



# Australian Ethical Shareholder Update

*March 2014*

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# Managing Director's Report

*Dear shareholder,*

We're very pleased to write to you with our half yearly update for the six months to 31 December 2013. The company is performing well in a number of areas with many of the improvements we've been implementing over the past few years bearing fruit. We've had strong performance in areas of financial performance, new business, investment performance and advocacy.

## *Significant Improvement in Profits*

Our profits for the period have improved significantly compared to the prior corresponding period, increasing by 150%. Underlying profit (profit adjusted to remove abnormal items) increased by 170%. This improvement in profits was due to investment returns, significant improvement in our net fund flows (higher inflows and less outflows) and continued management of our costs.

Revenues increased by 25.9% as a result of improved funds under management. Operating expenses<sup>1</sup> increased by 9.1%. Employment costs increased by 9.2% and included the costs of one-off redundancies following the substantial reduction of our Canberra operations.

## *Growth in Funds Under Management*

Funds under management were a record \$801.7m as at 31 December 2013, increasing \$94.1m during the period. This growth was due to both increases in market value due to fund returns (\$60.6m) and net inflows (\$33.5m).

## *Increase in New Business*

Our new business has improved dramatically over the past year.

### **Investment in online engagement**

Our investment in our digital communications and social media platforms provides an extremely effective and efficient means of building awareness and communicating with the ethically conscious investment community. The platforms (which include our website, social media as well as our Good Money magazine) are used not just for one way communication, but a highly interactive means of engaging with our community. The ability to communicate through networks provides a low-cost means of building awareness of Australian Ethical's activities.

There are four measures of the success of our social media strategy that are worth highlighting:

- Our "followers" – our number of Facebook fans is now 10,000. By way of comparison, the largest superfund in the country with around 2 million members has under 6,000.
- Our "engagement" rate – our engagement (those talking about the brand as a percentage of total "likes") averages around 30% compared to a typical financial services firm that average 5%. In fact, our engagement rate is higher than most consumer and media brands in Australia.
- Peer recognition – the team was recently recognised by their peers taking out the Best Use of Social Media Award at the inaugural ASFA Marketing Communications Awards (ASFA is the Association of Superannuation Funds of Australia, the peak industry body for the superannuation industry in Australia).
- Our results – our digital presence has not only increased the flow of traffic to our website but has helped to significantly increase our net flows.

<sup>1</sup> Operating expense comprise expenses that the Company has incurred as a result of performing its normal business operations.

### Dramatically improved new client sign-ups

Our new client sign-ups averaged 275 individuals per month over the period, across all products. This was a record rate of acquisition and compares to an average of 120 per month in the prior corresponding period. In addition, the number of new employers registering to use our super fund was four times that of the previous corresponding period.

We attribute the increase in new client joins to steadily increasing brand awareness through: more sophisticated, effective and targeted marketing; investment in efficient digital communication as described above; improvements to our website and its effectiveness in turning prospective clients into clients; and improved sales and client relationship management.

### Dramatically improved net inflows

Net inflows have also improved to \$33.5m during the period compared to net outflows of \$3.2m in the prior period. This was made up of net inflows to super of \$27.6m and net inflows to managed funds of \$5.9m (prior period was net inflows of \$9.5m and net outflows of \$12.7m respectively).

We attribute the improvement in flows to be due to improved sales and marketing efforts highlighted above, a return of investor confidence in equity markets that has driven industry flows into managed funds and away from term deposits and improved confidence in our products following fee reductions and other changes over the past few years.

### Investment performance

The investment performance of our funds continues to be strong over the long term with most of them performing in line with or above the median fund in their relevant Mercer survey. In the December survey, our Larger Companies Trust was ranked 3rd over one year and 2nd over two years in its category.

The long-term performance of our flagship Smaller Companies Trust remains well above benchmark returning 6.4% per annum (net of fees) for the last 7 years, ranking it 1st in the Australian Equity (All Caps) Mercer Survey.

### Advocacy/divestment initiatives

One of Australian Ethical's goals is to generate and disseminate information regarding standards of corporate behaviour and to engage in dialogue with the corporate sector as their activities directly relate to the Australian Ethical Charter.

We view active shareholder ownership and advocacy as the responsibility of ethical investors and key to creating positive, sustainable change. The growing collaboration between like-minded groups on key issues will have a dramatic impact on future corporate behaviour and performance in Australia and around the world.

