contracts. Average income per customer at £20 rose 5% in the period (H1 17: £19). We anticipate the number of Added Value Accounts in the market will continue to decline. The investments we have made in the last two years give us a strong platform for expanding our services for business customers in all markets and we are pursuing new opportunities.

Motor insurance policies grew 8% to 616,000 (H1 17: 572,000). We did well to achieve stable retention despite the challenges of renewal pricing transparency from April, the impact of Ogden on cost of premiums and therefore churn, and IPT increases. In addition, we benefited from the success of our in-house underwriter bringing in new business to the AA, and our ability to price with more agility following the installation of Insurer Hosted Pricing with two of our panel members (two more to follow shortly) as well as our own underwriter. Home policies fell 5%, but we expect this trend to reverse during the second half of the year as we are now following strategy we applied to motor insurance which successfully reversed a decline in motor policies that had been running for six years. Other insurance categories and Home Services are also down as we continue to pull away from less profitable business.

Management discussion and analysis (continued)

Principal risks and uncertainties

The Company's Principal Risks were detailed in the Annual Report 2017 and are summarised below:

1. Outstanding service

We are unable to maintain an outstanding service at a fair price.

The AA's brand and its continued success rely on delivering outstanding service that is superior to the rest of the market.

2. Roadside market share and margin

We are unable to maintain our market share and an ability to command a price premium on our roadside services.

Competitors that provide roadside services at a lower price or a different business model together with changes in car technology, threaten our roadside revenues.

3. Growing the business

We are unable to grow the business in a manner that complements and sustains the brand.

We may be unable to develop and grow new profitable business products and lines that complement the customer experience and which demonstrate standards and values that underlie our core brand.

4. Insurance Broking business

Aggregators and price comparison sites will further damage the insurance broker model.

The further growth of price comparison sites may continue to transfer value from our insurance broking business.

5. Insurance Underwriting

Higher than anticipated claims costs.

There are risks of higher than expected claims frequency, higher average cost per claim and catastrophic claims.

6. Regulatory environment

A changing regulatory environment may adversely affect our activities.

The changing regulatory environment could cause currently compliant services to become non-compliant with material implications to customer offerings, pricing and profitability. Failure to comply with regulatory obligations could result in substantial fines. Changes in Government legislation or taxation could impact the business model.

7. Business transformation

We are unable to successfully complete the essential business transformation.

We must continue to transform the AA to achieve the required efficient customer-centric services and to develop the business. There is still much to do and the required acceleration of improvements to process, embedded ways of working and culture, inherently involve risks in a customer-facing service environment.

8. IT transformation

We are unable to successfully deliver the essential IT transformation.

An essential programme of renewal and enhancement of our IT estate is in progress to address the risks to our brand and our competitive capability. The continuing work is extensive and complex. Given the scale and complexity, the programme involves inherent risks to the timely delivery of this implementation.

9. Debt

The AA is a highly leveraged company with a substantial pension fund, currently in deficit.

The Company is unable to repay or refinance its debt at an acceptable price. The Company has a large pension scheme, currently in deficit, whose assets and obligations are subject to future variation from investment returns, longevity and other similar factors.

10. Information security/cyber-crime

There is an increasing threat of cyber-attacks on organisations.

Critical information is not available where and when it is needed. The integrity of critical information is corrupted or the confidentiality of commercially sensitive, private or customer information is compromised by inappropriate disclosure. A serious data breach occurs.

Management discussion and analysis (continued)

Principal risks and uncertainties (continued)

The Board has reviewed these principal risks for material developments since the publication of the Annual Report 2017 and the significant changes, including those that may impact the second half performance, are detailed below:

- **Outstanding Service:** While our repair rate and single-task-completion are at an 11-year high and under-bonnet times an 9-year low, our own resource this year has been insufficiently flexible for varying workload patterns and, in order to maintain service levels, we use third party garages. Our service levels have not been compromised but drawing on third-party garages, which are most expensive in busy periods, adds cost and, as a result, profitability was lower. We are working to increase the flexibility of the patrol force and to improve our planning and forecasting to mitigate these costs in the future.
- **Roadside market share and margin:** Personal paid Membership numbers have remained stable.
- **Regulatory environment:**
 - Regulatory changes that impact on this risk include implementation of the FCA's Insurance Distribution Directive and preparing for the Senior Managers and Certification Regime in 2018. We have updated our renewal processes to comply with the new requirements on price transparency.
 - The new GDPR (General Data Protection Regulation) requirements come into force in May 2018. A major multi-disciplinary project has been put in place to prepare the AA for the changes to data protection that will come into effect next year.
 - Duplicate cover: We previously reported an issue we found relating to duplicate breakdown cover. The remediation plan we agreed with the FCA is on track to conclude this matter.
- **Business transformation:** We will reinvest in people, capabilities and culture. The focus will be on strengthening our call centres, improving our analytical skill base, and achieving a more flexible patrol force.
- **IT transformation:** The business is reviewing the timelines and priorities for the transformation of our systems as part of the review of our strategy and its execution.
- **Debt:**
 - Debt refinancing: The A1 (4.7%) and A4 (3.8%) loan notes have been repaid in full and replaced with A6 notes (2.75%). We incurred £10m of penalty interest due to the refinancing. £98m of the STF has been repaid out of free cash including the £24m held back following the sale of AA Ireland. The repayment period of the STF has been extended to July 2021. No debt is due to be repaid until 31 July 2020 (the A3 notes). In order for the Group to be able to refinance its borrowings, it is a key assumption of the directors that the Capital Markets remain open to the Group. The directors continue to be confident that they will be able to refinance these borrowings at an acceptable price. We will continue to make additional repayments to reduce the debt burden as opportunities for this arise although it is assumed there will be no further refinancing for at least 18 months, the Group will continue to delever through cash generated by the business.
 - Pension scheme changes: A pension consultation process with employees has been successfully completed and changes to the pension schemes implemented, including closure of the final salary pension scheme and move of all participants to the Career Average Section, to mitigate future exposure on the pension liability risk. The Group is still exposed to future variation from investment returns, longevity and other similar factors. We have agreed a nine-year deficit recovery additional funding plan with the Trustee, taking into account the continued funding of the previous deficit.

Management discussion and analysis (continued)

Principal risks and uncertainties (continued)

- **Information security/cyber-crime:** While we have made further progress enhancing our IT security and defences against cyber-crime, the external environment continues to be increasingly hostile to all businesses. A third party provider of services to the AA had an incorrectly configured server and this exposed data for 91,590 customers. The vulnerability in the third party's systems was closed promptly when it was identified. An exercise was undertaken to communicate with the affected customers and the matter was reported to the ICO and the FCA, although it did not arise in our regulated business.

