IDH Finance plc

Quarterly Financial Report
3 months ended 30 June 2017

Contents

Presentation of financial data

This report summarises consolidated financial and operating data derived from the unaudited consolidated financial statements of Turnstone Midco 2 Limited, the parent company of IDH Finance plc. The summary financial information provided has been derived from our records for the three month accounting period to 30 June 2017 which are maintained in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRS'). The interim results are not necessarily indicative of the results to be expected for the full year.

We have presented certain non-IFRS information in this quarterly report. This information includes "EBITDA" and other measures derived therefrom, including EBITDA before non-underlying items, which represents earnings before interest, tax, depreciation, amortisation, impairment and other non-underlying items. Our management believes metrics derived from EBITDA are meaningful for investors because they provide an analysis of our operating results, profitability and ability to service debt. Measures derived from EBITDA are also used by management to track our business development, establish operational and strategic targets and make important business decisions. EBITDA is the measure commonly used by investors and other interested parties in our industry.

Comparative information has been provided for the quarter ended 30 June 2016. Information presented in this report and described as like-for-like excludes any practices or other operating units trading in the group in the current financial year or the year ended 31 March 2017 but not in both.

References to "Integrated Dental Holdings", "IDH" and "the group" refer to Turnstone Midco 2 Limited and all of its subsidiaries.

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Summary highlights

- Revenue for the three months ended 30 June 2017 ("Q1 FY18") of £141.6m, which was 1.2% lower than the three months ended 30 June 2016 ("Q1 FY17"), predominantly due to lower Unit of Dental Activity ("UDA") delivery.
- Q1 FY18 like-for-like private revenue growth of 3.8%, or 7.2% if adjusted for the number of working days.
- Q1 FY18 gross margin percentage of 44.1% compared to 46.0% in Q1 FY17. This percentage is an improvement on recent quarters.
- Overheads, excluding depreciation, goodwill amortisation and non-underlying items, as a percentage of revenue were 35.5%, compared to 33.7% in Q1 FY17.
- EBITDA before non-underlying items for the three months ended 30 June 2017 of £12.8m (9.0% of revenue), 29.2% behind the three months to 30 June 2016 (£18.1m, 12.6% of revenue).
- Like-for-like UDA delivery per working day down 4.6% year-on-year, for the quarter.
- LTM EBITDA of £63.5m; and estimated pro-forma adjusted LTM EBITDA of £64.6m.
- One dental practice acquired and one practice closed during the quarter – total practices at 30 June 2017 were 672.
- Orthodontic materials distribution business acquired by Dental Directory at the end of June.
- Total consideration for acquisitions including contingent consideration for prior year acquisitions, was £2.8m.
- Cash generated from operations of £13.2m (Q1 FY17: £19.8m).
- Maintenance capital expenditure for the quarter ended 30 June 2017 was £4.1m.
- Normalised cash conversion adjusting for one-off items in working capital and maintenance capital expenditure was 96.0%.
- Cash and cash equivalents at 30 June 2017 of £12.8m and net debt was £528.0m.
- Gearing levels are 8.31 times and 8.17 times LTM EBITDA and estimated pro-forma adjusted LTM EBITDA respectively.
- £100m Super Senior Revolving Credit Facility undrawn at 30 June 2017.

Management's discussion and analysis of financial condition and results of operations

Overview

Integrated Dental Holdings ("IDH") announces its results for the quarter ended 30 June 2017.

IDH is the leading provider of dental services in the United Kingdom and, through mydentist, operates a network of 672 dental practices throughout England, Scotland, Wales and Northern Ireland.

mydentist's core business is the provision of primary care dental services on behalf of the NHS. The majority of dental practices also provide private dentistry services including general dentistry, hygienist and cosmetic services. A number of our practices also provide specialist and advanced services such as treatment under sedation, dental implants and orthodontics.

In addition, the group's Dental Directory business is a leading provider of materials, equipment and services to dental practices across the UK.

Commentary on results

The following discussion of IDH's financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes contained in this interim report.

The key performance indicators for the group for the four quarters from 1 April 2016 to 31 March 2017 and for the quarter ended 30 June 2017 are provided below:

Key performance indicators		Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Turnover (£m)		143.4	142.1	149.4	150.9	141.6
EBITDA (£m)		18.1	16.8	16.8	17.1	12.8
LTM EBITDA (£m)		80.5	77.7	72.5	68.8	63.5
Operating profit/(loss) (£m)		3.7	1.2	(13.4)	(14.3)	(10.7)
NHS dentistry services as a percentage of revenue		66.4%	66.6%	64.9%	65.1%	63.5%
Private dentistry services as a percentage of revenue		16.4%	16.5%	16.3%	16.3%	17.3%
Dental Directory as a percentage of revenue		17.2%	16.9%	18.8%	18.6%	19.2%
Like-for-like private revenue growth		10.0%	3.8%	6.2%	8.0%	3.8%
Gross profit margin %		46.0%	44.9%	43.7%	43.8%	44.1%
Overheads as a percentage of revenue		33.7%	33.4%	32.8%	32.7%	35.5%
EBITDA margin %		12.6%	11.9%	11.3%	11.3%	9.0%
Number of dental practices		674	675	677	674	672
Maintenance capital expenditure (£m)		5.3	5.4	3.2	3.9	4.1
Cash conversion after maintenance capital expenditure %	(1)	97.2%	116.7%	36.1%	108.5%	95.9%
Estimated pro-forma adjusted EBITDA (£m)		85.6	81.0	75.5	70.3	64.6

(1) Normalised cash conversion, after adjusting for one-off items in working capital and maintenance capital expenditure in Q1 FY18 was 96.0% (Q1 FY17: 102.3%).

