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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-Q**

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2020

or

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-39037

**SMILEDIRECTCLUB, INC.**

(Exact name of registrant as specified in its charter)

**Delaware** **83-4505317**  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

**414 Union Street** **37219**  
**Nashville, TN** (Zip Code)  
(Address of principal executive offices)

**(800) 848-7566**  
(Registrant's telephone number, including area code)

**Not applicable**  
(Former name, former address and former fiscal year, if changed since last report)

**Securities registered pursuant to Section 12(b) of the Act:**

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Class A common stock, par value \$0.0001 per share	SDC	The NASDAQ Stock Market LLC

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer,"

“accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  Yes  No

The registrant has the following number of shares outstanding of each of the registrant’s classes of common stock as of November 11, 2020:

Class A Common Stock: 113,546,706

Class B Common Stock: 272,512,403

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## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements. Any statements about our expectations, beliefs, plans, predictions, forecasts, objectives, assumptions, or future events or performance are not historical facts and may be forward-looking. These statements are often, but not always, made through the use of words or phrases such as “anticipates,” “believes,” “can,” “could,” “may,” “predicts,” “potential,” “should,” “will,” “estimate,” “plans,” “projects,” “continuing,” “ongoing,” “expects,” “intends,” and similar words or phrases. Although we believe that the expectations reflected in these forward-looking statements are reasonable, these statements are not guarantees of future performance and involve risks and uncertainties which are subject to change based on various important factors, some of which are beyond our control. For more information regarding these risks and uncertainties as well as certain additional risks that we face, refer to “*Risk Factors*” as well as the factors more fully described in “*Management’s Discussion and Analysis of Financial Conditions and Results of Operations*” in this report and in our Annual Report on Form 10-K for the year ended December 31, 2019. Among the factors that could cause our financial performance to differ materially from that suggested by the forward-looking statements are:

- our ability to effectively manage our growth, including international expansion;
- our ability to effectively execute our business strategies, implement new initiatives, and improve efficiency;
- our sales and marketing efforts;
- our manufacturing capacity and performance and our ability to reduce the per unit production cost of our clear aligners;
- our ability to obtain regulatory approvals for any new or enhanced products;
- our estimates regarding revenues, expenses, capital requirements, and needs for additional financing;
- our ability to effectively market and sell, consumer acceptance of, and competition for our clear aligners in new markets;
- our relationships with retail partners and insurance carriers;
- our research, development, commercialization, and other activities and projected expenditures;
- changes or errors in the methodologies, models, assumptions, and estimates we use to prepare our financial statements, make business decisions, and manage risks;
- our current business model is dependent, in part, on current laws and regulations governing remote healthcare and the practice of dentistry, and changes in those laws, regulations, or interpretations that are inconsistent with our current business model could have a material adverse effect on our business;
- our relationships with our freight carriers, suppliers, and other vendors;
- our ability to maintain the security of our operating systems and infrastructure (e.g., against cyber-attacks);
- the adequacy of our risk management framework;
- our cash needs and ability to raise additional capital, if needed;
- our intellectual property position;
- our exposure to claims and legal proceedings;
- our ability to remain in compliance with our debt covenants;

- our ability to manage the COVID-19 pandemic, including the protracted duration of COVID-19 and the potential resurgence of COVID-19 infections, through voluntary and regulatory containment measures and the related impacts on our business;
- our ability to gauge the impact of COVID-19 and related potential disruptions to the operations of our suppliers, freight carriers and retail partners, including social and economic constraints, tariffs and trade barriers, facilities closures, labor instability, and capacity reduction; and
- other factors and assumptions described in this Quarterly Report on Form 10-Q.

If one or more of the factors affecting our forward-looking information and statements proves incorrect, our actual results, performance or achievements could differ materially from those expressed in, or implied by, forward-looking information and statements. Therefore, we caution not to place undue reliance on any forward-looking information or statements. The effect of these factors is difficult to predict. Factors other than these also could adversely affect our results, and the reader should not consider these factors to be a complete set of all potential risks or uncertainties. New factors emerge from time to time, and management cannot assess the impact of any such factor on our business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement. Any forward-looking statements only speak as of the date of this document, and we undertake no obligation to update any forward-looking information or statements, whether written or oral, to reflect any change, except as required by law. All forward-looking statements attributable to us are expressly qualified by these cautionary statements.

You should read this Quarterly Report on Form 10-Q and the documents that we reference in this Quarterly Report on Form 10-Q and have filed with the Securities and Exchange Commission (“SEC”) as exhibits to this Quarterly Report on Form 10-Q with the understanding that our actual future results, levels of activity, performance, and events and circumstances may be materially different from what we expect.

**PART I—FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**SmileDirectClub, Inc.**  
**Condensed Consolidated Balance Sheets (Unaudited)**  
(in thousands)

	September 30, 2020	December 31, 2019
<b>ASSETS</b>		
Cash and cash equivalents	\$ 373,045	\$ 318,458
Accounts receivable	230,244	239,413
Inventories	26,101	18,431
Prepaid and other current assets	15,337	14,186
Total current assets	644,727	590,488
Accounts receivable, non-current	71,729	106,315
Property, plant and equipment, net	183,430	177,543
Operating lease right-of-use asset	30,564	—
Other assets	11,461	11,299
<b>Total assets</b>	<b>\$ 941,911</b>	<b>\$ 885,645</b>
<b>LIABILITIES AND PERMANENT EQUITY</b>		
Accounts payable	\$ 35,863	\$ 52,706
Accrued liabilities	93,308	93,339
Deferred revenue	51,851	25,435
Current portion of long-term debt	24,398	35,376
Other current liabilities	6,452	—
Total current liabilities	211,872	206,856
Long-term debt, net of current portion	391,283	173,150
Operating lease liabilities, net of current portion	32,038	—
Other long-term liabilities	43,400	47,354
Total liabilities	678,593	427,360
Commitment and contingencies		
<b>Permanent Equity</b>		
Class A common stock, par value \$0.0001 and 113,105,780 shares issued and outstanding at September 30, 2020 and 103,303,674 shares issued and outstanding at December 31, 2019	11	10
Class B common stock, par value \$0.0001 and 272,787,403 shares issued and outstanding at September 30, 2020 and 279,474,505 shares issued and outstanding at December 31, 2019	27	28
Additional paid-in-capital	479,419	447,866
Accumulated other comprehensive income (loss)	59	(272)
Accumulated deficit	(183,152)	(114,513)
Noncontrolling interest	(50,666)	125,166
Warrants	17,620	—
Total permanent equity	263,318	458,285
<b>Total liabilities and permanent equity</b>	<b>\$ 941,911</b>	<b>\$ 885,645</b>

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements.

**SmileDirectClub, Inc.**  
**Condensed Consolidated Statements of Operations (Unaudited)**  
(in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Revenue, net	\$ 156,459	\$ 168,663	\$ 434,796	\$ 522,529
Financing revenue	12,042	11,522	37,428	31,185
Total revenues	168,501	180,185	472,224	553,714
Cost of revenues	49,760	39,125	158,313	111,363
Cost of revenues—related parties	—	2,310	—	13,652
Total cost of revenues	49,760	41,435	158,313	125,015
Gross profit	118,741	138,750	313,911	428,699
Marketing and selling expenses	66,722	131,263	243,564	340,409
General and administrative expenses	74,110	389,828	233,828	486,319
Lease abandonment and impairment of long-lived assets	3,960	—	28,593	—
Other store closure and related costs	1,714	—	6,190	—
Loss from operations	(27,765)	(382,341)	(198,264)	(398,029)
Interest expense	15,555	4,291	29,627	11,607
Interest expense—related parties	—	—	—	75
Loss on extinguishment of debt	—	32	13,781	29,672
Other (income) expense	(1,028)	421	2,131	500
Net loss before income tax expense	(42,292)	(387,085)	(243,803)	(439,883)
Income tax expense	1,190	479	1,745	596
Net loss	(43,482)	(387,564)	(245,548)	(440,479)
Net loss attributable to noncontrolling interest	(30,892)	(299,268)	(176,909)	(352,183)
Net loss attributable to SmileDirectClub, Inc.	\$ (12,590)	\$ (88,296)	\$ (68,639)	\$ (88,296)
<b>Earnings per share of Class A common stock:</b>				
Basic	\$ (0.11)	\$ (0.89)	\$ (0.63)	\$ (0.89)
Diluted	\$ (0.11)	\$ (0.89)	\$ (0.64)	\$ (0.89)
<b>Weighted average shares outstanding:</b>				
Basic	111,703,080	99,533,877	108,459,488	99,533,877
Diluted	385,672,677	379,008,382	384,888,849	379,008,382

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements.



**SmileDirectClub, Inc.**  
**Condensed Consolidated Statements of Other Comprehensive Loss (Unaudited)**  
(in thousands, except per share amounts)

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>
Net loss	\$ (43,482)	\$ (387,564)	\$ (245,548)	\$ (440,479)
Other comprehensive loss:				
Foreign currency translation adjustment	62	—	1,211	—
Comprehensive loss	(43,420)	(387,564)	(244,337)	(440,479)
Comprehensive loss attributable to noncontrolling interests	(30,847)	—	(176,029)	—
Comprehensive loss attributable to SmileDirectClub, Inc.	\$ (12,573)	\$ (387,564)	\$ (68,308)	\$ (440,479)

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements.

**SmileDirectClub, Inc.**  
**Condensed Consolidated Statements of Changes in Equity (Deficit) (Unaudited)**  
(in thousands, except share/unit data and per share/unit amounts)

	SDC Financial (Prior to Reorganization Transactions)							
	Additional Paid in Capital		Warrants		Accumulated Deficit	Permanent Equity (Deficit)	Temporary Equity (Deficit)	
	Units	Amount	Units	Amount				
<b>Balance at June 30, 2019</b>	88,168	\$ (24,976)	369	\$ 315	\$ (201,344)	\$ (226,005)	\$ 425,395	
Net income prior to Reorganization Transactions	—	—	—	—	(51,330)	(51,330)	—	
Preferred Unit redemption accretion	(20,710)	(21,746)	—	—	—	(21,746)	21,746	
Share-based compensation prior to Reorganization Transactions	—	299	—	—	—	299	—	
Distributions payable	—	(43,400)	—	—	—	(43,400)	—	
Effect of Reorganization Transactions	(88,168)	89,823	(369)	(315)	252,674	342,182	(447,141)	
<b>Balance at September 30, 2019</b>	—	\$ —	—	\$ —	\$ —	\$ —	\$ —	
<b>Balance at December 31, 2018</b>	108,878	\$ 57,677	369	\$ 315	\$ (148,429)	\$ (90,437)	\$ 388,634	
Net income prior to Reorganization Transactions	—	—	—	—	(104,245)	(104,245)	—	
Preferred Unit redemption accretion	—	(58,507)	—	—	—	(58,507)	58,507	
Redemptions prior to Reorganization Transactions	(20,710)	(54,154)	—	—	—	(54,154)	—	
Share-based compensation prior to Reorganization Transactions	—	8,561	—	—	—	8,561	—	
Distributions payable	—	(43,400)	—	—	—	(43,400)	—	
Effect of Reorganization Transactions	(88,168)	89,823	(369)	(315)	252,674	342,182	(447,141)	
<b>Balance at September 30, 2019</b>	—	\$ —	—	\$ —	\$ —	\$ —	\$ —	

	SmileDirectClub, Inc. Stockholders' Equity									
	Class A Shares	Class B Shares	Class A Amount	Class B Amount	Additional Paid-in Capital	Warrants	Accumulated Deficit	Noncontrolling Interest	Accumulated Other Comprehensive Income (Loss)	Total
<b>Balance at Reorganization Transactions date</b>	—	—	—	—	—	—	—	—	—	—
Effect of Reorganization Transactions	70,238,188	279,474,505	7	28	104,609	—	—	315	—	104,959
Issuance of Class A common stock in IPO, net of costs	58,537,000	—	5	—	1,278,848	—	—	—	—	1,278,853
Repurchases of Class A shares and LLC Units from Pre-IPO investors	(31,621,975)	—	(3)	—	(696,486)	—	—	—	—	(696,489)
Issuance of Class A shares in connection with IBA vesting	5,654,078	—	1	—	(1)	—	—	—	—	—
Initial effect of the Reorganization Transactions and IPO on noncontrolling interests	—	—	—	—	(444,636)	—	—	444,636	—	—
Net loss subsequent to Reorganization Transactions	—	—	—	—	—	—	(88,296)	(247,938)	—	(336,234)
Equity-based compensation subsequent to Reorganization Transactions	—	—	—	—	283,124	—	—	—	—	283,124
Equity-based payments subsequent to Reorganization Transactions	—	—	—	—	(83,603)	—	—	—	—	(83,603)
<b>Balance at Balance at September 30, 2019</b>	102,807,291	279,474,505	\$ 10	\$ 28	\$ 441,855	\$ —	\$ (88,296)	\$ 197,013	\$ —	\$ 550,610

**SmileDirectClub, Inc.**  
**Condensed Consolidated Statements of Changes in Equity (Deficit) (Unaudited)**  
(in thousands, except share/unit data and per share/unit amounts)

	SmileDirectClub, Inc. Stockholders' Equity									
	Class A Shares	Class B Shares	Class A Amount	Class B Amount	Additional Paid-in Capital	Warrants	Accumulated Deficit	Noncontrolling Interest	Accumulated Other Comprehensive Income (Loss)	Total
<b>Balance at June 30, 2020</b>	110,123,999	275,376,789	\$ 11	\$ 27	\$ 470,838	\$ 17,620	\$ (170,562)	\$ (20,052)	\$ 42	\$ 297,924
Net loss	—	—	—	—	—	—	(12,590)	(30,892)	—	(43,482)
Issuance of Class A shares in connection with RSU vesting	392,395	—	—	—	—	—	—	—	—	—
Exchange of Class B common stock for Class A common stock	2,589,386	(2,589,386)	—	—	(233)	—	—	233	—	—
Equity-based compensation	—	—	—	—	10,972	—	—	—	—	10,972
Equity-based payments	—	—	—	—	(2,447)	—	—	—	—	(2,447)
Foreign currency translation adjustment	—	—	—	—	—	—	—	45	17	62
Other	—	—	—	—	289	—	—	—	—	289
<b>Balance at September 30, 2020</b>	113,105,780	272,787,403	\$ 11	\$ 27	\$ 479,419	\$ 17,620	\$ (183,152)	\$ (50,666)	\$ 59	\$ 263,318
<b>Balance at December 31, 2019</b>	103,303,674	279,474,505	\$ 10	\$ 28	\$ 447,866	\$ —	\$ (114,513)	\$ 125,166	\$ (272)	\$ 458,285
Net loss	—	—	—	—	—	—	(68,639)	(176,909)	—	(245,548)
Issuance of Class A shares in connection with RSU vesting	1,655,618	—	—	—	—	—	—	—	—	—
Issuance of Class B shares in connection with warrant exercise	—	1,459,386	—	—	(15)	—	—	937	—	922
Exchange of Class B common stock for Class A common stock	8,146,488	(8,146,488)	1	(1)	740	—	—	(740)	—	—
HPS Warrant issuance	—	—	—	—	—	17,620	—	—	—	17,620
Equity-based compensation	—	—	—	—	38,189	—	—	—	—	38,189
Equity-based payments	—	—	—	—	(6,976)	—	—	—	—	(6,976)
Foreign currency translation adjustment	—	—	—	—	—	—	—	880	331	1,211
Other	—	—	—	—	(385)	—	—	—	—	(385)
<b>Balance at September 30, 2020</b>	113,105,780	272,787,403	\$ 11	\$ 27	\$ 479,419	\$ 17,620	\$ (183,152)	\$ (50,666)	\$ 59	\$ 263,318

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements.

**SmileDirectClub, Inc.**  
**Condensed Consolidated Statements of Cash Flows (Unaudited)**  
(in thousands)

	<b>Nine Months Ended September 30,</b>	
	<b>2020</b>	<b>2019</b>
<b>Operating Activities</b>		
Net loss	\$ (245,548)	\$ (440,479)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	39,399	16,237
Deferred loan cost amortization	3,021	1,496
Equity-based compensation	38,189	332,759
Loss on extinguishment of debt	13,594	17,693
Paid in kind interest expense	5,118	—
Lease abandonment, impairment of long-lived assets and other store closure and related charges	30,903	—
Changes in ROU asset	5,797	—
Other non-cash operating activities	—	1,783
Changes in operating assets and liabilities:		
Accounts receivable	43,755	(137,509)
Inventories	(8,456)	(5,852)
Prepaid and other current assets	(2,844)	(6,205)
Accounts payable	(9,441)	(4,475)
Accrued liabilities	(8,559)	45,880
Due to related parties	—	(19,177)
Deferred revenue	26,416	5,834
Net cash used in operating activities	(68,656)	(192,015)
<b>Investing Activities</b>		
Purchases of property, equipment, and intangible assets	(68,768)	(66,355)
Net cash used in investing activities	(68,768)	(66,355)
<b>Financing Activities</b>		
Payment of IPO related costs	(1,155)	1,285,759
Proceeds from warrant exercise	922	—
Repurchase of Class A shares and related fees	—	(696,489)
Repurchase of Class A shares to cover employee tax withholdings	(6,976)	(81,603)
Settlement of canceled awards	—	(2,000)
Issuance of Class A common stock	—	6
Proceeds from HPS Credit Facility and Warrants, net	388,000	—
Borrowings on long-term debt	16,807	176,000
Payments of loan costs	(11,784)	(6,127)
Principal payments on long-term debt	(187,579)	(159,047)
Principal payments on related party debt	—	(24,581)
Payments on finance leases	(7,543)	—
Other	1,319	86
Net cash provided by financing activities	192,011	492,004
Increase in cash and cash equivalents	54,587	233,634
Cash and cash equivalents at beginning of period	318,458	313,929
Cash and cash equivalents at end of period	\$ 373,045	\$ 547,563

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements.