The risks listed above do not comprise all those associated with the AA, and are not set out in any order of priority. Additional risks and uncertainties, not presently known to management or currently deemed to be less material, may also have an adverse effect on the business. The Group risk profile will evolve as mitigating activities succeed in reducing the net risks over time, or as new risks emerge.

Post Balance Sheet Events

On 7 September 2017, the UK Ministry of Justice announced a draft change to the law used to set the discount rate used in calculating upfront personal injury payments (Ogden discount rate reforms). The proposal could result in a rate change from the current rate of -0.75% to a rate between 0% and 1%. It will not be applied retrospectively. The proposal, which is currently in draft form, is expected to take a few months to finalise prior to the legislation being enacted. As a result of the uncertainty, the Insurance Underwriter reserves as at 31 July 2017 have been calculated based on the current Ogden rate of -0.75%.

On 21 September 2017 the AA Ireland Pension Scheme triennial valuation as at 31 December 2016 was completed with an agreed deficit on a going concern funding basis of €9.0m. The previous valuation as at 31 December 2013 valued the deficit at €6.5m. No changes were made to the schedule of contributions as a result of the updated valuation.

On 25 September 2017 Simon Breakwell was appointed permanent CEO. For the year ended 31 January 2019, Simon's salary as CEO will be £700,000. Under the standard three-year renewal cycle, the Directors' Remuneration Policy is subject for renewal at the 2018 AGM, and the Remuneration Committee will be engaging with major shareholders regarding the terms of the new policy. The remuneration package will follow typical FTSE practices. The Company does not intend to grant any awards to Simon under the legacy Management Value Participation Share structure.

Management discussion and analysis (continued)

	Six months ended July 2017 £m	Six months ended July 2016 £m
Revenue	467	455
Cost of sales	(172)	(166)
Gross profit	295	289
Administrative & marketing expenses	(115)	(155)
Operating profit	180	134
Trading EBITDA	194	194
Pension past service credit	34	-
Items not allocated to a segment	(12)	(10)
Amortisation and depreciation	(32)	(28)
Exceptional items	(4)	(22)
Operating profit	180	134
Finance costs	(98)	(84)
Profit before tax	82	50
Tax expense	(17)	(11)
Profit for the period from continuing operations	65	39
Discontinued operations		
Profit for the period from discontinued operations	-	6
Profit for the period	65	45

Revenue: Revenue increased by £12m from £455m in the six months ended 31 July 2016 to £467m in the six months ended 31 July 2017. The prior period revenue included an exceptional revenue provision of £10m for refunds for customers who may have duplicate breakdown cover. Excluding this item, trading revenue increased by £2m from £465m in the six months ended 31 July 2016 to £467m in the six months ended 31 July 2017.

Roadside Assistance: Trading Revenue was flat during the period at £370m (H1 17: £370m). Whilst the membership base and gross subscriptions were up, the benefit of these were offset by the anticipated increase in IPT (Insurance Premium Tax) and a one-off payment to an underwriting partner for our underwritten products, such as Breakdown Repair Cover.

Insurance Services: Trading Revenue for Insurance Services was up 3% to £66m largely as a result of the 8% growth in motor book to 616,000 policies (H117: 572,000). We did well to achieve stable retention despite the challenges of renewal pricing transparency from April, the impact of Ogden on cost of premiums and therefore churn, and IPT increases. In addition, we benefited from AA plc group underwriter bringing new business to the AA and the ability to price our broker business with more agility.

Driving Services: Driving Services Trading Revenue was flat at £31m. The number of instructors increased 6% due to improvements in our sales and marketing approach. In addition, we are pleased with the progress of our driver instructor training product which is a key source of new instructors.

Management discussion and analysis (continued)

Cost of sales: Cost of sales increased from £166m in the six months ended 31 July 2016 to £172m in the six months ended 31 July 2017.

Administrative and marketing expenses: Administrative and marketing expenses decreased by £40m or 26% from £155m in the six months ended 31 July 2016 to £115m in the six months ended 31 July 2017. £34m of the decrease in administrative and marketing expenses is due to a one-off past service credit in relation to changes made to the UK defined benefit pension scheme. In addition, exceptional costs were £18m lower in the current period.

Operating profit: Operating profit increased by £46m or 34% from £134m in the six months ended 31 July 2016 to £180m in the six months ended 31 July 2017. The increase in operating profit was primarily driven by the reduction in administrative expenses described above.

Finance costs: Finance costs at £98m were considerably higher than the prior period as a result of some one-off costs of the refinancing in July 2017 (2016: £84m).

Taxation: The tax charge in the six months ended 31 July 2017 was £17m compared to £11m in the six months to 31 July 2016. The charge for the current period reflects higher profit before tax.

Trading EBITDA

Trading EBITDA was flat at £194m in the six months ended 31 July 2016 and in the six months ended 31 July 2017. The Trading EBITDA margin at 41.5% was marginally lower than last year (2016: 41.7%).

Roadside Assistance: Trading EBITDA decreased 2.8% to £174m. This was mainly the result of the increased costs of third-party garaging. In addition, we incurred a one-off accumulated charge with a third party underwriter for such products as Breakdown Repair Cover.

Insurance Services: Core Insurance trading EBITDA increased by £3m, as a result of the growth of our motor book, the focus on growing more profitable business lines and disciplined cost management. The Trading EBITDA margin at 57.6% was up substantially (H1 17: 54.7%).

Driving Services Driving Services trading EBITDA was flat on last year, reflecting flat revenue and costs.

Head Office Costs: Head Office Costs decreased by £2m or 6.9% from £29m in the six months ended 31 July 2016 to £27m in the six months ended 31 July 2017. The decrease in Head Office Costs is principally due to cost savings.

Management discussion and analysis (continued)

Consolidated statement of cash flows

	Six months ended July 2017 £m	Six months ended July 2016 £m
Net cash flows from operating activities before tax	180	194
Tax paid	(11)	(8)
Net cash flows from operating activities	169	186
Investing activities		
Capital expenditure	(26)	(37)
Proceeds from sale of fixed assets	10	6
Acquisition and disposals, net of cash acquired or disposed of	-	(2)
Net cash flows used in investing activities	(16)	(33)
Financing activities		
Proceeds from borrowings	250	-
Issue costs on borrowings	(6)	-
Debt repayment penalties	(11)	-
Repayment of borrowings	(328)	-
Refinancing transactions	(95)	-
Interest paid on borrowings	(72)	(73)
Payment of finance lease capital excluding final payments	(19)	(20)
Payment of finance lease interest	(3)	(3)
Dividend paid	(20)	-
Net cash flows from financing activities	(209)	(96)
Net (decrease)/increase in cash and cash equivalents	(56)	57

Change in working capital: The change in working capital represented a cash inflow of £17m in the six months ended 31 July 2016 compared to a cash outflow of £37m in the six months ended 31 July 2017. £34m of this charge related to the one-off past service pension credit noted above and in addition to this were timing differences related to payments of IPT. Offsetting this were timing differences in cash receipts from Business Services customers.

