

24 September 2019

AA plc interim results for the six months ended 31 July 2019

First-half performance in line with expectations; on-track to deliver Trading EBITDA growth and strong cash flow generation in FY20

Simon Breakwell, Chief Executive Officer, said:

“We are pleased to report a first-half performance in line with our expectations, with growth in Trading EBITDA and strong free cash flow generation. In our Roadside business, we have stabilised our personal membership base, and are confident that this will be broadly flat this year and return to growth next year. Our Insurance business continues to generate strong rates of profitable policy growth, and we expect this to continue during the second half.”

“We are making significant progress on our strategic plan and are building operational momentum across the AA, including our strategic partnership with Admiral as well as the launch of Smart Breakdown in Q4.”

“We remain on-track to deliver Trading EBITDA growth this financial year in line with current market expectations.”

	Six months ended		Change
	July 19 (H1 20)	July 18 (H1 19)	
GAAP measures			
Revenue (£m)	491	480	+2.3%
Operating profit (£m)	120	116	+3.4%
Profit before tax (PBT) (£m)	42	28	+50.0%
Basic EPS (pence)	5.5	3.8	+44.7%
Interim dividend per share (pence)	0.6	0.6	-
Non-GAAP measures			
Trading EBITDA ^{1,5} (£m)	165	161	+2.5%
Trading EBITDA ² margin (%)	33.6	33.5	+0.3%
Free cash flow to equity ⁴ (£m)	44	14	+214.3%
Adjusted profit before tax ³ (£m)	46	50	-8.0%
Adjusted basic EPS ³ (pence)	6.0	6.5	-7.7%

H1 highlights

Financial:

- Revenue up 2% to £491m, reflecting solid performance of Roadside and Insurance divisions
- Operating profit up 3% to £120m, Trading EBITDA up 2.5% to £165m and PBT up 50% to £42m
- Free cash flow to equity (pre-dividends and bond buy-back) up 214% to £44m (H1 19: £14m)
- Capex of £37m (H1 19: £36m) in line with expectations. FY20 and FY21 capex guidance maintained
- S&P reaffirmation of ratings of Class A notes and Class B2 note
- Interim dividend of 0.6p, in line with prior year

Operational:

- Roadside
 - Membership base stabilised at 3.19m; on track to deliver broadly flat membership this financial year and a return to growth next year in line with guidance
 - Average income per member up 4% to £165
 - Three-year strategic partnership formed with Admiral
 - Significant progress with the development and roll-out of new products and services; Smart Breakdown launch in Q4
 - AA top of table in Which? research and awarded Recommended Provider status for breakdown cover, achieving a top scoring five stars within 'fix at the roadside' category
- Insurance
 - Strong performance from both broker and in-house underwriter, well positioned to deliver significant growth in policies this year
 - 22% growth in motor policies to 803,000 and 3% growth in home policies to 841,000, benefiting from investment in marketing, incremental sales and renewals through our in-house underwriter as well as systems investments including Insurer Hosted Pricing (IHP)
 - Aviva to join motor panel in Q3 FY20
 - In-house underwriter continues to deliver strong levels of growth utilising proprietary member data
 - Strong conversion rates of 32% into our Roadside business
 - Average income per motor and home policy lower at £67 reflecting investment in new business volumes

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Presentation

A presentation by Simon Breakwell, CEO, and Mark Strickland, Interim CFO, will be held for analysts, investors and bond holders at 9am today at the London Stock Exchange, 10 Paternoster Square, London, EC4M 7LS

- Dial-in to the presentation: Conference call dial in: +44 20 3936 2999, Access code: 313855
- Replay: UK: +44 20 3936 3001; US: +1 845 709 8569; Access code: 928779
- Link to the webcast <https://www.investis-live.com/aa/5d4d502a741a5211001b33e7/strq>

Notes

1. Earnings before net finance costs, tax, depreciation, amortisation, exceptional operating items, share-based payments and pension service charge adjustments.
2. Trading EBITDA divided by Revenue arising within operating segments.
3. Adjusted for a number of one-offs of which the largest are exceptional operating items, share-based payments, pension service charge adjustment, the write off of debt issue fees, penalties on early repayment of debt and transfer from cash flow hedge reserve.
4. Net increase in cash and cash equivalents pre-dividends and bond buy-back.
5. Trading EBITDA for July 19 includes a £2m benefit from the adoption of IFRS 16 during the period. The comparative for July 2018 does not have any IFRS 16 impact included.

Business performance and strategic update

Roadside

	Six months ended		Year ended
	July 19	July 18	Jan 19
Revenue (£m)	418	411	841
Trading EBITDA (£m)	137	132	283
Trading EBITDA margin (%)	32.8	32.1	33.7
Operating profit before exceptional items (£m)	97	96	209
Paid personal members (m)	3.19	3.25	3.21
Average income per paid personal members (£)	165	159	162
Business customers (m)	9.00	9.68	9.79
Average income per business customer (£)	22	21	21
Number of breakdowns (m)	1.65	1.91	3.73

Revenue grew by 2% to £418m driven largely by the increase in the average income per paid member as well as the acquisition of Prestige Fleet Servicing (Prestige), which we acquired in February 2019.

