

**LETTER FROM THE MANAGING DIRECTOR**

Dear Shareholders,

I am extremely pleased to deliver our accounts for the year ended 30 June 2016. The results are solid and strong. I am especially happy to report that 1300SMILES has declared a record final dividend of 11.5c and a record full year total dividend of 22.5c per share.

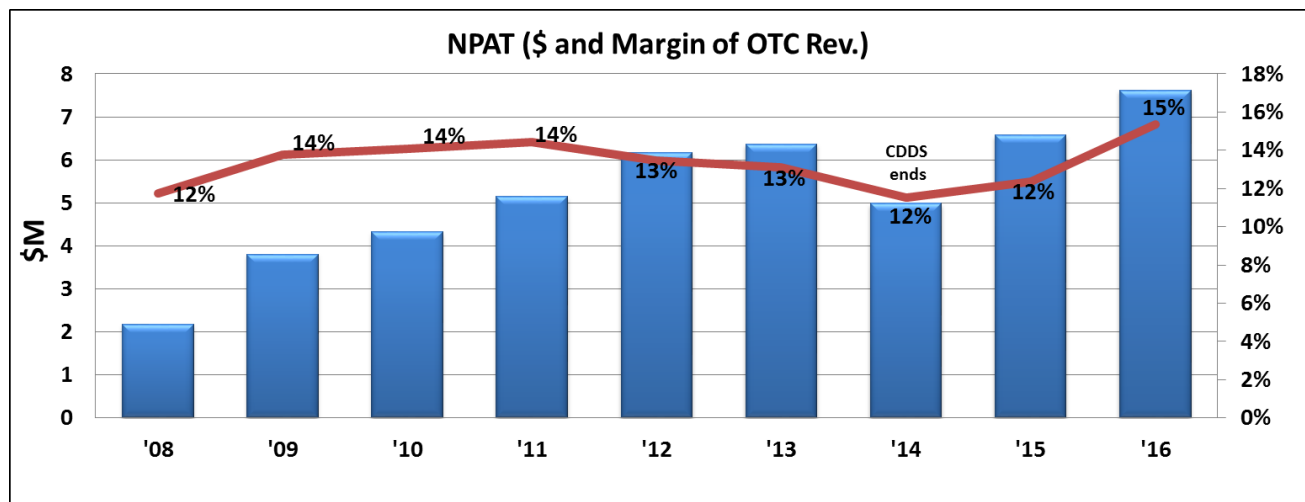
Over a decade in which everything about business, technology, and society has been changing rapidly, our company’s single core focus has continued to deliver good returns to shareholders.

Our services to patients, our management tools, and our administrative processes have all improved radically over the past decade, but we have maintained our solid focus on providing quality dental care to patients, an attractive working environment to dentists and staff, and good financial results for shareholders.

The overall result for 2016 is consistent and pleasing, but with a notable difference from previous periods. A consistent and quite normal aspect of our results is that our Net Profit After Tax and Earnings Per Share were both up by an acceptable 15.8%. The unusual aspect of this good result is that it was achieved in a period in which Revenue was flat. I will discuss this further after the main results presentation.

**Financial Results for the year ended 30 June 2016**

- NPAT up 15.8% to \$7.6 million
- Earnings per Share up 15.8% to 32.2c
- Full year dividend up 17.2% to 22.5c
- Cash balance up 20.0% to \$7.5 million
- Revenue (Statutory) unchanged at \$36.4 million
- Revenue (Over-the-Counter) down 3.9% at \$51.1 million
- EBITDA up 8.1% to \$13.1 million
- Bank debt unchanged at \$0

