



AA INTERMEDIATE CO LIMITED

INTERIM REPORT

FOR THE SIX MONTHS ENDED 31 JULY 2019

Management discussion and analysis

Introduction

The directors present the condensed financial statements of AA Intermediate Co Limited (“the Company”) and its subsidiary undertakings (together “the Group”) for the period ended 31 July 2019. The Company is an Obligor and a parent company of each of the other Obligors that provide security and guarantees under the financing arrangements entered into by the AA on 2 July 2013. The Company’s immediate parent is AA Mid Co Limited. There is no material difference in the financial conditions and results of operations between the AA Intermediate Co Limited group and the AA Mid Co Limited group.

Principal activity and review of business developments

The Group provides AA branded goods and services across the UK and operates two segments. These are Roadside, which includes Roadside Assistance and Driving Services, and Insurance, which includes our Insurance Broker and our Financial Services partnership with Bank of Ireland.

The AA’s principal activity is the provision of Roadside Assistance to its personal members and business customers (which in aggregate makes up 87% of Group Revenue). The AA business strategy includes cross-selling Insurance Services to its membership utilising its marketing database and multiple points of contact with its customers.

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

Key operating measures

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

	July 2019	July 2018
Roadside		
Paid personal members (m)	3.19	3.25
Average income per paid personal member (£)	165	159
Business customers (m)	9.00	9.68
Average income per business customer (£)	22	21
Number of breakdowns (m)	1.65	1.91
Insurance		
Total Motor policies (000s)	803	659
Total Home policies (000s)	841	816
Average income per policy ¹ (£)	67	73

¹ Motor and Home only

Management discussion and analysis (continued)

Key operating measures (continued)

Roadside

Personal memberships

In line with management expectations, paid personal memberships were broadly flat during the period at 3.19m (H1 19: 3.25m, FY 19: 3.21m) and retention was also broadly flat at approximately 80%. The rate of decline in the paid personal membership base of 0.6% in the period compares favourably to the 1.2% rate of decline this time last year. Underpinned by outstanding service delivery, our confidence in the outlook for the paid personal membership base reflects the benefit of additional and sustained marketing spend, including the recently launched 'Red Dwarf' advertising campaign, increased cross-sell rates from our Insurance, Driving Schools and AA Cars platform as well as targeted investment in our differentiated proposition. We continue to expect a broadly flat membership base this financial year and a return to growth next year.

Average income per paid member increased by 4% since last year and was up 2% since year end to £165 (H1 19: £159, FY 19: £162). The figure is tracking broadly in line with inflation on an annualised basis. The increase in the period includes the proportion of new personal members taking up monthly subscriptions and improved product mix.

Stay AA, our retention team, continues to deliver strong results and we are now retaining over 70% of those who call to cancel.

Business to business

In line with our expectations, average income per business customer was up 5% in the period to £22 and B2B customers were 9.0m, principally due to our decision to not renew our contract with Groupe PSA. Our focus within B2B is on forming partnerships which are aligned from both a strategic and commercial perspective.

We retained a number of key contracts during the period including Toyota, Lex Autolease and Northgate. Over the next 12 months, there are several large new B2B opportunities for tender and we remain optimistic in our ability to win these, utilising our best-in-class customer service delivery, approach to innovation and the broad range of driving services including Service, Maintenance and Repair (SMR) we can offer our partners.

In February 2019, we announced the acquisition of Prestige Fleet Servicing (Prestige), a profitable and growing technology-led supplier of SMR services to fleet and leasing companies. The SMR market plays a key role in addressing a driver's planned and unplanned needs and represents a significant opportunity for the AA to grow new revenue streams without incurring significant capital expenditure. We have successfully integrated Prestige and its proprietary UNITY system into our new technical services business, which we launched in March 2019, with the aim of providing a nationwide service for the automotive industry and UK drivers to help with issues such as: vehicle recall campaigns, SMR and onsite technical support for our OEM partners.

In April 2019, we announced a three-year contract with Admiral to offer AA Roadside Assistance to Admiral's 4.3 million UK motor insurance customers. The contract, which commenced in September 2019, is our first significant contract in the insurance market and will see Admiral and the AA work together across a number of strategic initiatives aimed at enhancing the automotive ecosystem for all UK motorists.

Management discussion and analysis (continued)

Key operating measures (continued)

Operational review

We continue to deliver best-in-class customer service delivery in our Roadside Assistance business and in June 2019, were pleased to have been awarded top Which? Recommended Provider status for breakdown cover, achieving a top scoring five stars within the 'fix at the roadside' category. The Which? award builds on our success in January 2019 in being named as the UK's most reliable breakdown cover provider by What Car? in 2018.

Total breakdowns fell in the period by 14% to 1.65m (H1 19: 1.91m). This resulted in a significant reduction to third-party garaging costs which was partially offset by the lower revenue generated from our pay-for-use B2B contracts.

Overall call-to-arrive times averaged below 45 minutes in the period compared to above 55 minutes over the same period last year, a significant improvement and below our long-term target of 45 minutes. We responded to a majority of calls to our call centre within 20 seconds and are tracking ahead of our target of answering 80% of calls within 20 seconds. Our repair rates and average repair times were also strong in the period and ahead of last year.

Innovation

We continue to make significant progress with the development and roll-out of new products and services that will differentiate the AA and help generate additional revenue streams from both within and outside the core membership base as well as deliver operational and cost efficiencies.

In Q4 FY20, we will be launching Smart Breakdown, a new offering that will transform our breakdown service by using connected technology to enable early identification of faults, prevent breakdowns and get our members back on the road faster. In preparation of the launch, we have completed the integration of the Smart Breakdown functionality into our leading AA app.

More than 1.4 million members are now registered for the AA app and it is used in approximately 30% of the personal breakdowns that we service. In aggregate, 52% of our personal breakdowns are now handled via our digital channels. Following the launch of our 'Red Dwarf' advertising campaign in July 2019, we have increased the average monthly registration of the app from 377,000 to 395,000. Over the next twelve months, we will be layering in several new functionalities into the app including SMR as well as features and content which make everyday driving life better. These features will be available to all UK drivers – including existing customers, and also drivers who hold no products with us. We believe this will help to deliver improved cross-sell rates, increase retention and drive engagement.

During the period we launched our award winning new online breakdown reporting channel on our website (theaa.com) to supplement our existing phone and AA app channels. The channel has already proven successful with over 700,000 breakdowns reported since launch. The ability to report a breakdown directly on our website helps to improve the experience for our members by giving them greater choice of how they communicate with us; saving their time, making our service even more accessible and helping us to improve our overall call handling times.

Driving Services

During the period, we were pleased to have renewed a three-year award for the Bedfordshire, Cambridgeshire and Hertfordshire framework contract (previously known as the Thames Valley Framework contract) and the Police Service Northern Ireland contract in our DriveTech business.

Looking ahead, under new leadership in both businesses we are developing strategies to help return the Driving Services division back to sustainable growth. Within Driving School, we have invested in improving our digital interface and have significantly improved digital customer journeys for pupils, offering more competitive franchise opportunities, layering in wider benefits such as Roadside membership through our Standby promotion and we will also be launching a bespoke AA Driving Schools app later this year. Within DriveTech, we are looking to build new recurring revenue streams within our corporate driver training business.

Management discussion and analysis (continued)

Key operating measures (continued)

Insurance

Insurance Services (including Insurance broking and Financial Services)

The motor insurance policy book grew by 22% since last year to 803,000 (H1 19: 659,000, FY 19: 731,000) and the home book grew by 3% to 841,000 (H1 19: 816,000, FY 19: 830,000), reflecting the continued strong growth of the AA plc group's in-house underwriter as well as the benefit of ongoing investment in systems including Insurer Hosted Pricing (IHP). Over 80% of new motor business volumes are currently being written on IHP and we will continue to roll-out this technology across our motor base during the second half of the year with the addition of a new panel member. We are targeting IHP roll-out on home early next year.

