26 September 2017

AA plc Interim Results for the six months ended 31 July 2017

- Simon Breakwell has been appointed permanent Chief Executive Officer (CEO).
- Interim results in line with market expectations; Roadside robust; Insurance growing. Interim dividend maintained at 3.6 pence per share.
- Building on the transformation to date, we are focusing on the core Roadside and Insurance businesses and investing in them. EBITDA for FY 18 is expected to be between £390m and £395m.
- IT transformation delayed and a more measured approach to migration leading to additional capex of c£35m into FY 19.
- Further information on business review in first half of next year.

	Six months ended		
	July 17	**July 16**	**Change**
Trading revenue (£m)[1,2]	471	467	1%
Trading EBITDA[1,3] (£m)	193	192	1%
Trading EBITDA[1,4] margin (%)	41.0	41.1	<0%
Operating profit[1] (£m)	178	132	35%
Group PBT[1] (£m)	80	48	67%
Basic EPS[1] (p)	10.5	6.2	69%
Adjusted basic EPS[1,5](p)	10.2	10.3	-1%
Cash conversion[1,6] (%)	101	99	2%
Interim dividend per share (p)	3.6	3.6	No change

Financial and operational headlines

- Financial performance was robust in Roadside and strong in Insurance.
  - Trading revenue rose 1% to £471m reflecting growth in both insurance broking and underwriting. Roadside demonstrated its resilience, maintaining revenue, and despite the anticipated retention challenges, membership numbers rose slightly year-on-year.
  - Trading EBITDA up 1% to £193m reflecting gains in insurance broking as well as reduced Head Office costs. In Roadside Assistance, the increased costs related to erratic workload patterns and the relatively inflexible resourcing model held back profitability.
  - Robust cash conversion at 101% (H1 17: 99%).
- Key operational achievements.
  - Membership base rose to 3,325,000 (H1 17: 3,321,000) driven by a 13% increase in new members and stable retention.
  - We have retained or extended contracts with five of our major business-to-business (B2B) accounts and increased average income per customer; we continue to expand our service offering in this market.
  - Motor insurance policy numbers grew 8% to 616,000 (H1 17: 572,000). The in-house underwriter now has 321,000 (H1 17: 25,000) motor and home policies in force.
  - The new advertising campaign has been well received and driven a significant increase in awareness amongst our target segment.
  - 38% of members are registered for the App and it is used in 28% of breakdowns (FY17: 22%).
  - Car Genie, our connected car technology, was launched in the summer and has potential to pre-empt breakdowns in up to 30% of cases.

- The refinancing in July 2017, which included the use of cash to repay £98m of the Senior Term Facility, further reduced the cost of borrowings and extended the average maturity of our debt. Since the IPO in June 2014 we will have reduced the annual debt interest cost on our borrowings by £90m excluding the hedging costs.

- Changes to the UK defined benefit pension scheme resulted in a mitigation of the current and future liabilities while preserving the benefits of a defined benefit scheme for its members. This resulted in a one-off past service credit of £34m.

Strategic headlines

The stabilisation of the membership base and growth in motor insurance are testament to the success of the transformation to date.

Simon Breakwell is reviewing the business to ensure that we strengthen the platform for sustainable growth, building on our foundations.

We are sharpening our focus on those businesses within the Group where we see most value and future profit opportunity. We will continue to invest in the core Roadside Assistance business, including connected car, and in our Insurance businesses. We have identified the following immediate priorities:

- We will continue to focus on delivering excellent customer experience and high service levels. This will be achieved through investing in our people and facilities. We will strengthen the leadership team and focus on our call centres and back office systems. We believe this will improve customer experience.
- In addition, we will seek to address the inflexibility of our operations to improve the management of the impact of volatility on our performance thereby reducing costs.
- We are encouraged by the significant opportunities for growth within our Insurance businesses and expect to invest to take advantage of this.
- The final stages of the original IT transformation programme are under way. We expect to begin the transition of our renewing members to the new system from the end of this year. The delay to systems integration and a more measured approach to implementation means additional capitalised labour costs will be incurred into FY 19. This is expected to lead to additional capex of c£35m. We also recognise that in order to deliver an increasingly efficient operation and a distinctive membership proposition, additional IT investment will be required. We will provide further information in the first half of next year.

Outlook

We expect the investment required in the current financial year to result in EBITDA of between £390m and £395m assuming utilisation rates are consistent with recent years.

We remain highly confident in the future of the AA and believe that the transformation since the IPO provides us with a stronger, more resilient platform for future growth.

We believe new leadership; the prioritisation of customer experience; a more measured approach to the IT transformation; a more focused portfolio will enable the business to deliver an efficient operation and distinctive customer proposition. We will provide greater clarity of our plans for growth in the first half of next year.

The highly cash generative nature of the AA is unchanged. Further investment will be funded from operational cash flow. We expect free cash flow generation to drive the return of value to shareholders.

Dividends

The Board has declared that the interim dividend will be maintained at 3.6 pence per share. It will be paid on 10 November 2017 to shareholders on the register on 6 October 2017 with the ex-dividend date set for 5 October 2017.

John Leach, Chairman, said:

"The Board is very pleased that Simon Breakwell has agreed to take the role of CEO on a permanent basis. He has, since his appointment as Acting CEO, invested his full energy and skills into the Company and identified the means of strengthening it, reinvigorating our people, and rebuilding the culture under his leadership."

Simon Breakwell, CEO, said:

"I am delighted to be appointed CEO of this great company. As a member of the Board since September 2014, I have had time enough to recognise that it is indeed a great company with enormous strength at a fundamental level. A huge amount has also been done since the IPO to improve its performance and create a platform upon which to grow.

"I am now reviewing what the business needs to deliver its potential. I am confident that we have the financial strength to build the right team and equip it appropriately to deliver a distinctive business proposition which can generate growth. This will give us the best chance to realise the promise we have all recognised in the AA."