During the quarter, we acquired one dental practice and closed one dental practice for a total of 672 dental practices in our estate as at 30 June 2017 (30 June 2016: 674).

Revenue

Group revenue decreased by £1.7m, or 1.2%, from £143.4m for the three month period ended 30 June 2016 (“Q1 FY17”) to £141.6m for the three month period to 30 June 2017 (“Q1 FY18”).

mydentist revenue decreased by £4.4m from £118.8m to £114.5m. This is partly due to there being two fewer trading days in the first quarter of FY18 than the equivalent period in FY17.

Revenue from Dental Directory, after the elimination of intragroup trading, increased by £2.6m from £24.6m in Q1 FY17 to £27.2m in Q1 FY18.

Group revenue	Q1 2018	Q1 2017	Movement
	£'000	£'000	£'000
Practices owned as at 1 April 2016	113,077	118,705	(5,628)
Practices acquired or opened:			
During the 12 months ended 31 March 2017	1,184	102	1,082
During the 3 months ended 30 June 2017	196	-	196
Total mydentist revenue	114,457	118,807	(4,350)
Dental Directory revenue	27,192	24,584	2,608
Group revenue	141,649	143,391	(1,742)

Revenue of £1.2m was contributed by the six practices acquired during the period 1 April 2016 to 31 March 2017 (“FY17 acquisitions”) in the quarter ended 30 June 2017, a £1.1m increase over the £0.1m contributed by the two practices acquired in the first quarter of the last financial year. The one practice acquired during the first quarter of FY18 (“FY18 acquisition”) contributed an additional £0.2m.

NHS revenue

NHS revenue for the quarter ended 30 June 2017 was £90.0m, a decrease of £5.3m or 5.5% from £95.3m in Q1 FY17. An additional £1.2m of revenue was generated by FY17 and FY18 acquisitions.

NHS revenue generated from practices owned at 1 April 2016 reduced from £95.2m to £88.7m. The decrease is principally due to a lower level of UDA delivery in the quarter when compared to FY17. The lower level of UDA delivery is largely due to some clinicians reducing the number of UDA’s they wish to perform, a reduction in the productivity of dentists due to an increase in the average appointment time and the influence of private growth due to patient choice. Management have taken action to accelerate the recruitment of additional clinicians to reduce the current shortfall in UDA’s contracted to clinicians. However it can take between six to nine months for a clinician position to be filled. We are starting to see an increase in the total number of contracted clinicians which we expect will start to reverse the decline we have experienced in UDA performance during the later months of the current financial year. Clinician turnover remains at low levels of less than 10% per annum.

The decrease is partially offset by the expected NHS dentistry contract rate uplift. Although the NHS is yet to announce the amount of any uplift we expect this to be in line with recent years and, therefore, we have included an uplift of 0.60% applicable from 1 April 2017. The uplift for contracts in Wales has been announced at 1.44%. However, there can be no certainty that the NHS in England will announce a contract rate uplift for the year ending 31 March 2018 in line with the amount we have assumed, or at all.

Private revenue

Private revenue for the quarter ended 30 June 2017 was £24.5m, 4.0% higher than £23.6m for the equivalent period in FY17.

Like-for-like practices increased private sales by £0.9m, or 3.8%, with acquired practices generating £0.1m of additional private revenue. Private revenue growth continues to reflect the benefits from expanding the range of treatment options available to our patients and the offering of additional services including hygienists in addition to certain price increases.

Dental Directory revenue

Revenue of £27.2m (Q1 FY17: £24.6m) has been generated from the business units across the Dental Directory division. The increase of £2.6m is principally derived from the high street and facial aesthetics sectors, reflecting some volume growth but mainly due to price increases based on assessments of the market conditions following the decline in exchange rates over the last financial year.

Cost of sales

Gross margin for the quarter ended 30 June 2017 was 44.1% a 1.9% decrease from 46.0% in the quarter ended 30 June 2016. mydentist gross margin for Q1 FY18 was 46.5% (Q1 FY17: 47.9%) and gross margin in Dental Directory was 30.1% (Q1 FY17: 30.7%).

Cost of sales increased by £1.7m, or 2.2%, from £77.4m to £79.2m for the quarter ended 30 June 2017. The increase principally reflects the revenue growth within Dental Directory.

The drop in mydentist gross margin to 46.5% reflects higher dentists fees, including higher locum costs, and higher materials costs compared to the previous year. This has been partially offset by the 0.6% NHS contract uplift that we have assumed will take effect from 1 April 2017.