Management discussion and analysis (continued)

Net cash flows from operating activities before tax: Net cash flow from operating activities before tax decreased from a cash inflow of £194m in the six months ended 31 July 2016 to a cash inflow of £180m in the six months ended 31 July 2017. This was driven by the decrease in working capital described above, partially offset by higher operating profit.

Tax paid: Cash outflow from tax paid was £8m in the six months ended 31 July 2016 compared to £11m in the six months ended 31 July 2017. This was due to higher profit before tax in the current period.

Investing activities: Cash outflow from investing activities was £33m in the six months ended 31 July 2016 compared to £16m in the six months ended 31 July 2017. The decrease in cash outflow from investing activities was driven by a decrease in capital expenditure, partially offset by increase in proceeds from the sale of fixed assets.

Financing transactions: Net cash flow from financing transactions was a cash outflow of £nil in the six months ended 31 July 2016 compared to £95m in the six months ended 31 July 2017. The increase in financing outflows relates to the refinancing carried out in the current period.

Interest paid on borrowings: Cash outflow from interest paid on borrowings was £73m in the six months ended 31 July 2016 compared to £72m in the six months ended 31 July 2017.

Debt repayment penalties: Cash outflow from debt repayment penalties was £nil in the six months ended 31 July 2016 compared to £11m in the six months ended 31 July 2017. This payment related to the penalty on early redemption of the Class A1 and A4 notes in the current period.

Payment of finance lease capital and interest: Cash outflow from the payment of finance lease capital and interest was £23m in the six months ended 31 July 2016 compared to £22m in the six months ended 31 July 2017, so was relatively stable.

Dividend: The Group has paid £20m dividend to AA plc in the six months ended 31 July 2017 (H1 17: £nil).

Management discussion and analysis (continued)

Net debt and covenants	As at 31 July 2017 £m	As at 31 July 2016 £m
Senior Term Facility	250	454
Class A notes	1,950	1,725
Less: cash and cash equivalents	(80)	(122)
Net Senior Secured Debt ¹	2,120	2,057
Class B notes	570	735
Finance lease obligations	56	51
Net Debt ²	2,746	2,843
Trading EBITDA for the last twelve months ³	406	419
Class B2 Leverage ratio ⁴	6.8x	6.8x
Senior leverage ratio ⁵	5.2x	4.9x
Class A Free Cash Flow: Debt Service ⁶	3.1x	3.3x
Class B Free Cash Flow: Debt Service ⁷	2.2x	2.3x

1 Principal amounts of the Senior Term Facility and Class A notes less cash and cash equivalents

2 Principal amounts of the Senior Term Facility, Class A notes, Class B notes and finance leases less cash and cash equivalents

3 Includes discontinued operations as required by the debt documents

4 Ratio of Net Debt to Trading EBITDA for the last twelve months

5 Ratio of Net Senior Secured Debt to Trading EBITDA for the last twelve months

6 Ratio of last twelve months free cash flow to proforma debt service relating to the Senior Term Facility and Class A notes

7 Ratio of last twelve months free cash flow to proforma debt service

Cash generation for the Group has remained strong with net cash inflows from operating activities before exceptional items and tax of £196m in the six months ended 31 July 2017 compared to £203m in the six months to 31 July 2016. Net debt to Trading EBITDA for the last 12 months stood at 6.8 times and net senior secured debt to Trading EBITDA has increased to 5.2 times as at 31 July 2017.

Class A free cash flow to debt service was 3.1 times as at 31 July 2017 and Class B free cash flow to debt service was 2.2 times, showing substantial covenant headroom.

The cash within the ring-fenced group headed by AA Mid Co Limited is part of the whole business securitisation (WBS). A dividend cannot be paid from the ring-fenced group until a number of criteria have been met. These include:

- Class A Free Cash Flow: Debt Service is above 1.35x
- Class B Free Cash Flow: Debt Service is above 1.00x
- The Senior Leverage ratio is less than 5.5x
- Finance charges: Trading EBITDA is above 2x where finance charges relate to the ring-fenced group and are on a proforma basis based on the Group's borrowings at the time of the test and exclude the amortisation of debt issue fees and net finance expense on defined benefit schemes
- The Group is also subject to a maximum cumulative dividend payout related to the cumulative cash generation and cumulative net income since the WBS was established, which are significantly higher than the proposed dividends. These calculations are adjusted for items required by the financing documents.

The Group has a cash balance of £80m, invested in AAA money market funds, giving overnight access and high liquidity. The Group has not drawn its Working Capital Facility and does not currently envisage needing to do so.

The Group is required to hold segregated funds as 'restricted cash' in order to satisfy regulatory requirements governing our insurance regulated business. These restricted cash balances were £7m at 31 July 2017 excluding any restricted cash balances shown as held for sale (2016: £8m).

Consolidated income statement

	Note	Six months ended July 2017 £m	Six months ended July 2016 £m
Revenue	2	467	455
Cost of sales		(172)	(166)
Gross profit		295	289
Administrative & marketing expenses		(115)	(155)
Operating profit		180	134
Trading EBITDA	2	194	194
Pension past service credit	4	34	-
Items not allocated to a segment	4	(12)	(10)
Amortisation and depreciation		(32)	(28)
Exceptional items	4	(4)	(22)
Operating profit		180	134
Finance costs	5	(98)	(84)
Profit before tax		82	50
Tax expense	6	(17)	(11)
Profit for the period from continuing operations		65	39
Discontinued operations			
Profit for the period from discontinued operations	3	-	6
Profit for the period		65	45

The accompanying notes are an integral part of these financial statements.

Consolidated statement of comprehensive income

	Note	Six months ended July 2017 £m	Six months ended July 2016 £m
Profit for the period		65	45
Other comprehensive income on items that are or may be reclassified to profit and loss in subsequent years			
Exchange differences on translation of foreign operations		(1)	1
Effective portion of changes in fair value of cash flow hedges		8	(1)
Tax effect		(1)	-
		6	-
Other comprehensive income on items that are not to be reclassified to profit and loss in subsequent years			
Remeasurement losses on defined benefit schemes	16	2	(330)
Tax effect		-	56
		2	(274)
Total other comprehensive income		8	(274)
Total comprehensive income for the period		73	(229)

The accompanying notes are an integral part of these financial statements.

