



24 February 2020

Mr Corey Lian
Adviser, ASX Listings

Via email: corey.lian@asx.com.au

Dear Mr Lian

RE: Query Letter 18 February 2020

SIL has considered your recent queries and have outline their responses below.

- 1. With respect to SIL's loan facilities with National Australia Bank ('NAB'), please confirm:**
 - a. the complete list of conditions on which NAB waived the covenant breaches referred to in the date of SIL's FY19 annual report (see paragraph G above) and whether SIL has met those conditions.**
 - b. whether modified covenants were agreed and, if so, what they are and whether SIL has complied with those covenants.**
 - c. whether NAB has extended the facility beyond the November 2019 review point and, if so, on what terms.**
 - d. if NAB did extend the facilities, and to the extent not already dealt with in responses to questions to 1.c:**
 - i. the current balances and maturity dates of these facilities.**
 - ii. the frequency of repayments.**
 - iii. the quantum of repayments / the basis on which repayments are calculated.**
 - iv. any performance-based events of default; and**
 - v. when (and how often) covenants will be tested, and**
 - e. if NAB did not extend the facilities, what alternative arrangements SIL has made with respect to this debt.**

As disclosed in March and June 2019, SIL was granted a waiver with respect to its covenants subject to conditions.

These conditions were:

- an investigating accountant be engaged to provide ongoing review and regular reporting.
- the temporary increase that had been provided of \$675,000 in the outstanding balance of facilities, was to be repaid, by October 21, 2020.
- SIL providing ongoing financial information and a 3-way financial forecast; and
- modified covenants be developed in due course.

These were the complete list of terms associated with the waiver. SIL confirms that:

- Deloitte were appointed as an investigating accountant and reviews were conducted.
- the \$675,000 temporary increase in the company's facilities, was repaid by the 21 October 2020 deadline.
- a 3-way financial forecast was provided to the NAB in November 2019 and financial information continues to be provided on an ongoing basis; and
- at the time of writing, the modified covenants have not been developed with the NAB, though discussions are ongoing (including in respect of the expiry date of the facilities).

The current balance of the NAB facilities are as follows, and as disclosed in our recent Appendix 4C disclosure:

- Acquisitions facility: \$14,034,266.
- Working capital facility \$4,000,000.
- Multi-purpose facility comprising credit card (\$500,000) and bank guarantee facilities of (\$268,422).

Interest payments associated with the acquisitions and working capital facilities are calculated and payable quarterly. The corporate credit cards of the business are repaid in full monthly, and bank guarantee facilities are fully secured by term deposits (the current balance held in these accounts is \$533,969).

SIL's facilities with NAB include customary performance-based events of default. Covenants and testing will be negotiated as part of any formal extension of the facilities.

SIL assesses its debt funding arrangements and alternative options on an ongoing basis.

- 2. Please confirm the dates of the pay-cycles and the total outflows for each cycle in:**
- a. the quarter ended 30 September 2019; and**
 - b. the quarter ended 31 December 2019.**

SIL confirms that its wages are processed fortnightly on the Wednesday for receipt into employee bank accounts over the course of the following 24 hours (but in some instances later depending on our employees banking arrangements). The specific pay dates for each quarter are as follows:

Date	Gross Wages (\$AUD)
3/07/2019	698,862
17/07/2019	714,843
31/07/2019	663,756
14/08/2019	686,582
28/08/2019	703,565
11/09/2019	702,540
25/09/2019	673,474
	\$4,843,623

Date	Gross Wages (\$AUD)
9/10/2019	659,309
23/10/2019	643,027
6/11/2019	645,458
20/11/2019	706,918
4/11/2019	646,727
18/12/2019	653,520
31/12/2019	531,010
	\$4,485,968

For the quarters ended September 2019 and December 2019, the total amount of gross wages paid were \$4,843,622 and \$4,485,968 respectively.

3. Please provide a breakdown of:

- a. the “non-underlying costs” disclosed in the Appendix 4C released on 31 October 2019; and
- b. the payments referred to in notes 3 and 4 of the Appendix 4C released on 31 January 2020.

Non-underlying costs of \$0.214 million in the quarter ended September 2019 comprise employment redundancies (approximately \$17,000), legal costs (approximately \$150,000) and professional fees (approximately \$47,000).

Notes 3 and 4 of SIL’s 4C for the quarter ended December 2019 stated:

Note 3: “Administration and Corporate costs for the period, included significant cash outlays setting amounts in accordance with the proposed usage of funds which were outlined in disclosures associated with the Company’s rights issue, which settled on October 16, 2019.”

Specifically, the amounts comprised:

Repayment of Temporary Banking Facilities	\$0.675 million
Retiring Debt associated with equipment purchases approved prior to 28 February 2019	\$0.89 million
CAPEX Requirement	\$0.75 million
Working Capital	\$0.77 million
Cost of the Offer	\$0.25 million

Note 4: The Company has had significant “one-off” outlays for the quarter associated with full year insurance costs, settlement of litigation matters and restructure costs.

