



AA INTERMEDIATE CO LIMITED

INTERIM REPORT

FOR THE SIX MONTHS ENDED 31 JULY 2020

Introduction

The directors present the condensed financial statements of AA Intermediate Co Limited (“the Company”) and its subsidiary undertakings (together “the Group”) for the period ended 31 July 2020. The Company is an Obligor and a parent company of each of the other Obligors that provide security and guarantees under the financing arrangements entered into by the AA on 2 July 2013. The Company’s immediate parent is AA Mid Co Limited. There is no material difference in the financial conditions and results of operations between the AA Intermediate Co Limited group and the AA Mid Co Limited group.

Principal activities and business performance

Roadside

	Six months ended July 20 (H1 21)	Six months ended July 19 (H1 20)
Revenue (£m) ¹	395	412
Trading EBITDA (£m) ¹	145	136
Trading EBITDA margin (%) ¹	36.7	33.0
Paid personal members (000s)	3,150	3,190
Average income per paid personal members (new) (£) ²	164	164
Average income per paid personal members (old) (£) ²	167	165
Business customers (000s)	8,918	8,994
Average income per business customer (£)	23	22
Number of breakdowns (000s)	1,438	1,648

1 During the year and reflecting the way that the Group will be managed going forwards, the Group has determined that its AA Cars business should be included within the Insurance segment, having previously been included in the Roadside segment. This has been reflected in the analysis of segmental performance and corresponding comparatives.

2 The average income per paid personal member under the old basis is represented as a proportion of closing paid personal membership holdings. The average income per paid personal member under the new basis is represented as a proportion of the average paid personal membership holdings over the relevant period.

Revenue fell by 4.1% in the period to £395m due to the impact of COVID-19 on our smaller Roadside businesses. Our core Roadside business continues to deliver a solid performance.

Trading EBITDA was up 6.6% to £145m and the Trading EBITDA margin was up 11.2% to 36.7%, reflecting the operational resilience of our core Roadside business and our ability to act swiftly to protect profitability during the lockdown.

Principal activities and business performance (continued)

Business-to-consumer

In line with our expectations, the paid membership base fell by 2.0% during the first half to 3,150k (H1 20: 3,190k, FY20: 3,215k) with the customer retention rate flat at 80% (H1 20: 80%, FY20: 80%). This was due to the early impact of the lockdown restrictions in March which limited driving on Britain's roads and led to an initial decline in new business volumes. Following the gradual lifting of the lockdown restrictions in June and our recently launched above the line marketing campaign in July, we have seen a steady improvement in new business volumes and expect progressive recovery to continue into H2. Both new business volumes and customer retention rates are currently at near normal levels.

During the period, we revised the basis of the calculation of the average income per paid member to reflect the average income earned from the paid membership base over the last 12 months as a proportion of the average paid personal membership holdings as opposed to the closing paid membership holdings on which it was previously calculated. This results in a flat average income per paid member of £164 as at 31 July 2020 compared to last year (H1 20: £164, FY20: £166). The figure has fallen by 1.2% since year end due to the initial impact of the lockdown restrictions which led to fewer motorists driving and as a consequence fewer new member sales across our digital and call-centre channels. Our cross-sell channels, however, continue to perform strongly, in particular through our Insurance business and represent an increasing proportion of our member base. European Breakdown Cover revenue also fell in the period due to the lockdown travel restrictions. Under the previous measure, the average income per paid member increased by 1.2% since year end to £167, reflecting the lower paid membership holding as at 31 July 2020 compared to year end which more than offset the reduction to the average income outlined above.

Business-to-business

Within our B2B business, we successfully retained or extended all our key contracts due for renewal in the first half, including Porsche, Hyundai, Jaguar Land Rover and Honda. As expected, total business customers fell in the period to 8,918k (H1 20: 8,994k, FY20: 9,048k) due largely to the effect of a significant reduction in new car registrations as a result of COVID-19. Average income per business customer was up 4.5% to £23 (H1 20: £22, FY20: £22) reflecting the lower customer holdings as well as the benefit of higher pay-for-use income and additional income generated from the broad range of additional services that we provided during the lockdown.

During the period we continued to deliver ground breaking and unique digital services to our customers in B2B with the launch of SPARX in collaboration with ARC, our European partner. SPARX is an integrated digital network connecting the leading European roadside assistance clubs. This platform enables the real time transfer of breakdown information between breakdown clubs meaning customers can track and report a breakdown digitally across the whole of Europe (cross border). We also launched our digital mobility service which enables a patrol to identify and book a replacement (rental) vehicle from an app on their phone providing a quick seamless roadside experience for customers in the event a car cannot be repaired at the roadside.

Other business lines

With limited driving on Britain's roads and a number of independent garages closed during the lockdown, the roll-out of our consumer Service, Maintenance and Repair (SMR) proposition (Smart Care) was adversely impacted. Notwithstanding this, we continued to press ahead with our Smart Care product development plans which included the launch of a consumer collection and delivery option, digital authorisation for additional work and an enhanced journey. We provided additional B2B support throughout lockdown in areas where the preferred SMR provider was unavailable and as a result successfully signed a number of new B2B SMR contracts in the first half and have seen increased volumes from the existing customer base. We now redirect all SMR work for our Driving Schools business through our platform and into our network which will improve driving instructor retention levels and promote cross-sell opportunities. Following the easing of the lockdown in June, we have reinitiated our web-based marketing offers and member benefits offers for Smart Care, and are also moving ahead with our plans to expand our network of certified garages, and have recently welcomed our 500th garage partner.

Our Driving Schools and DriveTech businesses were severely impacted by the lockdown restrictions under COVID-19 and in aggregate revenue declined by 35.5% to £20m (H1 20: £31m).

Principal activities and business performance (continued)

Driving Schools was particularly hard hit as we elected to waive franchise fees for instructors for 14 weeks to support them during the lockdown. On 4 July, the Government announced that driving lessons could restart again in England which was a welcome relief for thousands of pupils and instructors.

As expected with fewer people driving and as a consequence fewer speed awareness courses, our DriveTech business generated significantly lower revenues in the period. Despite this, DriveTech was the first to provide comprehensive online speeding courses as an alternative to class-based learning and in total delivered 117,230 online courses in the period. As the lockdown restrictions have eased we have started to see a steady increase in police referral volumes for courses as more people take to the road.

COVID-19 response

The AA is a much-loved, long-standing and trusted British brand and our response at the start of the COVID-19 outbreak was to act decisively and step up at a time when the UK needed us most.

Within ten days of the lockdown we provided free breakdown assistance to all NHS workers travelling to and from work. Over the 3-month campaign, we helped over 8,000 NHS workers at the roadside and reached more than 30m people with our offer of support, receiving overwhelmingly positive feedback from the NHS, the general public and politicians alike.

Throughout lockdown we provided breakdown cover to ambulance services, new ambulance commissioning support, logistical support moving ambulances across the UK, management infill support and on-site vehicle servicing and maintenance to several ambulance services. Most notably, we directly supported the London Ambulance Service with over 200 of our people, helping to keep over 500 ambulances on the road throughout the lockdown period and beyond.

We were also able to provide a range of additional services and support to our B2B partners to ensure their customers were able to remain operational and on the road. Most motor manufacturers extended their warranty periods through the lockdown giving customers peace of mind. However, with numerous dealerships and garages closed we were able to step-in and work closely with our partners to provide customers with the additional warranty repair support allowing their customers to stay mobile. We also launched a key worker initiative with free breakdown cover during the pandemic for all Toyota and Lexus customers. Additionally, for Lloyds Banking Group we extended free Home Start cover to their customers for the month of June as people started to get back on the road.

In our Driving Schools business, we waived franchise fees for a period of 14 weeks to support our Driving Instructors and under the internal mantra of #ProudToKeepBritainMoving, we were also one of the first companies to get behind the initial Channel 4 #ClapForOurCarers campaign.

We remain committed to serving the needs of our customers during this challenging time. With an already established and highly refined homeworking capability in place for our call centre workers, we were able to scale this model at pace to transition the vast majority of our colleagues to homeworking within two weeks. During this transition period, we were proud to have maintained good customer service levels. We introduced new digital contact capabilities to ensure we were always there for customers and we made temporary adjustments to our policies and processes to support customers facing financial hardship.

As the lockdown restrictions gradually began to lift, and more of the British public began thinking about local journeys and staycations, we launched a new marketing campaign called 'That Feeling', tapping into the mood of the nation and a universal desire to return to the freedom of driving. The campaign has received an exceptionally positive response and contributed to an increase in new member volumes in the latter half of H1.

To minimise the impact of COVID-19 on trading, we executed a number of operational and financial changes to our business that resulted in the deferral and reduction of a range of operating costs across the Group including: no pay rises, a general hiring freeze, a 15% reduction in pay for all Board members for three months, and tight cost control across the business. The Group also applied for the Government's furlough scheme for those parts of our business where it has been necessary for us to adjust to reduced levels of workload.

