LETTER FROM THE MANAGING DIRECTOR

Dear Shareholders,

The key to understanding the 2014 full year results lies in understanding the recent history of our company and the dental industry. The results are good and they reflect well on our many management initiatives. I ask for your patience, however, as I believe it is important to review the history of the past two years one last time before we turn to the 2014 results.

From the first era to the second era

In my last four letters to shareholders I have devoted considerable time to explaining how our business and indeed the entire dental industry have been transformed since the end of the 2012 year. This brief review marks the fact that 1300SMILES has now completed the transition from its first era as a listed company, through the turmoil of the 2013 year, to its second era.

The first era

The first era began in 1995, when we organised our first few practices into the private company which later became 1300SMILES. In March 2005, the company was listed on the ASX. From that time until the 2012 financial year, the company delivered growth in Revenue, Net Profit After Tax, and Dividends Per Share in every year but one. Over that period, Earnings Per Share grew from 9.8c per share in 2006, the company's first full year as a listed company, to 26.5c per share in 2012. The compound growth rate in EPS over the period was 18%. Over this era the company paid shareholders a total of 84.5c in fully franked dividends—a grossed up return of $1.21 on shares issued at 80c each in 2005.

During the first era the company saw alternating spells in which its growth came mainly from acquisitions in some years and mainly from organic growth in others. 1300SMILES has always restricted its acquisitions to those opportunities which offer an immediate and sustainable increment to Earnings Per Share. We have always been comfortable to forego acquisitions when the terms have been anything short of strongly favourable; we have never pursued growth in practice numbers for its own sake. I am proud to report that our organic growth has remained strong through all periods and continues to underpin the growth in our ongoing returns.

The transition - the 2013 year

The first era came to an end in August 2012, when the commonwealth government announced, without warning, the end of the Chronic Disease Dental Scheme (CDDS). The scheme would finish at the end of November 2012, which meant that dentists and patients scrambled furiously to get CDDS-funded dental care completed in those last three months.

This mad rush greatly inflated our Revenue in the first half to December 2013. Statutory revenue was about $21 million for the half, while Over the Counter (OTC) Revenue, which I have previously explained is a better measure of our total business activity, was just under $30 million. The half year set records on every front.

It was followed by a notably dull second half. Dentists took holidays after working exceptional hours during the first half. Many patients had had all of their CDDS work completed, while others stayed home, stunned and frightened about how they would pay for essential dental services. OTC revenue dropped from almost $30 million in the first half to under $20 million in the second half.

Don't think for a moment that we were sitting around wondering what to do during this period. We were busy laying the groundwork for future success. In particular, we introduced our $1 per day Dental Care Plan. By the end of the 2013 year, the Dental Care Plan was delivering ongoing membership fees at an annualised rate of $1.4 million, plus the extra income for services beyond those covered by the plan, but these effects just weren't in play for long enough to have much effect on the 2013 full year result.

Our 2013 OTC Revenue showed an increase of just 5.4% on the previous year. This was acceptable, under the circumstances, but a much smaller increase than those to which we had all grown accustomed. Considering the turmoil in our industry, however, I regard the fact that we delivered an increase in OTC at all as an extraordinary achievement and testament to the skill and tenacity of our managers, as well as the diligence of our dentists.
I regard the 2013 financial year as being the year of transition, not fully belonging to either the first or the second era.

The second era

The second era commenced with the first half to December 2013. Both Statutory and OTC Revenue in that first half were down sharply when compared to the greatly-inflated first half to December 2012, but this comparison offers no useful information.

The first half to December 2013 is important because it was the first reporting period of the second era, the baseline against which I urge shareholders to measure our progress. That first half reflected our operations in the new normal for the entire dental industry.

During this period we began to see significant numbers of patients who previously relied on CDDS benefits return to our surgeries, suddenly capable of funding their own dental care. This came as no surprise, because CDDS was not means-tested, so it paid for plenty of dental services for which patients could easily have paid themselves.

