

## LETTER FROM THE MANAGING DIRECTOR

Dear Shareholders,

Many key issues compete for top billing in this letter. They are all important. We have to deal with them in some order, but I don't want readers to think that this order amounts to some sort of ranking. These are the issues of great significance--to our dentists and staff, to our patients, to our suppliers, and to our shareholders--that I will address in this letter:

- First half results. These were solid as a rock with 7% growth in OTC revenue, 6% growth in EBITDA, and 4% growth in Net Profit After Tax.

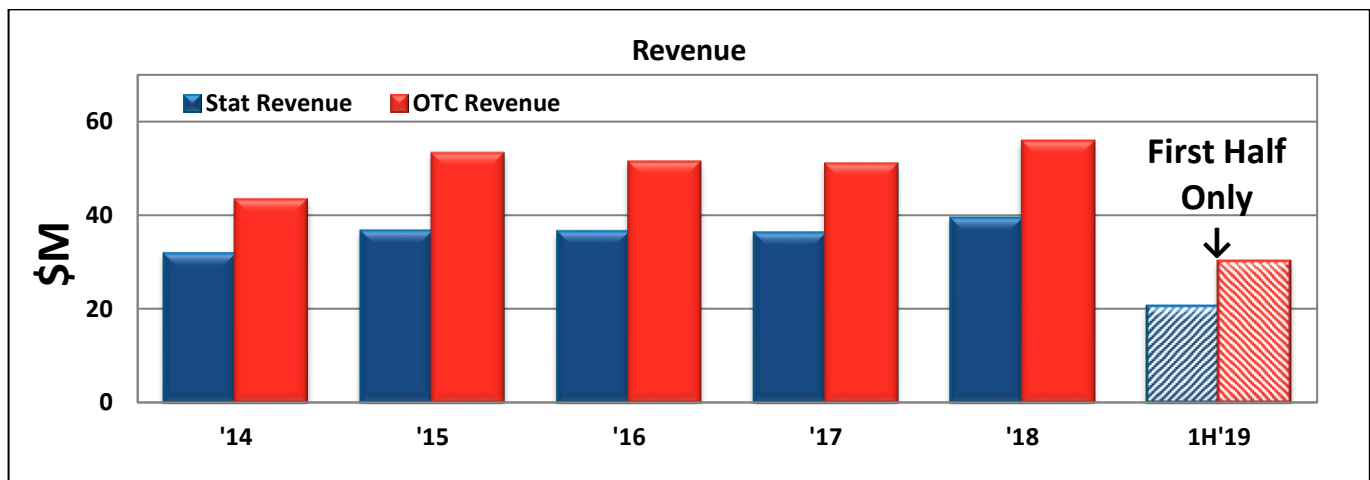
○ Revenue (OTC) up 7.1% to \$30.0 million	○ Revenue (Statutory) up 3.9% to \$20.5 million
○ EBITDA up 5.7% to \$7.1 million	○ Earnings per Share up 4.3% to 17.3cps
○ NPAT up 4.3% to \$4.1 million	○ NPBT up 4.5% to \$5.9 million
○ Interim dividend up 4.2% to 12.5cps	○ Bank debt at \$4.4 million

- Townsville floods. The recent floods affected dentists, staff, and patients at our seven Townsville practices. Many of our dentists and employees have had their homes and possessions badly affected--some lost everything – and the jobs and schooling of family members disrupted. I express my heartfelt sympathy to all who have been affected.
- Response to Townsville floods. The outpouring of care and concern has been phenomenal. For those of us at 1300SMILES it has been heartwarming to find out how many of our patients, suppliers, and colleagues have contacted us to enquire about the well-being of our staff and dentists. Thank you to all.
- Business response to Townsville floods. Our Townsville operations were briefly interrupted by the floods, as I'll discuss in detail below. But the response from everyone we rely on--our insurers, tradesmen, staff, dentists, and patients--has been simply wonderful.
- Economic rebound. In 1998, Townsville suffered flood damage on a comparable scale to that of the recent events. That flood set off an economic boom in the region which continued for years. Early indications suggest that the economic activity arising from the current re-building of Townsville will be far greater than that of 1998. In addition, this new activity coincides with a period of rebounding fortunes for the mining industry. We're entering into a period in which there will be simply much more money flowing through every corner of the regional Queensland economy.
- Mergers and Acquisitions; practice level acquisitions. Our activity on these fronts remains intense indeed, although these efforts produce results we announce to the market only infrequently. We expect to make significant announcements on this front soon.