Principal activities and business performance (continued)

Product and Service Innovation

We continue to make good progress with our pipeline of innovative products and services to differentiate the AA and enable us to target a broader base of UK drivers.

The roll-out of Smart Breakdown, our premium connected car offering, was affected by lockdown. Despite this, over 10,000 new and existing customers have Smart Breakdown and we are encouraged by the take up rates in our digital channels. Looking ahead, we will continue to build the base of new and existing customers who are connected through Smart Breakdown, whilst continually refining and optimising the customer experience.

During the first half of FY21, 16% of all breakdowns (both personal and business) were reported fully through our digital channels with no call handling intervention. This is up from 11% at year end as a result of the introduction of a digital reporting service for Lloyds customers via the app and web. Customers are also able to track and cancel their breakdowns online, with 44% of all national breakdowns touching our digital channels in some way.

Our app also remains central to our future plans. Approximately 753,000 unique users accessed the app on a monthly basis during the first half, of which around 62% were returning users and 38% were new. This is 7% up from the same period last year. Approximately 62% of members have registered for the app to date, up from 60% at year end.

Customer Service and Operations

The AA continues to deliver best-in-class customer service and in June 2020 we were pleased to have achieved the top place for breakdown cover in an assessment by independent consumer champion Which? This was the third year running we have been endorsed as the top provider. We also won the top six places for the second year running for best manufacturer breakdown cover. This is a strong validation of our business model and the outstanding customer service delivery we provide to all our B2C and B2B customers.

During the period, we also won the UK Business Awards for the Most Customer Centric Organisation, heading off competition from a number of leading industry players across a range of sectors. Like the Which? accolade, this is an incredible achievement and a testament to the hard work that our patrols, contact centre colleagues and support teams do, day-in-day-out to deliver outstanding customer service to our customers.

Total breakdowns fell by 12.7% to 1,438k (H1 20: 1,648k) due to the reduced traffic on Britain's roads. This in turn meant that we incurred lower third-party garaging and patrol-related costs compared to last year. Despite reduced breakdown volumes, there were a higher number of B2B related breakdowns as a higher proportion of business customers were driving during the lockdown. As a result, overall pay-for-use income was up compared to last year. Ancillary sales including battery sales were also significantly higher than last year as a considerable number of our members and customers experienced flat batteries due to their cars not being driven during the lockdown.

Despite the operational challenges presented under lockdown, we were pleased to have delivered outstanding customer service in the period with overall call-to-arrive times excellent and averaging 44.5 minutes in the period, against our target of 45 minutes. We responded to a majority of calls to our call centre in 20 seconds and our repair rates and average repair times were also strong and ahead of last year.

Principal activities and business performance (continued)

Insurance

Revenue

	Six months ended July 20 (H1 21)	Six months ended July 19 (H1 20)
Revenue (£m) ¹	66	68
Trading EBITDA (£m) ¹	21	25
Trading EBITDA margin (%) ¹	31.8	36.8
Total motor and home policy numbers in force ² (000s)	1,818	1,644
Average income per policy ³ (£)	65	67
Total Motor policies (000s)	966	803
Total Home policies (000s)	852	841
Financial Services products ⁴ (000s)	96	159

1 During the year and reflecting the way that the Group will be managed going forwards, the Group has determined that its AA Cars business should be included within the Insurance segment, having previously been included in the Roadside segment. This has been reflected in the analysis of segmental performance and corresponding comparatives.

2 Total Motor and Home policies sold in the last 12 months by our insurance broker.

3 Motor and Home only. The KPI in the AA plc interim results was £60 as this was calculated on a 6 month basis rather than 12 months.

4 Financial Services products includes the number of loans drawn down and savings accounts opened.

The Insurance division delivered continued growth and remained relatively resilient during COVID-19 with Insurance revenue down 2.9% to £66m (H1 20: £68m). This was driven by the strong performance of our new Accident Assist business which offset some of the anticipated decline in commissions due to ongoing investment in marketing and our decision to absorb costs to help our customers during the lockdown.

Trading EBITDA was down 16% to £21m (H1 20: £25m) and Trading EBITDA margin declined from 36.8% to 31.8%, as we continue to invest in accelerating the growth in policies, leveraging our strong brand and large distribution platform to deliver future value and Trading EBITDA growth.

Insurance broking and financial services

Revenue declined slightly by £2m to £66m (H1 20: £68m) with the strong performance of our new Accident Assist business offsetting some of the anticipated decline in commissions due to ongoing investment in marketing, our decision to absorb costs to help our customers during the lockdown as well as low trading activity in our AA Cars business. The motor policy book grew by 11.2% during the period to 966,000 policies (H1 20: 803,000, FY20: 869,000) and the home book grew by 0.9% to 852,000 (H1 20: 841,000, FY20: 844,000), reflecting the continued growth of the AA plc group in-house underwriter as well as the benefit of ongoing investment in pricing systems to enhance our competitiveness.

The ongoing improvements in our customer journey are helping to deliver consistent and healthy cross-sell conversions into our Roadside business with 35% of new insurance customers taking Roadside membership up from 30% this time last year and 33% at year end.

Principal activities and business performance (continued)

The ongoing investment in acquiring new business volumes, which have a lower average commission compared with the rest of the book, and our decision to help our customers during the COVID-19 outbreak through reduction in administrative and processing fees led the average income per motor and home policy to fall to £65 (H1 20: £67). Renewal rates have remained broadly steady.

Accident Assist, our recently launched in-house claims management proposition, is performing well, and, following the implementation of a new claims handling platform from ICE InsureTech and the consolidation of all our claims operations into Royal Tunbridge Wells in the period, we are starting to see positive momentum building. We have now completed the roll-out of this new capability across all our motor insurance panel members ahead of schedule and are planning to incorporate the Accident Assist service benefits to all our members from Q1 next year.

In March, we were pleased to have extended our Financial Services Distribution Agreement with Bank of Ireland UK by three years to at least 2028. As part of the agreement, our partnership now includes AA branded car finance products to sit alongside savings and loans products.

During the period, we reclassified AA Cars, our online used car platform with a growing financial service offering, into our Insurance segment. As expected, AA Cars suffered from significantly low demand during the period, however, the business is showing encouraging progress with significant increases in car viewings, vehicle inspections and car finance applications and conversions thus far in the second half of the year.

Principal risks and uncertainties

The Group's Principal Risks were detailed in the Annual Report 2020. The Board has reviewed these principal risks for material developments since the publication of the Annual Report 2020 and updates against each principal risk, including any significant changes that may impact the second half performance, are detailed in italics below:

1. Debt leverage

The risk that we are unable to manage our debt and the Group is unable to repay or refinance its debt at an acceptable price.

Following the refinancing on 5 February 2020 and the drawdown of the STF (to enable the repayment of the Class A3 notes), we have £0.9bn of debt to refinance by 2022. Since our Annual Report, the current bond market continues to suggest that the debt would need to be refinanced at a higher interest rate than the current debt and will, as with previous refinancing, require cash resources to be allocated to the associated one-off costs of enabling these transactions.

The Directors continue to believe that as long as the sterling bond markets have their usual liquidity and the investment grade rating of the Class A notes continues, there is a reasonable prospect that we will be able to refinance albeit at higher interest rates than the current interest rates. Modelling indicates that even at higher interest rates, the business remains cash generative and able to meet its interest and debt raising costs.

2. Regulatory and legal environment

The risk of a changing regulatory environment that may adversely affect our activities and/or 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, affordability in consumer credit and industry COVID-19 responses. The AA has continued to work 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 during the course of the year, none of which have been material. The FCA's Pricing Practices Consultation Paper was released on 22 September 2020, outlining proposed remedies to support effective competition and lead to good consumer outcomes. There are a number of proposals including requirements to ensure renewal prices offered are no higher than the equivalent new business price as well as requiring firms to assess fair value of the products they sell. We welcome the FCA's proposals and agree with the importance of delivering good outcomes to customers.

3. Outstanding service

The risk that 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.

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. In June 2020 we were pleased to have come top of the table for breakdown cover again by independent consumer champion Which? We were also proud to have been endorsed as a Which? Recommended Provider for breakdown cover for the third year running and to have won the top six places for the second year running for best manufacturer breakdown cover provider, a strong validation of our business model and the outstanding customer service delivery we provide to our OEM partners.

Due to lower traffic levels during lockdown, overall call-to-arrive times were excellent and were below our target of 45 minutes. We responded to a majority of calls to our call centre in 20 seconds and our repair rates and average repair times were also strong and ahead of last year.

Principal risks and uncertainties (continued)

4. Roadside market share and margin

The risk that 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.

