LETTER FROM THE MANAGING DIRECTOR

Dear Shareholder,

It is my privilege to present to you the seventh Annual Report of 1300SMILES Ltd. As I write this letter I am struck by how similar it will be to my letters from several previous years. I believe that this is a good thing. This consistency is a theme to which I will return several times.

In the full year ended 30 June 2011 our company delivered record results in Revenue, Net Profit After Tax, Earnings Per Share, and Dividends Per Share. That exact statement has been true for every one of the last four years.

Within those results a few figures really stand out. Since the 2007 year our Earnings Per Share have grown from 9.0c to 24.2c, delivering compound annual growth of more than 25%. Fully franked Dividends Per Share have increased over the same period from 6.8c to 15.5c, for compound annual growth of more than 22%.

Long term shareholders are well aware that my main financial reward for running this company comes from the dividends I receive from my shareholding, which greatly outweigh my pay and benefits. As a shareholder I take comfort from these results. Our growing revenue gives us greater stability, which I believe is as important to most shareholders as it is to me personally. This continuing growth has enabled us to consistently increase the dividend, albeit at a somewhat slower pace. In my view the dividend has become increasingly secure with each passing year while still delivering excellent growth in your dividend income.

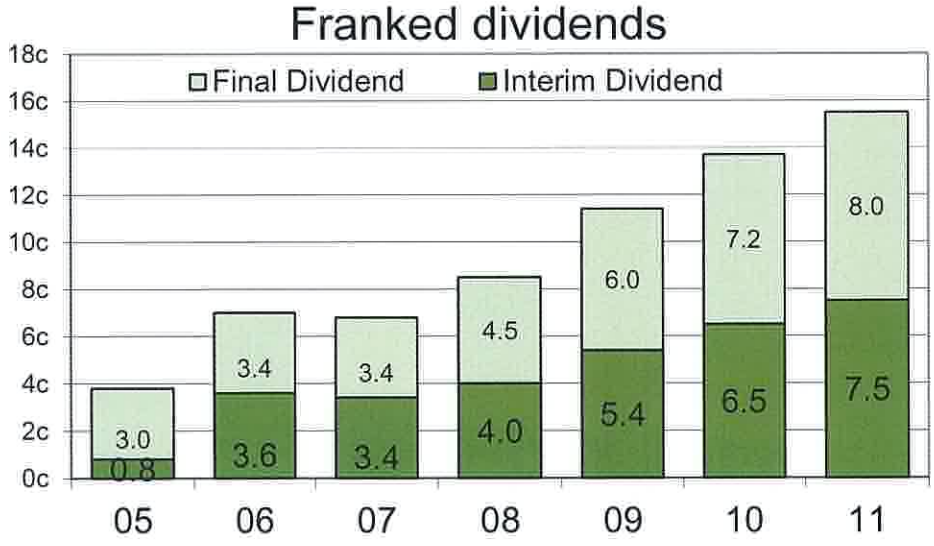
Financial Results for the year ended 30 June 2011

Compared to those of the previous year, the key results for the year to 30 June 2011 were as follows

- NPAT up 18.9% to $5.1 million
- NPBT up 15.4% to $7.1 million
- EBITDA up 20.8% to $8.9 million
- Earnings per share up 15.0% to 24.2c per share
- Full year franked dividend up 13.1% to 15.5c per share
- Retained Profits up 32.6% to $8.2 million

Dividends

As long term shareholders have heard me say many times before, our dividends reflect our core commitment to shareholders. I remind shareholders that all dividends paid are 100% franked. This year we have reached a dividend milestone, as the grossed-up value of all dividends paid since listing has reached a total of over 95c per share. That easily exceeds our 80c issue price back in 2005 and means that subscribers to our initial offering have now received more than their entire initial investment back in the form of dividends and franking credits.