**Financial results for the half year to 31 December 2018**

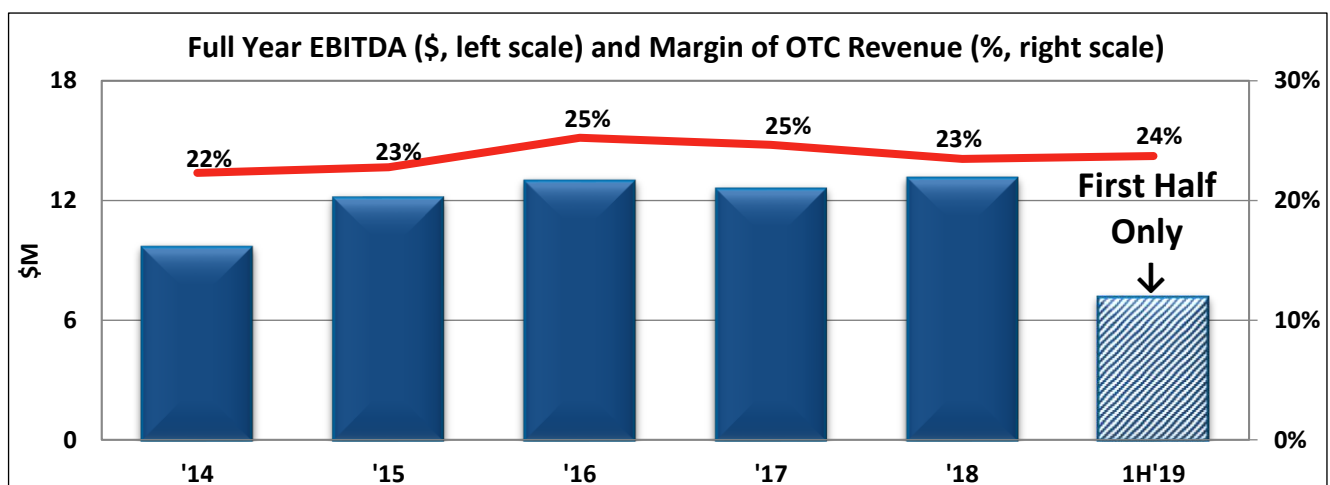
1300SMILES has delivered solid financial results for the first half of the year, with positive progress on all important measures.

Over-the-Counter Revenue was up 7.1% to \$30.0 million, a record high boosted by a combination of solid growth across our long-established practices plus the incorporation of the practices acquired toward the end of the 2018 financial year.

