

## ARTICLE

### *There's a little gleam in 1300 Smiles dental investments*

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Dental chain 1300 SMILES' main competitors in the \$9 billion sector aren't rival tooth manipulators, including the fellow ASX-listed Pacific Smiles.

Rather, they're booze shops, travel agents, restaurants and mortgage providers — any enterprise that saps discretionary dollars from consumers.

"Obviously people will get their urgent dental work done, but spending on routine dental care competes with the temptation to buy a new TV, take a holiday in Bali or just stay home and pay down the mortgage," founder and CEO Daryl Holmes says.

The consumer preference for hedonism over an hour of pain in the chair is not the only adversity faced by the profession, which faces subdued revenues at the same time as dental schools are churning out hundreds more graduates.

According to Holmes, between 50 and 70 per cent of the population don't make annual visits. We bet they don't floss, either.

The Australian Dental Association reckons that three out of 10 adult Australians have untreated tooth decay.

The government's attitude to the noble profession has been ambivalent: the \$1bn Chronic Diseases Dental Scheme was suddenly axed in 2012, replaced by a less generous Dental Health Reform Package for impecunious folk.

Added to mix, the private health funds are keen to rein in dental benefits in the same way as some insurers have played hard ball with private hospitals.

Given the vicissitudes, 1300 SMILES did well to boost its interim profit by 20 per cent to \$4.05m, on a 3 per cent revenue increase to \$19m.

Holmes cites cost benefits arising from economies of scale.

Townsville-based 1300 SMILES has noticed the fallout of the mining downturn has also sapped discretionary dental dollars. The woes of Clive Palmer's nickel smelter hasn't helped, although locals can still crack a grin given the fortunes of the 1300 SMILES-sponsored North Queensland Cowboys.

The bigger Pacific Smiles invoked investor frowns on Friday after reporting a 2 per cent interim net profit decline to \$4.9m, despite revenue growing 11 per cent to \$41.6m.

CEO John Briggs attributed the lacklustre result to the start-up cost of new centres and a TV ad blitz in regional locations.

While their models differ, both chains derive revenue from charging service fees to self-employed dentists working from company-owned facilities.

The model appeals to both young dentists who don't want to incur the cost of starting a practice and older ones getting long in the tooth. Because the companies handle the paperwork and billing, the dentists can focus on the drilling.

We've got to say that the listed history of professional practice consolidators leaves much to be desired. Greybeards will recall the collapse of the accounting chains Harts and Stockfords.

But investors in 1300 SMILES, which has graced the ASX since 2005, can't complain. Excluding divs the share price has appreciated more than sixfold since that time, when the company was only generating full-year earnings of \$1.5m.

Pacific Smiles listed in November 2014 at \$1.30 apiece, after a partial sell down by founders Alex Abrahams and Alison Hughes and fundie TDM Management. These parties retain skin in the game.

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Research house IBISworld forecasts annual growth rate at 2.4 per cent over the next five years.

“Continued demand from older Australians is expected to support industry operators, particularly as consumers increase their uptake of private health insurance extras to reduce out-of-pocket dental costs,” IBIS says.

Still, both chains realise they won’t prosper with a “build it and they will come” mentality to rolling out new clinics.

To address the affordability gap 1300 SMILES has instituted a \$1-a-day plan to cover two annual check-ups.

Pacific Smiles is about to align with the Velocity scheme — the first frequent-flyer tie up for the dental sector.

The attitude of health funds looms as key driver of the sector’s fortunes.

BUPA has taken the in-house strategy by acquiring the private Dental Corp and rebranding it as its own captive chain.

Medibank has opted not to make such a chunky investment, in favour of “preferred supplier” arrangements. Medibank’s discount arm AHM sold two underperforming Sydney practices to Pacific Smiles.

Holmes reckons dentists are still unsure whether the funds are “friends or foe”. While private health extras cover works fine for his chain, “on a broader scale there is a lot of friction between the private health funds and the dental industry”.

Briggs reckons the industry enjoys an inherent advantage, because private health insurance payments account for only 17 per cent of turnover.

Government payments also only account for 7 per cent of dental income, compared with 82 per cent for general medicine.

IBIS says the improvement in Australians’ oral health — partly the result of fluoridation — means younger people need fewer fillings.

Our wealth-creation advice is to treat dental investments as a long-term proposition — and don’t skimp on the Colgate and the waxy string.

As Criterion’s dentist counsels: “Only floss the teeth you want to keep.”

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