**SmileDirectClub, Inc.**  
**Notes to Condensed Consolidated Financial Statements (Unaudited)**  
**(in thousands, except share/unit data and per share/unit amounts)**

**Note 1—Organization and Basis of Presentation**

**Organization**

SmileDirectClub, Inc. was formed on April 11, 2019 with no operating assets or operations as a Delaware corporation for the purpose of facilitating an initial public offering and other related transactions in order to carry on the business of SDC Financial LLC and its subsidiaries. Unless otherwise indicated or the context otherwise requires, references to “we,” “us,” “our,” the “Company,” “SmileDirectClub,” and similar references refer to SmileDirectClub, Inc. and its consolidated subsidiaries, including SDC Financial LLC and its subsidiaries. “SDC Financial” refers to SDC Financial LLC and “SDC Inc.” refers to SmileDirectClub, Inc. The Company is engaged by its network of doctors to provide a suite of non-clinical administrative support services, including access to and use of its SmileCheck platform, as a dental support organization (“DSO”). For purposes of these notes to interim condensed consolidated financial statements (unaudited), the Company’s affiliated network of dentists and orthodontists is included in the definition of “we,” “us,” “our,” and the “Company” as it relates to any clinical aspect of the member’s treatment. All of the Company’s manufacturing operations are directly or indirectly conducted by Access Dental Lab, LLC (“Access Dental”), one of its operating subsidiaries.

SmileDirectClub is an oral care company and creator of the first MedTech platform for teeth straightening. Through the Company’s cutting-edge teledentistry technology and vertically integrated model, it is revolutionizing the oral care industry, from clear aligner therapy to its affordable, premium oral care product line. SmileDirectClub’s mission is to democratize access to a smile each and every person loves by making it affordable and convenient for everyone. SmileDirectClub is headquartered in Nashville, Tennessee and operates in the U.S., Costa Rica, Puerto Rico, Canada, Australia, New Zealand, United Kingdom, Ireland, Germany, Austria, Hong Kong, Singapore and Spain.

SDC Inc. is a holding company. Its sole material asset is its equity interest in SDC Financial which, through its direct and indirect subsidiaries, conducts all of the Company’s operations. SDC Financial is a Delaware limited liability company and wholly owns SmileDirectClub, LLC (“SDC LLC”) (a Tennessee limited liability company) and Access Dental (a Tennessee limited liability company). Because SDC Inc. is the managing member of SDC Financial, SDC Inc. indirectly operates and controls all of the business and affairs of SDC Financial and its subsidiaries.

*Initial Public Offering*

On September 16, 2019, SDC Inc. completed an initial public offering (“IPO”) of 58,537,000 shares of its Class A common stock at a public offering price of \$23.00 per share. SDC Inc. received \$1,286 million in proceeds, net of underwriting discounts and commissions. SDC Inc. used substantially all of the net proceeds after expenses to purchase newly-issued membership interest units from SDC Financial.

*Reorganization Transactions*

In connection with the IPO, the Company completed the following transactions (the “Reorganization Transactions”):

- the formation of SDC Inc. as a Delaware corporation to function as the ultimate parent of SmileDirectClub and a publicly traded entity;
- SDC Inc.’s acquisition of the pre-IPO membership interest units in SDC Financial (“Pre-IPO Units”) held by certain pre-IPO investors that are taxable as corporations for U.S. federal income tax purposes (“Blockers”), pursuant to a series of mergers (the “Blocker Mergers”) of the Blockers with wholly owned subsidiaries of SDC Inc., and the issuance by SDC Inc. to the equityholders of the Blockers shares of Class A common stock as consideration in the Blocker Mergers;

**SmileDirectClub, Inc.**  
**Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)**  
**(in thousands, except share/unit data and per share/unit amounts)**

- the amendment and restatement of the SDC Financial’s limited liability company operating agreement (the “SDC Financial LLC Agreement”) to, among other things, modify the capital structure of SDC Financial by replacing the different classes of Pre-IPO Units (including restricted Pre-IPO Units held by certain employees) with a single new class of membership interests of SDC Financial (“LLC Units”);
- the issuance to each of the pre-IPO investors previously holding Pre-IPO Units (including restricted Pre-IPO Units) of a number of shares of SDC Inc. Class B common stock equal to the number of LLC Units held by it;
- the issuance to certain employees of cash and shares of Class A common stock pursuant to their Incentive Bonus Agreements (“IBAs”); and
- the equitable adjustment, pursuant to their terms, of outstanding warrants to purchase Pre-IPO Units held by two service providers into warrants to acquire LLC Units (together with an equal number of shares of SDC Inc.’s Class B common stock).

Following the completion of the Reorganization Transactions and the IPO, SDC Inc. owned 26.9% of SDC Financial. Holders (other than SDC Inc.) of LLC Units following the consummation of the Reorganization Transactions and the IPO (“Continuing LLC Members”) owned the remaining 73.1% of SDC Financial.

SDC Inc. is the sole managing member of SDC Financial and, although SDC Inc. has a minority economic interest in SDC Financial, it has the sole voting power in, and controls the management of, SDC Financial. Accordingly, SDC Inc. consolidates the financial results of SDC Financial and reports a noncontrolling interest in its condensed consolidated financial statements. As the Reorganization Transactions are considered transactions between entities under common control, the financial statements for periods prior to the IPO and Reorganization Transactions have been adjusted to combine the previously separate entities for presentation purposes.

In connection with the Reorganization Transactions and the IPO, the Company entered into a Tax Receivable Agreement (the “Tax Receivable Agreement”) with the Continuing LLC Members, pursuant to which SDC Inc. agreed to pay the Continuing LLC Members 85% of the amount of cash tax savings, if any, in U.S. federal, state, and local income tax or franchise tax that SDC Inc. actually realizes as a result of (a) the increases in tax basis attributable to exchanges of LLC Units by Continuing LLC Members and (b) tax benefits related to imputed interest deemed to be paid by SDC Inc. as a result of the Tax Receivable Agreement.

***Basis of Presentation and Consolidation***

The accompanying unaudited condensed financial statements have been prepared in accordance with United States generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X of the SEC and, in the opinion of management, reflect all normal recurring adjustments necessary for a fair presentation of results for the unaudited interim periods presented. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted. The results of operations for the interim period are not necessarily indicative of the results to be obtained for the full fiscal year. All intercompany accounts and transactions have been eliminated in the unaudited condensed financial statements.

The interim condensed consolidated financial statements include the accounts of SDC Inc., which consolidates SDC Financial and its wholly-owned subsidiaries, as well as accounts of contractually affiliated professional corporations (“PCs”) managed by the Company.

The interim condensed consolidated financial statements include the accounts of variable interest entities in which the Company is the primary beneficiary under the provisions of Accounting Standards Codification (“ASC”) Topic 810, “Consolidation.” At September 30, 2020, the variable interest entities include 52 dentist owned PCs and at December 31, 2019 the variable interest entities included 44 dentist owned PCs. The Company is a dental service organization and does not engage in the practice of dentistry. All clinical services are provided by dentists and orthodontists who are engaged as independent contractors or otherwise engaged by the dentist-owned PCs. The Company contracts with the PCs and dentists and orthodontists through a suite of agreements, including but not

**SmileDirectClub, Inc.**  
**Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)**  
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limited to, management services agreements, supply agreements, and licensing agreements, pursuant to which the Company provides the administrative, non-clinical management services to the PCs and independent contractors. The Company has the contractual right to manage the activities that most significantly impact the variable interest entities' economic performance through these agreements without engaging in the corporate practice of dentistry. Additionally, the Company would absorb substantially all of the expected losses of these entities should they occur. The accompanying consolidated statements of operations reflect the revenue earned and the expenses incurred by the PCs.

All significant intercompany balances and transactions are eliminated in consolidation.

In January 2020, the Company adopted lease accounting guidance as discussed in Note 2 and Note 7 to the Unaudited Condensed Consolidated Financial Statements. Adoption of the new lease accounting guidance had a material impact to the Company's unaudited condensed consolidated balance sheets and related disclosures, and resulted in the recording of additional right-of-use assets and lease liabilities as of the date of adoption. This guidance was applied using the optional transition method which allowed the Company to not recast comparative financial information but rather recognize a cumulative-effect adjustment to retained earnings as of the effective date in the period of adoption. No material adjustments to retained earnings were made as a result of the adoption of this guidance. Consistent with the optional transition method, the financial information in the condensed consolidated balance sheets prior to the adoption of this new lease accounting guidance has not been adjusted and is therefore not comparable to the current period presented. The standard did not materially impact the Company's condensed consolidated statements of operations, comprehensive loss, changes in equity (deficit), or cash flows. For additional information, including the required disclosures, related to the impact of adopting this standard, see Note 2 and Note 7 to the Unaudited Condensed Consolidated Financial Statements.

**COVID-19 Pandemic**

The Company continues to navigate the uncertain and unprecedented economic and operating conditions resulting from COVID-19 and its protracted duration. In response to COVID-19 and the related containment measures, the Company made the following operational changes to ensure the health and safety of its employees and its members: transitioned its team members, where possible, to a remote working environment; closed a portion of its SmileShops based on the Company's real estate repositioning program as well as local public health guidelines and evolving customer behaviors and expectations; reconfigured its SmileShops to reduce customer overlap in the waiting area and require touchless temperature screening upon arrival; heightened the personal protective equipment protocol ("PPE") requirements for Smile Guides; reconfigured its production lines to observe social distancing; and implemented enhanced cleaning and sanitizing routines, thermal temperature screening, mandatory PPE protocols and other health and safety measures at its manufacturing facilities. The Company also enacted a resilience policy that provides its team members paid leave for COVID-19 testing and up to two weeks of paid leave for any required self-quarantine due to the team member testing positive for COVID-19.

Additionally, the Company took the following actions in an effort to fortify the financial position of the business: reduced its marketing spend as a percentage of revenue; reduced its headquarters and retail workforce; secured the HPS Credit Facility; and initiated a real estate repositioning program.

Beginning in the second quarter, the Company performed a review of its real estate needs and initiated restructuring actions related to a real estate repositioning program that remains ongoing. As a result of these changes, the Company incurred one-time charges of \$5,674 and \$34,783 during the three and nine months ended September 30, 2020, respectively, primarily associated with: the closure of its manufacturing facility in Kyle, Texas; the consolidation of several floors at its headquarters in Nashville, Tennessee; the closure and consolidation of a portion of its SmileShops; and the impairment of right of use assets and leasehold improvements at the closed SmileShops. Given the uncertain operating environment and the shift to work-from-home, the Company made the strategic decisions to align its rent costs with the current needs of the business, while also ensuring that it has sufficient capacity to support future growth. The Company continues to evaluate its SmileShops and other properties to determine if it will further rationalize its footprint to better align with marketplace demand, including the direct and indirect effects of the COVID-19 pandemic. For a complete discussion of our restructuring actions, see "Note 5—Lease Abandonment, Impairment of Long-lived Assets and Store Closure and Other Related Charges" in the Notes to the Unaudited Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

**SmileDirectClub, Inc.**  
**Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)**  
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**Note 2—Summary of Significant Accounting Policies**

***Management Use of Estimates***

The preparation of the interim condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that impact the reported amounts. On an ongoing basis, the Company evaluates its estimates, including those related to the fair values of financial instruments, useful lives of property, plant and equipment, revenue recognition, equity-based compensation, long-lived assets, and contingent liabilities, among others. In connection with its credit facility with HPS Investment Partners, the Company issued warrants to certain affiliates of HPS Investment Partners. The warrants were recorded at fair value within equity on the condensed consolidated balance sheets using the Black-Scholes option pricing model (see Note 10). Each of these estimates varies in regard to the level of judgment involved and its potential impact on the Company's financial results. Estimates are considered critical either when a different estimate could have reasonably been used, or where changes in the estimate are reasonably likely to occur from period to period, and such use or change would materially impact the Company's financial condition, results of operations, or cash flows. Actual results could differ from those estimates.

***Revenue Recognition***

The Company's revenues are derived primarily from sales of aligners, impression kits, whitening gel, and retainers, and interest earned through its *SmilePay* financing program. Revenue is recorded for all customers based on the amount that is expected to be collected, which considers implicit price concessions, discounts and returns.

The Company identifies a performance obligation as distinct if both of the following criteria are met: the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer and the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract. Determining the standalone selling price ("SSP") and allocation of consideration from a contract to the individual performance obligations, and the appropriate timing of revenue recognition, is the result of significant qualitative and quantitative judgments. Management considers a variety of factors such as historical sales, usage rates (the number of times a customer is expected to order additional aligners), costs, and expected margin, which may vary over time depending upon the unique facts and circumstances related to each performance obligation, in making these estimates. Further, the Company's process for estimating usage rates requires significant judgment and evaluation of inputs, including historical data and forecasted usages. Changes in the allocation of the SSP between performance obligations will not affect the amount of total revenues recognized for a particular contract. The Company uses the expected cost plus a margin approach to determine the SSP for performance obligations, and discounts are allocated to each performance obligation based on the relative standalone selling price. However, any material changes in the allocation of the SSP could impact the timing of revenue recognition, which may have a material effect on the Company's financial position and result of operations as the contract consideration is allocated to each performance obligation, delivered or undelivered, at the inception of the contract based on the SSP of each distinct performance obligation.

The Company estimates the amount expected to be collected based upon management's assessment of historical write-offs and expected net collections, business and economic conditions, and other collection indicators. Management relies on the results of detailed reviews of historical write-offs and collections as a primary source of information in estimating the amount of contract consideration expected to be collected and implicit price concessions. Uncollectible receivables are written-off in the period management believes it has exhausted its ability to collect payment from the customer. The Company believes its analysis provides reasonable estimates of its revenues and valuations of its accounts receivable.

A description of the revenue recognition for each product sold by the Company is detailed below.

*Aligners and Impression Kits:* The Company enters into contracts with customers for aligner sales that involve multiple future performance obligations. The Company determined that aligner sales comprise the following distinct performance obligations: initial aligners, modified aligners, refinement aligners, and retainers for international sales only which can occur at any time throughout the treatment plan (which is typically between five to ten months) upon the direction of and prescription from the treating dentist or orthodontist.



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The Company allocates revenues for each performance obligation based on its SSP and recognizes the revenues as control of the performance obligation is transferred upon shipment of the aligners. The Company recognizes aligner revenue on amounts expected to be collected during the course of the treatment plan.

The Company bills its customers either upfront for the full cost of aligners or monthly through its *SmilePay* financing program, which involves a down payment and a fixed amount per month for up to 24 months. The Company's accounts receivable related to the *SmilePay* financing program are reported at the amount expected to be collected on the consolidated balance sheets, which considers implicit price concessions. Financing revenue from its accounts receivable is recognized based on the contractual market interest rate with the customer, net of implicit price concessions. There are no fees or origination costs included in accounts receivable.

The Company sells doctor prescribed impression kits to its customers as an alternative to an in-person visit at one of its SmileShops or Partner Network locations, comprised of affiliated dentist and orthodontist offices, where the customer receives a free oral digital imaging of their teeth. The Company combines the sales of its impression kits with aligner sales and recognizes the revenues as control of the performance obligation is transferred upon shipment of the aligners. The Company estimates the amount of impression kit sales that do not result in an aligner therapy treatment plan and recognizes such revenue when aligner conversion becomes remote.

**Retainers and Other Products:** The Company sells retainers and other products (such as whitening gel and tooth brushes) to customers, which can be purchased on the Company's website or certain retail outlets. The sales of these products are independent and separate from the customer's decision to purchase aligner therapy for domestic sales. The Company determined that the transfer of control for these performance obligations occurs as the title of such products passes to the customer.

