

ASX Announcement

ASX Code: AEF
Date: 19 October 2007

Shareholder Newsletter

Please find attached a copy of a shareholder newsletter that will shortly be distributed to Australian Ethical's shareholders.

/end.

Company Background

Australian Ethical is a funds manager that specialises exclusively in ethical funds management. It offers managed investment schemes and corresponding superannuation strategies (for accumulation and pension accounts). The Australian Ethical Charter is the foundation of the investment process. It aims to avoid harmful investments and actively seeks investments that benefit society and the environment. Uniquely, the company's constitution requires that 10% of profit is donated to charitable and conservation initiatives.

October 2007

Chair's report

An excellent year and a sound outlook

The board is pleased to report that the Australian Ethical Investment group has had another strong year in terms of profit and growth in funds under management, with a record dividend declaration of \$1.92 per share. The growth in return to our shareholders has been achieved without any compromise to our deep green investment strategy or our commitment to the Australian Ethical Charter. Our balance sheet remains strong with the ability to finance our change in superannuation administrator and to extend our marketing reach over 2008 as discussed over the page.

Climate change

In 2007 we have seen climate change become a mainstream concern. While overdue, this concern is positive for focusing consumer, government and corporate attention. Perhaps the Stern report of October 2006 created the tipping point in climate change awareness when it stated that 'climate change is the greatest and widest ranging market failure ever seen'. More positively, it reports that the benefits of strong, early action considerably outweigh the costs.

Australian Ethical has for a long time been a major investor in companies that are helping to prevent climate change.

World Trust

After many years with an unchanged product offering, we launched a new retail product, the Australian Ethical World Trust, in July. The World Trust aims to provide investors with long-term growth through investment in overseas companies which meet our Charter. The World Trust enables investors to support a wide range of socially and environmentally attractive activities that are not available for investment in Australia. Providing a specialised international product gives investors more choice in achieving an ethical and appropriately diversified investment strategy.

The World Trust makes its investments through our new international wholesale trust, the Australian Ethical International Equities Trust.

Staff and management worked very hard to launch the new products on time, and the board has been pleased with interest in the World Trust to date.

Trevor Pearcey House

In March 2007, we moved into our refurbished premises at Block E Trevor Pearcey House in the Canberra suburb of Bruce.

The refurbishment is a significant statement to the commercial building sector of how energy and resource intensity can be significantly reduced with appropriate forethought. The fact that the building is a refurbishment rather than a new building demonstrates that the existing cohort of conventional commercial buildings can be reworked to produce better environmental and productivity outcomes. An application has been lodged with the Green Building Council of Australia for a Green Star rating. So far our building has won two prizes – a highly commended in the United Nations Association of Australia World Environment Day Awards and the Commercial Winner and Overall Winner in the Keep Australia Beautiful ACT Sustainable Cities Awards.

Community grants

Our company's growing profits means greater returns to the community through our community grants program. The 2006–07 record profit translates into a grant of \$225 000. In 2007, for the first time, a major project grant of \$50 000 was made to The Australia Institute. The Institute will develop teaching materials on climate change for secondary schools. We chose to support this major project as it ties in with our charter commitment to education, the environment and to achieving long term positive change in society.

Our commitment to supporting grass roots community groups also continues. In 2007 grants were made to 40



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organisations involved in a wide range of conservation and charitable activities in Australia and overseas.

Corporate governance

The board has focused considerable effort in strengthening our company's corporate governance. With the departure of Pauline Vamos to take on a full-time role at ASFA, we have initiated a major review of our corporate governance at board level, including:

- actively seeking at least one additional independent director;
- a skills audit of current and prospective directors;
- performance assessments of current directors;
- investigating ways to improve board, committee and management function;
- a continuing commitment to our stated objective of achieving a majority of independent directors, assuming the availability of suitable candidates.

Year ahead – strategic plans

In March 2007, the board and senior management conducted a review of the Australian Ethical group's strategy. As a result of this review, we are aiming to broaden

our marketing reach beyond our traditional support base. Strategies are in place to target a more mainstream retail market and the associated adviser distribution channels. Greater resources will also be allocated to attracting institutional investment. This is a new direction in terms of our marketing effort, but not in terms of our commitment to being Australia's most ethical and deep green fund manager.