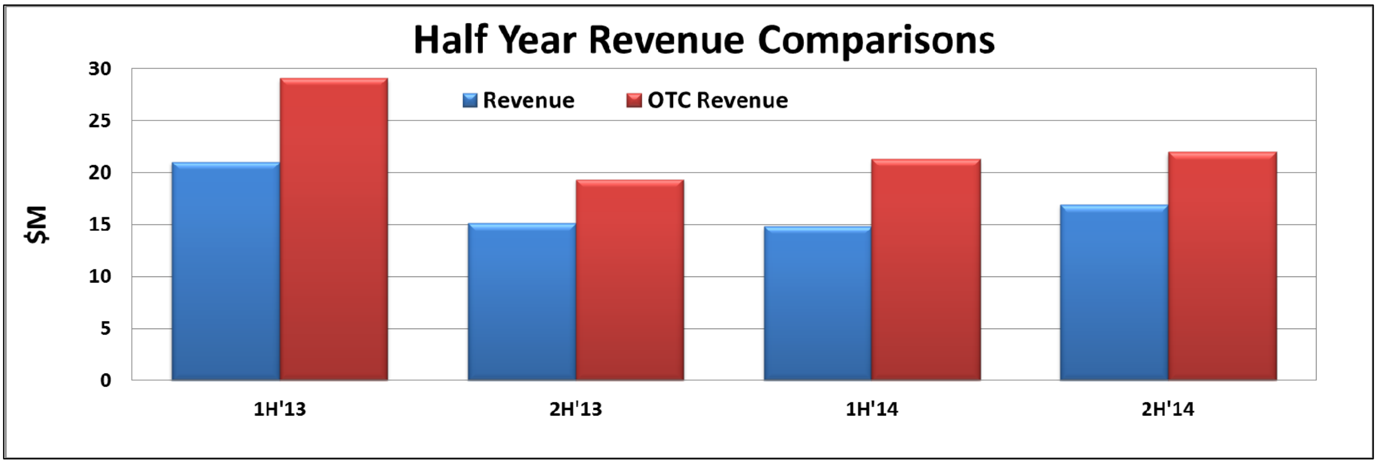
Compared to the previous year's first half, the half year to December 2013 started in a dental industry whose total revenue was about 20% smaller than it was in the previous year. For 1300SMILES, this first half was one in which we operated in relatively normal conditions:

- no inflated revenue from CDDS
- ongoing organic and incremental growth
- early indications of success for our $1-a-day Dental Care Plan membership program
- significant capacity within our surgeries for organic growth
- early contributions from our public-private operations which have taken much of the backlog load from Queensland Health while not creating any dependence on a big single purchaser of dental services as had developed under CDDS.

In the first half to December 2013, 1300SMILES delivered the results which form our new baseline: OTC Revenue of $21.3 million, NPAT of $2.5 million, EPS of 10.69 cents per share, and a fully-franked interim dividend of 6.5 cents.

The second half to June 2014 compares favourably to these results on all measures, reflecting the fact that the company delivered growth on all fronts: organic growth, with more dentists working more hours in more surgeries; growth in membership fees and additional professional fees in our Dental Care Plan; and, late in the year, our acquisition of BOH Dental, an important step which I will discuss separately.

Please see below a chart showing the Revenue and OTC Revenue results for the four consecutive half-years to June 2014. I rather hope that this is the last time I'll have to talk about what happened in the transition year of 2013.



As I have outlined above and elsewhere, the baseline against which we will measure our future results is the first half of the 2014 year. Against that first half, the second half of the year showed solid progress:

- Statutory Revenue up 14.1%
- EBITDA up 5.0%
- OTC Revenue up 3.2%
- Fully franked dividend up 23%