The strong growth of the non-member motor book and improvements in our customer journey are helping to deliver consistent and healthy conversions into our Roadside business with 32% of new insurance customers taking Roadside membership.

The on-going investment in acquiring new business volumes, which have a lower average commission compared to the rest of the book, led to a reduction in the average income per motor and home policy to £67 compared to £69 at year end (H1 19: £73).

In Q3 FY20, we will be broadening our motor panel base with the addition of Aviva, which will help to further accelerate volume growth in the motor book.

At the end of July 2019, we had 158,895 Financial Services products across our credit cards, personal loans and savings portfolio. This represents a balance sheet size of approximately £586m, broadly matched by deposits and both of which are held on the balance sheet of Bank of Ireland. The loan book has continued to grow well in a competitive market place with the combination of the AA's brand and distribution platform and the Bank of Ireland's expertise in service delivery offering a distinct competitive advantage. The AA membership base and brand are benefiting the business with 31% of the non-ISA savings books held by members and 37% of our personal loans being written for vehicles. In addition, through our AA Cars platform, we are well positioned to expand our loan offering into the growing market for used car financing.

Management discussion and analysis (continued)

Principal risks and uncertainties

The Group's Principal Risks were detailed in the Annual Report 2019. The Board has reviewed these principal risks for material developments since the publication of the Annual Report 2019 and updates against each principal risk, including any significant changes that may impact the second half performance, are detailed in italics below:

1. Outstanding service

We are unable to maintain an outstanding service: The AA's brand and its continued success, and in particular the loyalty of its customers, relies on delivering outstanding service that is superior to the rest of the market. Inadequate investment in technology, systems, people and processes would place this objective at increasing risk.

Our call to arrive time, repair rate, single-task-completion and under-bonnet times are significantly improved since last year. We have continued to invest in our contact centre agents, increased the flexibility of the patrol force and improved our planning and delay related forecasting to ensure we are better placed to respond to extreme weather events.

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 have a different business model, together with changes in car technology, threaten our market share. If we charge a price premium that is above that which our service can sustain, we will not grow our member or B2B customer base and, in the long-term, sustainably grow profits. We need to improve, innovate, demonstrate and deliver a superior proposition and ensure our pricing is competitive relative to this position. We also need to ensure our pricing practices are in line with the expectations of our customers and regulators.

Personal paid membership numbers have remained relatively stable and we have retained our main B2B contracts.

3. Regulatory and legal environment

A changing regulatory environment may adversely affect our activities. Material litigation against the AA: 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 fines and reputational damage. Changes in Government legislation or taxation could impact the business model.

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

4. Information security/Cyber crime/Data breach

We are unable to protect ourselves from a significant data breach or cyber security incident: The integrity of critical information is corrupted, resulting in it not being available where and when it is needed, or the confidentiality of commercially sensitive, private or customer information is compromised by inappropriate disclosure or a serious data breach occurs.

A comprehensive information security initiative has delivered significant improvements on technology, data, colleague and third party supplier risks; a high level of focus will continue in order to reduce the risk but the risk remains high.

5. Business & IT transformation

We are unable to successfully complete essential business transformation: We must continue to transform the AA to achieve the required efficient customer-centric services and to develop the business. Although much has been achieved in FY19 there remains much to do and the required improvements to process, embedded ways of working and culture, inherently involves risks in a customer facing service environment.

Management discussion and analysis (continued)

We have continued to improve our technology, data and digital capabilities to enable improved customer and employee experience and drive sustained benefits. We are executing against a disciplined programme of capex investment, and will continue to review timelines and priorities as part of the execution of our declared strategy.

6. Insurance Broking

Price comparison sites will further damage the insurance broker model: Consumers' use of price comparison sites may continue to transfer value away from our insurance broking business.

This remains on track to deliver forecast growth in customer numbers. We accept that price comparison sites will continue to transfer value from our broking business and we manage this risk through carefully selecting the positioning of the AA brand where quotes appear on price comparison sites and through continued promotion of our own direct channels and the Defaqto ratings of the AA's products. We continue to work with the price comparison sites to maximise value for mutual benefit, for example through targeted growth and promotional offers.

7. Debt Leverage and Pensions

Debt: We are unable to manage our debt: the Group is unable to repay or refinance its debt at an acceptable price.

We are due to refinance £1.5bn of debt by July 2022 of which £200m relates to the refinancing of the Class A3 note in July 2020 and can be fully funded by a committed forward starting senior facility with a maturity date of July 2023. The current bond market suggests that debt would need to be refinanced at a much higher interest rate than the current debt and this is considered an emerging risk. Consistent with our approach to proactive debt management, we continue to regularly assess a range of strategic options and are monitoring market conditions closely.

Modelling indicates that even at higher interest rates, the business remains cash generative and able to meet its financing commitments at the same time as being able to pay down debt.

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.

Management discussion and analysis (continued)

	Six months ended July 2019 £m	Six months ended July 2018 £m
Revenue	480	472
Cost of sales	(188)	(193)
Gross profit	292	279
Administrative and marketing expenses	(175)	(162)
Operating profit	117	117
Finance costs	(78)	(88)
Profit before tax	39	29
Tax expense	(8)	(6)
Profit for the period	31	23

Reconciliation of Trading EBITDA to Operating Profit

Trading EBITDA	161	161
Share-based payments	(1)	(3)
Pension service charge adjustment	(2)	(3)
Amortisation and depreciation	(41)	(33)
Exceptional operating items	-	(5)
Operating profit	117	117

Revenue: Revenue increased by £8m to £480m during the period (H1 19: £472m).

Roadside Assistance: Revenue increased by £7m during the period to £387m (H1 19: £380m) despite the anticipated decline in personal memberships and business customers. This was largely due to the additional revenue from consolidating the results of Prestige (acquired on 1 February 2019).

Driving Services: Revenue remained flat at £31m (H1 19: £31m).

Insurance Services: Revenue increased 2% in the period to £62m (H1 19: £61m), in line with our expectations. The motor insurance policy book grew by 22% since last year to 803,000 (H1 19: 659,000, FY 19: 731,000) and the home book grew by 3% to 841,000 (H1 19: 816,000, FY 19: 830,000), reflecting the continued strong growth of the AA plc group's in-house underwriter as well as the benefit of ongoing investment in systems including Insurer Hosted Pricing (IHP). Over 80% of new motor business volumes are currently being written on IHP and we will continue to roll-out this technology across our motor base during the second half of the year with the addition of a new panel member. We are targeting IHP roll-out on home early next year.

Cost of sales: Cost of sales decreased by £5m during the period to £188m (H1 19: £193m) due to lower unplanned costs from third party garaging in Roadside Assistance, compared to the exceptionally high numbers of breakdowns attended in the prior period due to the extreme weather.

Administrative and marketing expenses: Administrative and marketing expenses increased by £13m during the period to £175m (H1 19: £162m). This was driven by the anticipated increase in amortisation and depreciation costs to £41m (H1 19: £33m) reflecting the historic and ongoing investments in IT.

Operating profit: Operating profit was flat at £117m during the period (H1 19: £117m). The aforementioned increase in amortisation and depreciation costs was offset somewhat by decreases in exceptional operating costs and share-based payment charges.

Finance costs: Net finance costs fell during the period to £78m (H1 19: £88m) principally due to non-reoccurrence of the early repayment penalty of £15m in the prior period figure related to the July 2018 refinancing.

Management discussion and analysis (continued)

Taxation: The tax charge in the period increased to £8m (H1 19: £6m) reflecting the higher profitability. The tax charge consisted of a current tax charge of £6m (H1 19: £2m) and a deferred tax charge of £2m (H1 19: £4m).

Trading EBITDA

Trading EBITDA is a non-IFRS measure and is not a substitute for any International Financial Reporting Standards measure.

Trading EBITDA was flat during the period at £161m (H1 19: £161m). The Trading EBITDA margin was also broadly flat at 33.5% (H1 19: 34.1%).