In line with our expectations, Trading EBITDA was up 4% to £137m due to the solid performance of the Roadside Assistance business. The performance of the Driving Services business was flat in the period. Trading EBITDA margin improved from 32.1% to 32.8% reflecting the Trading EBITDA improvement in the Roadside Assistance business.

Roadside Assistance

Revenue grew by 2% to £387m (H1 19: £380m) reflecting the benefit of higher B2C income as well as the acquisition of Prestige. This more than offset the anticipated decline in revenue from the 51% sale of AA Media Limited on 29 March 2019.

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 and as previously announced, 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.

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.

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

Revenue in our Driving Services division, which consists of our Driving Schools and DriveTech businesses, was flat at £31m (H1 19: £31m).

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.

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.

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.

Insurance

	Six months ended		Year ended
	July 19	July 18	Jan 19
Revenue (£m)	73	69	138
Trading EBITDA (£m)	28	29	58
Trading EBITDA margin (%)	38.4	42.0	42.0
Operating profit before exceptional items (£m)	23	25	50
Total motor and home policy numbers in force ¹ (000s)	1,644	1,475	1,561
Average income per policy ² (£)	67	73	69
Total Motor policies (000s)	803	659	731
Total Motor underwritten (000s)	401	258	339
Total Home policies (000s)	841	816	830
Total Home underwritten (000s)	304	205	259
Financial Services products ³ (000s)	159	136	112

¹ Rolling sales for the last 12 months including Home Services but not Financial Services.

² Motor and Home only.

³ Financial Services products includes the number of credit cards activated, loans drawn down, mortgages and savings accounts opened

Insurance Revenue (which includes the broker and in-house underwriter) was up at £73m (H1 19: £69m) driven by the growth in revenue from the broker and in-house underwriter.

In line with our expectations, Trading EBITDA fell marginally to £28m (H1 19: £29m) as a result of the ongoing investment in marketing needed to position the business for long-term growth. Trading EBITDA margin declined from 42.0% to 38.4%, reflecting the investment in the broker as noted above as well as the increase in the lower-margin underwriter revenue.

Insurance Services (including Insurance broking and Financial Services)

Revenue increased by 2% to £62m (H1 19: £61m), in line with our expectations. The motor 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 our in-house underwriter as well as the benefit of ongoing investment in systems including Insurer Hosted Pricing (IHP) for the broker. 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 starting with our in-house underwriter.

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.

From October 2019, we will be streamlining our claims management process for motor insurance and bringing currently outsourced services in-house. This, together with the introduction of a new claims handling platform from ICE Insuretech, will help facilitate a smoother end-to-end experience for our customers, deliver operational efficiencies, and generate additional revenue for our Insurance business. Beyond insurance claims management, we are also developing our accident management capabilities to serve our broader membership, as we believe this is a very exciting prospect and will be an important differentiator for our roadside business moving forward.

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.

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.

Insurance underwriting

Revenue for our underwriting business continued to grow strongly to £11m compared to £8m in the prior period. Gross earned premiums were £29m (H1 19: £12m). Deferral of broker commissions amounted to a reduction in revenue of £2m (H1 19: nil) due to growth in Insurance Services broker commissions (see above). Revenue is reported after accounting for the broker deferral adjustment, where the broker commission is recognised over the life of the policy along with the underwriter premium for policies underwritten by our in-house underwriter.

In line with our strategy to drive profitable growth of the insurer using our proprietary data to deliver more competitive premiums, we grew the motor book by 55% since last year to 401,000 (H1 19: 258,000, FY 19: 339,000) driven largely by our non-member channel which is currently at 138,000 policies and the underwritten home book increased by 48% to 304,000 (H1 19: 205,000, FY 19: 259,000).

Alongside the non-member policy growth, we are actively developing strategies to increase our online competitiveness and cross-sell capabilities to increase the penetration levels within our existing member base. We are also looking to insure younger drivers, a demographic we do not currently target, utilising our Smart Breakdown technology. Our younger driver insurance proposition will go live in Q3 FY20, initially through our offline channels followed thereafter by our online web-based channels.

Our Combined Operating Ratio (COR) was in-line with our long-term target of 95%. We have also achieved strong rates of retention across our motor and home policies book. Net claims paid during the period were £10m (H1 19: £4m).

Trading EBITDA grew strongly and was up at £4m (H1 19: £1m) as the growth in Revenue and the benefit of the deferral of the acquisition costs more than offset the increased direct costs associated with growing the motor and home book.

The in-house underwriter business remains well capitalised under the Solvency II capital requirements which came into effect on 1 January 2016. As at 31 July 2019, the solvency coverage headroom was 139% over requirement and can be funded from the profits of the underwriter and AA plc available cash.

Board changes

During the period, we announced the departure of Martin Clarke, who stepped down as Chief Financial Officer (CFO) on 29 April 2019. Mark Strickland, who has been with the AA since 2016 leading the day-to-day running of the AA's finance team, was appointed interim CFO with effect from 30 April 2019. The interim role is not a Board position. The process to select a permanent CFO is ongoing and we will make an announcement in due course.

On 6 September 2019, we announced two changes to the membership of our Committees. Andrew Blowers was appointed as a member of the Risk Committee and ceased to be a member of the Remuneration Committee. Mark Brooker was appointed a member of the Remuneration Committee and ceased to be a member of the Risk Committee.