The reduction in Dental Directory gross margin is largely due to the continuing impact from the decline in the value of the Pound against the Euro following the EU referendum last year and the recent General Election. The margin declines seen in previous quarters have now been largely mitigated through supplier support and market based price increases to customers. Further exchange rate volatility could have an impact on the cost of sales of Dental Directory as c.40% of the division’s purchases are made on a wholesale basis mainly in Euros or, to a lesser extent, in US Dollars.

Overheads

Overheads, including administrative expenses, distribution costs, amortisation of intangible assets, depreciation, grant income and other non-underlying items were £73.8m for Q1 FY18, an increase of £10.6m from £63.2m in the three months to 30 June 2016.

Overheads excluding amortisation of intangible assets, depreciation, grant income and other non-underlying items were £50.2m, an increase of £1.8m from £48.4m in Q1 FY17.

The increase in overheads principally reflects higher dental practice staff costs through both headcount and living wage increases. Dental Directory support centre headcount has also increased to support the revenue growth.

The group’s largest overhead is the cost of staff working in dental practices, in operational management and at the divisional support centres. In the quarter ended 30 June 2017, staff costs were £33.2m, an increase of £2.2m from £31.0m in Q1 FY17.

Rent expense for the quarter was £3.7m, 2.6% of revenue and in line with Q1 FY17.

Dental equipment and practice property maintenance costs for Q1 FY18 were £2.9m, £0.1m higher than Q1 FY17.

Other operating income

Other operating income for the three months ended 30 June 2017 was £0.5m. Other operating income includes contractual support received from Scottish Health Boards to assist in the upkeep of our Scottish dental practices (based on the proportion of NHS treatment carried out by each practice) and property rental income.

Other gains

Other gains include net realised and unrealised foreign exchange gains and losses arising in Dental Directory, principally in relation to foreign exchange forward contracts which are used to hedge the cash impact of a proportion of the cost of goods purchased in Euros and US Dollars.

EBITDA before non-underlying items

Earnings before interest, tax, depreciation, amortisation and non-underlying items for the three months ended 30 June 2017 was £12.8m.

Estimated pro-forma adjusted LTM EBITDA

	£'000
LTM EBITDA before exceptional items at 30 June 2017	63,537
Estimated adjusted EBITDA of acquired dental practices at 30 June 2017	694
EBITDA from disposals	214
Reversal of one off VAT grouping adjustment	197
Estimated pro-forma adjusted EBITDA	64,642

Estimated pro-forma adjusted LTM EBITDA has been calculated following the methodology set out in the IDH Finance plc Offering Memorandum dated 22 July 2016.

The estimated adjusted EBITDA for acquired businesses are management estimates for the annual EBITDA of an acquired business less the actual results consolidated in LTM EBITDA from the date of acquisition. The EBITDA from disposals adds back trading losses incurred in the last twelve months in practices closed or disposed of in the period from 1 July 2016 to 30 June 2017.

Non-underlying items

The mydentist practice portfolio review has so far identified a small number of practices (approximately 20) which are no longer considered to be economically viable. The decision has therefore been taken to either close, or market these practices for sale, with completions expected over the remainder of FY18. As a result, the group has written down the carrying value of the assets associated with these practices to their recoverable amount and reclassified those assets as held for sale. This has resulted in a charge to the income statement of £9.7m during Q1 FY18, included within non-underlying items. The portfolio review will continue to review the status of certain practices through this financial year.

Finance costs

Finance costs of £11.0m in Q1 FY18 include £9.8m in respect of the £275.0m Senior Secured Fixed Rate Notes, £150.0m Senior Secured Floating Rate Notes and £130.0m Second Lien Notes. A further £1.1m relates to the amortisation of debt arrangement fees, interest rate swap charges and interest and non-utilisation fees payable in respect of the Super Senior Revolving Credit Facility (“SSRCF”). The remaining £0.1m arises from the unwinding of discount in respect of contingent consideration and certain provisions which are expected to be settled in future periods.

Finance income of £0.5m principally arises from the unrealised mark-to-market movement in the value of the group’s interest rate swap contracts, both of which expired on 1 June 2017.

Debt and liquidity

At 30 June 2017, net debt was £528.0m, compared to £527.6m at 31 March 2017. This increase principally reflects the amortisation of facility arrangement fees.

Net cash flow for the quarter was an inflow of £0.2m. This arises from cash generated from operating activities of £13.2m and proceeds from the sale of dental equipment of £0.1m, offset by expenditure of £6.1m for the servicing of finance, capital expenditure of £4.2m and £2.8m on acquisitions. The SSRCF was utilised for short term liquidity during the quarter, however the drawn amount was repaid before 30 June 2017.

Working capital movements

Cash generated from operations decreased from £19.8m in Q1 FY17 to £13.2m principally due to an increase in stock within the Dental Directory and the prepayment of annual support contracts within mydentist during Q1 FY18.

