smiles inclusive

ABN 27 621 105 824
ACN 621 105 824

ASX Announcement
28 October 2020

Smiles Inclusive Limited: Half year results – 31 December 2019

Smiles Inclusive Limited (ASX: **SIL**) today announced its financial results for the half year ended 31 December 2019.

Key financial outcomes:

- Practice revenue (statutory) of $17.8 million, up 10.2% (1H FY19: $16.1m)
- Net loss after tax (statutory) of $13.6 million (1H FY19: $(1.6m))
- Net loss after tax (underlying) of $4.6 million (1H FY19: NPAT $585,000)

The Company achieved a 10.2% increase in practice revenue for the six months to December 2019, driven by increased patient demand and a focus on maximising surgery utilisation. Despite this, the underlying financial performance of the Company was below expectations due to a number of under-performing practices and operational deficiencies which are being addressed through the implementation of the turnaround plan, which includes the divestment of non-core practices. In December 2019, the Company sold its Gatton and Laidley practices for gross proceeds of $2.0 million.

The statutory net loss after tax of $13.6 million included a number of non-cash items including:

- Impairment of goodwill and property, plant and equipment of $5.5 million
- Impairment of right-of-use assets of $1.9 million, relating to AASB16
- Change in fair value of joint venture partner contribution liability of $1.4 million
- Write-off of deferred tax assets of $2.7 million.

Operational Update

Since 31 December 2019, the Company has undertaken a number of important operational improvements as part of its turnaround plan.

- Appointed key management personnel including the Managing Director and CEO, Michelle Aquilina who has 30 years' experience in the dental industry and previously led the turnaround of Primary Dental Care for Healius Limited
- Divested a number of non-core and underperforming practices and consolidated the dentures and mobile divisions
- Improved engagement of dentists and staff and invested in frontline services to drive revenue growth
- Right-sized practice and corporate staffing levels and introduced rigorous cost controls throughout the organisation
- Improved supply chain strategy to generate scale economies and ensure competitively priced practice consumables and equipment
- Responded to the COVID-19 pandemic and Government restrictions which forced the temporary closures of all practices between March and April/May 2020 and Victorian practices in August 2020.

These actions are part of the Company's Sustainable Improvement Strategy which addresses a number of critical immediate issues and provides the business with a pathway to sustainable growth in the short and longer term.

In the immediate term, the strategy focuses on achieving revenue growth from existing practices by maximising surgery utilisation through dentist recruitment and retention, and improving engagement with dentists and staff. The strategy is designed to empower dentists and frontline teams to drive growth, with corporate support in operations and governance. Rigorous cost control and removing unnecessary expenses is an important focus, along with introducing more disciplined systems and processes.

The Company commenced a dentist recruitment strategy in July as part of the focus on practice revenue growth, with 13 new practitioners joining the business to date. Smiles Inclusive now has 126 dental dentists, oral health therapists and hygienists.

Sixty per cent of Totally Smiles dentists and staff completed an engagement survey in August 2020. Results showed that dentists and staff felt the new leadership is a positive change for the business and had created a culture of teamwork and cooperation.

Since 31 December 2019, the Company has divested its Miranda (July 2020) and Yarram practices (August 2020) and entered a buy-out of its Joint Venture Partner in the Clayfield and Glen Waverley practices. The Company currently owns 49 practices and is continuing to review its portfolio to identify and divest other non-core assets. A total of 15 property leases have been exited through the consolidation of the dentures and mobile divisions and the divestment of non-core and underperforming practices.

Longer term, the strategy is a combination of actions for operational effectiveness and growth. It focuses on delivering improved business performance and as a result, better returns for shareholders. The Company is also working on innovations that will open new markets for its practices to support growth.

Refinancing Update

In October 2020, Smiles Inclusive signed an underwriting agreement with Aitken Murray Capital Partners Pty Ltd and intends to raise approximately $8 million ($7.6 million after transaction expenses) via a fully underwritten rights issue at an issue price of 2.5c per share. Proceeds from the capital raising will be used to discharge liabilities to NAB.

Smiles Inclusive has also agreed with NAB to revise the terms of its Release Deed. NAB has agreed to release and discharge the Company from liability under its various banking facilities on receipt of payment of $12 million plus amounts owing under credit card, bank guarantee and JobKeeper facilities and reasonable associated expenses by 3 November 2020. The total debt balance held with NAB at close of business 27 October 2020 was $19.1 million. On settlement of the agreement, Smiles Inclusive anticipates debt forgiveness from NAB of approximately $6.0 million.

The revised deed remains part of the Company's broader recapitalisation plan and the Company is in advanced negotiations with potential funders to facilitate payments to NAB.

Trading Outlook

The Company's auditor has included a disclaimer of conclusion on the interim financial report. This notwithstanding, Smiles Inclusive believes the factors driving demand in the dental industry remain positive and provide the environment for profitable growth in practice revenue as the Sustainable Improvement Strategy is successfully implemented. While the refinancing and a number of corporate matters remain immediate priorities for the Company, a range of early improvements to operational performance have been achieved since April 2020 and are driving gains in chair utilisation and dentist recruitment. Implementing the strategy to improve Company's performance and financial position and grow shareholder returns remains the primary focus of the Board and management.

This announcement has been approved for release by the Board.

For further information please contact:

Michelle Aquilina, Chief Executive Officer
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Smiles Inclusive Limited (ASX:SIL)

Appendix 4D

Results for Announcement to the Market

Reporting period: Half year ended 31 December 2019
Previous corresponding period: Half year ended 31 December 2018

Statutory Financial Results	**31 Dec 19**	**31 Dec 18**	**Movement up/(down)**	
	$'000	**$'000**	**$'000**	**%**
Revenue from ordinary activities	17,778	16,132	1,646	10.2%
Loss from ordinary activities after tax [1]	(13,615)	(1,592)	(12,023)	(755%)
Net loss attributable to members	(13,615)	(1,592)	(12,023)	(755%)
Earnings per share (basic and diluted) - cents per share	(13.8)	(2.8)	(11.0)	(393%)
Underlying Financial Results[2]	**31-Dec-19**	**31-Dec-18**	**Movement up/(down)**	
	$'000	**$'000**	**$'000**	**%**
Revenue from ordinary activities	17,778	15,396	2,382	15.5%
Profit/(Loss) from ordinary activities after tax	(4,640)	585	(5,225)	(893%)
Net profit/(loss) attributable to members	(4,640)	585	(5,225)	(893%)
Earnings/(loss) per share (basic and diluted) - cents per share	(4.7)	1.0	(5.7)	(570%)

[1] Loss from ordinary activities after tax includes the following non-cash items:
- impairment of goodwill and property, plant and equipment of $5.5 million; and
- impairment of right-of-use assets of $1.9 million, associated with AASB 16; and
- change in fair value of joint venture partner contributions of $1.4 million; and
- write-off of deferred tax assets of $2.7 million.

[2.] Underlying Financial Result are non-IFRS profit measures used by Directors and Management to assess the underlying performance of the Group which have not been audited/reviewed.

Reconciliation from Statutory to Underlying Financial Results	**31 Dec 19**	**31 Dec 18**	**Movement up/(down)**	
	$'000	**$'000**	**$'000**	**%**
Statutory loss after tax	**(13,615)**	**(1,592)**	(12,023)	(755%)
Integration costs	-	1,554	(1,554)	(100%)
Business transaction costs: once-off costs	93	519	(426)	(82.1%)
Significant practice events	-	930	(930)	(100%)
Net impairment and revaluation	6,030	-	6,030	N/A
Deferred Tax assets not recognised	2,687	-	2,687	N/A
Impact of AASB 16 Leases accounting	278	-	278	N/A
(Gain)/loss on disposal of practices	(113)	-	(113)	N/A
Income tax effect of adjustments	-	(826)	826	(100%)
Underlying loss after tax	**(4,640)**	**585**	(5,225)	(893%)

For further explanation of the statutory and underlying figures above refer to the accompanying Interim Report for the half year ended 31 December 2019, which includes the Directors' Report.