The following table summarizes revenue recognized for each product sold by the Company:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>
Aligner revenue, net of implicit price concessions \$	139,279 \$	162,174 \$	388,111 \$	508,898
Financing revenue, net of implicit price concessions	12,042	11,522	37,428	31,185
Retainers and other products revenue	17,180	6,489	46,685	13,631
Total revenue	<u>\$ 168,501 \$</u>	<u>\$ 180,185 \$</u>	<u>\$ 472,224 \$</u>	<u>\$ 553,714</u>
Implicit price concessions included in total revenue	<u>\$ 15,362 \$</u>	<u>\$ 17,299 \$</u>	<u>\$ 50,051 \$</u>	<u>\$ 56,394</u>

**Deferred Revenue:** Deferred revenue represents the Company's contract liability for performance obligations associated with sales of aligners. Of the Company's revenues during the three and nine months ended September 30, 2020 and 2019, \$2,684, \$1,882, \$19,547, and \$16,386 was previously included in deferred revenue on the consolidated balance sheets as of December 31, 2019 and 2018, respectively.

**Shipping and Handling Costs**

Shipping and handling charges are recorded in cost of revenues in the consolidated statements of operations upon shipment. The Company incurred approximately \$5,891, \$4,481, \$18,516 and \$12,082 in outsourced shipping expenses for the three and nine months ended September 30, 2020 and 2019, respectively.

**Cost of Revenues**

Cost of revenues includes the total cost of products produced and sold. Such costs include direct materials, direct labor, overhead costs (occupancy costs, indirect labor, and depreciation), fees retained by doctors, freight and duty expenses associated with moving materials from vendors to the Company's facilities and from its facilities to the customers, and adjustments for shrinkage (physical inventory losses), lower of cost or net realizable value, slow moving product and excess inventory quantities.

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**Marketing and Selling Expenses**

Marketing and selling expenses include direct online and offline marketing and advertising costs, costs associated with intraoral imaging services, selling labor, and occupancy costs of SmileShop locations. All marketing and selling expenses are expensed as incurred. For the three and nine months ended September 30, 2020 and 2019, the Company incurred marketing and selling costs of \$66,722, \$131,263, \$243,564 and \$340,409, respectively.

**General and Administrative Expenses**

General and administrative expenses include payroll and benefit costs for corporate team members, equity-based compensation expenses, occupancy costs of corporate facilities, bank charges and costs associated with credit and debit card interchange fees, outside service fees, and other administrative costs, such as computer maintenance, supplies, travel, and lodging.

**Depreciation and Amortization**

Depreciation includes expenses related to the Company's property, plant and equipment, including finance leases. Amortization includes expenses related to definite-lived intangible assets and capitalized software. Depreciation and amortization are calculated using the straight-line method over the useful lives of the related assets, ranging from three to ten years. Leasehold improvements are amortized using the straight-line method over the shorter of the related lease terms or their useful lives. Depreciation and amortization are included in cost of revenues, selling expenses, and general and administrative expenses depending on the purpose of the related asset. Depreciation and amortization by financial statement line item were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Cost of revenues	\$ 5,945	\$ 2,518	\$ 17,385	\$ 6,932
Marketing and selling expenses	1,635	1,257	4,906	3,318
General and administrative expenses	6,462	2,739	17,108	5,987
Total	\$ 14,042	\$ 6,514	\$ 39,399	\$ 16,237

**Fair Value of Financial Instruments**

The Company measures the fair value of financial instruments as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

- Level 1 — Quoted (unadjusted) prices in active markets for identical assets or liabilities.
- Level 2 — Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.
- Level 3 — Inputs that are generally unobservable and typically reflect management's estimate of assumptions that market participants would use in pricing the asset or liability.

The Company's financial instruments consist of cash, receivables, accounts payable, debt instruments, warrants, and derivative financial instruments. Due to their short-term nature, the carrying values of cash, current receivables, and trade payables, approximate current fair value at each balance sheet date. The warrants are recorded at their initial fair value. The Company had \$404,569 and \$150,448 in borrowings under its debt facilities (as discussed in Note 10) as of September 30, 2020 and December 31, 2019, respectively. Based on market interest rates (Level 2 inputs), the carrying value of the borrowings under its debt facilities approximates fair value for each period reported.

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**Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)**  
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***Derivative Financial Instruments***

The Company accounts for derivative financial instruments in accordance with applicable accounting standards for such instruments and hedging activities, which require that all derivatives are recorded on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting, and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company had no outstanding derivatives at September 30, 2020 or December 31, 2019; however, the Company may enter into derivative contracts that are intended to economically hedge a certain portion of its risk, even though hedge accounting does not apply or the Company elects not to apply the hedge accounting standards.

***Certain Risks and Uncertainties***

The Company's operating results depend to a significant extent on the ability to market and develop its products. The life cycles of the Company's products are difficult to estimate due, in part, to the effect of future product enhancements and competition. The inability to successfully develop and market the Company's products as a result of competition or other factors would have a material adverse effect on its business, financial condition, and results of operations.

The Company provides credit to customers in the normal course of business. The Company maintains reserves for potential credit losses and such losses have been within management's expectations. No individual customer accounted for 1% or more of the Company's accounts receivable at September 30, 2020 or December 31, 2019, or net revenue for the three or nine months ended September 30, 2020 and 2019.

Some of the Company's products are considered medical devices and are subject to extensive regulation in the U.S. and internationally. The regulations to which the Company is subject are complex. Regulatory changes could result in restrictions on the Company's ability to carry on or expand its operations, higher than anticipated costs or lower than anticipated sales. The failure to comply with applicable regulatory requirements may have a material adverse impact on the Company.

The Company's reliance on international operations exposes it to related risks and uncertainties, including difficulties in staffing and managing international operations, such as hiring and retaining qualified personnel; political, social and economic instability; interruptions and limitations in telecommunication services; product and material transportation delays or disruption; trade restrictions and changes in tariffs; import and export license requirements and restrictions; fluctuations in foreign currency exchange rates; and potential adverse tax consequences. If any of these risks materialize, operating results may be harmed.

The Company purchases certain inventory from sole suppliers, and the inability of any supplier or manufacturer to fulfill the supply requirements could materially and adversely impact its future operating results.

***Cash and Cash Equivalents***

Cash and cash equivalents consists of all highly-liquid investments with original maturities of less than three months. Cash is held in various financial institutions in the U.S. and internationally, including certain reserve accounts in accordance with the Company's credit facility with HPS Investment Partners (see Note 10).

***Inventories***

**SmileDirectClub, Inc.**  
**Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)**  
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Inventories are stated at the lower of cost or net realizable value using the first-in, first-out method of inventory accounting. Inventory consists of raw materials for producing impression kits and aligners and finished goods. Inventory is net of shrinkage and obsolescence.

***Property, Plant and Equipment, net***

Property, plant and equipment are stated at cost less accumulated depreciation and amortization. Routine maintenance and repairs are charged to expense as incurred. At the time property, plant and equipment are retired from service, the cost and accumulated depreciation or amortization are removed from the respective accounts and the related gains or losses are reflected in the consolidated statements of operations.

***Leases***

On January 1, 2020, the Company adopted the new leases standard using the modified retrospective transition method, which requires that it recognizes leases differently pre- and post-adoption. See “Recently Adopted Accounting Pronouncements—ASU No. 2016-02” below for more information. The Company categorizes leases at their inception as either operating or finance leases. Lease agreements cover certain retail locations, office space, warehouse, manufacturing and distribution space and equipment. Operating leases are included in operating lease right-of-use assets, other current liabilities, and long-term right-of-use operating lease obligations in the condensed consolidated balance sheet. Finance leases are included in property, plant and equipment, net, current portion of long-term debt, and long-term debt.

Leased assets represent the Company’s right to use an underlying asset for the lease term, and lease liabilities represent the Company’s obligation to make lease payments arising from the lease. Operating lease right-of-use assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. The Company uses a secured incremental borrowing rate as the discount rate for determining the present value of lease payments when the rate implicit in the contract is not readily determinable. Leases that have a term of twelve months or less upon commencement date are considered short-term in nature. Accordingly, short-term leases are not included on the condensed consolidated balance sheets and are expensed on a straight-line basis over the lease term, which commences on the date we have the right to control the property.

***Internally Developed Software Costs***

The Company generally provides services to its customers using software developed for internal use. The costs that are incurred to develop such software are expensed as incurred during the preliminary project stage. Once certain criteria have been met, direct costs incurred in developing or obtaining computer software are capitalized. Training and maintenance costs are expensed as incurred. Capitalized software costs are included in property, plant and equipment in the consolidated balance sheets and are amortized over a three-year period. During the three and nine months ended September 30, 2020 and 2019, the Company capitalized \$3,556, \$2,143, \$10,938, and \$7,029, respectively, of internally developed software costs. Amortization expense for internally developed software was \$2,091, \$810, \$5,373, and \$1,547 for the three and nine months ended September 30, 2020, and 2019, respectively.

***Impairment***

The Company evaluates long-lived assets (including finite-lived intangible assets) for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. An asset or asset group is considered impaired if its carrying amount exceeds the future undiscounted net cash flows that the asset or asset group is expected to generate. Factors the Company considers important which could trigger an impairment review include significant negative industry or economic trends, significant loss of customers and changes in the competitive environment. If an asset or asset group is considered to be impaired, the impairment to be recognized is calculated as the amount by which the carrying amount of the asset or asset group exceeds its fair market value. The Company’s estimates of future cash flows attributable to long-lived assets require significant judgment based on its historical and anticipated results and are subject to many assumptions. The estimation of fair value utilizing a discounted cash flow approach includes numerous uncertainties which require significant judgment when making assumptions of expected growth rates and the selection of discount rates, as well as assumptions regarding

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**Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)**  
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general economic and business conditions, and the structure that would yield the highest economic value, among other factors.

**Debt Issuance Costs**

The Company records debt issuance costs related to its term debt as direct deductions from the carrying amount of the debt. The costs are amortized to interest expense over the life of the debt using the effective interest method.

**Income Taxes**

SDC Inc. is the managing member of SDC Financial and, as a result, consolidates the financial results of SDC Financial in the unaudited condensed consolidated financial statements. SDC Financial and its subsidiaries are limited liability companies and have elected to be taxed as partnerships for income tax purposes except for a subsidiary, SDC Holding, LLC (“SDC Holding”) and its domestic and foreign subsidiaries, which are taxed as corporations. As such, SDC Financial does not pay any federal income taxes, as any income or loss is included in the tax returns of the individual members. SDC Financial does pay state income tax in certain jurisdictions, and the Company’s income tax provision in the consolidated financial statements reflects the income taxes for those states. Additionally, certain wholly-owned entities taxed as corporations are subject to federal, state, and foreign income taxes, in the jurisdictions in which they operate, and accruals for such taxes are included in the consolidated financial statements. The Company further evaluates deferred tax assets in each jurisdiction and recognizes associated benefits when positive evidence of realization exceeds negative evidence, and otherwise records valuation allowances as necessary.

**Tax Receivable Agreement**

In connection with the Reorganization Transactions and the IPO, the Company entered into a Tax Receivable Agreement (the “Tax Receivable Agreement”) with the Continuing LLC Members, pursuant to which SDC Inc. agreed to pay the Continuing LLC Members 85% of the amount of cash tax savings, if any, in U.S. federal, state, and local income tax or franchise tax that SDC Inc. actually realizes as a result of (a) the increases in tax basis attributable to exchanges by Continuing LLC Members and (b) tax benefits related to imputed interest deemed to be paid by SDC Inc. as a result of the Tax Receivable Agreement. The Company recognizes this contingent liability in its consolidated financial statements when amounts become probable as to incurrence and estimable in amount.

**Recent Accounting Pronouncements**

In January 2020, the Company adopted FASB ASU 2018-07, “*Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*,” which expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from non-employees. The adoption of this guidance did not have a material impact on the Company’s condensed consolidated financial statements and related disclosures.

In fiscal year 2020, the Company adopted FASB ASU 2018-15, “*Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*.” This update clarifies the accounting treatment for fees paid by a customer in a cloud computing arrangement (hosting arrangement) by providing guidance for determining when the arrangement includes a software license. The adoption of ASU 2018-15 did not have a material impact on the Company’s condensed consolidated financial statements and related disclosures.

**SmileDirectClub, Inc.**  
**Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)**  
(in thousands, except share/unit data and per share/unit amounts)

**Note 3—Inventories**

Inventories are comprised of the following:

	<b>September 30, 2020</b>	<b>December 31, 2019</b>
Raw materials	\$ 6,067	\$ 5,950
Finished goods	20,034	12,481
<b>Total inventories</b>	<b>\$ 26,101</b>	<b>\$ 18,431</b>

**Note 4—Prepaid and other assets**

Prepaid and other assets are comprised of the following:

	<b>September 30, 2020</b>	<b>December 31, 2019</b>
Prepaid expenses	\$ 9,195	\$ 10,503
Deposits to vendors	2,199	3,132
Other	3,943	551
<b>Total prepaid and other current assets</b>	<b>\$ 15,337</b>	<b>\$ 14,186</b>
Prepaid expenses, non-current	\$ 2,721	\$ 1,308
Deposits to vendors, non-current	1,672	3,346
Indefinite-lived intangible assets	6,833	6,217
Other intangible assets, net	235	428
<b>Total other assets</b>	<b>\$ 11,461</b>	<b>\$ 11,299</b>

In March 2019, the Company purchased an intangible asset related to manufacturing. The Company evaluates the remaining useful life and carrying value of this indefinite-lived intangible asset at least annually or when events and circumstances warrant such a review, to determine whether significant events or changes in circumstances indicate that a change in the useful life or impairment in value may have occurred. There were no impairment charges related to the Company's indefinite-lived intangible asset during the three and nine months ended September 30, 2020.

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**Note 5—Lease Abandonment, Impairment of Long-lived Assets and Store Closure and Other Related Charges**

Beginning in the second quarter of 2020, the Company performed a review of its real estate needs and initiated restructuring actions related to a real estate repositioning program. As a result of these changes, the Company incurred one-time charges of \$5,674 and \$34,783 for the three and nine months ended September 30, 2020. These charges were primarily associated with the closure of the manufacturing facility in Kyle, Texas; the consolidation of several floors at the Company headquarters in Nashville, Tennessee; the closure and consolidation of a portion of SmileShops, which is an on-going evaluation; and the impairment of right of use assets and leasehold improvements at the closed manufacturing facility and SmileShops. Given the uncertain operating environment and the shift to work-from-home, the Company made the strategic decision to align its rent costs with the current needs of the business, while also ensuring that the Company has sufficient capacity to support future growth. The Company continues to evaluate its SmileShops and other properties to determine if it will further rationalize its footprint to better align with marketplace demand, including the direct and indirect effects of the COVID-19 pandemic. Additional future restructuring charges may result from the Company's real estate repositioning and optimization initiatives.

The following table summarizes charges for the three and nine months ended September 30, 2020. There were no similar charges for the three and nine months ended September 30, 2019.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
<b>Lease abandonment and impairment of long-lived assets and inventory:</b>				
Impairment of property, plant and equipment	\$ 3,131	\$ —	\$ 19,878	\$ —
Impairment of right of use asset	829	—	8,715	—
	<u>\$ 3,960</u>	<u>\$ —</u>	<u>\$ 28,593</u>	<u>\$ —</u>
<b>Store closure and other related charges:</b>				
Impairment of inventory	\$ 786	\$ —	\$ 786	\$ —
Short-term lease termination fees	864	—	4,687	—
Other expenses	64	—	717	—
	<u>\$ 1,714</u>	<u>\$ —</u>	<u>\$ 6,190</u>	<u>\$ —</u>

The balance of the accruals for the restructuring programs recorded in accrued expenses in the condensed consolidated balance sheets as of September 30, 2020 was \$605.

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**Note 6—Property, plant and equipment, net**

Property, plant and equipment were comprised of the following:

	<b>September 30, 2020</b>	<b>December 31, 2019</b>
Lab and SmileShop equipment	\$ 92,252	\$ 79,103
Computer equipment and software	74,346	48,401
Leasehold improvements	24,447	13,275
Furniture and fixtures	13,491	13,152
Vehicles	6,154	2,660
Construction in progress	49,978	60,317
Property, plant and equipment, gross	260,668	216,908
Less: accumulated depreciation	(77,238)	(39,365)
Property, plant and equipment, net	<u>\$ 183,430</u>	<u>\$ 177,543</u>

The carrying values of assets under finance leases were \$22,981 and \$26,501 as of September 30, 2020 and December 31, 2019, respectively, net of accumulated depreciation of \$12,947 and \$4,670, respectively.



**SmileDirectClub, Inc.**  
**Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)**  
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**Note 7—Leases**

The Company leases property and equipment under finance and operating leases. For leases with terms greater than 12 months, the Company records the related right-of-use assets and right-of-use obligations at the present value of lease payments over the term. Certain of the Company's leases include rental escalation clauses and renewal options that are factored into the determination of lease payments when appropriate. Certain of the Company's leased store locations have variable payments based upon scan volume as well as other variable property related costs. The Company does not separate lease and non-lease components of contracts.

Generally, the Company uses its estimated incremental borrowing rate to discount the lease payments based on information available at lease commencement, as most of its leases do not provide a readily determinable implicit interest rate. The Company estimates its collateralized incremental borrowing rate based upon a synthetic credit rating and yield curve analysis at commencement or modification date in determining the present value of lease payments.