Capital expenditure

Capital expenditure for Q1 FY18 was £4.2m. This included acquisition refurbishments of £0.1m and “maintenance” capital expenditure of £4.1m.

Cash conversion

Cash conversion is measured as the ratio of EBITDA to cash generated from operations less maintenance capital expenditure and for the quarter was 95.9% compared to 97.2% in the corresponding quarter in FY17.

Cash conversion excluding working capital movements was 68.2% (Q1 FY17: 70.6%).

Acquisitions

Acquisitions capital expenditure in the quarter was £2.8m and included the acquisition of one dental practice, an orthodontic materials distribution business acquired by Dental Directory, and contingent consideration paid in respect of acquisitions completed in previous years.

Risk factors

The latest opportunity and risk position of the group is detailed in the Annual Report to bondholders for Turnstone Midco 2 for the year ended 31 March 2017.

Turnstone Midco 2 Limited

Condensed interim consolidated financial statements – Unaudited

Quarter ended 30 June 2017

Consolidated income statement (unaudited)

For the quarter ended 30 June 2017

	Note	Q1 2018 £'000	Q1 2017 £'000
Revenue	4	141,649	143,391
Cost of sales		(79,155)	(77,433)
Gross profit	4	62,494	65,958
Distribution costs		(4,207)	(4,249)
Administrative expenses		(69,633)	(58,937)
Other operating income		525	479
Other gains		132	433
Operating (loss)/profit	4	(10,689)	3,684
EBITDA before non-underlying items	4	12,791	18,063
Amortisation of intangible assets		(8,222)	(8,159)
Depreciation		(5,427)	(5,070)
Amortisation of government grant income		14	19
Other non-underlying items		(9,977)	(1,602)
Foreign exchange gains		132	433
Operating (loss)/profit	4	(10,689)	3,684
Finance costs		(11,010)	(9,661)
Finance income		495	193
Net finance costs		(10,515)	(9,468)
Loss before income tax	4	(21,204)	(5,784)
Income tax credit	5	2,648	1,062
Loss for the period		(18,556)	(4,722)
Attributable to:			
Owners of the parent		(18,554)	(4,727)
Non-controlling interests		(2)	5
		(18,556)	(4,722)

There are no items of other comprehensive income during the current or previous period other than those stated above and therefore no separate statement of comprehensive income has been presented.

Consolidated balance sheet (unaudited)

At 30 June 2017

	Note	Q1 2018 £'000	Q1 2017 £'000
Non-current assets			
Goodwill	*8*	313,253	339,283
Other intangible assets	*8*	410,114	446,320
Property, plant and equipment		96,292	101,048
Deferred tax income tax assets		13,704	9,741
		833,363	896,392
Current assets			
Inventories		23,114	20,932
Trade and other receivables		45,161	49,318
Current income tax		131	-
Derivative financial instruments		185	1,000
Cash and cash equivalents		12,766	21,852
		81,357	93,102
Assets classified as held for sale		2,266	265
Total assets		916,986	989,759
Equity attributable to the owners of the parent			
Share capital		410,961	410,961
Accumulated losses		(219,646)	(139,631)
		191,315	271,330
Non-controlling interest		99	94
Total equity		191,414	271,424
Non-current liabilities			
Borrowings	*7*	540,786	532,498
Other payables	*6*	1,111	1,634
Deferred income tax liabilities		42,250	50,201
Post employment benefits		321	-
Provisions		6,724	7,299
Derivative financial instruments		-	1,844
Total non-current liabilities		591,192	593,476
Current liabilities			
Trade and other payables	*6*	132,854	122,782
Current income tax		3	277
Provisions		1,505	1,708
Derivative financial instruments		18	92
Total current liabilities		134,380	124,859
Total liabilities		725,572	718,335
Total equity and liabilities		916,986	989,759

Consolidated statement of changes in equity (unaudited)

For the quarter ended 30 June 2017

	Q1 2018				
	Share capital	Retained earnings	Total equity attributable to the owners of the parent	Non-controlling interest	Total equity
	£'000	£'000	£'000	£'000	£'000
Balance at beginning of the period	410,961	(201,092)	209,869	101	209,970
Comprehensive expense for the period					
Total comprehensive expense for the period	-	(18,554)	(18,554)	(2)	(18,556)
Balance at end of the period	410,961	(219,646)	191,315	99	191,414

	Q1 2017				
	Share capital	Retained earnings	Total equity attributable to the owners of the parent	Non-controlling interest	Total equity
	£'000	£'000	£'000	£'000	£'000
Balance at beginning of the period	410,961	(134,904)	276,057	89	276,146
Comprehensive expense for the period					
Total comprehensive expense for the period	-	(4,727)	(4,727)	5	(4,722)
Balance at end of the period	410,961	(139,631)	271,330	94	271,424

Consolidated cash flow statement (unaudited)