We continue to improve our roadside membership proposition by strengthening our roadside product offerings and engaging more members in additional benefits. We have improved our communications with both new and existing members, engaging members in their existing services and benefits to drive loyalty. Our pricing team has significant expertise to monitor market pricing levels and ensure that we are treating both new and loyal customers fairly while remaining competitive.

Personal paid membership fell slightly as a result of COVID-19. This was due to the early impact of the lockdown restrictions in March which limited driving on Britain's roads and led to an initial sharp decline in new member volumes. Following the gradual lifting of the lockdown restrictions in June and our recently launched above the line marketing campaign in July, we have seen a steady pick-up in new member volumes and expect progressive recovery to continue into H2. In respect of our B2B business, we retained or extended all key contracts in the period. There is still uncertainty in respect of the long-term COVID-19 impact to the business, especially should there be a prolonged period of recurring waves.

5. Insurance broking

The risk that we are unable to achieve desired margin, remain competitive and achieve our growth and profitability objectives.

Despite the initial COVID-19 impact to new business volumes, the insurance broker delivered a robust performance in the period with growth in motor and home policies. There remains uncertainty in respect of the long-term COVID-19 impact to the business, both with ourselves, as well as our panel insurers. The FCA's Pricing Practices Consultation Paper was released on 22 September 2020, outlining proposed remedies to support effective competition and lead to good consumer outcomes. There are a number of proposals including requirements to ensure renewal prices offered are no higher than the equivalent new business price as well as requiring firms to assess fair value of the products they sell. We welcome the FCA's proposals and agree with the importance of delivering good outcomes to customers.

6. Business & IT transformation

The risk that 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 recent years there remains much to do and the required improvements to processes, 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 capital investment and continue to review timelines and priorities as part of the execution of our declared strategy. As part of our COVID-19 response, some of these activities were brought forward to enable us to successfully move some staff to a home working environment.

Principal risks and uncertainties (continued)

7. Information security/cybercrime/data breach

The risk that 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.

Cybercrime continues to present a significant risk to the AA. We continue to invest in our information security programme to manage and mitigate these risks which 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.

8. Health and safety

We must continue to effectively manage the risks to the safety of our workforce and customers and ensure that effective controls are deployed to achieve this. Accountability to take action is essential in this as is oversight, review and embracing continual improvement.

The AA continues to strive to maintain a safe environment for employees and members. As part of our COVID-19 response the AA continues to follow government guidance in our operations, both internally for our staff as well as externally to our members to minimise risk to all parties. As a result of our response, we have and will continue to incur additional costs (such as PPE and additional resources within offices) to maintain safe systems of work in line with government guidance.

9. Pensions

The Company has a large defined benefit (DB) pension scheme, currently in deficit, whose assets and obligations are subject to future variation from investment returns, longevity and other similar factors.

We continue to execute the recovery plan agreed with the trustees in March 2019 and continue to assume that the deficit will be fully repaid by July 2025. The Group has recently been informed by the trustee of the AA UK Pension Scheme (AAUK scheme) of a possible need to review the AAUK scheme's approach to "equalising" certain pension benefits earned before 1 April 1992, so that the benefits earned by male and female members are equal. A detailed legal analysis will be needed to determine whether any additional liabilities need to be recognised by the Group before this can be appropriately assessed. The CARE section of the AAUK scheme has now been closed, and from April 2020 pension accrual is now on a defined contribution basis with transitional arrangements for affected employees over a 3 year period from 1 April 2020.

COVID-19

The COVID-19 pandemic continues to have material impact within the UK and internationally. During the first half of FY21, our immediate focus was on operational risks, with several changes to working practices implemented, including home working to ensure the safety of our employees and customers. As the pandemic progressed, we took additional steps to manage any potential conduct risks and ensure customer vulnerability was identified and appropriate measures put in place. We continue to monitor our activities to ensure that the risks and issues posed by COVID-19 on the business are appropriately addressed; however, as the pandemic progresses, particularly with a risk of a second and subsequent waves, direct and indirect effects may continue to have an adverse impact on our operations.

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's risk profile will evolve as mitigating activities succeed in reducing the net risks over time, or as new risks emerge.

Management discussion and analysis

	Six months ended July 2020 £m	Six months ended July 2019 £m
Revenue	461	480
Cost of sales	(175)	(188)
Gross profit	286	292
Administrative and marketing expenses	(171)	(175)
Operating profit	115	117
Finance costs	(96)	(78)
Profit before tax	19	39
Tax expense	(4)	(8)
Profit for the period	15	31

Reconciliation of Trading EBITDA to Operating Profit

Trading EBITDA	166	161
Share-based payments	(1)	(1)
Pension service charge adjustment	(2)	(2)
Amortisation and depreciation	(47)	(41)
Adjusting operating items	(1)	-
Operating profit	115	117

Revenue: Revenue reduced by £19m to £461m during the period (H1 20: £480m).

Roadside: Revenue reduced by £17m during the period to £395m (H1 20: £412m) due to the impact of COVID-19 on the smaller Roadside businesses particularly Driving Schools where franchise fees were waived for 14 weeks to support instructors during lockdown and fewer speed awareness courses were provided by DriveTech. The core Roadside business continued to deliver a solid performance.

Insurance: Revenue reduced by 2.9% in the period to £66m (H1 19: £68m), This was driven by the strong performance of the new Accident Assist business which offset some of the anticipated decline in commissions due to ongoing investment in marketing and the decision to absorb certain administration fees to help customers during the lockdown as well as low trading activity in the AA Cars business.

Cost of sales: Cost of sales decreased by £13m during the period to £175m (H1 20: £188m) due to lower breakdown volumes from reduced traffic during the lockdown period.

Administrative and marketing expenses: Administrative and marketing expenses reduced by £4m during the period to £171m (H1 20: £175m) as we reduced marketing expenses, particularly during the lockdown period.

Operating profit: Operating profit reduced by £2m during the period to £115m (H1 20: £117m). This was due to the increase in amortisation and depreciation costs offset by the increase in Roadside EBITDA (see below).

Management discussion and analysis (continued)

Finance costs: Net finance costs increased during the period to £96m (H1 20: £78m) principally due to £20m of one-off adjusting finance costs relating to the February 2020 refinancing transaction.

Taxation: The tax charge in the period reduced to £4m (H1 20: £8m) reflecting the lower profit before tax. The tax charge consisted of a current tax charge of £3m (H1 20: £6m) and a deferred tax charge of £1m (H1 20: £2m).

Trading EBITDA

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

Trading EBITDA was up by £5m during the period at £166m (H1 20: £161m). The Trading EBITDA margin improved by 7.5% to 36.0% (H1 20: 33.5%).

Roadside: EBITDA was up 6.6% to £145m (H1 20: £136m) and the Trading EBITDA margin was up 11.2% to 36.7%, reflecting the operational resilience of our core Roadside business and our ability to act swiftly to protect profitability during the lockdown.

Insurance: Trading EBITDA was down 16% to £21m (H1 20: £25m) and Trading EBITDA margin declined from 36.8% to 31.8%, as we continue to invest in accelerating the growth in policies, leveraging our strong brand and large distribution platform to deliver future value and Trading EBITDA growth.

Management discussion and analysis (continued)

Consolidated statement of cash flows

	Six months ended July 2020 £m	Six months ended July 2019 £m
Net cash flows from operating activities before tax	143	174
Tax paid	(13)	(4)
Net cash flows from operating activities	130	170
Investing activities		
Capital expenditure	(29)	(35)
Payment for acquisition of subsidiary, net of cash acquired	(1)	(8)
Investment in joint venture	(1)	-
Proceeds from sale of subsidiaries, net of cash sold	(1)	-
Net cash flows used in investing activities	(32)	(43)
Financing activities		
Proceeds from borrowings	525	15
Issue costs on borrowings	(8)	-
Debt repayment premium and penalties	(6)	-
Repayment of borrowings	(525)	(15)
Financing transactions	(14)	-
Interest paid on borrowings	(71)	(65)
Lease capital repayments net of proceeds from sale of fixed assets	(13)	(9)
Payment of lease interest	(1)	(2)
Net cash flows from financing activities	(99)	(76)
Net (decrease)/increase in cash and cash equivalents	(1)	51

Change in working capital: The change in working capital represented a cash outflow of £10m during the period (H1 20: cash inflow £28m) and was partly caused by the impact of COVID-19 on cash receipts and also included a payment made in respect of the extension of our Financial Services contract with Bank of Ireland.

Net cash flows from operating activities before tax: Net cash flows from operating activities before tax decreased to a cash inflow of £143m (H1 20: cash inflow £174m) during the period. This was driven by the change in working capital.

Tax paid: Cash outflow from tax paid was £13m for the period (H1 20: cash outflow £4m). This reflected the change to the timing of corporation tax payments mandated by HMRC.