In the quarter ended December 2019, the company had significant cash outflows related to insurance (approximately \$400,000), litigation settlement (approximately \$182,000) legal costs (approximately \$150,000, inclusive of other settlement amounts) and restructure costs associated with marketing and branding efforts (approximately \$50,000). These costs were not considered representative of the true underlying costs of the business either as a result of their amount, their timing or their existence. As an example, the insurance costs that were entirely funded out of working capital for the quarter had previously been paid progressively over a year. Their existence is not abnormal; however, their timing is abnormal and not comparable to the previous cash flows associated with the business. SIL’s turnaround plan sets out initiatives to smooth cash flows so events like these do not have such a dramatic effect.

- 4. ASX refers to the figures reported by SIL for:**
- a. actual manufacturing and operating costs.**
 - b. estimated manufacturing and operating costs.**
 - c. actual staff costs; and**
 - d. estimated staff costs,**

in the Appendix 4Cs summarised in Annexure A.

Given the absence of an apparent downward trend in these overheads, is SIL in a position to provide more detail regarding the “several discrete initiatives, which vary in complexity” comprising its turnaround plan?

As previously disclosed, SIL is considering both revenue improvement and costs reduction initiatives to improve performance. Without limitation, the company has undertaken the following discrete activities:

- Preliminary improvement to its online booking facilities and a bespoke digital patient reactivation trial, with myhealth1st.
- Upskilling of practitioners through the completion of externally provided training programs concerned with high value services offerings such as implant dentistry, as previously disclosed.
- Upskilling of practice managers through provision of training days in Brisbane, Sydney and Melbourne.
- Development of further training programs to be rolled out in 2020, with respect to cosmetic and dento-facial rejuvenation.
- Proactive performance management and replacement of clinical and non-clinical personnel who were hindering performance.
- The ongoing reassessment and redesign of the support office functions designed to improve operational performance and reduce costs using technology and automation where possible and appropriate. For example, the company is in the process of implementing an automated integrated procurement management system improving purchasing power, purchase control, budget management and alleviating the business from the cost and time drains associated with the manual processing of approximately 60,000 invoices per annum.

Such fundamental changes to the operations of the business require substantial investment which will impact cashflows of operations for the next quarter. It is important to note that whilst the overall quantum of the company’s costs might not be immediately reducing, the nature of the spend is. We have had to change our staffing levels, activities and expenditures to meet our financial constraints – overall, we expect expenditures to be similar (albeit with different composition) as revenues improve.

Similarly, the company has been able to settle several significant legal matters and has seen a decrease in the corporate level distractions that have hindered the ability of management to focus solely on the improvement of the business. The distraction and diversion of resources – both time and money – to address these matters has been very significant, however SIL now considers that it can refocus its resources, including cash, to improving operations and shareholder value.

5. Please explain in detail the basis of SIL’s statement (reproduced in paragraph I ii above) that “it is seeing positive tangible change within the business (including in respect of cash flows on a like-for-like basis) as a result of the implementation of its turnaround plan.” (emphasis added).

As a result of the actions undertaken, and without limitation, the company has begun to see tangible signs of improvement in the following ways:

- Increased usage by patients of our online booking tools, as a result of the recent upgrades and improvements, and increases in the number of past patients returning to the business, as a result of the “reactivation efforts” which commenced in late December 2019. These two improvements have increased the number of patient bookings in the short term. The exact timing of the improvement for each practice is driven largely by the nature of the services of the practice which vary in complexity and price-point.
- Indications of future system efficiencies associated with process change and system implementation. Implementation of the procurement system is currently in testing phase (the project commenced late December 2019) and will be progressively rolled out across the business in March 2020. Early results show increased efficiency with ordering and invoice processing that will reduce the administrative burden, and cost, on the business as well as improved cost control and optimisation of the supply chain, supplier relationships and purchasing power.

The reference to cash flows on a like-for-like basis concerns underlying operating cash flows compared to prior periods after excluding the abnormal items noted above.

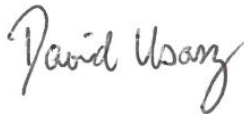
6. Please confirm that SIL is complying with listing rule 3.1 and that there is no information that should be given to ASX about its financial condition under that rule that has not already been released to the market.

SIL considers that it is complying with listing rule 3.1 and that there is no information that should be given to ASX about its financial condition under that rule that has not already been released to the market.

7. Please confirm that SIL's responses to the questions above have been authorised and approved in accordance with its published continuous disclosure policy or otherwise by its board or an officer of SIL with delegated authority from the board to respond to ASX on disclosure matters.

This response has been authorised and approved by the Board of SIL.