#### Corporate Advocacy/Divestment

A core aspect of how we aim to influence behaviour in others is through our engagement and advocacy activities with the companies we invest in. If we don't get the behaviour change we wish we will divest. We have recently had two achievements recently on this front:

- Lend Lease – we've been long term investors in Lend Lease and they've been strong sustainability advocates for many years. We were extremely disappointed when they were considering a contract in relation to the Abbott Point coal terminal in the Great Barrier Reef. Together with other activist organisations we advocated strongly against their involvement and they recently announced they were not proceeding, a great outcome. Whilst a range of factors influenced their decision, pressure from investors in these situations makes a big difference.
- Petratherm – we've also been long term investors in Petratherm, a company that has been focussed on the development of geothermal energy technologies. Last year they announced that they would be conducting oil and gas exploration in Tasmania. So we divested. If you haven't read the article on the website you can view it here <http://www.australianethical.com.au/news/petratherm-wrong-kind-drilling>

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## Legislative advocacy

We are also active in campaigning in respect of key areas of concern and encouraging our clients and followers to do likewise. Areas of activity include:

- **Submission to NSW Environmental Protection Agency regarding the burning of native forest waste to generate electricity (August 2013)**

We strongly oppose proposed amendments to current NSW laws to allow the burning of logging waste from native forests to generate electricity and lodged a submission.

- **Submission to Government opposing the repeal of the Carbon Price legislation (October 2013)**

We strongly oppose the repeal of the carbon price. In addition to this submission we also created an easy-to-use form that anyone could use, to make their own submission, using our template but also including a personal message. We raised awareness via social media and over 700 people made a submission.

- **Submission to Government with respect to the Emissions Reduction Fund and Direct Action on Climate Change (February 2014)**

Whilst we welcome any action on climate change we do not believe the Government's Emissions Reduction Fund will be adequate and will fall well short in achieving Australia's 5% emissions reduction target. We lodged a submission and also provided a template for others to use.

## *Becoming a B Corporation*

We have recently earned certification as a registered B Corporation. B Corporations (short for Benefit Corporation) are a growing global movement dedicated to using the power of business to solve social and environmental problems. Certification is evidence of meeting high standards of social and environmental performance. Australian Ethical is the first publicly listed company in Australia to be certified and one of only a few worldwide.

What makes Australian Ethical special is the impact we make in the world across all aspects of our business – our investment activities, our community grants program, the influence we have on our clients through communications platforms

and directly through our corporate activities (for example our advocacy work). It's our belief that if every company, large or small, operated in a similar way the world would be a significantly better place and many of the world's challenges would be solved. It's a case of leading by doing.

Whilst the concept of B Corporations is not yet well known – and we aim to help to change that – the principles align precisely with our values and it's a means of communicating and promoting our beliefs and having influence on others.

## *Purchase of Ethical Investor*

As part of our digital content strategy, we recently purchased Ethical Investor. Ethical Investor has been a respected source of industry news and information for over 10 years. Previously it produced a print magazine, however over the last two years its focus has been online content, distributed via a fortnightly eNewsletter.

We plan to refresh the website and newsletter, increase engagement with subscribers and build the subscriber base. Having a non-branded or semi-branded channel for content is an emerging marketing strategy that has been implemented successfully by a number of leading financial services companies.

## *Product development*

### **MySuper approval**

On 16 September 2013 we received approval to offer a MySuper product from APRA. This authorisation allows us to accept employer super contributions where the employee has not made a choice of funds. This is a key aspect to our strategy of being the default superfund of choice for ethical employers.

### **Launch of Ethical Fixed Interest Trust**

In December we launched the Fixed Interest Trust, which offers investors an opportunity to generate income from a portfolio of ethical diversified interest-bearing investments. It is the first ethically screened managed fund available to Australian retail investors that invests in longer term bonds.

The Fixed Interest Trust avoids debt issued by State Governments that provide undue support to mining and old growth forest logging or that own coal fired power assets. It is competitively priced for retail and wholesale investors.

## *Fee competitiveness*

We have discussed in previous newsletters the need to charge more competitive fees on our products. More competitive fees will allow us to grow and have greater influence and impact on furthering our mission. We aim to bring our fees more in line with market within a reasonable timeframe with a view to maintaining the sustainability of the business. When assessing competitiveness we take account of the extent of active ethical screening and engagement with investee companies that we conduct compared to others.