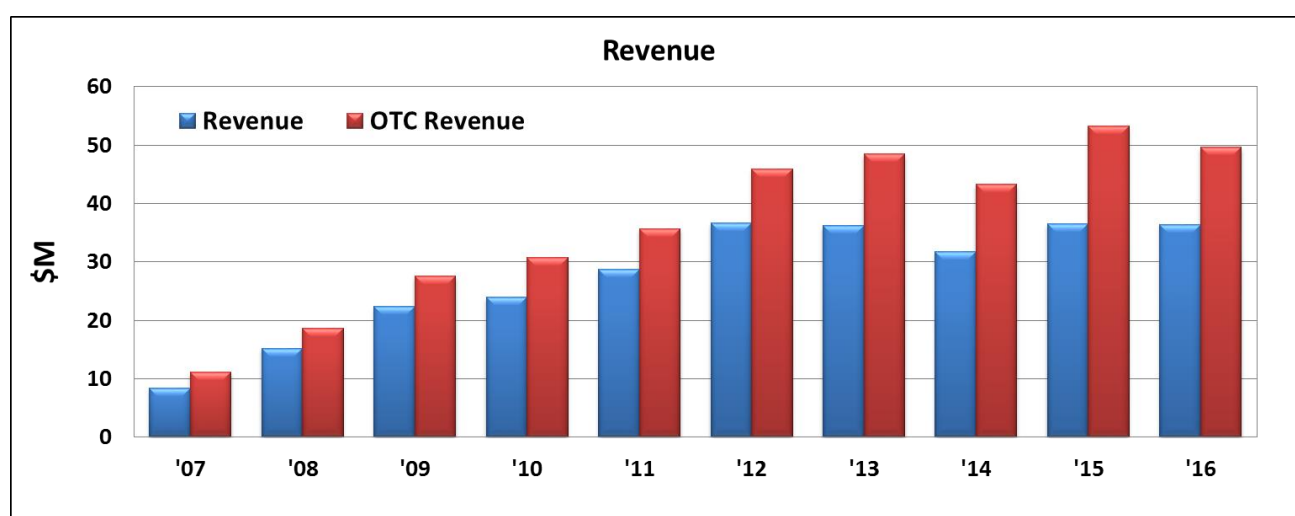


Shareholders know that we are fierce in our determination to make acquisitions only on terms which are immediately advantageous to shareholders. We made one strategic, bolt-on acquisition late in the 2016 financial year. The acquired practice was subsequently re-located and consolidated with an existing practice nearby, delivering a strong positive increment to profit which we expect to continue and grow in the financial year just beginning.

The dental market remains somewhat confused by the activity of private health insurers, private equity firms and other players with shallow roots in the dental industry. 1300SMILES plays a long game and we will wait until the acquisition opportunities are better. I speculate that the current market conditions will create significant opportunities for us in the foreseeable future.

2016 was a year in which much of our profit growth came from internal improvements--an achievement of which all our staff should be proud. Our relentless focus on costs and efficiency came to the fore in the 2016 year, and we finished the year leaner and more efficient than ever.

I expect Revenue growth to resume, following the current period of political and economic uncertainty, and as it does so I expect we'll see an increased portion of Revenue falling through to the bottom line. Within the 2016 financial year we saw notably positive improvements from the third to the fourth quarters, and I expect this trend to continue into the 2017 financial year.



#### Reconciliation of OTC Revenue (non-IFRS) to Statutory Revenue (per Financial Statements)

	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14	'15	'16
<b>OTC Revenue (\$m)</b>	7.0	8.3	11.2	18.6	27.6	30.7	35.7	45.9	48.5	43.3	53.2	51.1
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	16.7	14.7
<b>Statutory Revenue (\$m)</b>	5.4	6.2	8.4	15.2	22.4	23.9	28.7	36.7	36.2	31.8	36.5	36.4