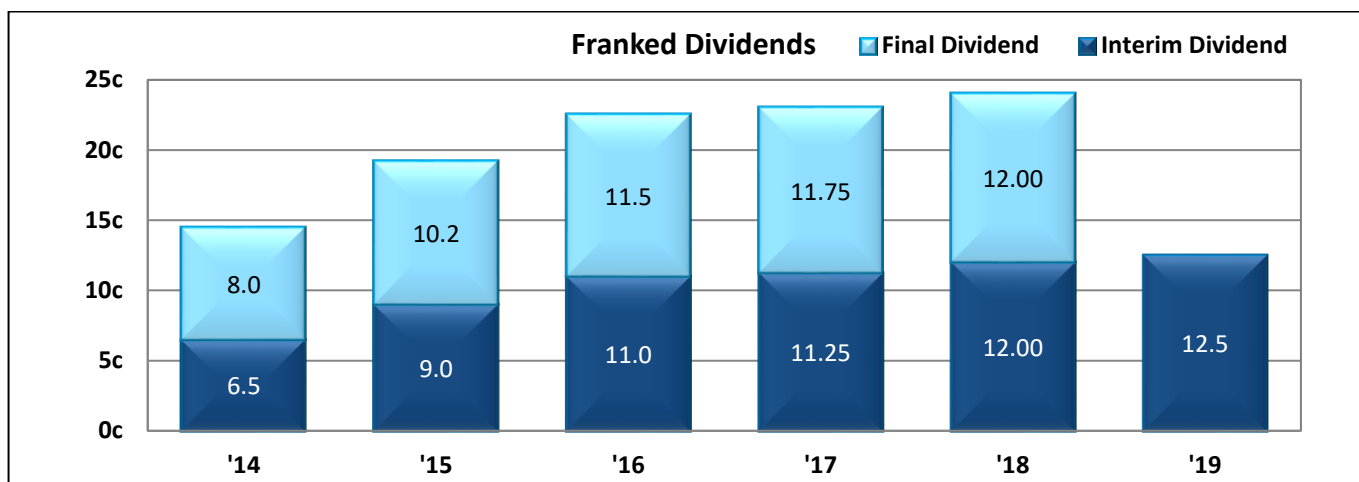


	'14	'15	'16	'17	'18	1H'19
<b>OTC Revenue (\$m)</b>	<b>43.3</b>	<b>53.2</b>	<b>51.4</b>	<b>51.0</b>	<b>55.8</b>	<b>30.0</b>
Less amount retained by self-employed Dentists (\$m)	11.5	16.6	14.9	14.8	16.5	9.5
<b>Statutory Revenue (\$m)</b>	<b>31.8</b>	<b>36.6</b>	<b>36.5</b>	<b>36.2</b>	<b>39.3</b>	<b>20.5</b>

EBITDA is an increasingly important measure in our industry, as Dental Service Organisations become a more important but still small part of the total dental industry in Australia. Our EBITDA was up an agreeable 5.7% to \$7.1 million and compares favourably to that produced by a number of our competitors.



Net Profit After Tax, Earnings Per Share, and the interim Dividend all increased by more than 4%. We have long committed to ensure that shareholders in 1300SMILES are truly treated as owners of this business, so in the normal course of things we expect our dividend to grow on a similar trajectory to that of Earnings Per Share.



Our balance sheet remains conservative indeed. We regard the \$4.4 million of bank debt deployed at the moment as modest in relation to the size of our business and the value of the acquisitions it has enabled.

### Townsville floods

Of our thirty-two dental facilities in Australia, seven are located in Townsville, Queensland's largest regional centre. All of these were affected to some degree by the floods of early 2019. Our greatest concern is focused on the disruption of the personal lives of our many dentists and staff members. In many cases the effect on their non-work lives has been far greater than any work-related disruptions. We're doing our best to look after all of our dentists and staff members with the care they deserve.



I am pleased to report that all of our Townsville facilities stood up well to the fierce and extended stormy weather. None of our practices was affected by flood waters or mud; all are positioned well above some of the worst flooding ever seen.

The sheer volume of rain, much of it horizontal and driven by powerful winds, caused some disruption at all seven of these practices. All Townsville practices were closed for a few days while the city itself was paralysed. There was no way for dentists, staff, or patients to travel.

Only two of our facilities were forced to shut briefly by water incursion. Not flooding, I emphasise, but various small water leaks leading to minor interior damage. No expensive equipment was damaged. The other five Townsville practices remained open and in full operation except for those few days when the whole city was shut down.

Thanks to exceptional work by our insurers and tradesmen, all seven of our practices were fully operational and in excellent condition first thing on the morning of Monday 11 February, just days after the worst of the weather subsided.



We carry business interruption insurance as a normal part of our risk management and expect to recoup all repair costs and lost profit arising from this event.

I have so many people to thank for the fact that the harm to our business was absolutely minimised. I note the hard work and good cheer of our staff, dentists, and patients. I salute the solid response from Townsville's emergency services--with massive assistance from the Army--and the public at large. What a great community.

