

Dear Shareholders,

What a difference a year makes! Just one year ago, our interim report was crowded with urgent topics. Some of these -- the Townsville floods and the potential disruption to the dividend franking system -- have resolved themselves. The ongoing consolidation in the dental industry, a top issue a year ago, remains close to the top of the list today.

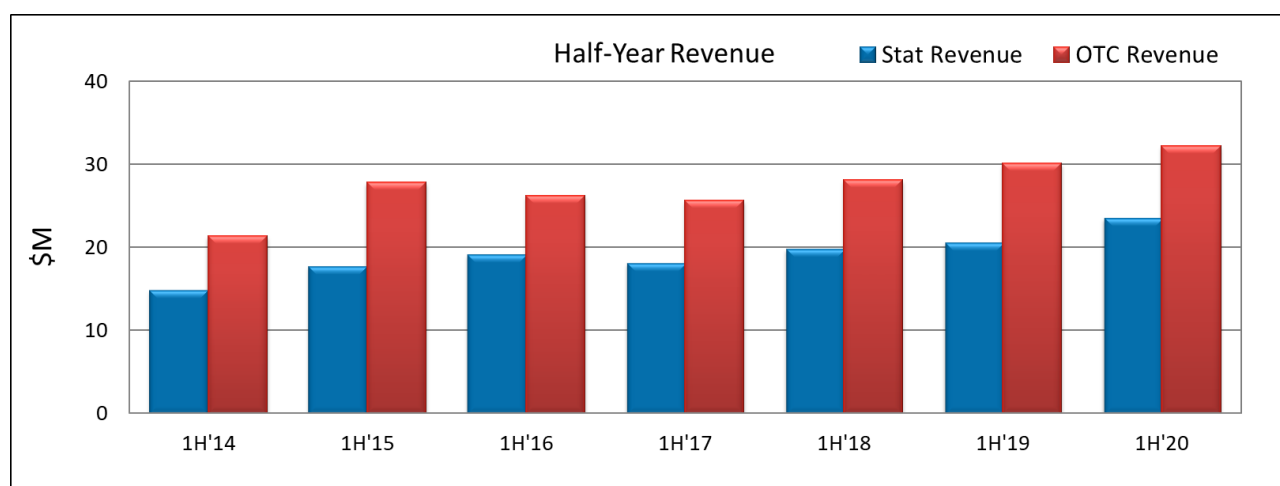
This year, a different issue of importance to shareholders has pushed its way up the list: a new accounting standard which has a significant effect on our reported results.

Over the years I have always done my best to help shareholders distinguish between the numbers produced by ever-changing accounting standards and the real results delivered by our real business. Such accounting changes have sometimes made our results look better, sometimes worse. Shareholders know that I have always explained these effects, good or ill, along the way.

Our underlying results are positive and reflective of our well performing and growing business. The application of the new accounting standards (AASB 16), effective from 1 July 2019 further increases some of our reported profits, whilst decreasing others marginally. Let's review the headline results and then dig into the details.

Financial results for the half-year to 31 December 2019

- o Revenue (OTC) up 7.0% to \$32.1 million
- o EBITDA up 31.6% to \$9.4 million
- o EBITDA (*pre-AASB 16*) up 11.2% to \$7.9 million
- o NPAT up 6.8% to \$4.4 million
- o Interim dividend up 6% to 13.25c
- o Revenue (Statutory) up 14.5% to \$23.5 million
- o NPBT up 3.7% to \$6.1 million
- o NPBT (*pre-AASB 16*) up 5.9% to \$6.2 million
- o Earnings Per Share up 6.8% to 18.52c
- o Bank debt up 21.7% to \$11.2 million



	1H'14	1H'15	1H'16	1H'17	1H'18	1H'19	1H'20
OTC Revenue (\$m)	21.3	27.7	26.2	25.6	28.0	30.0	32.1
Less amount retained by self-employed Dentists (\$m)	6.5	10.1	7.1	7.6	8.3	9.5	8.6
Statutory Revenue (\$m)	14.8	17.6	19.0	18.0	19.8	20.5	23.5

Revenue/Sales performance

Overall Statutory Revenue was up a very healthy 14.5% whilst our internal measure, Over the Counter (OTC) Revenue (more meaningful in many ways) was up 7%.