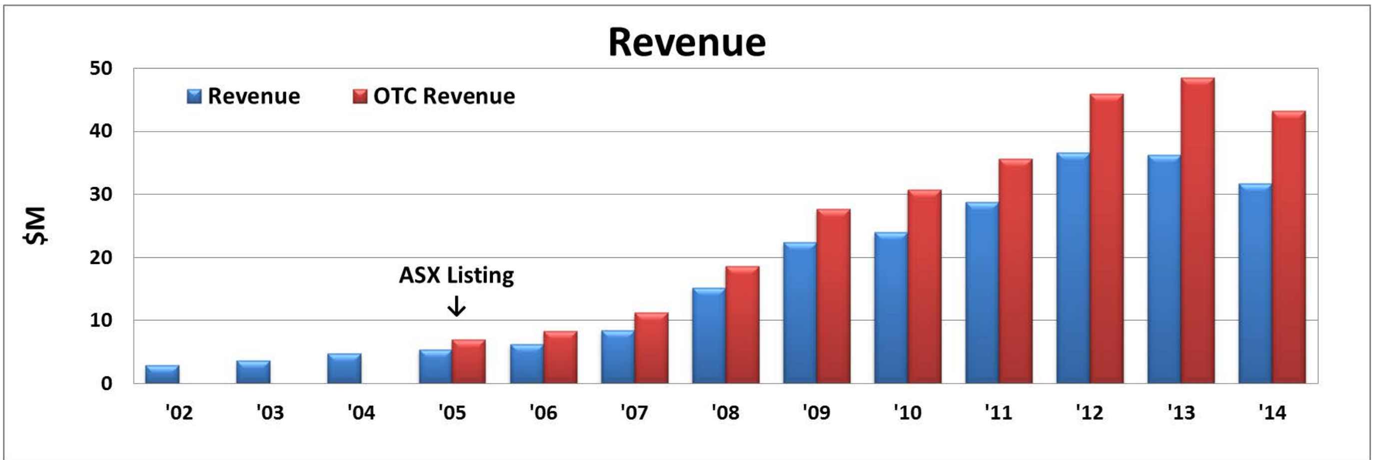
I am confident that these first indications of renewed growth will prove to be illustrative of the new growth phase the company has entered.

Financial Results for the year ended 30 June 2014

I am proud to deliver for shareholder inspection our results for 2014, the first year of the new era:

- Revenue (Statutory) down 12.3% to $31.8 million
- Revenue (Over-the-Counter) down 10.7% to $43.3 million
- EBITDA down 13.1% to $9.7 million
- NPAT down 21.7% to $5.0 million
- Earnings Per Share down 21.9% to 21.0c
- Full year dividend down 21.6% at 14.5c per share

On virtually all important financial measures, the results for the 2014 full year are inferior to those of the previous year. These declines across the board are all attributable, in whole or in part, to the abrupt end of the CDDS. As I have noted before, we are entitled to be proud of these results given that the entire dental industry has recently undergone a step-change downward in total industry revenue of about 20%. Make no mistake, conditions in our industry were as tough during the 2014 year as they have ever been. I believe that our company has emerged from this tough period more resilient and efficient than ever, and that our results, while down on previous periods, are more robust and more thoroughly tested than ever before.



Reconciliation of OTC Revenue (non-IFRS) to Statutory Revenue per (Financial Statements)										
	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14
OTC Revenue ($m)	7.0	8.3	11.2	18.6	27.6	30.7	35.7	45.9	48.5	43.3
Less amount retained by self-employed Dentists ($m)	1.6	2.1	2.8	3.4	5.3	6.8	6.9	9.2	12.3	11.5
Statutory Revenue ($m)	5.4	6.2	8.4	15.2	22.4	23.9	28.7	36.7	36.2	31.8

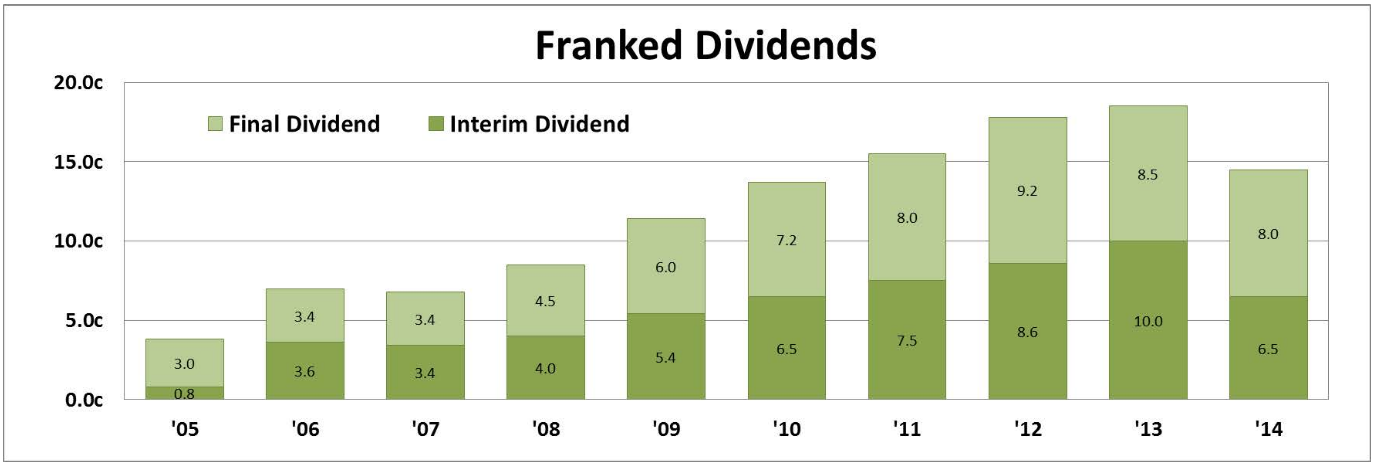
"Revenue" in the chart above is the Revenue we report in our statutory accounts.