The Interim Results Presentation released in conjunction with this Results Announcement provides further analysis of the results for the half year ended 31 December 2019.

Dividends	Amount per security (cps)	Franked amount
Dividends paid		
FY 2019 final dividend	Nil	N/A
Dividends declared		
FY 2019 dividend declared	Nil	N/A
Record date for determining entitlements to the dividend	N/A	N/A
Date dividend payable	N/A	N/A

Dividends	Amount per security (cps)	Franked amount
Dividends paid		
FY 2019 final dividend	Nil	N/A
Dividends declared		
FY 2019 dividend declared	Nil	N/A
Record date for determining entitlements to the dividend	N/A	N/A
Date dividend payable	N/A	N/A

The Company does not currently offer a dividend reinvestment plan.

Net Tangible Assets/(Liabilities) Per Security	31 Dec 19	31 Dec 18	Movement up/(down)	
	Cents	Cents	Cents	%
Net tangible liabilities per ordinary security	(35.4)	(55.2)	19.8	35.9%

Independent Review by Auditor
The financial statements were reviewed by the auditor and the review report is attached as part of the Interim Report.

Joint Ventures, Foreign Entities and Control Gained or Lost Over Entities
Not applicable during the period of the previous corresponding period.

David Usasz
Chairman

Smiles Inclusive Limited

Date: 28 October 2020

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Smiles Inclusive Limited

Interim Report

31 December 2019

This half-year financial report constitutes the Appendix 4D prepared in accordance with the Australian Securities Exchange Listing Rules and the half-year financial report in accordance with the Corporations Act 2001. This interim financial report does not include all of the notes of the type normally included in an annual financial report. Accordingly, this report is to be read in conjunction with the annual financial report for the year ended 30 June 2019 and any public announcements made by Smiles Inclusive Ltd during the interim reporting period in accordance with the continuous disclosure requirements of the Corporations Act 2001.

CONTENTS

DIRECTORS' REPORT

The Directors of Smiles Inclusive Limited ("the Company") present their report together with the consolidated interim financial statements for the six months ended 31 December 2019 and the auditor's review report thereon.

DIRECTORS AND OFFICERS

The Directors and Company Secretary of the Company at any time during or since the end of the period are as follows:

David Usasz	Non-Executive Director and Chairman (Appointed as Chairman 22 May 2019)
Peter Evans	Non-Executive Director (Appointed 1 August 2018, resigned 23 September 2020)
Peter Fuller	Non-Executive Director (Appointed 25 June 2019)
Genna Levitch	Non-Executive Director (Appointed 24 September 2020)
Michelle Aquilina	Managing Director (Appointed 14 April 2020)
Emma Corcoran	Company Secretary (Appointed 20 June 2019, resigned 15 May 2020)
Andrew Ritter	Company Secretary (Appointed 15 May 2020)

PRINCIPAL ACTIVITIES

During the period the principal continuing activities of the Group consisted of the operation of dental practices. The Group owns and operates fully serviced treatment rooms, providing equipment, consumables, marketing, and administrative services to dentists through the Totally Smiles Dental Group.

REVIEW OF OPERATIONS

Key results

Key financial outcomes of the Group's 31 December 2019 results are:

- practice revenue (net of direct costs) of $17.8 million, an increase of 10.2%;
- statutory loss after tax of $13.6 million, which includes the following non-cash items:
    - impairment of goodwill and property, plant and equipment of $5.5 million; and
    - impairment of right-of-use assets of $1.9 million, associated with AASB 16; and
    - change in fair value of joint venture partner contribution liability of $1.4 million gain; and
    - write-off of deferred tax assets of $2.7 million;
- underlying trading loss of $4.6 million;
- cash balances $1.0 million.

The key financial metrics for the business for the period are presented below:

Adjustments to the statutory income statement (unaudited)	31 December 2019	31 December 2018	Change	Change
	$'000	$'000	$'000	%
Underlying profit/(loss) after tax	**(4,640)**	**585**	**(5,225)**	**(893%)**
Integration costs	-	(1,554)	1,554	100%
Business transaction costs	(93)	(519)	426	82.1%
Significant practice events	-	(930)	930	100%
Net impairment and revaluation	(6,030)	-	(6,030)	N/A
Deferred tax assets not recognised	(2,687)	-	(2,687)	N/A
Impact of AASB 16 Leases accounting	(278)	-	(278)	N/A
Gain/(loss) on disposal of practices	113	-	113	N/A
Income tax effect of adjustments	-	826	(826)	(100%)
Statutory loss after tax	**(13,615)**	**(1,592)**	**(12,023)**	**(755%)**

Despite an overall 10.2% increase in practice revenue, which was in line with expectations, the underlying overall performance of the Group for the half year ended 31 December was below expectations due to a number of under-performing practices and operational deficiencies, which management are addressing through the implantation of its turnaround plan, including the divestment of non-core practices.

In December 2019, the Group sold its Gatton and Laidley practices for gross proceeds of $2.0 million.

Implementation of AASB 16 Leases

This is the first set of the Group's financial statements in which AASB 16 Leases has been applied. Under the transition methods chosen, comparative information has not been restated. The 31 December 2019 results are therefore not directly comparative to prior years. Changes to significant accounting policies and the impact of applying the new standard is described in Note 6.

Outlook

Smiles Inclusive maintains its belief that the fundamentals of the dental industry are unchanged and the Group remains focused on its multi-faceted turnaround plan, capitalising on the oversupply of dentists, its scale and unique Joint Venture Partner model in a disaggregated sector by providing strong clinical governance, support to dentists and staff, commitment to care and highly experienced management team to lead and provide services and facilities and innovation across its national practice network.

The Group is continuing to implement its turnaround plan, which consists of divestment of non-core practices combined with several discrete initiatives, varying in complexity, and disciplined strategic execution plan.

The Group expects improvements in cashflows in the short to medium term and is actively pursuing multiple avenues to raise further cash via equity capital markets or through alternative means.

GOING CONCERN

These interim financial statements have been prepared on the basis that the Group is a going concern and is able to realise its assets and settle its liabilities in the ordinary course of business.

During the half year ended 31 December 2019 the Group incurred a net loss before tax of $10.9 million and had net cash outflows from operating activities of $4.0 million. As at 31 December 2019, the Group had a net asset deficiency of $7.2 million, and cash of $1.0 million.

As a result of significant ongoing operational issues and poor trading performance over the past 6 months the Group has recorded an impairment expense of $7.4 million in relation to goodwill, property, plant and equipment and right of use assets. The Group is also a party to a number of ongoing and threatened legal matters which may result in the further liabilities arising, the outcome and quantum of which is unknown at this date.

The Group has financing facilities with National Australia Bank (NAB) (refer to Note 9) which are drawn to $18.0 million at 31 December 2019. The facilities consist of an acquisition facility, a working capital facility and other ancillary facilities. The facilities have covenant requirements which must be complied with at all times. In March 2019 NAB advised the Group that they were in breach of financial covenants. During the half year and subsequent to 31 December 2019, the Group continued to be in breach of these covenants. The Group also has additional overdue loan facilities as outlined in note 9.

The Group continues to implement its turnaround plan and a new Sustainability Improvement Strategy, which commenced in June 2019 and includes the following actions:

- The appointment of key management personnel with significant industry experience, including Managing Director in April 2020, Chief Operating Officer in May 2020, and Chief Financial Officer expected to be appointed in the second half of FY21;
- Consolidation of dentures and mobile divisions, including the exit of associated property leases;
- Divestment of non-core and underperforming practices, including the exit of associated property leases;
- Improved engagement of dentists and staff together with investment in frontline services to drive revenue;
- Right-sizing of practice and corporate staffing levels;
- Rigorous operating cost control throughout the organisation; and
- Improved supply chain strategy to capitalise on scale, ensuring competitively priced practice consumables and equipment.

The ability to execute this turnaround plan is dependent upon the continued support of stakeholders including but not limited to financiers, creditors and joint venture partners.