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Presentation

A presentation by Simon Breakwell, CEO, and Martin Clarke, CFO, will be held for analysts, investors and bond holders at 9am today at The LSE, 10 Paternoster Square, London, EC4M 7LS

- Dial-in to the presentation: Webcast audio dial in: +44 20 3059 8125, Password: The AA
- Replay except from the US: +44 121 260 4861; from the US: 1 844 2308 058; Code: 6893830 #
- Link to the webcast: http://www.investis-live.com/aa/593814a6e8adb21200476673/fcas

Notes
1. Excludes discontinued operations.
2. Trading revenue excludes exceptional revenue item.
3. Earnings before interest, tax, depreciation and amortisation excluding exceptional items, items not allocated to a business segment and pension past service credit.
4. Trading EBITDA divided by trading revenue arising within operating segments.
5. Earnings per share excluding discontinued operations adjusted for a number of one-offs of which the largest are exceptional items, items not allocated to a segment, the write off of debt issue fees, pension past service credit, penalties on early repayment of debt and transfer from cash flow hedge reserve.
6. Net cash inflows from continuing operating activities before tax and exceptional items divided by Trading EBITDA.

Performance and business review

Group performance

	Six months ended		Year ended
	July 17	**July 16**	**Jan 17**
Trading revenue[1,2] (£m)	471	467	940
Trading EBITDA[1,3] (£m)	193	192	403
Trading EBITDA[1,4] margin (%)	41.0	41.1	42.9
Net cash inflows from continuing operating activities before tax and exceptional items[5] (£m)	194	190	371
Cash conversion[6] (%)	101	99	92
Adjusted basic earnings per share[7] (pence)	10.2	10.3	21.3

Notes
1. Excludes discontinued operations.
2. Trading revenue excludes exceptional revenue item.
3. Earnings before interest, tax, depreciation and amortisation excluding exceptional items, items not allocated to a business segment and pension past service credit.
4. Trading EBITDA divided by trading revenue arising within operating segments.
5. Net cash inflows from continuing operating activities before tax and excluding cash flows from exceptional items.
6. Net cash inflows from continuing operating activities before tax and exceptional items divided by Trading EBITDA.
7. Earnings per share excluding discontinued operations adjusted for a number of one-offs of which the largest are exceptional items, items not allocated to a segment, the write off of debt issue fees, pension past service credit, penalties on early repayment of debt and transfer from cash flow hedge reserve.

Group Trading Revenue was £471m, up 1% on last year (H1 17: £467m) reflecting a strong performance in Insurance Services and the Underwriter while Roadside Assistance and Driving Services were flat.

Roadside Assistance Trading Revenue (which is reported net of Insurance Premium Tax (IPT) and payments to third party underwriters) was flat at £370m (H1 17: £370m). This led to a 1% fall in the average income per member to £156. Despite the significant anticipated challenges to retention, we maintained it at 82%. With continued growth in new business, paid personal membership numbers were slightly up year-on-year, although marginally down on the last six-month period. Business customer numbers were down year-on-year, although up on the last six-month period. Average income per business customer was £20, up 5% year on year (H1 17: £19).

Insurance Services Trading Revenue rose 3% to £66m (H1 17: £64m) as a result of strong growth in the motor book. Underwriting Revenue rose significantly to £3m (H1 17: £1m) since launch in January 2016, although this figure significantly understates the progress achieved to date due to the revenue deferral policy. Driving Services Trading Revenue was flat at £32m.

Group Trading EBITDA rose 1% to £193m also reflecting strong performances in Insurance Services and Underwriting combined with Head Office cost savings which offset the lower Trading EBITDA from Roadside Assistance. The negative impact from increased costs relating to the erratic workload patterns, particularly in June and July, reversed a stable performance in the first four months of the period. As noted in our trading update, performance was negatively affected by a non-recurring charge of £2m (H1 17: £nil) for accumulated adjustments with a third party underwriter. However, we offset some of these negative impacts with improved cost management achieving a 7% reduction in Head Office costs to £28m (H1 17: £30m). As a result, the Trading EBITDA margin at 41.0% was only marginally lower than last year (H1 17: 41.1%).

Operating profit was up significantly to £178m (H1 17: £132m) as a result of the pension past service credit and reduced exceptional costs. Amortisation and depreciation amounted to £33m (H1 17: £28m) with the increase related to the continuing IT investment.

Exceptional items incurred in the six months ended 31 July 2017 were £4m (H1 17: £22m) relating to the continued business and IT transformation. Last year's exceptional charges included a provision of £10m to cover refunds and associated costs of those customers with duplicate Roadside cover. We are making good progress in the remediation programme and believe that this sum will prove to be sufficient.

Items not allocated to a segment were £12m (H1 17: £10m) made up of share based payment charges of £5m and a pensions service cost of £7m.

The restructuring of the UK pension scheme resulted in a 'past service credit' of £34m which is a one-off benefit recognised in the period. This comprised a £12m gain from closure of the Final Salary sections of the AA UK scheme and a £22m gain from the change in inflation indexation from RPI to CPI for the career average salary scheme. Additional detail is provided below.

Profit before tax rose significantly to £80m (H1 17: £48m), mainly as a result of the one off pension benefit and despite an increase in finance costs to £98m (H1 17: £84m) as a result of the refinancing in July which incurred £10m early repayment penalties. The refinancing extended the maturity of our debt and reduced our future interest costs. This is covered in more detail below.

Profit after tax was up significantly to £64m (H1 17: £38m). The tax charge was higher in the period at £16m (H1 17: £10m) calculated on an effective rate of 20.0% (H1 17: 20.8%) and included a transfer between current and deferred tax of £5m on the one-off pension credit in respect of changes to the AA UK pension scheme. We do not expect to be materially affected by the new legislation restricting the deductibility of interest by reference to UK EBITDA because the Group is almost entirely UK based.

Basic earnings per share from continuing operations rose 69.4% to 10.5p (H1 17: 6.2p).

Adjusted underlying profit after tax was £62m (H1 17: £63m) and adjusted basic and diluted earnings per share were 10.2p (H1 17: 10.3p). The adjustments were for exceptional items of £4m; items not allocated to a segment of £12m; penalties on early repayment of debt of £10m; transfer from cash flow hedge reserve of £5m; and refinancing debt issue fees write-off of £1m. These were offset by a pension past service credit of £34m.

