

26 September 2018

AA plc interim results for the six months ended 31 July 2018

- Interim results in line with expectations; on-track to deliver FY19 Trading EBITDA of between £335m to £345m, despite extreme weather conditions
- Good operational progress across key strategic initiatives in Roadside and Insurance
- Building resilience through investment in key hires and technology whilst maintaining opex and capex discipline
- Continued strong and stable levels of cash conversion
- Successful refinancing and S&P credit ratings reaffirmed
- Well positioned to return to growth from FY19 base and meet our medium term growth targets

	Six months ended		
	July 18	July 17	Change
GAAP measures			
Revenue (£m)	480	471	2%
Operating profit (£m)	116	178	(35%)
Group profit before tax	28	80	(65%)
Group profit after tax	23	64	(64%)
Basic EPS	3.8	10.5	(64%)
Non-GAAP measures			
Trading EBITDA ¹ (£m)	161	193	(17%)
Trading EBITDA ² margin (%)	33.5	41.0	(18%)
Adjusted basic EPS ³ (p)	6.5	10.2	(36%)
Cash conversion ⁴ (%)	104	101	3%
Interim dividend per share	0.6	3.6	(83%)

Financial and operational headlines

- Financial performance in line with expectations
 - Revenue rose by 2% to £480m reflecting a solid performance across Roadside and Insurance
 - Trading EBITDA down 17% to £161m and operating profit down 35% to £116m reflecting the additional strategic opex and additional costs due to the higher weather induced workload
 - Cash conversion (before capex) remains strong at 104% (H1 18: 101%), with capex in line with guidance, FY19 guidance of £105m (excluding accruals) maintained
 - Extended effective near term debt maturities until January 2022; blended cost of debt reduced slightly to 4.51% (H1 18: 4.52%); S&P credit ratings reaffirmed
 - Pension deficit reduced by £154m improves balance sheet position
 - Interim dividend of 0.6p, full year total expected dividend of 2.0p as previously announced

- Key operational achievements
 - Roadside
 - New business volumes steady with retention down 1%, in line with expectations reflecting regulatory pressures, increased competitor activity and the impact of re-phased marketing spend
 - Membership base down 2% to 3,254,000 (H1 18: 3,325,000) with average income per member up 2%, broadly in line with inflation, to £159
 - Average income per B2B member up 5% reflecting the additional income generated from the pay-for-use B2B contracts due to the higher weather induced workload
 - Extended and renewed all B2B contracts in the period including JLR and Volkswagen; won a three-year contract with Arval, a significant win in the Fleet and Leasing sector
 - Enhanced app functionality driving higher levels of engagement; levels of registration and usage in breakdowns growing steadily
 - Connected car strategy and forward investment plan being optimised
 - Building operational resilience through key management hires and target for recruitment of 65 additional patrols met
 - Insurance
 - Strong performance from broker and in-house underwriter, well positioned to deliver significant growth from FY20
 - 7% growth in motor policies to 659,000, benefiting from increased acquisition marketing spend, incremental sales and renewals through our in-house underwriter as well as systems investments including Insurer Hosted Pricing (IHP)
 - Stabilised the decline in the home policy book, ahead of expectations
 - Average income per motor and home policy flat at £73 (H1 18: £73) despite the weakening rate environment
 - In-house underwriter commenced writing new motor insurance for never-members through a new reinsurance relationship with Munich Re

Simon Breakwell, CEO, said:

“The first half of FY19 has seen exceptional weather conditions, from extreme cold and snow in February and March to the hottest summer in recent memory, with the severe winter also creating a pothole ‘epidemic’ on the UK’s roads. All this led to a 15 year high in the number of breakdowns we serviced. Against this backdrop, I am extremely proud of our achievements and to be reporting results in line with our guidance as we continue to build resilience throughout the business.”

“We are making good operational progress across our Roadside and Insurance businesses and firmly believe that we have the people and strategy in place to unlock the full potential of the AA and crystallise long term value for our shareholders. We remain on-track to meet our Trading EBITDA guidance for FY19 and to return to growth thereafter.”

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Presentation

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

- Dial-in to the presentation: Conference call dial in: +44 20 3936 2999, Access code: 149114
- Replay: UK: +44 20 3936 3001; US: +1 845 709 8569; Access code: 476839
- Link to the webcast <https://www.investis-live.com/aa/5b715eb47fa26e1000759d56/ybgs>

Notes

1. Earnings before net finance costs, tax, depreciation, amortisation, exceptional operating items, share-based payments and pension service charge adjustments.
2. Trading EBITDA divided by trading revenue arising within operating segments.
3. Earnings per share adjusted for a number of one-offs of which the largest are exceptional operating items, share-based payments, pension service charge adjustment, the write off of debt issue fees, pension past service credit, penalties on early repayment of debt and transfer from cash flow hedge reserve.
4. Net cash inflows from continuing operating activities before tax and exceptional items divided by Trading EBITDA.

Performance and business review

Group performance

	Six months ended July 18	Six months ended July 17	Year ended Jan 18
Revenue (£m)	480	471	959
Trading EBITDA ¹ (£m)	161	193	391
Trading EBITDA ² margin (%)	33.5	41.0	40.8
Operating profit	116	178	307
Net cash inflows from continuing operating activities before tax and exceptional items ³ (£m)	168	194	368
Free cash flow ⁴ (£m)	14	(38)	(5)
Adjusted basic earnings per share ⁵ (pence)	6.5	10.2	21.8

Notes

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

Lower profitability in line with guidance

Group Revenue was £480m, up 2% on last year (H1 18: £471m) reflecting a solid performance of both the Roadside and Insurance divisions.

Roadside Revenue (which includes Roadside Assistance and Driving Services) was up 2% at £411m (H1 18: £402m). This was principally due to the additional revenue generated from pay-for-use contracts in our B2B division from the higher workload as well as the benefit of consolidating the results of AA Cars; (AA Cars is the trading name of Used Car Sales Limited which we acquired on 1 March 2018).

Insurance Revenue (which includes the broker and in-house underwriter) was flat from last year at £69m (H1 18: £69m). This was a strong performance considering the lower revenues generated from the Home Emergency Services consumer business, which we sold in January 2018. Excluding the Home Emergency Services business, Insurance Trading Revenue grew 6% from £63m to £67m, reflecting the strong growth of the in-house underwriter. Looking ahead, we expect the investments in our Insurance business to drive a significant growth in revenue and Trading EBITDA.

In line with our expectations, Group Trading EBITDA fell by 17% to £161m (H1 18: £193m). This was largely due to the reduction in the Roadside Trading EBITDA. Roadside Trading EBITDA declined by £27m to £132m reflecting a combination of higher planned strategic opex in our people and systems as well as additional unplanned costs from third party garaging due to the exceptionally higher number of breakdowns attended in the period.

The decrease in Insurance Trading EBITDA from £34m to £29m reflects the impact of the increased acquisition marketing spend by the broker as well as the lower contribution from the Home Emergency Services consumer book.

Overall head office costs increased by £8m to £36m (H1 18: £28m) due to additional IT software costs. These costs have been directly allocated where it is possible to do this, all other costs are allocated on the basis of a pro-rata share of revenue being £31m (H1 18: £24m to Roadside) and £5m (H1 18: £4m) to Insurance.

Trading EBITDA margin reduced from 41.0% to 33.5% reflecting the impact of the additional strategic expenditure in our Roadside and Insurance businesses as well as the impact of higher costs from the additional workload in the period in our Roadside business.

The share-based payment charge reduced by £2m, reflecting the expiration of the second vesting period for the MVP B shares. The pension service charge adjustment decreased by £4m as a result of the changes agreed with the pension trustees.

Operating profit before exceptional items decreased by £27m to £121m, a period-on-period decrease of 18%. This reduction was largely driven by the decline in Roadside Trading EBITDA and the increase in amortisation and depreciation reflecting the recent investments in IT transformation and growth capital expenditure.

The decrease in Insurance operating profit before exceptional items from £29m to £25m reflects the decrease in Insurance Trading EBITDA.

Overall depreciation and amortisation for the Group increased by £1m, reflecting the additional amounts spent on IT transformation and growth capital expenditure.

Overall exceptional items increased to £5m from a credit of £30m in the comparable period last year. The figure last year included the impact from the restructuring of the UK pension scheme which resulted in a one-off past service credit of £34m.

Other exceptional operating items included £5m relating to business transformation and £1m relating to IT systems transformation being partially offset by a £1m profit on disposal of fixed assets.

Total finance costs fell by £10m to £88m, with benefits of £5m from lower interest on external borrowings following the refinancing in July 2017, £2m from lower finance charges payable under finance leases and £13m from the change in the non-cash adjustment to the cash flow hedge reserve compared to the prior period. These were partly offset by the early repayment penalties of £15m (H1 18: £10m) in relation to early repayment of £300m of A3 notes and an increase of £4m in debt issue fees written off as part of the refinancing completed in July 2018. In addition, there was a £4m increase in amortisation of debt issue fees.

The tax charge in the period fell to £5m (H1 18: £16m) principally due to the lower profitability. The tax charge is made up of a current tax charge of £2m (H1 18: £11m) and a deferred tax charge of £3m (H1 18: £5m). The effective tax rate was 19.2% (H1 18: 20.0%). As the Group is almost entirely UK based, we do not expect to be materially affected by the new legislation restricting the deductibility of interest by reference to UK EBITDA.

Profit after tax fell to £23m (H1 18: £64m) and basic earnings per share fell by 6.7p, from 10.5p to 3.8p.

Adjusted underlying profit after tax and adjusted basic and diluted earnings per share fell to £40m (H1 18: £62m) and 6.5p (H1 18: 10.2p) respectively.

Reduced pension deficit improves balance sheet position

Net liabilities reduced by £146m in the period. The largest movement was due to the defined benefit pension deficit which reduced by £154m during the period due to increasing discount rates, falling long-term inflationary expectations, changes in the demographic assumptions (reflecting the latest outlook for mortality rates) and Group contributions paid into the schemes.