Consolidated statement of financial position

	Note	July 2017 £m	July 2016 £m	January 2017 £m
Non-current assets				
Goodwill and other intangible assets	7	1,285	1,269	1,276
Property, plant and equipment	8	113	117	131
Investments in joint ventures and associates		6	7	6
Deferred tax assets		56	107	62
		1,460	1,500	1,475
Current assets				
Inventories		7	6	6
Trade and other receivables	9	169	159	164
Amounts owed by parent undertakings	10	1,213	1,212	1,214
Cash and cash equivalents	11	80	122	136
		1,469	1,499	1,520
Assets held for sale	3	-	93	-
Total assets		2,929	3,092	2,995
Current liabilities				
Trade and other payables	12	(481)	(494)	(502)
Amounts due to parent undertakings		(21)	-	-
Current tax payable		(12)	(11)	(11)
Provisions	13	(10)	(21)	(19)
		(524)	(526)	(532)
Non-current liabilities				
Borrowings and loans	14	(2,739)	(2,922)	(2,819)
Finance lease obligations		(17)	(21)	(20)
Defined benefit pension scheme liabilities	16	(364)	(622)	(395)
Provisions		(9)	(7)	(11)
		(3,129)	(3,572)	(3,245)
Liabilities held for sale	3	-	(40)	-
Total liabilities		(3,653)	(4,138)	(3,777)
Net liabilities		(724)	(1,046)	(782)
Equity				
Share capital		-	20	-
Currency translation reserve		-	-	1
Cash flow hedge reserve		9	(11)	2
Retained earnings		(733)	(1,055)	(785)
Total equity attributable to equity holders of the parent		(724)	(1,046)	(782)

The accompanying notes are an integral part of these financial statements.

Consolidated statement of changes in equity

Attributable to the equity holders of the parent

	Share capital £m	Currency translation reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total £m
At 1 February 2016	20	(1)	(10)	(832)	(823)
Profit for the period	-	-	-	45	45
Other comprehensive income	-	1	(1)	(274)	(274)
Total comprehensive income	-	1	(1)	(229)	(229)
Share-based payments	-	-	-	6	6
At 31 July 2016	20	-	(11)	(1,055)	(1,046)
At 1 February 2017	-	1	2	(785)	(782)
Profit for the period	-	-	-	65	65
Other comprehensive income	-	(1)	7	2	8
Total comprehensive income	-	(1)	7	67	73
Share-based payments	-	-	-	5	5
Dividends	-	-	-	(20)	(20)
At 31 July 2017	-	-	9	(733)	(724)

The accompanying notes are an integral part of these financial statements.

Consolidated statement of cash flows

	Note	Six months ended July 2017 £m	Six months ended July 2016 £m
Profit before tax		82	57
Amortisation and depreciation		32	29
Net finance costs		98	84
Other adjustments to profit before tax		5	7
Working capital:			
(Increase) in trade and other receivables		(5)	(12)
Increase in trade and other payables		13	26
(Decrease) / increase in provisions		(11)	13
Difference between pension charge and cash contributions		(34)	(10)
Total working capital adjustments		(37)	17
Net cash flows from operating activities before tax		180	194
Tax paid		(11)	(8)
Net cash flows from operating activities		169	186
Investing activities			
Capital expenditure		(26)	(37)
Proceeds from sale of fixed assets		10	6
Acquisition and disposals, net of cash acquired or disposed of		-	(2)
Net cash flows used in investing activities		(16)	(33)
Financing activities			
Proceeds from borrowings		250	-
Issue costs on borrowings		(6)	-
Debt repayment penalties		(11)	-
Repayment of borrowings		(328)	-
Refinancing transactions		(95)	-
Interest paid on borrowings		(72)	(73)
Payment of finance lease capital		(19)	(20)
Payment of finance lease interest		(3)	(3)
Dividend paid		(20)	-
Net cash flows from financing activities		(209)	(96)
Net (decrease)/increase in cash and cash equivalents		(56)	57
Net foreign exchange differences		-	1
Cash and cash equivalents at the beginning of the period		136	94
Cash and cash equivalents		80	152
Cash transferred to asset held for sale	3	-	(30)
Cash and cash equivalents from continuing operations	11	80	122

The cash flows from operating activities are stated net of cash outflows relating to exceptional items of £16m (2016: £9m). This relates to the cost of business transformation of £9m (2016: £7m), non-recurring costs of IT system implementation and other restructuring activities of £nil (2016: £1m), duplicate cover reimbursements of £6m (2016: £nil) and onerous property provision lease costs in respect of vacant properties of £1m (2016: £1m).

Other adjustments to profit before tax relate to share based payments £5m (2016: £6m) and impairment of software £nil (2016: £1m).

Operating cash flows from discontinued operations were £nil (2016: £10m) (see note 3).

The accompanying notes are an integral part of these financial statements.

Notes to the financial statements

1 Basis of preparation

a) Accounting policies

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standard 34 'Interim Financial Reporting' (IAS 34). Accordingly, they do not include all the information and disclosures required in the annual financial statements and should be read in conjunction with the Group's annual financial statements as at 31 January 2017.

The accounting policies adopted in the preparation of the interim condensed consolidated financial statements are consistent with those followed in the preparation of the Group's annual consolidated financial statements for the year ended 31 January 2017 which were prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and have been applied consistently across all periods.

These financial statements do not constitute statutory accounts within the meaning of Section 435 of the Companies Act 2006. Statutory accounts for the year to 31 January 2017 were approved by the board of directors on 7 June 2017 and delivered to the Registrar of Companies. The report of the auditors on those accounts was unqualified and did not contain any statement under Section 498 of the Companies Act 2006.

b) Going concern

The Group has long-term contracts with a number of suppliers across different industries and is strongly cash generative. The Group's borrowings are long-term in nature and in addition to the cash balances at the reporting date the Group has agreed undrawn credit facilities in place. The directors have considered this along with the projected future cash flows and have concluded that the Group has sufficient funds to continue trading for the foreseeable future. Therefore, the interim condensed consolidated financial statements have been prepared using the going concern basis.

c) Segmental analysis

The nature of the Group's operations means that for management's decision making and internal performance management the key performance metric is earnings before interest, tax, depreciation and amortisation (EBITDA) by trading segment which excludes certain unallocated items (referred to as Trading EBITDA). Items not allocated to a segment relate to transactions that do not form part of the ongoing segment performance and include transactions which are one-off in nature. Trading EBITDA is further analysed as part of the segmental analysis in note 2. The segmental results for the prior year exclude Ireland which is a discontinued operation, see note 3.

d) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control is achieved where the Company has rights to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies into line with those used by the Group. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

e) Critical accounting estimates and judgements

The principal estimates and assumptions that have a risk of causing an adjustment to the carrying value amounts of assets and liabilities within the next financial period are consistent with those disclosed in the financial statements for the year ended 31 January 2017.

