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SMILES all round

Dear Shareholder,

I wish to take this opportunity to comment on our results for the half-year ended 31 December 2008. Against the gloomy economic situation, our company has shown considerable resilience and delivered substantial growth.

Growth: revenue, profit, dividends

Compared to the first half results from the previous year, the results for the six months to December 2008 were as follows:

- Revenue up 58% to \$11.0 million
- NPAT up 83% to \$2.1 million
- EBITDA up 77% to \$3.4 million
- Earnings per share up 82% to 10.31c per share
- First half fully franked dividend up 35% to 5.4c per share
- Cash flow from operations up 40% to \$2.2 million

These results suggest to me that our company has reached critical mass, in the sense that we now operate on a scale which enables us to increase NPAT faster than revenue. In the year ended June 2008, we enjoyed full-year revenue growth of 81% and NPAT growth of 30%. While both of these figures were agreeable enough on their own, they reflected the fact that our business was still approaching an efficient size.

I believe that we turned this corner during the half year to December 2008, in which NPAT growth exceeded revenue growth. This reflects the fact that we now have our core infrastructure fully in place, and that additional revenue is now burdened with a shrinking share of overhead and head office expense.

All of the 2009 year to date has been focussed on consolidation, internal growth, and efficiency. You'll recall that we completed a number of major acquisitions during the 2008 year, so we began the current year with the task of integrating these new centres into our operations. The results for this first half suggest that we are doing an acceptably good job on this front.

In setting the first half dividend at 5.4c per share (an increase of 20% on the June 2008 dividend and 35% on that of December 2007) your directors have sought to balance our commitment to deliver growing dividends with the prudent application of capital to reduce debt and preserve our ability to make agreeable acquisitions as and when they arise.

Our accounts

We seek at all times to deliver our results in such a way as to ensure that our shareholders face no barriers to understanding how well our business is performing. Current Australian Accounting Standards (AAS), make this increasingly difficult. I speculate that the standards are aimed at exposing developing financial catastrophes sooner, but the effect on sound companies operating simple, conservative businesses is to make the accounts of those companies less useful and sometimes unintelligible.

In November 2008 we forecast that our NPAT for the first half would show an increase of 67% on the previous first half. From a management point of view, and from a shareholder's point of view, we believe that our actual results exceeded this forecast result by a small margin. Our reported results, however, show a greater NPAT increase of 83%. While this number is precisely and strictly correct under AAS, I believe that it overstates the real growth in our NPAT. The results from the first half of 2009 were excellent by any measure, but if this were a family company I suspect we would be celebrating a practical and real growth in NPAT of about 70%.

The difference between the core result and the AAS figure is the net result of several factors which pulled in both positive and negative directions. The biggest single factor was a benefit to our tax expense of about \$80,000. While this is a real cash benefit to us, it does not represent an increment to our ongoing business.

Forgive me for going on at such length about this issue. I assure you that we will continue to comment on matters which assist our shareholders in understanding our results.

Outlook

Our growth over the past few years has come both from acquisitions and from recruiting additional dentists to run their practices from within our established facilities. Looking ahead, both of these sources of growth remain open to us.

On the acquisition side, we have the resources required to complete acquisitions on any conceivable scale. We can do so because we have a low level of debt, committed credit lines available to draw as needed, and strong established cash flow. That said, we are under no pressure to make further acquisitions, and we will continue to do so only when we can acquire practices on terms which ensure that the acquired businesses make an immediate positive contribution to NPAT and to earnings per share.

The alternative route to growth—that of bringing more dentists into our established facilities—remains wide open. All of our Practices were designed with this sort of growth in mind, and we can accommodate additional dentists in top-quality facilities in many different cities, at little or no capital cost to us.

It is too early to forecast full year results for the 2009 year. On a per-dentist basis, revenue in the second half of the year is usually slightly lower than in the first half. We have not yet detected any decrease in revenue, but we have to suppose that some patients will seek to delay or forego some treatments as the economic downturn bites.

At a company level, this effect of a slower second half has always been overwhelmed by the ongoing increase in the total number of dentists. We aim to maintain this record in 2009.

Market presence

1300SMILES Ltd has seventeen multi-dentist facilities in Cairns, Townsville, Mackay, Rockhampton, Gladstone, Bundaberg, Caloundra, Brisbane, Toowoomba, and the Gold Coast, where we've recently opened a new practice at Tweed Heads (NSW) to meet an obvious market need.

Earnings per share

Our top objective is that of increasing earnings per share (EPS). To grow our EPS, we must not only increase profit, but we must also keep the number of shares on issue under tight control.

We issued a small number of shares (281,273) during the half year as part consideration for the practice acquired in Bundaberg. This brought the total number of issued shares to 20,340,508.

Borrowing and the financial markets

The company closed the period with net debt of \$3.6 million, down from \$4.5 million at 30 June 2008. All of this debt was incurred in the course of acquiring profitable dental practices. These funds were drawn from established facilities with our banks.

As noted in our Annual Report for 2008, the gyrations in the financial markets have caused us no difficulties of any kind. Our access to loan funds has not been affected in any way, and we believe that our continuing growth will not be inhibited by any restriction on funds available to us. We employ no fancy financial structures of any kind. We hold our surplus funds in conventional bank facilities. We have no exposure of any kind to any structured financial product.

Thank you

As always, we thank you, our shareholders, for your support.

I would particularly like to thank our hard-working employees and the growing number of dentists who choose to conduct their practices in our facilities.

Yours faithfully,



Dr Daryl Holmes
Managing Director

20 February 2009

ABOUT 1300SMILES LTD

OVERVIEW OF THE COMPANY'S BUSINESS

The Company provides the use of dental surgeries and practice management and other services to self employed dentists who carry on their own dental practices. The Company provides surgery facilities at eighteen sites serving the ten major population centres in Queensland. The head administrative office is in Townsville.

The services provided by the Company allow the dentists to focus on the delivery of dental services rather than on the administrative aspects of carrying on their businesses. The dentists pay fees to the Company for the provision of these services under a Dental Service Agreement with the Company.

The dentists who use the Company's services range from new graduates to experienced dental professionals. Several dentists who use the Company's services have special interest and experience in such areas as endodontics, oral surgery, implants and periodontics and cross-refer work to other dentists who use the Company's services.

The Company provides comprehensive services in the areas of marketing, administration, billing and collections, and facilities certificates and licensing to all participating dentists. The Company also provides all equipment and facilities, and sources all consumable goods using the buying power which derives from such a large group of dental businesses.

FUTURE DEVELOPMENTS

The Company's core objective is to continue to increase profits and shareholder returns while providing a rewarding environment for our staff and the dentists using our facilities.

The Company aims to achieve a combination of organic growth in its existing locations and the addition of new practice management facilities.

The key drivers for future growth of the Company are:

- Increasing the number of dentists who use the Company's existing facilities.
- Assisting the dentists who use the Company's facilities to increase their turnover.
- Acquiring additional practices in existing and new regions.
- Establishing new practices in existing and new regions.

DENTIST ENQUIRIES

Owners of dental practices who are interested in unlocking the goodwill value of their businesses are invited to contact Dr. Daryl Holmes, Managing Director, on 07 4721 1238 or on md@1300SMILES.com.au.

Qualified dentists who wish to know more about joining one of our established facilities are also encouraged to contact Dr. Holmes directly, or email dentistrecruitment@1300SMILES.com.au.