During the half year, the Group raised net equity of $3.3 million after capital raising costs through a non-renounceable entitlement offer, which was utilised for the partial repayment of temporary banking facilities and working capital. In addition, the Group raised $2.0 million from the sale of two dental practices. These funds were further used for working capital purposes.

Subsequent to 31 December 2019, the Group was significantly impacted by the COVID-19 pandemic which resulted in the closure and/or limited operating capacity of certain practices within Government directed restrictions. The Group was and continues to be a recipient of JobKeeper subsidies, which has contributed to working capital for the continuation of operations.

Subsequent to 31 December 2019, NAB agreed to release and discharge the Group from liability under its various banking facilities upon receipt of $12.0 million plus repayment of amounts outstanding on the corporate credit card and temporary JobKeeper facilities by 4 November 2020, resulting in an expected debt forgiveness of approximately $6.0 million. The Group has previously entered into a similar agreement with NAB, but was unable to raise the necessary funds to comply with the timeframes for repayments specified in that agreement.

The Group is currently in negotiation with potential financiers to provide the funding to repay the NAB facilities and raise additional working capital. The Group plans to complete a rights issue with a proposed completion in December 2020 to raise $7.6 million (net of associated fees). At the date of this report the Group is yet to finalise either the financing or rights issue arrangements.

The Directors have prepared cash flow projections for the coming 12 months that support the ability of the Group to continue as a going concern. The cash flow projections include significant assumptions and the ongoing operation of the Group is critically dependent upon:

- the Group continuing to receive JobKeeper subsidies for the period to 31 March 2021; and
- the Group improving its trading performance to generate positive cash flows from operations; and
- the Group obtaining sufficient funding from other parties to allow for the repayment of the NAB loan facilities (by 4 November 2020), other debts and outstanding creditors, and to provide additional working capital; and
- the Group's trade creditors and financiers continuing to provide financial support and not enforcing payment of overdue balances where the Group does not have sufficient liquid funds to make payment; and
- the Group resolving legal claims and regulatory compliance related matters; and
- the Group divesting certain poor performing practices to provide additional funding to the Group.

These conditions give rise to significant material uncertainties that may cast doubt upon the Group's ability to continue as a going concern. In the event the Group does not achieve the above initiatives within the required time frames, the Group may not continue as a going concern and may not be able to realise its assets and extinguish its liabilities in the ordinary course of operations.

DIVIDENDS

No dividends were declared by the Group for the half year ended 31 December 2019 or up to the date of signing.

SUBSEQUENT EVENTS

COVID-19 Pandemic

In response to the global pandemic, COVID-19 in March 2020 and subsequent Victorian declared State of Disaster, the Group implemented the guidelines of the Australian Dental Association, The Victorian Dental Association, The Australian Health Protection Principle Committee and Dental Board of Australia by closing all practices in early April 2020 and again in Victoria in August 2020, with some practices only operating on an "on-call" basis to provide emergency procedures.

The COVID-19 recovery plan involved the implementation of further enhanced infection control protocols, social distancing and enhanced operating efficiencies as part of a staged re-opening of practices, commencing with 20 practices on 27 April 2020 with the remaining practices re-opening by 15 May 2020.

Subsequent to the re-opening of remaining practices and the constant evolving dynamics of the COVID-19 pandemic, practices were closely monitored daily with operations of some practices varying, resulting in some reduced hours and some subsequent closures.

The Group's Victorian practices were further impacted by the reintroduction of restrictions in August 2020, with the temporary closure of four practices and the remaining five practices operating under level 2 and level 3 restrictions.

In order to minimise the financial impact of COVID-19, the Group accessed available federal and state government assistance initiatives including Cash Flow Boost, Job Keeper and payroll tax concessions, while also negotiating rent concessions with landlords, which has resulted in the Group becoming cash flow positive.

The financial impacts of COVID-19, including any impacts on the carrying value of goodwill and joint venture partner liabilities is still being assessed by the Group. The Directors anticipate further significant impairment of goodwill and other assets as a result of the impact of COVID-19. The Directors are in the process of completing the annual impairment test of goodwill for the purposes of 30 June 2020 financial reporting and at the date of this report estimate the financial impact of further impairment on goodwill and other assets to be in the range of $14.0 million to $18.0 million. The additional estimated impairment is considered to be a subsequent event as a result of COVID-19 and other operational matters.

Directors and senior management

In April 2020, Mr Tony McCormack resigned as Chief Executive Officer and was replaced by Ms Michelle Aquilina who was also appointed as Managing Director.

In May 2020, Mr Mark O'Brien was appointed as Chief Operating Officer.

In May 2020, Ms Emma Corcoran resigned as Company Secretary and Chief Financial Officer and was replaced by Mr Andrew Ritter as Company Secretary. The Group is in the process of recruiting a new Chief Financial Officer.

In September 2020, Mr Peter Evans resigned as Non-executive Director and was replaced by Dr Genna Levitch.

Financing arrangements

The Group's primary financier agreed to release and discharge the Company from liability under its various banking facilities upon receipt of $12.0 million by 4 November 2020 plus repayment of amounts outstanding on the corporate credit card and temporary JobKeeper facilities. Upon settlement of the agreement, the expected debt forgiveness by the financier will be approximately $6.0 million.

Capital raising

The Group is undertaking a rights issue to raise approximately $7.6 million after capital raising costs, with proceeds used to repay existing debt facilities as outlined above.

Business turnaround and sale of practices

As part of ongoing strategic review, the Group has identified a number of non-core practices for which it is undertaking a sale process to divest these practices, enabling the Group to focus on core practices and enhance shareholder value. In addition, the Group has resolved to close certain underperforming practices.

The Group sold its Miranda and Yarram practices in July 2020 and August 2020 respectively, with proceeds used for the reduction of debt and working capital purposes. In addition, the Group restructured the dentures and mobile divisions, resulting in the consolidation of 15 tenancies. The Group also entered into a JVP buyout for Clayfield and Glen Waverley practices, which forms part of the Company's multi-faceted strategy.

ASIC

On 24 September 2020, ASIC commenced action against the Company requiring the Company to lodge its 31 December 2019 financial statements no later than 3 November 2020.

PROCEEDINGS ON BEHALF OF THE COMPANY

The Group is the subject of several legal proceedings as at the date of this report and is also the subject of a number of possible actions or claims. It is currently not possible to determine whether the actual or threatened actions will result in a financial impact on the Group. The Group intends to defend its position in relation to all actual or threatened actions.

AUDITOR'S INDEPENDENCE DECLARATION

The lead auditor's independence declaration is set out on page 9 and forms part of the directors' report for the six months ended December 2019.

ROUNDING OFF

The Company is of a kind referred to in ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191 and in accordance with that instrument, amounts in the interim financial report and directors' report have been rounded off to the nearest thousand dollars, unless otherwise stated.

Signed in accordance with a resolution of the directors:

David Usasz
Chairman

Brisbane
28 October 2020

KPMG

Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To the Directors of Smiles Inclusive Limited

I declare that, to the best of my knowledge and belief, in relation to the review of Smiles Inclusive Limited for the half-year ended 31 December 2019 there have been:

i. no contraventions of the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the review; and

ii. no contraventions of any applicable code of professional conduct in relation to the review.

KPMG

KPMG

Adam Twemlow
Partner
Gold Coast
28 October 2020

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

For the six months ended 31 December 2019

	Note	31 Dec 19 $'000	31 Dec 18 $'000
Practice revenue	3	**17,778**	**16,132**
Other income		58	-
Direct costs		(1,318)	(987)
Consumables supplies expenses		(1,477)	(827)
Employee expenses		(10,416)	(9,073)
Marketing expenses		(146)	(383)
Occupancy expenses		(521)	(1,823)
Administration and other expenses		(5,442)	(4,178)
Depreciation and amortisation expense		(2,134)	(383)
Loss before finance costs, income tax, impairment and changes in fair value		**(3,618)**	**(1,522)**
Impairment of goodwill, right-of-use assets and property, plant & equipment	5, 6, 7	(7,416)	-
Change in fair value of joint venture partner contribution	10	1,386	-
Net impairment and changes in fair value		(6,030)	-
Loss before finance costs and income tax		**(9,648)**	**(1,522)**
Net Finance Cost		(1,280)	(616)
Loss before income tax		**(10,928)**	**(2,138)**
Income tax benefit / (expense)	4	(2,687)	546
Loss for the half-year		**(13,615)**	**(1,592)**
Other comprehensive income		-	-
Total comprehensive loss for the half-year		**(13,615)**	**(1,592)**

Earnings per share for loss attributable to the ordinary equity holders of the company

Basic and diluted earnings per share (cents per share)	12	(13.8)	(2.8)

The Group has initially applied AASB 16 at 1 July 2019, using the modified retrospective approach. Under this approach, comparative information is not restated and the cumulative effect of initially applying AASB 16 is recognised in retained earnings at the date of initial application. See Note 6.