On 23 August 2018, the AA UK Pension Scheme purchased a bulk annuity policy from Canada Life which insures all the benefits payable under the scheme in respect of 2,510 pensioner and dependant members. The Scheme sees all financial and demographic risks hedged for the covered members and the annuity provides the scheme with a regular income equal to its pension payments to covered members. The annuity is therefore a very precise liability hedging asset that provides an income stream to match future payments. As we expect the premium paid for the annuity to exceed the defined benefit obligation measured as at 31 January 2019, this difference will be recognised as an increase in the balance sheet deficit as at that date. In future reporting periods, the volatility around the deficit will be reduced due to the matching qualities of this asset. It should be noted that this is separate to the measure of the funding deficit (used to set cash contributions to the Scheme) which we expect will be reduced as a result of this policy. For further details please see Note 20.

Cash conversion remains strong

The AA continues to generate high levels of operating cash of £168m (H1 18: £194m), representing cash conversion (before tax, exceptional items and capex) of 104% (H1 18: 101%).

Total capital expenditure (including finance lease capital payments and net of proceeds from sale of fixed assets) in the period was £45m (H1 18: £35m), in line with our expectations. Of this amount £15m relates to the original IT transformation capital expenditure, £4m relates to growth capital expenditure, £24m relates to maintenance capital expenditure and £2m relates to capital expenditure accruals. We expect total capex spend for FY19 to be £105m (excluding capex accruals), in line with our guidance.

Free cash flow this year will come in slightly below our expectations due to the impact of the refinancing, however, as we move towards the end of the original IT transformation programme in FY20 and a more normalised period of capex spend beyond FY21, we are confident that we can reduce leverage to our target range of 3 to 4 times.

Business performance

Roadside

	Six months ended		Year ended
	July 18	July 17	Jan 18
Revenue (£m)	411	402	814
Trading EBITDA (£m)	132	159	320
Trading EBITDA margin (%)	32.1	39.6	39.3
Operating profit before exceptional items	96	119	243
Paid personal Members ¹ (000s)	3,254	3,325	3,289
Average income per paid personal members ¹ (£)	159	156	157
Business customers ¹ (000s)	9,680	10,016	9,928
Average income per business customer ¹ (£)	21	20	20
Number of breakdowns (000s)	1,907	1,761	3,648
Driving instructors	2,747	2,669	2,742

1. Last 12 months

Revenue grew in the period by 2% to £411m driven largely by the additional pay-for-use B2B revenue as well as the benefit of consolidating the results of AA Cars.

In line with expectations, Trading EBITDA declined by 17% to £132m due to the additional strategic opex investments and associated costs of the increased workload in the period. Head office costs were up at £31m compared to £24m for the prior period. Trading EBITDA margin decreased from 39.6% to 32.1% reflecting the Trading EBITDA decline.

Roadside Assistance

Roadside Assistance Revenue grew by 3% in the period to £380m (H1 18: £370m) despite the anticipated decline in personal memberships and business customers. This was largely due to the additional pay-for-use revenue from B2B as a result of the higher breakdowns and the benefit of consolidating the results of AA Cars.

In line with our expectations, paid personal memberships were down in the period at 3,254,000 (H1 18: 3,325,000), due largely to the reduction in the retention rate to 81%. The retention performance over the last 12 months has been impacted by regulatory pressures (including renewal price transparency), increased competitor activity and the re-phased marketing spend. New business volumes were steady, with sales broadly flat year on year. Looking ahead, the completion and implementation of the new membership IT system (CATHIE) as well as ongoing improvements to the 'Stay AA' customer retention proposition is expected to lead to improved retention rates and a growing paid membership base over the medium term.

We continue to make good progress with the deployment of CATHIE. New customers who purchase either online or through call centres can now do so through the new system. We expect to migrate existing customers in a phased approach commencing later this financial year to allow retention benefits from the new system to be realised in FY20. The phased approach to migration will help to minimise customer and data risk while optimising the retention benefit. The completion of this migration, together with investments in the already deployed Pega Marketing CRM system and breakdown app, will give us important capabilities to drive cost reduction and improve retention performance.

Average income per paid member was up 2% at £159 (H1 18 £156), broadly in line with inflation, and also includes the impact of a significant increase in the sales of ancillary products and services at the roadside due to the cold weather.

Business customer numbers were down 3% year-on-year at 9,680,000 (H1 18: 10,016,000). This was anticipated due to the continuing decline in Added Value Accounts across the banking sector and also the reduction in new car registrations across the automotive sector, in particular diesel car sales. Despite these challenges, we have done well to extend and renew all of our contracts in the period. Since the year end, the AA has extended and renewed its contracts with Jaguar Land Rover (JLR), Volkswagen and Suzuki. In addition, the AA won a three-year contract with Arval following a competitive tendering process, a significant win for the AA in the Fleet and Leasing sector. The higher workload in the period resulted in additional revenue being recognised under our pay-for-use B2B contracts. This alongside the new contract wins as well as the decline in the overall business customer base led to a 5% increase in the average income per customer to £21 (H1 18: £20). By continuing to invest in improving our range of products and services including app penetration across our B2B base, we are confident that we can leverage our market leading position and generate additional revenue streams.

Total breakdowns increased in the period by 8% to 1.91m. This was significantly higher than both our expectations and the average over the last 15 years due to the extreme weather conditions. This resulted in increased costs of third-party garaging to supplement our own patrol availability which was partially offset by the additional revenue from our pay-for-use B2B contracts as noted above. To counter this, we have invested in our front line and were pleased to have achieved our target of recruiting an additional 65 new patrols in FY19, who have been allocated to high service areas. We have also exceeded our target of recruiting in excess of 200 planned contact agent staff. In addition, we are also developing strategies to enable us to monetise more referrals and better manage our workload through the App. In the longer term, increased utilisation of the breakdown services drives brand awareness and retention.

More than 1 million members are now registered for the App and it is used in 34% (H1 18: 28%) of the breakdowns that we service. During the second half of this financial year, we will be integrating additional functionality into the app including migrating our Car Genie app into the AA breakdown app thereby allowing our members to benefit fully from an integrated app platform that will drive higher levels of customer engagement.

We are also making good progress with testing the market for connected car breakdown solutions initially through the roll-out of our award winning product, Car Genie. As at the end of August, approximately 15,500 units were distributed to and activated by our personal member base and it continues to perform in line with our experience since launch, in predicting up to one third of breakdowns before they occur. During the second half of the year, we will continue to develop our connected car strategy working closely with our OEM partners.

Trading EBITDA (before allocation of Head Office costs) fell by 10% to £156m (H1 18: £174m). This was largely due to the additional strategic opex investments including recruitment of additional patrols and call-centre staff as well as increased third-party garaging costs resulting from the significantly higher workload in the period.

Driving Services

Revenue declined by 3% in the period to £31m. The 3% rise in driving instructor franchises to 2,747 (H1 18: 2,669) reflects the improvements to our franchise proposition and the strength of the AA and BSM brands. This partially offset the decline in the number of speed awareness courses for the police and delayed implementation of new contract wins for our corporate partners.

Trading EBITDA (before allocation of Head Office costs) fell to £7m (H1 18: £9m) largely reflecting the impact of the decline in the number of speed awareness courses as well as the delayed earnings benefit of new contract wins from our corporate partners.

Insurance

	Six months ended		Year ended
	July 18	July 17	Jan 18
Revenue (£m)	69	69	145
Trading EBITDA	29	34	71
Trading EBITDA margin (%)	42.0	49.3	49.0
Operating profit before exceptional items	25	29	61
Total motor and home policy numbers in force ¹ (000s)	1,475	1,460	1,447
Average income per policy ² (£)	73	73	74
Total Motor policies (000s)	659	616	629
Total Motor underwritten (000s)	258	200	223
Total Home policies (000s)	816	844	818
Total Home underwritten (000s)	205	121	184
Financial Services products ³ (000s)	136	131	142

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

2 Motor and Home only.

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

Insurance Revenue (which includes the broker and in-house underwriter) was flat in the period at £69m (H1 18: £69m). The strong growth in revenue from the in-house underwriter helped to offset the lower revenues from the Home Emergency Services consumer business, which we sold in January 2018. Excluding the Home Emergency Services consumer business, the Insurance segment generated revenues of £67m in the period, compared to £63m in the comparable period last year.

In line with our expectations, Trading EBITDA fell 15% to £29m as a result of higher acquisition marketing spend needed to position the business for long-term growth. Trading EBITDA margin declined from 49.3% to 42.0%, as a result of the increase in the lower-margin underwriter revenue and the impact of the additional acquisition marketing spend by the broker.

Insurance Services (including Insurance broking and Financial Services)

Revenue fell 8% in the period to £61m (H1 18: £66m), in line with our expectations. We achieved 7% growth in motor policies to 659,000, benefiting from increased acquisition marketing spend, incremental sales and renewals through our in-house underwriter as well as systems investments including Insurer Hosted Pricing (IHP). IHP has now been installed with five of our motor panel members. This has enabled us to price more competitively and convert a greater proportion of quotes on Price Comparison Websites (PCWs).

In relation to the home policy book, we are pleased to report that we are making good progress in stabilising the overall decline. Since the year-end, the home policy book has been broadly flat at 816,000 (FY18: 818,000, H1 18: 844,000). This was a strong performance as we have yet to make the investment in IHP to improve our pricing agility. Looking beyond FY19, we are confident that the additional investments in our systems as well as the commencement of the roll-out of IHP can return the home policy book to growth.

Average income per motor and home policy was flat in the period at £73 (H1 18: £73), a good result in a weakening rate environment.

At the end of July 2018, we had 136,000 Financial Services products across our credit cards, personal loans and savings portfolio. This represents a balance sheet size of approximately £522m, broadly-matched by deposits and both of which are held on the balance sheet of Bank of Ireland. Our partnership with Bank of Ireland is working well with the inherent strength of the AA brand and our marketing expertise continuing to support the business. The AA membership base and brand are benefiting the business with 17% of the non-ISA savings books held by members and 39% of our personal loans being written for vehicles. In addition, through our AA Cars platform, we are well positioned to expand our loan offering into the growing used car market.

Trading EBITDA (before allocation of Head Office costs) for Insurance Services fell 13% to £33m (H1 18: £38m) as a result of the increased acquisition marketing spend by the broker and falling contribution from the sale of the Home Emergency Services consumer book.