For the quarter ended 30 June 2017

	Q1 2018 £'000	Q1 2017 £'000
Cash flows from operating activities		
Loss before taxation	(21,204)	(5,784)
Depreciation of property, plant and equipment	5,427	5,070
Amortisation of government grants	(14)	(19)
Amortisation of intangible assets	8,222	8,159
Finance costs	11,010	9,661
Finance income	(495)	(193)
Loss on business and asset disposals	9,713	2
Differences between contingent consideration paid and initial estimates	52	(91)
Net unrealised foreign exchange losses	(303)	(261)
Cash generated from operations before movements in working capital	12,408	16,544
Changes in working capital		
Movement in inventories	(3,482)	(381)
Movement in trade and other receivables	(3,688)	529
Movement in trade and other payables	8,263	3,534
Movement in provisions	(345)	(425)
Cash generated from operations	13,156	19,801
Taxation	-	-
Net cash inflow from operating activities	13,156	19,801
Cash flows from investing activities		
Acquisitions (net of cash acquired)	(2,807)	(2,478)
Purchase of property, plant and equipment	(4,180)	(6,071)
Proceeds from business and asset disposals	89	(2)
Interest received	2	4
Net cash outflow from investing activities	(6,896)	(8,547)
Cash flows from financing activities		
Drawdown of bank loans	10,000	-
Repayment of bank loans	(10,000)	-
Bank and bond interest paid	(6,087)	(4,344)
Net cash outflow from financing activities	(6,087)	(4,344)
Net increase in cash and cash equivalents	173	6,910
Cash and cash equivalents at the beginning of the period	12,593	14,942
Cash and cash equivalents at the end of the period	12,766	21,852

Reconciliation of net cash flow to movement in net debt (unaudited)

For the quarter ended 30 June 2017

	Q1 2018	Q1 2017
	£'000	£'000
Increase in cash for the period	173	6,910
Drawdown of bank loans	(10,000)	-
Repayment of bank loans	10,000	-
Total cash movement in net debt	173	6,910
Amortisation of loan arrangement fees	(620)	(630)
Total non-cash movement in net debt	(620)	(630)
Total movement in net debt	(447)	6,280
Net debt brought forward	(527,573)	(516,926)
Net debt carried forward	(528,020)	(510,646)

Notes

Forming part of the financial statements

1 General information and basis of preparation

Turnstone Midco 2 Limited (the "company", and with its subsidiaries, the "group") is a company registered in England. It is the parent company of IDH Finance plc (the "issuer"). The company is 100% owned by Turnstone Midco 1 Limited and the ultimate UK parent company is Turnstone Equityco 1 Limited.

The condensed interim consolidated financial statements (the 'interim financial statements') of the company have been prepared for the quarter ended 30 June 2017. Comparative results are provided for the quarter ended 30 June 2016.

The interim financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRS') and, specifically, IAS 34 'Interim Financial Reporting'. The interim financial statements are presented in thousands of pounds sterling (£'000's) except where otherwise stated. Pounds sterling is the functional currency of both Turnstone Midco 2 Limited and Turnstone Equityco 1 Limited.

The content of this report does not constitute statutory financial statements and is unaudited.

These interim financial statements do not include all of the disclosure information required in annual financial statements prepared in accordance with IFRS and should therefore be read in conjunction with the consolidated financial statements of Turnstone Midco 2 Limited and Turnstone Equityco 1 Limited for the year ended 31 March 2017, both of which are available from our website, www.mydentist.co.uk.

2 Significant accounting policies

The interim financial statements have been prepared on the basis of the accounting policies set out in the 2017 annual report and consolidated financial statements for Turnstone Midco 2 Limited and Turnstone Equityco 1 Limited.

a) Basis of consolidation

Subsidiaries

The group controls an entity when the group has power over that entity, is exposed to or has rights to variable returns from its involvement with the entity and has the ability to affect these returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the group. They are deconsolidated from the date that control ceases. The group has applied IFRS 10 – Consolidated Financial Statements ('IFRS 10') retrospectively in accordance with the transitional provisions of IFRS 10.

Partnerships

Certain members of the group management team act as partners on behalf of group companies in a number of dental practice partnerships. These partnerships are held on trust on behalf of a number of group companies. All profits arising from partnership activity are transferred to a group trading company.

As a result, the group considers that it has control of these partnerships and consequently the results of the partnerships are consolidated into the group's financial statements. The partnerships are accounted for in accordance with the group's accounting policies.

Notes

Forming part of the financial statements

Transactions eliminated on consolidation

Intragroup balances, and any gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the consolidated financial information. Losses are eliminated in the same way as gains, but only to the extent that there is no evidence of impairment.

b) Foreign currency translation

Foreign currency transactions are translated into the functional currency of each subsidiary or partnership using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions, including realised gains and losses arising from foreign exchange forward contracts and from the translation at period-end exchange rates of monetary assets and liabilities denominated in foreign currencies, are recognised in the income statement within other gains or losses.

Unrealised gains and losses arising from derivative financial instruments used to hedge against movements in foreign exchange rates (principally foreign exchange forward contracts) are recognised in the income statement within other gains or losses.

c) Business combinations

The acquisition of subsidiaries is accounted for using the purchase method. The fair value of consideration of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the group in exchange for control over the acquiree. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 – Business Combinations (Revised) ('IFRS 3') are recognised at their fair values at the acquisition date. All acquisition costs are expensed as incurred and included within administrative expenses.