The AA has continued to generate high levels of operating cash of £194m (H1 17: £190m), representing cash conversion of 101% (H1 17: 99%), slightly higher than the prior period due to the relative timing of working capital movements.

Business performance

Roadside Assistance

	Six months ended		Year ended
	July 17	**July 16**	**Jan 17**
Trading revenue (£m)	370	370	742
Trading EBITDA (£m)	174	179	365
Trading EBITDA margin (%)	47.0	48.4	49.2
Paid personal Members[1] (000s)	3,325	3,321	3,335
Average income per paid personal Members[1] (£)	156	157	158
Business customers[1] (000s)	10,016	10,179	9,976
Average income per business customer[1] (£)	20	19	20
Number of breakdowns (000s)	1,761	1,759	3,635

1. Last 12 months

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 and a one-off payment to an underwriting partner for our underwritten products such as Breakdown Repair Cover.

We have done well to maintain our retention rate at 82%. Retention is facing significant challenges including IPT rises; our redress programme for customers affected by duplicate cover; the introduction in April of renewal price transparency; and an increase in newer members whom we initially tend to retain at lower rates. We have however offset these impacts through continued improvements to our proposition and retention activity. The programme to resolve duplicate cover is well progressed but we anticipate this will result in a majority of the 17,000 customers we originally identified as affected giving up their membership. In view of all these challenges, and the fact that we are yet to benefit from the transition of renewal customers to the new IT systems, we are encouraged by our resilience and the effectiveness of the membership proposition.

We grew new members (as measured on a paid only basis) by 13%, a strong performance against last year's high base and strong growth. A wide-ranging programme of activity is improving our new membership performance across many channels. In particular, our digital sales channel is showing strong growth. We are also benefiting from expanding into new marketing and sales channels to drive further growth in new memberships. In this regard, our recent advertising campaign has been well-received.

Paid personal memberships were 3,325,000 (H1 17: 3,321,000) up slightly although just down on the FY17 figure of 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 from December 2015. However, the growth in new members has offset this.

Average income per member was 1% lower at £156 (H1 17: £157). The fall in the period reflects our restraint in passing through price increases much above IPT over the last two years; the impact of one-off payments to our third-party underwriter; and the impact of increasing new memberships in the overall paid membership base. IPT increased by 3.5% in November 2015, by an additional 0.5% in October 2016, and by a further 2.0% in June 2017. As revenue is recognised over the 12 months of the life of the policy it takes two years for IPT increases to fully flow through the year on year comparison. Our success in growing new memberships in the past two years has meant a larger proportion of the base is receiving introductory discounts. While we have reduced the level of these discounts, our success in growing the number of new memberships has the effect of diluting income per member in the short term. These effects were partly offset by ancillary sales which grew by 9% in the period.

Business customer numbers were down 2% year-on-year at 10,016,000 (H1 17: 10,179,000) but up slightly on the FY17 figure of 9,976,000. This 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.

Approximately 38% of our membership have registered for the App and it is currently used in 28% of breakdowns (H1 17: 14%).

We continue to invest in advertising. Our most recent campaign, launched in June, focuses on the customer segment which we believe has the greatest potential of engaging with the benefits of membership. These are the time-stretched, young families who join the AA for the peace of mind it offers.

We launched our connected car product, Car Genie, in August 2017, following the successful trial which indicated that we should be able to pre-empt up to one third of breakdowns. Our email marketing campaign has had higher-than-expected take-up by members and we anticipate this take-up to increase following the TV advertising campaign launched in August. We are encouraged that the opportunity to pre-empt breakdowns seen since the launch is in line with what we saw in the trial. We believe increased engagement and connectivity with members is positive and feedback indicates that they value the additional benefits this offers, including locating lost cars, reducing fuel consumption and helping members with general car maintenance. We are investigating many options for the future development of connectivity for personal members and business customers.

While the overall number of breakdowns was flat and the key metrics of repair rate (vehicles repaired at the roadside) and single-task-completion (percentage of repairs done using only a single resource) are at an 11-year high, costs have risen as workload patterns have been erratic. Our own resource is insufficiently flexible in varying workload patterns and, in order to maintain service levels, we resort to third party garages which adds costs and lowers profitability. We are reviewing options to increase the flexibility of the patrol force with improvements to our planning and forecasting to mitigate these costs in the future.

Trading EBITDA fell by 3% to £174m (H1 17: £179m). 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

	Six months ended		Year ended
	July 17	**July 16**	**Jan 17**
Trading revenue (£m)	66	64	131
Trading EBITDA	38	35	76
Trading EBITDA margin (%)	57.6	54.7	58.0
Policy numbers in force[1] (000s)	1,845	1,962	1,879
Motor policies in force (000s)	616	572	594
Home policies in force (000s)	844	891	857
Average income per policy[2] (£)	72	67	70
Financial Services products[3] (000s)	131	82	100

1 Rolling sales for the last 12 months including Home Services but not Financial Services
2 Average income per policy includes Financial Services revenue
3 Financial Services products includes the number of credit cards activated, loans drawn down and savings accounts opened

This segment includes our insurance broker, financial services and home emergency services businesses.

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 (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. As a result of this focus on greater profitability, average income per policy was up 7% to £72 (H1 17: £67).

At the end of July 2017, we on-boarded c131,000 Financial Services customers across our credit cards, personal loans and savings portfolio since the inception of our new financial services partnership with Bank of Ireland in 2015. This represents a balance sheet size of c£250m, match funded by AA originated deposits. The revenue from these is included in total average revenue per policy for the division mentioned above. Our partnership with Bank of Ireland is working well with the inherent strength of the AA brand and our marketing expertise continuing to support the business. We are encouraged by the value that the AA membership base and brand are bringing to the business with over 50% of the non-ISA savings book held by members and 40% of our personal loans being written for cars.