The following table presents lease-related assets and liabilities at September 30, 2020:

<b>Leases Assets and Liabilities</b>	<b>Balance Sheet Classification</b>	<b>September 30, 2020</b>
<i>Assets:</i>		
Operating leases	Operating lease right-of-use asset	\$ 30,564
Finance leases	Property, plant, and equipment, net	22,981
		<u>\$ 53,545</u>
<i>Liabilities:</i>		
Operating leases	Other current liabilities	\$ 6,452
Finance leases	Current portion of long-term debt	10,631
Operating leases	Operating lease liabilities, net of current portion	32,038
Finance leases	Long-term debt, net of current portion	14,015
		<u>\$ 63,136</u>
<b>Weighted average remaining term:</b>		
Operating leases		5.9 years
Finance leases		1.9 years
<b>Weighted average discount rate:</b>		
Operating leases		5.70 %
Finance leases		7.50 %

<sup>(1)</sup> Finance lease assets are recorded net of accumulated amortization of \$12,947 as of September 30, 2020.

<sup>(2)</sup> Upon adoption of the new lease standard, discount rates used for existing leases were established at January 1, 2020.

The following table presents certain information related to lease expense for finance and operating leases:

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Expense Category	Statement of Operations Classification	Three Months Ended September 30, 2020	Nine Months Ended September 30, 2020
<b>Finance lease expense:</b>			
Amortization of leased assets	Cost of revenues	\$ 2,497	\$ 7,491
Interest of lease liabilities	Interest expense	493	1,619
Operating leases <sup>(3)</sup>		2,296	7,333
Short-term lease expense <sup>(3)</sup>		3,255	12,898
Variable lease expense <sup>(3)</sup>		351	2,855
<b>Total lease expense</b>		<b>\$ 8,892</b>	<b>\$ 32,196</b>

<sup>(3)</sup> Expenses are included in “Cost of revenues”, “Marketing and selling expenses”, or “General and administrative expenses” in our condensed consolidated statements of operations, depending on the purpose of the related asset.

*Other Information*

The following table represents supplemental cash flow information:

	Nine Months Ended September 30, 2020
<b>Cash paid for amounts used in the measurement of lease liabilities:</b>	
Cash used in operating activities	\$ 6,799
Cash used in investing activities	\$ —
Cash used in financing activities	\$ 7,543

*Maturities of Lease Liabilities*

The following table reconciles the undiscounted cash flows to the finance lease liabilities and operating lease liabilities recorded on the condensed consolidated balance sheet at September 30, 2020:

	Finance Leases	Operating Leases
2020 (remaining)	\$ 3,038	\$ 2,046
2021	11,209	8,298
2022	6,859	7,558
2023	—	6,904
2024	—	6,136
2025 and thereafter	—	15,404
<b>Total minimum lease payments</b>	<b>21,106</b>	<b>46,346</b>
Residual value	5,661	—
Amount representing interest	(2,121)	(7,856)
Present value of future minimum lease payments	24,646	38,490
Less: current portion	(10,631)	(6,452)
<b>Long-term lease liabilities</b>	<b>\$ 14,015</b>	<b>\$ 32,038</b>

**SmileDirectClub, Inc.**  
**Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)**  
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**Note 8—Accrued liabilities**

Accrued liabilities were comprised of the following:

	September 30, 2020	December 31, 2019
Accrued marketing and selling costs	\$ 21,202	\$ 31,804
Accrued payroll and payroll related expenses	29,609	25,019
Accrued sales and other taxes	13,249	8,367
Other	29,248	28,149
<b>Total accrued liabilities</b>	<b>\$ 93,308</b>	<b>\$ 93,339</b>

**Note 9—Income taxes**

SDC Inc. is the managing member of SDC Financial and, as a result, consolidates the financial results of SDC Financial. SDC Financial and its subsidiaries are limited liability companies and have elected to be taxed as partnerships for income tax purposes except for a subsidiary, SDC Holding and certain of its domestic and foreign subsidiaries, which are taxed as corporations. As such, SDC Financial does not pay any federal income taxes, as any income or loss is included in the tax returns of the individual members. SDC Financial does pay state income tax in certain jurisdictions, and the Company's income tax provision in the consolidated financial statements reflects the income taxes for those states. Additionally, certain wholly-owned entities taxed as corporations are subject to federal, state, and foreign income taxes in the jurisdictions in which they operate, and accruals for such taxes are included in the consolidated financial statements. The Company further evaluates deferred tax assets in each jurisdiction and recognizes associated benefits when positive evidence of realization exceeds negative evidence, and otherwise records valuation allowances as necessary.

The Company's U.S. federal and state income tax returns for the tax years 2015 and beyond remain subject to examination by the Internal Revenue Service. The Company also has operations in Costa Rica, Puerto Rico, Canada, Australia, New Zealand, the U.K., Ireland, Germany, Austria, Spain, Hong Kong, and Singapore with tax filings in each foreign jurisdiction. With respect to state and local jurisdictions, the Company and its subsidiaries are typically subject to examination for several years after the income tax returns have been filed. The Internal Revenue Service has commenced an examination of the U.S. income tax return of SDC, LLC, a subsidiary of SDC Financial, for 2017. We anticipate this audit will conclude within the next twelve months. Although the outcome of tax audits is always uncertain, the Company believes that adequate amounts of tax, interest and penalties have been provided for in the accompanying consolidated financial statements for any adjustments that may be incurred due to state or local audits and uncertain tax positions. The Company is also subject to withholding taxes in foreign jurisdictions. The Company's income tax expense may vary from the expense that would be expected based on statutory rates due principally to its organizational structure and recognition of valuation allowances against deferred tax assets.

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The income tax provision was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
<b>Current:</b>				
Federal	\$ 186	\$ —	\$ 186	\$ —
State	160	63	318	165
Foreign	525	—	865	—
Current income tax provision	<u>\$ 871</u>	<u>\$ 63</u>	<u>\$ 1,369</u>	<u>\$ 165</u>
<b>Deferred:</b>				
Federal	\$ —	\$ —	\$ —	\$ —
State	319	416	376	431
Foreign	—	—	—	—
Deferred income tax provision	<u>\$ 319</u>	<u>\$ 416</u>	<u>\$ 376</u>	<u>\$ 431</u>
Total income tax provision	<u>\$ 1,190</u>	<u>\$ 479</u>	<u>\$ 1,745</u>	<u>\$ 596</u>

At September 30, 2020 the Company had unused federal net operating loss carryforwards (tax effected) for federal income tax purposes of approximately \$31,785, which can be carried forward indefinitely and may be used to offset future taxable income. In addition, the Company had unused net operating loss carryforwards (tax effected) for state income tax purposes of approximately \$16,913, which expire from 2029 through 2034. The Company also had unused net operating loss carryforwards (tax effected) for foreign income tax purposes of approximately \$1,320. Additionally, the Company has certain other deferred tax assets related to potential future tax benefits. All deferred tax assets are evaluated using positive and negative evidence as to their future realization. The Company considers recent historic losses to be significant negative evidence, and as such, records a valuation allowance against substantially all of its deferred tax assets.

As of September 30, 2020, the Company maintained a valuation allowance of approximately \$218,681 against its deferred tax assets. If there is a change in the Company's assessment of the amount of deferred income tax assets that is realizable, adjustments to the valuation allowance will be made in future periods.

**Tax Receivable Agreement**

The Company expects to obtain an increase in its share of the tax basis in the net assets of SDC Financial when LLC Units are redeemed from or exchanged by Continuing LLC Members. The Company intends to treat any redemptions and exchanges of LLC Units as direct purchases of LLC Units for U.S. federal income tax purposes. These increases in tax basis may reduce the amounts that it would otherwise pay in the future to various tax authorities. They may also decrease gains (or increase losses) on future dispositions of certain capital assets to the extent tax basis is allocated to those capital assets.

In connection with the Reorganization Transactions and the IPO, the Company entered into the Tax Receivable Agreement with the Continuing LLC Members. The Tax Receivable Agreement provides for the payment by SDC Inc. of 85% of the amount of any tax benefits that SDC Inc. actually realizes, or in some cases is deemed to realize, as a result of (i) increases in SDC Inc.'s share of the tax basis in the net assets of SDC Financial resulting from any redemptions or exchanges of LLC Units, (ii) tax basis increases attributable to payments made under the Tax Receivable Agreement, and (iii) deductions attributable to imputed interest pursuant to the Tax Receivable Agreement (the "TRA Payments"). The Company expects to benefit from the remaining 15% of any of cash savings, if any, that it realizes.

During the year ended December 31, 2019, the Company acquired an aggregate of \$635,690 in LLC Units in connection with the redemption of certain Continuing LLC Members, which resulted in an increase in the tax basis of

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the assets of SDC Financial subject to the provisions of the Tax Receivable Agreement. The Company has not recognized any additional liability under the Tax Receivable Agreement after concluding it was not probable that such TRA Payments would be paid based on its estimates of future taxable income. No payments were made to the Continuing LLC Members pursuant to the Tax Receivable Agreement during the nine month period ended September 30, 2020.

The amounts payable under the Tax Receivable Agreement will vary depending upon a number of factors, including the amount, character, and timing of the taxable income of SDC Inc. in the future. If the valuation allowance recorded against the deferred tax assets applicable to the tax attributes referenced above is released in a future period, the Tax Receivable Agreement liability may be considered probable at that time and recorded within earnings.

**Note 10—Long-Term Debt**

The Company’s debt and capital lease obligations are comprised of the following:

	September 30, 2020	December 31, 2019
HPS Credit Facility, net of unamortized financing costs of \$10,942	\$ 377,267	\$ —
JPM Credit Facility, net of unamortized financing costs of \$2,513	—	147,935
Align redemption promissory note	13,767	34,090
Capital lease obligations (Note 7)	24,646	26,501
Total debt	415,680	208,526
Less current portion	(24,398)	(35,376)
Total long-term debt	\$ 391,282	\$ 173,150

**HPS Credit Facility**

In May 2020, SDC U.S. SmilePay SPV (“SPV”), a wholly-owned special purpose subsidiary of the Company, entered into a Loan Agreement among SPV, as borrower, SmileDirectClub, LLC, as the seller and servicer, certain lenders, and HPS Investment Partners, LLC, as administrative agent and collateral agent, providing a five year secured term loan facility to SPV in an initial aggregate maximum principal amount of \$400,000, net of original issue discount of \$12,000, with the ability to request incremental term loans of up to an additional aggregate principal amount of \$100,000 with the consent of the lenders participating in such increase (the “HPS Credit Facility”).

The proceeds of the HPS Credit Facility were used to repay all outstanding amounts under the previous JPM Credit Facility and for working capital and other corporate purposes. In connection with the repayment, the Company paid \$187 in fees and wrote-off the remaining unamortized loan costs of \$1,594, both of which are included in loss from extinguishment of debt in the accompanying condensed consolidated statements of operations.

The Company recorded \$11,784 related to deferred financing costs of the HPS Credit Facility. During the nine months ended September 30, 2020, the Company amortized under the effective interest rate method \$842 of deferred financing costs. The original issue discount is included in loss from extinguishment of debt in the accompanying condensed consolidated statements of operations.

Outstanding loans under the HPS Credit Facility bear interest at a variable rate equal to three-month LIBOR (subject to a 1.75% per annum floor), plus 7.50% per annum payable in cash, plus 3.25% per annum payable in kind or, at the Company’s election, wholly or partially in cash.

Subject to certain exceptions, the HPS Credit Facility is secured by first-priority security interests in SPV’s assets, which consist of certain receivables, cash governed by a control agreement with HPS, intellectual property and related assets. SPV’s obligations under the Loan Agreement are guaranteed on a limited basis by SmileDirectClub, LLC and SDC Financial LLC. As of September 30, 2020, the Company had \$345,996 of its receivables collateralized as part of the HPS Credit Facility.

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The HPS Credit Facility contains various restrictions, covenants, ratios and events of default, including:

- SPV has limitations on consolidations, creation of liens, incurring additional indebtedness, dispositions of assets, investments and paying dividends or other distributions.
- SDC Financial LLC, its consolidated subsidiaries and certain originator entities must maintain minimum monthly liquidity of \$100,000 and are subject to additional leverage ratios upon the occurrence of additional debt.
- SDC Financial LLC is subject to a consolidated leverage ratio measured as of the end of each fiscal quarter beginning March 31, 2022, to be calculated based on annualized EBITDA for the first three quarters of 2022, and thereafter, to be calculated based on EBITDA during the trailing four fiscal quarters for the relevant period.

The HPS Credit Facility can be refinanced during the first year, provided that SPV would be required to pay the amount of interest that would have accrued during the remainder of the first year, plus 4% of the principal amount prepaid; and after the first year, for a fee of 4% of the principal amount prepaid, with the prepayment fee decreasing each year to 3% in the third year, 2% in the fourth year and 1% in the fifth year.

As of September 30, 2020, the Company had \$404,569 outstanding and was in compliance with all covenants in the HPS Credit Facility.

#### ***HPS Warrants***

In connection with the HPS Credit Facility, the Company issued warrants (“HPS Warrants”) to affiliates of HPS Investment Partners, LLC exercisable at any time into an aggregate of 3,889,575 shares of the Company’s Class A common stock, which amounted to 1% of the Company’s total outstanding Class A and Class B common stock, including the HPS Warrants, as of the closing date of the HPS Credit Facility, at an exercise price of \$7.11 per share, payable in cash or pursuant to a cashless exercise. The HPS Warrants were recorded at their initial fair value of \$17,620 and are being accreted through interest expense to the outstanding loan balance of the HPS Credit Facility.

#### ***JPM Credit Facility***

In June 2019, the Company entered into a loan and security agreement with JPMorgan Chase Bank, N.A., as the administrative agent, the collateral agent and a lender (the “JPM Credit Facility”), providing a secured revolving credit facility in an initial aggregate maximum principal amount of \$500 million with the potential to increase the aggregate principal amount that may be borrowed up to an additional \$250 million with the consent of the lenders participating in such increase. The proceeds of the HPS Credit Facility were used to pay all outstanding amounts under the JPM Credit Facility.

The Company recorded \$6,188 related to deferred financing costs of the JPM Credit Facility. During the nine months ended September 30, 2020, the Company amortized under the effective interest rate method \$919 of deferred financing costs.

#### ***Align Redemption Promissory Note***

In connection with the required redemption of Align’s 20,710 Pre-IPO Units described in Note 16, the Company entered into a promissory note with Align Technology, Inc. (“Align”). Under the terms of the promissory note, the Company will make monthly payments of \$2,311 to Align through March 2021. The promissory note bears annual interest of 2.52% which is included in the consolidated statement of operations. As of September 30, 2020, the Company has \$13,767 outstanding under this promissory note.

#### ***Future Maturities***

Annual future maturities of long-term debt, excluding finance lease obligations, unamortized financing costs and unamortized HPS Warrant value, are as follows:

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	HPS Credit Facility	Align Redemption Promissory Note	Total
2020 (remaining)	\$ —	\$ 6,861	\$ 6,861
2021	—	6,906	6,906
2022	—	—	—
2023	—	—	—
2024	—	—	—
2025	404,569	—	404,569
Total	\$ 404,569	\$ 13,767	\$ 418,336

**Note 11—Noncontrolling Interests**

SDC Inc. is the sole managing member of SDC Financial and consolidates the financial results of SDC Financial. Therefore, SDC Inc. reports a noncontrolling interest based on the common units of SDC Financial held by the Continuing LLC Members. Changes in SDC Inc.'s ownership interest in SDC Financial, while SDC Inc. retains its controlling interest in SDC Financial, are accounted for as equity transactions. As such, future redemptions or direct exchanges of LLC Units by the Continuing LLC Members will result in a change in ownership and reduce or increase the amount recorded as noncontrolling interest and increase or decrease additional paid-in capital when SDC Financial has positive or negative net assets, respectively. As of September 30, 2020, SDC Inc. had 113,105,780 shares of Class A common stock outstanding, which resulted in an equivalent amount of ownership of LLC Units by SDC Inc. As of September 30, 2020, SDC Inc. had a 29.3% economic ownership interest in SDC Financial.

**Note 12—Variable Interest Entities**

Upon completion of the IPO, SDC Inc. became the managing member of SDC Financial with 100% of the management and voting power in SDC Financial. In its capacity as managing member, SDC Inc. has the sole authority to make decisions on behalf of SDC Financial and bind SDC Financial to signed agreements. Further, SDC Financial maintains separate capital accounts for its investors as a mechanism for tracking earnings and subsequent distribution rights. Accordingly, management concluded that SDC Financial is determined to be a limited partnership or similar legal entity as contemplated in ASC 810.

Furthermore, management concluded that SDC Inc. is SDC Financials' primary beneficiary. As the primary beneficiary, SDC Inc. consolidates the results of SDC Financial for financial reporting purposes under the variable interest consolidation model guidance in ASC 810.

SDC Inc.'s relationship with SDC Financial results in no recourse to the general credit of SDC Inc. SDC Financial and its consolidated subsidiaries represents SDC Inc.'s sole investment. SDC Inc. shares in the income and losses of SDC Financial in direct proportion to SDC Inc.'s ownership percentage. Further, SDC Inc. has no contractual requirement to provide financial support to SDC Financial.

