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AGM Presentations

André Morony, Chair

Welcome to the 2011 AGM for Australian Ethical.

Before I begin, I would like to acknowledge the traditional aboriginal owners of this land.

The 2011 financial year was once again characterised by difficult market conditions and a changing regulatory environment.

The ongoing uncertainty and challenges in Europe and the US are a stark illustration that the global financial system will need more time to fully recover from the effects of the financial crisis.

As ethical investors, we are of course alive to the negative consequences of a drive for growth at all costs, but there is no doubt that the turmoil abroad continues to undermine confidence locally, and our own investments are by no means immune.

The question of how to secure global survival in the face of climate change lies waiting. After the tragic events in Japan, we are seeing glimpses of the future of energy. Renewable energy and natural gas are likely to play a larger part post-Fukushima.

Seeking to take advantage of these longer term themes, we continue to find new and exciting investment opportunities. For example, we invested for the first time in Carnegie Wave Energy, after the company completed the first trial of its commercial scale wave power unit in May 2011. The trial established proof of concept and power output met expectations.

In our investment universe, cyclical industries like mining that do not meet our rigorous ethical investment criteria continue to outperform, putting pressure on short term fund performance. However, we are supremely confident in the quality and skill of our investment team who continue to prove their ability as long-term stock pickers.

As an example, an exciting investment opportunity that the team found this year that, as an ex-burns victim, was close to my heart was Avita Medical. We helped this company raise nearly $12m to commercialize skin cell technology pioneered by ex Australian of the year Fiona Wood. The technology, which came to the forefront after the Bali bombings, utilizes the natural regenerative properties of skin, whereby healthy skin cells are harvested from one's own body, incubated for 30 minutes and sprayed on to the wound burn site.

Our Ethical Charter is at the very core of everything we do. It is a real point of difference. While others play around the edges of ethical investment, we are unwavering in our commitment to be "true to label".

This often means we have to take tough investment decisions also. Since we last met, we have divested Origin Energy due to concerns about their emerging coal seam gas business.

We first acquired shares in Origin 11 years ago, and have remained invested because of its investment in renewables, its exposure to natural gas, its Greenpower program and significant investment in rooftop solar installation.

In conjunction with our advisors, CAER, we have been monitoring and analysing the CSG issue and Origin Energy's involvement. There are concerns that, despite CSG's benefits as a transitional fuel, Origin's extraction plans entail many negative impacts on the environment and local communities. As a consequence, we decided to take a precautionary stance in support of our ethical frameworks and divested from Origin.

Turning now to our more immediate operating environment, we continue to see change here also.

The Future of Financial Advice draft legislation released in August by Minister Bill Shorten will be the latest in a series of regulatory changes meaning that funds management and superannuation businesses need to evolve their operating model and drive scale and efficiencies in preparation for a lower fees environment.

The planned introduction of the low cost MySuper from July 2013 and the proposed increase in the superannuation guarantee from 9 to 12 per cent will also bring further change to the industry

These developments pose significant challenges and opportunities and agile companies adapting quickly to the new environment will emerge stronger. I believe Australian Ethical will be one of those companies.

And there are many reasons to be very excited about the future.

Ethical investment is a growth business. Australian's are becoming increasingly conscious of the social and ethical implications of their actions and looking for tangible ways to do the right thing.

In difficult economic times, people re-evaluate what's important to them and there is strong evidence that the recent economic turmoil has raised levels of social consciousness. These are trends that bode well for the future success of our business and it is important for us to take full advantage of the opportunities these changes present.

Despite the difficult conditions of the 2011 financial year, we achieved an increase in funds under management to $644m, an increase of 4.9%.

2011 reported Net Profit After Tax (NPAT) rose 25% versus the prior year, however underlying NPAT was reduced by a quarter when the impact of restructuring costs and the onetime benefit of the purchase of the Lawley House property was taken into account.

The results reflect two things. First, the investments we have made in restructuring the business and investing in the right capability to help it realise its full potential. And, second, the increasing competitiveness of the market and the pressure this is exerting on fee margins. Despite these, Australian Ethical delivered a total dividend to shareholders of 170 cents per share.

As I have described, the sheer scale of change in our operating environment means we have no choice but to make prudent investments in our core strategic assets – our people, products, brands and systems to deal with the challenges and take full advantage of developing opportunities.

In this context I would note that the necessary process of change continues inside Australian Ethical. Last year saw the passing from the company of our two remaining founders, Howard Pender and James Thier and it is the right time now for generational change in the business and for a new team to take this company forward.