Financial review

Group performance

	Six months ended		Year ended
	July 19	July 18	Jan 19
Revenue (£m)	491	480	979
Trading EBITDA ¹ (£m)	165	161	341
Trading EBITDA ² margin (%)	33.6	33.5	34.8
Operating profit (£m)	120	116	219
Net cash inflows from continuing operating activities before tax and exceptional items ³ (£m)	170	168	296
Free cash flow ⁴ (£m)	44	14	(22)
Adjusted basic earnings per share ⁵ (pence)	6.0	6.5	14.9

Notes

- Earnings before net finance costs, tax, depreciation, amortisation, exceptional operating items, share-based payments, contingent consideration remeasurement movements and pension service charge adjustments.
- Trading EBITDA divided by Revenue arising within operating segments.
- Net cash inflows from continuing operating activities before tax and excluding cash flows from exceptional items.
- Net cashflow before payments of dividends to equity shareholders and bond buy-back.
- Earnings per share adjusted for a number of one-offs of which the largest are exceptional operating items, share-based payments, pension service charge adjustment, the write off of debt issue fees, pension past service credit, penalties on early repayment of debt and transfer from cash flow hedge reserve.

Profitable growth delivered in line with expectations

Group Revenue was £491m, up 2% on last year (H1 19: £480m) reflecting the solid performance of both the Roadside and Insurance divisions.

Roadside Revenue (which includes Roadside Assistance and Driving Services) was up 2% at £418m (H1 19: £411m). This was principally due to the higher income generated in our B2C business as well as the acquisition of Prestige Fleet Servicing (Prestige), which we acquired in February 2019. Prestige is a profitable and fast-growing technology-led supplier of Service, Maintenance and Repair (SMR) services that will deliver new revenue streams to our Roadside business without incurring significant capital expenditure.

Insurance Revenue (which includes the broker and in-house underwriter) was up 6% from last year at £73m (H1 19: £69m), with the strong performance of both the broker and in-house underwriter more than offsetting the lower revenues from the Home Emergency Services consumer business, which we sold in January 2018.

In line with our expectations, Group Trading EBITDA was up 2.5% to £165m (H1 19: £161m), including a benefit of £2m from the adoption of IFRS 16 (please see note 1(e)). Roadside Trading EBITDA increased by £5m to £137m reflecting the benefit of higher average income per paid member, reduction in the blended cost of acquiring new personal paid members as well as the benefit of reduced third-party garaging costs. Insurance Trading EBITDA was 3% lower at £28m (H1 19: £29m) due to the impact of ongoing investment in marketing to accelerate the growth in policies of the broker.

We remain on track to deliver Trading EBITDA growth in FY20 in line with current market expectations. As with prior years, we expect the Trading EBITDA split between H1 and H2 to be similar to last year, reflecting the inherent seasonality of our business.

Overall head office costs increased by £2m to £38m (H1 19: £36m). 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. Head office costs have been directly allocated where it is possible to do so. All other costs are allocated on the basis of a pro-rata share of revenue being £32m (H1 19: £31m) to Roadside and £6m (H1 19: £5m) to Insurance.

Trading EBITDA margin was stable at 33.6% (H1 19: 33.5%) with improved Roadside Trading EBITDA margins offsetting the anticipated reduction in Insurance Trading EBITDA margins.

The share-based payment charge reduced in the period by £1m, in part due to the expiration of the third vesting period for the Management Value Participation (MVP) C shares. The vesting performance conditions for all classes of the MVP shares were not met following the final testing date of 27 June 2019. The vesting performance conditions for the Long-Term Bonus Plan were also not satisfied on 27 June 2019.

The pension service charge adjustment decreased by £1m in the period.

Operating profit increased by £4m to £120m (H1 19: £116m), a period-on-period increase of 3%. This was attributable to the increase in Roadside Trading EBITDA, a reduction of £5m in relation to exceptional items, as well as the reduction in the share-based payment and pension service charges as noted above. These were offset somewhat by the anticipated increase of £7m in amortisation and depreciation reflecting the historic and ongoing investments in IT.

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.

In line with our expectations, profit before tax rose significantly to £42m (H1 19: £28m), a period on period increase of 50%, due to the higher profitability in the period as well as the reduced finance costs noted above.

The tax charge in the period increased to £8m (H1 19: £5m) reflecting the higher profitability. The tax charge consisted of a current tax charge of £7m (H1 19: £2m) and a deferred tax charge of £1m (H1 19: £3m). The effective tax rate was flat at 19.2% (H1 19: 19.2%), in line with our expectations and the UK statutory tax rate.

Profit after tax was up significantly to £34m (H1 19: £23m) and basic earnings per share increased by 1.7p, from 3.8p to 5.5p. Adjusted profit after tax and adjusted basic and diluted earnings per share decreased to £37m (H1 19: £40m) and 6.0p (H1 19: 6.5p) respectively reflecting the lower exceptional costs and exceptional finance costs in the period as noted above (please see note 8).

Net liabilities increase due to changes in market conditions

Net liabilities increased by £6m in the period. The largest movement was due to the defined benefit pension deficit which increased by £33m during the period. This was primarily due to decreasing bond yields and a corresponding fall in discount rates, partially offset by changes in the demographic assumptions (reflecting the latest outlook for mortality rates) and Group contributions paid into the schemes.