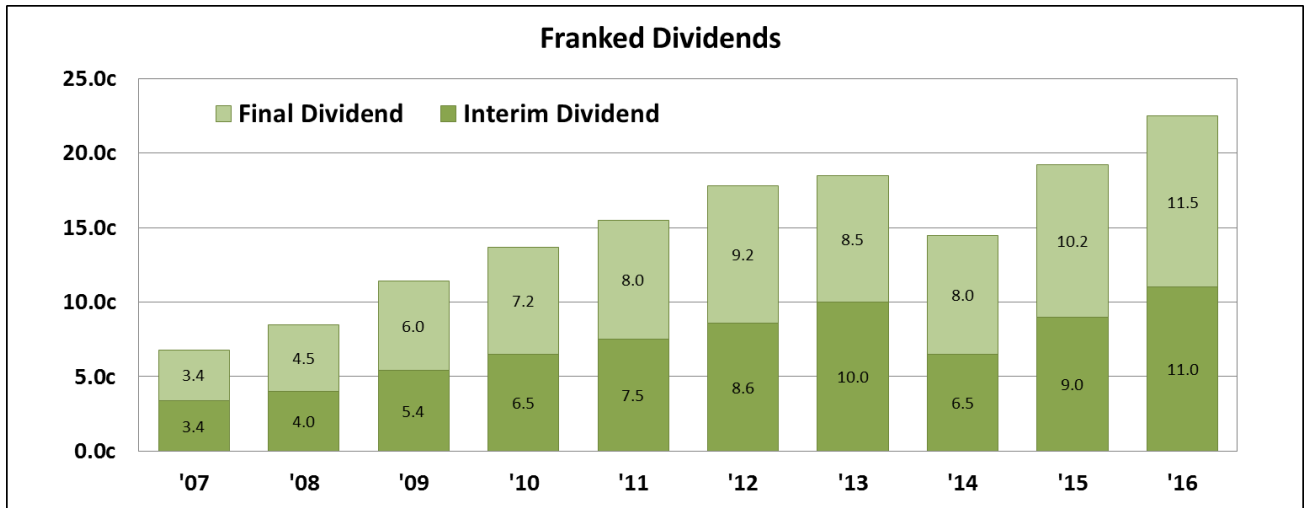
"Revenue" in the chart above is the Revenue we report in our statutory accounts. "Over-the-Counter (OTC) Revenue" is a measure which captures the full value paid by patients for all services rendered. OTC Revenue gives a clearer indication of the scale of our business. The difference is that "Revenue" excludes the portion of patient fees retained by self-employed dentists.

#### Dividends

As I have reported many times before, the directors of 1300SMILES are committed to declare dividends which give shareholders the opportunity to participate fully as the owners of the business. This year's final dividend is our highest final dividend ever and the highest ever dividend for any period.

In setting this year's final dividend at 11.5c per share (bringing the full year dividend to 22.5c fully franked) your directors considered the increase in the year's Earnings Per Share, the company's future capital requirements, and the fact that the company has no debt and a cash balance of over \$7.5 million.

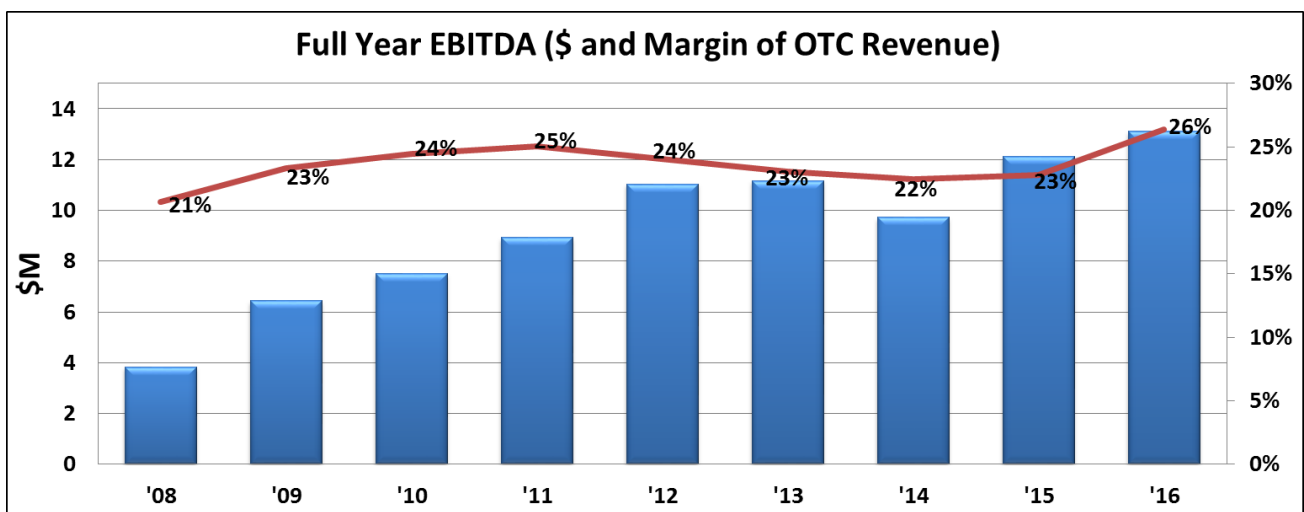
I notice that our full year dividend of 22.5c for the 2016 is more than the combined full year dividends for the 2008 and 2009 years--two good, solid years of which we were quite proud. By sticking to our knitting over the intervening years we've delivered an acceptable result for shareholders, and we aim to carry on doing so.