The above Consolidated Statement of Profit or Loss and Other Comprehensive Income should be read in conjunction with the accompanying notes.

CONSOLIDATED BALANCE SHEET

As at 31 December 2019

	Note	31 Dec 19 $'000	30 Jun 19 $'000
Assets			
Cash and cash equivalents		1,017	1,595
Receivables and other assets		3,001	2,837
Inventories		542	558
Deferred tax assets		-	2,687
Property, plant & equipment	5	3,588	8,270
Right-of-use assets	6	18,677	-
Intangible assets	7	27,783	34,438
Total Assets		**54,608**	**50,385**
Liabilities			
Interest bearing liabilities	9	19,353	23,413
Payables		5,780	6,927
Lease Liabilities	6	20,934	-
Deferred revenue		465	570
Provisions		2,192	2,405
Joint Venture Partner Contribution	10	13,055	13,730
Total Liabilities		**61,779**	**47,045**
Net Assets		**(7,171)**	**3,340**
Contributed equity	11	42,392	39,297
Reserves		9	-
Retained earnings/(accumulated losses)		(49,572)	(35,957)
Total Equity		**(7,171)**	**3,340**

The Group has initially applied AASB 16 at 1 July 2019, using the modified retrospective approach. Under this approach, comparative information is not restated and the cumulative effect of initially applying AASB 16 is recognised in retained earnings at the date of initial application. See Note 6.

The above Consolidated Balance Sheet should be read in conjunction with the accompanying notes.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the six months ended 31 December 2019

	Note	Contributed Equity $'000	Reserves $'000	Retained Earnings/ (accumulated losses) $'000	Total Equity $'000
Opening Balance at 1 July 2019		**39,297**	**-**	**(35,957)**	**3,340**
Total comprehensive loss for the half-year		-		(13,615)	(13,615)
Transactions with owners of the Company					
Issue of securities	11	3,329		-	3,329
Options granted - employees		-	9	-	9
Capital raising costs	11	(234)		-	(234)
Balance at 31 December 2019		**42,392**	**9**	**(49,572)**	**(7,171)**

	Note	Contributed Equity $'000	Reserves $'000	Retained Earnings/ (accumulated losses) $'000	Total Equity $'000
Opening Balance at 1 July 2018		**38,085**	**-**	**(4,955)**	**33,130**
Total comprehensive loss for the half-year		-	-	(1,592)	(1,592)
Transactions with owners of the Company					
Issue of securities	11	-	-	-	-
Options granted - employees		-	-	-	-
Capital raising costs	11	-	-	-	-
Balance at 31 December 2018		**38,085**	**-**	**(6,547)**	**31,538**

The above Consolidated Statement of Changes in Equity should be read in conjunction with the accompanying notes.

CONSOLIDATED STATEMENT OF CASH FLOW

For the six months ended 31 December 2019

	Note	31 Dec 19 $'000	31 Dec 18 $'000
Cash flow from operating activities			
Receipts from patients		23,667	23,195
Payments to suppliers and employees		(27,113)	(27,399)
Interest received/(paid)		-	3
Finance costs including interest and joint venture partner profits paid		(554)	(538)
Net cash flows from/(used in) operating activities		**(4,000)**	**(4,739)**
Cash flows from investing activities			
Payments for property, plant and equipment		(242)	(751)
Proceeds from disposal of property, plant and equipment		-	56
Payments for practices, net of cash received		-	(2,749)
Proceeds from the disposal of businesses		2,000	-
Payment for rental bond term deposits		-	(63)
Net cash flows (used in)/ from investing activities		**1,758**	**(3,507)**
Cash flow from financing activities			
Proceeds from issue of securities	11	3,329	-
Costs associated with issue of securities	11	(234)	-
Net proceeds/(repayment) from borrowings		(674)	5,750
Proceeds from sale & leaseback of property, plant and equipment		-	1,711
Lease payments		(757)	(214)
Net cash flows (used in)/ from financing activities		**1,664**	**7,247**
Net increase/(decrease) in cash and cash equivalents		(578)	(999)
Cash and cash equivalents at the beginning of the year		1,595	2,009
Cash and cash equivalents at the end of the year		**1,017**	**1,010**

The Group has initially applied AASB 16 at 1 July 2019, using the modified retrospective approach. Under this approach, comparative information is not restated and the cumulative effect of initially applying AASB 16 is recognised in retained earnings at the date of initial application. See Note 6.

The above Consolidated Statement of Cash Flow should be read in conjunction with the accompanying notes.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Significant Accounting Policies

(a) Reporting Entity

This consolidated interim financial report for the half year reporting period ended 31 December 2019 has been prepared in accordance with Accounting Standard AASB 134 Interim Financial Reporting and the Corporations Act 2001.

This consolidated interim financial report does not include all the notes of the type normally included in an annual financial report. Accordingly, this report is to be read in conjunction with the annual report for the year ended 30 June 2019 and any public announcements made by Smiles Inclusive Limited during the interim reporting period in accordance with the continuous disclosure requirements of the Corporations Act 2001.

This interim financial report was approved by the Board of Directors on the date of signing.

(b) Basis of preparation

These interim financial statements have been prepared on an accruals basis and are based on historical costs, modified where applicable, by the measurement at fair value of selected non-current assets, financial assets and financial liabilities. Cost is based on the fair value of consideration given in exchange for assets.

All amounts are presented in Australian dollars, which is the Company's functional currency.

Except as described below, the accounting policies adopted in preparation of the half year financial report are consistent with those adopted and disclosed in the Company's annual financial report for the financial year ended 30 June 2019. If applicable, additional accounting policies are presented for new types of transactions that have occurred since the end of the previous financial year.

This is the first set of the Group's financial statements where AASB 16 Leases has been applied. Changes to significant accounting policies are described in Note 6.

The Company is of a kind referred to in ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191. Pursuant to this instrument, amounts in the Directors' Report and financial report have been rounded off to the nearest thousand dollars, or in certain cases, to the nearest dollar.

(c) New Standards, interpretations and amendments adopted by the Group

A number of new or amended standards became applicable for the current reporting period and the Group has changed its accounting policies as a result of adopting AASB 16 Leases. The impact of the adoption of the leasing standard and the new accounting policy in relation to the standard is disclosed below. The other standards did not have any impact on the Group's accounting policies and did not require retrospective adjustments.

The Changes in accounting policies are also expected to be reflected in the Group's consolidated financial statements as at and for the year ending 30 June 2020.

AASB 16 Leases

The Group has adopted AASB 16 Leases using the simplified method from 1 July 2019, and has not restated comparatives for the 30 June 2019 reporting period, as permitted under the specific transitional provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognised in the opening balance sheet on 1 July 2019.

Prior to 1 July 2019, leases of property were classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) were charged to profit or loss, within occupancy expenses.

From 1 July 2019, the Group applied a single recognition and measurement approach for all property leases of which it is the lessee. Leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Group. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

- fixed payments (including in-substance fixed payments), less any lease incentives receivable;
- variable lease payments that are based on an index or a rate;
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

The lease payments are discounted using the lessee's incremental borrowing rate, being the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions.

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability;
- any lease payments made at or before the commencement date less any lease incentives received;
- any initial direct costs; and
- restoration costs.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less. Low-value assets comprise of office equipment.

