

**LETTER FROM THE MANAGING DIRECTOR**

Dear Shareholders,

The first half of the 2018 financial year has delivered solid, positive results on all key measures.

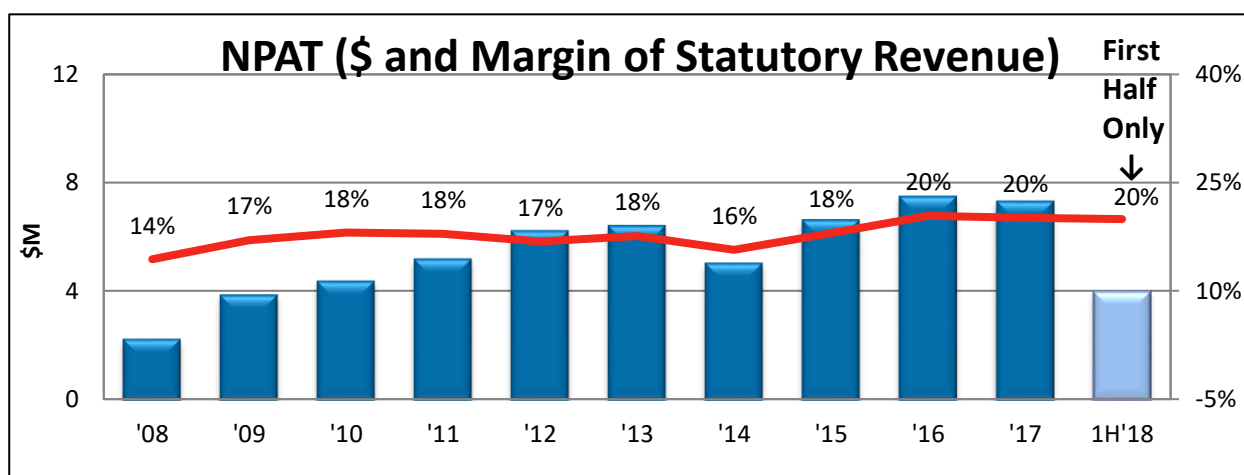
Perhaps the most notable change since my letter of this time last year is that the number of acquisitions we have completed over the past twelve months is significantly higher than in the past few years. As always, I emphasise that we never lower our demanding standards simply to increase the number of acquisitions. The past twelve months have offered us a large number of attractive opportunities, for a variety of reasons I'll discuss further later in this letter.

Before we address the specific numbers, let me give you my impression of how our company has changed in the past year. I believe that we now have the best management team we've ever had, and that the foundation of our business is now more solid and safer than ever before. I'm well aware that shareholders don't pay me to deliver excitement and that you'd rather see growing and secure returns over the long term. Over the past year we have certainly achieved that objective.

**Financial results for the half year to 31 December 2017**

- Revenue (Statutory) up 9.7% to \$19.8 million
- Revenue (OTC) up 9.6% to \$28.0 million
- NPBT up 5.5% to \$5.6 million
- EBITDA up 5% to \$6.7 million
- NPAT up 4.0% to \$3.9 million
- Earnings per Share up 4.0% to 16.6 cps
- Interim dividend up 7% to 12 cps
- Bank debt at \$4.2 million