Regards



David Usasz
Chairman

18 February 2020

Reference: ODIN14068

Ms Emma Corcoran
Company Secretary / CFO
Smiles Inclusive Limited
PO Box 382
West Burleigh, QLD 4219

By email

Dear Ms Corcoran

Smiles Inclusive Limited ('SIL'): Query Letter

ASX refers to:

- A. the Appendix 4Cs released by SIL on the ASX market announcements platform ('MAP') for each quarter between 1 March 2019 and 31 December 2019 in which SIL reported the key figures detailed in the table at Annexure A to this letter;
- B. SIL's announcement released on MAP on 28 February 2019 titled "Half year results, management changes and guidance" which included the following statement:
"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."
- C. SIL's announcement released on MAP on 24 April 2019 titled "Withdrawal of FY19 guidance", which included the following statement:
"the turnaround plan is being implemented as a consultative process with the Company's joint venture partners, financiers and other stakeholders to maximise prospects of a long term solution."
- D. the covering announcement to the Appendix 4C released on 30 April 2019, which included the following statement:
"the turnaround plan is underway and the Company is working with its senior lender on its turnaround plan implementation."
- E. the covering announcement to the Appendix 4C released on 31 July 2019, which included the following statement:
"Turnaround plan implementation is progressing and has involved revision of operational strategy, reduction in support office staffing levels and other costs...";
- F. SIL's reporting of its financing facilities in its Appendix 4C for the quarter ended 30 September 2019, being (relevantly):
 - i. (at 8.1 – loan facilities): \$19,608,000 total facility amount; \$19,608,000 drawn at quarter end; and
 - ii. (at 8.4): "Loan facilities in 8.1 include the NAB senior debt and acquisition facility of \$14,708,000 and the working capital facility of \$4,000,000 and 3rd party loans of \$900,000. Weighted average interest rate on these loans at 30 September 2019 was 3.92%."

- G. SIL's annual report to shareholders for the year ended 30 June 2019, released on MAP on 1 November 2019, which included the following statements:

"The Group has financing facilities with National Australia Bank (refer to Note 6) which are drawn to \$18.708 Million at 30 June 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 National Australia Bank (NAB) advised the Group that they were in breach of financial covenants, and have agreed to a conditional waiver and extension of the existing facilities until the end of November 2019 which includes:

- *the ongoing review of the Group and regular reporting by an investigating accountant;*
- *a reduction of \$675,000 in the existing facilities by 21 October 2019;*
- *provision of ongoing financial information including a 3-way financial forecast and*
- *development of modified covenants.*

Following the appointment of a new management team, the Group has developed a turnaround plan which is being reviewed by advisors on behalf of the Group's primary banker, National Australia Bank (NAB). The implementation of the turnaround plan commenced in June 2019 and is dependent upon the continued support of stakeholders including financiers and creditors." (on page 12 of the Directors' report)

- H. SIL's reporting of its financing facilities in its Appendix 4C for the quarter ended 31 December 2019, being (relevantly):

- i. (at 8.1 – *loan facilities*): \$18,934,000 total facility amount; \$18,934,000 drawn at quarter end; and
- ii. (at 8.4): "Loan facilities in 8.1 include the NAB senior debt and acquisition facility of \$14,708,000 and the working capital facility of \$4,000,000 and 3rd party loans of \$900,000. Weighted average interest rate on these loans at 31 December 2019 was 3.94%."

- I. SIL's announcement released on MAP on 7 February 2020 titled "Response to ASX Appendix 4C Query", disclosing:

- i. *"The Company is continuing to implement its turnaround plan, which consists of several discrete initiatives, which vary in complexity, being executed."*
- ii. *"The Company expects to be able to continue its operations and to meet its business objectives on the basis that it continues to have the support of its stakeholders and that it is seeing positive tangible change within the business (including in respect of cash flows on a like-for-like basis) as a result of the implementation of its turnaround plan."*

Questions and Request for Information

Having regard to the above, ASX asks SIL to respond separately to each of the following questions and requests for information:

1. With respect to SIL's loan facilities with National Australia Bank ('NAB'), please confirm:
 - a. the complete list of conditions on which NAB waived the covenant breaches referred to in the date of SIL's FY19 annual report (see paragraph G above) and whether SIL has met those conditions;
 - b. whether modified covenants were agreed and, if so, what they are and whether SIL has complied with those covenants;