SDC Inc.'s financial position, performance and cash flows effectively represent those of SDC Financial as of and for the period ended September 30, 2020. Prior to the IPO and Reorganization Transactions, SDC Inc. was not impacted by SDC Financial.

**Note 13—Incentive Compensation Plans**

In connection with the IPO, the Company adopted the 2019 Omnibus Incentive Compensation Plan (the "2019 Plan") in August 2019. The Company's board of directors or the compensation committee of the board of directors, acting as plan administrator, administers the 2019 Plan and the awards granted under it. The Company reserved a total of 38,486,295 shares of Class A common stock for issuance pursuant to the 2019 Plan. The Company currently has two types of share-based compensation awards outstanding under the 2019 Plan: Class A common stock options ("Options") and Class A restricted stock units ("RSUs"), including those issued pursuant to IBAs.

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**Class A Common Stock Options**

Options activity was as follows during the nine months ended September 30, 2020:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2019	1,744,556	\$ 23.00	9.7 \$	—
Granted	—	—	—	—
Exercised	—	—	—	—
Expired	—	—	—	—
Forfeited	65,217	23.00	—	—
Outstanding at September 30, 2020	1,679,339	\$ 23.00	9.0 \$	—
Exercisable at September 30, 2020	298,908	\$ 23.00	9.0 \$	—

The Company estimates fair value of the Options using the Black-Scholes option pricing model. Inputs to the Black-Scholes option pricing model include an expected dividend yield of 0%, expected volatility of 45%, risk-free interest rate of 1.7% and an expected term of 6.0 years or 6.5 years, pursuant to vesting terms, resulting in a weighted average fair value of \$10.29 or \$10.68 per Option pursuant to vesting terms. As of September 30, 2020, unrecognized compensation expense related to the Options was \$11,398. This expense is expected to be recognized over a weighted average period of 2.0 years.

Expected dividend yield - An increase in the expected dividend yield would decrease compensation expense.

Expected volatility - This is a measure of the amount by which the price of the equity instrument has fluctuated or is expected to fluctuate. The expected volatility was based on the historical volatility of a group of guideline companies. An increase in expected volatility would increase compensation expense.

Risk-free interest rate - This is the U.S. Treasury rate as of the measurement date having a term approximating the expected life of the award. An increase in the risk-free interest rate would increase compensation expense.

Expected term - The period of time over which the awards are expected to remain outstanding. The Company estimates the expected term as the mid-point between actual or expected vesting date and the contractual term. An increase in the expected term would increase compensation expense.

**Restricted Stock Units**

*Incentive Bonus Awards*

The Company has IBA agreements with several key employees to provide a bonus payment in the event of a liquidation event as defined in each agreement. The bonus amounts are calculated based on the value of the Company at the time of the liquidation event, less an amount determined upon the employee entering into the agreement. The right to the payment generally vests annually over a five-year period, with certain liquidation events resulting in an acceleration of the vesting period. As the vesting of these awards was contingent on a liquidation event, no amounts were required to be recorded prior to a liquidation event. The IBA agreements were modified in August 2019 to accelerate certain vesting conditions upon a liquidation event and to modify the settlement terms, whereby the Company settled the vested portion of each IBA in 50% shares of Class A common stock and/or vested RSUs and 50% cash, of which approximately 80% of the cash (40% of the total vested portion of the award) that the IBA holders would have otherwise received was withheld by the Company to fulfill tax withholding obligations and the remainder was paid out to IBA holders upon the occurrence of a liquidation event. As a result of the modification and the occurrence of a liquidation event through the IPO, the Company recorded equity-based compensation expense of \$316,959, equivalent to the amount of IBAs vested at the time of the IPO, in the form of cash, 5,654,078 shares of Class A common stock and 2,199,453 vested RSUs to be released over a period of six to twenty-four months following the date of the IPO. The unvested portion of the IBAs are represented in the form of unvested RSUs that will vest,



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subject to the holders' continued employment, over a period generally ranging from 2 years to 4 years.

*Non-IBA Restricted Stock Units*

The Company granted RSUs to certain team members that generally vest annually over two to three years or after three years from the date of grant, subject to the recipient's continued employment or service to the Company through each vesting date.

A summary of activity related to these RSUs is as follows:

	IBA RSUs	Non-IBA RSUs	Total RSUs	Weighted Average Grant Date Fair Value
RSUs outstanding, December 31, 2019	4,794,394	1,089,796	5,884,190	\$ 21.88
Granted	—	1,852,696	1,852,696	\$ 8.61
Vested	(2,218,257)	(142,375)	(2,360,632)	\$ 22.98
Forfeited	(143,556)	(347,118)	(490,674)	\$ 14.26
RSUs outstanding, September 30, 2020	2,432,581	2,452,999	4,885,580	\$ 17.10

As of September 30, 2020, unrecognized compensation expense related to unvested IBA and non-IBA RSUs was \$47,933. This expense is expected to be recognized over a weighted average period of 1.7 years.

*Incentive Bonus Units*

SDC Financial issued Incentive Bonus Units ("IBUs") to employees and non-employees. For employee IBUs, the fair value is based on SDC Financial's unit value on the date of grant. For non-employee IBUs the fair value is determined at the time of vesting.

Two employee IBU agreements were modified in July 2019 to accelerate certain vesting conditions upon a change of control. As a result of the acceleration of vesting conditions resulting from the Reorganization Transactions and the IPO, the Company recognized incremental compensation expense of \$436 during the year ended December 31, 2019. As of September 30, 2020, unrecognized compensation expense related to unvested IBUs was \$424.

*Employee Stock Purchase Plan*

The SmileDirectClub, Inc. team member Stock Purchase Plan ("SPP") was initiated in November 2019. Under the SPP, the Company is authorized to issue up to 5,772,944 shares of its Class A common stock to qualifying employees. Eligible team members may direct the Company, during each six months option period, to withhold up to 30% of their base salary and commissions, the proceeds from which are used to purchase shares of Class A common stock at a price equal to the lesser of 85% of the closing market price on the exercise date or the grant date. For accounting purposes, the SPP is considered a compensatory plan such that the Company recognizes equity-based compensation expense based on the fair value of the options held by the employees to purchase the Company's shares.

*Summary of Equity-Based Compensation Expense*

The Company recognized compensation expense of \$10,972, \$324,497, \$38,189, and \$332,759 for the three and nine months ended September 30, 2020 and 2019, respectively. Amounts are included in general and administrative expense on the consolidated statements of operations.

**Note 14—Earnings per Share**

Basic earnings per share of Class A common stock is computed by dividing net income attributable to SDC Inc. by the weighted-average number of shares of Class A common stock outstanding during the period. Diluted earnings per share of Class A common stock is computed by dividing net income attributable to SDC Inc., adjusted for the assumed exchange of all potentially dilutive LLC Units for Class A common stock, by the weighted-average number

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of shares of Class A common stock outstanding adjusted to give effect to potentially dilutive elements. Prior to the IPO, the SDC Financial membership structure included Pre-IPO Units, some of which were profits interests. The Company analyzed the calculation of earnings per unit for periods prior to the IPO and determined that it resulted in values that would not be meaningful to the users of these unaudited consolidated financial statements. Therefore, earnings per share information presented for the three and nine months ended September 30, 2019.

The following table sets forth reconciliations of the numerators and denominators used to compute basic and diluted earnings per share of Class A common stock:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>
<b>Numerator:</b>				
Net loss	\$ (43,482)	\$ (387,564)	\$ (245,548)	\$ (440,479)
Less: Net income attributable to SDC Financial prior to the Reorganization Transactions	—	(51,330)	—	(104,245)
Less: Net loss attributable to noncontrolling interests subsequent to the Reorganization Transactions	(30,892)	(247,938)	(176,909)	(247,938)
Net loss attributable to SDC Inc. - basic	(12,590)	(88,296)	(68,639)	(88,296)
Add: Reallocation of net loss attributable to noncontrolling interests after the Reorganization Transactions from the assumed exchange of LLC Units for Class A common stock	(30,892)	(247,938)	(176,909)	(247,938)
Net loss attributable to SDC Inc. - diluted	\$ (43,482)	\$ (336,234)	\$ (245,548)	\$ (336,234)
<b>Denominator:</b>				
Weighted average shares of Class A common stock outstanding - basic	111,703,080	99,533,877	108,459,488	99,533,877
Add: Dilutive effects as shown separately below				
LLC Units that are exchangeable for Class A common stock	273,969,597	279,474,505	276,429,361	279,474,505
Weighted average shares of Class A common stock outstanding - diluted	385,672,677	379,008,382	384,888,849	379,008,382
Earnings per share of Class A common stock outstanding - basic	\$ (0.11)	\$ (0.89)	\$ (0.63)	\$ (0.89)
Earnings per share of Class A common stock outstanding - diluted	\$ (0.11)	\$ (0.89)	\$ (0.64)	\$ (0.89)

Shares of the Company's Class B common stock do not participate in the earnings or losses of the Company and are therefore not participating securities. As such, separate presentation of basic and diluted earnings per share of Class B common stock under the two-class method has not been presented.

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**Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)**  
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Due to their anti-dilutive effect, the following securities have been excluded from diluted net loss per share in the periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Options	1,679,339	1,760,860	1,679,339	1,760,860
Restricted Stock Units	4,885,580	6,062,955	4,885,580	6,062,955
Warrants	3,889,575	1,471,735	3,889,575	1,471,735
Underwriters option to purchase additional shares	—	8,780,550	—	8,780,550

In connection with the IPO, the Company issued to the representative of the underwriters in the IPO an option to purchase additional shares of Class A common stock. The option expired prior to exercise.

**Note 15—Employee Benefit Plans**

The Company has a defined contribution retirement plan under Section 401(k) of the Internal Revenue Code of 1986, as amended, that covers substantially all U.S. employees who meet minimum age and service requirements and allows participants to defer a portion of their annual compensation on a pre-tax basis. For the nine months ended September 30, 2020 and 2019, the Company matched 100% of employees' salary deferral contributions up to 3% and 50% of employees' salary deferral contributions from 3% to 5% of employees' eligible compensation. The Company contributed \$890, \$711, \$2,551 and \$1,742 to the 401(k) plan for the three and nine months ended September 30, 2020 and 2019, respectively.

**Note 16—Related Party Transactions**

**Products and Services**

The Company is affiliated through common ownership by the Company's Chairman and Chief Executive Officer, with several other entities ("Affiliates"). Certain Affiliates incur (or previously incurred) costs related to the Company, including travel costs, certain senior management personnel costs, freight, and rent, the most significant of which is freight. The Company reimbursed \$0, \$2,646, \$0 and \$7,433 of freight incurred through an Affiliate during the three and nine months ended September 30, 2020 and 2019, respectively, which is included in cost of revenues—related parties. These costs incurred by Affiliates related to the Company are billed at actual cost to the Company by the Affiliates.

In addition, the Company paid one of the Affiliates \$0, \$355, \$0 and \$1,255 in management fees for the three and nine months ended September 30, 2020 and 2019, respectively, which is included in general and administrative expenses. These fees include charges relating to several individuals who provide senior leadership to the Company as well as certain other services. Certain of these individuals have been granted IBUs, which have resulted in equity-based compensation expense (see Note 12).

The Company purchased legal services from a law firm where a partner is an immediate family member of a director of the Company. Fees paid for services totaled \$1,761, \$311,000, \$4,305 and \$656,000 for the three and nine months ended September 30, 2020 and 2019, respectively.

The Company was party to a Strategic Supply Agreement with Align, a former equityholder of the Company, in which the Company had the option to purchase aligners from Align at a price that varies with the level of product purchased. While the majority of the Company's aligners were manufactured in-house, the Company did purchase aligners under this agreement during the first quarter of 2019. Additionally, the Company purchases oral digital imaging equipment from Align. For the three and nine months ended September 30, 2020 and 2019, purchases from Align of equipment were \$0, \$0, \$0 and \$6,025, respectively, and purchases of aligners included in cost of revenues—related parties were \$0, \$0, \$0 and \$7,659, respectively.

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**Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)**  
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In February 2019, the Company entered into an agreement with the David Katzman Revocable Trust (the “Trust”) to purchase all of the issued and outstanding membership units of a limited liability corporation (“SDC Plane”) owned by the Trust for a purchase price of approximately \$1,100, which was the Trust’s acquisition cost. SDC Plane owns an interest in an aircraft, which is available for use by its executives.

In February 2020, the Company completed the purchase of a private aircraft from Camelot SI Leasing, LLC, for \$3,400, the appraised value of the aircraft.

***Distribution Payable***

In August 2019, SDC Financial declared a distribution of \$43,400 less any amount determined to be due and payable to Align in connection with the current Align arbitration proceedings to the pre-IPO investors. Such distribution will be paid upon final determination of the outcome and amount payable, if any, in connection with such current arbitration proceedings. This amount is presented within other long-term liabilities on the accompanying condensed consolidated balance sheets.

**Note 17—Commitments and Contingencies**

***Legal Matters***

In the ordinary course of conducting its business, the Company is involved, from time to time, in various contractual, product liability, intellectual property, and other claims and disputes incidental to its business. Litigation is subject to many uncertainties, the outcome of individual litigated matters is not predictable with assurance, and it is reasonably possible that some of these matters may be decided unfavorably to the Company. In addition, the Company periodically receives communications from state and federal regulatory and similar agencies inquiring about the nature of its business activities, licensing of professionals providing services, and similar matters. Such matters are routinely concluded with no financial or operational impact on the Company.

From September to December 2019, a number of purported stockholder class action complaints were filed in the U.S. District Court for the Middle District of Tennessee and in state courts in Tennessee, Michigan and New York against the Company, members of the Company’s board of directors, certain of its current officers, and the underwriters of its IPO. The following complaints have been filed to date: Mancour v. SmileDirectClub, Inc., 19-1169-IV (TN Chancery Court filed 9/27/19), Vang v. SmileDirectClub, Inc., 19c2316 (TN Circuit Court filed 9/30/19), Fernandez v. SmileDirectClub, Inc., 19c2371 (TN Circuit Court filed 10/4/19), Wei Wei v. SmileDirectClub, Inc., 19-1254-III (TN Chancery Court filed 10/18/19), Andre v. SmileDirectClub, Inc., 19-cv-12883 (E.D. Mich. filed 10/2/19), Ginsberg v. SmileDirectClub, Inc., 19-cv-09794 (S.D.N.Y. filed 10/23/19), Franchi v. SmileDirectClub, Inc., 19-cv-962 (M.D. Tenn. filed 10/29/19), Nurlybayev v. SmileDirectClub, Inc., 19-177527-CB (Oakland County, MI Circuit Court filed 10/30/19), Sasso v. Katzman, et al., No. 657557/2019 (NY Supreme Court filed 12/18/19), Nurlybayev v. SmileDirectClub, Inc., No. 652603/2020 (Supreme Ct. N.Y. Cty. filed June 19, 2020). The complaints all allege, among other things, that the registration statement filed with the SEC on August 16, 2019, and accompanying amendments, and the Prospectus filed with the SEC on September 13, 2019, in connection with the Company’s initial public offering were inaccurate and misleading, contained untrue statements of material facts, omitted to state other facts necessary to make the statements made not misleading, and omitted to state material facts required to be stated therein. The complaints seek unspecified money damages, other equitable relief, and attorneys’ fees and costs. All of the actions are in the preliminary stages. The Company denies any alleged wrongdoing and intends to vigorously defend against these actions.

In December 2019, the Fernandez, Vang, Mancour and Wei Wei actions were consolidated and re-captioned In re SmileDirectClub, Inc. Securities Litigation, 19-1169-IV (Davidson County, TN Chancery Court). Plaintiffs filed a consolidated amended complaint on December 20, 2019, and Defendants moved to stay or dismiss the action on February 10, 2020. On June 4, 2020, the court denied that motion. Defendants subsequently moved for permission to seek an interlocutory appeal of that decision. On June 22, 2020, the court granted that motion. On August 3, 2020, Defendants filed an application for interlocutory appeal with the court of appeals, which was denied. On September 21, 2020, Defendants filed an application for interlocutory appeal with the Tennessee Supreme Court, which is fully briefed and remains pending.

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The Andre and Ginsberg actions were transferred to the U.S. District Court for the Middle District of Tennessee, where they were consolidated with the Franchi action. Plaintiffs filed a consolidated amended complaint on February 21, 2020, and Defendants moved to dismiss the action on March 23, 2020. That motion remains pending.

In the Nurlybayev action, on January 10, 2020, the Defendants moved to dismiss or stay the entire action in favor of the related actions pending in Tennessee, which motion was granted and the case was dismissed on February 26, 2020. On June 19, 2020, Plaintiff Nurlybayev filed a substantially similar action in New York state court. On August 21, 2020, Defendants filed a motion to dismiss that action, which is fully briefed and remains pending.

In the Sasso action, Plaintiff agreed to stay the action pending resolution of any motions to dismiss in any of the related actions. The Court so-ordered the parties' stipulation to that effect on January 22, 2020.