Insurance underwriting

Revenue for our underwriting business grew strongly to £8m compared to £3m in the prior period. Gross earned premiums were £12m (H1 18: £19m). Deferral of broker commissions amounted to a reduction in revenue of £nil (H1 18: £2m). Trading Revenue is reported after accounting for the broker deferral adjustment, where the broker commission is recognised over the life of the policy along with the underwriter premium for policies underwritten by our in-house underwriter.

In line with our strategy to drive growth of the insurer using our proprietary data to deliver more competitive premiums, we grew the motor book from 200,000 to 258,000 and the home book from 121,000 to 205,000 between 31 July 2017 and 31 July 2018. A significant element of our growth will come from a new motor insurance scheme for non-members which we commenced in May 2018 through a new reinsurance relationship with Munich Re. Alongside increased penetration within the existing base, we remain on-track to deliver strong growth for the insurer.

Our Combined Operating Ratio (COR) was ahead of our long-term target of 95%. We have also achieved strong rates of retention across our motor and home policies book. Net claims paid during the period were £4m (H1 18: £2m).

Trading EBITDA was up at £1m (H1 18: £nil) as the growth in Trading Revenue and the benefit of the deferral of the acquisition costs more than offset the increased direct costs associated with growing the motor and home book.

From 20 April 2017 the existing motor portfolio (excluding the new non-members proposition) moved from a 80% quota share reinsurance arrangement to a 80% coinsurance arrangement. Under a coinsurance agreement, only the net 20% of premium is reported in the accounts compared to the reinsurance agreement where premiums are presented gross. This results in gross earned premiums reducing even though the policy book is growing. The new motor portfolio for non-members which commenced in May 2018 has been agreed under a quota share reinsurance contract and therefore gross earned premiums will increase significantly, offsetting the above reduction. Home insurance continues to be covered through quota share reinsurance contracts.

The in house underwriter business remains well capitalised under the Solvency II capital requirements which came into effect on 1 January 2016. As at 31 July 2018, the solvency coverage headroom was approximately £5m and can be funded from the profits of the underwriter and AA plc available cash.

Refinancing

In July 2018 we successfully completed a further refinancing package which resulted in the extension of our effective near-term debt maturity until January 2022.

AA Bond Co Limited, a subsidiary of AA plc, issued £550m of new Sub-Class A7 Fixed Rate Notes with an expected maturity of 31 July 2024 and a final maturity of 31 July 2043, with a coupon of 4.875% payable semi-annually in arrears.

The proceeds from the issuance of the Class A7 Notes were used to repay in full the Group's previous £250m Senior Term Facility due 2021. The remaining £300m of the proceeds of the Class A7 Notes were used to redeem £300m of the outstanding £500m aggregate principal of Class A3 Notes.

The AA also entered into a £200m forward starting senior term facility due in July 2023 in order to secure committed funding to be able to redeem the £200m of Class A3 Notes left outstanding at their effective maturity on 31 July 2020. This forward starting facility replaces the Group's previous £250m Senior Term Facility.

A new working capital facility of £60m (together with a £15m accordion facility), has also been put in place to replace the previous £75m working capital facility, with a maturity to 31 July 2023 and with the same margin as the previous facility.

These refinancings are in line with the AA's disciplined and pro-active approach to managing its capital structure and reduce any refinancing risk in the near-term. The extension in maturity of debt will mean that the next repayment of borrowings (other than that to be funded by the committed forward starting senior facility) is not due until January 2022, providing significant runway for the business to focus on the recently-announced strategic plan.

Financial key performance indicators

The following tables and narrative provide further analysis of the financial key performance indicators which are described in the financial highlights on page 1, the performance and business reviews on pages 4 to 10, the debt covenant calculations on page 17 and the figures shown in notes 2, 3 and 6 to these condensed, consolidated financial statements.

Adjusted performance measures

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

Reconciliation of Trading EBITDA to Operating Profit

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

	Note	Six months ended July 2018 £m	Six months ended July 2017 £m
Trading EBITDA	2	161	193
Pension service charge adjustment		(3)	(7)
Share based payments		(3)	(5)
Amortisation and depreciation	7,8	(34)	(33)
Exceptional operating items	3	(5)	30
Operating Profit		116	178

Adjusted earnings per share

Adjusted earnings per share adjusts profit after tax for certain operating costs, one-off financing costs and tax charges, see note 6 for the calculation.

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

Board changes

During the period, we announced the appointment of three Non-Executive Directors (NEDs) as well as the departure of Andrew Miller who stepped down as a NED at the AGM on 7 June 2018. The new appointments help to broaden and deepen the skills and expertise of the Board.

The roles now held by the Board are as follows:

- John Leach is Chairman. John joined the AA in June 2014 as a Non-Executive Director and was appointed as Senior Independent Director on 13 November 2014, and Chairman on 1 August 2017. John is a member of the Nomination Committee.
- Simon Breakwell joined the AA in September 2014 as a Non-Executive Director. Simon was appointed Interim Chief Executive Officer on 1 August 2017 and then Chief Executive Officer on 25 September 2017.
- Martin Clarke is Chief Financial Officer having joined in June 2014 as an executive director.
- Andrew Blowers was appointed Senior Independent Director, replacing John Leach in that role on 1 August 2017. Andrew joined the AA in September 2014 as a Non-Executive Director and is Chair of the Nomination Committee and a member of the Remuneration Committee.
- Suzi Williams joined the AA in October 2015 as a Non-Executive Director. She is Chair of the Remuneration Committee and is also a member of the Nomination and Risk Committees.
- Cathryn Riley joined the AA plc board in February 2018 as a Non-Executive Director. Cathryn joined on 1 January 2015 as a Non-Executive Director of Automobile Association Insurance Services Limited (AAISL) and was its Chair from 1 April 2016 until joining the AA plc board. She is Chair of the Risk Committee and a member of the Audit Committee.
- Steve Barber joined the AA in June 2018 as a Non-Executive Director. He is Chair of the Audit Committee and a member of the Remuneration and Risk Committees.
- Mark Brooker joined the AA in July 2018 as a Non-Executive Director. He is a member of the Audit and Risk Committees.

Strategic update

On 21 February 2018, we announced our new strategy to invigorate the AA by putting service, innovation and data at its heart. The key focus of our strategy is to develop a digital product proposition which can transform our members' experience. This will enable us to innovate and grow our Roadside business and accelerate growth in our Insurance business.

The strategic plan will be delivered in three phases as we test and iterate new digital propositions and open up our insurance offering. It will be underpinned by improving our operations, service and culture. By phase three, we will fully utilise our data and digital offering to deliver connected, integrated Roadside and Insurance propositions that will generate additional sources of revenue per member and a distinct competitive advantage compared to our peers.

Roadside initiatives – Innovate and grow

Our Roadside initiatives cover five core areas: (1) Ongoing innovation to differentiate our products and services; (2) Growing our base with younger customers; (3) Digital adoption and innovation to drive broader member engagement; (4) Membership systems to drive retention; and (5) Transform our breakdown service to be fully connected. We will measure our success against these objectives through the following measures:

- Return to membership growth in FY21
- 50% of all members to be registered on the App by FY21
- 20% reduction in breakdowns reported through contact centres

Ongoing innovation to differentiate our products and services

We are continuously looking at ways of innovating and differentiating our range of products and services for our B2B partners and personal members. During the period we successfully retained our roadside contract with JLR for another 3 years and launched a new market leading onward mobility solution with them. We are confident that this, alongside other mobility solutions we are working on with our B2B partners, can generate additional sources of revenue in the near-to-medium term.

Growing our base with younger segments

In addition to our traditional 50-year plus core demographic, we are looking to diversify our customer base to younger segments who, whilst heavily car reliant, are less aware of the importance and value of good quality breakdown cover. We will use very different lead messages and strategies for reaching these consumers, appealing to their need for ease and simplicity in keeping their day on track. The key is not only to have a healthy, high value and diversified pipeline of customers but also to ensure we deliver propositions and services that meet their needs throughout their driving lives. This will have the dual benefit of increasing the paid membership base and retention levels on a sustainable basis.

Digital adoption and innovation to drive broader member engagement

Our breakdown app, "the App", continues to perform strongly and over one third of our members have now registered for it. The App simplifies the breakdown experience and longer term will enable us to lower the cost of attending a breakdown. The App is now used in 34% (H1 18: 28%) of the breakdowns that we service. We will continue to build on this and appeal to new customer segments and engage them in our app as a portal to a wider set of services and member benefits, while reducing call centre costs. During the second half of this financial year, we will add new functionality including integrating elements of our Car Genie app into the AA breakdown app thereby allowing our members to benefit fully from an integrated journey at the point of breakdown that we believe will drive higher levels of member engagement.

Membership systems investment to drive retention

We are making good progress with the deployment of CATHIE. New customers who purchase either online or through call centres can now do so through the new system. We expect to migrate existing customers in a phased approach commencing later this financial year to allow retention benefits from the new system to be realised in FY20. The phased approach to migration will help to minimise customer and data risk while optimising the retention benefit. The completion of this migration, together with investments in the already deployed Pega Marketing CRM system and breakdown App, will give us important capabilities to drive cost reduction and improve retention performance.

'Stay AA', our reactive customer retention proposition continues to be effective, with the retention rate currently at 72%, up from 57% at launch in 2014, and a discount rate at an all-time low of 20%, down from 35% at launch.

Transform our breakdown service to be fully connected

As cars become more technologically advanced, we need to develop our digital and technical capabilities to enable us to position ourselves at the forefront of connected breakdown recovery for personal members and business customers. This should not only help us deliver a premium level of service to our members but will also help us to lower our costs through better resourcing of our operational base.

We are testing the market for connected car breakdown solutions initially through the roll-out of our award winning product, Car Genie. As at end August, approximately 15,500 units were distributed to and activated by our personal member base. During the second half of the year, we will continue with the roll-out plan, allowing a larger-scale test of its impact on membership retention, operational benefits and distribution models. We will also integrate elements of our Car Genie app into the AA breakdown app this year allowing our members to benefit from an integrated journey at the point of breakdown. From FY20 we plan to extend the rollout to include B2B partners and connected insurance propositions, and to drive mass adoption. We believe we can reach scale with B2B partners from FY21.