Any contingent consideration to be transferred by the group is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration are recognised at fair value through profit or loss.

d) Intangible assets

Goodwill

Goodwill represents the excess of the fair value of consideration paid on acquisition of a business over the fair value of assets, including any intangible assets identified, liabilities and contingent liabilities acquired.

Goodwill is tested for impairment at least annually.

On disposal of a subsidiary, the attributable net book value of goodwill, based on relative fair value, is included in the determination of the profit or loss on disposal.

Externally acquired intangible assets

Externally acquired intangible assets are initially recognised at cost and subsequently amortised on a straight-line basis over their useful economic lives. The amortisation expense is included within administrative expenses in the income statement.

Intangible assets are recognised on business combinations if they are separable from the acquired entity or give rise to other contractual or legal rights. The amounts ascribed to such intangibles are determined by using appropriate valuation techniques.

Notes

Forming part of the financial statements

The significant intangible assets recognised by the group, their estimated useful economic lives and the methods used to determine the cost of intangible assets acquired through business combinations are as follows:

Intangible asset	**Estimated useful economic life**	**Valuation method**
Contractual arrangements and relationships	20 years	Estimated discounted cash flow
Customer relationships	10-20 years	Estimated discounted cash flow
Brands and trademarks	15 years	Estimated royalty stream if the rights were to be licensed

Contractual arrangements reflect long term, fixed income contracts with the NHS for the delivery of dentistry services. These contracts specify targeted annual volumes of units of dental activity (‘UDA’s’) for a contracted dental practice or entity. The majority of these contracts have no fixed term and will roll over indefinitely provided that certain performance targets are achieved. The intangible assets arising from these contractual arrangements are amortised over a period of 20 years to reflect the potential for future changes to government policy in this area.

e) Impairment of non-financial assets

The carrying amounts of the group’s non-financial assets, other than inventories and deferred income tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset’s recoverable amount is estimated. For goodwill, and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated at the same time in each period.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to dispose. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the ‘cash-generating unit’or ‘CGU’). The goodwill acquired in a business combination, for the purpose of impairment testing, is allocated to CGU’s. Subject to an operating segment ceiling test, for the purposes of goodwill impairment testing, CGU’s to which goodwill has been allocated are aggregated so that the level at which impairment is tested reflects the lowest level at which goodwill is monitored for internal reporting purposes.

An impairment loss is recognised if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognised through the income statement. Impairment losses recognised in respect of CGU’s are allocated first to reduce the carrying amount of any goodwill allocated to the units, and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

Notes

Forming part of the financial statements

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

f) Derivative financial instruments

The group's activities expose it to the financial risks resulting from fluctuations in interest rates and foreign exchange rates.

From time-to-time, the group may use derivative financial instruments (interest rate swaps) to hedge a proportion of its exposure to floating interest rate fluctuations. Foreign exchange forward contracts are used to hedge a proportion of the group's exposure to fluctuations in foreign exchange rates.

In addition, in a very small number of instances, the group has entered into option contracts with the vendors of businesses in which the group has acquired a majority shareholding in order to enable the group to acquire the remaining equity interest at a pre-determined price, or by reference to a pre-determined earnings multiple, in the future.

The group does not hedge account for any derivative financial instruments.

The use of financial derivatives is governed by the group's policies approved by the Board of Directors, which provide written principles in the use of financial derivatives consistent with the group's risk management strategy. The group does not use derivative financial instruments for speculative purposes.

g) Revenue

Revenue represents the income received in the ordinary course of business for dentistry or other goods or services provided to the extent that the group has obtained the right to consideration. Amounts are stated net of discounts, returns and value added taxes. Revenue derived from NHS contracts in England and Wales is recognised on the volume of dental activity delivered in the financial year. Revenue from all private dental work and NHS patients in Scotland and Northern Ireland is recognised based upon the completion of each piece of treatment carried out, with the exception of orthodontic treatment, which is recognised based on the stage of completion reached during the course of treatment. Revenue from the sale of goods by Dental Directory is recognised upon despatch and revenue generated from the installation or repair of equipment, or from other services, is recognised upon completion of the service.

Deferred income

Where the group receives an amount upfront in respect of future income streams, the value of the receipt is amortised over the period of the contract as the services are delivered and the unexpired element is disclosed in trade and other payables as deferred income.

h) Leases

The costs associated with operating leases are charged to the income statement on an accruals basis over the period of the lease. The benefit of any lease incentives is recognised in the income statement evenly over the period of the lease up to the lease expiry date.

Notes

Forming part of the financial statements

i) Income tax

Income tax for the accounting periods presented comprises current and deferred income tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current income tax is the expected tax payable or refundable on the taxable income or loss for the year, based upon the tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred income tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

The following temporary differences are not provided for: the initial recognition of goodwill; the initial recognition of other assets or liabilities that affect neither accounting nor taxable profit; nor differences relating to investments in subsidiaries to the extent that they are unlikely to reverse in the foreseeable future. The amount of deferred income tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred income tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred income tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except for on deferred income tax liabilities where the timing of the reversal of the temporary difference is controlled by the group and it is probable that the temporary difference will not reverse in the foreseeable future.