In applying AASB 16 for the first time, the Group has used the following practical expedients permitted by the standard:

- the use of a single discount rate to a portfolio of leases with reasonably similar characteristics;
- reliance on previous assessments on whether leases are onerous;
- the accounting for leases with a remaining lease term of less than 12 months as short-term leases;
- the exclusion of initial direct costs for the measurement of the right-of-use asset at the date of initial application; and
- the use of hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

Refer to Note 6 for further disclosure of the right-of-use asset and lease liability.

(d) Use of judgements and estimates

In preparing these interim financial statements, Management has made judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

The significant judgements made by Management in applying the Group's accounting policies and the key sources of estimation were the same as those described in the last annual financial statements, except for the new significant judgements related to lessee accounting under AASB 16, as described below.

During the half year ended 31 December 2019 management reassessed its estimates in respect of:

- Note 4 Deferred tax asset
- Note 5 Property, plant and equipment
- Note 6 Right-of-use assets
- Note 7 Intangible assets
- Note 10 Joint venture partner contribution
- Note 13 Going concern
- Note 14 Subsequent events

(e) Financial risk management

The Group's overall financial risk management focuses on the unpredictability of financial markets and seeks to minimise potentially adverse effects on the Group's financial performance. The Group uses different methods to measure and mitigate the different types of risks to which it is exposed. The Group manages liquidity risk, where possible, by continuously monitoring forecast and actual cash flows to ensure sufficient liquidity is always available to meet liability obligations as they fall due. Ageing analysis and monitoring of specific credit exposures are undertaken to manage credit risk.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2. Operating Segments

An operating segment is a component of the Group that:

- engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the Group);
- whose operating results are regularly reviewed by the Group's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance; and
- for which discrete financial information is available.

The Group also considers other factors in determining operating segments such as the existence of a line manager and the level of segment information presented to the Board.

Operating segments are identified based on internal reports that are regularly reviewed by the chief operating decision maker in order to allocate resources to the segment and assess its performance. Management review segment performance on a practice level, or where two or more practices share cashflows, at a joint venture partner level. This represents the lowest level at which cash generating units are measured.

Individual cash generating units are aggregated for segment purposes as the Group's activities are within the dental sector located in Australia and are consistent for the Group as a whole.

The Group's revenue relates to the provision of dental services to Australian customers.

3. Revenue

The Groups operations and main revenue streams are those described in the last annual financial statements. The Group's revenue is derived from contracts with customers.

	31 Dec 19 $'000	31 Dec 18 $'000
Dental service fees	17,411	15,708
Laboratory fees	367	424
Total practice revenue	**17,778**	**16,132**

4. Income tax

The Group has determined that the recovery of deferred tax assets is not probable. Accordingly, deferred tax assets of $2.7 million were derecognised during the period.

5. Property, Plant and Equipment

Movements in the value of Property, Plant and equipment are set out below:

	Leasehold improvements $'000	Plant and equipment $'000	Leased Assets $'000	Total $'000
Opening balance at 1 Jul 2019	**1,462**	**3,579**	**3,229**	**8,270**
Transfer to right-of-use assets	-	-	(3,229)	(3,229)
Additions	89	153	-	242
Disposals	(19)	(727)	-	(746)
Depreciation	(159)	(242)	-	(401)
Impairment	-	(548)	-	(548)
Carrying amount at 31 December 2019	**1,373**	**2,215**	**-**	**3,588**

Refer to note 7 for details of impairment testing.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

6. Right-of-use Asset and Lease Liability

(a) Right-of-use Assets

Movements in the value of right-of-use are set out below:

	Leased Properties $'000	Leased equipment $'000	Total $'000
Adjustment on adoption of AASB 16 as at 1 July 2019	**19,003**	**3,229**	**22,232**
Additions	-	501	501
Disposals	(345)	(57)	(402)
Depreciation charge	(1,242)	(491)	(1,733)
Impairment	(1,921)	-	(1,921)
Closing Balance	15,495	3,182	18,677
Cost	18,658	5,185	23,843
Accumulated depreciation and impairment	(3,163)	(2,003)	(5,166)
Closing Balance as at 31 December 2019	15,495	3,182	18,677

Refer to note 7 for details of impairment testing.

The effect of adopting AASB 16 as at 1 July 2019 (increase/(decrease)) is as follows:

	01 Jul 19 $'000
Assets	
Right-of-use assets	22,232
Property, plant & equipment	(3,229)
	19,003
Liabilities	
Lease Liabilities	23,000
Interest bearing liabilities	(3,997)
	19,003

(b) Lease Liabilities

On adoption of AASB 16, the Group recognised lease liabilities in relation to leases which had previously been classified as 'operating leases' under the principles of AASB 117 Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as at 1 July 2019. The weighted average lessee's incremental borrowing rate applied to the lease liabilities on 1 July 2019 was 5.73%.

A reconciliation between Operating Leases disclosed as Commitments to the Lease Liability on transition is below:

	01 Jul 19 $'000
Operating Lease Commitments disclosed as at 30 June 2019	**16,494**
Add: Adjustments as a result of different treatment of extension and termination options	5,018
Discounted using the lessee's incremental borrowing rate of at the date of initial application	(2,509)
Add: Finance lease liabilities recognised as at 30 June 2019	3,997
	23,000

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

7. Intangible Assets

	31 Dec 19 $'000	30 Jun 19 $'000
Goodwill	60,090	62,904
less: accumulated amortisation and impairment	(32,367)	(28,534)
	27,723	**34,370**
Rights, licenses and software	82	82
less: accumulated amortisation and impairment	(22)	(14)
	60	**68**
Total intangible assets	**27,783**	**34,438**

(a) Accounting for intangibles

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired business at the date of acquisition. Goodwill on acquisitions of businesses is included in intangible assets.

Goodwill acquired in business combinations is not amortised. Instead, goodwill is tested for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired and is carried at cost less accumulated impairment losses.

(b) Impairment of assets

Goodwill is not subject to amortisation and is tested at least annually for impairment. Other assets, including those that are subject to depreciation or amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use.

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows which are largely independent of the cash flows from other assets or groups of assets (cash generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date. Cash inflows considered for the purposes of impairment testing are discounted to present value.

The Group experienced lower than expected results for certain CGU's for the first half of FY20. Additionally, the share price and market capitalisation of the Group declined significantly in the period, presenting indicators of impairment of intangible assets, and accordingly the Group assessed all cash generating units (CGU's) for impairment indicators at 31 December 2019.

In assessing the CGU's the Group generally identifies individual practices as a CGU, except in some instances where practices have a common Joint Venture Partner. Practices with a common Joint Venture Partner and shared cashflows (i.e. labour) are generally classified as a CGU at the Joint Venture Partner level.

As a result of this assessment certain CGU's were considered to have impairment indicators and the recoverable amount of these individual CGU's to which goodwill is allocated has been determined by reference to a fair value less cost of disposal calculation based on the following key assumptions and estimates:

- Year one cashflows are based on 30 June 2019 and 31 December 2019 actual result, adjusted for management's expectations of future performance including planned cost reductions;
- Cash flows in years two to five are based on the expected average percentage growth rate of 3.0% for revenue and 2.0% for expenses;
- A post-tax nominal discount rate of 12.5%;
- An indefinite terminal cash flow calculation has been applied for cash flows beyond year five, using the year 5 cash flow as a base and a growth rate of 2.0%.

Management determined impairment of $4,947,000 was required at 31 December 2019.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(c) Significant estimate: Impact of possible changes in key assumptions

The recoverable amounts in respect of CGUs continue to be highly sensitive to a range of assumptions, in particular the growth rates, discount rate and assumed year one adjustments for future performance. Any adverse change in any assumptions may result in further impairment.

8. Disposal of Businesses

In December 2019, the Group sold two practices located in Gatton and Laidley for gross proceeds of $2.0m. This resulted in a disposal of property, plant and equipment of $223,117 and goodwill of $1.4 million. As a result of the sale, the Group has recognised a gain on sale of $112,509.