Trading EBITDA for Insurance Services rose 9% to £38m (H1 17: £35m) as a result of the growth of our motor book, the focus on growing more profitable business lines and disciplined cost management. The Trading EBTIDA margin at 57.6% was up substantially (H1 17: 54.7%).

Insurance Underwriting

	Six months ended		Year ended
	July 17	**July 16**	**Jan 17**
Trading revenue (£m)	3	1	-
Trading EBITDA (£m)	-	(1)	(1)
Motor policies[1] (000s)	200	25	115
Home policies[1] (000s)	121	-	25

1 Underwritten by our Insurance Underwriter

In the second year of its operation, the in-house insurance underwriter has continued to make excellent progress with growth well ahead of our target in both motor policies and home policies, which were launched in August 2016. The combination of our brand and our proprietary data gives us a marked advantage in both markets. A substantial proportion of new policies are incremental to the AA's insurance business as a whole and we are achieving higher retention than our broker experiences with other panel members due to our more competitive pricing. Trading Revenue (net of the 80% reinsured element) of £3m to date understates the strength of the performance as it is recognised over the life of the policies.

As stated at the year end, the vertical integration of our broker and underwriter gives rise to an accounting treatment where the broker commission received and associated acquisition costs will be recognised over the life of the policy along with the underwriter premium. This does not affect overall profitability or cash flows of the business but, rather, defers the benefit of the strong growth of our Underwriter.

Trading EBITDA broke even, reversing last year's loss and we are confident of the value this business is bringing into the Group.

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%.

This segment also includes the result of our historic reinsurance business which remains flat year-on-year.

Driving Services

	Six months ended		**Year ended**
	July 17	**July 16**	**Jan 17**
Trading revenue (£m)	32	32	67
Trading EBITDA (£m)	9	9	20
Trading EBITDA margin (%)	28.1	28.1	29.9
Number of driving instructors	2,669	2,516	2,607

Driving Services Trading Revenue was flat at £32m. 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.

We are also encouraged by L Drive, our market-leading telematics-based app for learners which we recently launched. This enables us to continue to improve the learning-to-drive experience for our pupils as well as building a platform for connected car. Our longer term plans include offering more online self-serve options for pupils, and building on the success of L Drive to deepen the relationship our pupils have with the AA brand and increase their engagement with our broader service offering.

DriveTech trading revenue was flat with police speed awareness course volumes stable.

We are pleased that Driving Services Trading EBITDA was maintained at £9m (H1 17: £9m).

Refinancing

In July 2017 we completed a further refinancing package, allowing the use of some of our free cash flow to partially pay down debt, which resulted in the extension of the maturity of debt and further savings in annual interest costs.

AA Bond Co Limited, a subsidiary of the AA plc, issued a single class of Sub-Class A6 Fixed Rate Notes under its multicurrency note programme listed on the Irish Stock Exchange and used the proceeds to redeem the remaining Sub-Class A1 and Sub-Class A4 Fixed Rate Notes. At the same time, the AA group used available cash resources to reduce by £98m its senior term debt and extended that facility through the replacement of its existing Senior Term Facility with a new Senior Term Facility. The new facility extends the maturity of the senior term debt from 31 January 2019 to 31 July 2021.

We issued £250m of new Sub-Class A6 Fixed Rate Notes on 13 July 2017. The coupon of 2.75% is payable semi-annually in arrears and their maturity is at 31 July 2023.

The proceeds were used to redeem all of the remaining £175m 4.72% Sub-Class A1 Fixed Rate Notes and £55m 3.78% Sub-Class A4 Fixed Rate Notes plus make-whole payments that were paid on the 31 July 2017.

A new Working Capital Facility of £75m, reduced from the previous £150m facility, was put in place to 31 July 2021 on a reduced margin. This remains undrawn.

The extension in maturity of debt means that the next repayment of borrowings is due in July 2020. The initial annual interest saving is expected to be c£3m for the years ending 31 January 2018 and 31 January 2019, then will increase to an annual interest saving of c£14m from the year ending 31 January 2020 as a result of the expiry of the existing hedging arrangements allowing the use of more of our free cash flow to pay down debt. In addition, there will be a saving of fees amounting to £0.6m following the reduction of the Working Capital Facility.

This refinancing was in line with our strategy to reduce overall Group borrowings as well as the associated interest cost. Since the IPO in June 2014 we will have reduced the annual debt interest cost on our borrowings by £90m excluding the hedging costs.

Pensions

On 8 June 2017, we announced that the triennial review of the AA's UK defined benefit pension scheme had been concluded and the Trustee and the AA had come to agreement on the deficit funding plan. This plan was based on the triennial valuation of the UK's pension scheme deficit as at 31 March 2016 of £366m and compared with the previous 2013 triennial deficit valuation of £202m. The increase in the deficit is largely caused by the reduction in long term gilt yields.

We have agreed a nine-year deficit recovery additional funding plan with the Trustee, taking into account the continued funding of the previous deficit. We will make additional contributions of:

- £8m per annum for the next two years.
- £11m from April 2019 for one year.
- £11m plus inflation per annum from April 2020.
- £13m from April 2021 for one year.
- £13m plus inflation per annum from April 2022 to June 2026.

These will be incremental to the existing deficit reduction contributions to the UK pension scheme of £13m increasing with inflation through to 2038. The total deficit reduction payment to the UK pension scheme in the 2018 financial year will be approximately £20m. The next triennial actuarial review is scheduled for 31 March 2019.

The UK pension deficit under the defined benefit scheme was £295m (H1 17: £547m), as reported under IAS 19.

The AA has also put into action the changes to the defined benefit pension scheme which has Final Salary sections and a CARE (career average revalued earnings) section. All employees that were in the Final Salary section of the scheme were moved to the existing CARE section to build up future defined benefit pension benefits. Changes are also being made to the CARE section with the inflation measure for pension indexation moved to CPI from RPI and additional employee contributions of 1.5% of salary or a change to accrual rates.

This approach has mitigated some of the recent increases in pension service costs. Overall, the changes have reduced our exposure to pension risks, increased our competitiveness within our industry and provided for more consistent pension offering across our existing defined benefit scheme members.

