

Australian Ethical Shareholder Newsletter

October 2012

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Shareholder Calendar

Annual General Meeting.....	22 November 2012
Interim Results Announcement.....	28 February 2013
Record Date for Interim Dividend.....	15 March 2013
Payment Date for Interim Dividend	29 March 2013
Annual Results Announcement.....	30 August 2013

These dates may change at the company's discretion.

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Chair and Managing Director's Report

Dear shareholder,

The 2012 financial year has been one of significant change for Australian Ethical. Like all financial services companies, we continue to face a world that has fundamentally shifted.

The global financial crisis is now some five years old, markets continue to be down significantly from their peak, investors continue to be nervous and regulatory change is turning the financial services industry on its head putting pressure on fees and hence revenues.



In the face of this, three years ago, Australian Ethical found itself inadequately positioned to face such challenges. It was a high cost, high priced business with poorly structured products and was not able to meet basic client service standards required to operate in the market. Most critically, the company was heavily reliant for its revenues on up-front fees that were soon to be removed through regulation.

Over the past few years we have achieved a lot in addressing these issues and setting the company up for a sustainable, long term future. In particular, during the 2012 financial year we have made significant improvements in our products, client service and costs.

In addition, new client growth results have been very encouraging particularly in light of current market conditions, nervous investor sentiment and a rapidly evolving financial services environment. Over the 12 months to 30 June 2012, we had net new individual client growth of 5% across managed funds and superannuation. We also increased the number of default superannuation employer clients by 20% (from 248 to 297).

Our ethical approach

In all of this, nothing changes who we are or what we represent.

Our philosophy remains that people should be able to save and invest in a way that looks after society and the environment and provides financial performance and security. Our investment criteria remains the highest ethical conviction in the market. Our exit during the year from Origin Energy because of its exposure to Coal Seam Gas is evidence of our continued willingness to take a stand on key ethical issues.

We do, however, wish the company to be able to continue to deliver on this promise in such a way that allows it to not just remain viable, but to grow. The larger we are, the more influence we have to change the world for the better. To that end, over the last few months we conducted market and customer research, the result of which is a refreshed Australian Ethical brand plus an enhanced insight into our potential for sustainable growth.

The key areas of insight from the research were:

- There is a huge opportunity to expand our reach into our natural market. Australian Ethical is the only truly “green” investment manager and superannuation fund in Australia and our research shows that almost three-quarters of our 18,000 clients identify themselves as Greens voters. 1.2 million people voted for the Greens at the last election. This is what we call our natural market and should still be a hugely fertile source of new clients and growth.
- Commitment to the Australian Ethical brand is still very high relative to our mainstream and ethical competitors. However, the awareness of our brand amongst even the natural market is quite low compared to where it should be. We need to communicate to this wider audience more effectively so that more people understand who we are and what we offer.
- We are known as offering ‘the best ethical option’ by our clients. This is a reputation that we fully intend on retaining. However, we have found that we need to vastly improve the trust

people have in our investment performance and the competitiveness, attractiveness and service levels of our products. This will mean greater communication of our investment expertise to increase the level of trust from clients. More trust will translate to high average balances as client trust us with more of their life savings.

Business improvements

During the 2012 financial year we have made significant improvements in the following areas:

- **Enhanced products** – we have improved the insurance options available to our superannuation fund members, lowered the fees on our Cash Trust (formerly the Income Trust), removed the upfront fees on all our products and lowered the fees on our Smaller and Larger Companies Trusts and Climate Advocacy Fund for wholesale clients
- **Improved service** – we have upgraded our portfolio administration operations, invested in improved call centre and customer management systems and recently we appointed Russell Investments to be our superannuation administrator from April 2013, which will provide a much improved and lower cost service to members.
- **Reduced costs** – in order to be able to implement these changes and to properly position ourselves for what will be a lower fee environment in the years to come, we have had to reduce our costs with staff numbers reducing from 50 to 36 over the course of the past year.

These improvements and adjustments were absolutely necessary to ensure the long term sustainability of the company. Without them the company was at risk of not surviving.

Regulatory changes ahead

The financial services industry is going through significant regulatory changes that impact the business in a number of ways. In particular:

- Capital requirements for funds management businesses will change in November 2012 requiring greater liquidity to be held to comply with licensing requirements. This will be challenging to meet whilst we hold real estate, such as our Canberra premises, on our balance sheet. It also has an impact on dividends; and
- Two new areas of legislation (Future of Financial Advice and MySuper) have combined to impact fees in a number of ways. In general, this legislation has led to lower fees and a more

competitive environment. In particular it means the abolition of up-front fees. On 1 July 2012, as noted above, we removed up-front fees on all of our products in order to position us for this new environment.

Financial results

Our net profit after tax (NPAT) was \$0.402 million for the 12 months to 30 June 2012 (FY12) whilst our underlying profit after tax (UPAT) was \$0.859 million.