Insurance initiatives – Accelerate growth in Insurance

Our Insurance business performed strongly in the period supported by ongoing investments in the broker and our in-house underwriter. During the period, the motor book grew 7% and we are pleased to report that we have managed to stabilise the decline in the home book. While additional growth is expected to result in a short-term negative impact on EBITDA, it will help deliver long-term growth. We are targeting c2m motor and home policies by FY23 and growth in profitability.

Driving more competitive premiums

Our proprietary data is our competitive advantage and gives us the confidence that our planned programme of opex and capex investments (including IHP) will help deliver risk adjusted growth for the underwriter and broker. Total motor policies grew in the period by 7% to 659,000. Total home policies were flat at 816,000.

Broaden footprint to include non-members and younger customers

During the period, we commenced underwriting motor insurance to non-members or never members through a new reinsurance relationship with Munich Re, utilising proprietary data from our existing member base. We are pleased with the results to date and are confident that this will be a significant driver of new policy growth. We are also developing strategies to increase the penetration of our existing member base and the possibility of insuring younger drivers through a connected car membership solution.

New insurance innovation

We expect to benefit from using the data collected from Car Genie, and other connected car products, prior to pricing and insuring customers, allowing for compelling telematics economics.

The integration of our digital and connected car strategy across our Roadside and Insurance businesses will enable a leading member offering through its simplicity and as a straight forward solution for motoring needs.

We believe connected car offerings will unlock new propositions for younger, more digitally-focused drivers. The Driving School also gives us strong positioning with younger driver segments, reaching c100,000 customers per year.

Restore operational and service excellence

We experienced an unusually high workload during the first half of the year due to the extreme weather conditions. Total breakdowns during the period were 1.91m an increase of 8% compared to the same period last year. This was significantly higher than both our expectations and the average over the last 15 years. The additional demand for our services resulted in increased reliance on third party garaging to supplement our own patrol availability. This is both costlier to service from a breakdown perspective and generally leads to a lower level of service for our members.

To counter this, we have invested in our front line and were pleased to have achieved our target of recruiting an additional 65 new patrols in FY19, who have been allocated to high service areas. We have also exceeded our target of recruiting in excess of 200 planned contact agent staff. In addition, we are also developing strategies to enable us to monetise more referrals and better manage our workload through the App. In the longer term, increased utilisation of the breakdown services drives brand awareness and retention.

As part of our programme to improve the resilience of our business we have made a number of key hires in the period and implemented a number of operational initiatives while maintaining strict cost discipline. We have reorganised and simplified our management structure and reporting lines across our operational base to promote greater transparency and collaboration. We have also recently appointed James Frost as Chief Innovation Officer who will join in October and lead product innovation working closely with Gareth Kirkwood, Managing Director Roadside and Janet Connor, CEO AAISL and Director Insurance.

We are also implementing a number of improvements to our business and planning process to drive greater focus on value creation and cost structure.

Over the longer term, we expect to achieve the following targets for our Roadside operations:

- Absorb inflation in FY20 and FY21
- Improve consistency of call-to-arrive times to 45 minutes
- Increase consistency in call handling, answering 80% of calls in 20 seconds
- Achieve 10% growth in ancillary sales

Create a high performance culture

Driving a high performance culture is critical to realising our strategy because our people are a key enabler of our business. The results from the last employee engagement survey highlighted that we need to work harder as a leadership team to communicate better with all our employees and do more to promote development, recognition and collaboration across the organisation. This will take time to achieve but to highlight the importance of this for our business, we will be running the employee engagement survey annually and we will share the results with all of our employees and involve them in the action planning process.

Outlook

Despite the impact of the extreme weather during the first half, we remain on-track to deliver Trading EBITDA of between £335m and £345m.

We remain highly confident that our strategy will help to build a better, more resilient AA and give us the platform to achieve sustainable long-term growth across our Roadside and Insurance businesses.

Dividend

The Board has declared that the interim dividend will be 0.6 pence per share, in line with the guidance provided in February. It will be paid on 9 November 2018 to shareholders on the register on 5 October 2018 with the ex-dividend date set for 4 October 2018.

Cash flow, net debt and liquidity

Net debt and covenants

	As at 31 July 2018 £m	As at 31 July 2017 £m	As at 31 January 2018 £m
Senior Term Facility	-	250	250
Class A notes	2,200	1,950	1,950
Less: AA Intermediate Co Limited group cash and cash equivalents	(55)	(80)	(50)
Net Senior Secured Debt ¹	2,145	2,120	2,150
Class B2 notes	570	570	570
Finance lease obligations	53	56	64
Net WBS Debt ²	2,768	2,746	2,784
Less: AA plc group cash and cash equivalents ³	(100)	(58)	(100)
Net debt at period end	2,668	2,688	2,684
AA plc Trading EBITDA for the last 12 months	359	404	391
AA Intermediate Trading EBITDA for the last 12 months ⁴	360	406	393
Covenant			
Net debt ratio ⁵	7.4x	6.7x	6.9x
Class B2 Leverage ratio ⁶	7.7x	6.8x	7.1x
Senior leverage ratio ⁷	6.0x	5.2x	5.47x
Class A Free Cash Flow: Debt Service ⁸	>1.35x	3.3x	3.1x
Class B Free Cash Flow: Debt Service ⁹	>1.00x	2.4x	2.2x

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

2 WBS debt represents the borrowings and cash balances within the WBS structure headed by AA Intermediate Co Limited. This includes the principal amounts of the Senior Term Facility, Class A notes, Class B2 notes and finance leases less AA Intermediate Co Limited group cash and cash equivalents

3 Total cash and cash equivalents for the Group excluding the value reported as the AA Intermediate Co Limited group cash and cash equivalents

4 AA Intermediate Co Limited group trading EBITDA including discontinued operations as required by the debt documents

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

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

7 Ratio of Net Senior Secured Debt¹ to AA Intermediate Co Limited group Trading EBITDA for the last 12 months

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

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

Cash generation for the Group has remained strong with net cash inflows from operating activities before exceptional items and tax of £168m (H1 18: £194m) and cash conversion before capital expenditure of 104% (H1 18: 101%) in the six months ended 31 July 2018. Net debt to Trading EBITDA for the last 12 months increased to 7.4 times and net senior secured debt to Trading EBITDA stood at 6.0 times as at 31 July 2018.

Cash flow, net debt and liquidity (continued)

Class A free cash flow to debt service was 3.3 times as at 31 July 2018 and Class B free cash flow to debt service was 2.4 times, showing substantial headroom over the covenants which are set out below.

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

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

The Group has a cash balance of £112m, invested in AAA money market funds, giving overnight access and high liquidity. The Group drew £15m of its Working Capital Facility on 30 July 2018 and repaid it on 29 August 2018. The Group does not currently envisage needing to drawn on this facility again in the foreseeable future.

The Group holds segregated funds as 'restricted cash' in order to satisfy regulatory requirements governing our insurance regulated business. These restricted cash balances were £41m at 31 July 2018 (H1 18: £25m).

Principal risks and uncertainties

The Company's Principal Risks were detailed in the Annual Report 2018. The Board has reviewed these principal risks for material developments since the publication of the Annual Report 2018 and updates against each principal risk, including any significant changes that may impact the second half performance, are detailed in italics below:

1. Outstanding service

We are unable to maintain an outstanding service: the AA's brand and its continued success, and in particular the loyalty of our 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 the objective at increasing risk.

While our repair rate, single-task-completion and under-bonnet times are only slightly down on previous years, our resource has coped with the strain of the significant weather events both in winter and summer, with continued use of third party garages to support workload. Despite an 8% increase against forecast service levels, our customer service has only seen minor disruption and profitability has remained on target, albeit with an increase in complaint levels. We continue to increase the flexibility of the patrol force, improve our planning and delay related forecasting due to unexpected weather related demand to mitigate the costs of third party garage use in the future and be better placed to respond to extreme weather events.

2. Roadside market share and margin

We are unable to maintain our market share and an ability to command a price premium on our roadside services: competitors that provide roadside services at a lower price or have a different business model, together with changes in car technology, threaten our roadside market share. If we charge a price premium that is above what 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.

Personal paid Membership numbers have remained relatively stable.

3. Insurance Broking business

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

This remains on track to deliver forecast growth in customer numbers.

4. Insurance Underwriting

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

This remains on track to deliver growth with sustainable and profitable return on capital.

5. Business transformation

We are unable to successfully complete essential business transformation: we must continue to transform the AA to achieve the required efficient customer centric services and to develop the business. There is still much to do and the required improvements to process, embedded ways of working and culture, inherently involves risks in a customer facing service environment.

Significant investment in transformation resource and capability is driving structured, budgeted change across multiple areas of the business. There has been a focus on strengthening our call centres, improving our analytical skill base and achieving a more flexible patrol force.

6. IT transformation

We are unable to successfully deliver the essential IT transformation: an essential programme of renewal and enhancement of our IT estates is in progress to address the risks to our brand and our competitive capability. The IT transformation is extensive and involves a continuing complex programme of work. Given the scale and complexity, the programme involves inherent risks to the timely delivery of this implementation.

The business continues to review the timelines and priorities for the transformation of our systems as part of the review of declared strategy and its execution.

7. Safety

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

Incidents of safety issues for workforce and members remains very low.

8. Growing the business

We are unable to grow the business in a manner that complements and sustains the brand: we may be unable to develop and grow new profitable business products and lines that complement the customer experience and which demonstrate standards and values that underlie our core brand.

This remains on track for FY 19 against strategy.

9. Our people

Ineffective human resources to achieve the AA objectives: failure to recruit, train, develop and retain employees who have the skills and experience required by the business. Employee costs excessive. Staff of insufficient calibre.

Significant investment in contact centre personnel, patrols and subject matter experts will see improvement in providing outstanding service in the next half year. Work on reward and career opportunities is expected to reduce attrition in contact centres.

10. Debt Leverage and Pensions

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

Pension: We are unable to meet our pension liabilities: the Company has a large defined benefit pension scheme, currently in deficit, whose assets and obligations are subject to future variation from investment returns, longevity and other similar factors.