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- c. whether NAB has extended the facility beyond the November 2019 review point and, if so, on what terms;
 - d. if NAB did extend the facilities, and to the extent not already dealt with in responses to questions 1.a to 1.c:
 - i. the current balances and maturity dates of these facilities;
 - ii. the frequency of repayments;
 - iii. the quantum of repayments / the basis on which repayments are calculated;
 - iv. any performance-based events of default; and
 - v. when (and how often) covenants will be tested, and
 - e. if NAB did not extend the facilities, what alternative arrangements SIL has made with respect to this debt.
2. Please confirm the dates of the pay-cycles and the total outflows for each cycle in:
 - a. the quarter ended 30 September 2019; and
 - b. the quarter ended 31 December 2019.
 3. Please provide a breakdown of:
 - a. the “non-underlying costs” disclosed in the Appendix 4C released on 31 October 2019¹; and
 - b. the payments referred to in notes 3 and 4 of the Appendix 4C released on 31 January 2020.
 4. ASX refers to the figures reported by SIL for:
 - a. actual manufacturing and operating costs;
 - b. estimated manufacturing and operating costs;
 - c. actual staff costs; and
 - d. estimated staff costs,

in the Appendix 4Cs summarised in Annexure A.

Given the absence of an apparent downward trend in these overheads, is SIL in a position to provide more detail regarding the “several discrete initiatives, which vary in complexity”² comprising its turnaround plan?

5. Please explain in detail the basis of SIL’s statement (reproduced in paragraph I ii above) that “it is seeing positive tangible change within the business (including in respect of cash flows on a like-for-like basis) as a result of the implementation of its turnaround plan.” (emphasis added)
6. Please confirm that SIL is complying with listing rule 3.1 and that there is no information that should be given to ASX about its financial condition under that rule that has not already been released to the market.
7. Please confirm that SIL’s responses to the questions above have been authorised and approved in accordance with its published continuous disclosure policy or otherwise by its board or an officer of SIL with delegated authority from the board to respond to ASX on disclosure matters.

¹ Refer to n 4 below.

² Refer to paragraph I i above.

When and where to send your response

This request is made under listing rule 18.7. Your response is required as soon as reasonably possible and, in any event, by no later than **5:00 pm AEST on Friday, 21 February 2020**.

You should note that if the information requested by this letter is information required to be given to ASX under listing rule 3.1 and it does not fall within the exceptions mentioned in listing rule 3.1A, SIL's obligation is to disclose the information 'immediately'. This may require the information to be disclosed before the deadline set out in the previous paragraph.

For the purpose of preparing its answers to the above questions concerning when it was aware of particular matters, ASX also directs SIL to the following definition in chapter 19 of the listing rules³:

aware *an entity becomes aware of information if, and as soon as, an officer of the entity (or, in the case of a trust, an officer of the responsible entity) has, or ought reasonably to have, come into possession of the information in the course of the performance of their duties as an officer of that entity.*

ASX reserves the right to release a copy of this letter and your response on MAP under listing rule 18.7A.

Accordingly, your response should be in a form suitable for release to the market. Your response should be sent to me by e-mail. It should not be sent directly to the ASX Market Announcements Office. This is to allow me to review your response to confirm that it is in a form appropriate for release to the market, before it is published on the ASX Market Announcements Platform.

Enquiries

If you have any queries or concerns about any of the above, please contact me immediately.

Yours sincerely,

Corey Lian
Adviser, Listings Compliance (Sydney)

³ Refer also to the commentary at section 4.4 in Guidance Note 8.

Annexure A



	Actual						Estimated for next quarter			
Quarter ended (Date released on MAP)	Receipts from customers	Product manufacturing and operating costs	Staff costs	Administration Costs	Other (non- underlying costs):	Other (JVP profit share expense):	Product manufacturing and operating costs	Advertising and marketing	Staff costs	Administration Costs
31 March 2019 (26 April 2019)	\$11,320,000	\$6,342,000	\$5,324,000	\$1,145,000			\$6,000,000;	\$200,000	\$4,800,000	\$1,200,000
30 June 2019 (31 July 2019)	\$12,247,000	\$5,695,000	\$5,839,000	\$785,000			\$6,500,000	\$300,000	\$5,500,000	\$700,000
30 September 2019 (31 October 2019)	\$12,275,000	\$5,988,000	\$5,652,000	\$511,000	\$214,000 ⁴	\$402,000 ⁵	\$6,700,000	\$300,000	\$5,000,000	\$700,000
31 December 2019 (31 January 2020)	\$11,843,000	\$6,818,000	\$5,356,000 ⁶	\$2,105,000. ⁷			\$6,700,000	\$300,000	\$5,000,000	\$700,000

⁴ Note 1 said this “included redundancies, legal costs and professional fees associated with the turnaround strategy”.

⁵ Note 2 said this represented “amounts paid to joint venture partners”.

⁶ Note 2 said that SIL “incurred an additional pay-cycle for the months of December [sic], realizing a larger wages expense than other quarters”.

⁷ Notes 3 and 4 said “significant cash outlays ... in accordance with the proposed usage of funds raised in the Company’s rights issue which settled on October 16, 2019 [sic]” and “one-off” outlays for the quarter associated with full year insurance costs, litigation matters and restructure costs”.