Investing activities: Cash outflow from investing activities was £32m for the period (H1 20: cash outflow £43m). The decrease in cash outflow from investing activities was driven by lower capital expenditure reflecting the timing of project spend, reduction in labour costs and the re-prioritisation of IT maintenance spend due to COVID-19. In addition, the prior period included a net cash outflow relating to the acquisition of Prestige.

Financing transactions: Net cash flow from financing transactions for the period was a cash outflow of £14m (H1 20: £nil). This was due to the refinancing of the A5 notes in February 2020.

Interest paid on borrowings: Cash outflow from interest paid on borrowings increased by £6m to £71m (H1 20: £65m) for the period. The increase was due to the higher interest rate following the refinancing of the A5 notes in February 2020.

Payment of lease capital net of proceeds and lease interest: Cash outflow from the payment of lease capital and interest increased by £3m to £14m (H1 20: £11m) reflecting timing differences on payments.

Management discussion and analysis (continued)

Net Debt and covenants	As at 31 July 2020 £m	As at 31 July 2019 £m	As at 31 January 2020 £m
Senior Term Facility	200	-	-
Class A notes	1,997	2,200	2,197
Less: cash and cash equivalents	(101)	(71)	(102)
Total Class A Net Debt ¹	<u>2,096</u>	<u>2,129</u>	<u>2,095</u>
Class B2 notes	570	570	570
Lease obligations for covenant reporting ²	31	57	39
Net WBS debt ³	2,697	2,756	2,704
IFRS 16 lease adjustment for WBS for lease obligations ⁴	22	25	24
Net Debt	<u>2,719</u>	<u>2,781</u>	<u>2,728</u>
Reconciliation to covenants			
Lease obligations for covenant reporting ²	31	57	39
IFRS 16 lease adjustment for WBS for lease obligations ⁴	22	25	24
Total lease liabilities as reported in the statement of financial position	<u>53</u>	<u>82</u>	<u>63</u>
Group Covenant Trading EBITDA for the last 12 months ⁵	346	335	340
	Covenant		
Consolidated Leverage Ratio ⁶	7.8x	8.2x	8.0x
Total Class A Net Debt to EBITDA ratio ⁷	6.1x	6.4x	6.2x
Class A free cash flow: debt service ⁸	>1.35x	2.9x	3.4x
Class B free cash flow: debt service ⁹	>1.00x	2.1x	2.5x

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

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

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

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

5 Group Trading EBITDA as required by the debt documents based on frozen GAAP.

6 Ratio of Net WBS Debt³ to Group Covenant Trading EBITDA for the last 12 months⁵.

7 Ratio of Total Class A Net Debt¹ to Group Covenant Trading EBITDA for the last 12 months⁵.

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.

Class A free cash flow to debt service was 2.9 times as at 31 July 2020 and Class B free cash flow to debt service was 2.1 times, showing substantial headroom over the covenants which are set out above.

Management discussion and analysis (continued)

Net debt and covenants (continued)

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

- Class A Free Cash Flow: Debt Service is above 1.35x
- Class B Free Cash Flow: Debt Service is above 1.00x
- The Total Class A Net Debt to EBITDA 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 £101m at 31 July 2020.

Consolidated income statement

	Note	Six months ended July 2020 £m	Six months ended July 2019 £m
Revenue	2	461	480
Cost of sales		(175)	(188)
Gross profit		286	292
Administrative and marketing expenses		(171)	(175)
Operating profit		115	117
Finance costs	6	(96)	(78)
Profit before tax		19	39
Tax expense	7	(4)	(8)
Profit for the period		15	31

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

Consolidated statement of comprehensive income

	Six months ended July 2020 £m	Six months ended July 2019 £m
Profit for the period	15	31
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	(1)	-
	(1)	-
Other comprehensive income on items that will not be reclassified to the income statement in subsequent years		
Remeasurement losses on defined benefit schemes	-	(41)
Tax effect	-	7
	-	(34)
Total other comprehensive income	(1)	(34)
Total comprehensive income for the period	14	(3)

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

Consolidated statement of financial position

	Note	July 2020 £m	July 2019 £m	January 2020 £m
Non-current assets				
Goodwill and other intangible assets	8	1,348	1,339	1,350
Property, plant and equipment	9	49	55	52
Right-of-use assets	10	55	79	65
Investments in joint ventures and associates		5	5	5
Derivative financial instruments	18	-	1	-
Financial assets at amortised cost	22	4	4	4
Deferred tax assets		8	27	9
		1,469	1,510	1,485
Current assets				
Inventories		4	4	4
Trade and other receivables	11	197	176	182
Current tax receivable		2	-	-
Amounts owed by parent undertakings	12	1,214	1,214	1,214
Cash and cash equivalents	13	101	71	94
		1,518	1,465	1,494
Assets classified as held for sale		-	-	8
Total assets		2,987	2,975	2,987
Current liabilities				
Trade and other payables	14	(395)	(416)	(411)
Amounts due to parent undertakings		(67)	(45)	(48)
Current tax payable		-	(4)	(7)
Borrowings and loans	16	-	(200)	(200)
Lease liabilities		(20)	(46)	(23)
Provisions	15	(4)	(2)	(5)
		(486)	(713)	(694)
Non-current liabilities				
Borrowings and loans	16	(2,745)	(2,530)	(2,535)
Derivative financial instruments	18	(4)	(1)	(2)
Lease liabilities		(33)	(36)	(40)
Defined benefit pension scheme liabilities	19	(150)	(251)	(162)
Provisions	15	(6)	(4)	(6)
Deferred consideration	14	-	(10)	-
		(2,938)	(2,832)	(2,745)
Total liabilities		(3,424)	(3,545)	(3,439)
Net liabilities		(437)	(570)	(452)
Equity				
Cash flow hedge reserve		(3)	-	(2)
Retained earnings		(434)	(570)	(450)
Total equity attributable to equity holders of the parent		(437)	(570)	(452)

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

Consolidated statement of changes in equity

Attributable to the equity holders of the parent

	Share capital £m	Cash flow hedge reserve £m	Retained earnings £m	Total £m
At 1 February 2019	-	-	(568)	(568)
Profit for the period	-	-	31	31
Other comprehensive income	-	-	(34)	(34)
Total comprehensive income	-	-	(3)	(3)
Share-based payments	-	-	1	1
At 31 July 2019	-	-	(570)	(570)
At 1 February 2020	-	(2)	(450)	(452)
Profit for the period	-	-	15	15
Other comprehensive income	-	(1)	-	(1)
Total comprehensive income	-	(1)	15	14
Share-based payments	-	-	1	1
At 31 July 2020	-	(3)	(434)	(437)

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 2020 £m	Six months ended July 2019 £m
Profit before tax		19	39
Amortisation, depreciation and impairment	8,9,10	47	41
Net finance costs	6	96	78
Difference between pension charge and cash contributions		(11)	(11)
Other adjustments to profit before tax		2	(1)
Working capital and provisions:			
(Increase)/decrease in trade and other receivables		(14)	2
Increase in trade and other payables		5	26
Decrease in provisions		(1)	-
Total working capital and provisions adjustments		(10)	28
Net cash flows from operating activities before tax		143	174
Tax paid		(13)	(4)
Net cash flows from operating activities		130	170
Investing activities			
Capital expenditure		(29)	(35)
Payment for acquisition of subsidiary, net of cash acquired		(1)	(8)
Investment in joint venture		(1)	-
Proceeds from sale of subsidiaries, net of cash sold		(1)	-
Net cash flows used in investing activities		(32)	(43)
Financing activities			
Proceeds from borrowings		525	15
Issue costs on borrowings		(8)	-
Debt repayment premium and penalties		(6)	-
Repayment of borrowings		(525)	(15)
Refinancing transactions		(14)	-
Interest paid on borrowings		(71)	(65)
Lease capital repayments net of proceeds from sale of fixed assets		(13)	(9)
Payment of lease interest		(1)	(2)
Net cash flows from financing activities		(99)	(76)
Net (decrease)/increase in cash and cash equivalents		(1)	51
Cash and cash equivalents at the beginning of the period		102	20
Cash and cash equivalents	13	101	71

The cash flows from operating activities are stated net of cash outflows relating to adjusting operating items of £2m (2019: £2m). These items comprised £3m related to the closure costs of the CARE section of the AAUK pension scheme and the transitional agreement made with employees in that scheme (2019: £nil), costs of strategic initiatives of £2m (2019: £1m), conduct and regulatory costs of £nil (2019: £1m) and £3m related to emergency IT expenditure incurred setting up home working due to the COVID-19 pandemic (2019: £nil), offset by £6m related to government furlough support in respect of COVID-19 (2019: £nil).

Other adjustments to profit before tax relate to share-based payments of £1m (2019: £1m) and loss on sale of non-current assets £1m (2019: profit of £2m).

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 2020.

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 2020 which were prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and have been applied consistently across all periods.

