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Smiles Inclusive Limited: H1 FY19 Results

Smiles Inclusive Limited (ASX: **SIL**) reported practice revenue (net of direct costs) of \$16.1 million and a statutory loss after tax of \$1.59 million for the six months to 31 December 2018.

Summary

Key financial results for the half-year are:

- Statutory loss after tax of \$(1.59) million
- Practice revenue (net of direct costs) of \$16.1 million
- Underlying profit after tax of \$0.6 million
- Cash reserves \$1.0 million
- Undrawn debt facilities of \$17.8 million.

Overview of results

Despite having successfully completed the core elements of integration of the initial portfolio of 52 practices during the period, a number of operational matters impacted the result for the half year. These matters were disclosed in the Company's presentation at the AGM on 21 November 2018 and included:

- Non-disclosure of legal proceeding by practice vendor
- Unexpected deaths of lead practitioner and key business manager
- Delays in physical and digital branding
- Failure to put appropriate practitioner monitoring and staff rostering systems in place
- Under-estimation of change management requirements of systems upgrades and implementation
- Additional integration and stamp duty costs.

Smiles Inclusive CEO, Mike Timoney said that the undisclosed legal proceeding and deaths of two key people within the first 180 days of operations had distracted management efforts in ensuring key foundations were in place and operating effectively.

"The impact of a number of significant events over the last six months drew management attentions away from ensuring that key processes and systems were firmly bedded down".

"We are however now fully committed to this and to continuing the organic growth initiatives previously outlined and executing additional operational efficiencies."

Financial performance

The underlying performance of the business for the half year ended 31 December 2018, after considering the impacts of a small number of underperforming practices and operational deficiencies highlighted above, resulted in underlying practice earnings before interest, tax, depreciation and amortisation (before corporate and integration costs) of \$4.2 million. Further details of adjustments to statutory figures are set out in the table below.

Underlying corporate costs of \$2.4 million are in line with expectations and reflect the previously disclosed increases in the cost base due to compliance and resourcing requirements. However, the Company remains focused on achieving further cost efficiencies.

The practices which were impacted by significant events during the period have returned to operations including the first mobile dentistry bookings undertaken in late February 2019.

As previously disclosed, cash flows have improved through the period with completion of portfolio integration, rectification of operational deficiencies and a continued focus on extracting value from organic growth opportunities.

At the end of December 2018, the Company held cash reserves of \$1.0 million with a further \$0.2 million on deposit. The available facilities at 31 December 2018 of \$19.4 million comprise a \$17.6m of acquisition facility, a \$0.2m working capital facility and \$1.6m of ancillary facilities (bank guarantee and corporate card facilities).

The following table summarises key reconciling items between the the Company's statutory profit and underlying profit.

31-Dec-18							
\$'000	Practice EBITDA	Corporate and Integration Costs	EBITDA	EBIT	Interest	Tax	NPAT
Statutory profit	3,299	(4,438)	(1,139)	(1,522)	(616)	546	(1,592)
Significant Practice Events							
Mobile Dentistry	765	-	765	791	-	(218)	573
NSW JVP Death	137	-	137	139	-	(38)	101
One-Off Costs							
Integration Costs	-	1,554	1,554	1,554	-	(427)	1,127
Acquisition Costs	-	519	519	519	-	(143)	376
Underlying profit	4,201	(2,365)	1,836	1,481	(616)	(280)	585

Management changes

The Board announces management changes that will position the Company for the next phase of its development, driving improving business performance and building on the established current national network of 56 dental practices to achieve profitable growth.

Mike Timoney has stepped down as CEO but will continue to support the Board, including as a Director. Mr Tony McCormack has been appointed as Chief Operating Officer, reporting to the Board.

Mr McCormack is an executive General Manager and has consulted to Smiles Inclusive since November 2018. He is an experienced senior executive with an extensive track record in general management, operations, business planning and change management. He was Chief Operating Officer of ASX-listed Australian Agricultural Company from April 2016 to April 2018, and has held a range of senior executive positions including Chief Operating Officer of Stanbroke Pty Ltd, and Managing Director of Hevi Lift (PNG) Ltd.

Mr McCormack has developed and commenced implementation of plans to drive improved business performance with a focus on cost rationalisation and revenue growth, enhancing sustainability of the business model, addressing under-performance at specific practices, and continuing to strengthen Joint Venture Partner relationships.

The Board also confirms that Mr Paul Innes resigned from the role of CFO in December 2018 and will conclude his full-time employment with the Company at the end of February. He has also now resigned as joint Company Secretary. After an executive search, Ms Emma Corcoran has been appointed as CFO.

Ms Corcoran is a Chartered Accountant with broad management experience in financial, commercial, operational and project management functions. Her previous roles include leading Commercial Advisory services for two global engineering consultancies, and Principal/Partner at William Buck (now Crowe Horwath) between 2004 and 2009.

The Board has approved the appointment of a Special Project Accountant (Mr Scott Campbell) to assist Mr McCormack pending Ms Corcoran's commencement in early May 2019. Mr Campbell has previously served as the CFO of Dental Partners Australia and 1300 Smiles Ltd.

Chairman, David Herlihy said, "With the integration of the initial practice portfolio completed, the appointments of Tony McCormack and Emma Corcoran position Smiles Inclusive with exceptional commercial skills and leadership experience to unlock the Company's potential and deliver improved performance and profitable growth from our national network."

Mr Herlihy thanked Mr Innes for his contribution to establishing Smiles Inclusive and the Company's ASX listing.

FY19 outlook

Smiles Inclusive maintains its belief that the fundamentals of the dental industry are unchanged and the Company remains focused on capitalising on its scale and unique Joint Venture Partner model in a disaggregated sector by providing commitment to care, innovation and choice for patients across its national practice network.

In addition to the operational matters that impacted results for the six months to December 2018, trading performance in January is seasonally low. The Company notes the emphasis of matter in Note 12 in the notes to its consolidated financial statements for the period to 31 December 2018. It is working with its principal bank, National Australia Bank, which is considering a request for a covenant waiver as a result of the significant events affecting the first six months' performance.

The turnaround plan being implemented is a priority and the Board is confident that it will deliver a substantial improvement in business performance over time. The Company expects to report a statutory loss of between \$0.5m and \$1m for FY19 as these actions take place.

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