The NPAT result reflects lower revenues due to lower funds under management, arising from lower market values and the continued reduction of inflows across the industry, and our decision to gradually reduce management fees. These factors have been offset somewhat by a reduction in operating costs the full benefit of which was not realised in FY12

The result also includes a number of one off items such as a three yearly revaluation of the Canberra office building, redundancy costs associated with a business restructuring to lower operating costs and costs incurred in respect of shareholder actions conducted throughout the year.

Shareholder activity

During the year a general meeting was called by a group of shareholders. Whilst we fully respect shareholders exercising their rights, the board objects strongly to the manner in which this campaign was conducted. As one indication, some 105 resolutions were lodged over more than a dozen separate visits to the company, each one causing much speculation and disruption amongst staff. Resolutions were constantly amended, directors were nominated without consent and in other cases withdrawn, causing unnecessary work for our team. The process was extremely destabilising at a time when the business can least afford it. The direct cost impact on the company as a result of the campaign was \$125,000. The indirect cost impact on the business was immeasurable and far greater.

The outcome of the meeting was a vote firmly in favour of the board and the strategies being implemented by it. These strategies are, in the board's view, necessary to properly position the company to survive and thrive in a vastly more competitive and challenging environment. Whilst these changes have impacted many people, corporate shareholder activity should not be used to pursue personal agendas. We fully expect the shareholders to respect the vote of the shareholders as a whole as the company can ill afford another such campaign.

Director changes

During the year we welcomed Louise Herron to the board. Whilst Louise's tenure was short-lived (she recently became Chief Executive of the Sydney Opera House), she made a significant contribution to the company.

Following Louise's resignation, Steve Gibbs was appointed to the board. Steve brings with him a wealth of experience relevant to our business. He has been Chief Executive of ARIA, the Commonwealth Government superannuation fund and Executive Director of the Australian Institute of Superannuation Trustees. He has a long held involvement in Responsible Investment and was on the panel that originally proposed the United Nations Principles of Responsible Investment. We welcome Steve and look forward to his contribution.



A handwritten signature in black ink, appearing to read 'P. Vernon', with a long horizontal stroke extending to the right.

Phillip Vernon
Managing Director

In closing

The transformation of the company through the past financial year and continuing into this year is considerable. The changes have occurred by nature of the financial environment in which we are operating plus the strategic business imperatives for Australian Ethical's long term future. Our sincere thanks and appreciation go to all our staff and shareholders who have along the way provided constructive input and shown ongoing commitment to the business.

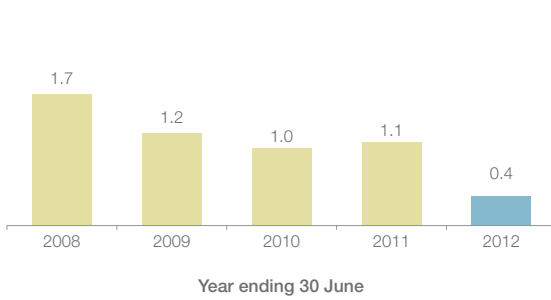


A handwritten signature in black ink, appearing to read 'André Morony', with a long horizontal stroke extending to the right.

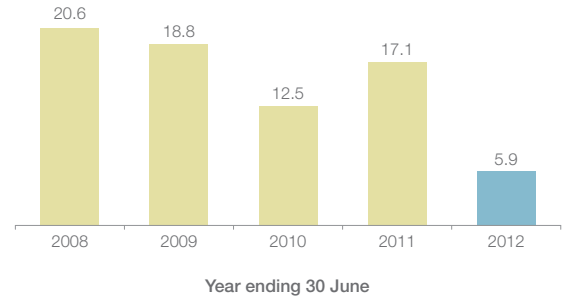
André Morony
Chair

Financial Summary

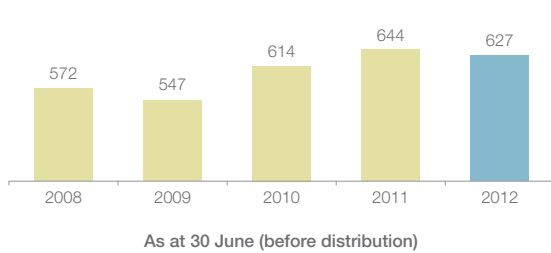
Profit After Tax (\$m)



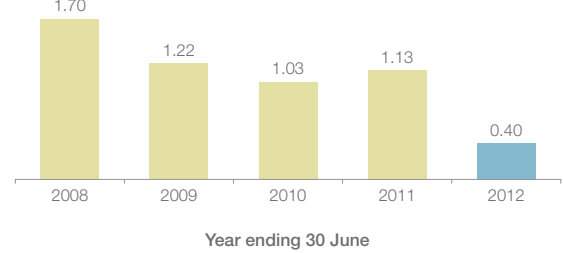
Return On Equity (%)