- *Debt refinancing - The A3 notes were partially repaid and replaced with new debt at no significant cost to leverage, but providing certainty to 2022 which in turn will enable delivery of the strategy declared in February without the distraction of re-financing in the near term.*
- *Pension liabilities – these have reduced in the period, hence reducing the risk.*

11. Information security/Cyber crime/Data breach

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

Improvement in patching, data access and third party supplier management will further reduce this risk by year end but the risk remains high.

12. Regulatory and legal environment

A changing regulatory environment may adversely affect our activities. Material litigation against the AA: the changing regulatory environment could cause currently compliant services to become non-compliant, with material implications to customer offerings, pricing and profitability. Failure to comply with regulatory obligations could result in fines and reputational damage. Changes in Government legislation or taxation could impact the business model.

- *Regulatory changes that impact on this risk include confirmation of the successful implementation of the FCA's Insurance Distribution Directive and preparing for the Senior Managers and Certification Regime in 2018.*
- *Although renewal processes to comply with the new requirements on price transparency were implemented, a small number of one-off breaches in certain Insurance and Road populations were identified and declared to the FCA, with remediation activity agreed where necessary.*
- *GDPR (General Data Protection Regulation) – the new GDPR requirements came into force in May 2018. Work is being carried out to deliver sustained compliance.*
- *There remains a potential financial and reputational risk pending finalisation of litigation with the former CEO, Bob Mackenzie.*

13. Brexit

Negative impact on the AA as a result of Brexit: at this stage of Brexit negotiations, it is difficult to fully identify and assess potential risks but the following have been highlighted as of potential concern for the AA:

- *Passporting for insurers and other regulatory change*
- *Impact on EU nationals in the UK and potential skills shortages*
- *Increasing future costs of supplies and services received by the AA*
- *UK recession as a result of Brexit reducing the demand for AA products and services*

There has been minimal impact to date with a small loss of revenue on International Driving Permits as the government moves this to the Post Office, cutting out AA involvement.

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

Consolidated income statement

	Note	Six months ended July 2018 £m	Six months ended July 2017 £m
Revenue	2	480	471
Cost of sales		(197)	(173)
Gross profit		283	298
Pension past service credit		-	34
Administrative & marketing expenses		(167)	(154)
Operating profit		116	178
Finance costs	4	(88)	(98)
Profit before tax		28	80
Tax expense	5	(5)	(16)
Profit for the period		23	64

Earnings per share from the profit for the period:

	Note	Six months ended July 2018 pence	Six months ended July 2017 pence
Basic from total operations	6	3.8	10.5
Diluted from total operations	6	3.8	10.5

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

Consolidated statement of comprehensive income

	Note	Six months ended July 2018 £m	Six months ended July 2017 £m
Profit for the period		23	64
Other comprehensive income on items that are or may be reclassified to profit and loss in subsequent years			
Exchange differences on translation of foreign operations		-	(1)
Effective value of cash flow hedge movement		(5)	8
Deferred Tax effect		1	(1)
		(4)	6
Other comprehensive income on items that are not to be reclassified to profit and loss in subsequent years			
Remeasurement differences on defined benefit schemes	15	147	2
Deferred tax effect		(25)	-
		122	2
Total other comprehensive income		118	8
Total comprehensive income for the period		141	72

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

Consolidated statement of financial position

	Note	July 2018 £m	July 2017 £m	January 2018 £m
Non-current assets				
Goodwill and other intangible assets	7	1,316	1,291	1,300
Property, plant and equipment	8	110	113	127
Investments in joint ventures and associates		5	10	8
Other receivables	9	-	-	3
Derivative financial instruments	15	2	-	-
Deferred tax assets		2	56	31
		1,435	1,470	1,469
Current assets				
Inventories		7	7	7
Trade and other receivables	9	213	200	201
Cash and cash equivalents	10	155	138	150
		375	345	358
Total assets		1,810	1,815	1,827
Current liabilities				
Trade and other payables	11	(504)	(477)	(480)
Finance lease obligations		(39)	(39)	(48)
Current tax payable		(2)	(12)	(10)
Borrowings and loans	13	(15)	-	-
Provisions	12	(1)	(10)	(13)
		(561)	(538)	(551)
Non-current liabilities				
Borrowings and loans	13	(2,718)	(2,722)	(2,727)
Derivative financial instruments	15	-	(17)	(9)
Finance lease obligations		(14)	(17)	(16)
Defined benefit pension scheme liabilities	16	(86)	(364)	(240)
Provisions		(5)	(9)	(4)
Deferred consideration		(11)	-	(11)
Insurance technical provisions		(24)	(19)	(24)
		(2,858)	(3,148)	(3,031)
Total liabilities		(3,419)	(3,686)	(3,582)
Net liabilities		(1,609)	(1,871)	(1,755)
Equity				
Share Capital		1	1	1
Share premium	17	407	404	406
Own shares		(30)	(27)	(29)
Cash flow hedge reserve		1	9	5
Retained earnings		(1,988)	(2,258)	(2,138)
Total equity attributable to equity holders of the parent		(1,609)	(1,871)	(1,755)

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

Consolidated statement of changes in equity

Attributable to the equity holders of the parent

	Share capital £m	Share premium £m	Own shares £m	Currency translation reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total £m
At 1 February 2017	1	403	(26)	1	2	(2,294)	(1,913)
Profit for the period	-	-	-	-	-	64	64
Other comprehensive income	-	-	-	(1)	7	2	8
Total comprehensive income	-	-	-	(1)	7	66	72
Dividends	-	-	-	-	-	(35)	(35)
Issue of share capital	-	1	-	-	-	-	1
Purchase of own shares	-	-	(1)	-	-	-	(1)
Share-based payments	-	-	-	-	-	5	5
At 31 July 2017	1	404	0	-	9	(2,258)	(1,871)
At 1 February 2018	1	406	(29)	-	5	(2,138)	(1,755)
Profit for the period	-	-	-	-	-	23	23
Other comprehensive income	-	-	-	-	(4)	122	118
Total comprehensive income	-	-	-	-	(4)	145	141
Dividends	-	-	-	-	-	(9)	(9)
Issue of share capital	-	1	-	-	-	-	1
Purchase of own shares	-	-	(1)	-	-	-	(1)
IFRS 9 conversion	-	-	-	-	-	13	13
IFRS 9 deferred tax impact	-	-	-	-	-	(2)	(2)
Share-based payments	-	-	-	-	-	3	3
At 31 July 2018	1	407	(30)	-	1	(1,988)	(1,609)

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

Consolidated statement of cash flows

	Note	Six months ended July 2018 £m	Six months ended July 2017 £m
Profit before tax		28	80
Amortisation and depreciation		34	33
Net finance costs		88	98
Other adjustments to profit before tax		2	5
<u>Working capital:</u>			
Increase in trade receivables		(7)	(5)
Increase in trade and other payables		35	9
Decrease in provisions		(11)	(8)
Difference between pension charge and cash contributions		(19)	(34)
Total working capital adjustments		(2)	(38)
Net cash flows from operating activities before tax		150	178
Tax paid		(10)	(11)
Net cash flows from operating activities		140	167
Investing activities			
Capital expenditure		(36)	(26)
Proceeds from sale of fixed assets		9	10
Payment for acquisition of subsidiary, net of cash acquired		(13)	-
Proceeds from sale of joint venture		2	-
Dividends from joint ventures and associates		1	-
Net cash flows used in investing activities		(37)	(16)
Financing activities			
Proceeds from borrowings		565	250
Issue costs on borrowings		(6)	(6)
Debt repayment premium and penalties		(17)	(11)
Repayment of borrowings		(550)	(328)
Financing transactions		(8)	(95)
Interest paid on borrowings		(61)	(72)
Payment of finance lease capital		(18)	(19)
Payment of finance lease interest		(2)	(3)
Dividends paid		(9)	(35)
Net cash flows from financing activities		(98)	(224)
Net increase/(decrease) in cash and cash equivalents		5	(73)
Cash and cash equivalents at the beginning of the period		150	211
Cash and cash equivalents	10	155	138

The cash flows from operating activities are stated net of cash outflows relating to exceptional items of £18m (2017: £16m). This relates to the cost of business transformation of £14m (2017: £8m), non-recurring costs of IT system implementation and other restructuring activities of £1m (2017: £1m), duplicate cover reimbursements of £1m (2017: £6m) and onerous property provision lease costs in respect of vacant properties of £2m (2017: £1m).

Other adjustments to profit before tax relate to share based payments of £3m (2017: £5m) and profit on sale of fixed assets £1m (2017: £nil)

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

Notes to the financial statements

1 Basis of preparation

a) Accounting policies

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standard 34 'Interim Financial Reporting' (IAS 34). Accordingly, they do not include all the information and disclosures required in the annual financial statements and should be read in conjunction with the Group's annual financial statements as at 31 January 2018.

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 2018 which were prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and have been applied consistently across all periods, other than as noted below for new standards.

These financial statements do not constitute statutory accounts within the meaning of Section 435 of the Companies Act 2006. Statutory accounts for the year to 31 January 2018 were approved by the board of directors on 16 April 2018 and delivered to the Registrar of Companies. The report of the auditors on those accounts was unqualified and did not contain any statement under Section 498 of the Companies Act 2006.

b) Going concern

The Group has long term contracts with a number of suppliers across different industries and is strongly cash generative. The Group has net current liabilities as at 31 July 2018. The Group's borrowings are long term in nature and in addition to the cash balances at the reporting date the Group has agreed additional undrawn credit facilities in place. The directors have considered these points along with the projected future cash flows and forecast covenant compliance and have concluded that the Group has sufficient funds to continue trading for the foreseeable future. Therefore, the interim condensed consolidated financial statements have been prepared using the going concern basis.

c) Alternative performance measures

The nature of the Group's operations means that for management's decision making and internal performance management the key performance metric is earnings before net finance costs, tax, exceptional operating items, share based payments, pension service charge adjustments, depreciation and amortisation (referred to as Trading EBITDA). Trading EBITDA is further analysed as part of the segmental analysis in note 2.

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 2018.