## *Sustainability Awards*

We won two major awards in late 2013. The first award from the Banksia Foundation, a respected not-for-profit that recognises environmental and business excellence, was for 'Leading in sustainability – Setting the standard for a Small to Medium Business'. The second award was from leading consumer publication, Green Lifestyle, who recognised Australian Ethical for their excellence as a 'Sustainable Large Business (over 15 employees)'.

## *New appointment – Head of Ethics*

We recently appointed Dr Stuart Palmer in the role of Head of Ethics and Corporate Advocacy. Stuart comes to us from the St James Ethics Centre where he has headed "The Practice" for the past three years. The Practice delivers the Ethics Centre's consulting services and leadership and learning programs including advising organisations on the implementation of ethical frameworks within their business to motivate and guide their people and support reasoned, consistent, and objective decision making.



**Phillip Vernon**  
Managing Director

28 February 2013

Prior to joining St James Ethics Centre, Stuart has been a Partner of a law firm working in the areas of funds management and capital markets, has worked in Investment Banking and has worked as a Director and consultant whilst obtaining his PhD.

Stuart's role will include working with the company's ethical consultants CAER and the investment team to further develop the company's ethical investment frameworks, which govern the way Australian Ethical interprets its Ethical Charter. He will also manage corporate advocacy, whereby companies are encouraged to improve their ethical behaviour across a number of issues.

Stuart brings a strong mix of the practical application of ethics, commercial and market experience and critical thinking required for the role.

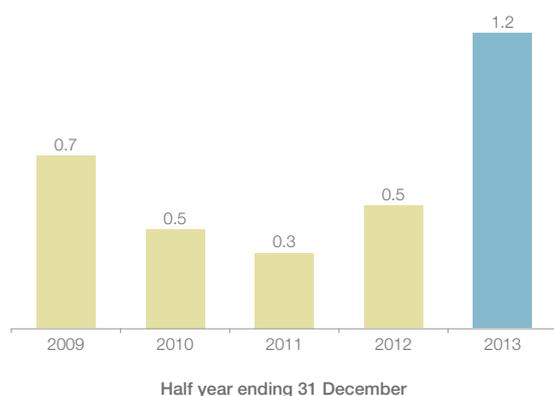
His skills and experience will be invaluable in navigating the complex issues that arise, ensuring that our corporate and investment decision making remain true to our Ethical Charter, serving all of our stakeholders including shareholders, superannuation fund members, managed fund investors and the community at large.

## *Operational changes*

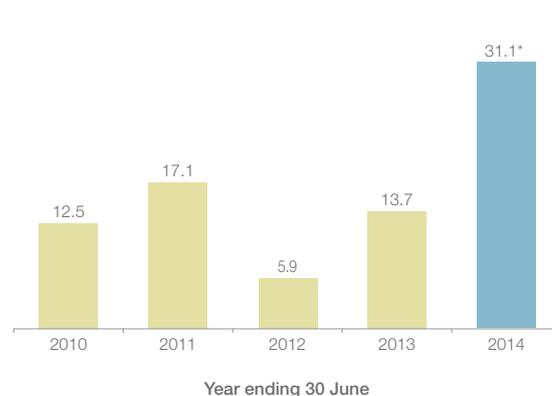
During the period we consolidated our operations into our Sydney office. Over the past few years the business had gradually evolved to be primarily based in Sydney in order to access the necessary skilled and qualified staff and to be connected with clients, investee companies and intermediaries. The management of two sites for an organisation of our size is inefficient.