I am very much looking forward to my new role as chair. The staff, management and board of Australian Ethical are hard working, innovative and passionate about our group's goals. It is an exciting time for the group as we push to implement our growth strategies. Wise use of the planet's resources has never been more important, and by growing our customer base and our funds under management we will contribute positively to this goal.



Naomi Edwards
Chair

Grants to community organisations

\$6600 \$10 000 \$50 000

Major project grant

The Australia Institute: teaching materials on climate change for Australian schools

National Trust of Australia (ACT) – St John's Church Heritage Conservation Fund: conservation of the Golden Sun Moth and its habitat
Engineers Without Borders
Friends of the Earth Australia: anti-nuclear campaigns

ACT Eden-Monaro Cancer Support Group
Barefoot Economy
Australian Marine Conservation Society
Camp Quality
Australians for Disability and Diversity Employment
Pedal Power ACT
WIRES (NSW Wildlife Information, Rescue and Education Service)
Bicycle Federation of Australia
NRMA CareFlight
WaterAid Australia

\$2900

Aid/Watch
Animal Liberation NSW
Animals Asia Foundation (Australia)
Asylum Seeker Resource Centre
Australian Crohn's & Colitis Association
Australian Drug Foundation
Canberra Environment and Sustainability Resource Centre
Chrysalis Insight Incorporated
Conservation Council south east region and Canberra
Edgar's Mission
Fair Trade Association of Australia and New Zealand
Head High
Hepburn Wildlife Shelter
HopeStreet Urban Compassion
International Women's Development Agency
Kids Under Cover
Mineral Policy Institute
National Parks Association of New South Wales
Rainforest Rescue
Respite Care Bega Valley
New Internationalist Publications
Prison Fellowship Australia (Victoria)
Vulcana Women's Circus
Darling Range Wildlife Shelter
Marine Stewardship Council (Asia Pacific)
The Friends of Oolong
Wildlife Preservation Society of Queensland

Chief Executive's report



The Australian Ethical Investment group continued to perform strongly in the second half of the 2006–07 financial year. I am very pleased to report a consolidated net profit of \$1 819 177. This trading result represents an increase of 34% over the previous financial year's net profit of \$1 362 612. The result continues the group's trend of an increased profit every

year since 2003.

Growth in funds under management was again strong with good investor inflow and positive returns from investments. At 30 June 2007, funds under management, after a distribution of \$59 million, stood at \$552 million.

Increasing funds under management is essential for the company as it results in increased revenue and assists in building economies of scale. The company's cost to income ratio continues to fall with a decrease from 77.4% in 2005–06 to 76.1% in 2006–07. This is a particularly pleasing result given the increased employment costs we have experienced. As a result of the improved profit, return on equity has increased from 24.1% to 26.1%.

The continued success and growth of our business is dependant on the performance of the Australian Ethical trusts. 2006–07 saw solid returns across all of the Australian Ethical trusts. The Australian Ethical Equities Trust was the star performer with a return of 36.9%, buoyed by a strong performance from its small company investments. The other three Australian Ethical trusts also performed strongly against their peer groups. The Australian Ethical World Trust was launched in July 2007 and we have been pleased with the response to date. We remain committed to investing in quality companies taking into account ethical, governance and financial strength and ensuring our returns are commensurate with the risk profile of the individual trust.

Historically the Australian Ethical Retail Superannuation Fund has experienced significant and steady growth. This strong growth continued during the financial year as people took advantage of choice of fund and recent changes to legislation.

Last year the directors took the decision to retain some of the profits to invest in the future growth of the company and to rebuild liquidity following the purchase of Block E Trevor Pearcey House. These aims have now been achieved. Mindful of the significant franking credits held by the company, the directors have decided that shareholders will be paid a final dividend (fully franked) of \$1.52 per ordinary share. Added to the interim dividend of 40 cents per share,

the total dividend for the 2006–07 financial year will be \$1.92 per share, an increase of 126% over the previous year.

As many of you would be aware we refurbished Block E of Trevor Pearcey House to meet high standards of energy efficiency and to provide our staff with a comfortable and productive working environment. We are now well settled into our new home and I am pleased to advise it is everything we hoped for in terms of amenity and resource efficiency.