3 Critical accounting judgements and estimates

The preparation of the group’s consolidated financial information under IFRS requires the Directors to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The Directors consider that the following estimates and judgements are likely to have the most significant effect on the amounts recognised in the consolidated financial information.

Notes

Forming part of the financial statements

3 Critical accounting judgements and estimates *(continued)*

(a) Critical judgements

Impairment of goodwill and other intangibles

Determining whether goodwill or other intangible assets are impaired requires an annual estimation of the value in use of the CGU's to which goodwill and other intangible assets have been allocated. The value in use calculation requires the group to estimate the future cash flows expected to arise from the CGU and a suitable discount rate in order to calculate present value.

Income tax

The current income tax provision directly relates to the actual tax payable on the group's profits. Assumptions and judgements are made in applying tax laws to the taxable profits in any given period in order to calculate the tax charge for that year, including any deferred income tax element. Where the eventual tax paid or reclaimed is different to the amounts originally estimated, or where deferred tax estimates are revised, the difference will be charged or credited to the income statement in the period in which it is determined.

Assets held for sale

Following a dental practice portfolio review, which remains ongoing, management have taken the decision to market certain dental practices for sale. As a result, the assets associated with these dental practices have been reclassified as held for sale. Assets held for sale are measured at the lower of their carrying amount and fair value less costs for sale. Accordingly, judgement is required in assessing the expected recoverable amount. Furthermore, in reclassifying these assets as held for sale, management have judged that a sale within a period of one year is highly probable.

(b) Critical estimates

Valuation of intangibles acquired in business combinations

Determining the fair value of contractual arrangements and customer relationships acquired in business combinations requires estimation of the value of the cash flows related to those arrangements or relationships and a suitable discount rate in order to calculate the present value.

Determining the fair value of brands or trademarks acquired in business combinations requires estimation of the discounted royalty payments that would have to be paid to acquire the brand or trademark if it had not been acquired as part of a business combination.

Useful economic lives of intangible assets

Intangible assets are amortised over their useful economic lives. Useful lives are based on management's estimates of the period over which the assets will generate revenue. Useful lives are periodically reviewed for their continued appropriateness. Changes to estimates can result in changes in the carrying values and hence change the amounts charged to the income statement in particular periods which could be significant.

Notes

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4 Segment reporting

The Directors have determined the operating segments based on the operating reports reviewed by both the Board of Directors and the Executive Management Team that are used to facilitate both performance and strategic decision making. The Executive Management Team is considered to be the chief operating decision maker in accordance with the requirements of IFRS 8 – Operating Segments.

The Executive Management Team considers the business to be split into two main operating segments being mydentist and Dental Directory.

Through mydentist, the group is the leading provider of dental services in the United Kingdom. mydentist owns and manages a national chain of dental practices with 672 sites at 30 June 2017 (30 June 2016: 674).

Dental Directory, which principally comprises Billericay Dental Supply Co. Limited, along with a number of smaller businesses, provides a range of products and services to the dental and wider healthcare sectors, including to mydentist. Sales to mydentist are carried out on an arms length basis.

All services are provided in the United Kingdom.

Notes

Forming part of the financial statements

4 Segment reporting *(continued)*

Q1 2018	mydentist	Dental Directory	Central costs and intra-segment eliminations	Total
	£'000	£'000	£'000	£'000
Revenue				
NHS dentistry	89,969	-	-	89,969
Private dentistry	24,488	-	-	24,488
Dental Directory	-	34,495	(7,303)	27,192
Total revenue	114,457	34,495	(7,303)	141,649
Gross profit	53,235	10,374	(1,115)	62,494
Gross margin	*46.5%*	*30.1%*		*44.1%*
Overheads	(42,664)	(8,603)	1,039	(50,228)
Overheads % of revenue	*37.3%*	*24.9%*		*35.5%*
Other income	525	-	-	525
EBITDA before non-underlying items	11,096	1,771	(76)	12,791
EBITDA margin	*9.7%*	*5.1%*		*9.0%*
Amortisation of intangible assets	(7,388)	(834)	-	(8,222)
Depreciation	(4,912)	(579)	64	(5,427)
Amortisation of government grant income	14	-	-	14
Impairment of non-current assets reclassified as held for sale	(9,700)	-	-	(9,700)
Other non-underlying items	(122)	(155)	-	(277)
Foreign exchange gains	-	132	-	132
Segment operating profit/(loss)	(11,012)	335	(12)	(10,689)
Net finance costs				(10,515)
Loss before income tax				(21,204)
Segment assets	810,800	109,608	(3,422)	916,986
Segment liabilities	(161,570)	(107,746)	(456,256)	(725,572)
Additions in the period				
Goodwill	676	(142)	-	534
Other intangible assets	817	37	-	854
Property, plant and equipment	3,687	630	(128)	4,189