Agency Risk

In my capacity as a private investor, I also own shares in companies other than 1300SMILES. In managing my own portfolio I am increasingly bedevilled by "agency risk," which is the risk that managers of a listed company might operate that company more for their own benefit than for that of shareholders. This risk is greatest where senior managers have more interest in maintaining their salary and benefits packages than they do in increasing Earnings Per Share and enhancing the long-term value of the company's shares. All too often I see companies with otherwise attractive businesses whose managers are paid too much, or where managers have share option packages which far outweigh their personal investment commitments to their companies. Maybe I'm just growing more cynical, but it seems to be getting harder to find companies in which such agency risk is not a major concern.

I trust you'll forgive this minor digression. I can assure shareholders that we work very hard to ensure that agency risk does not affect your investment in 1300SMILES.

(In past years shareholders have never been shy about telling me about other well-behaved companies. If you know of other good listed companies which have agency risk under control I would be pleased to hear about them.)

Earnings Per Share & Dilution

A discussion of agency risk goes hand-in-hand with a discussion of Earnings Per Share (EPS). Enhancing and protecting EPS is our top financial priority. This depends on growing our total Net Profit After Tax, but it also depends on keeping the total number of shares on issue under control. We issue new shares only with great care, and only where we are sure that any expansion of our capital base will in fact deliver benefits on a per-share basis to all shareholders.

During the 2011 year, our company issued a total of 187,942 new shares. I am confident that every one of these shares was issued for the best of reasons, which fall into two categories. The first category is that of bonus shares issued for out-performance. When we acquire established dental practices we pay mainly cash. In some cases we make an agreement with the vendor dentists that we will issue to them some shares in the company if and only if the acquired practices exceed our specified profit expectations over some years after the acquisition. In these cases I am confident that the extra profit delivered has produced extra value for every shareholder which easily outweighs the small dilutive effect of issuing the extra shares.

The second category is that of shares acquired by senior management. I say "acquired" because that is exactly what they do. I believe it is essential for the health of our company that senior managers have a stake in the company, and we encourage our managers to buy shares. In some cases we need to make new shares available for this purpose, but be assured that we're not giving these shares away. Our managers buy shares at the market price at the time, reflecting their faith in the company going forward and their commitment to it. This leads to minor dilution, but the overall effect is that of strengthening our company.

Because of the slightly larger number of shares on issue, Earnings Per Share increased by just 15.0% while Net Profit After Tax increased by a greater 18.9%. At the end of the year there were no share options on issue.

Growth and Expansion

During the year we spent $3.4 million on capital works, plant and equipment, and leasehold improvements. These expenditures generally lead directly to increased revenue and profit, as they enable us to accommodate additional dentists and hygienists.

In September 2010 we opened our second major facility in Bundaberg, supplementing our existing facility there which was operating at close to 100% capacity. Bundaberg has easily absorbed the extra services available and the new facility has delivered excellent results throughout its first year of operation.

In October 2010 we acquired an established practice in Bray Park (suburban Brisbane). This facility has met all of our expectations and it has certainly made a contribution to company profit in its first year.

In July 2011 we commenced the fitout of an entirely new, state-of-the-art, and greatly enlarged facility within the busy Carindale Shopping Centre. Our existing operation at Carindale has remained open and busy throughout the construction of the new facility. When the new site opens in late August or early September 2011 it will have more than double the capacity of the old facility.

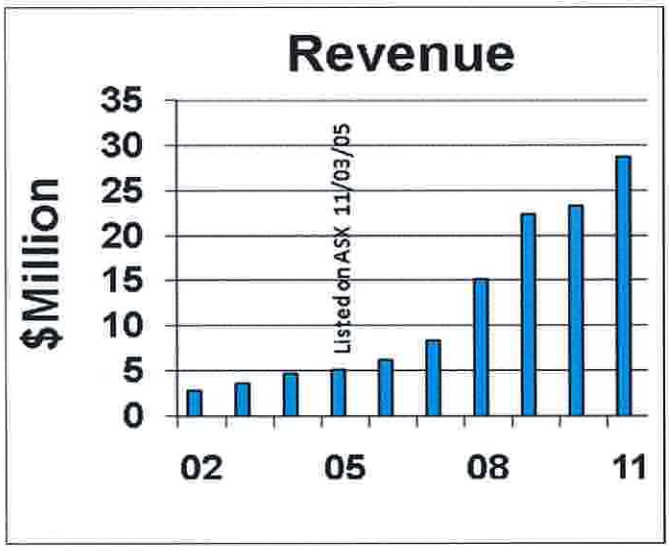
Back in our original Townsville market we expect to open a further facility in a substantial new medical development within Stockland's "North Shore" development in the third quarter of this financial year.