**Earnings Before Interest, Tax, and Depreciation (EBITDA)**

We report our EBITDA result because it is important to many in the financial community. EBITDA can be seen as a measure of our core business, regardless of our capital structure of our business. As a dollar figure, our EBITDA for the year was up 8.1% to \$13.1 million.

A related measure is our EBITDA Margin, which is EBITDA divided by OTC Revenue. The EBITDA Margin reflects the efficiency with which our company converts its Revenue to profit, again excluding the effect of the company's financial structure. Our EBITDA Margin improved from 22.8% to 25.6% for the full year.



The EBITDA Margin is just one measure. 1300SMILES operates in a favourable range on this measure, as shown in the chart above, but I note that the EBITDA Margin should never be considered in isolation. There are conceivable changes to our business which could be clearly positive but which could nevertheless cause our EBITDA Margin to decrease for some period of time. In saying so I make no forecast, but seek rather to ensure that shareholders understand this aspect of our accounts more fully.

## Future capital requirements

Shareholders should have no doubt whatever that 1300SMILES will continue to pursue sensible, profitable acquisitions. Our balance sheet is strong, and we believe we have access to capital sufficient to fund any opportunity we may choose to pursue. Our buying capacity comprises our cash balance, our established but undrawn bank lending facilities, and our access to equity capital markets.

## Operating efficiency

The directors and management of 1300SMILES never rest when it comes to improving the efficiency and performance of our operations. We've been working on this for more than a decade now and we'll keep on doing so, as this is a job which will never be finished.

Some of these efforts have immediate effects and some are helpful over longer periods. In the 2016 year the results of many of these efforts made themselves visible in our accounts. Among these is our ongoing Performance Management Project, which aims to deliver the best possible and most cost-effective corporate management.



Within our Performance Management Project we have just completed a major upgrade of our corporate management software. We have now largely completed the process of digitising, streamlining, and automating all head office processes. Our managers have access to better management data, faster, and at lower cost than ever before. We completed the transition to our new information management system late in the 2016 year, so it had only a small effect on the current year's results. The full effect will be apparent in all future periods.

While implementing better management tools and reducing expenses, we have stayed focused on building a culture of efficiency and effectiveness. We will spend money where it makes sense but everyone in our management structure knows that we expect solid, measurable benefits from every expenditure. Our call centre operation, for example, is at the core of our marketing effort. During the year we expanded our call centre operation, delivering increased Revenue from this operation while actually decreasing our total telephone expense. We expect continued growth in the contribution to Revenue from our call centre.

During the year we consolidated two of our practices into a single location, delivering an incremental reduction in rent and facilities expense while maintaining the Revenue formerly produced by the two separate facilities. In this case the increment to profit was large and immediate.

This fact is built into every one of our practices: wherever we buy, build, or renovate a facility, we make sure there's room to add in extra dentists. This extra capacity costs little up front but delivers generous increases to profit as we proceed with intensifying our activity at each site.

Also during the 2016 year we sold one practice which no longer met our performance standards, delivering a solid profit. While we do not regard the selling of practices as part of our core business I would note that our management discipline sometimes reveals that our business and shareholders would be well served by disposing of certain assets. If and when we decide to sell a given practice, we are certain that doing so makes a positive contribution to shareholder returns.