Board and senior management changes

On 1 August 2017, we announced that Bob Mackenzie had been removed by the Board from his role as Executive Chairman, from his other roles as a Director, and as an employee of the Company, for gross misconduct, with immediate effect.

Simon Breakwell was then appointed Acting CEO and today we announce his appointment as permanent CEO, expediting the split in the roles of CEO and Chairman. Simon joined the AA in September 2014 as a Non-Executive Director. He has now stepped down from his previous Committee roles.

The roles now held by the Board are as follows:

- John Leach is Chairman. John joined the AA in June 2014 as a Non-Executive Director and was appointed as Senior Independent Director on 13 November 2014. John is also Chair of the Nomination Committee and a member of the Risk and Audit Committees.
- Andrew Blowers was appointed Senior Independent Director, replacing John Leach in that role. Andrew joined the AA in September 2014 as a Non-Executive Director and is Chair of the Risk Committee and a member of the Audit and Nomination Committees. He was co-opted to the Remuneration Committee whilst Simon Breakwell was Acting CEO.
- Suzi Williams joined the AA in October 2015. She has taken over from Simon Breakwell as Chair of the Remuneration Committee and is also on the Nomimation and Risk Committees.
- Andrew Miller, who joined in June 2014, continues as Chair of the Audit Committee and member of the Risk and Remuneration Committees.
- Martin Clarke continues as Chief Financial Officer.

Transformation

We have made substantial progress against the strategic priorities set out at the time of our IPO just over three years ago. These were to:

- Strengthen the AA's foundations to modernise the platform to become the pre-eminent Membership services organisation in the UK.
- Revolutionise customer experience through investment in the Membership proposition and new technologies.
- Reduce Group borrowings and the associated interest costs.

The IT investment which is in its final phase has strengthened and modernised the AA's foundations and integrated technology offering in many critical areas as detailed below:

- AA Help 2, our service deployment platform, is improving the interface for our call centres and patrols, reducing average call handling time, training time and call-backs. It results in better member experience through improved geolocation of the breakdown.
- Our digital platform is improving the attractiveness and efficiency of the AA's products and processes by making them more immediate, intuitive and relevant. The commercial website has driven an increase in digital sales; the App is improving efficiency and, MyAA will allow self-help to provide both improved customer service and cost reductions.
- Improved in-vehicle technology for patrols has enhanced their efficiency, providing information ahead of and during a job, reducing time spent on administration, improving record keeping and sales processes for ancillary products.
- Our new Policy Administration system is live and is being used at scale for new Roadside membership sales in our call centres and online.
- The outbound marketing element of our new CRM system is live, and allows us to segment and market to customers in a more sophisticated, personalised and automated way, reaping rewards in retaining our Roadside members.
- Insurer Hosted Pricing allows our in-house Underwriter and two other panel members to tailor prices using enhanced data and to enable more dynamic and frequent price changes.
- Back office systems have also been modernised.

Our marketing strategy and brand investment have clarified and communicated the improved customer proposition, and are helping to create a more sustainable approach to pricing:

- The AA brand is as strong as ever. We remain the most well-known breakdown assistance provider with 94% unprompted awareness, compared with 85% and 71% for our peers, and we are achieving a 13 percentage point lead over our nearest peer in responses to the statement “is the best breakdown service in the UK”.
- The new advertising campaign has been very well received with a 34% increase in the number of people that are aware of our advertising four weeks into the campaign. The focus on the segment that is most responsive to the value of roadside assistance (the busy, young family which is seeking the reliability and freedom from anxiety which the AA can offer) is proving successful. As planned, the campaign awareness reflects this younger (under 45), female segment.

Car Genie, our connected car technology, has been launched with the support of TV advertising. It will further enhance customer experience by, among other features, notifying members of faults and pre-empting breakdowns in line with our successful trial. It will enable us to continually deepen our relationship with members and customers and enhance our market leadership.

Our key roadside repair rates have remained compelling throughout the transformation period; roadside service repair rates are at an 11-year high.

The launch of our in-house Insurance Underwriter has supported our insurance positioning with growth in motor policies in broking business. The broker is also benefiting from the increased pricing agility the new Insurer Hosted Pricing systems are enabling.

Business review

Simon Breakwell is reviewing the business to ensure that we strengthen the platform for sustainable growth, building on our foundations.

We are sharpening our focus on those businesses within the Group where we see most value and future profit opportunity. We will continue to invest in the core Roadside Assistance business, including connected car, and in our insurance businesses. We have identified the following immediate priorities:

- We will continue to focus on delivering excellent customer experience and high service levels. This will be achieved through investing in our people and facilities. We will strengthen the leadership team and focus on our call centres and back office systems. We believe this will improve customer experience. In addition, we will seek to address the inflexibility of our operations to improve the management of the impact of volatility on our performance thereby reducing costs.
- We are encouraged by the significant opportunities for growth within our insurance businesses. We expect to invest in the in-house underwriter to begin to take advantage of this.
- The final stages of the original IT transformation programme are under way. We expect to begin the transition of our renewing members to the new system from the end of this year. The delay to systems integration and a more measured approach to implementation mean additional capitalised labour costs will be incurred into FY 19. This is expected to lead to additional capex of c£35m. We also recognise that in order to deliver an increasingly efficient operation and a distinctive membership proposition, additional IT investment will be required. We will provide further information in the first half of next year.

Outlook

We expect the investment required in the current financial year to result in EBITDA of between £390m and £395m assuming utilisation rates are consistent with recent years.

We remain highly confident in the future of the AA and believe that the transformation since the IPO provides us with a stronger, more resilient platform for future growth.

We believe new leadership; the prioritisation of customer experience; a more measured approach to the IT transformation; a more focused portfolio will enable the business to deliver an efficient operation and distinctive customer proposition. We will provide greater clarity of our plans for growth in the first half of next year.

The highly cash generative nature of the AA is unchanged. Further investment will be funded from operational cash flow. We expect free cash flow generation to drive the return of value to shareholders.