The next triennial review valuation of the AA's UK defined benefit pension liability will be reported on as at 31 March 2019. The results from the review will be received by June 2020.

As part of the AA's approach to proactively managing its pension liability, 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 24 for further details. The bulk annuity purchase is in addition to the policy purchased from Canada Life last year, which insures the benefits payable under the AA UK Pension scheme in respect of 2,510 pensioner and dependent members.

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.

Strong cash generation, capex in line with guidance

Our business is delivering strong and predictable free cash flow and we remain on track to generate c.£80m of free cash flow (pre-dividends and bond buy-back) this year. As at 31 July 2019, we generated £44m (H1 19: £14m) of free cash flow, excluding the final dividend from last year of £8m and bond buy-back of £20m in February 2019. Net debt as at 31 July 2019 fell from £2,715m at year end to £2,698m, reflecting the £16m movement in net cash as well as the increase of £26m in respect of lease obligations due to the adoption of IFRS 16 (please see note 1(e)).

Total capital expenditure in the period was £37m (H1 19: £36m), in line with our expectations. This consists of £23m for growth capital expenditure and £14m for maintenance capital expenditure. We expect total capital expenditure this year to be in line with our guidance and not exceed £70m. We are also maintaining our FY21 capital expenditure guidance and expect this to be approximately £60m.

Lease expenditure was £23m (H1 19: £20m) which is offset by proceeds from the sale of fixed assets of £12m (H1 19 £9m).

In June 2019, S&P Global Ratings reaffirmed the investment grade (BBB-) credit rating of our Class A notes and non-investment grade (B+) credit rating of our Class B2 note. Following the refinancing in July 2018, our next repayment of borrowings (other than the Class A3 note which can be fully funded by a committed forward starting senior facility of £200m) is not due until January 2022.

We maintain a disciplined and proactive approach to managing our capital structure and will continue to assess our debt strategy in light of prevailing market conditions.

Dividend

The Board has declared that the interim dividend will be 0.6 pence per share, in line with last year. It will be paid on 8 November 2019 to shareholders on the register on 4 October 2019 with the ex-dividend date set for 3 October 2019.

Outlook

In our Roadside business, we have stabilised our personal membership base, and are confident that this will be broadly flat this year and return to growth next year. Our Insurance business continues to generate strong rates of profitable policy growth, and we expect this to continue during the second half.

We continue to make significant progress on our strategic plan and build operational momentum across the AA, including our strategic partnership with Admiral and the launch of Smart Breakdown in Q4.

We remain on-track to deliver Trading EBITDA growth this financial year in line with current market expectations.

Financial key performance indicators

The following tables and narrative provide further analysis of the financial key performance indicators which are described in the financial highlights on page 1, the business performance and financial reviews on pages 3 to 10, the debt covenant calculations on page 12 and the figures shown in notes 2, 3, 4 and 8 to these condensed, consolidated financial statements.

Adjusted performance measures

These interim accounts report 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 interim 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.

Reconciliation of Trading EBITDA to operating profit

Trading EBITDA is a performance measure required under the terms of our debt documents and is used for calculating our debt covenants. The Group also shows Trading EBITDA as a measure of underlying trading performance. Trading EBITDA is calculated as operating profit before adjustments as shown in the table below:

	Note	Six months ended July 2019 £m	Six months ended July 2018 £m
Trading EBITDA	3	165	161
Share-based payments		(2)	(3)
Pension service charge adjustment		(2)	(3)
Amortisation and depreciation	9,10,11	(41)	(34)
Exceptional operating items	4	-	(5)
Operating profit		120	116

Adjusted earnings per share

Adjusted earnings per share adjusts profit after tax for certain operating costs, one-off financing costs and tax charges, see note 8 for the calculation.

Adjusted profit before tax is included as a non-GAAP measure as it is used by management to evaluate performance and by investors to more easily and consistently track the underlying performance of the Group. Adjusted earnings per share is calculated as adjusted profit after tax divided by the weighted average number of shares in issue during the period.

Cash flow, net debt and liquidity

Net debt and covenants	As at 31 July 2019 £m	As at 31 July 2018 £m	As at 31 January 2019 £m
Senior Term Facility	-	-	-
Class A notes	2,200	2,200	2,200
Less: AA Intermediate Co Limited group cash and cash equivalents	<u>(71)</u>	<u>(55)</u>	<u>(20)</u>
Net Senior Secured Debt ¹	2,129	2,145	2,180
Class B2 notes	570	570	570
Lease obligations for covenant reporting ¹⁰	<u>57</u>	<u>53</u>	<u>61</u>
Net WBS Debt ²	2,756	2,768	2,811
Lease adjustment for IFRS 16 ¹¹	26	-	-
Less: AA plc group cash and cash equivalents ³	(61)	(100)	(96)
Bond buy-back	<u>(23)</u>	<u>-</u>	<u>-</u>
Net debt at period end	<u>2,698</u>	<u>2,668</u>	<u>2,715</u>
Reconciliation to covenants			
Lease obligations for covenant reporting ¹⁰	57	53	61
Lease adjustment for IFRS 16 ¹¹	<u>26</u>	<u>-</u>	<u>-</u>
Total lease liabilities as reported in the statement of financial position	<u>83</u>	<u>53</u>	<u>61</u>
AA plc Trading EBITDA for the last 12 months	<u>345</u>	<u>359</u>	<u>341</u>
AA Intermediate Trading EBITDA for the last 12 months ⁴	<u>335</u>	<u>360</u>	<u>337</u>
	Covenant		
Net debt ratio ⁵		7.8x	7.4x
Class B2 Leverage ratio ⁶		8.2x	7.7x
Senior Leverage ratio ⁷		6.4x	6.0x
Class A Free Cash Flow: Debt Service ⁸	>1.35x	2.9x	3.3x
Class B Free Cash Flow: Debt Service ⁹	>1.00x	2.1x	2.4x