Notes to the financial statements (continued)

2 Segmental information

	Six months ended July 2017 £m	Six months ended July 2016 £m
Revenue		
Roadside Assistance	370	370
Insurance Services	66	64
Driving Services	31	31
Trading Revenue	467	465
Exceptional revenue provision (see note 10)	-	(10)
Total Revenue	467	455
Trading EBITDA		
Roadside Assistance	174	179
Insurance Services	38	35
Driving Services	9	9
Head Office costs	(27)	(29)
Total Trading EBITDA	194	194
Items not allocated to a segment	(12)	(10)
Pension past service credit	34	-
Amortisation and depreciation	(32)	(28)
Exceptional items	(4)	(22)
Operating profit	180	134
Net finance costs	(98)	(84)
Profit before tax	82	50

Notes to the financial statements (continued)

2 Segmental information (continued)

For management purposes, the Group is organised into business units based on their products and services. The Group has four reportable operating segments as follows:

- *Roadside Assistance:* This segment is the largest part of the AA business. The AA provides a nationwide service, sending patrols out to members stranded at the side of the road, repairing their vehicles where possible and getting them back on their way quickly and safely.
- *Insurance Services:* This segment includes the insurance brokerage activities of the AA, primarily in arranging motor and home insurance for customers, its home emergency activities and its intermediary financial services business.
- *Driving Services:* This segment contains the AA Driving School and the British School of Motoring, which are the two largest driving schools in the UK, as well as AA DriveTech, which provides driver training and educative programmes.
- *Head Office costs:* This segment includes IT, property, finance and other back office support functions.

Segment performance is primarily evaluated using the Group's key performance measures of Trading revenue and Trading EBITDA.

Trading revenue is revenue on a continuing basis adjusted for exceptional items and business disposed of. Trading EBITDA is profit after tax on a continuing basis as reported, adjusted for depreciation, amortisation, exceptional operating items, items not allocated to a segment, net finance costs, tax expense and business disposed of. This better reflects the Group's underlying performance.

Depreciation, amortisation, exceptional items, net finance costs, past service credit and tax expense are not allocated to individual segments as they are managed on a group basis.

Segmental information is not presented for items in the Statement of Financial Position as management do not view this information on a segmental basis.

3 Assets and liabilities held for sale and discontinued operations

At the prior period end, the Ireland business segment was held for sale and has been reported as a discontinued operation as it represents a separate geographical area and there was a plan to dispose of the whole of the Irish operation. The entities being sold were AA Ireland Limited and its subsidiary undertakings. The sale was completed on the 11 August 2016.

a) Assets of disposal group classified as held for sale

	July 2017 £m	July 2016 £m
Goodwill	-	26
Other intangible assets	-	9
Property, plant and equipment	-	3
Trade and other receivables	-	25
Cash and cash equivalents	-	30
Total	-	93

Notes to the financial statements (continued)

3 Assets and liabilities held for sale and discontinued operations (continued)

b) Liabilities of disposal group classified as held for sale

	July 2017 £m	July 2016 £m
Trade and other payables	-	40
Total	-	40

c) Results of discontinued operations

	Six months ended July 2017 £m	Six months ended July 2016 £m
Revenue	-	23
Expenses	-	(15)
Trading EBITDA	-	8
Depreciation	-	(1)
Operating profit	-	7
Tax	-	(1)
Profit for the period from discontinued operations	-	6

d) Net cash flows of discontinued operations

	Six months ended July 2017 £m	Six months ended July 2016 £m
Operating cash flow	-	10
Investing cash flow	-	(3)
Total cash flows	-	7

Notes to the financial statements (continued)

4 Items not allocated to a segment and exceptional items

	Six months ended July 2017 £m	Six months ended July 2016 £m
Share-based payments	5	6
Difference between cash contributions to the pension scheme for ongoing service and the calculated annual service costs	7	4
Total items not allocated to a segment	12	10
Pension past service credit	(34)	-
Exceptional items	4	22

Exceptional items incurred in the six months ended 31 July 2017 of £4m included £6m relating to business transformation and £1m relating to IT systems transformation, being partially offset by £2m income from an onerous property and £1m profit on disposal of fixed assets.

In the prior period, exceptional items of £22m included an estimated £10m provision for revenue refunds to customers who may have duplicate breakdown cover, £9m relating to business transformation, £1m impairment of intangible assets and the remainder of £2m relating to IT transformation, loss on disposal of fixed assets and other restructuring activities.

The pension past service credit £34m is a one-off gain from the pension scheme restructuring (see note 16).

5 Finance costs

	Six months ended July 2017 £m	Six months ended July 2016 £m
Interest on external borrowings	68	74
Early repayment penalty	10	-
Finance charges payable under finance leases	4	3
Total cash finance costs	82	77
Amortisation of debt issue fees	6	2
Transfer from cash flow hedge reserve for extinguishment of cash flow hedge	5	-
Net finance expense on defined benefit pension schemes	5	5
Total non-cash finance costs	16	7
Total finance costs	98	84

During the period, the Group repaid Class A1 notes of £175m (2016: £nil) and Class A4 notes of £55m (2016: £nil). As a result, the Group incurred an early repayment penalty of £10m (2016: £nil).

During the period, there were £1m (2016: £nil) of amortised debt issue fees immediately written off following the refinancing.

During the period, the Group also repaid £98m (2016: £nil) of the Senior Term Facility, and transferred the £5m (2016: £nil) fair value of the cash flow hedges related to the repayment to the income statement.

Notes to the financial statements (continued)

6 Tax

The major components of the income tax expense are:

	Six months ended July 2017 £m	Six months ended July 2016 £m
Consolidated income statement		
Current income tax		
Current income tax charge	12	11
	12	11
Deferred tax		
Relating to origination and reversal of temporary differences – current year	5	-
	5	-
Tax charge in the income statement	17	11

Tax for the period has been calculated by applying the forecast effective tax rate for the full year, excluding some exceptional items, to the profit before tax result for the period.

UK deferred tax has been recognised at the enacted rates of 17% and 19% depending on the expected reversal profile (2016: enacted rates 18% and 19%). The UK corporation tax rate will be reducing to 17% (2016: 18%) in April 2020.