Dividend

The Board has declared that the interim dividend will be maintained at 3.6 pence per share. It will be paid on 10 November 2017 to shareholders on the register on 6 October 2017 with the ex-dividend date set for 5 October 2017.

Cash flow, net debt and liquidity

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: AA Intermediate Co Limited group cash and cash equivalents	(80)	(122)
Net Senior Secured Debt[1]	2,120	2,057
Class B2 notes	570	735
Finance lease obligations	56	51
Net WBS Debt[2]	2,746	2,843
Less: AA plc Group cash and cash equivalents[3]	(58)	(36)
Net debt at period end	2,688	2,807
AA plc Trading EBITDA for the last 12 months	404	416
AA Intermediate Trading EBITDA for the last 12 months[4]	406	419
Net debt ratio[5]	6.7x	6.7x
Class B2 Leverage ratio[6]	6.8x	6.8x
Senior leverage ratio[7]	5.2x	4.9x
Class A Free Cash Flow: Debt Service[8]	3.1x	3.4x
Class B Free Cash Flow: Debt Service[9]	2.2x	2.3x

1 Principal amounts of the Senior Term Facility and Class A notes less AA Intermediate Co Limited group cash and cash equivalents
2 WBS debt represents the borrowings and cash balances within the WBS structure headed by AA Intermediate Co Limited. This includes the principal amounts of the Senior Term Facility, Class A notes, Class B2 notes and finance leases less AA Intermediate Co Limited group cash and cash equivalents
3 Total cash and cash equivalents for the Group excluding the value reported as the AA Intermediate Co Limited group cash and cash equivalents
4 AA Intermediate Co Limited group trading EBITDA including discontinued operations as required by the debt documents
5 Ratio of Total Net Debt to AA plc Trading EBITDA for the last 12 months
6 Ratio of Net WBS Debt[2] to AA Intermediate Co Limited group Trading EBITDA for the last 12 months
7 Ratio of Net Senior Secured Debt[1] to AA Intermediate Co Limited group Trading EBITDA for the last 12 months
8 Ratio of last 12 months free cash flow to proforma debt service relating to the Senior Term Facility and Class A notes.
9 Ratio of last 12 months free cash flow to proforma debt service.

The above net debt as at 31 July 2016 did not include the available and restricted cash balances in AA Ireland that were classified as held for sale at the period end. Adjusting for the net proceeds received for the sale of Ireland, net debt would have been:

	£m
Net debt at period end	2,807
Net proceeds from the sale of AA Ireland	(130)
Adjusted net debt	2,677

Cash generation for the Group has remained strong with net cash inflows from continuing operating activities before exceptional items and tax of £194m (H1 17: £190m) and cash conversion of 101% (H1 17: 99%) in the six months ended 31 July 2017. Net debt to Trading EBITDA for the last 12 months remained at 6.7 times and net senior secured debt to Trading EBITDA stood at 5.2 times as at 31 July 2017.

Cash flow, net debt and liquidity (continued)

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 headroom over the covenants which are set out below.

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 £138m, 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 £25m at 31 July 2017 (H1 17: £21m excluding any restricted cash balances shown as held for sale).

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.

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.

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.

Consolidated income statement

	Note	**Six months ended July 2017 £m**	Six months ended July 2016 £m
Continuing operations			
Revenue	2	**471**	457
Cost of sales		**(173)**	(168)
Gross profit		**298**	289
Administrative & marketing expenses		**(120)**	(157)
Operating profit		**178**	132
Trading EBITDA	2	**193**	192
Pension past service credit	4	**34**	-
Items not allocated to a segment	4	**(12)**	(10)
Amortisation and depreciation		**(33)**	(28)
Exceptional items	4	**(4)**	(22)
Operating profit		**178**	132
Finance costs	5	**(98)**	(84)
Profit before tax		**80**	48
Tax expense	6	**(16)**	(10)
Profit for the period from continuing operations		**64**	38
Discontinued operations			
Profit for the period from discontinued operations	3	**-**	6
Profit for the period		**64**	44

Earnings per share from the profit for the period:

	Note	**Six months ended July 2017 pence**	Six months ended July 2016 pence
Basic from total operations	7	**10.5**	7.2
Basic from continuing operations	7	**10.5**	6.2
Diluted from total operations	7	**10.5**	7.2
Diluted from continuing operations	7	**10.5**	6.2

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		**64**	44
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 differences on defined benefit schemes	16	**2**	(330)
Tax effect		**-**	56
		2	(274)
Total other comprehensive income		**8**	(274)
Total comprehensive income for the period		**72**	(230)

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	8	**1,291**	1,276	1,283
Property, plant and equipment	9	**113**	117	131
Investments in joint ventures and associates		**10**	11	10
Deferred tax assets		**56**	107	62
		1,470	1,511	1,486
Current assets				
Inventories		**7**	6	6
Trade and other receivables	10	**200**	169	195
Cash and cash equivalents	11	**138**	158	211
		345	333	412
Assets held for sale	3	**-**	93	-
Total assets		**1,815**	1,937	1,898
Current liabilities				
Trade and other payables	12	**(516)**	(502)	(520)
Current tax payable		**(12)**	(11)	(11)
Provisions	13	**(10)**	(21)	(19)
		(538)	(534)	(550)
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)
Insurance technical provisions		**(19)**	(4)	(16)
		(3,148)	(3,576)	(3,261)
Liabilities held for sale	3	**-**	(40)	-
Total liabilities		**(3,686)**	(4,150)	(3,811)
Net liabilities		**(1,871)**	(2,213)	(1,913)
Equity				
Share capital		**1**	1	1
Share premium	17	**404**	401	403
Own shares		**(27)**	(24)	(26)
Currency translation reserve		**-**	-	1
Cash flow hedge reserve		**9**	(11)	2
Retained earnings		**(2,258)**	(2,580)	(2,294)
Total equity attributable to equity holders of the parent		**(1,871)**	(2,213)	(1,913)