Notes to the financial statements

e) Changes in significant accounting policies

IFRS 9 Financial Instruments

On 1 February 2018, the Group adopted IFRS 9 'Financial Instruments', which replaced IAS 39 'Financial Instruments: Recognition and Measurement'. The Group has not restated comparative information for prior periods.

Classification and measurement of financial assets and liabilities

On 1 February 2018, there were no changes to the carrying values of the Group's financial assets from adopting the new classification model.

There have been no changes to the classification of the Group's financial liabilities. The effect of adopting IFRS 9 on the carrying amount of financial liabilities at 1 February 2018 relates solely to new requirements relating to non-substantial modifications of Borrowings and loans, as described further below.

The following table demonstrates the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Group's financial assets and financial liabilities as at 1 February 2018.

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39 £m	New carrying amount under IFRS 9 £m
Financial Assets				
Trade and other receivables	Loans and receivables	Amortised cost	141	141
Cash and cash equivalents	Loans and receivables	Amortised cost	150	150
Total financial assets			291	291
Financial Liabilities				
Interest swaps used for hedging	Fair value – hedging instrument	Fair value – hedging instrument	(9)	(9)
Borrowings and loans ¹	Amortised cost	Amortised cost	(2,727)	(2,714)
Trade and other payables	Amortised cost	Amortised cost	(528)	(528)
Total financial liabilities			(3,264)	(3,251)

¹As part of the refinancing of existing debt, in prior years the Group performed a modification of borrowings, which is treated as a non-substantial modification under IFRS 9 which does not result in an extinguishment of debt.

The existing borrowings and loans are not derecognised, but the carrying value is adjusted. Under IAS 39, modifications were accounted for by discounting the remaining cash flows of the modified debt at a revised effective interest rate. Under IFRS 9, remaining cash flows should be discounted at the original effective interest rate, leading to an immediate gain or loss being recognised in the income statement. On transition to IFRS 9, using the original effective interest rate, the new carrying value of the borrowings was £13m lower than the old carrying value as a result of the lower interest rates on the refinanced debt. This gain was recognised as a decrease in the opening balance of borrowings and loans and an increase in opening retained earnings at 1 February 2018.

Notes to the financial statements

e) Changes in significant accounting policies (continued)

The adoption of IFRS 9 has resulted in a taxable gain of £13m, less the associated £2m of tax, being posted to reserves. As the restatement is taxable in the year of change the £2m is represented in the reserves movement as a deferred tax charge.

Impairment of financial assets

From 1 February 2018, the Group implemented an expected credit loss impairment model for financial assets. For trade receivables, our calculation methodology has been updated to consider expected losses based on their ageing profile. The adoption of the expected loss approach has not resulted in any material change in impairment provision for any financial asset.

Hedge accounting

The Group applied the hedge accounting requirements of IFRS 9 prospectively. At the date of initial application all of the Group's existing hedging relationships were eligible to be treated as continuing hedge relationships.

Transition

Changes in accounting policies resulting from adoption of IFRS 9 have been applied retrospectively, except as described below.

- The Group has taken an exemption not to restate comparative information for prior periods with respect to classification and measurement (including impairment) requirements. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 February 2018. Accordingly, the information presented for the prior period does not generally reflect the requirements of IFRS 9 but rather those of IAS 39.
- The determination of the business model assessment within which a financial asset is held has been made on the basis of the facts and circumstances that existed at the date of initial application.
- If an investment in a financial asset had low credit risk at the date of initial application of IFRS 9, then the Group has assumed that the credit risk on the asset had not increased significantly since its initial recognition.
- Changes to hedge accounting policies have been applied prospectively.
- All hedging relationships designated under IAS 39 at 31 January 2018 met the criteria for hedge accounting under IFRS 9 at 1 February 2018 and are therefore regarded as continuing hedging relationships.

IFRS 15 Revenue from contracts with customers

On 1 February 2018, the Group adopted IFRS 15 'Revenue from contracts with customers'. The Group has not restated comparative information for prior periods.

There have been no changes to the measurement of revenue as a result of this standard. However, additional disclosures have been required in the form of disaggregation of our different revenue streams. Please see note 2 where this disaggregation of revenue has been presented.

Notes to the financial statements (continued)

2 Segmental information and revenue disaggregation

Following the recent strategic announcement and reflecting the way that the Group is now managed, the Group has determined that it has two key segments – Roadside and Insurance. Roadside incorporates the previous Roadside Assistance and Driving Services segments and Insurance combines Insurance Services and Insurance Underwriting. Head Office costs have been allocated to these two key segments as these costs principally directly support the operations of these segments.

The Group has two reportable operating segments as follows:

- *Roadside*: This segment is the largest part of the AA business. The AA provides a nationwide service, sending patrols out to Members stranded at the side of the road, repairing their vehicles where possible and getting them back on their way quickly and safely. In addition this segment includes the Group's publishing and hotels business, the AA and BSM driving schools and Drivetech which provides driver training and educative programs.
- *Insurance*: This segment includes the insurance brokerage activities of the AA, primarily in arranging motor and home insurance for customers and its intermediary financial services business. This segment also includes the insurance underwriting and reinsurance activities of the AA.

	Six months ended July 2018 £m	Six months ended July 2017 £m
Revenue		
Roadside	411	402
Insurance	69	69
Revenue	480	471
Trading EBITDA		
Roadside	132	159
Insurance	29	34
Trading EBITDA	161	193
Share-based payments	(3)	(5)
Pension service charge adjustment	(3)	(7)
Amortisation and depreciation	(34)	(33)
Operating profit before exceptional items	121	148
Exceptional operating items	(5)	30
Operating profit	116	178
Net finance costs	(88)	(98)
Profit before tax	28	80

Notes to the financial statements (continued)

2 Segmental information and revenue disaggregation (continued)

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

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

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

Exceptional items, net finance costs and tax expense are not allocated to individual segments as they are managed on a group basis.

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

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

	Six months ended July 2018 £m	Six months ended July 2017 £m
Revenue		
Roadside Assistance	380	370
Insurance Services	61	66
Driving Services	31	32
Insurance Underwriting	8	3
Total Revenue	480	471
Trading EBITDA		
Roadside Assistance	156	174
Insurance Services	33	38
Driving Services	7	9
Insurance Underwriting	1	-
Head Office costs	(36)	(28)
Total Trading EBITDA	161	193

Notes to the financial statements (continued)

2 Segmental information and revenue disaggregation (continued)

Operating profit before exceptional items

	Roadside Six months ended July 2018 £m	Six months ended July 2017 £m	Insurance Six months ended July 2018 £m	Six months ended July 2017 £m
Former segment presentation				
Roadside Assistance	156	174	-	-
Insurance Services	-	-	33	38
Driving Services	7	9	-	-
Insurance Underwriting	-	-	1	-
Head Office costs	(31)	(24)	(5)	(4)
Trading EBITDA	132	159	29	34
Share-based payments	(2)	(4)	(1)	(1)
Pension service charge adjustment	(3)	(6)	-	(1)
Amortisation and depreciation	(31)	(30)	(3)	(3)
Operating profit before exceptional items	96	119	25	29

Disaggregation of revenue:

	Six months ended July 2018 £m	Six months ended July 2017 £m
Roadside:		
Consumer (B2C)		
Insured contracts	238	238
Pay for use contracts ¹	21	20
Business Services (B2B)		
Insured contracts	17	19
Pay for use contracts ¹	88	79
Roadside other	47	46
Total Roadside	411	402
Insurance:		
Brokering activities	61	66
Insurance Underwriting	8	3
Total Insurance	69	69
Total Revenue	480	471

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

Notes to the financial statements (continued)

3 Exceptional operating items

	Six months ended July 2018 £m	Six months ended July 2017 £m
Pension past service credit	-	(34)
Other exceptional operating items	5	4
Total exceptional operating items	5	(30)

Exceptional operating items in the period included £5m relating to business transformation and £1m relating to IT systems transformation partially offset by a £1m profit on disposal of fixed assets.

In the prior period, exceptional operating items included £6m relating to business transformation and £1m relating to IT systems transformation being partially offset by £2m income from an onerous property and £1m profit on disposal of fixed assets. The pension past service credit of £34m was the one-off gain from the pension scheme restructuring in the prior period.

4 Finance costs

	Six months ended July 2018 £m	Six months ended July 2017 £m
Interest on external borrowings	63	68
Finance charges payable under finance leases	2	4
Total ongoing cash finance costs	65	72
Ongoing amortisation of debt issue fees	9	5
Net finance expense on defined benefit pension schemes	3	5
Total ongoing non-cash finance costs	12	10
Transfer from cash flow hedge reserve for extinguishment of cash flow hedge	(8)	5
Gain on unhedged derivative	(1)	-
Early repayment penalty	15	10
Debt issue fees immediately written off following repayment of borrowings	5	1
One-off finance costs due to refinancing	11	16
Total finance costs	88	98

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

During the period, £5m (2017: £1m) of amortised debt issue fees were immediately written off following the refinancing.

During the period, the Group also repaid £250m (2017: £98m) of the Senior Term Facility, and transferred the £8m gain (2017: £5m loss) fair value of the cash flow hedges related to the repayment to the income statement.

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

Notes to the financial statements (continued)

5 Tax

The major components of the income tax expense are:

	Six months ended July 2018 £m	Six months ended July 2017 £m
Consolidated income statement		
Current income tax		
Current income tax charge	2	11
	2	11
Deferred tax		
Relating to origination and reversal of temporary differences – current year	3	5
	3	5
Tax charge in the income statement at an effective rate of 19.2% (July 2017: 20.0%)	5	16

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

The effective tax rate remains broadly consistent with the prior period but has reduced slightly in part due to the reduction of the UK corporation tax rate.

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

Notes to the financial statements (continued)

6 Earnings per share

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

	Six months ended July 2018	Six months ended July 2017
Basic earnings per share:		
Profit after tax from total operations (£m)	23	64
Weighted average number of shares outstanding (millions)	612	610
Basic earnings per share from total operations (pence)	3.8	10.5

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

Under the Group's share incentive plan, shares are purchased monthly at market value and are therefore not dilutive. In addition, matching shares are issued monthly and placed into the employee benefit trust and are therefore not dilutive. As at 31 July 2018 there are no outstanding shares to be issued under these schemes that are potentially dilutive.