Our practices have generated solid same store sales (SSS) performance, of positive 0.6% across the comparable store group, excluding recently acquired/divested practices. Pleasingly this positive SSS growth has continued into the second half of the year, even more strongly.

Earnings – EBITDA, NPBT and NPAT

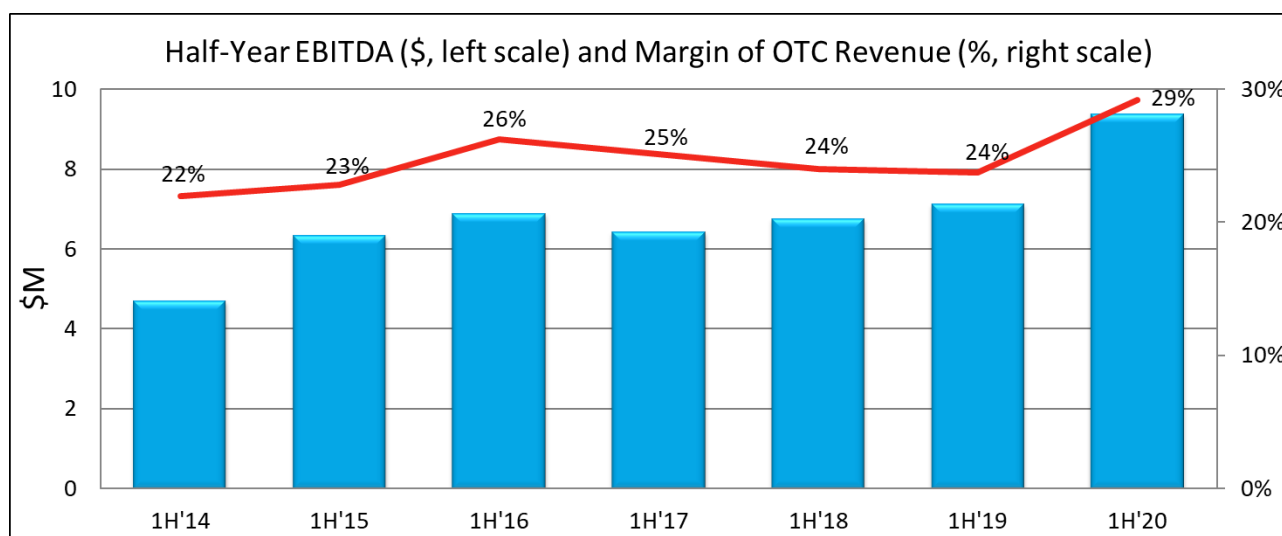
The most prominent effect of applying the new standard AASB 16 is that of significantly increasing reported EBITDA, and only minor net effects on the other profit figures.

	1H'20 \$000	1H'19 \$000	Change
EBITDA	9,375	7,124	31.6%
Rent not recognised in property expenses	(1,452)	-	-
EBITDA (pre-AASB 16)	7,923	7,124	11.2%