Over the next 12 months we will continue to invest in the business to position us for growth in market share and we have a clear plan to drive this business toward its objectives. Phil will talk more about this in a few moments.

I am also pleased to be able to report that the business is demonstrating encouraging signs of positive momentum. As our recent “status of employees” report demonstrates, while there is always more to do, our recent staff survey suggests that communication has improved significantly and that our people’s engagement with the company and its strategy is high.

So to summarise, there are very good reasons to be a shareholder in Australian Ethical.

Australian Ethical has a quality management team and a clear and focused strategy for growth. Management understands the changing environment and is investing prudently to evolve its business model to deliver sustainable returns over the long term.

The business has positive momentum, evidenced by an increase in funds under management despite a tough operating environment and improving employee engagement scores.

The success of Australian Ethical is incredibly important. In addition to providing great value to investors who share our social and environmental aims, we have a higher order mission to contribute to a just and sustainable human society and the protection of the natural environment.

For further information contact: Tom May, Company Secretary
Phone 1800 021 227 **Email** centre@australianethical.com.au **Fax** 02 6201 1987
Web www.australianethical.com.au **Post** GPO Box 2435 Canberra ACT 2601
Australian Ethical Investment Ltd **ABN** 47 003 188 930 **AFSL** 229949

Phillip Vernon, MD

I'd like to begin with a recap on the key themes and priorities from last year, what we've achieved, what we haven't achieved and what we've reconsidered or adapted. I will then move onto our progress on staff engagement and finish by talking about the outlook and priorities for the coming year.

Achievements/activities of the past year

Our focus and achievements over the past year have been:

- Client service – high quality client service is critical to our success. Over the course of the past year we have increased the resourcing in this area and invested in a new telephone system allowing us to bring back in-house the call centre management from Pillar giving us control of the up-front management of client calls. Improving client service further will be a continued focus for us over the coming years and will be at the forefront of any strategic or operational decision we make in the future.

- Advisers – we have barely penetrated this market beyond committed ethical advisers and we believe there is considerable opportunity. We have made good progress in the three areas critical to success in this space:

  - Ratings:

    a. We have maintained our ratings throughout the year and our flagship Smaller Companies Trust continues to enjoy a Recommended rating from Lonsec.
    b. Our investment team has been stable for the last few years after a number of years of high turnover and is steadily building its reputation with the rating agencies.

  - Adviser groups and platforms - we have increased our resources servicing advisers and were accepted onto BT Wrap, the most popular administration platform in the market used by the most number of Advisers.

  - Product and pricing - having a proper wholesale product with wholesale pricing which can be managed without the use of administratively clumsy fee rebates. This last item, whilst it may sound administrative and almost trivial in the scheme of things, has probably been a significant constraint to growth as it has prevented us from being used by major adviser groups. Whilst much of the background work has been completed the finalization of this product has been hampered by the delay in the Garradin project and we now expect this to be available by 31 December of this year.

- Superannuation – our superfund is a large part of our business and, with legislated superannuation contributions set to increase from 9% to 12%, it will continue to be a growth area for financial services for the foreseeable future. We have invested in certain features of our website making it easier for our clients and our employers to join nearly doubling new client uptake overnight. This has almost doubled the monthly intake of new individual and employer clients. We have also increased our focus and skills on servicing our employer clients with the appointment of Adam Kirk which I will discuss later.

- Robust operating systems – we are responsible for over $600 million of investor's funds under management and a major project for the year was the implementation of the Garradin portfolio management system. This project is part of a longer term process of improving our administration systems and transitioned us off an out of date system to a much more robust and contemporary platform. This was a major project for a company of our size and took longer than we had anticipated. This unfortunately had an impact on other projects most notably our ability to deliver on our wholesale product.

- During the year we also made a number of structural changes and the introduction of new skills to support our strategy.

  - Adam Kirk has a long career in corporate and retail superannuation with Skandia, Colonial First State and Catholic Super. His experience includes working with employers and advisers in developing employee engagement in their superannuation. He also has extensive experience in administration platforms which is critical for us as we work more in that space.

  - Paul Smith has a background in asset consultancy and marketing within funds management in the United Kingdom and Australia. His background in asset consultancy is an invaluable addition to the team as this aspect of our business becomes a fundamental part of our sales and marketing efforts. His marketing and strategic experience particularly within the sustainability and not for profit sectors also offers strength in bringing in new ideas and approaches to our business.

Projects that haven't eventuated for good reason.