In November and December 2019 and March 2020, three stockholder derivative actions were filed against the members of the Company's board of directors, certain of the Company's current officers and related entities: Doris Shenwick Trust v. Katzman et al., C.A. No. 2019-0940-MTZ (filed Nov. 22, 2019); Harts v. Katzman et al., C.A. No. 2019-1027-MTZ (filed Dec. 23, 2019); and Sammons v. Katzman et al., C.A. No. 2020-0169-MTZ (Mar. 5, 2020). The three derivative actions were consolidated into In Re SmileDirectClub, Inc. Derivative Litigation, C.A. No. 2019-0940-MTZ (Delaware Chancery Court) and Plaintiffs filed a consolidated amended complaint on April 8, 2020. The Company denies any alleged wrongdoing and has moved to dismiss the action. Briefing on the motion to dismiss was completed on November 6, 2020. A hearing on the motion to dismiss is scheduled for February 17, 2021.

Some state dentistry boards have established new rules or interpreted existing rules in a manner that limits or restricts the Company's ability to conduct its business as currently conducted in other states or have engaged in conduct so as to otherwise interfere with the Company's ability to conduct its business. We have filed actions in federal court in Alabama, Georgia, and California against the state dental boards in those states, alleging violations by the dental boards of various laws, including the Sherman Act and the Commerce Clause. While a national orthodontic association has filed Amicus Briefs in support of the dental boards in both the Georgia and Alabama litigations and has filed a motion to do the same in California (which motion was denied), the FTC and DOJ have filed joint Amicus Briefs in support of the Company in both the Alabama and Georgia matters. The California matter was amended and an order of dismissal was entered on July 7, 2020. The Company filed notice of appeal on July 17, 2020 and expects oral argument in or around the first quarter of 2021. Both the Alabama and Georgia matters were then sent to the 11th Circuit Court of Appeals as a result of the dental boards in both states appealing the lower court's decisions. Oral argument before the 11th Circuit Court of Appeals occurred in the Georgia matter on May 20, 2020 and in the Alabama matter on July 8, 2020. The FTC and DOJ participated in oral arguments in support of the Company. The DOJ's antitrust chief presented in the Alabama matter. On August 11, 2020, the 11th Circuit Court of Appeals affirmed the Georgia district court's denial of the board members' motion to dismiss.

In September 2019, a putative class action on behalf of a consumer and three orthodontists was brought against the Company in the U.S. District Court for the Middle District of Tennessee, Ciccio, et al. v. SmileDirectClub, LLC, et al., Case No. 3:19-cv-00845 (M.D. Tenn.). The Plaintiffs assert claims for breach of warranty, false advertising under the Lanham Act, common law fraud, and various state consumer protection statutes relating to the Company's advertising. Following a proactive voluntary dismissal by the majority of consumer plaintiffs, one consumer has since sought to rejoin the Middle District of Tennessee litigation or, in the alternative, to intervene, which the Court granted. That ruling has been appealed, and a motion to stay the consumer claims is pending before the Court. Litigation is in the pleading stage and discovery as to the purported provider class has commenced. A preliminary Case Management Order has been entered setting trial for some time in March 2022. The Company denies any alleged wrongdoing and intends to defend against this action vigorously.

In March 2019, a final arbitration award was issued in an arbitration proceeding brought by the Company alleging that one of its former members, Align Technology, Inc., had violated certain restrictive covenants set forth in its operating agreement. The arbitrator ruled that Align had breached both the non-competition and confidentiality provisions of its operating agreement and that, as a result, Align was required to close its Invisalign Stores, return all of the Company's confidential information, and sell its membership units to the Company or certain of the Company's pre-IPO unitholders for an amount equal to the balance of Align's capital account as of November 2017. The arbitrator also extended the non-competition period to which Align is subject through August of 2022 and prohibited Align from using the Company's confidential information in any manner going forward. The Company is paying Align \$54,000,

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pursuant to a promissory note payable over 24 months through March 2021, in full redemption of Align's membership units pursuant to this ruling. The ruling has been confirmed in its entirety in the circuit court of Cook County, Chicago, Illinois, but Align continues to object to the purchase price and repurchase documentation despite the arbitration ruling and its confirmation, and has since filed a subsequent arbitration proceeding disputing the \$54,000 redemption amount and seeking an additional \$43,400. The parties have completed the discovery phase. The arbitration is set to commence on December 14, 2020.

***Tax Receivable Agreement***

As described in Note 8, the Company is a party to the Tax Receivable Agreement pursuant to which SDC Inc. is contractually committed to pay the Continuing LLC Members 85% of the amount of any tax benefits that SDC Inc. actually realizes, or in some cases is deemed to realize, as a result of certain transactions. The Company is not obligated to make any payments under the Tax Receivable Agreement until the tax benefits associated with the transactions that gave rise to the payments are realized. TRA Payments are contingent upon, among other things, (i) generation of future taxable income over the term of the Tax Receivable Agreement and (ii) future changes in tax laws. If the Company does not generate sufficient taxable income in the aggregate over the term of the Tax Receivable Agreement to utilize the tax benefits, then it will not be required to make the related TRA Payments. During the three and nine months ended September 30, 2020 and 2019, the Company recognized no liabilities relating to its obligations under the Tax Receivable Agreement, after concluding that it was not probable that the Company would have sufficient future taxable income over the term of the Tax Receivable Agreement to utilize the related tax benefits. There were no transactions subject to the Tax Receivable Agreement for which the Company recognized the related liability, as the Company concluded that it would not have sufficient future taxable income to utilize all of the related tax benefits.

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**Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)**  
**(in thousands, except share/unit data and per share/unit amounts)**

**Note 18—Segment Reporting**

The Company provides aligner products. The Company's chief operating decision maker views the operations and manages the business on a consolidated basis and, therefore the Company has one operating segment, aligner products, for segment reporting purposes in accordance with ASC 280-10, "*Segment Reporting*." For the three and nine months ended September 30, 2020 and 2019, a substantial majority of the Company's revenues were generated by sales within the United States and substantially all of its net property, plant and equipment was within the United States.

## Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes thereto included elsewhere in this Quarterly Report on Form 10-Q. In addition to historical consolidated financial information, the following discussion contains forward-looking statements that reflect our plans, estimates, and beliefs. Our actual results could differ materially from those discussed in any forward-looking statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this Quarterly Report on Form 10-Q, particularly in “Risk Factors.” See “Cautionary Statement Regarding Forward-Looking Statements.”*

We are an oral care company and creator of the first MedTech platform for teeth straightening. Through our cutting-edge teledentistry technology and vertically integrated model, we are revolutionizing the oral care industry, from clear aligner therapy to our affordable, premium oral care product line. Our mission is to democratize access to a smile each and every person loves by making it affordable and convenient for everyone. We are headquartered in Nashville, Tennessee and operate in the U.S., Costa Rica, Puerto Rico, Canada, Australia, New Zealand, United Kingdom, Ireland, Germany, Austria, Hong Kong, Singapore and Spain.

### Key Business Metrics

We review the following key business metrics to evaluate our business performance:

#### *Unique aligner order shipments*

For the three months ended September 30, 2020 and 2019, we shipped 93,301 and 106,070 unique aligner orders, respectively. Each unique aligner order shipment represents a single contracted member. We believe that our ability to increase the number of aligner orders shipped is an indicator of our market penetration, growth of our business, consumer interest, and our member conversion. Compared to the prior year, we experienced a decline in aligner sales due to the effects of COVID-19 on our business, however we increased aligner shipments by 63% from 57,136 when compared to the three months ended June 30, 2020 as our business shifted to impression kit conversions versus scans in reaction to the current environment.

#### *Average aligner gross sales price*

We define average gross sales price (“ASP”) as gross revenue, before implicit price concession and other variable considerations and exclusive of sales tax, from aligner orders shipped divided by the number of unique aligner orders shipped. We believe ASP is an indicator of the value we provide to our members and our ability to maintain our pricing. Our ASP for the three months ended September 30, 2020 and 2019 was \$1,794 and \$1,788, respectively. Our ASP is less than our standard price as a result of discounts offered to select members.

### Key Factors Affecting Our Performance

We believe that our future performance will depend on many factors, including those described below and in the section titled “Risk Factors” included in Part I, Item 1A. in our Annual Report on Form 10-K for the year ended December 31, 2019, and updated elsewhere in this Form 10-Q.

#### *COVID-19 pandemic*

We continue to navigate the uncertain and unprecedented economic and operating conditions resulting from the COVID-19 pandemic and its protracted duration. In response to COVID-19 and the related containment measures, we made the following operational changes to ensure the health and safety of our employees and our members: transitioned our employees, where possible, to a remote working environment; closed a portion of our SmileShops based on our real estate repositioning program as well as local public health guidelines and evolving customer behaviors and expectations; reconfigured our SmileShops to reduce customer overlap in the waiting area and require touchless temperature screening upon arrival; heightened the personal protective equipment protocol (“PPE”) requirements for our Smile Guides; reconfigured our production lines to observe social distancing; and implemented enhanced cleaning and sanitizing routines, thermal temperature screening, mandatory PPE protocols and other health and safety measures at our manufacturing facilities. We also enacted a resilience policy that provides our team



members paid leave for COVID-19 testing and up to two weeks of paid leave for any required self-quarantine due to the team member testing positive for COVID-19.

Additionally, we took the following actions in an effort to fortify the financial position of the business: reduced our marketing spend as a percentage of revenue; reduced our headquarters and retail workforce; secured the HPS Credit Facility; and initiated a real estate repositioning program.

Beginning in the second quarter, we performed a review of our real estate needs and initiated restructuring actions related to a real estate repositioning program that remains on-going. As a result of these changes, we incurred one-time charges of \$5.7 million and \$34.8 million during the three and nine months ended September 30, 2020, respectively, primarily associated with: the closure of our manufacturing facility in Kyle, Texas; the consolidation of several floors at our headquarters in Nashville, Tennessee; the closure and consolidation of many of our SmileShops; and the impairment of right of use assets and leasehold improvements at the closed SmileShops. Given the uncertain operating environment and the shift to work-from-home, we made the strategic decision to align our rent costs with the current needs of the business, while also ensuring that we have sufficient capacity to support future growth. We continue to evaluate our SmileShops and other properties to determine if we will further rationalize our footprint to better align with marketplace demand, including the direct and indirect effects of the COVID-19 pandemic. For a complete discussion of our restructuring actions, see “Note 5—Lease Abandonment, Impairment of Long-lived Assets and Store Closure and Other Related Charges” in the Notes to Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

We bolstered our business continuity plans to address the evolving and on-going operational challenges associated with COVID-19. Specifically, we have a crisis management team that meets regularly with the heads of all functional areas to monitor the regulatory environment and health and safety guidelines and to manage the corresponding changes and impacts to our business. Our technology platforms continue to support a majority work from home environment. Our demand forecasting process is integrated with our suppliers to allow us to maintain target inventory levels. This collaborative relationship also allows us to monitor the impact of COVID-19 on our suppliers, review their related action plans and confirm they meet our standards as well as public health guidelines.

We believe that our teledentistry platform is well suited for the current operating environment. Our impression kit offers the ability to begin treatment or obtain any necessary Touch-ups (mid-course corrections or refinements) remotely from home. During the COVID-19 pandemic, we experienced a customer shift towards impression kits, with approximately 60% of our clear aligner sales originating from impression kits in the third quarter. Although we cannot know or control the duration and severity of COVID-19 and its impact on our business, we will continue to focus on efficient acquisition of new members, controlled growth and international expansion, each as more specifically discussed below.

#### *Efficient acquisition of new members*

- *Visits to our website:* During the third quarter, we averaged approximately three to four million unique visitors to our website each month, and we expect to continue to invest in sales and marketing to spread awareness and increase the number of individuals visiting our website.
- *Conversions from visits to aligner orders:* From our website, individuals can either sign up for a SmileShop appointment, order a doctor prescribed impression kit or book an appointment at an affiliated dentist or orthodontist office, which we refer to as our “Partner Network”, to evaluate and ultimately purchase our clear aligner treatment. We expect to continue to invest heavily in our proprietary technology platform, operations, and other processes to improve member conversion from website visit through SmileShop and Partner Network appointment booking, appointment attendance, and aligners ordered; and a similar process for our impression kits.
- *Referrals:* During the third quarter, we made positive progress on our member experience with referrals reaching 23% of all orders. We expect to continue to invest in our member journey to improve our member experience and increase our member referrals.

#### *SmilePay*

We offer *SmilePay*, a convenient monthly payment plan, to maximize accessibility and provide an affordable option for all of our members. The \$250 down payment for *SmilePay* covers our cost of manufacturing the aligners, and the interest income generated by *SmilePay* helps offset the negative impact of delinquencies and cancellations. A number of factors affect delinquency and cancellation rates, including member-specific circumstances, our efforts in member service and management, and the broader macroeconomic environment.

#### *Continued investment in controlled growth*

We intend to continue investing in our business to support future growth by focusing on strategies that best address our large market opportunity, both domestically and internationally, and focus on cost discipline across the business. Our key growth initiatives include enhancing our existing product platform; introducing new products to further differentiate our offerings; expanding our customer acquisition channels; and expanding our presence in the teen demographic. Additionally, we are focused on continued advancement in automating and streamlining our manufacturing and treatment planning operations to allow us to stay ahead of consumer demand; continued discipline around marketing and selling investments, including a focus on pushing more demand through our existing SmileShop network and Partner Network, comprised of affiliated dentist and orthodontist offices, and leveraging our referrals, aided awareness, and customer acquisition strategies. We also intend to continue to develop a suite of ancillary products for our members' oral care needs, lengthening our relationship with our members and enhancing our recurring revenue base. As part of these key investment initiatives, we will also continue to explore collaborations with retailers and other third-party partnerships as a component of our expansion strategy.

#### *International expansion*

We will continue to make significant investments to expand our presence in international markets, particularly in Europe, Asia-Pacific and other geographies.

#### *Pace of adoption for teledentistry*

The rate of adoption of teledentistry will impact our ability to acquire new members and grow our revenue.

### **Components of Operating Results**

#### *Revenues*

Our revenues are derived primarily from sales of aligners, impression kits, whitening gel, retainers, and other oral care products, as well as interest earned on *SmilePay*. Revenues are recorded based on the amount that is expected to be collected, which considers implicit price concessions, discounts, and returns. Revenues include revenue recognized from orders shipped in the current period, as well as deferred revenue recognized from orders in prior periods. We offer our members the option of paying the entire cost of their clear aligner treatment upfront or enrolling in *SmilePay*, our convenient monthly payment plan requiring a down payment and a monthly payment for 24 months.

Financing revenue includes interest earned on *SmilePay* aligner orders shipped in prior periods. Our average APR is approximately 18%, which is included in the monthly payment.

#### *Cost of revenues*

Cost of revenues includes the total cost of products produced and sold. Such costs include direct materials, direct labor, overhead costs (occupancy costs, indirect labor, and depreciation), fees retained by doctors, freight and duty expenses associated with moving materials from vendors to our facilities and from our facilities to our members, and adjustments for shrinkage (physical inventory losses), lower of cost or net realizable value, slow moving product, and excess inventory quantities.

We manufacture all of our aligners and retainers in our manufacturing facilities. We continue to invest in automating our manufacturing and treatment planning operations, launching our second generation manufacturing at the end of the third quarter, which we believe will contribute to increased efficiencies going forward. We have built extensive supply chain mechanisms that allow us to quickly and accurately create treatment plans and manufacture aligners.

### *Marketing and selling expenses*

Our marketing expenses include costs associated with an omni-channel approach supported by media mix modeling (MMM) and multitouch attribution modeling (MTA). These costs include online sources, such as social media and paid search, and offline sources, such as television, experiential events, local events, and business-to-business partnerships. We also have comprehensive strategies across search engine optimization, customer relationship management (CRM) marketing, and earned and owned marketing. We have invested significant resources into optimizing our member conversion process.

Our selling costs include both labor and non-labor expenses associated with our SmileShops and costs associated with our sales and scheduling teams in our customer contact center. Non-labor costs associated with our SmileShops include rent, travel, supplies, and depreciation costs associated with digital photography equipment, furniture, and computers, among other costs.

### *General and administrative expenses*

General and administrative expenses include payroll and benefit costs for corporate team members, equity-based compensation expenses, occupancy costs of corporate facilities, bank charges, costs associated with credit and debit card interchange fees, outside service fees, and other administrative costs, such as computer maintenance, supplies, travel, and lodging.

### *Interest and other expenses*

Interest expense includes interest from our financing agreements and other long-term indebtedness. Other expense includes unrealized gains and losses on currency translation adjustments related to certain intercompany loan agreements between legal entities, disposal of long-lived assets, and other non-operating gains and losses.