Another aspect of our operating efficiency is geography. The maldistribution of dentists across Australia is an issue which has dogged the industry and the various state health systems for many years. While the extremity of the situation has diminished somewhat over the past few years, it is still the case that there are too many dentists in the big cities, where many of them are much less busy than they would like to be. In contrast, dental practices located outside the major cities enjoy steady demand for appointments. Most 1300SMILES facilities are located in larger regional centres and in suburbs of major cities, and this approach continues to serve us well.

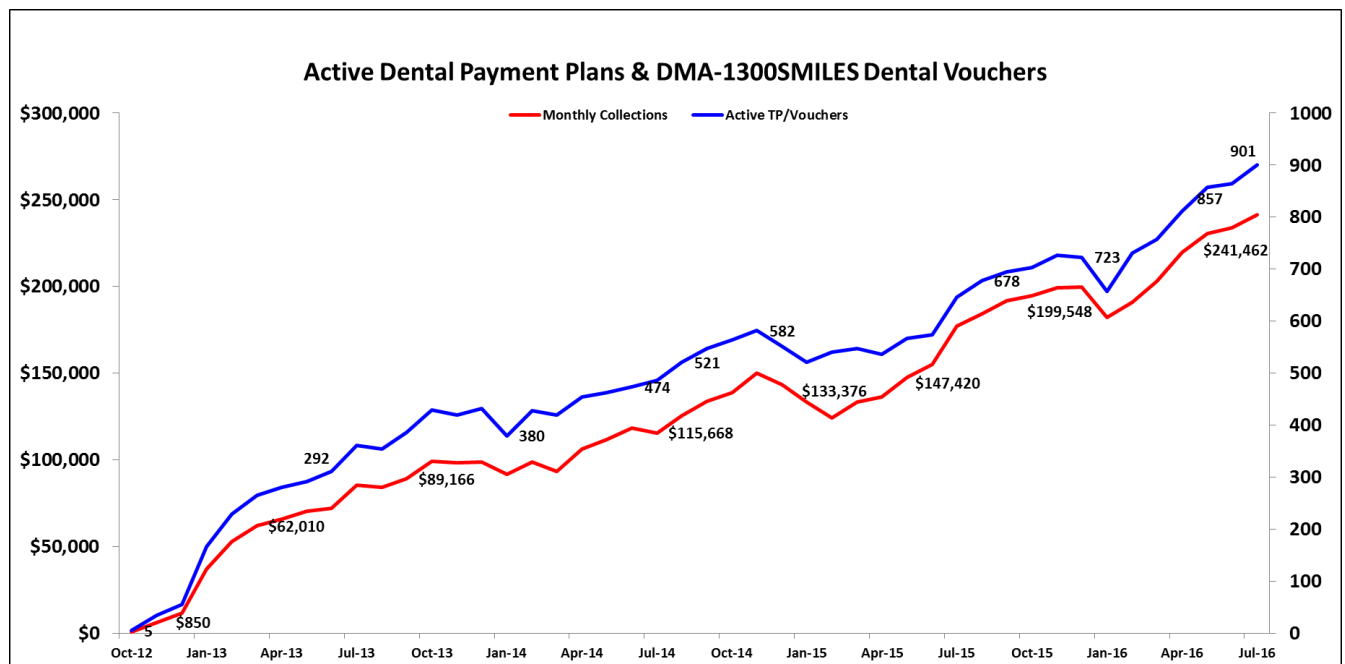
This does not in any way diminish the importance of our capital city facilities, all of which make solid contributions to profit. But it does underscore the importance of ensuring that city practices have special competitive advantages, because the outlook for yet another urban dental practice with no distinctive edge is poor indeed. I contend that our many service innovations and centralised professional marketing and management create an essential advantage for our central city practices.

**Family dentistry: availability, accessibility, and affordability**

The core business of 1300SMILES is owning, operating, and optimising dental practices by delivering quality dental services to ever more people across Australia.