9. Interest bearing loans and borrowings

	31 Dec 19	30 Jun 19
	$'000	$'000
Secured		
Bank loans	18,034	18,708
Borrowing Costs (Deferred)	(166)	(192)
Equipment lease facility	-	3,997
Other loans	1,485	900
	19,353	23,413

Bank loans

Bank loans include acquisition, working capital and multi option facilities with the Group's primary financier. These facilities were subject to the Group complying with covenants concerning such matters as net leverage ratio and fixed charges ratio. In March 2019, the primary financier advised the Group that they were in breach of financial covenants, and has continued to be in breach.

Subsequent to 31 December 2019, the Group's primary financier agreed to release and discharge the Company from liability under its various banking facilities upon receipt of $12.0 million by 4 November 2020 plus repayment of amounts outstanding on the corporate credit card and temporary JobKeeper facilities. Upon settlement of the agreement, the expected debt forgiveness by the financier will be approximately $6.0 million.

The Group is undertaking a rights issue to raise approximately $7.6 million after capital raising costs, with proceeds used for working capital purposes.

In accordance with the security arrangements of the acquisition, working capital and multi-option facilities, all assets of the Group are secured by floating charge except as identified below.

Equipment lease facility

The Group has an equipment leasing facility to assist with the financing of key items of capital expenditure. In accordance with the security arrangements of the equipment lease facility, specific property plant and equipment items are secured against the facility.

The Group applied AASB 16 *Leases* at 1 July 2019, and accordingly transferred equipment lease liabilities to lease liabilities. Refer to note 6 for further details.

Other loans

The Group has received three unsecured loans from three separate parties, which comprise:

- $700,000 representing funds to assist with the Group's turnaround plan, at an interest rate of 9.95% per annum and is repayable upon agreement between the Group and the lender at any time after 31 January 2020;
- $585,000 representing retained funds due to the joint venture partner following the sale of the Gatton and Laidley practices in December 2019, at an interest rate of 10% per annum and at call;
- $200,000 provided for working capital purposes to assist the Group to implement its turnaround plan, $100,000 of which is at an interest rate of 10% per annum with the remaining $100,000 interest free and at call.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

10. Joint venture partner contribution

Joint venture partner contributions are classified as financial liabilities at fair value through profit and loss with resulting fair value adjustments recognised in the income statement. Fair value is the amount payable on demand and is measured at the principal amount plus the joint venture's share of any increases or decrease in market value to reporting date.

Joint venture partner contributions are non-interest bearing and are payable at the end of the joint venture agreement. A joint venture partner may at any time, but not within the first 12 months, request the Group to procure a purchaser to buy out the joint venture partner. The Group has 12 months from the date the buy out is requested to procure a purchaser before it is required to pay the joint venture partner the buy out price.

The agreements provide the joint venture partner with a right to a profit share payment, being a defined percentage of the relevant practices' earnings before interest and tax.

The estimates of amounts expected to be settled less than and more than twelve months after reporting date are:

	31 Dec 19 $'000	30 Jun 19 $'000
Expected to be paid		
No more than twelve months	-	-
More than twelve months	13,055	13,730
Total joint venture partner contributions	**13,055**	**13,730**

The following table presents the changes in joint venture partner contributions for the financial period;

	31 Dec 19 $'000	30 Jun 19 $'000
Opening balance	13,730	21,435
Items recognised in profit or loss		
Change in fair value of joint venture partner contributions	(1,386)	(7,102)
JVP Liability Forgiveness	-	(432)
JVP accrued losses deemed not recoverable	1,498	-
Acquisition/(disposal) of practices	(641)	1,354
Accumulated joint venture partner losses	(146)	(1,525)
Total joint venture partner contributions	**13,055**	**13,730**

11. Contributed Equity

	31 Dec 19 $'000	30 Jun 19 $'000
Issued capital		
Ordinary securities fully paid	42,392	39,297
Total issued capital	**42,392**	**39,297**
Number of Ordinary securities fully paid	**133,245,670**	**66,622,835**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(a) Movements in ordinary share capital

	31 Dec 19	30 Jun 19	31 Dec 19	30 Jun 19
	No. '000	No. '000	$'000	$'000
Issued capital				
Ordinary securities fully paid	133,246	66,623	42,392	39,297
Total issued capital	**133,246**	**66,623**	**42,392**	**39,297**
Movement in issued securities during the period				
Balance at the beginning of the period	66,623	57,933	39,297	38,085
Securities issued	66,623	8,690	3,329	1,217
Transaction costs on issue of securities, net of tax	-	-	(234)	(5)
Ordinary securities fully paid	**133,246**	**66,623**	**42,392**	**39,297**

On 3 October 2019, the Company issued 12,722,666 new ordinary shares at 5 cents, raising $0.6 million to assist with the implementation of the Company's turnaround plan and to meet working capital requirements. The shares rank equally with existing fully paid ordinary shares.

On 21 October 2019, the Company issued 53,900,169 new ordinary shares at 5 cents, raising $2.7 million to assist with the implementation of the Company's turnaround plan and to meet working capital requirements. The shares rank equally with existing fully paid ordinary shares.

No dividends were declared or paid by the Group for the half year ended 31 December 2019.

12. Earnings Per Share

	31 Dec 19	31 Dec 19
	$'000	$'000
Statutory loss after income tax attributable to the owners of the Group	**(13,615)**	**(1,592)**
	#'000	**#'000**
Weighted average number of ordinary shares used in calculating basic loss per share	**98,769**	**57,933**
	Cents	**Cents**
Statutory basic and diluted loss per share	**(13.8)**	**(2.8)**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

13. Going Concern

These interim financial statements have been prepared on the basis that the Group is a going concern and is able to realise its assets and settle its liabilities in the ordinary course of business.

During the half year ended 31 December 2019 the Group incurred a net loss before tax of $10.9 million and had net cash outflows from operating activities of $4.0 million. As at 31 December 2019, the Group had a net asset deficiency of $7.2 million, and cash of $1.0 million.

As a result of significant ongoing operational issues and poor trading performance over the past 6 months the Group has recorded an impairment expense of $7.4 million in relation to goodwill, property, plant and equipment and right of use assets. The Group is also a party to a number of ongoing and threatened legal matters which may result in the further liabilities arising, the outcome and quantum of which is unknown at this date.

The Group has financing facilities with National Australia Bank (NAB) (refer to Note 9) which are drawn to $18.0 million at 31 December 2019. The facilities consist of an acquisition facility, a working capital facility and other ancillary facilities. The facilities have covenant requirements which must be complied with at all times. In March 2019 NAB advised the Group that they were in breach of financial covenants. During the half year and subsequent to 31 December 2019, the Group continued to be in breach of these covenants. The Group also has additional overdue loan facilities as outlined in note 9.

The Group continues to implement its turnaround plan and a new Sustainability Improvement Strategy, which commenced in June 2019 and includes the following actions:

- The appointment of key management personnel with significant industry experience, including Managing Director in April 2020, Chief Operating Officer in May 2020, and Chief Financial Officer expected to be appointed in the second half of FY21;
- Consolidation of dentures and mobile divisions, including the exit of associated property leases;
- Divestment of non-core and underperforming practices, including the exit of associated property leases;
- Improved engagement of dentists and staff together with investment in frontline services to drive revenue;
- Right-sizing of practice and corporate staffing levels;
- Rigorous operating cost control throughout the organisation; and
- Improved supply chain strategy to capitalise on scale, ensuring competitively priced practice consumables and equipment.

The ability to execute this turnaround plan is dependent upon the continued support of stakeholders including but not limited to financiers, creditors and joint venture partners.

During the half year, the Group raised net equity of $3.3 million after capital raising costs through a non-renounceable entitlement offer, which was utilised for the partial repayment of temporary banking facilities and working capital. In addition, the Group raised $2.0 million from the sale of two dental practices. These funds were further used for working capital purposes.