"OTC Revenue" is a measure we track which captures the full value paid by patients for all services rendered. OTC Revenue gives a clearer indication of the scale of our business. The difference is that "Revenue" excludes the portion of patient fees retained by self-employed dentists.

Dividends

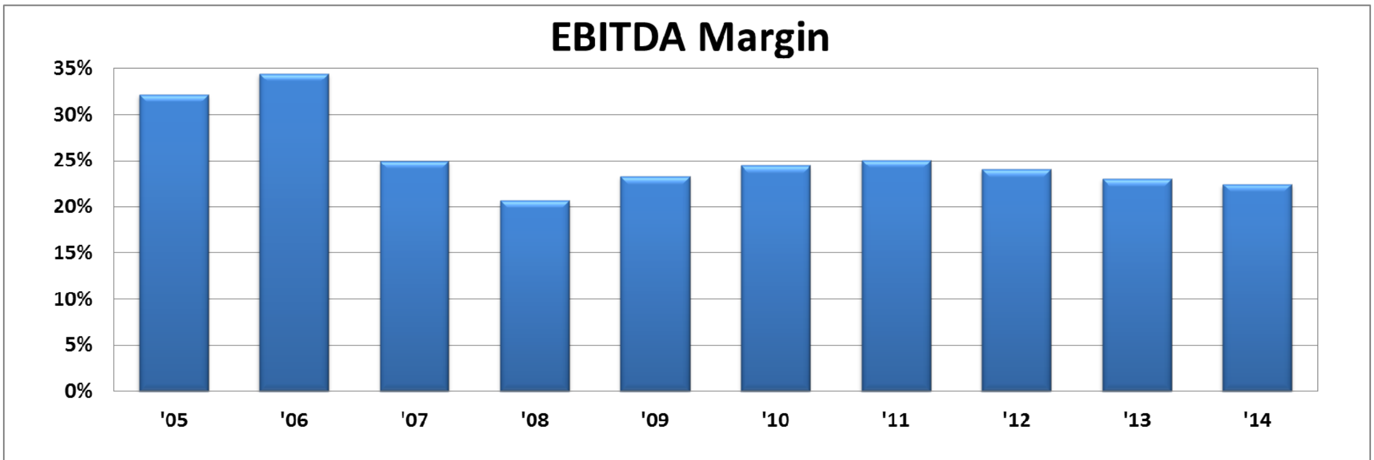
We have always regarded dividends as a way of enabling shareholders to participate in the company as true owners of the business. We are proud of our history of paying steadily growing and always fully franked dividends. For the 2014 year the full year dividend took a step downward, in parallel with our results. I join all shareholders in looking ahead to resumed dividend growth. As I have reminded you many times before, my reward for running the company comes mainly in the form of dividends I receive on my shareholding at exactly the same rate as every other shareholder.

The final dividend of 8.0c per share brings the total for the year to 14.5c. This represents a payout ratio of just under 70% of Earnings Per Share, the same as the previous full year. We endeavour always to set the dividend to ensure that shareholders participate in the company as true owners. With the reduced interim dividend, all shareholders joined me in experiencing the reality of our first half year of operations in the new era. I am extremely pleased that the second half of the year has delivered more agreeable results for all shareholders, and your directors will do their best to ensure that the company remains on this positive trajectory.