Roadside Assistance: Trading EBITDA (before allocation of Head Office costs) improved by 4% to £162m (H1 19: £156m). As noted above, this was due to the increase in the average income per paid member and reduction in the blended cost of acquisition of new personal paid members, as well as the benefit of reduced third-party garaging costs.

Driving Services: Trading EBITDA (before allocation of Head Office costs) was flat at £7m (H1 19: £7m) reflecting the impact of margin pressures on both businesses due to competition.

Insurance Services: Trading EBITDA (before allocation of Head Office costs) for Insurance Services decreased to £30m (H1 19: £33m), in line with our expectations due to the ongoing investment in marketing to accelerate the growth of the broker.

Head Office Costs: Overall head office costs increased by £3m to £38m (H1 19: £35m). This is due to the centralisation of costs previously allocated to the Roadside division, in particular recruitment costs for contact centre staff and patrols as well as costs related to training and development spend, in line with our strategy to invest in our people.

Management discussion and analysis (continued)

Consolidated statement of cash flows

	Six months ended July 2019 £m	Six months ended July 2018 £m
Net cash flows from operating activities before tax	174	143
Tax paid	(4)	(10)
Net cash flows from operating activities	170	133
Investing activities		
Capital expenditure	(35)	(36)
Proceeds from sale of fixed assets	12	9
Payment for acquisition of subsidiary, net of cash acquired	(8)	(13)
Dividends from joint ventures and associates	-	1
Net cash flows used in investing activities	(31)	(39)
Financing activities		
Proceeds from borrowings	15	565
Issue costs on borrowings	-	(6)
Debt repayment premium and penalties	-	(17)
Repayment of borrowings	(15)	(550)
Financing transactions	-	(8)
Interest paid on borrowings	(65)	(61)
Payment of lease capital	(21)	(18)
Payment of lease interest	(2)	(2)
Net cash flows from financing activities	(88)	(89)
Net increase in cash and cash equivalents	51	5

Change in working capital: The change in working capital represented a cash inflow of £28m during the period (H1 19: £10m), mainly due to timing differences in invoice payments and a decrease in provisions during the prior period.

Net cash flows from operating activities before tax: Net cash flow from operating activities before tax increased to a cash inflow of £174m (H1 19: cash inflow £143m) during the period. This was driven by the higher cash inflow from the change in working capital.

Tax paid: Cash outflow from tax paid was £4m for the period (H1 19: cash outflow £10m). This was due to lower profit before tax in the 2019 financial year than in the 2018 financial year.

Investing activities: Cash outflow from investing activities was £31m for the period (H1 19: cash outflow £39m). The decrease in cash outflow from investing activities was driven by the net cash outflow from the acquisition of Prestige in the current period being less than the net cash outflow from the acquisition of AA Cars in the prior period.

Financing transactions: Net cash flow from financing transactions for the period was £nil (H1 19: cash outflow £8m). The decrease in financing outflows is due to no refinancing in the current period whilst refinancing did occur in the prior period.

Management discussion and analysis (continued)

Interest paid on borrowings: Cash outflow from interest paid on borrowings was £65m (H1 19: £61m) for the period.

Debt repayment premium and penalties: Cash outflow from debt repayment premium and penalties was £nil (H1 19: £17m) for the period. The prior period payment related to the £15m penalty on early redemption of £300m of Class A3 Notes and a £2m premium incurred from the issue of the Class A7 Notes.

Payment of finance lease capital and interest: Cash outflow from the payment of lease capital and interest increased to £23m (H1 18: £20m) as a result of the adoption of IFRS 16 in the current period. Cash outflows relating to leases previously classified as operating leases were included in cash flows from operating activities in the prior period but in the current period were included in payments of lease capital and interest.

Management discussion and analysis (continued)

Net debt and covenants	As at 31 July 2019 £m	As at 31 July 2018 £m
Class A notes	2,200	2,200
Less: cash and cash equivalents	<u>(71)</u>	<u>(55)</u>
Net Senior Secured Debt ¹	2,129	2,145
Class B2 notes	570	570
Lease obligations for covenant reporting ⁸	<u>57</u>	<u>53</u>
Net WBS Debt ²	2,756	2,768
Lease adjustment for IFRS 16 ⁹	<u>25</u>	<u>-</u>
Net Debt at period end	<u>2,781</u>	<u>2,768</u>
 Reconciliation to covenants		
Lease obligations for covenant reporting ⁸	57	53
Lease adjustment for IFRS 16 ⁹	<u>25</u>	<u>-</u>
Total lease liabilities as reported in the statement of financial position	<u>82</u>	<u>53</u>
 Trading EBITDA for the last twelve months ³	 <u>335</u>	 <u>360</u>
	Covenant	
Class B2 Leverage ratio ⁴	8.2x	7.7x
Senior Leverage ratio ⁵	6.4x	6.0x
Class A Free Cash Flow: Debt Service ⁶	>1.35x	2.9x
Class B Free Cash Flow: Debt Service ⁷	>1.00x	2.1x

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

2 Net WBS Debt represents the borrowings and cash balances within the WBS structure headed by the Company. This includes the principal amounts of the Senior Term Facility, Class A notes, Class B2 notes and lease obligations for covenant reporting less cash and cash equivalents.

3 Group Trading EBITDA including discontinued operations as required by the debt documents based on frozen GAAP.

4 Ratio of Net WBS Debt² to Group Trading EBITDA for the last 12 months³.

5 Ratio of Net Senior Secured Debt¹ to Group Trading EBITDA for the last 12 months³.

6 Ratio of last 12 months free cash flow to proforma debt service relating to the Senior Term Facility and Class A notes.

7 Ratio of last 12 months free cash flow to proforma debt service.

8 The lease obligations for covenant reporting value is presented based on frozen GAAP pre-IFRS 16, as required by the debt documents. The figure above is therefore different to the lease liabilities value shown in the statement of financial position.

9 Difference between lease obligations for covenant reporting based on frozen GAAP and the lease liabilities value shown in the statement of financial position having adopted IFRS 16 from 1 February 2019.

Class A free cash flow to debt service was 2.9 times as at 31 July 2019 and Class B free cash flow to debt service was 2.1 times, showing substantial headroom over the covenants which are set out below.

Management discussion and analysis (continued)

Net debt and covenants (continued)

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 pension 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. These calculations are adjusted for items required by the financing documents.

The Group had a cash balance of £71m at 31 July 2019.

The Group holds segregated funds as 'restricted cash' in order to satisfy regulatory requirements governing our insurance regulated business. These restricted cash balances were £8m at 31 July 2019 (H1 19: £8m).

Consolidated income statement

	Note	Six months ended July 2019 £m	Six months ended July 2018 £m
Revenue	2	480	472
Cost of sales		(188)	(193)
Gross profit		292	279
Administrative and marketing expenses		(175)	(162)
Operating profit		117	117
Finance costs	6	(78)	(88)
Profit before tax		39	29
Tax expense	7	(8)	(6)
Profit for the period		31	23

The accompanying notes are an integral part of this consolidated income statement.

Consolidated statement of comprehensive income

	Six months ended July 2019 £m	Six months ended July 2018 £m
Profit for the period	31	23
Other comprehensive income on items that may be reclassified to the income statement in subsequent years		
Effective portion of changes in fair value of cash flow hedges	-	(5)
Tax effect	-	1
	-	(4)
Other comprehensive income on items that will not be reclassified to the income statement in subsequent years		
Remeasurement (losses)/gains on defined benefit schemes	(41)	147
Tax effect	7	(25)
	(34)	122
Total other comprehensive income	(34)	118
Total comprehensive income for the period	(3)	141

The accompanying notes are an integral part of this consolidated statement of comprehensive income.