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	Share premium £m	Own Shares £m	Currency translation reserve £m	Cash flow hedge reserve £m	Retained earnings £m	**Total £m**
At 1 February 2016	**1**	**399**	**(22)**	**(1)**	**(10)**	**(2,323)**	**(1,956)**
Profit for the period	-	-	-	-	-	44	44
Other comprehensive income	-	-	-	1	(1)	(274)	(274)
Total comprehensive income	-	-	-	1	(1)	(230)	(230)
Dividends	-	-	-	-	-	(33)	(33)
Issue of share capital	-	2	-	-	-	-	2
Purchase of own shares	-	-	(2)	-	-	-	(2)
Share-based payments	-	-	-	-	-	6	6
At 31 July 2016	**1**	**401**	**(24)**	**-**	**(11)**	**(2,580)**	**(2,213)**
At 1 February 2017	**1**	**403**	**(26)**	**1**	**2**	**(2,294)**	**(1,913)**
Profit for the period	-	-	-	-	-	64	64
Other comprehensive income	-	-	-	(1)	7	2	8
Total comprehensive income	-	-	-	(1)	7	66	72
Dividends	-	-	-	-	-	(35)	(35)
Issue of share capital	-	1	-	-	-	-	1
Purchase of own shares	-	-	(1)	-	-	-	(1)
Share-based payments	-	-	-	-	-	5	5
At 31 July 2017	**1**	**404**	**(27)**	**-**	**9**	**(2,258)**	**(1,871)**

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 from continuing and discontinued operations		**80**	55
Amortisation and depreciation		**33**	29
Net finance costs		**98**	84
Other adjustments to profit before tax		**5**	7
Working capital:			
Increase in trade receivables		**(5)**	(20)
Increase in trade and other payables		**9**	33
(Decrease)/increase in provisions		**(8)**	13
Difference between pension charge and cash contributions		**(34)**	(10)
Total working capital adjustments		**(38)**	16
Net cash flows from operating activities before tax		**178**	191
Tax paid		**(11)**	(7)
Net cash flows from operating activities		**167**	184
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 premium and penalties		**(11)**	-
Repayment of borrowings		**(328)**	-
Refinancing transactions		**(95)**	-
Purchase of own shares		**-**	(2)
Interest paid on borrowings		**(72)**	(73)
Payment of finance lease capital		**(19)**	(20)
Payment of finance lease interest		**(3)**	(3)
Dividends paid		**(35)**	(33)
Net cash flows from financing activities		**(224)**	(131)
Net (decrease)/increase in cash and cash equivalents		**(73)**	20
Net foreign exchange differences		**-**	2
Cash and cash equivalents at the beginning of the period		**211**	166
Cash and cash equivalents		**138**	188
Cash transferred to asset held for sale	3	**-**	(30)
Cash and cash equivalents from continuing operations	11	**138**	158

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 £8m (2016: £7m), non-recurring costs of IT system implementation and other restructuring activities of £1m (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 of £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 27 March 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 period 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	**32**	32
Insurance Underwriting	**3**	1
Trading Revenue	**471**	467
Exceptional revenue provision (see note 13)	**-**	(10)
Total Revenue	**471**	457
Trading EBITDA		
Roadside Assistance	**174**	179
Insurance Services	**38**	35
Driving Services	**9**	9
Insurance Underwriting	**-**	(1)
Head Office costs	**(28)**	(30)
Total Trading EBITDA	**193**	192
Items not allocated to a segment	**(12)**	(10)
Pension past service credit	**34**	-
Amortisation and depreciation	**(33)**	(28)
Exceptional items	**(4)**	(22)
Operating profit	**178**	132
Net finance costs	**(98)**	(84)
Profit before tax from continuing operations	**80**	48

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 five 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.
- *Insurance Underwriting:* This segment consists of the insurance underwriting and reinsurance activities of the AA.
- *Head Office costs:* This segment includes IT, property, finance and other back office system 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 of £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	**11**	10
	11	10
Deferred tax		
Relating to origination and reversal of temporary differences – current year	**5**	-
	5	-
Tax charge in the income statement at an effective rate of 20.0% (July 2016: 20.8%)	**16**	10

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 Earnings per share

Basic earnings per share amounts are calculated by dividing net profit for the period attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period.

	Six months ended July 2017	Six months ended July 2016
Basic earnings per share:		
Profit after tax from total operations (£m)	**64**	44
Weighted average number of shares outstanding (millions)	**610**	609
Basic earnings per share from total operations (pence)	**10.5**	7.2

	Six months ended July 2017	Six months ended July 2016
Basic earnings per share:		
Profit after tax from continuing operations (£m)	**64**	38
Weighted average number of shares outstanding (millions)	**610**	609
Basic earnings per share from continuing operations (pence)	**10.5**	6.2

For diluted earnings per share, the weighted average number of ordinary shares is adjusted to assume conversion of all dilutive potential ordinary shares.

As at 31 July 2017 and 31 July 2016, based on average market value of ordinary shares for the period, the MVP shares were not dilutive. Under the current SIP, shares are purchased monthly at market value and are therefore not dilutive.

There are no further classes of share that are dilutive as at 31 July 2017.

	Six months ended July 2017	Six months ended July 2016
Weighted average number of ordinary shares in issue (millions)	**610**	609
Potentially dilutive shares (millions)	**-**	-
Weighted average number of diluted ordinary shares (millions)	**610**	609
Diluted earnings per share from total operations (pence)	**10.5**	7.2
Diluted earnings per share from continuing operations (pence)	**10.5**	6.2

Notes to the financial statements (continued)

7 Earnings per share (continued)

Reconciliation of reported earnings per share to adjusted earnings per share:

	Six months ended July 2017 £m	Six months ended July 2016 £m
Profit after tax from continuing operations as reported	**64**	38
Adjusted for:		
Exceptional items (see note 4)	**4**	22
Items not allocated to a segment (see note 4)	**12**	10
Pension past service credit (see note 4)	**(34)**	-
Penalties on early repayment of debt (see note 5)	**10**	-
Transfer from cash flow hedge reserve for extinguishment of cash flow hedge (see note 5)	**5**	-
Write off of debt issue fees following refinancing	**1**	-
Tax expense (see note 6)	**16**	10
Underlying profit before tax	**78**	80
Tax at the effective rate of 20.0% (July 2016: 20.8%)	**(16)**	(17)
Underlying profit from continuing operations	**62**	63
Adjusted basic earnings per share from continuing operations (pence)	**10.2**	10.3
Adjusted diluted earnings per share from continuing operations (pence)	**10.2**	10.3