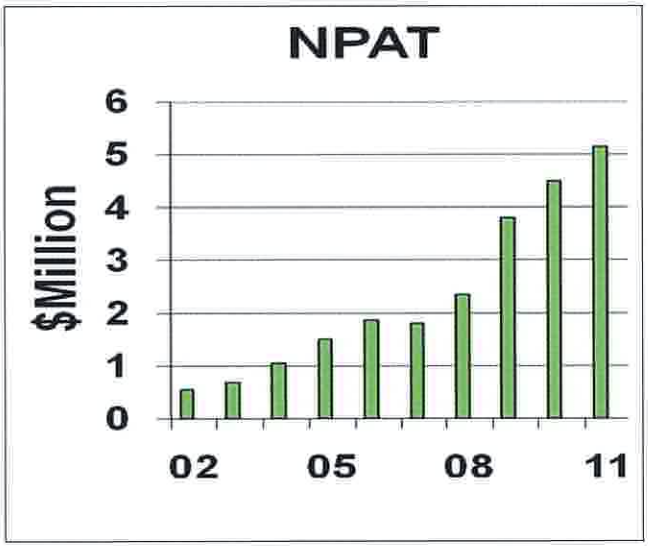
As always, we design all new facilities with in-built extra capacity. We once again expect much of our growth to come from in-filling this capacity with additional dentists. We also seek suitable practice acquisitions in all markets in Australia but we are careful to acquire practices only on terms which deliver positive increments to Earnings Per Share. We make every effort to secure profitable growth but we do not pursue growth for its own sake and we do not overpay for existing practices.

That said, we do seek to ensure that vendor dentists whose practices go on to deliver significant profits for 1300SMILES are generously compensated.

Revenue and Net Profit After Tax (NPAT)

We are in the habit of reporting Revenue and NPAT figures starting in 2002, which was three years before the company was listed on the Australian Stock Exchange. We do so because 2002 was the year in which the company settled on its present form, although it was not listed on the Australian Stock Exchange until 2005.





Our "Revenue" as shown in the accounts is a bit different from our "over the counter" revenue, which we regard as a more practical measure of the total business. Over the counter revenue grew to more than $35 million in the 2011 year. This figure reflects what dental patients actually paid for the services delivered in our centres and serves as a meaningful measure of the scale of our business. Revenue for accounting purposes is affected by the mix of self-employed dentists using our facilities and dentists actually employed by the company. This mix changes from year to year to accommodate the needs and preferences of individual dentists.

In last year's annual report I noted that our over the counter growth at 11.2% was both a bit higher and more reflective of the real growth in our business than our Revenue in that year. This year I make a comparable observation, but in the opposite direction. While our Revenue grew by 22.5%, our over the counter revenue grew by a more moderate 16.1%. As with the 2010 year, I believe the growth in over the counter revenue in 2011 most accurately reflects the growth of our business.

The fact that the growth in our over the counter revenue differs from that of Revenue, in different directions from year to year, is no cause for concern. Over the last six years, I note that over the counter revenue growth has been greater than the increase in Revenue in three years, lower in two years, and exactly the same in one. This simply reflects the always-changing mix of dentists in our system.

Balance Sheet

Because the 2011 year has been profitable and cash flow positive in every period--as have many preceding years--we once again finished the year with a very low level of borrowing. At year-end we had core borrowings of $7.5m, offset by a cash balance of $4.7m. These figures are very similar to those of the 2010 year. While our net indebtedness is about the same--and it was already low--our business at the end of 2011 was significantly larger than at the end of 2010. I believe that our balance sheet is conservative by any standard.