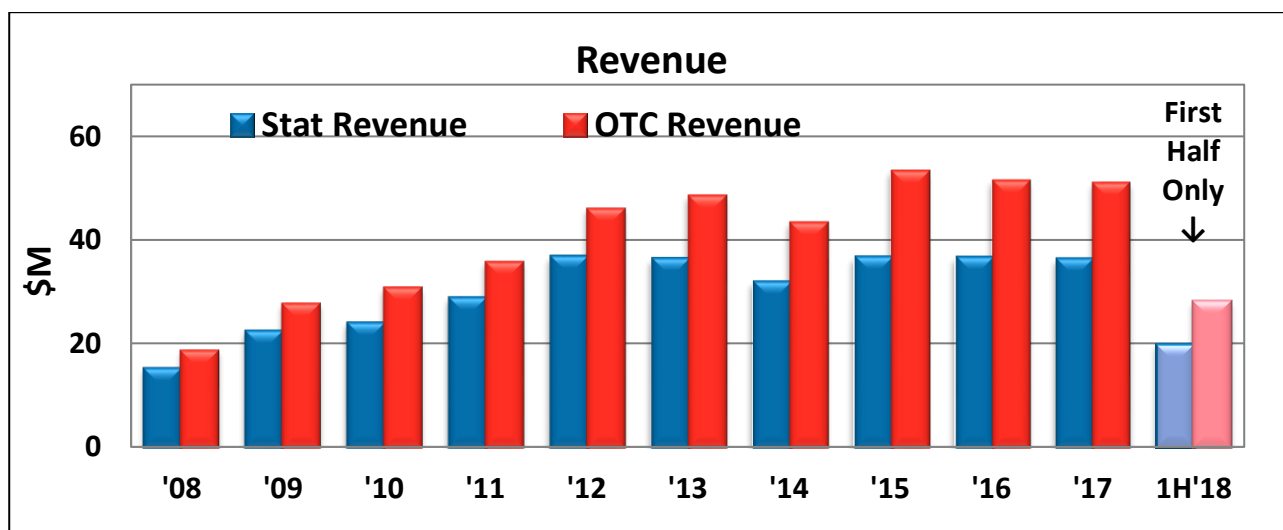
**Earnings & profit**



Shareholders will notice that our Earnings Before Tax increased by 5.5% while our NPAT increased by 4.0%. This results mainly from the sort of tax timing issue we see from one year to the next. Our effective tax rate for the first half of the current year was 29.8%, up one full percentage point from the previous first half's 28.8%.

There's nothing untoward in this sort of variation, and the benefits and costs to us balance out over time.

Shareholders will also be aware that in some years there are significant variations between the rate of growth of our Statutory Earnings and that of our Over-the-Counter (OTC) Earnings. When these differ, I remind shareholders that the OTC figure is the better measure of the scale of our business, as it reflects the total amount all of our customers have paid for services we render.



	'08	'09	'10	'11	'12	'13	'14	15	16	17	1H'18
<b>OTC Revenue (\$m)</b>	18.6	27.6	30.7	35.7	45.9	48.5	43.3	53.2	51.4	51.0	28.0
Less amount retained by self-employed Dentists (\$m)	3.4	5.3	6.8	6.9	9.2	12.3	11.5	16.6	14.9	14.8	8.2
<b>Statutory Revenue (\$m)</b>	15.2	22.4	23.9	28.7	36.7	36.2	31.8	36.6	36.5	36.2	19.8

In the current period, Statutory and OTC Revenue grew at 9.7% and 9.6% respectively. The fact that these growth rates nearly match for the current period is neither good nor bad, and we can expect these rates to diverge in the future as they have in the past.

### Cash & debt

At the end of the current period our cash balance stood at \$4.8 million, down from \$8.6 million one year earlier. This is good news, because it means we've found good acquisitions to which we have allocated some of our cash reserves.