The Group has another class of potential dilutive ordinary shares relating to the Management Valuation Participation shares. However, as at 31 July 2018, based on average market value of ordinary shares for the period, these are unlikely to vest and so were not dilutive.

There are no further classes of share that are dilutive as at 31 July 2018.

	Six months ended July 2018	Six months ended July 2017
Weighted average number of ordinary shares in issue (millions)	612	610
Potentially dilutive shares (millions)	-	-
Weighted average number of diluted ordinary shares (millions)	612	610
Diluted earnings per share from total operations (pence)	3.8	10.5

Notes to the financial statements (continued)

6 Earnings per share (continued)

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

	Six months ended July 2018 £m	Six months ended July 2017 £m
Profit after tax from total operations as reported	23	64
Adjusted for:		
Exceptional operating items (see note 3)	5	(30)
Share-based payment	3	5
Pension service charge adjustment	3	7
One-off finance costs due to refinancing (see note 4)	11	16
Tax expense	5	16
Adjusted profit before tax	50	78
Tax at the effective rate of 19.2% (July 2017: 20.0%)	(10)	(16)
Underlying profit from total operations	40	62
Adjusted basic earnings per share from total operations (pence)	6.5	10.2
Adjusted diluted earnings per share from total operations (pence)	6.5	10.2

Notes to the financial statements (continued)

7 Goodwill and other intangible assets

	Goodwill £m	Software £m	Total £m
Cost			
At 1 February 2017	1,173	203	1,376
Additions	-	23	23
At 31 July 2017	1,173	226	1,399
At 1 February 2018	1,197	254	1,451
Additions	-	30	30
At 31 July 2018	1,197	284	1,481
Amortisation and impairment			
At 1 February 2017	-	93	93
Amortisation	-	15	15
At 31 July 2017	-	108	108
At 1 February 2018	27	124	151
Amortisation	-	14	14
At 31 July 2018	27	138	165
Net book value			
At 31 July 2018	1,170	146	1,316
At 31 July 2017	1,173	118	1,291
At 31 January 2018	1,170	130	1,300

Notes to the financial statements (continued)

8 Property, plant and equipment

	Freehold land & buildings £m	Long leasehold land & buildings £m	Vehicles £m	Plant & equipment £m	Total £m
Cost or valuation					
At 1 February 2017	24	7	98	90	219
Additions	-	-	6	3	9
Disposal	-	-	(12)	-	(12)
At 31 July 2017	24	7	92	93	216
At 1 February 2018	24	7	104	104	239
Additions	-	-	9	-	9
Disposal	-	-	(18)	-	(18)
At 31 July 2018	24	7	95	104	230
Depreciation and impairment					
At 1 February 2017	7	3	26	52	88
Charge for the period	1	-	11	6	18
Disposals	-	-	(3)	-	(3)
At 31 July 2017	8	3	34	58	103
At 1 February 2018	8	4	36	64	112
Charge for the period	-	-	14	6	20
Disposals	-	-	(12)	-	(12)
At 31 July 2018	8	4	38	70	120
Net book value					
At 31 July 2018	16	3	57	34	110
At 31 July 2017	16	4	58	35	113
At 31 January 2018	16	3	68	40	127

Capital commitments

Amounts contracted to but not provided in the financial statements amounted to £18m (July 2017: £24m, January 2018: £22m).

Notes to the financial statements (continued)

9 Trade and other receivables

	July 2018 £m	July 2017 £m	January 2018 £m
Current			
Trade receivables	138	140	137
Deferred consideration	6	-	3
Prepayments and accrued income	35	28	33
Reinsurers share of insurance liability	28	28	24
Other receivables	6	4	4
	213	200	201
Non-current			
Deferred Consideration	-	-	3
	-	-	3

10 Cash and cash equivalents

	July 2018 £m	July 2017 £m	January 2018 £m
Ring-fenced cash at bank and in hand – available	47	73	42
Ring-fenced cash at bank and in hand – restricted	8	7	8
Non ring-fenced cash at bank and in hand – available	67	40	79
Non ring-fenced cash at bank and in hand – restricted	33	18	21
Cash and cash equivalents	155	138	150

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

Cash at bank and in hand - restricted includes £41m (July 2017: £25m, January 2018: £29m) held by and on behalf of the Group's insurance businesses which are subject to contractual or regulatory restrictions. These amounts are readily available to be used within the insurance business to meet short term needs, however are not readily available for remittance to other Group companies to be used for other purposes within the Group.

Notes to the financial statements (continued)

11 Trade and other payables

	July 2018 £m	July 2017 £m	January 2018 £m
Current			
Trade payables	110	105	103
Other taxes and social security costs	20	10	18
Accruals	64	63	54
Deferred income	242	247	236
Deferred consideration	-	-	15
Provision for unearned premiums in insurance underwriting	22	22	14
Other payables	46	29	40
Interest payable	-	1	-
	504	477	480

On 1 March 2018 the Group completed the purchase of the entire share capital of Used Car Sites Limited. A payment of £12m was made to the former owners and £3m was paid into an escrow account and was payable to the former owners, subject to certain conditions being met. These conditions have since been met and the £3m was paid to the former owners on 7 June 2018. These transactions cleared the balance of deferred consideration due within 1 year.

There have been no changes to the valuation techniques or key model inputs which were used to measure the contingent consideration from those that were reported in the last annual report and accounts.

12 Provisions (current)

	July 2018 £m	July 2017 £m	January 2018 £m
Duplicate breakdown cover	-	4	1
Property leases	-	6	2
Restructuring	1	-	10
	1	10	13

During the period, £1m of the duplicate breakdown cover provision was utilised (2017: £6m) and no additional provision was made (2017: nil). In addition, £8m of the restructuring provision was utilised (2017: £nil) and £1m (2017: £nil) was released.

As reported in the last annual report and accounts, on 7 March 2018, the Group received notification that former Executive Chairman, Bob Mackenzie, who was dismissed for gross misconduct on 1 August 2017, had on 6 March 2018 issued a Claim Form in the High Court, Chancery Division against AA plc, its subsidiary Automobile Association Developments Limited and personally against a number of their directors and the former Company Secretary. The Claim Form seeks a permanent injunction to retain his MVP shares and up to £225m in damages. As this litigation remains active at the date of signing these financial statements, the Board have reconsidered any potential financial impact. The Group has not made a provision for these amounts as the Group expects to be successful in rigorously defending these claims. However, the Group has incurred legal costs of approximately £1m to defend these claims, which it would seek to recover from Bob Mackenzie when the litigation concludes.

Notes to the financial statements (continued)

13 Borrowings and loans

	July 2018 £m	July 2017 £m	January 2018 £m
Current			
Borrowings and loans (see note 14)	15	-	-
Non-Current			
Borrowings (see note 14)	2,718	2,722	2,727
	2,733	2,722	2,727

Notes to the financial statements (continued)

14 Borrowings

	Expected maturity date	Interest rate	Principal £m	Issue costs £m	Amortised issue costs £m	Total as at 31 July 2018 £m	Total as at 31 July 2017 £m	Total as at 31 January 2018 £m
Senior Term Facility	31 July 2021	5.71%	-	-	-	-	249	249
Class A2 notes	31 July 2025	6.27%	500	(1)	1	500	499	500
Class A3 notes	31 July 2020	4.25%	200	(1)	1	200	499	499
Class A5 notes	31 January 2022	2.88%	700	(47)	13	666	667	671
Class A6 notes	31 July 2023	2.75%	250	(4)	1	247	246	246
Class A7 notes	31 July 2024	4.88%	550	(8)	-	542	-	-
Class B2 notes	31 July 2022	5.50%	570	(16)	9	563	562	562
		4.51%	2,770	(77)	25	2,718	2,722	2,727

At 31 July 2018 all borrowings have fixed interest rates. The weighted average interest rate for all borrowings of 4.51% has been calculated using the effective interest rate and carrying values on 31 July 2018.

	Senior term facility £m	Class A2 £m	Class A3 £m	Class A5 £m	Class A6 £m	Class A7 £m	Class B2 £m	Total £m
As at 1 February 2018	250	500	500	700	250	-	570	2,770
Issue/ repayment date:								
17 July 2018	(250)	-	(300)	-	-	550	-	-
Total	-	500	200	700	250	550	570	2,770

In order to show the Group's net borrowings, the notes and the issue costs have been offset. Issue costs are shown net of any premium on the issue of borrowings. Interest rate swaps are recognised in the Balance Sheet at fair value at the period end (see note 15 and below).

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 group can only pay a dividend when certain net debt to EBITDA and cash flow criteria are met.

Any voluntary repayment of the class B2 notes would be made at a fixed premium based on the date of redemption. Any voluntary early repayments of the Class A notes would incur a make-whole payment of all interest due to expected maturity date, except the Class A5, Class A6 and Class A7 notes which can be settled without penalty within 3 months, 2 months and 3 months respectively of the expected maturity date.

On 17 July 2018, the Group issued £550m of Class A7 notes at an interest rate of 4.88%. £8m of costs associated with the issue of the A7 notes were capitalised. This consisted of £2m of premium and £6m of new issue fees.

From the proceeds of the A7 notes, the Group repaid £300m of A3 notes incurring a premium of £15m and the £250m Senior Term Facility (STF). In line with the Group accounting policy, this was accounted for as an extinguishment of debt and therefore issue costs associated with the A3 notes and the STF have been written off totalling £5m.

On 17 July 2018 a new undrawn STF of £200m was incepted and the working capital facility was reduced from £65m to £60m. The fees associated with this were £3m and were written off.

Notes to the financial statements (continued)

14 Borrowings (continued)

Following the repayment of the STF, all but one of the outstanding interest rate swaps scheduled to conclude post 31 July 2018 were settled for £7m. One future dated interest rate swap was left in place to cover the undrawn STF. Following the settlement of the interest rate swaps and the repayment of the original STF, there is no longer an interest rate hedge on the original STF so the cash flow hedge reserve was also released back through Other Comprehensive Income.

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

In order to comply with the requirements of the Class A notes, we are required to maintain the Class A free cash flow to debt service ratio in excess of 1.35x and the senior leverage ratio below 5.5x (see page 17). The Class B2 notes require us to maintain the Class B2 free cash flow to debt service ratio in excess of 1x (see pages 17 and 18).