Outlook

We aim to continue the work which has delivered good results over our first six years as a listed company. We have greatly refined and improved our methods and our procedures, but our basic business remains the same. Our future growth will derive from:

- Increasing profits by attracting more dentists to our existing facilities and expanding those facilities which are already at full capacity;
- Assisting dentists who already practice within the 1300SMILES system to increase their turnover and income through benchmarking, training, and mentoring;
- Establishing new practices in existing and new regions (greenfield sites);
- Acquiring substantial existing practices where we can do so on favourable terms; and
- Managing dental facilities owned by others.

We seek to build the largest business we can while ensuring that every bit of growth delivers an incremental increase to both NPAT and earnings per share.

Competition

We remain the only dental services provider listed on the Australian Stock Exchange. Of the other significant companies which operate in our industry, one is controlled by a New Zealand listed company with operations in a number of industries. Control of another competitor has recently been acquired by an Indian private equity firm. The intention of this latter firm, as stated publicly, is to incorporate the controlled Australian dental operation into an entity to be listed on the Singapore stock exchange. Lately we notice that the rate at which this company acquires practices has diminished considerably, and we look ahead with interest to see what further changes this may bring to the competitive landscape.

Regardless of what comes next, we are quite comfortable with our view that certain competitors have paid far too much for practices acquired over the past few years. One company in particular bought a large number of high-turnover practices on five year contracts almost four years ago, and we are tempted to speculate that negotiations over the renewal of these contracts will be torrid. Once again I am pleased to note that dentists in the 1300SMILES system are engaged within the framework of a proven and sustainable business model, not on this basis.

The now-diminishing presence of such free-spending buyers in the market has certainly helped us sharpen our skills at building our company dentist by dentist, rather than relying entirely on acquisitions. I believe this has left us with a rather more robust business than those of some of our competitors. As I mentioned last year, I feel far more comfortable with my money in 1300SMILES, and I hope you do too.

As always, we do not forecast profits going forward. As in every one of the six years prior to the 2011 year, we start the new year with a bigger base business than ever before, and I assure you that we will do everything we can to continue our long history of profit growth.

Market Presence

1300SMILES Ltd has twenty-one full service multi-dentist facilities located in Cairns, Townsville, Mackay, Rockhampton, Gladstone, Bundaberg, Caloundra, Brisbane (several different sites), Tweed Heads, and Toowoomba. We remain keen to expand throughout Australia and will pursue this objective while taking steps which protect and enhance our profitability along the way.

Investment Performance

Long standing shareholders have heard me declare on many occasions that there are aspects of our business which are simply old-fashioned. We operate numerous dental centres as best we can; we seek to control costs while delivering the best possible service. We have a simple capital structure and absolutely nothing fancy about our financing. We make money, pay the tax due, and pass franked dividends on to our shareholders.