The government has announced that legislation restricting the deductibility of interest by reference to UK EBITDA will be introduced with effect from 1 April 2017. This legislation has not been enacted as at the balance sheet date.

As the AA plc group is largely UK based, the Group is expected to utilise the “group ratio” in determining the impact of any interest disallowance. This is not expected to result in a material disallowance of interest.

Notes to the financial statements (continued)

7 Goodwill and other intangible assets

	Goodwill £m	Software £m	Total £m
Cost			
At 1 February 2016	1,198	184	1,382
Additions	-	27	27
Transfer to assets held for sale	(26)	(14)	(40)
Exchange adjustment	-	1	1
At 31 July 2016	1,172	198	1,370
At 1 February 2017	1,172	197	1,369
Additions	-	23	23
At 31 July 2017	1,172	220	1,392
Amortisation and impairment			
At 1 February 2016	-	92	92
Amortisation	-	12	12
Impairment	-	1	1
Transfer to assets held for sale	-	(5)	(5)
Exchange adjustment	-	1	1
At 31 July 2016	-	101	101
At 1 February 2017	-	93	93
Amortisation	-	14	14
At 31 July 2017	-	107	107
Net book value			
At 31 July 2017	1,172	113	1,285
At 31 July 2016	1,172	97	1,269
At 31 January 2017	1,172	104	1,276

Notes to the financial statements (continued)

8 Property, plant and equipment

	Freehold Land & Buildings £m	Long Leasehold Land & Buildings £m	Vehicles £m	Plant & equipment £m	Total £m
Cost or valuation					
At 1 February 2016	24	10	89	125	248
Additions	.	-	11	9	20
Disposals	.	-	(12)	-	(12)
Transfer to assets held for sale	.	(3)	(6)	(8)	(17)
Exchange adjustments	.	-	1	-	1
At 31 July 2016	24	7	83	126	240
At 1 February 2017	24	7	98	90	219
Additions	.	-	6	3	9
Disposals	.	-	(12)	-	(12)
At 31 July 2017	24	7	92	93	216
Depreciation and impairment					
At 1 February 2016	7	4	22	93	126
Charge for the period	-	1	11	4	16
Disposals	-	-	(6)	-	(6)
Transfer to assets held for sale	-	(2)	(4)	(8)	(14)
Exchange adjustments	-	-	1	-	1
At 31 July 2016	7	3	24	89	123
At 1 February 2017	7	3	26	52	88
Charge for the period	1	-	11	6	18
Disposals	-	-	(3)	-	(3)
At 31 July 2017	8	3	34	58	103
Net book value					
At 31 July 2017	16	4	58	35	113
At 31 July 2016	17	4	59	37	117
At 31 January 2017	17	4	72	38	131

Notes to the financial statements (continued)

9 Trade and other receivables

	July 2017 £m	July 2016 £m	January 2017 £m
Current			
Trade receivables	138	132	139
Prepayments and accrued income	28	23	23
Other receivables	3	4	2
	169	159	164

10 Amounts owed by parent undertakings

	July 2017 £m	July 2016 £m	January 2017 £m
Amounts owed by parent undertakings	1,213	1,212	1,214

Amounts owed by parent undertakings are unsecured, have no repayment terms and bear no interest.

11 Cash and cash equivalents

	July 2017 £m	July 2016 £m	January 2017 £m
Cash at bank and in hand – available	73	114	128
Cash at bank and in hand – restricted	7	8	8
Cash and cash equivalents	80	122	136

Cash at bank and in hand - restricted includes £7m (July 2016: £8m, January 2017: £8m) held by and on behalf of the Group's insurance businesses which are subject to contractual or regulatory restrictions. These amounts are not readily available to be used for other purposes within the Group.

Notes to the financial statements (continued)

12 Trade and other payables

	July 2017 £m	July 2016 £m	January 2017 £m
Current			
Trade payables	100	104	103
Other taxes and social security costs	8	24	25
Accruals and deferred income	304	308	295
Other payables	29	27	32
Interest payable	1	1	-
Obligations under finance lease agreements	39	30	47
	481	494	502

13 Provisions (current)

	July 2017 £m	July 2016 £m	January 2017 £m
Duplicate breakdown cover	4	10	10
Property leases	6	6	6
Restructuring	-	5	3
	10	21	19

During the period, £6m of the duplicate breakdown cover provision was utilised (2016: nil) and no additional provision was made (2016: £10m).

14 Borrowings and loans

	July 2017 £m	July 2016 £m	January 2017 £m
Borrowings (see note 15)	2,722	2,895	2,799
Interest rate swap derivatives	17	27	20
	2,739	2,922	2,819

Notes to the financial statements (continued)

15 Borrowings

	Expected maturity date	Interest rate	Principal £m	Issue costs £m	Amortised issue costs £m	Total as at 31 July 2017 £m	Total as at 31 July 2016 £m	Total as at 31 January 2017 £m
Senior Term Facility	31 July 2021	5.71%	250	(4)	3	249	453	347
Class A1 notes	31 July 2018	-	-	-	-	-	474	175
Class A2 notes	31 July 2025	6.27%	500	(1)	-	499	499	499
Class A3 notes	31 July 2020	4.25%	500	(3)	2	499	498	499
Class A4 notes	31 July 2019	-	-	-	-	-	249	55
Class A5 notes	31 January 2022	2.88%	700	(37)	4	667	-	664
Class A6 notes	31 July 2023	2.75%	250	(4)	-	246	-	-
Class B2 notes	31 July 2022	5.50%	570	(16)	8	562	722	560
		4.52%	2,770	(65)	17	2,722	2,895	2,799

At 31 July 2017, the Senior Term Facility carried interest at a rate of LIBOR plus a margin of 1.75%. The variable element has been fully hedged using matching interest rate swap arrangements which fix LIBOR at 3.96% until 31 July 2018 and 6.67% until 31 January 2019. All other borrowings have fixed interest rates. The weighted average interest rate for all borrowings of 4.52% has been calculated using the effective interest rate and carrying values on 31 July 2017.

	Senior term facility £m	Class A1 £m	Class A2 £m	Class A3 £m	Class A4 £m	Class A5 £m	Class A6 £m	Class B2 £m	Total £m
As at 1 February 2017	348	175	500	500	55	700	-	570	2,848
Issue/ repayment date:									
13 July 2017	(98)	(175)	-	-	(55)	-	250	-	(78)
Total	250	-	500	500	-	700	250	570	2,770

In order to show the Group's net borrowings, the notes and the issue costs have been offset. Issue costs are shown net of any premium on the issue of borrowings. Interest rate swaps are recognised in the Balance Sheet at fair value at the period end (see note 14).