- Limited Advice – it remains our plan to be able to offer clients limited advice when they are seeking the best options to invest within our products. We undertook a pilot project on this and implemented a system, Midwinter, in order to support this service. We are currently considering the results of the pilot and considering other means of delivering advice before rolling out the service out more broadly.

- Direct investment capability –offering our clients the ability to invest directly into shares is an important priority for us, however the choice of platform is an equally important decision with implications for existing products, client administration and data as well as interfaces with other operational systems. Other projects, primarily the Garradin implementation has deferred the final consideration of this and it will be a focus for the coming year.

Complexity of the business

One theme that we would add to our strategy this year which is very much aligned with operational robustness is that of operational simplicity. Our business is far too complex for its size.

We have a retail superfund, 7 managed funds and we are a listed company. We operate through numerous channels – direct retail, wholesale advised, employers and institutional. We have a number of products that have been launched over the last few years that are not yet profitable.

Whilst the company has been very innovative over the years which is necessary for small startup companies, we have, I believe, fallen into the trap of thinking that we need to constantly come up with a new idea to prove our worth.

This adds pressure to limited resources in marketing, client service and our finance area, drives up our costs and increases our risk.

At the same time a lack of attention to some basic operational functions has cost us significant money. I cite the simple fact that, despite it being recommended, apparently, some 8 years ago, we still do not have a proper wholesale product. This has kept us from major platforms and been a blockage to access to a broader coverage of Advisers.

An ad-hoc approach to outsourcing and systems decisions over the years has lead to a less than ideal operational structure and difficulties in managing our clients and client information.

Thus, a theme that we have introduced into our strategic thinking is one of focus - "Do less but do it better". We will be constantly reviewing our products and processes looking for opportunities to reduce activity that do not add to shareholder value.

People report

I'd now like to touch briefly on our staff engagement. Our people are critical to our success and ensuring that we have the right environment where they are motivated to perform at their best is critical. Our constitution requires us to report on the status of our employees at the time of the AGM and in the past we have done this via the sustainability report. This year we have tried to improve on this by providing a report specifically on the status of employees which we provided last week and I'd like to talk about some aspects of that report.

- Staff survey results

  In September of this year we conducted a staff survey. I have been involved in many staff surveys throughout my career and I have to say the results were among the best I have ever seen. This was particularly pleasing not just because this has been a year of change at Australian Ethical and you would normally expect some negative results in such a year, but because they were an improvement over the previous two surveys (2008 and 2009) in many key categories.

  Particular areas to highlight are:

  - Satisfaction with current role - 97%, up from 79% in 2009
  - Satisfaction with communication - 77%, up from 54% in 2009
  - Satisfaction with L&D opportunities - 63%, up from 59% in 2009
  - Satisfaction with remuneration - 46%, down from 63% in 2009
  - Confidence in board - 59%, up from 37% in 2009 (only 3% disagreed compared to 32% in 2009)
  - Managing Director has clear vision - 77% with only 6% disagreeing
  - Confidence in MD and Mgmt team - 77%, up from 70% in 2009

- Staff turnover

  Staff turnover is another indicator of staff engagement. Turnover statistics were also provided in our report last week. Key highlights were:

  - Voluntary turnover was 12% which was an improvement on the previous year of 2010 of 16.4% and 15.4% for 2009. These compare to industry averages 14.1%, 11% and 15.6% respectively.
  - Involuntary turnover was 6.7%, compared to an industry average of 5.3%

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As these figures show turnover has improved over the previous two years and for the current year is less than the industry average. In the previous year turnover was higher than the industry average.

Focus and Priorities

Summing up, I characterise the past year versus the coming year as being one of getting some basics right – strengthening our client service, improving the robustness of our operating systems and getting our structure and skills right to deliver on the strategy.

The next year will be one of focus – getting the product, sales and service right particularly around our three key products, our Smaller Companies Trust, our Balanced Trust and our superannuation fund.

Underpinning everything we do, we see our core areas of competence as being:

- Ethics – ensuring that ethical judgments are robust, true to our Charter and well understood by clients and staff
- Investment performance – achieving superior investment performance over the long term
- Client service – providing a consistent and positive client service experience to advisers and clients
- Operational robustness and simplicity – ensuring that our operations are robust and efficient

Whilst conditions continue to be tough and show no signs of rapid improvement, I remain excited about the future of Australian Ethical and its future in continuing to carve out a special place in the Australian financial services landscape. It's a special company with unique potential to bring about change, satisfy people's ethical convictions whilst saving for their retirement and being a motivating and inspiring place to work for all its employees.

I'm looking forward to the year ahead.

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