### **Economic rebound**

Floods of the sort just suffered by Townsville are a fact of life. Following the 1991 flood and the extraordinary "Night of Noah" in 1998 (in which Townsville had almost a meter of rainfall in one day) we saw extraordinary, extended economic booms. Just looking along the streets we can see that sales of white goods, consumer and business electronics, and furniture sales are all about to boom, as are sales of building materials and flooring of all kinds, with much of this buying activity funded by insurance payouts. Every restaurant and hotel in town is getting ready for a sustained crush of demand. Every landlord looks out on a sea of eager tenants funded by insurance payouts and tradesman's premium rates.

As I have often reminded you, dental services are, to a degree, discretionary purchases driven by consumer buying power and consumer confidence. I have pointed out before that we compete with Harvey Norman or Amazon for consumer spending at least as much as we compete with other dentists, probably more. Looking ahead, our seven Townsville practices, recently surrounded by flood waters, will soon find themselves operating in a flood of consumer spending.

We observe this effect right now, on a smaller scale, in Airlie Beach. In March 2017, Cyclone Debbie clobbered Airlie Beach and most of the Whitsundays. Two years later, Airlie continues to enjoy an economic boom which shows no sign of diminishing. These effects show up clearly at our nearest facility, in Mackay.

Meanwhile, business at most of our regional Queensland facilities is getting a boost from the ongoing strength of the resources industry. It appears to us that this sector of the economy is still gathering strength, adding demand for dental services in almost all of the regional centres we serve.

### **Mergers and acquisitions**

Our senior managers spent a great deal of time on larger potential acquisitions during the first half of the current year. The transactions we work on are sensitive, complex, and large in scale. Progress on such deals is slow and exquisitely careful. We will of course announce finalised deals to the Australian Stock Exchange at the appropriate times.

### **Practice-level acquisitions**

Long term shareholders are well aware that acquisitions seem to come in spurts. The underlying work is constant and never-ending, but the results come in bunches.

After announcing a batch of acquisitions completed at the end of the 2018 financial year, the first half of the 2019 year produced no completed, announced deals. This does not suggest any lack of progress.

As of now I expect that we will soon be able to announce contracts, subject to the usual conditions, to acquire several additional larger practices delivering estimated additional annual revenue of at least \$6.5 million--a significant increment. These pending acquisitions will meet our usual strict performance standards and I expect them to make a contribution to EBITDA commensurate to the expected increase in revenue.

### **Politics and uncertainty**

Regional Australia has been facing economic challenges for some years now. More recently, capital city real estate prices have been dropping at startling rates. And, of course, we now face another federal election. Political uncertainty is always negative for consumer confidence. This year we have a bonus complication: a debate over whether to make significant changes to dividend imputation.

I'm not going to enter the argument about dividend imputation and franking credits. Over our fourteen years as a listed company we have been proud of our record of paying growing franked dividends. This record reflects our commitment to doing the right thing by shareholders in the economic and tax framework within which we operate. If that framework happens to change then we'll adjust our behaviour as necessary to continue our careful and fair treatment of shareholders.

Perhaps I can make a small contribution by reminding people of a bit of the history of dividend imputation. First of all, it was Paul Keating who thought of it, back in the 1980s. Today, it seems that many of the most adamant defenders of refundable imputation credits are people who don't like Keating and have a hard time believing that he introduced it. He did, and I would argue that the imputation system had lasting positive effects on the Australian economy and went a long way toward achieving its goal of eliminating double-taxation of company income.

I'll bet Keating never dreamed that any government would push the imputation system so far as to make excess franking credits refundable in cash. It took John Howard and Peter Costello to think of that, many years later. They were facing a difficult election campaign and came up with a sure vote winner among the growing population of self-managed super fund members: cash refunds. It worked for them, but it did so at vast and lasting cost to the Australian Treasury. This cost has been passed on, inevitably, to other tax payers.

That said, I'll resume my position standing back from this debate. I'm confident that if there are changes to the dividend imputation system, they will inevitably be less sweeping than feared or hoped (depending on your position), that they'll be eased in over some years rather than all at once, and that the small group of people badly affected by the change will be accommodated with some sort of transition arrangement. However it turns out, I assure you that 1300SMILES will continue to deliver benefits to shareholders to the best of its ability.

### **Thank you**

As always, but especially now, I express my enthusiastic thanks to our 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.



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).