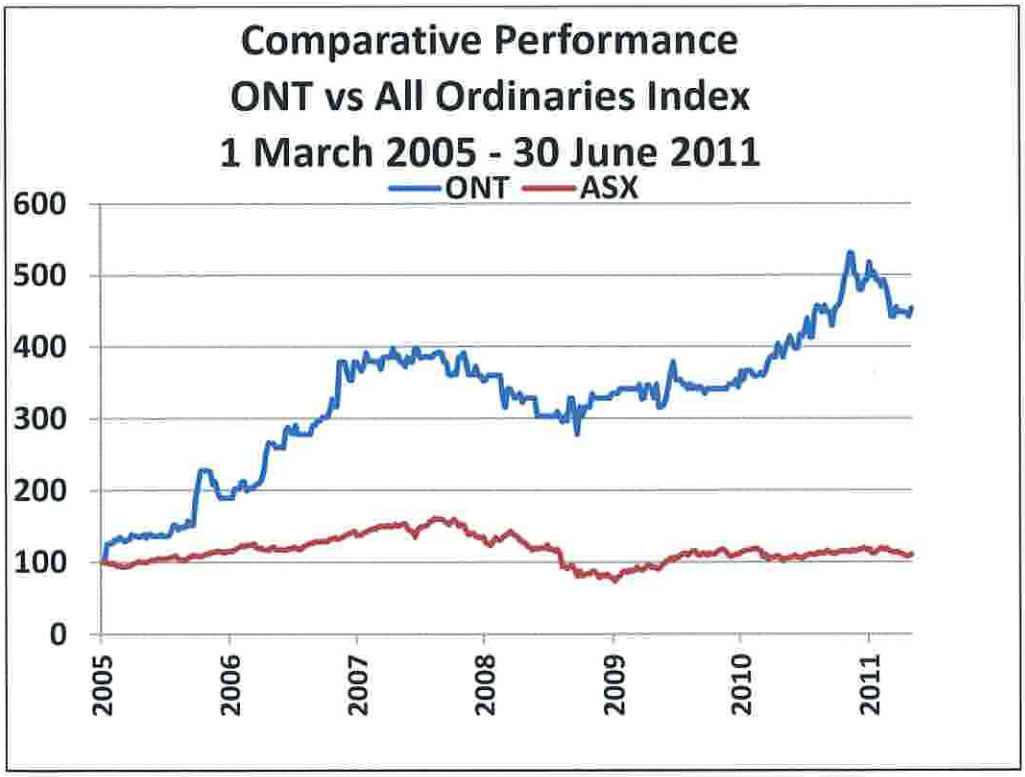
This approach has served our shareholders well in good economic times and bad, as well as through bull markets and bear markets.

You can be sure that we strive at all times to stay at the cutting edge in service quality, dental techniques and products, and communications with our patients. None of this interferes with our ability to run a simple and transparent business of the sort our long term shareholders have come to know well.

Over the time our company has been listed on the Australian Stock Exchange, we've seen the share market in many different moods. I take comfort from the fact that our shares have turned in an agreeable performance over this entire period.

Since listing in 2005 at 80c, 1300SMILES has out-performed the broader share market by a considerable margin. At the close of the 2011 financial year, our share price was $3.59. That was up only slightly from the price at the end of the 2010 year, but I'm entirely comfortable with our long term performance against the All Ordinaries Index and against every other sensible benchmark.

From listing to 30 June 2011, ONT's share price increased by 348% while the All Ordinaries Index gained less than 14% over the same period.



In the chart above, both the 1300SMILES share price and the All Ordinaries are initially set equal to 100.

As always, I note that there's nothing we can do to control the share price directly. We can and do promise that we will continue to operate our business in accordance with the same principles which have delivered our success over the past several years.

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

ABOUT 1300SMILES LIMITED

OVERVIEW OF THE COMPANY'S BUSINESS

1300SMILES Ltd owns and operates full-service dental facilities at twenty-one sites, mainly in the ten major population centres in Queensland. The company continually seeks to expand its presence into other geographical areas throughout Australia. It does so both by establishing its own new operations and by acquiring existing dental practices. The administrative and corporate offices are in Townsville.

1300SMILES enables the delivery of services to patients by providing the use of dental surgeries, practice management and other services to self employed dentists who carry on their own dental practices. 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. In some circumstances the company also employs qualified dentists.

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 interests 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 certification and licensing to all participating dentists. The company also provides all support staff, 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 profits by attracting more dentists to our existing facilities and expanding those facilities which are already at full capacity;
- Assisting dentists who already practice within the 1300SMILES system to increase their turnover and income through benchmarking, training, and mentoring;
- Establishing new practices in existing and new regions (greenfield sites);
- Acquiring substantial existing practices where we can do so on favourable terms; and
- Managing dental facilities owned by others.

DENTIST ENQUIRIES

Owners of dental practices who are interested in unlocking the goodwill value of their businesses (or freeing themselves from all the management hassles) are invited to contact Dr. Daryl Holmes, Managing Director, on +61 (7) 4720 1300 or 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, email dentalcareers@1300smiles.com.au or visit our website www.dentalcareersaustralia.com.au.