### *Provision for income tax expense*

We are subject to U.S. federal, state, and local income taxes with respect to our allocable share of any taxable income of SDC Financial, and we are taxed at the prevailing corporate tax rates. In addition to tax expenses, we also incur tax expenses related to our operations, as well as payments under the Tax Receivable Agreement. We receive a portion of any distributions made by SDC Financial. Any cash received from such distributions from our subsidiaries will first be used by us to satisfy any tax liability and then to make any payments required under the Tax Receivable Agreement. See Note 9.

## **Adjusted EBITDA**

To supplement our consolidated financial statements presented in accordance with GAAP, we also present Adjusted EBITDA, a financial measure which is not based on any standardized methodology prescribed by GAAP.

We define Adjusted EBITDA as net loss, plus depreciation and amortization, interest expense, income tax expense, equity-based compensation, impairment of long-lived assets, abandonment and other related charges and certain other non-operating expenses such as one-time store closure costs associated with our real estate repositioning strategy, severance and other labor costs, and unrealized foreign currency adjustments. Adjusted EBITDA does not have a definition under GAAP, and our definition of Adjusted EBITDA may not be the same as, or comparable to, similarly titled measures used by other companies. We use Adjusted EBITDA when evaluating our performance when we believe that certain items are not indicative of operating performance. Adjusted EBITDA provides useful supplemental information to management regarding our operating performance and we believe it will provide the same to members/stockholders.

We believe that Adjusted EBITDA will provide useful information to members/stockholders about our performance, financial condition, and results of operations for the following reasons: (i) Adjusted EBITDA is among the measures used by our management team to evaluate our operating performance and make day-to-day operating decisions and (ii) Adjusted EBITDA is frequently used by securities analysts, investors, lenders, and other interested parties as a common performance measure to compare results or estimate valuations across companies in our industry. Adjusted EBITDA should not be considered in isolation from, or as a substitute for, financial information

prepared in accordance with GAAP. A reconciliation of Adjusted EBITDA to net loss, the most directly comparable GAAP financial measure, is set forth below.

### Results of Operations

The following table summarizes our historical results of operations. The period-over-period comparison of results of operations is not necessarily indicative of results for future periods, and the results for any interim period are not necessarily indicative of the operating results to be expected for the full fiscal year. You should read this discussion of our results of operations in conjunction with our consolidated financial statements and related notes thereto included elsewhere in this Form 10-Q.

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
	(unaudited)			
<b>Statements of Operations Data:</b>				
Total revenues	\$ 168,501	\$ 180,185	\$ 472,224	\$ 553,714
Cost of revenues	49,760	41,435	158,313	125,015
Gross profit	118,741	138,750	313,911	428,699
Marketing and selling expenses	66,722	131,263	243,564	340,409
General and administrative expenses	74,110	389,828	233,828	486,319
Lease abandonment and impairment of long-lived assets	3,960	—	28,593	—
Other store closure and related costs	1,714	—	6,190	—
Loss from operations	(27,765)	(382,341)	(198,264)	(398,029)
Total interest expense	15,555	4,291	29,627	11,682
Loss on extinguishment of debt	—	32	13,781	29,672
Other (income) expense	(1,028)	421	2,131	500
Net loss before income tax (benefit) expense	(42,292)	(387,085)	(243,803)	(439,883)
Income tax expense	1,190	479	1,745	596
Net loss	(43,482)	(387,564)	(245,548)	(440,479)
Net loss attributable to non-controlling interest	(30,892)	(299,268)	(176,909)	(352,183)
Net loss attributable to SDC Inc.	\$ (12,590)	\$ (88,296)	\$ (68,639)	\$ (88,296)
<b>Other Data:</b>				
Adjusted EBITDA	\$ 3,021	\$ (45,184)	\$ (84,249)	\$ (42,885)

The following table reconciles Adjusted EBITDA to net loss, the most directly comparable GAAP financial measure.

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
	(unaudited)			
Net loss	\$ (43,482)	\$ (387,564)	\$ (245,548)	\$ (440,479)
Depreciation and amortization	14,042	6,514	39,399	16,237
Total interest expense	15,555	4,291	29,627	11,682
Income tax expense	1,190	479	1,745	596
Lease abandonment and impairment of long-lived assets	3,960	—	28,593	—
Other store closure and related costs	1,714	—	6,190	—
Loss on extinguishment of debt	—	32	13,781	29,672
Equity-based compensation	10,972	324,497	38,189	332,759
IPO related costs	—	6,146	—	6,146
Other non-operating general and administrative (gains) losses	(930)	421	3,775	502
Adjusted EBITDA	\$ 3,021	\$ (45,184)	\$ (84,249)	\$ (42,885)

## *Comparison of the three and nine months ended September 30, 2020 and 2019*

### **Revenues**

Revenues decreased \$11.7 million, or 6.5%, to \$168.5 million in the three months ended September 30, 2020 from \$180.2 million in the three months ended September 30, 2019. The decrease in revenues was primarily driven by the impacts of COVID-19 on our operations. Customers have migrated from scans in SmileShops to impression kits at home, with approximately 60% of our clear aligner sales originating from impression kits in the third quarter. This compares to approximately 90% origination from scans and 10% from impression kits in a pre-COVID-19 environment.

Revenues decreased \$81.5 million, or 14.7%, to \$472.2 million in the nine months ended September 30, 2020 from \$553.7 million in the nine months ended September 30, 2019, primarily driven by the impacts of COVID-19 on our operations.

### **Cost of revenues**

Cost of revenues increased \$8.3 million, or 20.1%, to \$49.8 million in the three months ended September 30, 2020 from \$41.4 million in the three months ended September 30, 2019. Cost of revenues increased as a percentage of revenues from 23% in the three months ended September 30, 2019 to 30% in the three months ended September 30, 2020, as a result of COVID-19 related changes to the composition of our revenue mix. Specifically, we experienced an increase in retail sales of oral care products as a percentage of revenue, which represents a lower associated gross margin. Additionally, a higher percentage of our aligner sales were driven by impression kits compared to the prior period, which resulted in higher material and shipping costs.

Gross margin decreased to 70% in the three months ended September 30, 2020 from 77% in the three months ended September 30, 2019, primarily as a result of the factors described above.

Cost of revenues increased \$33.3 million, or 26.6%, to \$158.3 million in the nine months ended September 30, 2020 from \$125.0 million in the nine months ended September 30, 2019.

### **Marketing and selling expenses**

Marketing and selling expenses were \$66.7 million or 40% of revenue in the three months ended September 30, 2020 compared to \$131.3 million or 73% of revenue in the three months ended September 30, 2019. The decrease was primarily due to cost containment measures taken as a result of the effects of COVID-19 on our revenues, including more efficient marketing spend and realignment of our SmileShops to align with demand and operate at a higher utilization percentage driving margin improvement.

Marketing and selling expenses as a percentage of revenues decreased to 52% in the nine months ended September 30, 2020 from 61% in the nine months ended September 30, 2019.

### **General and administrative expenses**

General and administrative expenses decreased \$315.7 million, or 81%, to \$74.1 million in the three months ended September 30, 2020 from \$389.8 million in the three months ended September 30, 2019. The prior year period included equity-based compensation expense of approximately \$324.5 million and other employee related bonuses of \$6.1 million as a result of the IPO compared to equity-based compensation of \$11.0 million in the current period. Adjusting for IPO related costs, including equity compensation, for the current and prior period, general and administrative expenses increased \$3.9 million or 7% from \$59.2 million in the prior year quarter to \$63.1 million primarily due to the expansion of our team members and services to support our business growth prior to the COVID-19 outbreak as well as higher depreciation and amortization associated with investments in the business. As a percent of revenue, general and administrative expenses increased from 33% in the three months ended September 30, 2019 to 37% in the three months ended September 30, 2020, primarily as a result of the factors mentioned above.

General and administrative expenses decreased \$252.5 million, or 52%, to \$233.8 million in the nine months ended September 30, 2020 from \$486.3 million in the nine months ended September 30, 2019.

### ***Lease abandonment, impairment of long-lived assets and other related charges***

Lease abandonment, impairment of long-lived assets and other related charges were \$6.0 million and \$35.1 million in the three and nine months ended September 30, 2020, respectively, compared to \$0.0 million in both the three and nine months ended September 30, 2019. These charges are primarily associated with the closure of our manufacturing facility in Kyle, Texas; the consolidation of several floors at our Company headquarters in Nashville, Tennessee; the closure and consolidation of a portion of our SmileShops, which is an on-going evaluation; and the impairment of right of use assets and leasehold improvements at our closed SmileShops. We continue to evaluate our SmileShops and other properties to determine if we will further rationalize our footprint to better align with marketplace demand, including direct and indirect effects of the COVID-19 pandemic.

### ***Interest expense***

Interest expense increased \$11.3 million, or 263%, to \$15.6 million in the three months ended September 30, 2020 from \$4.3 million in the three months ended September 30, 2019, primarily as a result of both higher principal balances and interest rates in new facilities.

Interest expense increased \$17.9 million, or 154%, to \$29.6 million in the nine months ended September 30, 2020 from \$11.7 million in the nine months ended September 30, 2019.

### ***Other (income) expense***

Other (income) expense increased \$1.4 million to income of \$1.0 million in the three months ended September 30, 2020 from expense of \$0.4 million in the three months ended September 30, 2019, primarily as a result of the impact of unrealized foreign currency translation adjustments.

Other expense increased \$1.6 million to \$2.1 million in the nine months ended September 30, 2020 from \$0.5 million in the nine months ended September 30, 2019.

### ***Provision for income tax expense***

Our provision for income tax expense was \$1.2 million and \$0.5 million for the three months ended September 30, 2020 and 2019.

Our provision for income tax expense was \$1.7 million and \$0.6 million for the nine months ended September 30, 2020 and 2019.

### **Liquidity and Capital Resources**

As of September 30, 2020, SDC Inc. had an accumulated deficit of \$183.2 million and had working capital of \$432.9 million. Our operations have been financed primarily through net proceeds from the sale of our equity securities and borrowings under our debt instruments.

Our short-term liquidity needs primarily include working capital, international expansion, innovation, research and development, and debt service requirements. We believe that our current liquidity, including net proceeds received in connection with the IPO and our HPS Credit Facility, will be sufficient to meet our projected operating, investing, and debt service requirements for at least the next 12 months. Our future capital requirements may vary materially from those currently planned and will depend on many factors, including our levels of revenue, sales and marketing activities, the results of research and development and other business initiatives, the timing of new product introductions, and overall economic conditions including the effects of the COVID-19 pandemic. To the extent that current and anticipated future sources of liquidity are insufficient to fund our future business activities and requirements, we may be required to seek additional equity or debt financing. The sale of additional equity would result in additional dilution to our stockholders. The incurrence of additional debt financing would result in debt service obligations, and any future instruments governing such debt could provide for operating and financing covenants that would restrict our operations.

SDC Inc. is a holding company with no operations of our own and, as such, we depend on our subsidiaries for cash to fund all of our operations and expenses. We depend on the payment of distributions by our subsidiaries, and such distributions may be restricted as a result of regulatory restrictions, state and international laws regarding

distributions, or contractual agreements, including agreements governing indebtedness. For a discussion of those restrictions, see “*Risk Factors—Risks Related to Our Organization and Structure—We are a holding company. Our sole material asset is our equity interest in SDC Financial, and as such, we depend on our subsidiaries for cash to fund all of our expenses, including taxes and payments under the Tax Receivable Agreement.*” included in our Annual Report on Form 10-K for the period ending December 31, 2019. We currently anticipate that such restrictions will not impact our ability to meet our cash obligations.

#### Cash flows

The following table sets forth a summary of our cash flows for the periods indicated.

(in thousands)

	Nine Months Ended September 30,	
	2020	2019
Net cash used in operating activities	\$ (68,656)	\$ (192,015)
Net cash used in investing activities	(68,768)	(66,355)
Net cash provided by financing activities	192,011	492,004
Increase in cash and cash equivalents	54,587	233,634
Cash and cash equivalents at beginning of period	318,458	313,929
Cash and cash equivalents at end of period	\$ 373,045	\$ 547,563

#### Comparison of the nine months ended September 30, 2020 and 2019

As of September 30, 2020, we had \$373.0 million in cash, a decrease of \$174.5 million compared to \$547.6 million as of September 30, 2019.

Cash used in operating activities decreased to \$68.7 million during the nine months ended September 30, 2020 compared to \$192.0 million in the nine months ended September 30, 2019, primarily due to the increase in collections net of new sales in our accounts receivables which continues to perform well during the pandemic.

Cash used in investing activities increased to \$68.8 million during the nine months ended September 30, 2020, compared to \$66.4 million in the nine months ended September 30, 2019, primarily resulting from the purchases of manufacturing automation equipment and investments in technology and software equipment as well as international expansion to support our planned growth.

Cash provided by financing activities was \$192.0 million during the nine months ended September 30, 2020, compared to \$492.0 million in the nine months ended September 30, 2019. This decrease in cash provided by financing activities is primarily due to net proceeds received from the JPM Facility and IPO in the prior year period as compared to net proceeds received from the HPS Credit Facility in the current year period.

#### Tax Receivable Agreement

Our purchase of LLC Units from SDC Financial, coupled with SDC Financial’s purchase and cancellation of LLC Units from the Pre-IPO Investors in connection with the IPO and any future exchanges of LLC Units for our Class A common stock or cash are expected to result in increases in our allocable tax basis in the assets of SDC Financial that otherwise would not have been available to us. These increases in tax basis are expected to provide us with certain tax benefits that can reduce the amount of cash tax that we otherwise would be required to pay in the future. We and SDC Financial are parties to the Tax Receivable Agreement with the Continuing LLC Members, pursuant to which SDC Inc. is obligated to pay the Continuing LLC Members 85% of the cash savings, if any, in U.S. federal, state, and local income tax or franchise tax that SDC Inc. actually realize as a result of (a) the increases in tax basis attributable to exchanges by Continuing LLC Members and (b) tax benefits related to imputed interest deemed to be paid by SDC Inc. as a result of the Tax Receivable Agreement. The amounts to be recorded for both the deferred tax assets and the liability for our obligations under the Tax Receivable Agreement will be estimated at the time of an exchange of LLC Units. All of the effects of changes in any of our estimates after the date of the exchange



will be included in net income. Similarly, the effect of subsequent changes in the enacted tax rates will be included in net income. Because SDC Inc. is the managing member of SDC Financial, which is the managing member of SDC LLC, which is the managing member of SDC Holding, we have the ability to determine when distributions (other than tax distributions) will be made by SDC Holding to SDC LLC and by SDC LLC to SDC Financial and the amount of any such distributions, subject to limitations imposed by applicable law and contractual restrictions (including pursuant to our debt instruments). Any such distributions will then be distributed to all holders of LLC Units, including us, pro rata based on holdings of LLC Units. The cash received from such distributions will first be used by us to satisfy any tax liability and then to make any payments required under the Tax Receivable Agreement. We expect that such distributions will be sufficient to fund both our tax liability and the required payments under the Tax Receivable Agreement.

## **Indebtedness**

### *HPS Credit Facility*

On May 12, 2020, we and a wholly-owned special purpose subsidiary, SDC U.S. SmilePay SPV (“SPV”), entered into a Loan Agreement among SPV, as borrower, SmileDirectClub, LLC, as the seller and servicer, certain lenders, and HPS Investment Partners, LLC, as administrative agent and collateral agent, providing a five-year secured term loan facility to SPV in an initial aggregate maximum principal amount of \$400 million, with the ability to request incremental term loans of up to an additional aggregate principal amount of \$100 million with the consent of the lenders participating in such increase.

The proceeds of the HPS Credit Facility were used to repay all outstanding amounts under the previous JPM Credit Facility and for working capital and other corporate purposes.

Outstanding loans under the HPS Credit Facility bear interest at a variable rate equal to three-month LIBOR (subject to a 1.75% per annum floor), plus 7.50% per annum payable in cash, plus 3.25% per annum payable in kind or, at the Company’s election, wholly or partially in cash.

Subject to certain exceptions, the HPS Credit Facility is secured by first-priority security interests in SPV’s assets, which consist of certain receivables, cash, intellectual property and related assets. SPV’s obligations under the Loan Agreement are guaranteed on a limited basis by SmileDirectClub, LLC and SDC Financial LLC.

The HPS Credit Facility can be refinanced during the first year, provided that SPV would be required to pay the amount of interest that would have accrued during the remainder of the first year, plus 4% of the principal amount prepaid; and after the first year, for a fee of 4% of the principal amount prepaid, with the prepayment fee decreasing each year to 3% in the third year, 2% in the fourth year and 1% in the fifth year.

## **Off-Balance Sheet Arrangements**

We did not have any off-balance sheet arrangements during the periods presented.

## **Critical Accounting Policies and Estimates**

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which we have prepared in accordance with GAAP. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that impact the reported amounts. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition and equity-based compensation, among others. Each of these estimates varies in regard to the level of judgment involved and its potential impact on our financial results. Estimates are considered critical either when a different estimate could have reasonably been used, or where changes in the estimate are reasonably likely to occur from period to period, and such use or change would materially impact our financial condition, results of operations, or cash flows. Actual results could differ from those estimates. While our significant accounting policies are more fully described in Note 2 to our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q, we believe that the following accounting policy and estimates are most critical to a full understanding and evaluation of our reported financial results.