Notes to the financial statements (continued)

8 Goodwill and other intangible assets

	Goodwill £m	Software £m	Total £m
Cost			
At 1 February 2016	1,199	191	1,390
Additions	-	26	26
Transfer to assets held for sale	(26)	(14)	(40)
Exchange adjustment	-	1	1
At 31 July 2016	**1,173**	**204**	**1,377**
At 1 February 2017	1,173	203	1,376
Additions	-	23	23
At 31 July 2017	**1,173**	**226**	**1,399**
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	-	15	15
At 31 July 2017	**-**	**108**	**108**
Net book value			
At 31 July 2017	**1,173**	**118**	**1,291**
At 31 July 2016	1,173	103	1,276
At 31 January 2017	1,173	110	1,283

Notes to the financial statements (continued)

9 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
Disposal	-	-	(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)

10 Trade and other receivables

	July 2017 £m	July 2016 £m	January 2017 £m
Current			
Trade receivables	**140**	136	141
Prepayments and accrued income	**28**	25	22
Reinsurers share of insurance liability	**28**	4	28
Other receivables	**4**	4	4
	200	169	195

11 Cash and cash equivalents

	July 2017 £m	July 2016 £m	January 2017 £m
Ring-fenced cash at bank and in hand – available	**73**	114	128
Ring-fenced cash at bank and in hand – restricted	**7**	8	8
Non ring-fenced cash at bank and in hand – available	**40**	23	60
Non ring-fenced cash at bank and in hand – restricted	**18**	13	15
Cash and cash equivalents	**138**	158	211

Ring-fenced cash and cash equivalents relate to cash held by AA Intermediate Co Limited and its subsidiaries. There are restrictions on dividends that can be paid to AA plc until certain debt to EBITDA and cash flow criteria are met.

Cash at bank and in hand - restricted includes £25m (July 2016: £21m, January 2017: £23m) 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	**105**	105	97
Other taxes and social security costs	**10**	25	27
Accruals	**63**	68	57
Deferred income	**247**	241	241
Provision for unearned premiums in insurance underwriting	**22**	5	18
Other payables	**29**	27	33
Interest payable	**1**	1	-
Obligations under finance lease agreements	**39**	30	47
	516	502	520

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 (July 2016: nil) and no additional provision was made (July 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 £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 cash flow, net debt and liquidity section). The Class B2 notes require us to maintain the Class B2 free cash flow to debt service ratio in excess of 1x (see cash flow, net debt and liquidity 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 notes 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.

The amounts recognised in the balance sheet are as follows:

	As at 31 July 2017			
	AAUK £m	AAI £m	AAPMP £m	Total £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)**

Notes to the financial statements (continued)

16 Defined benefit pension scheme liabilities (continued)

	As at 31 July 2016			
	AAUK £m	AAI £m	AAPMP £m	Total £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			
	AAUK £m	AAI £m	AAPMP £m	Total £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% (July 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 July 2017 %	AAUK July 2016 %	AAI July 2017 %	AAI July 2016 %	AAPMP July 2017 %	AAPMP 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.

17 Share premium

	£m
At 31 January 2016	399
Issue of shares	2
At 31 July 2016	**401**
At 31 January 2017	403
Issue of shares	1
At 31 July 2017	**404**

Notes to the financial statements (continued)

18 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:

		Fair value measurement using		
	Carrying value £m	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:

		Fair value measurement using		
	Carrying value £m	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.

Notes to the financial statements (continued)

18 Fair values (continued)

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.

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.

19 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.

20 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.

Directors' responsibility statement

The directors confirm that to the best of their knowledge:

- The consolidated interim financial information contained in this report has been prepared in accordance with International Accounting Standard 34 'Interim Financial Reporting' (IAS 34);
- The Chairman's statement and the financial report together include a fair review of the information required by the Financial Conduct Authority's Disclosure and Transparency Rules ('DTR') 4.2.7R (indication of important events during the first six months and description of principal risks and uncertainties for the remaining six months of the year); and
- The interim report includes a fair review of the information required by DTR 4.2.8R (disclosure of related party transactions and changes therein).

By order of the Board

Simon Breakwell

Chief Executive

25 September 2017

Forward-looking statements

This document contains various forward-looking statements that reflect management's current views with respect to future events and anticipated financial and operational performance. By their nature, forward-looking statements involve known and unknown risks, uncertainties and other factors because they relate to events and depend on circumstances that may or may not occur in the future. Forward-looking statements are not guarantees of future performance and the Group's actual financial condition, results of operations and cash flows, and the development of the industry in which it operates, may differ materially from (and be more negative than) those made in, or suggested by, the forward-looking statements contained in this document. In addition, even if its financial condition, results of operations and cash flows and the development of the industry in which it operates are consistent with the forward-looking statements contained in this document, those results or developments may not be indicative of results or developments in subsequent periods. Although the Group believes that the expectations reflected in these forward-looking statements are reasonable, it can give no assurance that they will materialise or prove to be correct. Because these forward-looking statements are based on assumptions or estimates and are subject to risks and uncertainties, the actual results or outcome could differ materially from those set out in the forward-looking statements.

Independent review report to AA plc

Introduction
We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 31 July 2017 which comprises the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of financial position, the consolidated statement of changes in equity, the consolidated statement of cash flows and the related explanatory notes. We have read the other information contained in the half yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with guidance contained in International Standard on Review Engagements 2410 (UK and Ireland) "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company, for our work, for this report, or for the conclusions we have formed.

Directors' Responsibilities
The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting", as adopted by the European Union.

Our Responsibility
Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

Scope of Review
We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion
Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 31 July 2017 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Ernst & Young LLP

London

25 September 2017