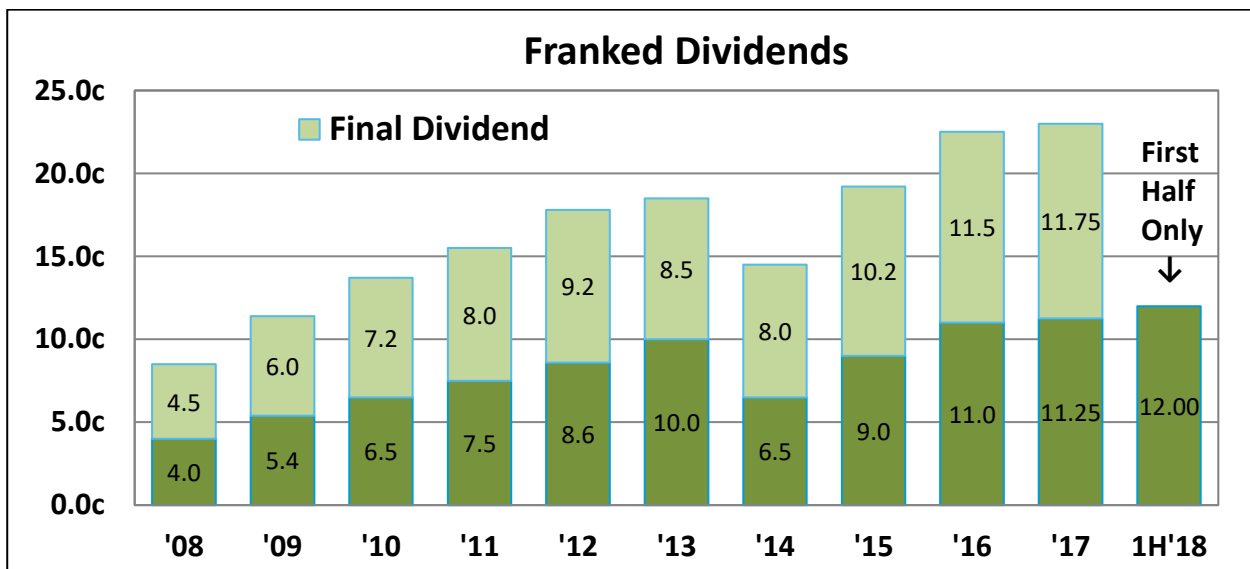
In the course of making the recent acquisitions we also drew on our existing loan facilities, finishing the first half with bank debt of \$4.2 million.

Our business is cash flow positive. Our gearing remains modest by any reasonable standard.

We remain able to complete acquisitions on any scale we can foresee thanks to our cash balance and the unused portion of our established credit lines.

## Dividend

In addition to rewarding our shareholders for their support of our company, I regard the dividend as a key part of our communication with shareholders. The increase in our interim dividend to 12c per share, fully franked, reflects the core strengths of our business and the board's belief that there is no reason to expect these core strengths to diminish.



In setting the dividend, we considered all of these factors:

- our business generates positive cash flow
- we expect continuing organic growth from our established centres
- we expect to complete an ongoing series of acquisitions over the coming years
- our gearing is modest with all borrowings allocated exclusively to income-producing assets
- we have the ability to complete all acquisitions which meet our standards
- the outlook for our business remains positive
- we are committed to treat shareholders as the true owners of our business.

## Acquisitions & growth

As mentioned above, our company has completed a number of solid acquisitions over the past year, many of them in the half-year period which is the subject of this report. We announce these acquisitions to the market as they are completed, but I note a few examples here:

- orthodontic practices in Chatswood (Sydney) and Bathurst, NSW, completed at the end of June 2017 and included in the current period's results.

- established dental practices in Maleny (Sunshine Coast hinterland), Roma, and Gladstone, all in Queensland, acquired in October 2017 and so making only a partial contribution to the current half-year results. These practices together are expected to deliver annual revenue of approximately \$4 million.
- an established dental practice in the sugar centre of Ingham, Queensland, completed in December 2017 and so making only a slight contribution to the current half-year result.
- subsequent to the end of the period, a dental practice in Buderim (Sunshine Coast), Queensland, expected to be completed in March 2018.

All of these will contribute, to varying degrees, to the full year 2018 results and we expect all of them to make positive contributions.

### **Our industry**

Last year at this time I reported my belief that our industry was under stress, and that on balance this stress worked in favour of 1300SMILES. So far that view has proved to be about right.