1 Principal amounts of the Senior Term Facility and Class A notes less AA Intermediate Co Limited group cash and cash equivalents.

2 Net 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 lease obligations for covenant reporting 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 based on frozen GAAP.

5 Ratio of Total Net Debt to AA plc Trading EBITDA for the last 12 months.

6 Ratio of Net WBS Debt² to AA Intermediate Co Limited group Trading EBITDA for the last 12 months.

7 Ratio of Net Senior Secured Debt¹ 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.

10 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.

11 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.

Cash flow, net debt and liquidity (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 £132m at 31 July 2019, of which £94m was invested in AAA money market funds, giving overnight access and high liquidity.

The Group holds segregated funds as 'restricted cash' in order to satisfy regulatory requirements governing our insurance regulated business. These restricted cash balances were £32m at 31 July 2019 (H1 19: £41m).

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.

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. Insurance Underwriting

Higher than anticipated claims costs: there are risks of higher than expected claims frequency, higher average cost per claim or catastrophic claims.

This remains on track to deliver growth with sustainable and profitable return on capital. We continually monitor claims frequency and trends and adjust pricing in the event of higher than expected claims frequency or cost per claim. We also analyse root cause of these and take appropriate action. Catastrophic claims are, in part, mitigated through reinsurance.

8. 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.

Consolidated income statement

	Note	Six months ended July 2019 £m	Six months ended July 2018 £m
Revenue	2	491	480
Cost of sales		(192)	(197)
Gross profit		299	283
Administrative and marketing expenses		(180)	(167)
Other income		1	-
Operating profit		120	116
Finance costs	6	(78)	(88)
Profit before tax		42	28
Tax expense	7	(8)	(5)
Profit for the period		34	23

Earnings per share from the profit for the period:

	Note	Six months ended July 2019 pence	Six months ended July 2018 pence
Basic from total operations	8	5.5	3.8
Diluted from total operations	8	5.5	3.8

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

Consolidated statement of comprehensive income

	Note	Six months ended July 2019 £m	Six months ended July 2018 £m
Profit for the period		34	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	20	(41)	147
Tax effect		7	(25)
		(34)	122
Total other comprehensive income		(34)	118
Total comprehensive income for the period		-	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	9	1,345	1,316	1,331
Property, plant and equipment	10	55	110	123
Right-of-use assets	11	80	-	-
Investments in joint ventures and associates		5	5	5
Derivative financial instruments	19	1	2	-
Financial assets at amortised cost	12	24	-	-
Deferred tax assets		28	2	22
		1,538	1,435	1,481
Current assets				
Inventories		4	7	4
Trade and other receivables	13	237	213	223
Cash and cash equivalents	14	132	155	116
		373	375	343
Assets classified as held for sale		-	-	6
Total assets		1,911	1,810	1,830
Current liabilities				
Trade and other payables	15	(485)	(504)	(462)
Current tax payable		(6)	(2)	(3)
Borrowings and loans	17	(200)	(15)	-
Lease liabilities		(46)	(39)	(49)
Provisions	16	(2)	(1)	(3)
		(739)	(561)	(517)
Non-current liabilities				
Borrowings and loans	17	(2,530)	(2,718)	(2,724)
Derivative financial instruments	19	(1)	-	-
Lease liabilities		(37)	(14)	(12)
Defined benefit pension scheme liabilities	20	(251)	(86)	(218)
Provisions	16	(4)	(5)	(4)
Deferred consideration	15	(10)	(11)	(10)
Insurance technical provisions		(35)	(24)	(30)
		(2,868)	(2,858)	(2,998)
Liabilities classified as held for sale		-	-	(5)
Total liabilities		(3,607)	(3,419)	(3,520)
Net liabilities		(1,696)	(1,609)	(1,690)
Equity				
Share capital		1	1	1
Share premium	21	409	407	408
Own shares		(32)	(30)	(31)
Cash flow hedge reserve		-	1	-
Retained earnings		(2,074)	(1,988)	(2,068)
Total equity attributable to equity holders of the parent		(1,696)	(1,609)	(1,690)