These financial statements do not constitute statutory accounts within the meaning of Section 435 of the Companies Act 2006. Statutory accounts for the year to 31 January 2020 were approved by the Board of Directors on 25 June 2020 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's operations are cash generative with a large proportion of its revenues coming from recurring transactions. The significant customer loyalty demonstrated by high renewal rates and lengthy customer tenure underpins this and, in addition to the cash balances at the reporting date, the Group has agreed undrawn credit facilities.

The Group's longer-term viability depends upon the key assumption that the Group can refinance its debt on its various expected maturity dates (see note 17) at an affordable interest rate with associated one-off costs. The majority of the Group's borrowings are long term in nature. The first maturities of the Group's facilities and bonds are £372m Class A5 notes on 31 January 2022 and £570m Class B2 notes on 31 July 2022 (of which £29m is held directly by AA plc, the Company's ultimate parent undertaking), respectively 15 and 21 months from the date of approval of these interim condensed financial statements. The Directors continue to believe that as long as the sterling bond markets have their usual liquidity and the investment grade rating of the Class A notes continues, there is a reasonable prospect that we will be able to refinance albeit at higher interest rates than the current interest rates. In addition, the Directors would expect to refinance these borrowings in advance of their respective due dates as the Group has access to a number of refinancing opportunities including bond issues, bank borrowings and repayments from existing cash resources. As with previous refinancings, this will require cash resources to be allocated to the associated one-off costs of enabling these transactions.

The Class A notes are currently rated as BBB- and this rating was reconfirmed as part of the Senior Term Facility drawdown in April 2020. The Directors have evaluated a downside scenario comprising a downgrade in Class A ratings below BBB-. There is no immediate operational or financial impact on the business in the event of such a downgrade. There would be no restriction on the Group's ability to refinance any maturing Class A notes through the issue of new Class A debt although this is likely to be at a higher interest rate depending on prevailing market conditions. The Group, in such a ratings downgrade scenario, will be restricted in its ability to issue new Class B notes within the WBS structure and accordingly will be required to raise capital outside the WBS to refinance the Class B2 notes that mature in July 2022. In the event that such capital is not capable of being raised by the maturity date, the Group would enter into negotiations with its Class B2 noteholders. In the event that the WBS group was unable to refinance or repay any of its borrowings falling due in 2022, then the relevant bondholders could enforce their security in accordance with the security trust and intercreditor deed, which in the case of the Class B bondholders includes a share pledge over the holding company of the WBS group.

The Directors have considered these points along with the projected cash flows, for a period of one year from the date of approval of these interim condensed financial statements and have concluded that the Group has sufficient funds to continue trading for this period. Additionally, no borrowings are due within 12 months from the date of approval of these interim condensed financial statements.

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, adjusting operating items, share-based payments, pension service charge adjustment, depreciation and amortisation (referred to as Trading EBITDA, see note 3).

d) Critical accounting estimates and judgements

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 2020.

Notes to the financial statements (continued)

2 Segmental information and revenue disaggregation

The Group has two key segments – Roadside and Insurance. Head Office costs have been allocated to these two key segments as these costs principally directly support the operations of these segments. Head Office costs are predominately allocated on a percentage of revenue basis.

The two reportable operating segments are 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 programmes.
- *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.

During the year and reflecting the way that the Group will be managed going forwards, the Group has determined that its AA Cars business should be included within the Insurance segment, having previously been included in the Roadside segment. This has been reflected in the below analysis of segmental performance and corresponding comparatives.

	Six months ended July 2020 £m	Six months ended July 2019* £m
Revenue		
Roadside	395	412
Insurance	66	68
Revenue	461	480
Trading EBITDA		
Roadside	145	136
Insurance	21	25
Trading EBITDA	166	161
Share-based payments	(1)	(1)
Pension service charge adjustment	(2)	(2)
Amortisation and depreciation	(47)	(41)
Operating profit before adjusting operating items	116	117
Adjusting operating items	(1)	-
Operating profit	115	117
Net finance costs	(96)	(78)
Profit before tax	19	39

All segments operate principally in the UK. Revenue by destination is not materially different from revenue by origin.

Segment performance is primarily evaluated using the Group's key performance measures of revenue and Trading EBITDA as well as operating profit before adjusting operating items.

Adjusting operating 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 does not view this information on a segmental basis.

Notes to the financial statements (continued)

2 Segmental information and revenue disaggregation (continued)

Operating profit before adjusting operating items	Roadside		Insurance	
	Six months ended July 2020	Six months ended July 2019*	Six months ended July 2020	Six months ended July 2019*
	£m	£m	£m	£m
Trading EBITDA	145	136	21	25
Share-based payments	(1)	(1)	-	-
Pension service charge adjustment	(2)	(2)	-	-
Amortisation and depreciation	(41)	(37)	(6)	(4)
Operating profit before adjusting operating items	101	96	15	21

Disaggregation of revenue:

	Six months ended July 2020	Six months ended July 2019*
	£m	£m
Roadside:		
Consumer (B2C)		
Insured contracts	235	241
Pay for use contracts ¹	25	23
Business Services (B2B)		
Insured contracts	19	19
Pay for use contracts ¹	84	81
Roadside other*	32	48
Total Roadside	395	412
Insurance:		
Brokering activities*	58	59
Insurance other*	8	9
Total Insurance	66	68
Total revenue	461	480

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

*Insurance other now comprises the Group's AA Cars and Financial Services businesses, which were previously included in Roadside other and Insurance brokering activities respectively. This will better reflect the nature of their products and the way that the Group will be managed going forwards. The segmental analysis and revenue disaggregation figures for the six months ended July 2019 have been restated to reflect this change.

Notes to the financial statements (continued)

3 Adjusted performance measures

Management reviews the Group's results and performance both on a statutory and non-GAAP (non-statutory) basis. The Group's adjusted performance measures are non-GAAP (non-statutory) financial measures and are included in these financial statements 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, adjusting operating items, share-based payments, pension service charge adjustment, 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	For the six months ended	
		July 2020 £m	July 2019 £m
Trading EBITDA	2	166	161
Share-based payments		(1)	(1)
Pension service charge adjustment		(2)	(2)
Amortisation and depreciation	8, 9, 10	(47)	(41)
Adjusting operating items	4	(1)	-
Operating profit		115	117

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

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

Notes to the financial statements (continued)

4 Adjusting operating items

	Six months ended July 2020 £m	Six months ended July 2019 £m
Adjusting operating items	1	-

In the current period, adjusting operating items comprised £3m related to the closure costs of the CARE section of the AAUK pension scheme and the transitional agreement made with employees in that scheme, £2m related to strategic review projects, a £1m loss on disposal of subsidiaries (see note 5), a £1m impairment of investments in joint ventures and £3m related to emergency IT expenditure incurred setting up home working due to the COVID-19 pandemic, offset by £6m related to government furlough support in respect of COVID-19, a £2m release of a provision for conduct and regulatory costs and a £1m profit on disposal of non-current assets.

As noted above, we have separately identified the incremental costs directly attributable to COVID-19 and the credit received from government furlough support, within adjusting operating items. The trading effects from COVID-19 are reflected within Trading EBITDA.

In the prior period, adjusting operating items comprised £1m related to strategic review projects and £1m related to conduct and regulatory costs, offset by a £2m profit on disposal of non-current assets.

Costs from the current period refinancing in February 2020 were directly attributable to the issue and repayment of loan notes and have therefore been included either in finance costs or in borrowings as debt issue fees (see notes 6 and 17).

5 Business combinations

Acquisitions during the period ended 31 July 2020

There were no acquisitions during the period ended 31 July 2020.

Acquisitions during the year ended 31 January 2020

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.

On acquisition, assets and liabilities acquired included £3m cash and £2m trade and other payables. Goodwill of £10m was initially recognised but was subsequently reallocated within the permitted measurement period, comprising additions of £11m to customer relationships, £1m to software and £2m to deferred tax liabilities. At the point of acquisition, the combined fair value of net assets acquired was therefore £11m, which resulted in £nil goodwill being recognised. The net outflow of cash to acquire these subsidiaries was £8m.

Prestige Motor Care Holdings Limited and its subsidiaries generated a combined revenue of £18m for the year ended 31 January 2020.

Disposals during the period ended 31 July 2020

On 21 May 2020, the Group completed the sale of the entire share capital of AA Underwriting Limited and Automobile Association Underwriting Services Limited for cash consideration of £5m. The combined net book value of net assets disposed of was £6m, which resulted in a £1m loss on disposal being recognised. The net outflow of cash to dispose of these subsidiaries was £1m.

The assets and liabilities disposed of had been presented as held for sale at 31 January 2020.