Outlook

As previously flagged, we are keen to attract increased non-retail investment and are working through strategies which will allow us to do this better. Rest assured this will not be at the expense of our existing retail customers who continue to be great supporters of the Australian Ethical trusts.

The share market can be a volatile creature. This has been amply demonstrated in recent months by the reaction of global financial markets to the poor lending practices of American sub-prime mortgage providers. Australian Ethical does not invest in any sub-prime mortgage debt in our fixed interest portfolio. We have no obvious exposure to 'at risk' issuers of sub-prime mortgages. However, sharp movements in markets inevitably affect investor sentiment and it seems likely that we are yet to see the full extent of the fallout from these problems. Other challenges facing the company include keeping investors informed about how the volatility of markets affects their savings and finding and retaining talented staff in Canberra's tight labour market.

We have made considerable progress in attaining greater efficiencies in our business. The transfer of trust assets to a single custodian is largely complete. We plan to transition the administration of the superannuation fund to a new service provider in 2008. This move will have a significant impact in reducing the cost of that service in future years and enabling an improvement in service standards.

Funds under management stood in excess of \$600 million in early September 2007 but recent volatility has taken a toll on capital growth and it has not been as strong as we would have liked. Management and the board have put considerable effort into developing a marketing strategy to attract new inflows and we are hopeful this will produce long-term results. In the mean time I am cautiously optimistic about our outlook for the current year.

I would like to thank all the staff for their work in achieving yet another great result. I would also like to thank you our shareholders for your on-going support and I look forward to seeing you at the annual general meeting on 22 November.