Subsequent to 31 December 2019, the Group was significantly impacted by the COVID-19 pandemic which resulted in the closure and/or limited operating capacity of certain practices within Government directed restrictions. The Group was and continues to be a recipient of JobKeeper subsidies, which has contributed to working capital for the continuation of operations.

Subsequent to 31 December 2019, NAB agreed to release and discharge the Group from liability under its various banking facilities upon receipt of $12.0 million plus repayment of amounts outstanding on the corporate credit card and temporary JobKeeper facilities by 4 November 2020, resulting in an expected debt forgiveness of approximately $6.0 million. The Group has previously entered into a similar agreement with NAB, but was unable to raise the necessary funds to comply with the timeframes for repayments specified in that agreement.

The Group is currently in negotiation with potential financiers to provide the funding to repay the NAB facilities and raise additional working capital. The Group plans to complete a rights issue with a proposed completion in December 2020 to raise $7.6 million (net of associated fees). At the date of this report the Group is yet to finalise either the financing or rights issue arrangements.

The Directors have prepared cash flow projections for the coming 12 months that support the ability of the Group to continue as a going concern. The cash flow projections include significant assumptions and the ongoing operation of the Group is critically dependent upon:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

- the Group continuing to receive JobKeeper subsidies for the period to 31 March 2021; and
- the Group improving its trading performance to generate positive cash flows from operations; and
- the Group obtaining sufficient funding from other parties to allow for the repayment of the NAB loan facilities (by 4 November 2020), other debts and outstanding creditors, and to provide additional working capital; and
- the Group's trade creditors and financiers continuing to provide financial support and not enforcing payment of overdue balances where the Group does not have sufficient liquid funds to make payment; and
- the Group resolving legal claims and regulatory compliance related matters; and
- the Group divesting certain poor performing practices to provide additional funding to the Group.

These conditions give rise to significant material uncertainties that may cast doubt upon the Group's ability to continue as a going concern. In the event the Group does not achieve the above initiatives within the required time frames, the Group may not continue as a going concern and may not be able to realise its assets and extinguish its liabilities in the ordinary course of operations.

14. Subsequent Events

COVID-19 Pandemic

In response to the global pandemic, COVID-19 in March 2020 and subsequent Victorian declared State of Disaster, the Group implemented the guidelines of the Australian Dental Association, The Victorian Dental Association, The Australian Health Protection Principle Committee and Dental Board of Australia by closing all practices in early April 2020 and again in Victoria in August 2020, with some practices only operating on an "on-call" basis to provide emergency procedures.

The COVID-19 recovery plan involved the implementation of further enhanced infection control protocols, social distancing and enhanced operating efficiencies as part of a staged re-opening of practices, commencing with 20 practices on 27 April 2020 with the remaining practices re-opening by 15 May 2020.

Subsequent to the re-opening of remaining practices and the constant evolving dynamics of the COVID-19 pandemic, practices were closely monitored daily with operations of some practices varying, resulting in some reduced hours and some subsequent closures.

The Group's Victorian practices were further impacted by the reintroduction of restrictions in August 2020, with the temporary closure of four practices and the remaining five practices operating under level 2 and level 3 restrictions.

In order to minimise the financial impact of COVID-19, the Group accessed available federal and state government assistance initiatives including Cash Flow Boost, Job Keeper and payroll tax concessions, while also negotiating rent concessions with landlords, which has resulted in the Group becoming cash flow positive.

The financial impacts of COVID-19, including any impacts on the carrying value of goodwill and joint venture partner liabilities is still being assessed by the Group. The Directors anticipate further significant impairment of goodwill and other assets as a result of the impact of COVID-19. The Directors are in the process of completing the annual impairment test of goodwill for the purposes of 30 June 2020 financial reporting and at the date of this report estimate the financial impact of further impairment on goodwill and other assets to be in the range of $14.0 million to $18.0 million. The additional estimated impairment is considered to be a subsequent event as a result of COVID-19 and other operational matters.

Directors and senior management

In April 2020, Mr Tony McCormack resigned as Chief Executive Officer and was replaced by Ms Michelle Aquilina who was also appointed as Managing Director.

In May 2020, Mr Mark O'Brien was appointed as Chief Operating Officer.

In May 2020, Ms Emma Corcoran resigned as Company Secretary and Chief Financial Officer and was replaced by Mr Andrew Ritter as Company Secretary. The Group is in the process of recruiting a new Chief Financial Officer.

In September 2020, Mr Peter Evans resigned as Non-executive Director and was replaced by Dr Genna Levitch.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Financing arrangements

The Group's primary financier agreed to release and discharge the Company from liability under its various banking facilities upon receipt of $12.0 million by 4 November 2020 plus repayment of amounts outstanding on the corporate credit card and temporary JobKeeper facilities. Upon settlement of the agreement, the expected debt forgiveness by the financier will be approximately $6.0 million.

Capital raising

The Group is undertaking a rights issue to raise approximately $7.6 million after capital raising costs, with proceeds used to repay existing debt facilities as outlined above.

Business turnaround and sale of practices

As part of ongoing strategic review, the Group has identified a number of non-core practices for which it is undertaking a sale process to divest these practices, enabling the Group to focus on core practices and enhance shareholder value. In addition, the Group has resolved to close certain underperforming practices.

The Group sold its Miranda and Yarram practices in July 2020 and August 2020 respectively, with proceeds used for the reduction of debt and working capital purposes. In addition, the Group restructured the dentures and mobile divisions, resulting in the consolidation of 15 tenancies. The Group also entered into a JVP buyout for Clayfield and Glen Waverley practices, which forms part of the Company's multi-faceted strategy.

ASIC

On 24 September 2020, ASIC commenced action against the Company requiring the Company to lodge its 31 December 2019 financial statements no later than 3 November 2020.

15. Share Based Payments

The Group agreed to grant its CEO, Tony McCormack, options to acquire 2.7m fully paid ordinary shares in the Company in accordance with schemes approved by shareholders.

For accounting purposes options allocated to employees are fair valued as at the grant date using a Black-Scholes model taking into account the terms and conditions upon which they were granted.

A total of 2,700,000 share options were granted in the six months to 31 December 2019.

(a) Share Options granted during the six months to 31 December 2019

Grant Date	No. of Options	Exercise Price $.00	Fair Value at Grant Date	Vesting Conditions
31/12/2019	1,350,000	0.100	0.006	Fully Vested as at the date of Grant
31/12/2019	1,350,000	0.150	0.003	100% vest on 31 December 2020
	2,700,000			

The inputs used in the measurement of the fair values at grant date of the equity- based options were as follows:

	Share Options	Share Options
Grant Date	31/12/19	31/12/19
Fair Value at grant Date	$0.006	$0.003
Share Price at grant date	$0.05	$0.05
Exercise Price	$0.10	$0.15
Expected Volatility	50%	50%
Expected Life	3 years	3 years
Risk Free Rate	0.75%	0.75%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(b) Employee expenses recognised in the Profit and Loss

	31 Dec 19	31 Dec 18
Share Options Granted - 2019	8,767	-
Total expense recognised as employee costs	**8,767**	**-**

16. Related Party Transactions

Other than remuneration for their positions as directors and executives of the Company, key management personnel or entities related to them entered into a few transactions with the Company.

Information on these transactions is set out below.

Key management personnel or their related parties held shares in the Company during 2019, and as such, are entitled to participate in dividends.

Amounts recognised in respect of other transactions with key management personnel were:

The Group paid professional fees for services provided by entities associated with David Usasz. Fees were based on an agreement approved by the Board for services in relation to business negotiations and totalled $40,000 during the period.

In addition the Group has leased practice premises from Peter Fuller and the rent paid for the period ending 31 December 2019 totalled $14,300.

	31 Dec 19	31 Dec 18
	$'000	$'000
Property leasing expenses	14	-
Professional Fees	40	-
	54	**-**

17. Contingent liabilities

The Group is the subject of a number of legal matters as at the date of this report and is also the subject of possible actions or claims. It is currently not possible to determine whether the actual or threatened actions will result in a financial impact on the Group. The Group intends to defend its position in relation to all actual or threatened actions.