Disposals during the year ended 31 January 2020

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

Notes to the financial statements (continued)

6 Finance costs

	Six months ended July 2020 £m	Six months ended July 2019 £m
Interest on external borrowings	70	65
Finance charges payable on lease liabilities	1	3
Total ongoing cash finance costs	71	68
Ongoing amortisation of debt issue fees	4	7
Fair value movement on interest rate swaps	1	-
Net finance expense on defined benefit pension schemes	-	3
Total ongoing non-cash finance costs	5	10
Early repayment penalty	6	-
Debt issue fees immediately written off following repayment of borrowings	5	-
Total adjusting cash finance costs	11	-
Unamortised debt issue fees written off following repayment of borrowings	9	-
Total adjusting non-cash finance costs	9	-
Total finance costs	96	78

During the current period, the Group issued £325m of Class A8 notes in exchange for £325m of Class A5 notes (see note 17). As a result, the Group incurred adjusting finance costs associated with this refinancing of £20m, consisting of £6m of exchange premium, £5m of transaction fees and a £9m write-off of unamortised issue fees associated with the Class A5 notes.

Notes to the financial statements (continued)

7 Tax

The major components of the income tax expense are:

	Six months ended July 2020 £m	Six months ended July 2019 £m
Consolidated income statement		
Current income tax		
Current income tax charge	3	6
	3	6
Deferred tax		
Relating to origination and reversal of temporary differences – current year	1	2
	1	2
Tax charge in the income statement	4	8

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

The effective tax rate remains broadly consistent with the prior period. The UK corporation tax rate was expected to reduce from 19% to 17% on 1 April 2020 and therefore deferred tax was recognised at a rate of 17% as at 31 January 2020. The March 2020 budget announced that the reduction in tax rate would be cancelled and the 19% rate retained after 1 April 2020. Retaining the 19% rate has resulted in a restatement of the deferred tax asset to 19% which has been offset by permanent differences in the tax computation relating to company disposals, share-based payments and corporate interest restriction.

Notes to the financial statements (continued)

8 Goodwill and other intangible assets

	Goodwill £m	Customer relationships £m	Software £m	Total £m
Cost				
At 1 February 2019	1,197	-	248	1,445
Additions	10	-	23	33
Disposals	-	-	(7)	(7)
At 31 July 2019	1,207	-	264	1,471
At 1 February 2020	1,197	11	296	1,504
Additions	-	-	27	27
Reclassification	-	-	(2)	(2)
Disposals	-	-	(37)	(37)
At 31 July 2020	1,197	11	284	1,492
Amortisation and impairment				
At 1 February 2019	27	-	92	119
Amortisation	-	-	20	20
Disposals	-	-	(7)	(7)
At 31 July 2019	27	-	105	132
At 1 February 2020	27	1	126	154
Amortisation	-	1	26	27
Disposals	-	-	(37)	(37)
At 31 July 2020	27	2	115	144
Net book value				
At 31 July 2020	1,170	9	169	1,348
At 31 July 2019	1,180	-	159	1,339
At 31 January 2020	1,170	10	170	1,350

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 (see note 5). At 31 July 2019, this had resulted in the initial recognition of £10m of goodwill. At 31 January 2020, this £10m goodwill had subsequently been reallocated to customer relationships, software and deferred tax balances within the permitted measurement period.

Notes to the financial statements (continued)

9 Property, plant and equipment

	Freehold land & buildings £m	Buildings on long leasehold land £m	Vehicles £m	Plant & equipment £m	Total £m
Cost or valuation					
At 1 February 2019	24	12	113	86	235
Adjustment for change in accounting policy	-	-	(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
At 1 February 2020	24	7	4	80	115
Additions	-	-	-	2	2
Reclassification	-	-	-	2	2
Disposals	-	-	-	(9)	(9)
At 31 July 2020	24	7	4	75	110
Depreciation and impairment					
At 1 February 2019	8	4	47	53	112
Adjustment for change in accounting policy	-	-	(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
At 1 February 2020	9	4	4	46	63
Charge for the period	1	-	-	5	6
Disposals	-	-	-	(8)	(8)
At 31 July 2020	10	4	4	43	61
Net book value					
At 31 July 2020	14	3	-	32	49
At 31 July 2019	15	3	-	37	55
At 31 January 2020	15	3	-	34	52

Notes to the financial statements (continued)

10 Right-of-use assets

	Property £m	Vehicles £m	Plant & equipment £m	Total £m
Cost or valuation				
At 1 February 2019	-	-	-	-
Adjustment for change in accounting policy	22	111	8	141
At 1 February 2019 restated	22	111	8	141
Additions	-	16	-	16
Disposals	-	(27)	-	(27)
At 31 July 2019	22	100	8	130
At 1 February 2020	23	73	8	104
Additions	-	4	-	4
Disposals	-	(7)	-	(7)
At 31 July 2020	23	70	8	101
Depreciation and impairment				
At 1 February 2019	-	-	-	-
Adjustment for change in accounting policy	-	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
At 1 February 2020	3	28	8	39
Charge for the period	1	13	-	14
Disposals	-	(7)	-	(7)
At 31 July 2020	4	34	8	46
Net book value				
At 31 July 2020	19	36	-	55
At 31 July 2019	21	58	-	79
At 31 January 2020	20	45	-	65

Notes to the financial statements (continued)

11 Trade and other receivables

	July 2020 £m	July 2019 £m	January 2020 £m
Current			
Trade receivables	151	142	142
Prepayments	22	15	19
Contract assets	16	16	15
Other receivables	8	3	6
	197	176	182

12 Amounts owed by parent undertakings

	July 2020 £m	July 2019 £m	January 2020 £m
Amounts owed by parent undertakings	1,214	1,214	1,214

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

13 Cash and cash equivalents

	July 2020 £m	July 2019 £m	January 2020 £m
Cash at bank and in hand – available	101	63	62
Cash at bank and in hand – restricted	-	8	40
Cash and cash equivalents as presented in consolidated statement of cash flows	101	71	102
Less: presented as assets held for sale	-	-	(8)
Cash and cash equivalents as presented in consolidated statement of financial position	101	71	94

Restricted cash is cash which is subject to contractual or regulatory restrictions. Restricted cash includes £nil (July 2019: £8m, January 2020: £8m) held by and on behalf of the Group's insurance businesses which are subject to contractual or regulatory restrictions. At 31 January 2020, restricted cash also included £32m held in a separate bank account due to a requirement under the terms of the Group's debt documents (July 2019: £nil). The requirement is to deposit a calculated amount of 'excess cash' at the period end when within an 'accumulation period' (the 12 months before which any borrowings become due). This applied to the Class A3 notes which were due on 31 July 2020. On 31 July 2020, the Group completed the refinancing of the £200m outstanding Class A3 notes using the £200m proceeds from drawing down the Senior Term Facility (see note 17). Therefore, as it was no longer required, the excess cash was returned to available cash on 31 July 2020.

Notes to the financial statements (continued)

14 Trade and other payables

	July 2020 £m	July 2019 £m	January 2020 £m
Current			
Trade payables	98	102	98
Other taxes and social security costs	20	11	25
Accruals	58	59	55
Deferred income	200	224	213
Deferred consideration	-	-	1
Other payables	19	20	19
	395	416	411
Non-current			
Deferred consideration	-	10	-

15 Provisions

	July 2020 £m	July 2019 £m	January 2020 £m
Property leases	4	4	3
Other	6	2	8
	10	6	11
Current	4	2	5
Non-current	6	4	6
	10	6	11

The property leases provision relates to dilapidations.

At 31 January 2020, other provisions included £2m (2019: £2m) relating to anticipated compensation costs for poorly handled complaints. During the period to 31 July 2020, an in-depth review was completed and it was determined that this provision was not required, therefore £2m was released from other provisions.

The remaining balance in other provisions of £6m (2019: £nil) relates to a reclassification of self-funded insurance liabilities from accruals to provisions, where the Group provides for the cost of certain claims made against it, for example motor vehicle accident damage and employer liability claims.

During the period, total provisions of £3m were utilised (2019: £nil) and net additional provisions of £2m were made (2019: £nil).

Notes to the financial statements (continued)

15 Provisions (continued)

Litigation – Mr Mackenzie’s claim

As reported previously, 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. The majority of Mr Mackenzie’s claim arises from his exclusion from a share option scheme which, in any event, lapsed for all participants without any payment in June 2019. However, Mr Mackenzie has now issued an amended claim which includes a new claim for personal injury allegedly suffered as a result of stress arising from his role as CEO and Chairman. The Companies have filed a full defence in relation to Mr Mackenzie’s amended claim. After further discussion with external counsel the Companies decided to apply for a strike-out application in relation to the entirety of Mr Mackenzie’s claims against them. This application was filed in May 2020 and the Companies have been given a court date in March 2021 in respect of this. 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.

From time to time the Group is subject to other claims and potential litigation. At the time of these interim financial statements, the Directors do not consider any such claims and litigation to have anything other than a remote risk of resulting in any material liability to the Group.