Earnings Before Interest, Tax, and Depreciation (EBITDA)

EBITDA is a measure of the quality of a company's core operations. The chart below illustrates the fact that our results at the EBITDA level have proved to be extremely resilient in the face of the industry shocks absorbed over the past two years. This performance results from the endless hard work of ensuring that every aspect of our operation is as efficient and as effective as possible. A lot of this work is neither flashy nor photogenic, but we devote a great deal of management time and real money to the job of enhancing the quality of our total operation.



Outlook

As always, we plan to deliver growth in the following main ways:

1. Organic Growth

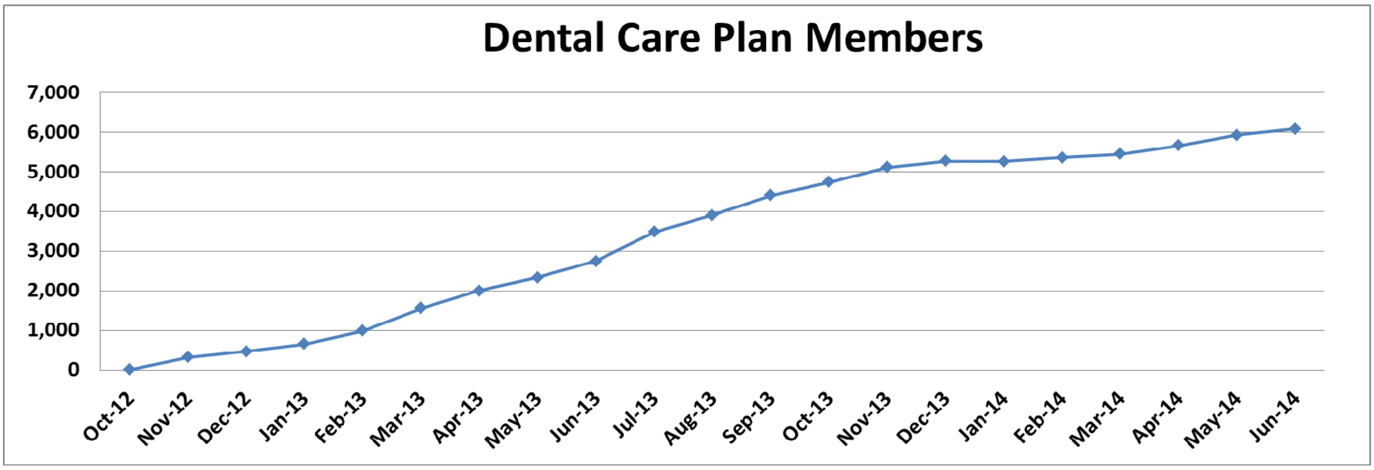
Almost all of our facilities can accommodate extra dentists at no further capital cost and extremely little in the way of startup costs. We always design our facilities with this extra capacity.

2. Acquisitions

We are always extremely picky about acquisitions and we will go for extended periods with no new acquisitions if potential acquisition targets fail to meet our requirements. At the end of the 2014 year, however, we made our largest single acquisition ever. This will deliver an immediate increment to NPAT and Earnings Per Share. This acquisition was included for only a short period in the 2014 year but it will be included for the full year in 2015.

3. Dental Care Plan – *Making Dentistry Affordable*

Under our $1-a-day Dental Care Plan members receive all routine dental maintenance and checkups at no further cost. Where more extensive treatment is required, members benefit from our Dental Treatment Plan, under which they enjoy both a 10% discount on the total cost of treatment plus six month, interest-free payment plans. At the end of the year the combined revenue from membership fees plus treatment fees was running at an annual rate of well over $3 million.



4. New Initiatives and ongoing innovation

Our $1-a-day membership plan boosts our business on many important measures, from the efficiency with which we use our facilities to our success in recruiting additional dentists. This front-end effort is further supported by our fierce commitment to ongoing systems development which enable us to control, measure, benchmark, and improve every aspect of our operations. This is reflected in our excellent EBITDA performance which I address elsewhere in this letter.

5. Child Dental Benefits Scheme

As cautious as we are about becoming dependent on any government scheme, CDBS covers up to $1,000 worth of treatment over two years for a population of about 3.4 million children. (Unlike the defunct CDDS, CDBS is effectively means-tested, but still available to a large proportion of families.) From a zero start in January 2014, CDBS now delivers a steady and useful increment to Revenue. This additional revenue is now running at an annualised rate of over $3 million.