DIRECTORS' DECLARATION

In the directors' opinion:

(a) the financial statements and notes set out on pages 10 to 25 are in accordance with the Corporations Act 2001, including:

  (i) complying with Australian Accounting Standard AASB 134 Interim Financial Reporting and the Corporations Regulations 2001; and

  (ii) giving a true and fair view of the consolidated entity's financial position as at 31 December 2019 and of its performance for the half year ended on that date; and

(b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the Board of Directors.

Davis Usasz
Chairman

28 October 2020

Independent Auditor's Review Report

To the shareholders of Smiles Inclusive Limited

Report on the Interim Financial Report

Disclaimer of Conclusion

We were engaged to review the accompanying ***Interim Financial Report*** of Smiles Inclusive Limited.

We do not express a conclusion on the accompanying Interim Financial Report of the Group.

Because of the significance of the matters described in the Basis for Disclaimer of Conclusion we have not been able to obtain sufficient appropriate evidence to provide a basis for a review conclusion on the Interim Financial Report.

The ***Interim Financial Report*** comprises:

- Consolidated balance sheet as at 31 December 2019
- Consolidated statement of profit or loss and other comprehensive income, Consolidated statement of changes in equity and Consolidated statement of cash flows for the half-year ended on that date
- Notes 1 to 17 comprising a summary of significant accounting policies and other explanatory information
- The Directors' Declaration.

The ***Group*** comprises Smiles Inclusive Limited (the Company) and the entities it controlled at the half year's end or from time to time during the half-year.

Basis for Disclaimer of Conclusion

As set out in Note 14 "Subsequent Events", ASIC commenced action against the Company requiring the Company to lodge its 31 December 2019 financial statements no later than 3 November 2020. As set out in Note 13 "Going Concern" the Group is critically dependent upon achieving a number of assumptions to continue as a going concern. Many are not at a stage where counterparties have committed to the course of action the Group proposes, are sufficiently secured at this time, or evidence is not available to us to perform our obligations. The status of these assumptions have material and pervasive negative impacts on our ability to gather evidence to form a conclusion, in particular in testing the existence of plans the Group has put in place, the existence of other mitigating factors, the feasibility of these plans, and whether the outcome of these plans will materialise to support going concern, as and when needed. Further details of the reasons for our inability to gather sufficient appropriate evidence are provided below.

Going concern – potential financiers to fund repayment of NAB facility and raise additional working capital

Note 13 communicates the negotiations with potential financiers to provide the funding to repay the NAB facilities and raise additional working capital. A binding written agreement regarding the quantum, timing, terms and conditions of this arrangement was not available to us. Additionally, evidence regarding the ability of the potential financiers to honour the commitment, in the timeframes required by the Group was not available to us. Accordingly, we consider to have not gathered sufficient appropriate evidence regarding the implications of this on whether the going concern basis of preparation is appropriate.

Going concern – overdue loan facilities, creditors and other liabilities

Note 9 and 13 communicate certain overdue loan facilities, creditors and other liabilities which have not been repaid. Binding written agreements regarding the re-negotiation of the loan facilities, repayment conditions and/or extinguishment of the debts were not available to us. Accordingly, we consider to have not gathered sufficient appropriate evidence regarding the implications of this on whether the going concern basis of preparation is appropriate.

Going concern – NAB support

Note 13 communicates the agreement with NAB regarding the repayment of a portion of the outstanding facilities by 4 November 2020 to allow for forgiveness of the remaining amounts. Given the history of such agreements with NAB and the periodic renegotiation of such, we sought communications regarding the continued support of NAB in the event the conditions of the agreement are not satisfied. We were not able to communicate with NAB. Accordingly, we consider to have not gathered sufficient appropriate evidence regarding the implications of this on whether the going concern basis of preparation is appropriate.

Going concern – proposed rights issue

Note 13 communicates the proposal to complete a rights issue with a proposed completion in December 2020 to raise $7.6m (net of associated fees). As the terms of the underwriting agreement have been breached, a binding written confirmation waiving the right to terminate the underwriting agreement was not available to us. Evidence regarding the ability of the Group to execute the timetable and steps required in preparing and lodging a long-form prospectus, in light of ASIC's determination which prevents the Group from issuing a transaction specific prospectus, was not available to us. Additionally, there is uncertainty in relation to the Group's ability to successfully raise the minimum funds required to complete the capital raising. Accordingly, we consider to have not gathered sufficient appropriate evidence regarding the implications of this on whether the going concern basis of preparation is appropriate.

Going concern – outstanding legal claims and regulatory compliance related matters

Note 13 communicates legal claims and regulatory compliance related matters, and the Group's dependency on resolving these. Details of these matters including the likelihood of these resulting in a liability to the Group, and the impact of this on the Group's ability to continue as a going concern were not provided to us. Accordingly, we consider to have not gathered sufficient appropriate evidence regarding the implications of this on whether the going concern basis of preparation is appropriate, and whether other liabilities and/or contingent liabilities may need to be disclosed.

Going concern – EGM

The Group lodged an ASX announcement on 20 October 2020 notifying of an intention to call an extraordinary general meeting ("EGM") under sections 203D(2) and 249F of the *Corporations Act 2001*. An assessment of the implications of the EGM, including any termination clauses for agreements described above, were not available to us. Accordingly, we consider to have not gathered sufficient appropriate evidence regarding the implications of this on whether the going concern basis of preparation is appropriate.

We were unable to satisfy ourselves by alternative means on all of the above matters. Therefore in aggregate we have not been able to obtain sufficient appropriate evidence. In addition, Note 13 communicates the dependency on the turnaround plan improving the Group's trading performance to generate positive cash flows from operations. We consider the implications of the COVID-19 pandemic, combined with the historic performance of the Group, to be a material uncertainty regarding the Group's ability to achieve this turnaround plan.

As a result of all these matters, we are unable to form a conclusion whether the going concern basis of preparation is appropriate, whether the Directors Declaration statement regarding the reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable is appropriate, and whether adjustments are required to the recorded values of assets and liabilities in the Interim Financial Report, are complete and accurate. Given the material and pervasive impacts of this to the Interim Financial Report as a whole, we are therefore unable to conclude on the Interim Financial Report.

Emphasis of matter – subsequent events

We draw attention to Note 14 to the Interim Financial Report, which describes the estimated financial impact of COVID-19 to 30 June 2020 goodwill amounts. Reporting this matter does not alter our disclaimer of conclusion as described in the Basis for Disclaimer of Conclusion.

Responsibilities of the Directors for the Interim Financial Report

The Directors of the Company are responsible for:

- the preparation of the Interim Financial Report that gives a true and fair view in accordance with *Australian Accounting Standards* and the *Corporations Act 2001*
- for such internal control as the Directors determine is necessary to enable the preparation of the Interim Financial Report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

Auditor's responsibility for the review of the Interim Financial Report

Our responsibility is to conduct a review of the Company's Interim Financial Report in accordance with ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*. However, because of the matters described in the Basis for Disclaimer of Conclusion section of our report, we were not able to obtain sufficient appropriate evidence to provide a basis for a review conclusion on the Interim Financial Report.

We are independent of the Company in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the *Accounting Professional and Ethical Standards Board's APES 110 Code of Ethics for Professional Accountants (including Independence Standards)* (the Code) that are relevant to our audit of the annual financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

KPMG

KPMG

Adam Twemlow
Partner
Gold Coast
28 October 2020

Smiles Inclusive Limited
Corporate Directory

Principal Registered Office

C/- Talbot Sayer
Level 27, 123 Eagle Street, Brisbane, QLD 4000

W: smilesinc.com.au

Directors

David Usasz
Non-executive Chairman

Genna Levitch
Non-executive Director

Peter Fuller
Non-executive Director

Michelle Aquilina
Managing Director and Chief Executive Officer

Company Secretary

Andrew Ritter

Auditor

KPMG

Share Registry

Link Market Services Limited

Stock Exchange Listing

Smiles Inclusive Limited shares are listed on the Australian Security Exchange under the code "SIL".