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

Consolidated statement of changes in equity

	Share capital £m	Share premium £m	Own shares £m	Cash flow hedge reserve £m	Retained earnings £m	Total £m
At 1 February 2018	1	406	(29)	5	(2,138)	(1,755)
Profit for the period	-	-	-	-	23	23
Other comprehensive income	-	-	-	(4)	122	118
Total comprehensive income	-	-	-	(4)	145	141
Dividends	-	-	-	-	(9)	(9)
Issue of share capital	-	1	-	-	-	1
Purchase of own shares	-	-	(1)	-	-	(1)
IFRS 9 conversion	-	-	-	-	13	13
IFRS 9 conversion deferred tax impact	-	-	-	-	(2)	(2)
Share-based payments	-	-	-	-	3	3
At 31 July 2018	1	407	(30)	1	(1,988)	(1,609)
At 1 February 2019	1	408	(31)	-	(2,068)	(1,690)
Profit for the period	-	-	-	-	34	34
Other comprehensive income	-	-	-	-	(34)	(34)
Total comprehensive income	-	-	-	-	-	-
Dividends	-	-	-	-	(8)	(8)
Issue of share capital	-	1	-	-	-	1
Purchase of own shares	-	-	(1)	-	-	(1)
Share-based payments	-	-	-	-	2	2
At 31 July 2019	1	409	(32)	-	(2,074)	(1,696)

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		42	28
Amortisation, depreciation and impairment	9, 10, 11	41	34
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:			
Increase in trade and other receivables		(14)	(7)
Increase in trade and other payables		28	35
Increase/(decrease) in provisions		5	(11)
Total working capital adjustments		19	17
Net cash flows from operating activities before tax		168	150
Tax paid		(4)	(10)
Net cash flows from operating activities		164	140
Investing activities			
Capital expenditure		(37)	(36)
Proceeds from sale of fixed assets		12	9
Payment for financial asset at amortised cost		(20)	-
Payment for acquisition of subsidiary, net of cash acquired		(8)	(13)
Proceeds from sale of joint venture		-	2
Dividends from joint ventures and associates		-	1
Interest received		1	-
Net cash flows used in investing activities		(52)	(37)
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)
Dividends paid		(8)	(9)
Net cash flows from financing activities		(96)	(98)
Net increase in cash and cash equivalents		16	5
Cash and cash equivalents at the beginning of the period		116	150
Cash and cash equivalents	14	132	155

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 £2m (2018: £3m), other income of £1m (2018: £nil) 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) and the Financial Conduct Authority's Disclosure and Transparency Rules. 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 2 April 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 has net current liabilities as at 31 July 2019. 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 February 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'.

Measurement of lease liabilities

	£m
Operating lease commitments disclosed at 31 January 2019 (not recognised in statement of financial position)	40
(Less): short-term and low-value leases not recognised as a liability	-
	40
(Less): discount using the lessee's incremental borrowing rate at the date of initial application	(14)
Discounted lease liabilities not recognised as at 31 January 2019	26
Add: finance lease liabilities recognised as at 31 January 2019	61
Lease liability recognised at 1 February 2019	87
Of which are:	
Current lease liabilities	52
Non-current lease liabilities	35
	87

Notes to the financial statements (continued)

e) Changes in significant accounting policies (continued)

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.

Subsequently the right-of-use assets will be depreciated over their remaining lease terms.

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 of £66m
- Right-of-use assets – increase of £89m
- Lease incentive accrual – decrease of £2m
- Onerous lease provision – decrease of £1m
- Lease liabilities – increase of £26m

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

Earnings per share was unchanged for the six months to 31 July 2019 as a result of the adoption of IFRS 16.

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 combines Insurance Services and Insurance Underwriting. 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. This segment also includes the insurance underwriting and reinsurance activities of the AA.

	Six months ended July 2019 £m	Six months ended July 2018 £m
Revenue		
Roadside	418	411
Insurance	73	69
Revenue	491	480
Trading EBITDA		
Roadside	137	132
Insurance	28	29
Trading EBITDA	165	161
Share-based payments	(2)	(3)
Pension service charge adjustment	(2)	(3)
Amortisation and depreciation	(41)	(34)
Operating profit before exceptional items	120	121
Exceptional operating items	-	(5)
Operating profit	120	116
Net finance costs	(78)	(88)
Profit before tax	42	28

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
Insurance Underwriting	11	8
Total Revenue	491	480
Trading EBITDA		
Roadside Assistance	162	156
Insurance Services	30	33
Driving Services	7	7
Insurance Underwriting	4	1
Head Office costs	(38)	(36)
Total Trading EBITDA	165	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	-	-
Insurance Underwriting	-	-	4	1
Head Office costs	(32)	(31)	(6)	(5)
Trading EBITDA	137	132	28	29
Share-based payments	(1)	(2)	(1)	(1)
Pension service charge adjustment	(2)	(3)	-	-
Amortisation and depreciation	(37)	(31)	(4)	(3)
Operating profit before exceptional items	97	96	23	25

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
Insurance Underwriting	11	8
Total Insurance	73	69
Total Revenue	491	480

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

These financial statements report 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 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:

	Note	Six months ended July 2019 £m	Six months ended July 2018 £m
Trading EBITDA	2	165	161
Share-based payments		(2)	(3)
Pension service charge adjustment		(2)	(3)
Amortisation and depreciation	9, 10, 11	(41)	(34)
Exceptional operating items	4	-	(5)
Operating profit		120	116

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, 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)

3 Adjusted performance measures (continued)

Adjusted earnings per share

Adjusted earnings per share adjusts profit after tax for items that are either discontinued operations, one-off in nature or relate to transactions that do not form part of the ongoing performance of the Group.