6. New cooperation with government

Our ongoing relationship with Queensland Health has assisted in greatly reducing waiting times for public dental patients while delivering incremental Revenue and profit to the company.

Acquisition of BOH Dental, Brisbane CBD

Completed at the end of May 2014, our acquisition of BOH Dental is the largest we have ever made, on every measure: the biggest increment to Revenue, to NPAT, and to Earnings Per Share arising from any single acquisition, and the highest price we have ever paid. I believe that BOH will prove to be well worth the acquisition price, and a lot more. All of the partners of BOH supported the acquisition and all have committed to stay on in their well-established practices.

The scale and solidity of the BOH business mean that in this case we have acquired a sustainable earnings stream which is both larger and more certain than those of our previous acquisitions. The partners of BOH all agreed, effectively, to underwrite the agreed levels of revenue and margin we expect to derive from the BOH operations. I expect that BOH will make an annual contribution at the EBIT level of at least $1.25 million.

We believe that benefits will flow in both directions. Seven of the ten BOH dentists are senior specialists, enabling dentists elsewhere in the 1300SMILES system to make referrals within our system. While BOH's long-established practice is quite a strong business in its own right, we believe we can build further on that strength by introducing our Dental Care Plan to the thousands of BOH patients to whom it was not previously available. BOH is located in the heart of the Brisbane CBD and gives us a substantial presence in that city.

Allow me a soapbox moment (1)

The only shadow over our acquisition of BOH Dental is the accounting treatment of stamp duty. Our acquisition of BOH caused us to incur a stamp duty charge of $544,031. This is a real cash expense which reduced our 2014 NPAT by that full amount and, accordingly, exerted downward pressure on our Earnings Per Share.

There is, however, a bizarre twist. That stamp duty, which we paid with real cash and which our accounts recognise as a real expense, is NOT deductible for tax purposes. The Australian Tax Office regards stamp duty as a capital cost. That could make sense, but only if the tax treatment and the accounting treatment were aligned. While the accounts are presented in accordance with accounting standards, this misalignment gives a distorted view of the effect of this transaction. If the $500,000 were an expense--as it is in our accounts--it would also reduce our tax bill by $150,000. As it is, we must record the $500,000 as an expense while still paying the $150,000 tax which would be due in the absence of this expense. At the very least, this makes it difficult for shareholders to appreciate the immediate and lasting benefit to be derived from the BOH acquisition.

Stamp duty in its many forms is a job-killer, discouraging productive transactions across the economy. Its continued damaging effects arise, I understand, because the commonwealth and state governments cannot seem to work out a sensible way of sharing GST revenue, leaving the state to rely on destructive, job-killing taxes such as Stamp Duty and Payroll Tax. Both the state and federal governments have been under the control of the same party for a long time now; it's time to sort out the revenue sharing issue so the state can reduce or eliminate these damaging, job-destroying taxes.

Allow me a soapbox moment (2)

I usually avoid detailed discussions of obscure accounting matters because they tend to even out from one year to the next. But this year I must mention the impact of our effective company tax rate. Over time, the income tax paid by 1300SMILES averages out at a figure very close to 30%, the standard company tax rate. The company does not pursue any aggressive tax strategy, and we structure our business activities to achieve the greatest possible sustainable return.

In most years, our effective tax rate is either a little above or a little below 30%, thanks to timing differences which inevitably arise in every accounting period. In the 2014 year, however, we have seen a particularly large swing, from 28.79% in 2013 to 32.36% in 2014, an increase of 3.57%.

Our net profit before tax for 2014 was $7.37 million. If we add back the stamp duty expense the figure rises to nearly $8 million. That 3.57% change in effective tax rate therefore caused our Net Profit After Tax figure to be lower by more than $280,000, compared to what it would have been had the previous year's rate applied.

Combined with the $544,031 stamp duty charge mentioned above, these two non-operational numbers have the effect of reducing our NPAT by more than $800,000--a decrement of more than 16%, with an equal effect on our Earnings Per Share. Our underlying business suffered no such decline and it's a pity that the accounting standards require us to present our accounts in this way.