All of the Class A notes and Senior Term Facility are secured by first ranking security in respect of the undertakings and assets of AA Intermediate Co Limited and its subsidiaries. The Class A facility security over the AA Intermediate Co Limited group's assets ranks ahead of the Class B2 notes. The Class B2 notes have first ranking security over the assets of the immediate parent undertaking of the AA Intermediate Co Limited group, AA Mid Co Limited. AA Mid Co Limited group can only pay a dividend when certain net debt to EBITDA and cash flow criteria are met.

The Class B2 notes have an initial period to 31 July 2018 when any voluntary repayment would incur a make-whole payment and incur all remaining interest due to 31 July 2018. After this period, there is a further two year period when any voluntary repayment would be made at a fixed premium based on the date of redemption. Any voluntary early repayments of the Class A notes would incur a make-whole payment of all interest due to expected maturity date, except the Class A5 and Class A6 notes which can be settled without penalty within 3 months and 2 months respectively of the expected maturity date.

Notes to the financial statements (continued)

15 Borrowings (continued)

On 13 July 2017, the Group issued £250m of Class A6 notes at an interest rate of 2.75%. £4m of costs associated with the issue of the A6 notes were capitalised. This consisted of £1m of premium and £3m of new issue fees.

From the proceeds of the A6 notes, the Group repaid the remaining £175m of A1 notes incurring an interest penalty of £7m and the remaining £55m of A4 notes incurring an interest penalty of £3m. 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 £1m.

Following the sale of the Irish business during the prior year (see note 3), we held back £24m 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 £24m was used as part of a repayment of £98m 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 £150m to £75m. The fees associated with this were under £1m and were written off.

In order to comply with the requirements of the Class A notes, we are required to maintain the Class A free cash flow to debt service ratio in excess of 1.35x and the senior leverage ratio below 5.5x (see net debt and covenants section). The Class B2 notes require us to maintain the Class B2 free cash flow to debt service ratio in excess of 1x (see net debt and covenants section).

The Class A and Class B2 notes therefore place restrictions on the Group's ability to upstream cash from the key trading companies to pay external dividends and finance activities unconstrained by the restrictions embedded in the debts.

The Class A notes only permit the release of cash providing the senior leverage ratio after payment is less than 5.5x and providing there is sufficient excess cash flow to cover the payment. The Class B2 note restrictions only permit the release of cash providing the fixed charge cover ratio after payment is more than 2:1 and providing that the aggregate payments do not exceed 50% of the accumulated consolidated net income.

Notes to the financial statements (continued)

16 Defined benefit pension scheme liabilities

The Group operates two funded defined benefit pension schemes: the AA UK Pension Scheme (AAUK) and the AA Ireland Pension Scheme (AAI). The assets of the schemes are held separately from those of the Group in independently administered funds. The AAUK scheme has final salary sections and a Career Average Revalued Earnings (CARE) section. The CARE section provides for benefits to accrue on an average salary basis. Since 2004, new entrants to the AAUK scheme accrue benefits in the CARE section but the Scheme was closed to new entrants from 1 October 2016, although employees retain an eligibility to join provided they are within the first year of their employment with the Group and had started employment before 1 October 2016. On 1 July 2017 accrual ceased under the final salary sections and members were moved to the CARE section for future accrual of benefits. This preserved defined benefits for current scheme members. In addition, pension indexation in the CARE section will now be based on CPI inflation, rather than RPI inflation, from April 2018 onwards. The AAI scheme is closed to new entrants and future accrual of benefits. The Group also operates an unfunded post-retirement Private Medical Plan (AAPMP), which is treated as a defined benefit scheme and it is not open to new entrants. During the prior year, following the sale of the Irish business by the Group (see note 3), AA Corporation Limited, a UK subsidiary of the Group, became the sponsor of the AAI scheme.

In June 2017 the Group completed the AAUK scheme triennial valuation as at 31 March 2016 agreeing a deficit of £366m with the pension trustees. The Group has committed to paying an additional £8m per annum from July 2017 to March 2019, £11m per annum from April 2019 to March 2021 uplifted in line with RPI from 1 April 2020 and £13m per annum from April 2021 to June 2026 uplifted in line with RPI from 1 April 2022 annually. Following the November 2013 triennial valuation the Group implemented an asset backed funding scheme which remains in place. The asset backed funding scheme provides a long-term deficit reduction plan where the Group makes an annual deficit reduction contribution of £13m increasing annually with inflation, until November 2038, secured on the Group's brands.

Using an inflation assumption of 3.0% and a discount rate assumption of 2.4%, the present value of the future deficit reduction contributions has been calculated. Based on these assumptions, the Group expects the present value of deficit reduction contributions to exceed the IAS 19 deficit. The Group notes that, in the event that a surplus emerges, it would have an unconditional right to a refund of the surplus assuming the gradual settlement of AAUK scheme liabilities over time until all members have left the plan.

The Group has recognised a one-off past service credit of £34m as a result of the benefit changes described above. This comprised a £12m gain from closure of the Final Salary sections of the AAUK scheme, due to the assumed deferred pension revaluation being lower than the assumed pensionable earnings increases, and a £22m gain from the change in indexation in the CARE section from RPI-based to CPI-based, which is expected to be lower in the long term.

The remeasurement gain of £2m shown in the consolidated statement of comprehensive income for the six months to 31 July 2017 is primarily a result of actual inflationary increases applied to benefits being lower than assumed, a reduction in future inflation expectations and higher asset returns than expected over the period mostly offset by the decrease in the discount rate.

Notes to the financial statements (continued)

16 Defined benefit pension scheme liabilities (continued)

The amounts recognised in the balance sheet are as follows:

	As at 31 July 2017			Total £m
	AAUK £m	AAI £m	AAPMP £m	
Present value of the defined benefit obligation in respect of pension and healthcare plans	(2,515)	(53)	(60)	(2,628)
Fair value of plan assets	2,220	44	-	2,264
Deficit	(295)	(9)	(60)	(364)

	As at 31 July 2016			Total £m
	AAUK £m	AAI £m	AAPMP £m	
Present value of the defined benefit obligation in respect of pension and healthcare plans	(2,577)	(61)	(55)	(2,693)
Fair value of plan assets	2,030	41	-	2,071
Deficit	(547)	(20)	(55)	(622)

	As at 31 January 2017			Total £m
	AAUK £m	AAI £m	AAPMP £m	
Present value of the defined benefit obligation in respect of pension plans	(2,515)	(53)	(59)	(2,627)
Fair value of plan assets	2,190	42	-	2,232
Deficit	(325)	(11)	(59)	(395)

Fair value of plan assets

The table below shows the AAUK plan assets split between those that have a quoted market price and those that are unquoted. Of the AAI scheme, 33.5% (2016: 26.0%) of assets do not have a quoted market price.