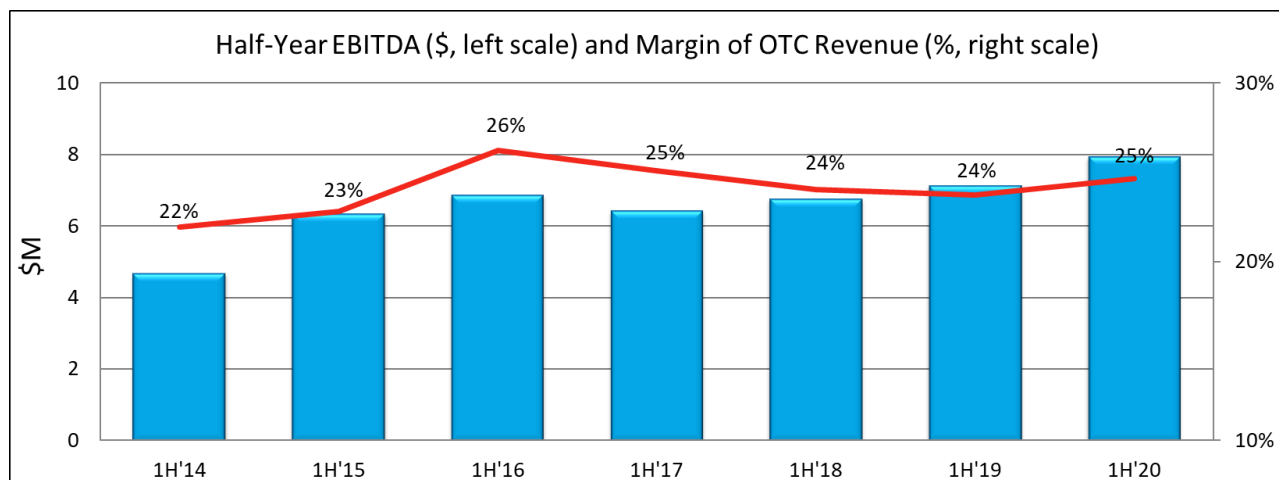
We often focus on EBITDA because it enables investors to compare different businesses with different financial structures. It's a tool for discerning the real returns from a business, stripping away the effects of borrowings and other factors. It also enables investors to compare the earnings quality of companies operating in different industries.

Our reported EBITDA is affected by the new, mandatory treatment of leases. While I won't attempt to explain these new standards in detail, the basic effect is this: in the old days, we paid the rent on leased facilities and treated that rent as an expense. That's how you would do it in your own business.

Under the new standard our leases are treated in a new way. Each lease, as before, gives us the right to occupy a certain space for a certain period of time. This right is assigned a present capital value, which we must depreciate as time goes by. Although we're still paying rent, just as before, we don't treat that as an expense but rather recognise the expense by depreciating the asset, as well as a new interest expense that must be recognised (\$148k this half-year). I have faith that there's some industry somewhere in which this approach makes sense. For 1300SMILES and our shareholders, we just have to accept that this is the way we have to do it.



Pre-AASB 16 / normalised



I have mentioned in previous reports that a key management metric is EBITDA as a percentage of Revenue. Under the new standards this measure has been disrupted by the change in how EBITDA is calculated. As the graph above illustrates clearly, the relationship between EBITDA and Revenue is on track and as good as ever.

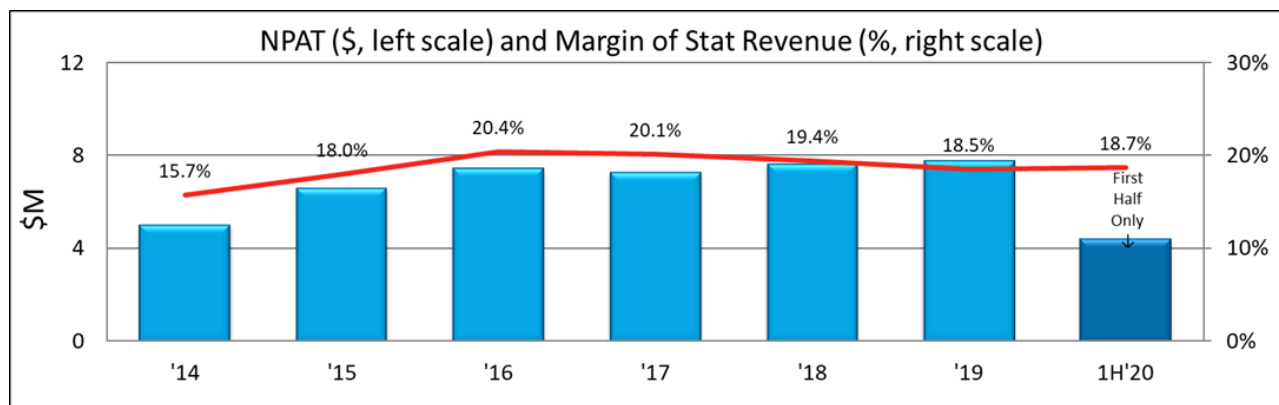
Net Profit Before Tax (NPBT)