16 Borrowings and loans

	July 2020 £m	July 2019 £m	January 2020 £m
Current			
Borrowings (see note 17)	-	200	200
Non-current			
Borrowings (see note 17)	2,745	2,530	2,535
	2,745	2,730	2,735

Notes to the financial statements (continued)

17 Borrowings

	Expected maturity date	Interest rate	Principal £m	Issue costs £m	Amortised issue costs £m	Total as at 31 July 2020 £m	Total as at 31 July 2019 £m	Total as at 31 January 2020 £m
Senior Term Facility	31 July 2023	2.72%	200	-	-	200	-	-
Class A2 notes	31 July 2025	6.27%	500	(1)	1	500	500	500
Class A3 notes	31 July 2020	4.25%	-	-	-	-	200	200
Class A5 notes	31 January 2022	2.88%	372	(25)	17	364	675	677
Class A6 notes	31 July 2023	2.75%	250	(4)	2	248	247	248
Class A7 notes	31 July 2024	4.88%	550	(8)	3	545	543	544
Class A8 notes	31 July 2027	5.50%	325	(3)	-	322	-	-
Class B2 notes	31 July 2022	5.50%	570	(16)	12	566	565	566
		4.71%	2,767	(57)	35	2,745	2,730	2,735

The Senior Term Facility is subject to a variable interest rate of LIBOR plus a margin of 1.75% per annum. However, the Group has an interest rate swap in place which exchanges LIBOR for a fixed interest rate of 0.97% thereby fixing the Senior Term Facility's interest rate at 2.72% through to 31 July 2021. Thereafter, the Group has an interest rate cap in place which caps the variable interest rate at 1.00% through to 31 July 2023.

At 31 July 2020 all other borrowings have fixed interest rates. The weighted average interest rate for all borrowings of 4.71% has been calculated using the effective interest rate and carrying values on 31 July 2020.

On 5 February 2020, the Group issued £325m of Class A8 notes at an interest rate of 5.50% in exchange for £325m of Class A5 notes. £3m of new issue premium associated with the issue of the Class A8 notes was capitalised. In line with accounting for a substantial modification of a debt instrument under IFRS 9, costs of £20m associated with the issue of the Class A8 notes and the cancellation of the Class A5 notes were written off, consisting of £6m of exchange premium, £5m of transaction fees and £9m of unamortised issue costs associated with the Class A5 notes.

On 23 April 2020, consistent with the Group's proactive approach to debt management, the Group announced that it had drawn down in full its £200m Senior Term Facility early to de-risk ahead of the planned refinancing of the remaining £200m Class A3 notes which were due on 31 July 2020.

On 31 July 2020, the Group completed the refinancing of the £200m outstanding Class A3 notes using the proceeds from the Senior Term Facility.

In order to show the Group 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 18 and 21).

Notes to the financial statements (continued)

17 Borrowings (continued)

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

Any voluntary repayment of the Class B2 notes would have been made at a fixed premium until 31 July 2020 after which there is no premium to pay on redemption. Any voluntary early repayments of the Class A notes would incur a make-whole payment of all interest due to expected maturity date, except the Class A5, Class A6, Class A7 and Class A8 notes which can be settled without penalty within three months, two months, three months and six months respectively of the expected maturity date.

All of the Group 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 2020 was 2.9x (2019: 2.9x). The Class B2 notes require the Group to maintain the Class B2 free cash flow to debt service ratio in excess of 1.0x. The actual Class B2 free cash flow to debt service ratio as at 31 July 2020 was 2.1x (2019: 2.1x) (see pages 14 and 15).

The Class A notes only permit the release of cash providing the Total Class A Net Debt to EBITDA ratio after payment is less than 5.5x and providing there is sufficient excess cash flow to cover the payment. The actual Total Class A Net Debt to EBITDA at 31 July 2020 was 6.1x (2019: 6.4x). The Class B2 notes restrictions only permit the release of cash providing the Fixed Charge Coverage 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 actual Fixed Charge Coverage ratio at 31 July 2020 was 2.6x (2019: 2.6x).

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.

On 5 February 2020, S&P Global Ratings reaffirmed the credit rating of the Group's Class A notes at BBB- and the Class B2 notes at B+. On 23 April 2020, as part of the Senior Term Facility drawdown process, the Group announced that S&P had again confirmed the credit rating on the Class A notes at BBB-.

In addition to the Senior Term Facility, the Group has a working capital facility available of £60m, of which £56m remains undrawn at the period end.

18 Derivative financial instruments

	July 2020 £m	July 2019 £m	January 2020 £m
Assets			
Forward fuel contracts	-	1	-
Liabilities			
Interest rate swap derivatives	(1)	(1)	-
Forward fuel contracts	(3)	-	(2)
	(4)	-	(2)

Notes to the financial statements (continued)

19 Defined benefit pension scheme liabilities

The Group operates two funded defined benefit pension schemes: the AA UK Pension Scheme (AAUK) and the AA Ireland Pension Scheme (AAI). The assets of the schemes are held separately from those of the Group in independently administered funds. The AAUK scheme has a closed final salary and a Career Average Revalued Earnings (CARE) section which was closed from 1 April 2020 following consultation with affected employees. All future pensions build-up from 1 April 2020 in the UK is now on a defined contribution basis. The CARE section provided for benefits to accrue on an average salary basis. 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 2020 by independent qualified actuaries.

Notes to the financial statements (continued)

19 Defined benefit pension scheme liabilities (continued)

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

	As at 31 July 2020			Total £m
	AAUK £m	AAI £m	AAPMP £m	
Present value of the defined benefit obligation in respect of pension and healthcare plans	(2,717)	(65)	(46)	(2,828)
Fair value of plan assets	2,628	50	-	2,678
Deficit	(89)	(15)	(46)	(150)

	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 January 2020			Total £m
	AAUK £m	AAI £m	AAPMP £m	
Present value of the defined benefit obligation in respect of pension and healthcare plans	(2,576)	(61)	(44)	(2,681)
Fair value of plan assets	2,472	47	-	2,519
Deficit	(104)	(14)	(44)	(162)

The decrease in the deficit during the period is primarily the result of Group contributions paid towards the deficit, as well as strong asset returns offsetting the impact of the decrease in corporate bond yields and corresponding fall in discount rates.

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 £14m increasing annually with inflation, until October 2038 or until the AAUK scheme funding deficit is removed if earlier, secured on the Group's brands.

In February 2020, the actuarial triennial review for the AAUK pension scheme was completed as at 31 March 2019. This resulted in a significant reduction to the technical provisions deficit of 64% from £366m as at 31 March 2016 to £131m. Under the previous 2016 valuation, the recovery plan extended through to 2038 in respect of the Asset-Backed Funding element and to 2026 in respect of the Additional Funding element. A new recovery plan has now been put in place and agreed with the trustee which assumes that the scheme's technical deficit will be fully repaid by July 2025, which is 1 year earlier than previously planned in terms of the Additional Funding element and 13 years earlier in terms of the Asset-Backed Funding element. To do this, the Group has committed to paying an additional (above the Asset-Backed Funding scheme payments) £10m per annum from April 2020 to March 2021, £11m per annum from April 2021 to March 2022 and £12m per annum from April 2022 to July 2025. From 1 February 2020, the trustee has also met its own costs of running the scheme. As a result, annual cash costs for the Group are expected to reduce by around £6m.

Consultation on the closure of the CARE section of the AAUK pension scheme commenced on 18 January 2020 through employee representatives and concluded on 18 March 2020. The Group had proposed that, from 1 April 2020, all future pension accrual would be on a defined contribution basis. Following a review of the feedback received during consultation, the Group has confirmed that the proposals will be implemented on a modified basis and future pension accrual will be on a defined contribution basis for all UK employees with transitional arrangements which will cost c.£11m over three years starting from 1 April 2020.

Notes to the financial statements (continued)

19 Defined benefit pension scheme liabilities (continued)

The agreed transitional arrangements provide a valuable enhanced Group pension contribution over a three year period commencing 1 April 2020 available to all members who make a contribution of at least 4% of pensionable salary per year. Further enhancements to the Group pension contribution are also available during the transitional period to members willing to make higher contributions.

On an ongoing basis, the regular (non-transitional) pension accrual costs for the affected members are expected to be c.£4m per year lower than the previous costs in the AAUK scheme as a result of the closure.

In addition, without scheme closure the Group would have incurred increased pension accrual cash costs in relation to the CARE section of a further c.£5m per annum from 1 April 2020 (under the triennial valuation agreement). Closure also curtails the ongoing build-up of defined benefit risk for the Group.

Following agreement of the 31 March 2019 triennial valuation in February 2020, as well as conclusion of the consultation on closure of the AAUK scheme to future accrual, the Group has a much clearer visibility over pension costs for at least the next three years (where finalisation of the 31 March 2022 triennial valuation would reasonably be expected). The ongoing volatility from accrual costs has been removed but future volatility of deficit costs does remain. The immediate impact of COVID-19 on the global financial markets means higher fluctuation of the funding level in the AAUK scheme, albeit partially mitigated by the de-risked investment strategy and high levels of hedging. Should these conditions persist at the time of the 2022 triennial valuation then there is a risk that the contributions required from the Group could increase.