Consolidated statement of financial position

	Note	July 2019 £m	July 2018 £m	January 2019 £m
Non-current assets				
Goodwill and other intangible assets	8	1,339	1,312	1,326
Property, plant and equipment	9	55	110	123
Right-of-use assets	10	79	-	-
Investments in joint ventures and associates		5	5	5
Derivative financial instruments	18	1	2	-
Financial assets at amortised cost	22	4	-	-
Deferred tax assets		27	2	22
		1,510	1,431	1,476
Current assets				
Inventories		4	7	4
Trade and other receivables	11	176	182	179
Amounts owed by parent undertakings	12	1,214	1,214	1,214
Cash and cash equivalents	13	71	55	20
		1,465	1,458	1,417
Assets classified as held for sale		-	-	6
Total assets		2,975	2,889	2,899
Current liabilities				
Trade and other payables	14	(416)	(455)	(406)
Amounts due to parent undertakings		(45)	(32)	(34)
Current tax payable		(4)	(1)	(2)
Borrowings and loans	16	(200)	(15)	-
Lease liabilities		(46)	(39)	(49)
Provisions	15	(2)	(1)	(3)
		(713)	(543)	(494)
Non-current liabilities				
Borrowings and loans	16	(2,530)	(2,718)	(2,724)
Derivative financial instruments	18	(1)	-	-
Lease liabilities		(36)	(14)	(12)
Defined benefit pension scheme liabilities	19	(251)	(86)	(218)
Provisions	15	(4)	(5)	(4)
Deferred consideration	14	(10)	(11)	(10)
		(2,832)	(2,834)	(2,968)
Liabilities classified as held for sale		-	-	(5)
Total liabilities		(3,545)	(3,377)	(3,467)
Net liabilities		(570)	(488)	(568)
Equity				
Cash flow hedge reserve		-	1	-
Retained earnings		(570)	(489)	(568)
Total equity attributable to equity holders of the parent		(570)	(488)	(568)

The accompanying notes are an integral part of this consolidated statement of financial position.

Consolidated statement of changes in equity

Attributable to the equity holders of the parent

	Share capital £m	Cash flow hedge reserve £m	Retained earnings £m	Total £m
At 1 February 2018	-	5	(648)	(643)
Profit for the period	-	-	23	23
Other comprehensive income	-	(4)	122	118
Total comprehensive income	-	(4)	145	141
Share-based payments	-	-	3	3
IFRS 9 conversion	-	-	13	13
IFRS 9 deferred tax impact	-	-	(2)	(2)
At 31 July 2018	-	1	(489)	(488)
At 1 February 2019	-	-	(568)	(568)
Profit for the period	-	-	31	31
Other comprehensive income	-	-	(34)	(34)
Total comprehensive income	-	-	(3)	(3)
Share-based payments	-	-	1	1
At 31 July 2019	-	-	(570)	(570)

The accompanying notes are an integral part of this consolidated statement of changes in equity.

Consolidated statement of cash flows

	Note	Six months ended July 2019 £m	Six months ended July 2018 £m
Profit before tax		39	29
Amortisation and depreciation	8,9,10	41	33
Net finance costs	6	78	88
Difference between pension charge and cash contributions		(11)	(19)
Other adjustments to profit before tax		(1)	2
Working capital:			
Decrease / (increase) in trade and other receivables		2	(6)
Increase in trade and other payables		26	28
Decrease in provisions		-	(12)
Total working capital adjustments		28	10
Net cash flows from operating activities before tax		174	143
Tax paid		(4)	(10)
Net cash flows from operating activities		170	133
Investing activities			
Capital expenditure		(35)	(36)
Proceeds from sale of fixed assets		12	9
Payment for acquisition of subsidiary, net of cash acquired		(8)	(13)
Dividends from joint ventures and associates		-	1
Net cash flows used in investing activities		(31)	(39)
Financing activities			
Proceeds from borrowings		15	565
Issue costs on borrowings		-	(6)
Debt repayment premium and penalties		-	(17)
Repayment of borrowings		(15)	(550)
Financing transactions		-	(8)
Interest paid on borrowings		(65)	(61)
Payment of lease capital		(21)	(18)
Payment of lease interest		(2)	(2)
Net cash flows from financing activities		(88)	(89)
Net increase in cash and cash equivalents		51	5
Cash and cash equivalents at the beginning of the period		20	50
Cash and cash equivalents	13	71	55

The cash flows from operating activities are stated net of cash outflows relating to exceptional items of £2m (2018: £18m). This relates to the cost of business and IT rationalisation and transformation of £1m (2018: £14m), conduct and regulatory costs of £1m (2018: £1m), duplicate cover reimbursements of £nil (2018: £1m) and a net cash outflow from onerous property lease provisions in respect of vacant properties of £nil (2018: £2m).

Other adjustments to profit before tax relate to share based payments of £1m (2018: £3m) and profit on sale of non-current assets £2m (2018: £1m).

The accompanying notes are an integral part of this consolidated statement of cash flows.

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 2019.

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 2019 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, other than as noted below for new standards.

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 2019 were approved by the board of directors on 28 June 2019 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 additional undrawn credit facilities in place. The directors have considered these points along with the projected future cash flows and forecast covenant compliance 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) Alternative performance measures

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 net finance costs, tax, exceptional operating items, share based payments, pension service charge adjustments, depreciation and amortisation (referred to as Trading EBITDA, see note 3).

d) Critical accounting estimates and judgements

As described further in note 1(e), on adoption of IFRS 16 the Group recognised lease liabilities in relation to leases which had previously been classified as 'operating leases' under the principles of IAS 17 Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the Group's incremental borrowing rate as of 1 February 2019. Management's approach to determining the Group's incremental borrowing rate for a right-of-use asset involves using data provided by the Group's external advisors on the rate of interest that the Group would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the relevant right-of use asset.

Except for the incremental borrowing rate, the principal estimates and assumptions that have a significant risk of causing a material 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 2019.

Notes to the financial statements (continued)

e) Changes in significant accounting policies

IFRS 16 'Leases'

On 1 February 2019, the Group adopted IFRS 16 'Leases', which replaced IAS 17 'Leases'. The Group has not restated comparative information for prior periods as permitted under the specific transition provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognised in the opening statement of financial position on 1 January 2019.

On adoption of IFRS 16, the Group recognised lease liabilities in relation to leases which had previously been classified as operating leases under the principles of IAS 17. These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of 1 February 2019.

For leases previously classified as finance leases the Group recognised the carrying amount of the lease asset and lease liability immediately before transition as the carrying amount of the right of use asset and the lease liability at the date of initial application. The measurement principles of IFRS 16 are only applied after that date. This has not resulted in any remeasurement adjustments to lease liabilities or the related right-of-use assets in respect of leases previously classified as finance leases under IAS 17.

Practical expedients applied

In applying IFRS 16 for the first time, the Group has used the following practical expedients permitted by the standard:

- applying a single discount rate to a portfolio of leases with reasonably similar characteristics
- relying on previous assessments on whether leases are onerous as an alternative to performing an impairment review
- accounting for operating leases with a remaining lease term of less than 12 months as at 1 February 2019 as short-term leases
- excluding initial direct costs for the measurement of the right-of-use asset at the date of initial application, and
- using hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

The Group has also elected not to reassess whether a contract previously accounted for as a finance lease is or contains a lease at the date of initial application. Instead, for contracts entered into before the transition date the Group relied on its assessment made applying IAS 17 and Interpretation 4 'Determining whether an Arrangement contains a Lease'.

Notes to the financial statements (continued)

e) Changes in significant accounting policies (continued)

Measurement of lease liabilities

	£m
Operating lease commitments disclosed at 31 January 2019 (not recognised in statement of financial position)	39
(Less): short-term and low-value leases not recognised as a liability	-
	39
(Less): discount using the lessee's incremental borrowing rate at the date of initial application	(14)
Discounted using the lessee's incremental borrowing rate at the date of initial application	25
Add: finance lease liabilities recognised as at 31 January 2019	61
Lease liability recognised at 1 February 2019	86
Of which are:	
Current lease liabilities	52
Non-current lease liabilities	34
	86

Measurement of right-of-use assets

The associated right-of-use assets for property leases were measured on a retrospective basis as if the new rules had always been applied. Other right-of use assets were measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position as at 31 January 2019.