Adjusted profit before tax is included as a non-GAAP measure as it is used by management to evaluate performance and by investors to more easily and consistently track the underlying performance of the Group. Adjusted earnings per share is calculated as adjusted profit after tax divided by the weighted average number of shares.

	Six months ended July 2019	Six months ended July 2018
Profit after tax as reported (£m)	34	23
Adjusted for:		
Exceptional operating items (see note 4) (£m)	-	5
Share-based payments (£m)	2	3
Pension service charge adjustment (£m)	2	3
Exceptional finance costs (see note 6) (£m)	-	11
Tax expense (see note 7) (£m)	8	5
Adjusted profit before tax (£m)	46	50
Tax at the effective rate of 19.2% (July 2018: 19.2%) (£m)	(9)	(10)
Adjusted profit after tax (£m)	37	40
Weighted average number of shares outstanding (millions)	614	612
Adjusted basic earnings per share (pence)	6.0	6.5
Weighted average number of diluted ordinary shares (millions)	614	612
Adjusted diluted earnings per share (pence)	6.0	6.5

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 18).

Notes to the financial statements (continued)

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	7	2
	7	2
Deferred tax		
Relating to origination and reversal of temporary differences – current year	1	3
	1	3
Tax charge in the income statement at an effective rate of 19.2% (July 2018: 19.2%)	8	5

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.

The effective tax rate remains consistent with the prior period. There has been no change in the UK corporation tax rate.

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 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 2019	Six months ended July 2018
Basic earnings per share:		
Profit after tax (£m)	34	23
Weighted average number of shares outstanding (millions)	614	612
Basic earnings per share (pence)	5.5	3.8

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

Under the Group's Employee Share Incentive Plan, shares are purchased monthly at market value and therefore any dilution is immediately accounted for in the earnings per share. In addition, matching shares are issued monthly and placed into the Employee Benefit Trust therefore any dilution is immediately accounted for in the earnings per share and the issue of matching shares has no further dilutive effect. As at 31 July 2019 there are no outstanding shares to be issued under these schemes that are potentially dilutive.

The Group had another class of potentially dilutive ordinary shares relating to the Management Valuation Participation shares. As the vesting conditions for all classes of MVP shares were not met following the final testing date of 27 June 2019, the shares were not dilutive. At 31 July 2018, based on the average market value of ordinary shares for the period, it was considered that the MVP shares were unlikely to vest and so were not dilutive in the prior period.

There are no further classes of share that we believe will have a material dilutive impact as at 31 July 2019.

	Six months ended July 2019	Six months ended July 2018
Weighted average number of ordinary shares in issue (millions)	614	612
Potentially dilutive shares (millions)	-	-
Weighted average number of diluted ordinary shares (millions)	614	612
Diluted earnings per share (pence)	5.5	3.8

Notes to the financial statements (continued)

8 Earnings per share (continued)

Adjusted earnings per share adjusts profit after tax for items that are either one-off in nature or relate to transactions that do not form part of the ongoing performance of the Group.

	Six months ended July 2019	Six months ended July 2018
Profit after tax as reported (£m)	34	23
Adjusted for:		
Exceptional operating items (see note 4) (£m)	-	5
Share-based payments (£m)	2	3
Pension service charge adjustment (see note 20) (£m)	2	3
Exceptional finance costs (see note 6) (£m)	-	11
Tax expense (see note 7) (£m)	8	5
Adjusted profit before tax (£m)	46	50
Tax at the effective rate of 19.2% (July 2018: 19.2%) (£m)	(9)	(10)
Adjusted profit after tax (£m)	37	40
Adjusted basic earnings per share (pence)	6.0	6.5
Adjusted diluted earnings per share (pence)	6.0	6.5

Notes to the financial statements (continued)

9 Goodwill and other intangible assets

	Goodwill £m	Software £m	Total £m
Cost			
At 1 February 2018	1,197	254	1,451
Additions	-	30	30
At 31 July 2018	1,197	284	1,481
<hr/>			
At 1 February 2019	1,197	257	1,454
Additions	10	25	35
Disposals	-	(8)	(8)
At 31 July 2019	1,207	274	1,481
<hr/>			
Amortisation and impairment			
At 1 February 2018	27	124	151
Amortisation	-	14	14
At 31 July 2018	27	138	165
<hr/>			
At 1 February 2019	27	96	123
Amortisation	-	20	20
Disposals	-	(7)	(7)
At 31 July 2019	27	109	136
<hr/>			
Net book value			
At 31 July 2019	1,180	165	1,345
At 31 July 2018	1,170	146	1,316
At 31 January 2019	1,170	161	1,331

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)

10 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

Capital commitments

Amounts contracted for but not provided in the financial statements amounted to £11m (July 2018: £18m, January 2019: £15m).

Notes to the financial statements (continued)

11 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))	23	111	8	142
At 1 February 2019 restated	23	111	8	142
Additions	-	16	-	16
Disposals	-	(27)	-	(27)
At 31 July 2019	23	100	8	131
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	22	58	-	80
At 31 July 2018	-	-	-	-
At 31 January 2019	-	-	-	-

Notes to the financial statements (continued)

12 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	-	-
Listed corporate debt	20	-	-
	24	-	-

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.