Notes

Forming part of the financial statements

4 Segment reporting *(continued)*

Q1 2017	mydentist	Dental Directory	Central costs and intra-segment eliminations	Total
	£'000	£'000	£'000	£'000
Revenue				
NHS dentistry	95,255	-	-	95,255
Private dentistry	23,552	-	-	23,552
Dental Directory	-	32,584	(8,000)	24,584
Total revenue	118,807	32,584	(8,000)	143,391
Gross profit	56,962	10,005	(1,009)	65,958
Gross margin	*47.9%*	*30.7%*		*46.0%*
Overheads	(40,924)	(8,063)	613	(48,374)
Overheads % of revenue	*34.4%*	*24.7%*		*33.7%*
Other income	479	-	-	479
EBITDA before non-underlying items	16,517	1,942	(396)	18,063
EBITDA margin	*13.9%*	*6.0%*		*12.6%*
Amortisation of intangible assets	(7,326)	(833)	-	(8,159)
Depreciation	(4,677)	(421)	28	(5,070)
Amortisation of government grant income	19	-	-	19
Other non-underlying items	(1,414)	(188)	-	(1,602)
Foreign exchange losses	-	433	-	433
Segment operating profit/(loss)	3,119	933	(368)	3,684
Net finance costs				(9,468)
Loss before income tax				(5,784)
Segment assets	881,367	117,239	(8,847)	989,759
Segment liabilities	(159,477)	(114,071)	(444,787)	(718,335)
Additions in the period				
Goodwill	217	46	-	263
Other intangible assets	1,118	-	-	1,118
Property, plant and equipment	6,343	536	(270)	6,609

Notes

Forming part of the financial statements

5 Taxation

	Q1 2018 £'000	Q1 2017 £'000
Current income tax		
Current income tax for the period	(1)	-
Total current income tax	(1)	-
Deferred income tax		
Origin and reversal of temporary differences	(2,647)	(1,062)
Total deferred income tax	(2,647)	(1,062)
Total income tax credit	(2,648)	(1,062)

The main rate of corporation tax reduced from 20% to 19% with effect from 1 April 2017. A further reduction in the main rate of corporation tax to 17% from 1 April 2020 was substantively enacted on 15 September 2016 and both the deferred income tax asset and liability have been re-measured accordingly.

6 Trade and other payables

	Q1 2018 £'000	Q1 2017 £'000
Current		
Trade payables	23,169	19,001
Accruals and deferred income	104,225	92,360
Other taxation and social security	3,040	4,734
Contingent consideration	2,365	6,632
Government grants	55	55
	132,854	122,782
Non-current		
Contingent consideration	919	1,389
Government grants	192	245
	1,111	1,634

Contingent consideration is due to the vendors of individual acquired practices.

Notes

Forming part of the financial statements

7 Borrowings

	Q1 2018	Q1 2017
	£'000	£'000
Non-current		
Senior secured, floating rate and second lien notes		
Due between two and five years	-	500,671
Due after five years	550,411	-
	550,411	500,671
Bank loans		
Due between two and five years	-	39,000
Less: unamortised arrangement fees and related costs	(9,625)	(7,173)
Total non-current loans and borrowings	540,786	532,498

On 5 August 2016, the group re-financed its existing notes and drawings from its Super Senior Revolving Credit Facility through the issue of:

- £275m of 6.25% Senior Secured Fixed Rate Notes due 2022 at 100%;
- £150m of Senior Secured Fixed Rate Notes due 2022. The notes are set at a floating rate of GBP LIBOR (set at a minimum of 0%) plus 6% each quarter;
- £130m of Second Lien Notes due 2023. The Second Lien Notes are set at a floating rate of GBP LIBOR (set at a minimum of 1%) plus 8%;

A new £100m Super Senior Revolving Credit Facility (“SSRCF”) was agreed with an interest charge of GBP LIBOR plus 3.5%. At the quarter end the SSRCF was undrawn.

Notes

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8 Business combinations

Set out below are details of the acquisitions completed during the quarter ended 30 June 2017. Acquisitions during the quarter ended 30 June 2017 comprised one unincorporated dental practice acquired by mydentist and the acquisition of a small orthodontic materials distribution business by Dental Directory. The directors consider each of these acquisitions to be individually immaterial to the group, having considered a number of qualitative and quantitative factors. Therefore, these acquisitions have been aggregated for disclosure purposes.

	Q1 2018		
	mydentist	Dental Directory	Total
	£'000	£'000	£'000
Consideration			
Cash	1,635	-	1,635
Contingent consideration	108	145	253
Total consideration	1,743	145	1,888
Fair value of assets and liabilities acquired			
Intangible assets	817	37	854
Property, plant and equipment	50	20	70
Inventories	1	52	53
Trade and other receivables	-	73	73
Trade and other payables	-	(37)	(37)
Deferred taxation	(139)	(6)	(145)
Provisions	(5)	-	(5)
Total identifiable net assets	724	139	863
Goodwill	1,019	6	1,025
Total	1,743	145	1,888