Adjustments recognised in the statement of financial position on 1 February 2019

The change in accounting policy affected the following items in the statement of financial position on 1 February 2019:

- Property, plant and equipment – decrease by £66m
- Right-of-use assets – increase by £88m
- Lease incentive accrual – decrease by £2m
- Onerous lease provision – decrease by £1m
- Lease liabilities – increase by £25m

The net impact on retained earnings on 1 February 2019 was £nil.

Impact on segment disclosures and earnings per share

Trading EBITDA for the six months to 31 July 2019 increased as a result of the change in accounting policy. The following segments were affected by the change in policy:

	Six months ended 31 July 2019 £m
Roadside	2
Insurance	-
Total IFRS 16 impact on Trading EBITDA	2

Notes to the financial statements (continued)

2 Segmental information and revenue disaggregation

The Group has determined that it has two key segments – Roadside and Insurance. This reflects the way that the Group is managed. Roadside incorporates the previous Roadside Assistance and Driving Services segments and Insurance includes Insurance Services. Head Office costs have been allocated to these two key segments as these costs principally directly support the operations of these segments.

The Group has two reportable operating segments as follows:

- *Roadside*: 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. In addition, this segment includes the AA and BSM driving schools and DriveTech which provides driver training and educative programs.
- *Insurance*: This segment includes the insurance brokerage activities of the AA, primarily in arranging motor and home insurance for customers and its intermediary financial services business.

	Six months ended July 2019 £m	Six months ended July 2018 £m
Revenue		
Roadside	418	411
Insurance	62	61
Revenue	480	472
Trading EBITDA		
Roadside	137	132
Insurance	24	29
Trading EBITDA	161	161
Share-based payments	(1)	(3)
Pension service charge adjustment	(2)	(3)
Amortisation and depreciation	(41)	(33)
Operating profit before exceptional items	117	122
Exceptional operating items	-	(5)
Operating profit	117	117
Net finance costs	(78)	(88)
Profit before tax	39	29

Notes to the financial statements (continued)

2 Segmental information and revenue disaggregation (continued)

Segment performance is primarily evaluated using the Group's key performance measures of Revenue and Trading EBITDA as well as operating profit before exceptional costs.

Trading EBITDA is profit after tax on a continuing basis as reported, adjusted for depreciation, amortisation, exceptional operating items, share based payments, pension service charge adjustments, net finance costs and tax expense. This better reflects the Group's underlying performance.

The pension service charge adjustment relates to the difference between the cash contributions to the pension scheme for ongoing contributions and the calculated annual service costs.

Exceptional items, net finance costs 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.

The segmental analysis based on the previous segmental view is as follows:

	Six months ended July 2019 £m	Six months ended July 2018 £m
Revenue		
Roadside Assistance	387	380
Insurance Services	62	61
Driving Services	31	31
Total Revenue	480	472
Trading EBITDA		
Roadside Assistance	162	156
Insurance Services	30	33
Driving Services	7	7
Head Office costs	(38)	(35)
Total Trading EBITDA	161	161

Notes to the financial statements (continued)

2 Segmental information and revenue disaggregation (continued)

Operating profit before exceptional items	Roadside		Insurance	
	Six months ended July 2019 £m	Six months ended July 2018 £m	Six months ended July 2019 £m	Six months ended July 2018 £m
Former segment presentation				
Roadside Assistance	162	156	-	-
Insurance Services	-	-	30	33
Driving Services	7	7	-	-
Head Office costs	(32)	(31)	(6)	(4)
Trading EBITDA	137	132	24	29
Share-based payments	(1)	(2)	-	(1)
Pension service charge adjustment	(2)	(3)	-	-
Amortisation and depreciation	(37)	(31)	(4)	(2)
Operating profit before exceptional items	97	96	20	26

Disaggregation of revenue:

	Six months ended July 2019 £m	Six months ended July 2018 £m
Roadside:		
Consumer (B2C)		
Insured contracts	241	238
Pay for use contracts ¹	23	21
Business Services (B2B)		
Insured contracts	19	17
Pay for use contracts ¹	81	88
Roadside other	54	47
Total Roadside	418	411
Insurance:		
Brokering activities	62	61
Total Insurance	62	61
Total Revenue	480	472

¹ Pay for use contracts relate to contracts that take into account the volume of breakdowns.

Notes to the financial statements (continued)

3 Adjusted performance measures

Management reviews the Group's results and performance both on a statutory and non-GAAP (non-statutory) basis. The Group's adjusted performance measures are non-GAAP (non-statutory) financial measures and are included in these accounts as they are key financial measures used by management to evaluate performance of business segments. The measures enable investors to more easily and consistently track the underlying operational performance of the Group and its business segments. Some of the measures are also required under our debt documents for debt covenant calculations.

Trading EBITDA is profit after tax on a continuing basis as reported, adjusted for depreciation, amortisation, exceptional operating items, share-based payments, pension service charge adjustments, net finance costs, contingent consideration remeasurement movements and tax expense.

The pension service charge adjustment relates to the difference between the cash contributions to the pension scheme for ongoing contributions and the calculated annual service costs.

Reconciliation of Trading EBITDA to operating profit

Trading EBITDA is calculated as operating profit before adjustments as shown in the table below:

		For the six months ended	
	Note	July 2019 £m	July 2018 £m
Trading EBITDA	2	161	161
Share-based payments		(1)	(3)
Pension service charge adjustment		(2)	(3)
Amortisation and depreciation	8, 9, 10	(41)	(33)
Exceptional operating items	4	-	(5)
Operating profit		117	117

Trading EBITDA excludes discontinued operations and the effects of significant items of income and expenditure which may have an impact on the quality of earnings, such as restructuring costs, legal expenses and impairments when the impairment is the result of an isolated, non-recurring event. It also excludes the effects of share-based payments, contingent consideration remeasurement gains or losses, defined benefit pension service charge adjustments, amortisation, depreciation and unrealised gains or losses on financial instruments.

These specific adjustments are made between the GAAP measure of operating profit and the non-GAAP measure of Trading EBITDA because Trading EBITDA is a performance measure required and clearly defined under the terms of our debt documents and is used for calculating our debt covenants. Given the significance of the Group debt, Trading EBITDA is a key measure for our bondholders and therefore management. In addition, the Group shows Trading EBITDA to enable investors and management to more easily and consistently track the underlying operational performance of the Group and its business segments.

Notes to the financial statements (continued)

4 Exceptional operating items

	Six months ended July 2019 £m	Six months ended July 2018 £m
Exceptional operating items	-	5

Exceptional operating items in the period comprised a £2m profit on disposal of non-current assets offset by Business and IT rationalisation and transformation costs of £1m and conduct and regulatory costs of £1m.

In the prior period, exceptional operating items included £5m relating to business transformation and £1m relating to IT systems transformation partially offset by a £1m profit on disposal of non-current assets.

Costs from the prior period refinancing in July 2018 were directly attributable to the issue and repayment of loan notes and have therefore been included either in finance costs or in borrowings as debt issue fees (see notes 6 and 17).

5 Business combinations

Acquisitions during the period ended 31 July 2019

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

At the point of acquisition, the combined fair value of net assets acquired was £1m, including £3m cash and £2m trade and other payables. This resulted in goodwill of £10m being recognised. This amount is provisional and will be reviewed as part of a purchase price allocation exercise to be concluded before the year end. This may result in a reallocation of some of the goodwill balance to other intangible assets.

Prestige Motor Care Holdings Limited and its subsidiaries made a combined profit before tax of £1m for the period 1 February 2019 to 31 July 2019.

Acquisitions during the year ended 31 January 2019

There were no acquisitions during the year ended 31 January 2019.

Disposals during the period ended 31 July 2019

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

Disposals during the year ended 31 January 2019

There were no disposals during the year ended 31 January 2019.