Net profit before tax is \$6.1 million, up 3.7%. When adjusted for AASB 16, it becomes \$6.2 million, up 5.9%, as outlined in the table below.

	1H'20 \$000	1H'19 \$000	Change
Net Profit Before Tax	6,082	5,866	3.7%
AASB 16 impacts			
Depreciation on right-of-use asset	1,435	-	
Lease interest expense	148	-	
Rent expense	(1,452)	-	
Total AASB 16 impacts	131		
Net Profit Before Tax (pre-AASB 16)	6,213	5,866	5.9%

Net Profit After Tax (NPAT)

AASB 16 only minimally affected NPAT by decreasing it by \$95k.



Industry dynamics

A six-monthly report is hardly the vehicle for up-to-date news on a fast-rationalising industry. However, I will mention a few key developments and their effects on 1300SMILES Ltd.

Shareholders would be aware that our efforts to acquire the Australian business called Maven Dental Group from New Zealand-listed Abano Healthcare Group Ltd did not succeed. In the end, a competing bidder made an offer for the entirety of Abano, including its much more extensive operations in New Zealand.

We chose not to make a competing bid on this basis and, while we regret the outcome, I can assure shareholders that the re-organisation of our industry is very much ongoing.

Shareholders will also be aware that another listed dental services organisation here in Australia suffered some terrible troubles in the past year. We considered acquiring that entire company but decided the risks were too great. In December we acquired two healthy and solid dental practices from that company, and we are continuing the process of integrating those practices into the 1300SMILES system.

As a well performing company in the sector, we see 1300SMILES Ltd as a key player that is positioned to participate as consolidation in the industry occurs.

Practice acquisitions and sales

The two acquired practices mentioned above (in Gatton and Laidley, both in Queensland) operated as part of our company for only three business days in the first half, so they made no significant contribution to our first half results but have been trading very well year to date.

We also sold one of our locations during the half-year and one subsequently in January 2020. Given the scale of our operations, such sales are part of our normal business.

The practices we acquired in FY19, being Springfield Lakes, Maroochydore and Strathpine Central, have been integrated and performed well since transitioning to 1300SMILES Ltd ownership and have been delivering good patient outcomes.

Looking ahead, I would expect that our continuing drive to deliver profitable expansion will from time to time create circumstances in which it is simply good business to sell a given practice. As I have mentioned many times, our focus is always on delivering the best results achievable. We neither acquire nor retain practices merely to inflate the number of sites we operate. Instead we focus on delivering the best returns to shareholders over the long term.

Floods and fires

In last year's report we addressed the issues created by the Townsville floods of January and February 2019. The disruption to our operations was minimal, overall, and our practices in all flood-affected areas have resumed their steady growth.

The unfortunate truth is that this sort of natural disaster quickly turns into an economic stimulus as insurance money flows into the region. In addition, many renovation projects scheduled for the next few years have been accelerated, so the construction sector is busy. Mining activity generally is also moving in a positive direction, underpinning the steady growth of operations in several of our regional centres.

As to the fires which have afflicted so much of Australia, I can report that none of our facilities have been affected and none of our operations have been interrupted. I extend our sympathy to the many people who have been less lucky during this terrible fire season.

Thank you

As always, I express my thanks to our dentists, clinical, and management staff, all of whom have worked tirelessly 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