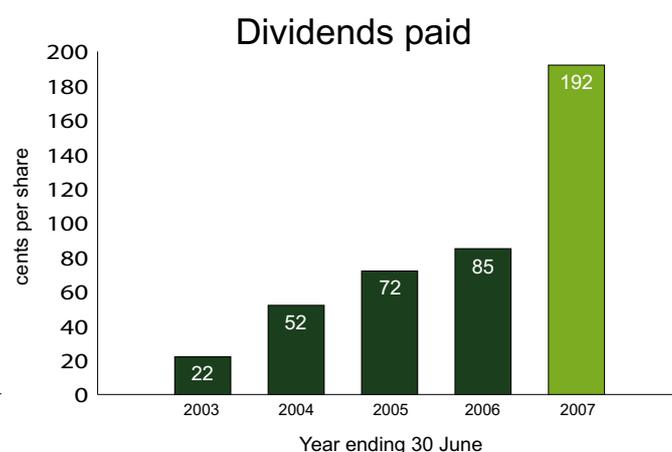
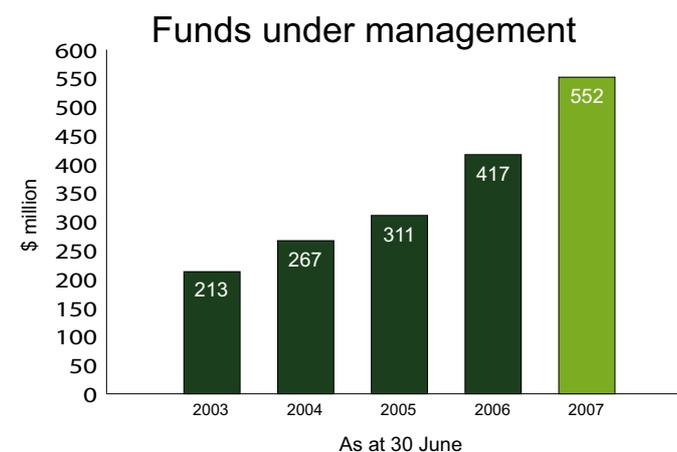
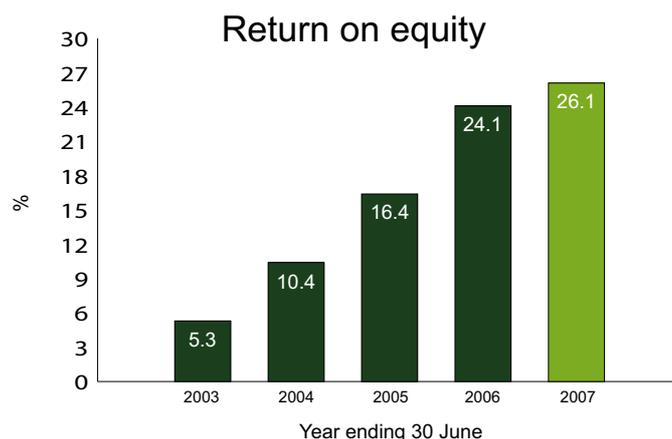
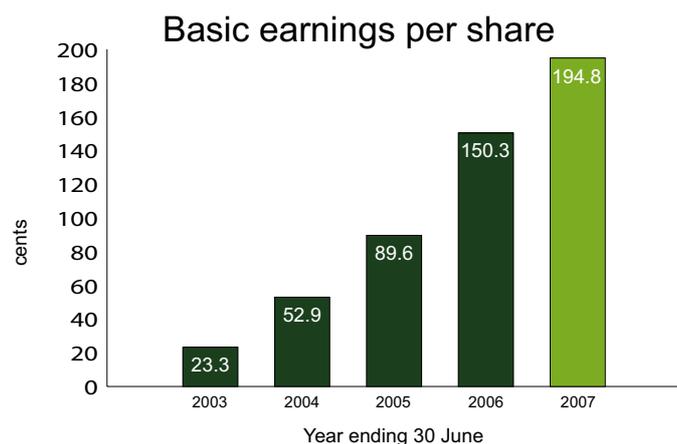
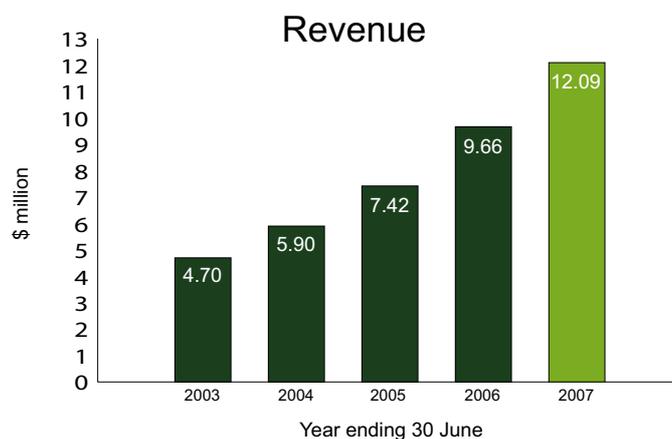
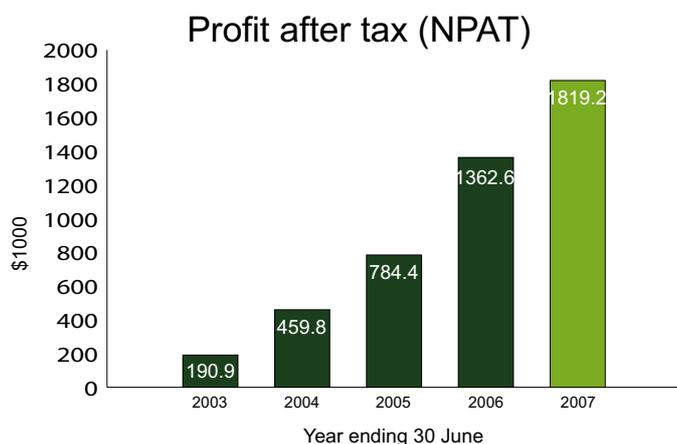
A handwritten signature in black ink, appearing to read 'Anne O'Donnell'. The signature is fluid and cursive, with a large initial 'A' and 'O'.

Anne O'Donnell
Chief Executive Officer

Financial summary

to 30 June 2007

as at	30 June 2007	30 June 2006	30 June 2005	30 June 2004
Current assets (\$'000)	5 174	5 176	5 833	5 074
Non-current assets (\$'000)	4 879	3 103	701	517
Current liabilities (\$'000)	2 293	1 928	1 456	974
Non-current liabilities (\$'000)	76	77	31	75
Net assets (\$'000)	7 684	6 274	5 047	4 542



2005 figures in the above tables and graphs have been adjusted where necessary as for first time adoption of Australian equivalents to International Financial Reporting Standards (AIFRS).

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