Notes to the financial statements (continued)

6 Finance costs

	Six months ended July 2019 £m	Six months ended July 2018 £m
Interest on external borrowings	65	63
Finance charges payable on lease liabilities	3	2
Total ongoing cash finance costs	68	65
Ongoing amortisation of debt issue fees	7	9
Net finance expense on defined benefit pension schemes	3	3
Total ongoing non-cash finance costs	10	12
Transfer from cash flow hedge reserve for extinguishment of cash flow hedge	-	(8)
Gain on unhedged derivative	-	(1)
Early repayment penalty	-	15
Debt issue fees immediately written off following repayment of borrowings	-	5
Exceptional finance costs	-	11
Total finance costs	78	88

During the prior period, the Group repaid £300m of Class A3 notes. As a result, the Group incurred an early repayment penalty of £15m.

During the prior period, £5m of amortised debt issue fees were immediately written off following the refinancing.

During the prior period, the Group also repaid £250m of the Senior Term Facility and transferred the £8m gain in fair value of the cash flow hedges related to the repayment to the income statement.

Notes to the financial statements (continued)

7 Tax

The major components of the income tax expense are:

	Six months ended July 2019 £m	Six months ended July 2018 £m
Consolidated income statement		
Current income tax		
Current income tax charge	6	2
	6	2
Deferred tax		
Relating to origination and reversal of temporary differences – current year	2	4
	2	4
Tax charge in the income statement	8	6

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. The UK corporation tax rate will be reducing to 17% in April 2020.

Notes to the financial statements (continued)

8 Goodwill and other intangible assets

	Goodwill £m	Software £m	Total £m
Cost			
At 1 February 2018	1,197	248	1,445
Additions	-	29	29
At 31 July 2018	1,197	277	1,474
Amortisation and impairment			
At 1 February 2018	27	122	149
Amortisation	-	13	13
At 31 July 2018	27	135	162
At 1 February 2019	27	92	119
Amortisation	-	20	20
Disposals	-	(7)	(7)
At 31 July 2019	27	105	132
Net book value			
At 31 July 2019	1,180	159	1,339
At 31 July 2018	1,170	142	1,312
At 31 January 2019	1,170	156	1,326

On 1 February 2019, the Group completed the purchase of the entire share capital of Prestige Motor Care Holdings Limited and its three wholly owned subsidiaries Prestige Fleet Servicing Limited, Prestige Car Servicing Limited and Prestige Motor Care Limited for cash consideration of £11m, resulting in the addition of £10m of goodwill (see note 5).

Notes to the financial statements (continued)

9 Property, plant and equipment

	Freehold land & buildings £m	Buildings on long leasehold land £m	Vehicles £m	Plant & equipment £m	Total £m
Cost or valuation					
At 1 February 2018	24	7	104	104	239
Additions	-	-	9	-	9
Disposals	-	-	(18)	-	(18)
At 31 July 2018	24	7	95	104	230
At 1 February 2019	24	12	113	86	235
Adjustment for change in accounting policy (see note 1(e))	-	-	(111)	(8)	(119)
At 1 February 2019 restated	24	12	2	78	116
Additions	-	-	1	5	6
Reclassification	-	(5)	-	5	-
Disposals	-	-	-	(1)	(1)
At 31 July 2019	24	7	3	87	121
Depreciation and impairment					
At 1 February 2018	8	4	36	64	112
Charge for the period	-	-	14	6	20
Disposals	-	-	(12)	-	(12)
At 31 July 2018	8	4	38	70	120
At 1 February 2019	8	4	47	53	112
Adjustment for change in accounting policy (see note 1(e))	-	-	(45)	(8)	(53)
At 1 February 2019 restated	8	4	2	45	59
Charge for the period	1	-	1	6	8
Disposals	-	-	-	(1)	(1)
At 31 July 2019	9	4	3	50	66
Net book value					
At 31 July 2019	15	3	-	37	55
At 31 July 2018	16	3	57	34	110
At 31 January 2019	16	8	66	33	123

Notes to the financial statements (continued)

10 Right-of-use assets

This note provides information for leases where the Group is a lessee. Under IFRS 16, right-of-use assets are recognised in the statement of financial position in respect of leased assets. The Group has therefore recognised right-of-use assets in the statement of financial position from the Group's date of transition to IFRS 16, being 1 February 2019.

	Property £m	Vehicles £m	Plant & equipment £m	Total £m
Cost or valuation				
At 1 February 2019	-	-	-	-
Adjustment for change in accounting policy (see note 1(e))	22	111	8	141
At 1 February 2019 restated	22	111	8	141
Additions	-	16	-	16
Disposals	-	(27)	-	(27)
At 31 July 2019	22	100	8	130

Depreciation and impairment

At 1 February 2019	-	-	-	-
Adjustment for change in accounting policy (see note 1(e))	-	45	8	53
At 1 February 2019 restated	-	45	8	53
Charge for the period	1	12	-	13
Disposals	-	(15)	-	(15)
At 31 July 2019	1	42	8	51

Net book value

At 31 July 2019	21	58	-	79
At 31 July 2018	-	-	-	-
At 31 January 2019	-	-	-	-

11 Trade and other receivables

	July 2019 £m	July 2018 £m	January 2019 £m
Current			
Trade receivables	142	135	141
Deferred consideration	-	6	3
Prepayments	15	17	14
Contract assets	16	18	17
Other receivables	3	6	4
	176	182	179

Notes to the financial statements (continued)

12 Amounts owed by parent undertakings

	July 2019 £m	July 2018 £m	January 2019 £m
Amounts owed by parent undertakings	1,214	1,214	1,214

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

13 Cash and cash equivalents

	July 2019 £m	July 2018 £m	January 2019 £m
Cash at bank and in hand – available	63	47	12
Cash at bank and in hand – restricted	8	8	8
	71	55	20

Cash at bank and in hand - restricted includes £8m (July 2018: £8m, January 2019: £8m) held by and on behalf of the Group's insurance businesses which are subject to contractual or regulatory restrictions.

Notes to the financial statements (continued)

14 Trade and other payables

	July 2019 £m	July 2018 £m	January 2019 £m
Current			
Trade payables	102	104	79
Other taxes and social security costs	11	18	9
Accruals	59	62	58
Deferred income	224	238	229
Deferred consideration	-	-	2
Other payables	20	33	29
	416	455	406
Non-current			
Deferred consideration	10	11	10

15 Provisions

	July 2019 £m	July 2018 £m	January 2019 £m
Property leases	4	5	5
Restructuring	-	1	-
Other	2	-	2
	6	6	7
Current	2	1	3
Non-current	4	5	4
	6	6	7

The property leases provision primarily relates to dilapidations. The restructuring provision related to redundancy and other related costs following the restructuring of operations in the 2018 financial year. Other provisions relate to anticipated compensation costs for poorly handled complaints.

During the period, no provisions were utilised (2018: £10m) and no additional provision was made (2018: £1m released). Property lease provisions of £1m in respect of onerous leases were reclassified to right-of-use assets (2018: £nil) as a result of the adoption of IFRS 16 (see note 1(e)).

Notes to the financial statements (continued)

15 Provisions (continued)

Litigation – Mr Mackenzie’s claim

As reported in the financial statements for the 2018 financial year, the former Executive Chairman, Bob Mackenzie, who was dismissed for gross misconduct on 1 August 2017, had on 6 March 2018 issued a claim for substantial damages against AA plc, its subsidiary (Automobile Association Developments Limited) (together, ‘the Companies’) and personally against a number of their directors (existing and former) and the former Company Secretary.

In November 2018, Mr Mackenzie’s claim against all the directors and the former Company Secretary was dismissed in full and he was ordered to pay their costs to be assessed by the Court if not agreed. Mr Mackenzie’s claim against the Companies has not progressed materially, nor has he provided the Companies with full details of his alleged loss. The majority of Mr Mackenzie’s claim arises from the loss of a share option scheme which lapsed for all employees without any payment in June 2019. The Companies continue to maintain their counterclaim for the reimbursement of previous bonuses paid to Mr Mackenzie. The Board assumes for the purpose of these financial statements that Mr Mackenzie will proceed with the claim against the Companies but maintains that it is not necessary for the Group to make a financial provision as it expects the defence will prevail.