The fair value of the AAUK plan assets and the return on those assets were as follows:

	As at 31 July 2017		As at 31 July 2016	
	Assets with a quoted market price £m	Assets without a quoted market price £m	Assets with a quoted market price £m	Assets without a quoted market price £m
Equities	180	300	150	322
Bonds	825	200	790	142
Property	84	179	76	175
Hedge funds	-	426	-	344
Cash/current assets	24	2	29	2
Total plan assets	1,113	1,107	1,045	985

Notes to the financial statements (continued)

16 Defined benefit pension scheme liabilities (continued)

Pension plan assumptions

The principal actuarial assumptions were as follows:

	AAUK		AAI		AAPMP	
	July 2017 %	July 2016 %	July 2017 %	July 2016 %	July 2017 %	July 2016 %
Pensioner discount rate	2.4	2.3	1.6	0.9	2.4	2.3
Non pensioner discount rate	2.6	2.5	2.5	1.6	2.3	2.3
Pensioner RPI	3.2	2.7	-	-	3.2	2.7
Non pensioner RPI	3.2	2.9	-	-	3.2	2.7
Rate of increase of pensions in payment – pensioner	3.0	2.6	-	-	-	-
Rate of increase of pensions in payment - non pensioner	3.0	2.7	-	-	-	-
Pensioner increase for deferred benefits	2.1	1.9	1.5	1.3	-	-
Medical premium inflation rate	-	-	-	-	7.2	6.7

CPI inflation is assumed to run 1.1% below RPI inflation in future, with consequent impacts on assumed pension increases for the CARE section. Mortality assumptions for the AAUK scheme are set using standard tables based on scheme specific experience where available and an allowance for future improvements. For 2017, the assumptions used were in line with the SAPS (S2) series mortality tables (31 July 2016 – SAPS (S1) series) with future improvements in line with the CMI_2015 model with a 1.5% long-term rate of improvement (31 July 2016 – CMI_2012 model with a 1.5% long-term rate of improvement). The AAI scheme mortality assumptions are set using standard tables with scheme specific adjustments.

The AA schemes' overall assumptions are that an active male retiring in normal health currently aged 60 will live on average for a further 27 years and an active female retiring in normal health currently aged 60 will live on average for a further 30 years.

Notes to the financial statements (continued)

17 Fair values

Financial instruments held at fair value are valued using quoted market prices or other valuation techniques.

The fair values are periodically reviewed by the Group Treasury function. The following tables provide the quantitative fair value hierarchy of the Group's interest rate swaps and loan notes. The carrying values of all other financial assets and liabilities (including the Senior Term Facility) approximate to their fair values:

At 31 July 2017:

	Carrying value £m	Fair value measurement using		
		Quoted prices in active markets (Level 1) £m	Significant observable inputs (Level 2) £m	Significant unobservable inputs (Level 3) £m
Financial liabilities measured at fair value				
Interest rate swaps (note 14)	17	-	17	-
Liabilities for which fair values are disclosed				
Loan notes (note 15)	2,473	2,714	-	-

At 31 July 2016:

	Carrying value £m	Fair value measurement using		
		Quoted prices in active markets (Level 1) £m	Significant observable inputs (Level 2) £m	Significant unobservable inputs (Level 3) £m
Financial liabilities measured at fair value				
Interest rate swaps (note 14)	27	-	27	-
Liabilities for which fair values are disclosed				
Loan notes (note 15)	2,442	2,616	-	-

Valuation techniques include net present value and discounted cash flow models, and comparison to similar instruments for which market observable prices exist. Assumptions and market observable inputs used in valuation techniques include interest rates.

The objective of using valuation techniques is to arrive at a fair value that reflects the price of the financial instrument at each period end at which the asset or liability would have been exchanged by market participants acting at arm's length.

Observable inputs are those that have been seen either from counterparties or from market pricing sources and are publicly available. The use of these depends upon the liquidity of the relevant market. When measuring the fair value of an asset or a liability, the Group uses observable inputs as much as possible. Fair values are categorised into different levels in a fair value hierarchy based on the inputs used in the valuation as follows:

Level 1 - Quoted market prices in an actively traded market for identical assets or liabilities. These are the most reliable.

Level 2 - Inputs other than quoted prices included in Level 1 that are observable for the assets or liabilities. These include valuation models used to calculate the present value of expected future cash flows and may be employed either when no active market exists or when there are quoted prices available for similar instruments in active markets. The models incorporate various inputs including interest rate curves and forward rate curves of the underlying instrument.

Notes to the financial statements (continued)

17 Fair values (continued)

Level 3 - Inputs for assets or liabilities that are not based on observable market data.

If the inputs used to measure the fair values of an asset or a liability might be categorised in different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level as the lowest input that is significant to the entire measurement.

18 Related parties

The following table provides the total value of transactions that have been entered into with associates during each financial year:

Transactions with associates:

Associate	Nature of transaction	July 2017 £m	July 2016 £m	January 2017 £m
ACTA SA	Call handling fees paid	-	1	2
ARC Europe SA	Registration fees paid	1	-	1

The Group's interest in ACTA SA was sold on 6 October 2016.

19 Post Balance Sheet Events

On 7 September 2017, the UK Ministry of Justice announced a draft change to the law used to set the discount rate used in calculating upfront personal injury payments (Ogden discount rate reforms). The proposal could result in a rate change from the current rate of -0.75% to a rate between 0% and 1%. It will not be applied retrospectively. The proposal, which is currently in draft form, is expected to take a few months to finalise prior to the legislation being enacted. As a result of the uncertainty, the Insurance Underwriter reserves as at 31 July 2017 have been calculated based on the current Ogden rate of -0.75%.

On 21 September 2017 the AA Ireland Pension Scheme triennial valuation as at 31 December 2016 was completed with an agreed deficit on a going concern funding basis of €9.0m. The previous valuation as at 31 December 2013 valued the deficit at €6.5m. No changes were made to the schedule of contributions as a result of the updated valuation.

On 25 September 2017 Simon Breakwell was appointed permanent CEO. For the year ended 31 January 2019, Simon's salary as CEO will be £700,000. Under the standard three-year renewal cycle, the Directors' Remuneration Policy is subject for renewal at the 2018 AGM, and the Remuneration Committee will be engaging with major shareholders regarding the terms of the new policy. The remuneration package will follow typical FTSE practices. The Company does not intend to grant any awards to Simon under the legacy Management Value Participation Share structure.