### **Revenue recognition**

As discussed in Note 2 to our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q, we adopted ASC 606, “Revenue from Contracts with Customers,” as of January 1, 2017 using the full retrospective method.

Our revenue is generated through sales of aligners, retainers, and other oral care products. Our aligner sales commitment contains multiple promises which may include (i) initial aligners, and (ii) Touch-up aligners. Our members are eligible for modified or refinement aligners, which we refer to as “Touch-up aligners,” at any point during their treatment plan or immediately following their original treatment plan (which is typically between five and ten months), in each case, upon the direction of, and pursuant to a prescription from, the treating dentist or orthodontist. Under ASC 606, we evaluate whether the initial aligners and Touch-up aligners represent separate or combined performance obligations. We have determined that these promises, within the aligner sales commitment, represent separate performance obligations.

The terms of the aligner and retainer sales include member rights to cancel the orders and return unopened aligner, impression kit, or retainer boxes for a refund of any consideration paid related to the returned products. The rights of return create variability in the amount of transaction consideration, and in turn, revenue we can recognize for fulfilling related performance obligations. We recognize revenue based on the amount of consideration to which we expect to be entitled, which excludes consideration received for products expected to be returned. Accordingly, we are required to make estimates of expected returns and related refund liabilities. We estimate expected returns based upon our assessment of historical and expected cancellations.

We offer our members the option of paying for the entire cost of their aligners upfront or enrolling in *SmilePay*, a convenient monthly payment plan that requires a \$250 down payment, with the remaining consideration due over a period up to 24 months. Approximately 65% of our members elect to purchase our aligners using *SmilePay*. The amount of contract consideration we estimate to be collectible from our *SmilePay* members results in an implicit price concession. We estimate the amount of implicit price concession based upon our assessment of historical write-offs and expected net collections, business and economic conditions, including the uncertainty of the lasting effects of the COVID-19 pandemic, and other collection indicators. We believe our analysis provides reasonable estimates of our revenues and valuations of our accounts receivable.

Revenue is recognized for Touch-up aligners when the promised goods are transferred to the member. Touch-up aligners represent a promise to transfer goods to members, and not all members order Touch-up aligners. We make our best estimate of Touch-up aligner member usage rates, which we use to determine the amount of revenue to allocate to those performance obligations at inception of our aligner sales commitment. Our process for estimating usage rates requires significant judgment and evaluation of inputs, including historical data and forecasted usages. Any material changes to usage rates could impact the timing of revenue recognition, which may have a material effect on our financial position and result of operations.

Amounts received prior to satisfying the above revenue recognition criteria are recorded as a contract liability in our historical consolidated balance sheets.

### **Equity-based compensation**

Prior to the IPO, we issued equity-based compensation awards to team members and non-team members through granting of incentive units. There have been no significant changes to this critical accounting policy which is disclosed in our Final IPO Prospectus.

Following the IPO, we have two types of equity-based compensation awards outstanding: Options and RSUs, including those issued pursuant to IBAs.

We account for equity-based compensation for team members in accordance with ASC 718, “Compensation-Stock Compensation.” In accordance with ASC 718, compensation cost is measured at estimated fair value on grant date and is included as compensation expense over the vesting period during which a team member provides service in exchange for the award.

We used the Black-Scholes Option Pricing Method to allocate the total equity fair value to outstanding Options. The Black-Scholes Option Pricing Method includes various assumptions, including the expected life of Options, the

expected volatility, and the expected risk-free interest rate. These assumptions reflect our best estimates, but they involve inherent uncertainties based on market conditions generally outside our control. As a result, if other assumptions had been used, equity-based compensation cost could have been materially impacted. Furthermore, if we use different assumptions for future grants, equity-based compensation cost could be materially impacted in future periods.

The fair value of RSUs is determined by our stock price on the date of grant and related compensation expense is generally recognized over the requisite service period.

#### ***Income tax expense***

SDC Inc. is the managing member of SDC Financial and, as a result, consolidates the financial results of SDC Financial. SDC Financial and its subsidiaries are limited liability companies and have elected to be taxed as partnerships for income tax purposes except for a subsidiary, SDC Holding, that is treated like a corporation. As such, SDC Financial does not pay any federal income taxes, as any income or loss will be included in the tax returns of the individual members. SDC Financial does pay state income tax in certain jurisdictions, and the Company's income tax provision in the consolidated financial statements reflects the income taxes for those states. Additionally, certain wholly-owned entities are required to be looked at on a stand-alone basis resulting in federal income taxes, and such federal income taxes are included in the consolidated financial statements.

We use the asset and liability method to account for income taxes and apply the principles of ASC 740, "Income Taxes," in determining when our tax positions should be recognized. Under this method, deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. If a net operating loss carryforward exists, we make a determination as to whether that net operating loss carryforward will be utilized in the future. A valuation allowance will be established for certain net operating loss carryforwards and other deferred tax assets where the recoverability is deemed to be uncertain. The carrying value of the net deferred tax assets is based upon estimates and assumptions related to our ability to generate sufficient future taxable income in certain tax jurisdictions. If these estimates and related assumptions change in the future, we will be required to adjust our deferred tax valuation allowances.

In connection with the Reorganization Transactions and the IPO, we entered into the Tax Receivable Agreement with certain of the Continuing LLC Members that provides for the payment by us of 85% of the amount of any tax benefits that SDC Inc. actually realizes, or in some cases is deemed to realize, as a result of (i) increases in SDC Inc.'s share of the tax basis in the net assets of SDC Financial resulting from any redemptions or exchanges of LLC Units, (ii) tax basis increases attributable to payments made under the Tax Receivable Agreement, and (iii) deductions attributable to imputed interest pursuant to the Tax Receivable Agreement (the "TRA Payments"). We expect to benefit from the remaining 15% of any of cash savings, if any, that we realize.

The amounts payable under the Tax Receivable Agreement will vary depending upon a number of factors, including the amount, character, and timing of the taxable income of SDC Inc. in the future. If the valuation allowance recorded against the deferred tax assets applicable to the tax attributes referenced above is released in a future period, the Tax Receivable Agreement liability may be considered probable at that time and recorded within earnings.

#### **Recent Accounting Pronouncements**

For a discussion of new accounting pronouncements recently adopted and not yet adopted, see Note 2 to our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

#### ***Interest rate risk***

Our cash and restricted cash consists primarily of an interest-bearing accounts at large U.S. banks with limited interest rate risk. We intend to maintain our portfolio of cash equivalents in a variety of investment-grade securities, which may include commercial paper, money market funds, and government and non-government debt securities. Because of the short-term maturities of our cash and cash equivalents and marketable securities, we do not believe that

an increase in market rates would have any significant negative impact on the realized value of our investments. At September 30, 2020, we held no investments in marketable securities.

In May 2020, we entered into the HPS Credit Facility in an initial aggregate maximum principal amount of \$400 million with the potential to borrow up to an additional \$100 million. Outstanding loans under the HPS Credit Facility bear interest at a variable rate equal to three-month LIBOR (subject to a 1.75% per annum floor), plus 7.50% per annum payable in cash, plus 3.25% per annum payable in kind or, at our election, wholly or partially in cash. As of September 30, 2020, we had \$404.6 million of outstanding borrowings under the HPS Credit Facility.

#### *Foreign currency exchange risk*

Historically we have operated primarily in the U.S. and substantially all of our revenue, cost, expense and capital purchasing activities for the nine months ended September 30, 2020 were transacted in United States dollars. As we are expanding our sales and operations internationally, we are more exposed to changes in foreign exchange rates. Our international revenue is currently predominantly from Canada and is denominated primarily in Canadian dollars, with a limited portion from Australia, New Zealand, the U.K., Ireland, Hong Kong, Germany, Austria, Singapore, and Spain, which are denominated in their local currencies. In the future, as we continue to expand into additional international jurisdictions, we expect that our international sales will be primarily denominated in foreign currencies and that any unfavorable movement in the exchange rate between U.S. dollars and the currencies in which we conduct foreign sales could have an adverse impact on our revenue. To minimize this risk, our expenses, other than manufacturing, are incurred in local currency to effectively create a natural hedge against currency risk.

A portion of our operating expenses are incurred outside the United States and are denominated in foreign currencies, which are also subject to fluctuations due to changes in foreign currency exchange rates. In particular, in our Costa Rican operations, we pay payroll and other expenses in Costa Rican colones. In addition, our suppliers incur many costs, including labor costs, in other currencies. To the extent that exchange rates move unfavorably for our suppliers, they may seek to pass these additional costs on to us, which could have a material impact on our gross margins. Our operating results and cash flows are, therefore, subject to fluctuations due to changes in foreign currency exchange rates. However, we believe that the exposure to foreign currency fluctuation from operating expenses is relatively small at this time as the related costs do not constitute a significant portion of our total expenses.

Our exposures to foreign currency risks may change as we continue to grow our international operations and could have a material adverse impact on our financial results. We may in the future hedge our foreign currency exposure and may use currency forward contracts, currency options, and/or other common derivative financial instruments to reduce foreign currency risk. It is difficult to predict the effect any future hedging activities would have on our operating results.

#### *Inflation risk*

Inflationary factors, such as increases in our cost of revenues, advertising costs and other selling and operating expenses, may adversely affect our operating results. Although we do not believe that inflation has had a material impact on our financial position or results of operations to date, a high rate of inflation in the future may have an adverse effect on our ability to maintain and increase our gross margin or to maintain current levels of selling, general, administrative and other operating expenses as a percentage of revenues if the selling price of our products do not increase with these increased costs.

#### *Credit risk*

We are exposed to credit risk through our *SmilePay* financing option. In the first half of 2020, approximately 69% of our members choose to finance their treatment through *SmilePay*. As of December 31, 2019, *SmilePay* amounted to approximately \$345.7 million in net receivables and an associated delinquency rate of 9%. As of September 30, 2020, *SmilePay* amounted to approximately \$302.0 million in net receivables and an associated delinquency rate of approximately 10% of revenue. We may experience an increase in payment defaults and uncollectible accounts due to, among other things, the uncertainty of the lasting effects of the COVID-19 pandemic on general economic conditions and consumer behavior, and may be required to revise our collection estimates, which would adversely affect our revenue and net loss.

#### **Item 4. Controls and Procedures**

##### **Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our CEO and CFO, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our CEO and CFO have concluded that as of September 30, 2020, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the SEC, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

##### **Changes in Internal Control over Financial Reporting**

We adopted ASU No. 2016-02, *Leases (Topic 842)* as of January 1, 2020 (see Note 2 and Note 6). As a result, we updated accounting policies affected by ASC 842 and modified internal controls over financial reporting related to ASC 842.

There were no other changes in our internal control over financial reporting (as defined in Rules 13a-15(d) and 15d-15(d) under the Exchange Act) during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

##### **Limitations on Effectiveness of Controls and Procedures**

In designing and evaluating the disclosure controls and procedures and internal control over financial reporting, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures and internal control over financial reporting must reflect the fact that there are resource constraints and that management is required to apply judgment in evaluating the benefits of possible controls and procedures relative to their costs.

## **PART II—OTHER INFORMATION**

#### **Item 1. Legal Proceedings**

[See Note 17 to our interim unaudited condensed consolidated financial statements.](#)

#### **Item 1A. Risk Factors**

*In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2019, as updated and supplemented below. However, the risks and uncertainties we face are not limited to those described in this report and in our Annual Report on Form 10-K. Additional risks and uncertainties not currently known to us or that we currently believe to be immaterial may also adversely affect our business, particularly given the rapidly evolving nature of the COVID-19 pandemic and containment measures, and the related impacts to economic and*

operating conditions.

***The COVID-19 pandemic and the measures implemented to contain the spread of the virus have had, and are expected to continue to have, a material adverse impact on our business, results of operations and cash flows.***

The emergence of the COVID-19 pandemic and the resulting containment measures have had, and we expect will continue to have, a material adverse impact on our business, results of operations and cash flows, the extent and duration of which depend on numerous evolving factors and future developments that we are unable to predict, including the duration, spread and severity of the outbreak; the nature, extent and effectiveness of containment measures; the immediate and long-term impact on the economy, unemployment, consumer confidence and consumer spending; and how quickly and to what extent normal economic and operating conditions can resume.

The COVID-19 pandemic and containment measures have contributed to certain negative impacts on our business, including, without limitation, the following:

- Decreased sales of our clear aligners, retainers and other products that we expect will continue throughout the remainder of 2020 and potentially beyond.
- Closed a portion of our SmileShops based on our real estate repositioning program as well as local public health guidelines and evolving customer behaviors and expectations.
- Decreased sales of our oral care product line as our retail partners experience disruption due to mandated or encouraged shelter-in-place and social distancing policies.
- Reduced consumer demand due to deteriorating economic and political conditions such as increased unemployment, decreased salary and wage rates, and decreased consumer confidence and consumer perception of economic conditions.
- Reduced marketing efforts, which has had and may continue to have negative impacts on our ability to increase demand and improve member conversion.
- Reduced a portion of our headquarters and retail workforce, which may result in an additional loss of key employees, that in turn may significantly delay or prevent the achievement of our business objectives, and further may negatively impact our ability to recruit and retain personnel in the future.
- Revised the timing of expansion into certain international markets due to delays in the regulatory approval process of certain foreign governments.
- Experienced increased order cancellations.
- Experienced increased payment deferral requests.

Additionally, due to the protracted nature of the COVID-19 pandemic, including the recent resurgence of COVID-19 infections, as well as the evolving regulatory environment, our business and financial results may be adversely effected by numerous evolving factors, many of which we cannot control or predict, including, without limitation, our ability to:

- Manage a new work environment, including our internal controls and financial reporting, as a substantial portion of our headquarters team members are currently working remotely.
- Re-open and operate SmileShops in compliance with both voluntary and mandated health and safety protocols; and correspondingly, our customers' willingness to visit and have confidence in the process of our SmileShop experience.
- Process and manufacture impression kits at a volume higher than historical levels.
- Gauge the impact of COVID-19 and related potential disruptions to the operations of our suppliers, freight carriers and retail partners, including social and economic constraints, tariffs and trade barriers, facilities closures, labor instability, and capacity reduction.
- Anticipate the potential for increased defaults on our SmilePay financing plan, including the potential for an increase in our delinquency rates and number of uncollectible accounts, as the economic impacts of COVID-19 intensify.
- Estimate or forecast the financial impact of the COVID-19 pandemic on our actual or future results.

The above impacts of the COVID-19 pandemic and containment measures are likely to continue, and in some

instances, may worsen. The duration and severity of the pandemic may also heighten other risks described in the “Risk Factors” section in our Annual Report on Form 10-K for the year ended December 31, 2019. The full extent to which the COVID-19 pandemic will negatively affect our business, results of operations and cash flows is not yet known, cannot be predicted and may continue even once the pandemic is controlled and containment measures are lifted.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Not applicable.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

Not applicable.

## Item 6. Exhibits

### Exhibit Index

<u>Exhibit No.</u>	<u>Exhibit Description</u>
31.1	<a href="#">Certification of Principal Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>
31.2	<a href="#">Certification of Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>
32.1†	<a href="#">Certifications of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed herewith.

† The certifications attached as Exhibit 32.1 that accompany this Quarterly Report on Form 10-Q are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of the Registrant under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Quarterly Report on Form 10-Q, irrespective of any general incorporation language contained in such filing.



## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SMILEDIRECTCLUB, INC.

(Registrant)

November 16, 2020

Date

/s/ Kyle Wailes

Kyle Wailes

Chief Financial Officer

*(Principal Financial Officer)*

November 16, 2020

Date

/s/ Troy Crawford

Troy Crawford

Chief Accounting Officer

*(Principal Accounting Officer)*

**Management Certification Pursuant to  
Section 302 of the Sarbanes-Oxley Act of 2002**

I, David Katzman, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of SmileDirectClub, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) [Paragraph omitted in accordance with Exchange Act Rule 13a-14(a)];
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 16, 2020

/s/ David Katzman

David Katzman  
Chief Executive Officer  
*(Principal Executive Officer)*

**Management Certification Pursuant to  
Section 302 of the Sarbanes-Oxley Act of 2002**

I, Kyle Wailes, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of SmileDirectClub, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) [Paragraph omitted in accordance with Exchange Act Rule 13a-14(a)];
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 16, 2020

/s/ Kyle Wailes

Kyle Wailes

Chief Financial Officer

*(Principal Financial Officer)*

**Certification of CEO and CFO Pursuant to  
18 U.S.C. Section 1350,  
as Adopted Pursuant to  
Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report on Form 10-Q of SmileDirectClub, Inc. (the "Company") for the quarterly period ended September 30, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), David Katzman, as Chief Executive Officer of the Company, and Kyle Wailes, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 16, 2020

/s/ David Katzman

David Katzman  
Chief Executive Officer  
*(Principal Executive Officer)*

/s/ Kyle Wailes

Kyle Wailes  
Chief Financial Officer  
*(Principal Financial Officer)*