16 Borrowings and loans

	July 2019 £m	July 2018 £m	January 2019 £m
Current			
Borrowing and loans (see note 17)	200	15	-
Non-current			
Borrowings (see note 17)	2,530	2,718	2,724
	2,730	2,733	2,724

Notes to the financial statements (continued)

17 Borrowings

	Expected maturity date	Interest rate	Principal £m	Issue costs £m	Amortised issue costs £m	Total as at 31 July 2019 £m	Total as at 31 July 2018 £m	Total as at 31 January 2019 £m
Class A2 notes	31 July 2025	6.27%	500	(1)	1	500	500	500
Class A3 notes	31 July 2020	4.25%	200	(1)	1	200	200	200
Class A5 notes	31 January 2022	2.88%	700	(47)	22	675	666	670
Class A6 notes	31 July 2023	2.75%	250	(4)	1	247	247	247
Class A7 notes	31 July 2024	4.88%	550	(8)	1	543	542	543
Class B2 notes	31 July 2022	5.50%	570	(16)	11	565	563	564
		4.52%	2,770	(77)	37	2,730	2,718	2,724

At 31 July 2019 all 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 2019.

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

The current borrowing as at 31 July 2018 related to a £15m draw down of the Working Capital Facility on 30 July 2018 which was repaid on 29 August 2018.

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 statement of financial position at fair value at the period end (see note 18 and 21).

All of the Class A notes 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 can only pay a dividend when certain Net Debt to Trading EBITDA and cash flow criteria are met.

Any voluntary repayment of the Class B2 notes would be made at a fixed premium based on the date of redemption. Any voluntary early repayments of the Class A notes would incur an early redemption payment based on a reference gilt and the date of redemption, except the Class A5, Class A6 and Class A7 notes which can be settled without penalty within 3 months, 2 months and 3 months respectively of the expected maturity date.

Notes to the financial statements (continued)

17 Borrowings (continued)

All of the Group's loan notes are listed on the Irish Stock Exchange.

In order to comply with the requirements of the Class A notes, the Group is required to maintain the Class A free cash flow to debt service ratio in excess of 1.35x. The actual Class A free cash flow to debt service ratio as at 31 July 2019 was 2.9x (2018: 3.3x). The Class B2 notes require the Group to maintain the Class B2 free cash flow to debt service ratio in excess of 1x. The actual Class B2 free cash flow to debt service ratio as at 31 July 2019 was 2.1x (2018: 2.4x) (see pages 12 and 13).

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. At 31 July 2019, the senior leverage ratio was 6.4x. 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.

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 current borrowing of £200m relates to the Class A3 notes for which the expected maturity date is 31 July 2020. This repayment of borrowings can be fully funded by a committed forward starting senior facility of £200m, which was undrawn at 31 July 2019 and has a maturity date of 31 July 2023.

18 Derivative financial instruments

	July 2019 £m	July 2018 £m	January 2019 £m
Assets			
Interest rate swap derivatives	-	1	-
Forward fuel contracts	1	1	-
Liabilities			
Interest rate swap derivatives	(1)	-	-
	-	2	-

Notes to the financial statements (continued)

19 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 closed final salary and Career Average Revalued Earnings (CARE) sections. CARE provided for benefits to accrue on an average salary basis. From April 2018 pension indexation in the CARE section was changed and is now based on CPI inflation, rather than RPI inflation. During the 2017 financial year and following the sale of the Irish business by the Group, AA Corporation Limited, a UK subsidiary of the Group, became the sponsor of the AAI scheme. The Group also operates an unfunded post-retirement Private Medical Plan (AAPMP), which is treated as a defined benefit scheme and is not open to new entrants.

The AAUK scheme is governed by a corporate trustee whose board is currently composed of member-nominated and Company-nominated directors. The AAI scheme is governed by a corporate trustee whose board is currently composed of Company-nominated directors of which some are also members of the scheme. For both pension schemes the Company-nominated directors include an independent director whom the trustee board directors have nominated as Chairman. The trustee of each scheme is responsible for paying members' benefits and for investing scheme assets, which are legally separate from the Group.

The AAUK and AAI schemes are subject to full actuarial valuations every three years using assumptions agreed between the trustee of each scheme and the Group. The purpose of this valuation is to design a funding plan to ensure that the pension scheme has sufficient assets available to meet the future payment of benefits to scheme members.

The valuation of liabilities for funding purposes differs from the valuation for accounting purposes, mainly due to the different assumptions used and changes in market conditions between different valuation dates. For funding valuation purposes, the assumptions used to value the liabilities are agreed between the trustee and the Group with the discount rate, for example, being based on a bond yield plus a margin based on the assumed rate of return on scheme assets. For accounting valuation purposes the assumptions used to value the liabilities are determined in accordance with IAS 19, with the discount rate, for example, being based on high-quality (AA rated) corporate bonds.

The valuations have been based on a full assessment of the liabilities of the schemes which have been updated where appropriate to 31 July 2019 by independent qualified actuaries.

Notes to the financial statements (continued)

19 Defined benefit pension scheme liabilities (continued)

The amounts recognised in the statement of financial position are as follows:

	As at 31 July 2019			Total £m
	AAUK £m	AAI £m	AAPMP £m	
Present value of the defined benefit obligation in respect of pension and healthcare plans	(2,678)	(63)	(48)	(2,789)
Fair value of plan assets	2,489	49	-	2,538
Deficit	(189)	(14)	(48)	(251)

	As at 31 July 2018			Total £m
	AAUK £m	AAI £m	AAPMP £m	
Present value of the defined benefit obligation in respect of pension and healthcare plans	(2,363)	(48)	(43)	(2,454)
Fair value of plan assets	2,323	45	-	2,368
Deficit	(40)	(3)	(43)	(86)

	As at 31 January 2019			Total £m
	AAUK £m	AAI £m	AAPMP £m	
Present value of the defined benefit obligation in respect of pension plans	(2,409)	(50)	(45)	(2,504)
Fair value of plan assets	2,242	44	-	2,286
Deficit	(167)	(6)	(45)	(218)

The increase in the deficit during the period is primarily due to decreasing bond yields leading to a corresponding fall in discount rates. The increase was partially offset by changes in the demographic assumptions (reflecting the latest outlook for mortality rates) and Group contributions paid into the schemes.

In November 2013 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 October 2038, secured on the Group's brands. In June 2017 the Group completed the AAUK scheme triennial valuation as at 31 March 2016 agreeing a funding 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. The next triennial valuation of the AAUK scheme will take place as at 31 March 2019. The results from the review will be received by June 2020.

Using an inflation assumption of 3.2% and a discount rate assumption of 2.0%, 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 scheme.

Notes to the financial statements (continued)

19 Defined benefit pension scheme liabilities (continued)

In the period since the statement of financial position date, the AAUK scheme has purchased a bulk annuity policy which insures all the benefits payable under the scheme in respect of 1,790 pensioner and dependant members. Please see note 23 for further details on this.

The last triennial valuation for the AAI scheme was as at 31 December 2016, the result of which was an increase in the going concern deficit with the contribution level remaining the same. The Group made deficit reduction contributions of £2m in the year ended 31 January 2019 and will continue to make annual deficit reduction contributions, increasing with inflation, until December 2023 or until an alternative agreement is signed with the trustees. The next triennial valuation of the AAI scheme will take place as at 31 December 2019.

In total, the Group is currently committed to pay £21m in ongoing employer contributions and £25m in deficit reduction employer contributions to its defined benefit plans (AAUK and AAI) in the year ending 31 January 2020.

Fair value of plan assets

The overall expected rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the plan's investment portfolio.

The tables below show the AAUK scheme assets split between those that have a quoted market price and those that are unquoted.