QIP Accreditation

I am proud to advise that 1300SMILES Ltd has achieved the highest level of accreditation for all of its dental practices under a scheme developed by the Quality Innovation Performance Group (QIP) under the Australian Dental Association's accreditation program. QIP advises that "1300SMILES is the first dental group in Australia to undertake accreditation of all of their dental practices in a single process to achieve accreditation by QIP against the National Safety and Quality Health Service standards."

I invite you to consider the implications of this achievement. We believe that individual dental practices will in many cases struggle to satisfy the QIP requirements, if for no other reason than that the administrative demands of achieving this certification may be beyond the management capacity of smaller dental operations. Within 1300SMILES, dentists enjoy the administrative support required to deliver the many management services which are essential but not directly related to the delivery of patient care. Our business focusses totally on freeing dentists to do what they do best--hands-on dentistry--while freeing them from the administrative burdens.

Only a few hundred of Australia's 8,000 dental practices have achieved this qualification; we have achieved it for all twenty five of our facilities.

Youth With A Mission

YWAM continues to deliver medical, dental and optical services on an extraordinary scale directly to remote areas of Papua New Guinea which for the most part have no other medical care available.

I am joined by many 1300SMILES staff and dentists who have volunteered their time and effort both on board the ship and in other capacities. As a company, we support and encourage this generosity on the part of our people.

YWAM's latest initiative, called "Overcoming the Impossible," aims to raise the remaining $5 million required to convert a former cruise ship into its primary operating vessel, known as M.V. Ammari. I personally am proud to assist YWAM with this effort.

OLD SHIP – Pacific Link

$6.5m

NEW SHIP – MV Ammari

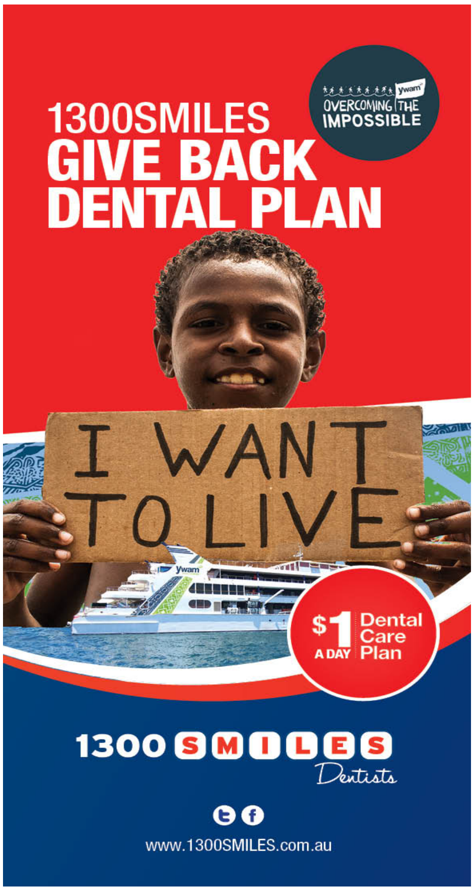
VISIT YWAMSHIPS.ORG.AU

ywam medicalships

FOLLOW #OVERCOMEIMPOSSIBLE

I am especially pleased to invite all shareholders to take the opportunity to visit YWAM's new ship during the Overcoming the Impossible Tour. The ship will call in at ten ports between Cairns and Sydney between August and December. I urge you to come aboard and have a tour. You will be amazed by the facilities, and the generosity of the volunteer crew will leave you speechless. For more information and details please visit their website at www.ywamships.org.au

Most recently we announced that five percent of the ongoing payments received from all new members in our $1-a-day Dental Care Plan will be donated to YWAM Medical Ships. This ongoing funding will assist YWAM to address critical oral health problems in some of PNG's most remote and vulnerable communities.



Thank you

I have many people to thank, as I do every year. I thank our dentists and staff, many of whom put in extraordinary extra effort in this extraordinary year. I thank you, our shareholders, and I look forward to seeing as many of you as possible at the Annual General Meeting.

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 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.

Qualified dentists who wish to know more about joining one of our established facilities are also Encouraged to contact Dr. Holmes directly or email dentalcareers@1300smiles.com.au or visit our www.dentalcareersaustralia.com.au.