For the foreseeable future, dentistry will remain a retail business in the sense that dental services can only be delivered to one patient at a time, by one or two professionals devoting their entire attention to that one patient. Those services must be available, accessible, and affordable to patients.

In previous reports I have discussed in detail our 1300SMILES Dental Vouchers program. This program gives patients affordable access to essential dental work which might otherwise have been unavailable to them. The Vouchers enable patients to fund their treatment via fixed weekly direct debit payments of \$49 to \$99. Patients choose a payment scheme compatible with their family budgets while our company has the certainty of payment via the direct debit system over the course of treatment.

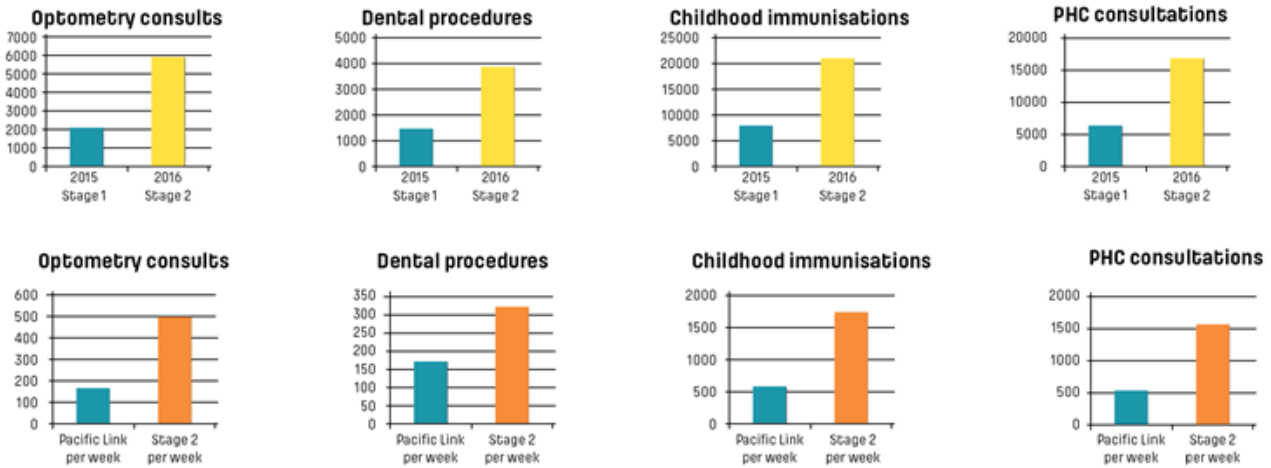


To learn more about 1300SMILES Dental Vouchers please visit <https://www.dentalmembers.com.au/1300-smiles-vouchers>.

The 1300SMILES Dental Vouchers scheme fits perfectly with our key objectives of availability, accessibility, and affordability. Vouchers continue to deliver growth to our business, in terms of both Revenue and significant numbers of new patients, keeping our dentists supplied with a steady stream of work.

**Youth With A Mission (YWAM)**

In last year’s report I mentioned that YWAM’s new medical/dental ship, the MV YWAM PNG, had just completed its nine week maiden voyage rendering essential care to our nearest neighbours up in Papua New Guinea.



The new ship’s operations have since increased to the planned level. Just since February 2016, this one ship and its hundreds of volunteers have delivered urgent dental care to 1,900 people, optometry care to over 6,000 people with sight-saving eye operations to 184, medical treatments to over 22,000 people, and basic healthcare training to hundreds of people who live in villages which might not otherwise have access to even basic medical attention once a year or, in many cases, never.



YWAM creates an extraordinary amount of value. Consultants AEC Group recently estimated that the value of labour performed by YWAM volunteers over the past four years was more that \$24 million. Absent these volunteers, most of this valuable work would never have been completed, because the personnel and supporting resources simply would not have been available.

I would urge shareholders to visit YWAM’s web site: [www.ywamships.org](http://www.ywamships.org).

**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

*Daryl*

Daryl Holmes  
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).