One of the essential relationships which we simply must get right is that between our company and the dentists who choose to base their practices within our facilities. Of the major players in the dental industry, there is now only one--1300SMILES Ltd--whose chief executive is a practising dentist. While that's not everything, it certainly counts for something.

I still work as a dentist in one of our practices every week. I maintain immediate, practical, and personal awareness of the issues affecting our dentists. This doesn't guarantee that a dentist will choose to work with our company instead of one of the others, but I am confident that it is a positive factor.

1300SMILES Ltd grew from a desire to manage multiple dental practices in the best way possible, maximising efficiency and profitability while optimising dentist and patient satisfaction. These objectives are entirely compatible.

We are dentists and practice managers first and foremost. I believe this makes us different from some of the other dental operators, many of whose managers come from outside the industry and some of whom may see a dental operation as an asset to be traded for the right price.

For several years we have watched as certain players in the dental services market paid prices for dental practices which look way too high to us. While we can never know exactly what motivates this sort of buying, we can speculate that the desire to establish a permanent presence in the dental market is not the top objective of some of these players.

Our approach gives us the ability to be patient and sensible. When others are acquiring practices for silly amounts, we simply step back and let someone else do the buying. The dentists involved sometimes pocket plenty of money--and I'm happy for them--but as their contracts with other companies come to an end these capable dentists are increasingly coming available once again.

The consolidation of the dental market is nowhere near complete. In the end there will be a number of quality corporate dental operators (increasingly known as DSOs "Dental Service Organisations"), and there will be a persistent rump of owner-operators working out of small surgeries here and there. I cannot say how the Dental Service Organisation segment of the dental market will be divided among the key players, but we can be confident there will be further change.

We will continue to pursue our proudly conservative financial practices and our strict approach to potential acquisitions to ensure that our company is in a strong position to deal with the ongoing evolution of our industry.

## **Outlook**

Based on the opportunities before us, it would appear that the number of promising acquisition candidates will remain solid for some time to come. As always, we will make only those acquisitions which make immediate and lasting contributions to our revenue, profit, and core strength. We will never pursue sub-standard acquisitions merely for the sake of increasing the number of practices we operate.

A year ago it seemed to me that the political situation was about as bad as it could get. I was wrong about that. As our federal and state governments continue to explore new depths of incompetence and depravity we find that our economy somehow persists.

Our government could surely take fewer steps to harm consumers and businesses, but the economy upon which we all depend seems to keep ticking over. I'm tempted to imagine that the political situation can only get better, as one wouldn't think it could get much worse, but we're committed to manage our business to meet economic conditions as we find them and protect the interests of our shareholders as best we can.

## **Board & management**

I mentioned at the top of this letter that I am extremely pleased with the quality of our management, which I believe is the best it has ever been.

At the board level, we welcomed two new directors at our Annual General Meeting of 23 November 2017, Evonne Collier and Jason Smith. Evonne and Jason bring abundant experience and plenty of energy to our ever-compact board of directors. It's a pleasure to work with them and they share my commitment to putting shareholders first. Please see further information about our new directors in our announcements of 23 November 2017.

## **Thank you**

As always I express my enthusiastic thanks to all of our hard working dentists, clinical staff, and management staff, all of whom have worked hard to deliver the good results reported here. I also thank you, our shareholders, for your continuing trust and support.

Yours faithfully

Dr Daryl Holmes (OBE)  
Managing Director

## **ABOUT 1300SMILES LTD**

### **OVERVIEW OF THE COMPANY'S BUSINESS**

1300SMILES Ltd owns and operates full-service dental facilities at its sites in New South Wales, South Australia, and 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](mailto:md@1300SMILES.com.au) .

Qualified dentists who wish to know more about joining one of our established facilities are encouraged to contact Dr. Holmes directly or email [dentalcareers@1300smiles.com.au](mailto:dentalcareers@1300smiles.com.au) or visit our website [www.1300smiles.com.au/careers](http://www.1300smiles.com.au/careers) .