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

	As at 31 July 2019		As at 31 July 2018		As at 31 January 2019	
	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	Assets with a quoted market price £m	Assets without a quoted market price £m
Equities	46	333	183	364	156	324
Bonds/ swaps	788	295	838	215	514	205
Property	87	194	85	186	87	189
Hedge funds	1	353	23	396	21	394
Private equity	16	25	-	-	17	14
Cash/net current assets	20	12	31	2	15	2
Annuity policies	-	319	-	-	-	304
Total plan assets	958	1,531	1,160	1,163	810	1,432

Notes to the financial statements (continued)

19 Defined benefit pension scheme liabilities (continued)

Pension plan assumptions

The principal actuarial assumptions were as follows:

%	AAUK and AAPMP			AAI		
	July 2019 %	July 2018 %	January 2019 %	July 2019 %	July 2018 %	January 2019 %
Pensioner discount rate	2.0	2.6	2.5	0.4	1.6	1.3
Non-pensioner discount rate	2.2	2.8	2.7	1.1	2.6	2.1
Pensioner RPI	3.4	3.2	3.2	-	-	-
Non-pensioner RPI	3.2	3.2	3.1	-	-	-
Pensioner CPI	2.3	2.1	2.1	1.2	1.6	1.3
Non-pensioner CPI	2.1	2.1	2.0	1.2	1.6	1.3
Rate of increase of pensions in payment (final salary sections) - pensioner	3.2	3.0	3.1	-	-	-
Rate of increase of pensions in payment (final salary sections) – non-pensioner	3.1	3.0	3.0	-	-	-
Rate of increase of pensions in payment (CARE section) - pensioner	1.8	1.7	1.7	-	-	-
Rate of increase of pensions in payment (CARE section) – non-pensioner	1.7	1.7	1.6	-	-	-
Pensioner increase for deferred benefits	2.1	2.1	2.0	1.2	1.6	1.3
Medical premium inflation rate	7.4	7.2	-	-	-	-

Mortality assumptions are set using standard tables based on scheme-specific experience where available and an allowance for future improvements. For 2019, the assumptions used were in line with the SAPS (S2) series mortality tables (2018 – SAPS (S2) series) with future improvements in line with the CMI_2018 model with a 1.25% long-term rate of improvement and Core period smoothing and initial addition parameter (2018 – CMI_2017 model with a 1.25% 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 29 years.

Notes to the financial statements (continued)

19 Defined benefit pension scheme liabilities (continued)

Sensitivity analysis

Reasonably possible changes at the reporting date to one of the relevant actuarial assumptions, holding other assumptions constant, would have affected the defined benefit liability by the amounts shown below:

	For the six months ended 31 July 2019		
	AAUK £m	AAI £m	AAPMP £m
Increase of 0.25% in discount rate	136	3	2
Increase of 0.25% in RPI	(108)	(1)	-
Increase of 1% in medical claims inflation	-	-	(9)
Increase of one year of life expectancy	(108)	(2)	-

An equivalent decrease in the assumptions at 31 July 2019 would have had the equal but opposite effect on the amounts shown above, on the basis that all other variables remain constant.

20 Related parties

The following tables provide the total values of transactions that have been entered into with associates and joint ventures in the period.

Transactions with associates:

Associate	Nature of transaction	Six months ended		Year ended
		July 2019	July 2018	January 2019
		£m	£m	£m
ARC Europe SA	Registration fees and claims	1	1	4

Transactions with joint ventures:

Joint venture	Nature of transaction	Six months ended		Year ended
		July 2019	July 2018	January 2019
		£m	£m	£m
AA Media Ltd	Services supplied to AA Media	1	-	-
Intelematics Ltd	Goods supplied to Intelematics	-	3	5

Notes to the financial statements (continued)

21 Fair values

Fair values

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

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

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

Observable inputs are those that have been seen either from counterparties or from market pricing sources and are publicly available. The use of these depends upon the liquidity of the relevant market. When measuring the fair value of an asset or a liability, the Group uses observable inputs as much as possible.

Fair values are categorised into different levels in a fair value hierarchy based on the inputs used in the valuation as follows:

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

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

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.

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) are approximate to their fair values.

At 31 July 2019:

	Carrying value £m	Fair value measurement using		
		Quoted prices in active markets (Level 1) £m	Significant observable inputs (Level 2) £m	Significant unobservable inputs (Level 3) £m
Financial assets measured at fair value				
Forward fuel contracts (note 18)	(1)	-	(1)	-
Financial liabilities measured at fair value				
Interest rate swap derivatives (note 18)	1	-	1	-
Deferred consideration (due in more than one year) (note 14)	10	-	10	-
Liabilities for which fair values are disclosed				
Loan notes (note 17)	2,730	2,643	-	-

Notes to the financial statements (continued)

21 Fair values (continued)

At 31 July 2018:

	Carrying value £m	Fair value measurement using		
		Quoted prices in active markets (Level 1) £m	Significant observable inputs (Level 2) £m	Significant unobservable inputs (Level 3) £m
Financial assets measured at fair value				
Interest rate and fuel swaps (note 18)	(2)	-	(2)	-
Financial liabilities measured at fair value				
Deferred consideration (due in more than one year) (note 14)	11	-	11	-
Liabilities for which fair values are disclosed				
Loan notes (note 17)	2,718	2,749	-	-

At 31 January 2019:

	Carrying value £m	Fair value measurement using		
		Quoted prices in active markets (Level 1) £m	Significant observable inputs (Level 2) £m	Significant unobservable inputs (Level 3) £m
Financial liabilities measured at fair value				
Deferred consideration (due in more than one year) (note 14)	10	-	10	-
Liabilities for which fair values are disclosed				
Loan notes (note 17)	2,724	2,577	-	-

Notes to the financial statements (continued)

22 Financial assets at amortised cost

Financial assets at amortised cost include the following debt investments:

	July 2019 £m	July 2018 £m	January 2019 £m
Non-current			
Loans to related parties	4	-	-
	4	-	-

On 29 March 2019, the Group completed the sale of 51% of the share capital of AA Media Limited. The Group retained 49% of the share capital, subsequently accounting for its investment as an investment in a joint venture. Also on 29 March 2019, AA Media Limited issued £4m of 5% fixed rate loan notes to the Group, redeemable at par on 29 March 2024. The Group has recognised this receivable from a related party as a financial asset at amortised cost.

23 Events after the reporting period

Pension buy-in

In the period since the statement of financial position date, the Trustee of the AA UK Pension Scheme has purchased a bulk annuity policy which insures all the benefits payable under the scheme in respect of 1,790 pensioner and dependant members. The Trustee has invested in such a policy as the Scheme will see all financial and demographic risks exactly matched for the covered members. This policy secures the benefits of a further proportion of scheme members following the purchase of a bulk annuity policy in August 2018 which insured all the benefits payable under the scheme in respect of 2,510 pensioner and dependant members.

The annuity policy has been purchased in the name of the Trustee and therefore remains an asset of the AA UK Pension Scheme. Under IAS 19, this policy is considered to be a qualifying insurance policy which exactly matches the amount and timing of certain benefits payable under the scheme. The fair value of the insurance policy is therefore deemed to be the present value of the related defined benefit obligations.

At 9 September 2019, the date of the risk transfer to the insurer, the defined benefit obligation for the covered population was c.£25m less than the estimated premium of c.£250m paid for the policy. This difference between premium paid and fair value of the insurance policy will be recognised in the statement of financial position at the 31 January 2020 year end through other comprehensive income as an asset loss. It should be noted that this is separate to the measure of the funding deficit (used to set cash contributions to the Scheme) which we expect will be reduced as a result of this policy given the prudent nature of the funding measure.

There will be a final adjustment premium paid once a data cleanse has taken place to take account of differences between the data used for quotation purposes and the finalised data, which will be concluded within 24 months of the risk transfer date. Any further premiums, or refunds where relevant, will be recognised through other comprehensive income.

A range of actions have been taken in recent years to reduce the risks associated with the pension scheme. The scheme's investment strategy has been developed such that its financial exposures to changes in long-term interest rates and inflation are now broadly 80% hedged. In addition, the two recent bulk annuity purchases have also hedged the associated longevity risks on c.20% of the scheme's IAS 19 liabilities. While risks remain, this represents significant progress in controlling our exposure to future increases in the deficit.