On 20 February 2019, the Group completed the purchase of £23m of Class B2 notes in AA Bond Co Limited from the market for cash consideration of £20m. The Class B2 notes have an expected maturity date of 31 July 2022 and pay interest at a fixed rate of 5.5%. The Group has recognised this listed corporate debt as a financial asset at amortised cost.

13 Trade and other receivables

	July 2019 £m	July 2018 £m	January 2019 £m
Current			
Trade receivables	144	138	142
Deferred consideration	-	6	3
Prepayments	21	16	18
Contract assets	16	19	17
Reinsurers' share of insurance liabilities	52	28	39
Other receivables	4	6	4
	237	213	223

14 Cash and cash equivalents

	July 2019 £m	July 2018 £m	January 2019 £m
Ring-fenced cash at bank and in hand – available	63	47	12
Ring-fenced cash at bank and in hand – restricted	8	8	8
Non ring-fenced cash at bank and in hand – available	37	67	68
Non ring-fenced cash at bank and in hand – restricted	24	33	28
	132	155	116

Ring-fenced cash and cash equivalents relate to cash held by AA Intermediate Co Limited and its subsidiaries. Dividends can only be paid to AA plc when certain debt to Trading EBITDA and cash flow criteria are met.

Cash at bank and in hand includes £32m (July 2018: £41m, January 2019: £36m) 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)

15 Trade and other payables

	July 2019 £m	July 2018 £m	January 2019 £m
Current			
Trade payables	114	110	88
Other taxes and social security costs	14	20	12
Accruals	63	64	61
Deferred income	229	242	233
Deferred consideration	-	-	2
Provision for unearned premiums in Insurance Underwriting	37	22	26
Other payables	28	46	40
	485	504	462
Non-current			
Deferred consideration	10	11	10

Non-current deferred consideration relates to the expected contingent consideration outstanding in respect of the purchase of the entire share capital of Used Car Sites Limited during the 2018 financial year.

16 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)

16 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.

Notes to the financial statements (continued)

17 Borrowings and loans

	July 2019 £m	July 2018 £m	January 2019 £m
Current			
Borrowings and loans (see note 18)	200	15	-
Non-current			
Borrowings (see note 18)	2,530	2,718	2,724
	2,730	2,733	2,724

18 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.

On 20 February 2019, the Group completed the purchase of £23m of Class B2 notes in AA Bond Co Limited for cash consideration of £20m. This has been presented as an asset held at amortised cost (see note 12) as the asset is held by the Group outside of the WBS, but is linked to the Class B2 notes shown above which are held by the Group within the WBS. The asset and liability have been separately presented in the statement of financial position as the current restrictions of the WBS prevent the loan notes from being purchased by an entity within the WBS and offset through settlement in this manner.

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 notes 19 and 23).

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.

Notes to the financial statements (continued)

18 Borrowings (continued)

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.

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.

19 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)

20 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)

20 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)

20 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 24 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)

20 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)

20 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.

21 Share premium

	£m
At 31 January 2018	406
Issue of shares	1
At 31 July 2018	407
At 31 January 2019	408
Issue of shares	1
At 31 July 2019	409

22 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 £m	July 2018 £m	January 2019 £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 £m	July 2018 £m	January 2019 £m
AA Media Ltd	Services supplied to AA Media	1	-	-
Intelematics Ltd	Goods supplied to Intelematics	-	3	5

Notes to the financial statements (continued)

23 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 19)	(1)	-	(1)	-
Financial liabilities measured at fair value				
Interest rate swap derivatives (note 19)	1	-	1	-
Deferred consideration (due in more than one year) (note 15)	10	-	10	-
Liabilities for which fair values are disclosed				
Loan notes (note 18)	2,730	2,643	-	-

Notes to the financial statements (continued)

23 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 19)	(2)	-	(2)	-
Financial liabilities measured at fair value				
Deferred consideration (due in more than one year) (note 15)	11	-	11	-
Liabilities for which fair values are disclosed				
Loan notes (note 18)	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 15)	10	-	10	-
Liabilities for which fair values are disclosed				
Loan notes (note 18)	2,724	2,577	-	-

Notes to the financial statements (continued)

24 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.

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

Chief Executive Officer

23 September 2019

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

Report on the consolidated interim financial statements

Our conclusion

We have reviewed AA plc's consolidated interim financial statements (the "interim financial statements") in the Interim Report of AA plc for the 6 month period ended 31 July 2019. Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

What we have reviewed

The interim financial statements comprise:

- the consolidated statement of financial position as at 31 July 2019;
- the consolidated income statement and consolidated statement of comprehensive income for the period then ended;
- the consolidated interim statement of cash flows for the period then ended;
- the consolidated statement of changes in equity for the period then ended; and
- the explanatory notes to the interim financial statements.

The interim financial statements included in the Interim Report have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1 to the interim financial statements, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the Group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Responsibilities for the interim financial statements and the review

Our responsibilities and those of the directors

The Interim Report, including the interim financial statements, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the Interim Report in accordance with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

Our responsibility is to express a conclusion on the interim financial statements in the Interim Report based on our review. This report, including the conclusion, has been prepared for and only for the company for the purpose of complying with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority and for no other purpose. We do not, in giving this conclusion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What a review of interim financial statements involves

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, 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.

We have read the other information contained in the Interim Report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the interim financial statements.