Using an inflation assumption of 2.9% and a discount rate assumption of 1.3%, 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.

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 £1m in the year ended 31 January 2020 and will continue to make annual deficit reduction contributions, increasing with inflation, until December 2023 or until an alternative agreement is signed with the AAI scheme trustee. The next triennial valuation of the AAI scheme will take place as at 31 December 2019 and is currently ongoing. The results from the review are expected to be received in late 2020.

In total, the Group paid £4m in ongoing employer contributions until the closure of the AAUK scheme CARE section and is currently committed to pay £25m in deficit reduction employer contributions to its defined benefit plans (AAUK and AAI) in the year ending 31 January 2021.

The Group has recently been informed by the trustee of the AAUK scheme of a possible need to review the scheme's approach to "equalising" certain pension benefits earned before 1 April 1992, so that the benefits earned by male and female members are equal. This requirement, stemming from EU law, is common to most UK defined benefit pension schemes. In simple terms, this requires some pre-1992 pensions to be treated as if payable from a more generous age of 60, rather than the AAUK scheme's normal retirement age of 65. Action was taken in 1992 to put in place a mechanism for equalisation of these benefits, but the trustee has raised questions about the effectiveness of the mechanism used.

This is a highly technical matter that relates only to the benefits of members who joined certain sections of the AAUK scheme before 1 November 1987 and remained in service after 17 May 1990. At this early stage of our analysis we consider the scope of potentially impacted benefits to be limited to those accrued in the period 17 May 1990 to 31 March 1992. A detailed legal analysis will be needed to determine whether any additional liabilities need to be recognised by the Group or whether the existing methods used by the AAUK scheme trustee to equalise benefits are in fact valid. Without this detailed analysis, as well as obtaining scheme information dating back to the 1990s, making a reliable estimate of the potential impact is extremely difficult due to the range of possible conclusions (including a scenario where no additional liability is recognised). Given the need for this extensive legal analysis and information collation, a reliable estimate is unavailable at this stage.

Notes to the financial statements (continued)

19 Defined benefit pension scheme liabilities (continued)

Fair value of plan assets

The table below shows 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 was as follows:

	As at 31 July 2020		As at 31 July 2019		As at 31 January 2020	
	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	-	485	46	333	-	244
Bonds/gilts	30	731	788	295	474	571
Property	43	251	87	194	32	255
Hedge funds	1	416	1	353	1	300
Private equity	-	60	16	25	-	44
Cash/net current assets	26	43	20	12	15	9
Annuity policies	-	542	-	319	-	527
Total plan assets	100	2,528	958	1,531	522	1,950

Approximately £32m of unquoted assets allocated to private equity and £8m of unquoted assets allocated to property have been measured at amortised cost rather than fair value.

All assets of the AAUK scheme are held in unquoted pooled investment vehicles which invest in mixtures of quoted and unquoted funds. The above table displays the quoted and unquoted splits of the underlying investments.

Notes to the financial statements (continued)

19 Defined benefit pension scheme liabilities (continued)

Pension plan assumptions

The principal actuarial assumptions were as follows:

%	AAUK and AAPMP			AAI		
	July 2020 %	July 2019 %	January 2020 %	July 2020 %	July 2019 %	January 2020 %
Pensioner discount rate	1.3	2.0	1.6	0.6	0.4	0.3
Non-pensioner discount rate	1.5	2.2	1.8	0.7	1.1	0.8
Pensioner RPI	2.9	3.4	2.9	-	-	-
Non-pensioner RPI	2.8	3.2	2.8	-	-	-
Pensioner CPI	2.0	2.3	2.0	1.0	1.2	1.2
Non-pensioner CPI	2.0	2.1	2.0	1.0	1.2	1.2
Rate of increase of pensions in payment (final salary sections) - pensioner	2.9	3.2	2.8	-	-	-
Rate of increase of pensions in payment (final salary sections) – non-pensioner	2.8	3.1	2.8	-	-	-
Rate of increase of pensions in payment (CARE section) - pensioner	1.7	1.8	1.7	-	-	-
Rate of increase of pensions in payment (CARE section) – non-pensioner	1.7	1.7	1.7	-	-	-
Pension increase for deferred benefits	2.0	2.1	2.0	1.0	1.2	1.2
Medical premium inflation rate	6.9	7.4	6.9	-	-	-

Mortality assumptions are set using standard tables based on scheme-specific experience where available and an allowance for future improvements. For July 2020, the assumptions used were in line with the SAPS (S3) series mortality tables with scheme-specific adjustments (July 2019 – SAPS (S2) series) with future improvements in line with the CMI_2019 model with a 1.25% long-term rate of improvement (July 2019 – CMI_2018 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 25 years (July 2019: 26 years) and an active female retiring in normal health currently aged 60 will live on average for a further 28 years (July 2019: 28 years).

Notes to the financial statements (continued)

19 Defined benefit pension scheme liabilities (continued)

Sensitivity analysis

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

	For the six months ended 31 July 2020		
	AAUK £m	AAI £m	AAPMP £m
Increase of 0.25% in discount rate	134	4	2
Increase of 0.25% in RPI	(119)	(2)	-
Increase of 1% in medical claims inflation	-	-	(8)
Increase of one year of life expectancy	(112)	(2)	-

An equivalent decrease in the assumptions at 31 July 2020 would have had a broadly equal but opposite effect on the amounts shown above, on the basis that all other variables remain constant. The amounts shown above are the effects of changing the assumptions on the gross defined benefit liability, rather than on the net deficit. The de-risked investment strategy and high levels of hedging reduce the sensitivities of changing these assumptions on the net deficit considerably.

20 Related parties

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

Transactions with associates:

Associate	Nature of transaction	Six months ended	Year ended
		July 2020	July 2019
		£m	January 2020 £m
ARC Europe SA	Registration and call handling fees	1	5

At 31 July 2020, the Group had an outstanding balance payable to ARC Europe SA of £1m (2019: £1m) in respect of the above transactions.

Transactions with joint ventures:

Joint venture	Nature of transaction	Six months ended	Year ended
		July 2020	July 2019
		£m	January 2020 £m
AA Media Limited	Services supplied to AA Media Limited	-	1
Drvn Solutions Limited	Goods supplied by Drvn Solutions Limited	1	1

At 31 July 2020, the Group had an outstanding balance receivable from AA Media Limited of £4m comprising fixed rate loan notes (2019: £4m) (see note 22).

Intelematics Europe Limited changed its name to Drvn Solutions Limited on 10 June 2020. At 31 July 2020, the Group had an outstanding balance payable to Drvn Solutions Limited of £nil (2019: £nil) in respect of the above transactions.

Notes to the financial statements (continued)

21 Fair values

Fair values

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

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

The objective of using valuation techniques is to arrive at a fair value that reflects the price of the financial instrument at each year 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 measurements.

The fair values are periodically reviewed by the Group Treasury function. The following tables provide the quantitative fair value hierarchy of the Group's fuel and 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 2020:

	Carrying value £m	Fair value measurement using		
		Quoted prices in active markets (Level 1) £m	Significant observable inputs (Level 2) £m	Significant unobservable inputs (Level 3) £m
Financial liabilities measured at fair value				
Interest rate swap derivatives (note 18)	1	1	-	-
Forward fuel contracts (note 18)	3	3	-	-
Liabilities for which fair values are disclosed				
Loan notes (note 17)	2,545	2,492	-	-

Notes to the financial statements (continued)

21 Fair values (continued)

At 31 July 2019:

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

At 31 January 2020:

	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				
Forward fuel contracts (note 18)	2	2	-	-
Liabilities for which fair values are disclosed				
Loan notes (note 17)	2,735	2,772	-	-

Notes to the financial statements (continued)

22 Financial assets at amortised cost

Financial assets at amortised cost include the following debt investments:

	July 2020 £m	July 2019 £m	January 2020 £m
Non-current			
Loans to related parties	4	4	4
	4	4	4

Loans to related parties comprises £4m of 5% fixed rate loan notes in issue from AA Media Limited to the Group. The Group accounts for its 49% shareholding in AA Media Limited as an investment in a joint venture.

23 Events after the reporting period

Potential offer for AA plc

On 4 August 2020, it was announced that the ultimate parent of the Group, AA plc, was in preliminary discussions with a number of parties in relation to a potential offer for AA plc. Discussions have been progressed with TowerBrook Capital Partners (U.K.) LLP and Warburg Pincus International LLC (together the "Consortium") and the deadline for the Consortium to either announce a firm intention to make an offer or announce that it does not intend to make an offer was extended to 27 October 2020.