# Financial Summary

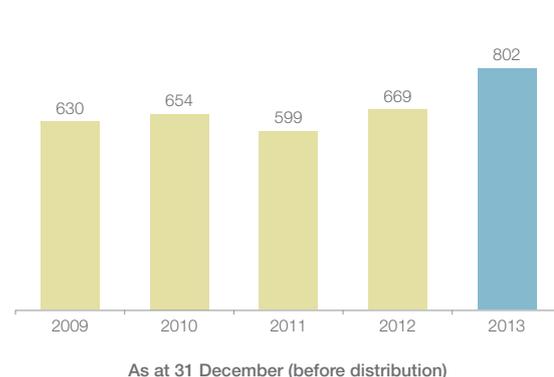
*Profit After Tax (\$m)*



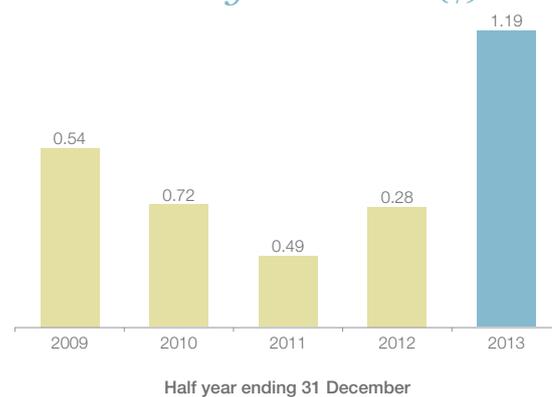
*Return On Equity (%)*



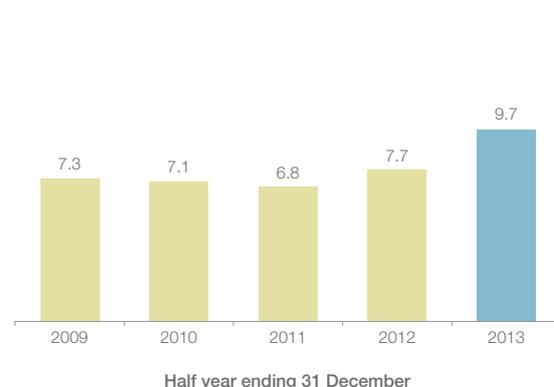
*Funds Under Management (\$m)*



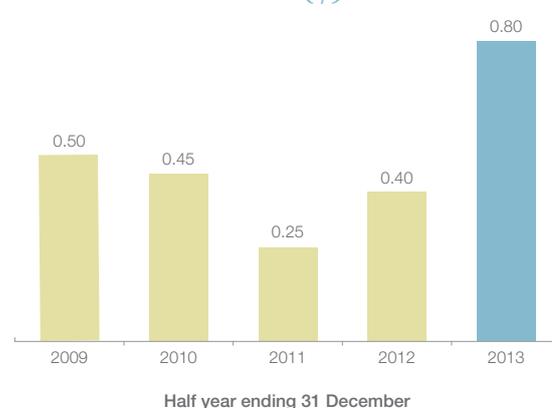
*Basic Earnings Per Share (\$)*



*Revenue (\$m)*



*Interim Dividend (\$)*



\* Return on Equity quoted for 2014 is an annualised ROE for the full year. These do not represent a forecast of full year results for the Group in respect of the 2014 financial year

## Financial results for the half-year to 31 December 2013

<b>Profit</b>	<b>31 December 2012 (\$,000)</b>	<b>31 December 2013 (\$,000)</b>	<b>% Change</b>
Revenue	7,737	9,745	26%
Operating expenses	(6,731)	(7,342)	9.1%
Depreciation, amortisation, community grants and tax	(519)	(1,187)	(218%)
<b>Net profit after tax</b>	<b>487</b>	<b>1,216</b>	<b>150%</b>
Adjustments (gross)			
Add back employment restructure expenses		296	
Add back legal costs for shareholder actions	56		
Tax on adjustments	(17)	(89)	
<b>Underlying profit after tax</b>	<b>526</b>	<b>1,423</b>	<b>170%</b>

	<b>Six months to 31 December 2012</b>	<b>Six months to 31 December 2013</b>	<b>% Change</b>
<b>Funds under management</b>			
Opening FUM	627	708	12.9%
Super flows (net)	10	27	170%
Managed Funds flow (net)	(13)	6	
Net flows	(3)	33	
Market movement	45	61	35.6%
Closing FUM	669	802	19.9%

<b>Dividends</b>	<b>2012/2013 (cents per share)</b>	<b>2013/2014 (cents per share)</b>
Interim	40.0	80.0
Final	45.0	To be declared at August 2014
<b>Total dividend</b>	<b>85.0</b>	<b>80.0</b>

This table has been prepared in accordance with the Australian Institute of Company Directors (AICD)/Finsia principles for reporting underlying profit and ASIC's Regulatory Guide 230 Disclosing non-IFRS financial information. Underlying profit after tax has not been reviewed or audited by our external auditors, however the adjustments to net profit have been extracted from the books and records that have been audited.

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