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

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

The current borrowing relates to a £15m draw down of the Working Capital Facility on 30 July 2018 which was repaid on 29 August 2018. The Group does not currently envisage needing to drawn on this facility again in the foreseeable future.

Notes to the financial statements (continued)

15 Derivative financial instruments

	July 2018 £m	July 2017 £m	January 2018 £m
Assets			
Interest rate swap derivatives	1	-	-
Forward fuel contracts	1	-	-
Liabilities			
Interest rate swap derivatives	-	(17)	(9)
	2	(17)	(9)

16 Defined benefit pension scheme liabilities

The Group operates two funded defined benefit pension schemes: the AA UK Pension Scheme (AAUK) and the AA Ireland Pension Scheme (AAI). The assets of the schemes are held separately from those of the Group in independently administered funds. The AAUK scheme has final salary sections and a Career Average Revalued Earnings (CARE) section. The CARE section provides for benefits to accrue on an average salary basis. Since 2004, new entrants to the AAUK scheme accrue benefits in the CARE section but the Scheme was closed to new entrants from 1 October 2016. On 1 July 2017 accrual ceased under the final salary sections and members were moved to the CARE section for future accrual of benefits. This preserved defined benefits for current scheme members. In addition, pension indexation in the CARE section is based on CPI inflation, rather than RPI inflation, from April 2018 onwards. The AAI scheme is closed to new entrants and future accrual of benefits. AA Corporation Limited, a UK subsidiary of the Group, is 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 to 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 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 IAS19 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 2018 by independent qualified actuaries.

Notes to the financial statements (continued)

16 Defined benefit pension scheme liabilities (continued)

The amounts recognised in the balance sheet are as follows:

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

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

	As at 31 January 2018			
	AAUK £m	AAI £m	AAPMP £m	Total £m
Present value of the defined benefit obligation in respect of pension plans	(2,491)	(50)	(45)	(2,586)
Fair value of plan assets	2,303	43	-	2,346
Deficit	(188)	(7)	(45)	(240)

The decrease in the deficit is due to increasing discount rates, falling long-term inflationary expectations, changes in the demographic assumptions (reflecting the latest outlook for mortality rates) and Group contributions paid into the schemes.

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

Using an inflation assumption of 3.0% and a discount rate assumption of 2.6%, 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.

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

Notes to the financial statements (continued)

16 Defined benefit pension scheme liabilities (continued)

In the period since the balance sheet date, the AAUK scheme has purchased a bulk annuity policy which insures all the benefits payable under the scheme in respect of 2,510 pensioner and dependant members. Please see note 20 for further details on this.

The last triennial valuation for the AAI scheme was as at 31 December 2016, the result of which was an increase in the Going Concern deficit with the contribution level remaining the same. The Group made deficit reduction contributions of c. £2m in the year ended 31 January 2018 and will continue to make annual deficit reduction contributions, increasing with inflation, until December 2023 or until an alternative agreement is signed with the trustees. The next triennial valuation of the AAI scheme will take place as at 31 December 2019.

In total, the Group is currently committed to pay c. £22m in on going employer contributions and c. £24m in deficit reduction employer contributions to its defined benefit plans (AAUK and AAI) in the year ending 31 January 2019.

In November 2017 the Group completed a full accounting valuation of the AAPMP with a valuation date of 31 January 2017. This updated the previous full accounting valuation of the AAPMP that was performed as at 31 January 2013 and was projected forward to relevant reporting dates.

The 31 January 2017 full accounting valuation of the AAPMP revealed a reduction in reported deficit as a result of the actual level of medical premium inflation experienced being lower than that assumed over the period between full valuations and the impact of the latest longevity expectations.

Fair value of plan assets

The table below shows the AAUK plan assets split between those that have a quoted market price and those that are unquoted. Of the AAI scheme, 30.2% (July 2017: 33.5%) of assets do not have a quoted market price.

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

	As at 31 July 2018		As at 31 July 2017		As at 31 January 2018	
	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	183	364	180	300	174	352
Bonds/ swaps	838	215	825	200	813	211
Property	85	186	84	179	88	183
Hedge funds	23	396	-	426	23	440
Cash/current assets	31	2	24	2	17	2
Total plan assets	1,160	1,163	1,113	1,107	1,115	1,188

Notes to the financial statements (continued)

16 Defined benefit pension scheme liabilities (continued)

Pension plan assumptions

The principal actuarial assumptions were as follows:

	AAUK and AAPMP			AAI		
%	July 2018 %	July 2017 %	January 2018 %	July 2018 %	July 2017 %	January 2018 %
Pensioner discount rate	2.6	2.4	2.5	1.6	1.6	1.6
Non pensioner discount rate	2.8	2.6	2.6	2.6	2.5	2.3
Pensioner RPI	3.2	3.2	3.3	-	-	-
Non pensioner RPI	3.2	3.2	3.3	-	-	-
Pensioner CPI	2.1	2.1	2.2	1.6	1.5	1.6
Non pensioner CPI	2.1	2.1	2.2	1.6	1.5	1.6
Rate of increase of pensions in payment (final salary sections) - pensioner	3.0	3.0	3.1	-	-	-
Rate of increase of pensions in payment (final salary sections) - non pensioner	3.0	3.0	3.1	-	-	-
Rate of increase of pensions in payment (CARE section) - pensioner	1.7	1.5	1.7	-	-	-
Rate of increase of pensions in payment (CARE section) - non pensioner	1.7	1.5	1.7	-	-	-
Pensioner increase for deferred benefits	2.1	2.1	2.2	1.6	1.5	1.6
Medical premium inflation rate	7.2	7.2	7.3	-	-	-

Mortality assumptions are set using standard tables based on scheme specific experience where available and an allowance for future improvements. For 2018, the assumptions used were in line with the SAPS (S2) series mortality tables (2017 – SAPS (S2) series) with future improvements in line with the CMI_2017 model with a 1.25% long-term rate of improvement (2017 – CMI_2015 model with a 1.5% long-term rate of improvement). The AAI scheme mortality assumptions are set using standard tables with scheme specific adjustments.

The AA schemes' overall assumptions are that an active male retiring in normal health currently aged 60 will live on average for a further 27 years and an active female retiring in normal health currently aged 60 will live on average for a further 29 years.

Notes to the financial statements (continued)

16 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 2018		
	AAUK £m	AAI £m	AAPMP £m
Increase of 0.25% in discount rate	115	2	2
Increase of 0.25% in Inflation rate	(93)	(1)	-
Increase of 1% in medical claims inflation	-	-	(8)
Increase of one year of life expectancy	(85)	(2)	-

An equivalent decrease in the assumptions at 31 July 2018 would have had the equal but opposite effect on the amounts shown above, on the basis that all other variables remain constant.

17 Share premium

	£m
At 31 January 2017	403
Issue of shares	1
At 31 July 2017	404
At 31 January 2018	406
Issue of shares	1
At 31 July 2018	407

Notes to the financial statements (continued)

18 Fair values

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

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

At 31 July 2018:

		Fair value measurement using		
		Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	Carrying value £m	£m	£m	£m
Financial assets measured at fair value				
Interest rate swaps (note 15)	1	-	1	-
Fuel hedge (note 15)	1	-	1	-
Financial liabilities measured at fair value				
Interest rate swaps (note 15)	-	-	-	-
Liabilities for which fair values are disclosed				
Loan notes (note 14)	2,718	2,749	-	-

At 31 July 2017:

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

Notes to the financial statements (continued)

18 Fair values (continued)

At 31 January 2018:

	Carrying value £m	Fair value measurement using		
		Quoted prices in active markets (Level 1) £m	Significant observable inputs (Level 2) £m	Significant unobservable inputs (Level 3) £m
Financial liabilities measured at fair value				
Interest rate and fuel swaps (note 15)	9	-	9	-
Deferred consideration (due in more than one year)	11	-	11	-
Liabilities for which fair values are disclosed				
Loan notes (note 14)	2,478	2,639	-	-

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

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

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

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

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

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

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

Notes to the financial statements (continued)

19 Related parties

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

Transactions with associates:

Associate	Nature of transaction	July 2018 £m	July 2017 £m	January 2018 £m
ARC Europe SA	Registration fees incurred	1	1	4

20 Post Balance Sheet Events

Pension buy-in

In the period since the balance sheet date, the Trustee of the AA UK Pension Scheme has purchased a bulk annuity policy from Canada Life which insures all the benefits payable under the scheme in respect of 2,510 pensioner and dependant members. The Trustee has invested in such a policy as the Scheme will see all financial and demographic risks exactly matched for the covered members.

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

At 23 August 2018, the date of the risk transfer to Canada Life, the defined benefit obligation for the covered population was c.£47m less than the premium of c.£351m paid for the policy. This difference between premium paid and fair value of the insurance policy will be recognised on balance sheet at the 31 January 2019 year-end through other comprehensive income ("OCI") as an asset loss. It should be noted that this is separate to the measure of the funding deficit (used to set cash contributions to the Scheme) which we expect will be reduced as a result of this policy given the prudent nature of the funding measure.

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

Directors' responsibility statement

The directors confirm that to the best of their knowledge:

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

By order of the Board

Chief Executive Officer

25 September 2018

Forward-looking statements

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

Independent review report to AA plc

Report on the interim condensed consolidated financial statements

Our conclusion

We have reviewed AA plc's interim condensed consolidated financial statements (the "interim financial statements") in the interim report of AA plc for the 6 month period ended 31 July 2018. Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

What we have reviewed

The interim financial statements comprise:

- the Consolidated statement of financial position as at 31 July 2018;
- the Consolidated income statement and Consolidated statement of comprehensive income for the period then ended;
- the Consolidated statement of cash flows for the period then ended;
- the Consolidated statement of changes in equity for the period then ended; and
- the explanatory notes to the interim financial statements.

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

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

Responsibilities for the interim financial statements and the review

Our responsibilities and those of the directors

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

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

What a review of interim financial statements involves

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

Independent review report to AA plc

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

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

PricewaterhouseCoopers LLP
Chartered Accountants
London
25 September 2018