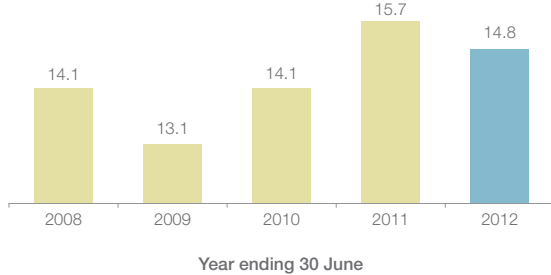
Funds Under Management (\$m)



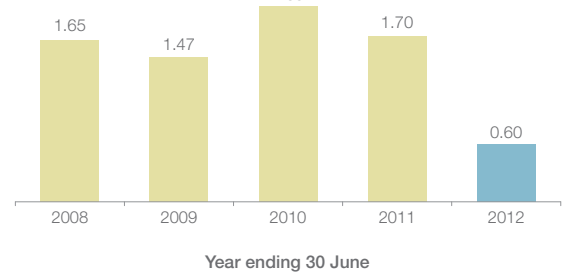
Basic Earnings Per Share (\$)



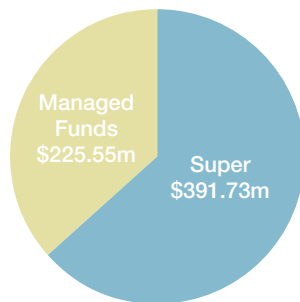
Revenue (\$m)



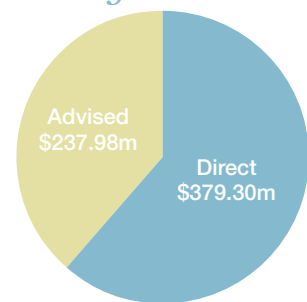
Dividends Paid (\$)



Funds Under Management By Product



Funds Under Management By Channel



Financial results

Net profit after tax (NPAT):

\$0.402 million

Full year underlying profit after tax (UPAT):

\$0.859 million

Key factors impacting the result were:

- **Lower market values** – The All Ordinaries Index dropped 11% over the period. As our revenues are primarily related to funds under management, this had a direct impact.
- **Impairment to building** – A non-cash impairment charge of \$210,000 was incurred arising from a three yearly revaluation of the property at Trevor Pearcey House in Bruce, ACT. The reduced value is due to the more subdued commercial property market in Canberra.
- **Business restructuring** – redundancy costs of \$319,000 were incurred as the business restructured to reduce operating costs to position it for a more competitive, lower fee environment in the future. This has reduced staff numbers from 50 to 36. The full year benefit of these cost reductions were not felt in these results.
- **Shareholder action** – during the year a group of shareholders called a general meeting. Direct costs incurred in respect of the campaign were \$125,000 primarily in respect of legal costs incurred as a result numerous misleading allegations made.

After taking these last three items into account, the result is a decrease in underlying NPAT of 12%. This result is summarised in the table below.

	2011* (\$,000)	2012 (\$,000)	% Change
Net profit after tax			
Revenue	15,744	14,793	(6%)
Expenses	(13,124)	(13,359)	(2%)
Operating profit	2,620	1,434	(45%)
Community grants	(153)	(53)	
EBITDA	2,467	1,379	(44%)
Depreciation/amortisation/options/rights	(677)	(658)	3%
Tax	(665)	(320)	52%
Net profit after tax	1,125	401	(64%)
Adjustments (gross)			
• Add back employment restructure expenses	445	319	
• Add back property revaluation	-	210	
• Add back legal costs for shareholder actions	-	125	
• Deduct acquisition fee Lawley House	(651)	0	
Tax on adjustments	62	(196)	
Underlying profit after tax	981	859	(12%)

* Restated.

Balance sheet

The balance sheet holds a number of assets that the board believe are inappropriate for a company of our size and nature. The company is looking to realise these assets in an orderly manner and reinvest the proceeds in liquid and cash equivalents. In particular:

- The company purchased its own premises in Canberra in 2006 and undertook significant renovations over the course of 2006 and 2007 to bring it to 6 star Green Star rating standard. Whilst the board is supportive of the company occupying appropriately rated premises, it is of the view that it is inappropriate for the company to own real estate. We have entered into a marketing and sales agreement with CBRE to sell the property.
- The company has, over the past few years, supported the activities of the Climate Advocacy Fund (CAF) an index fund that engages in shareholder advocacy in relation to climate change. In particular it has purchased shares in the companies that the CAF was putting resolutions to on behalf of nominees in order to allow the resolutions to be put. Unrealised losses in respect of these activities amount to \$106,000. We will be selling these investments over coming months.
- The company has, in the past, invested some surplus cash in unit trusts that it manages. These will also be liquefied and reinvested into cash or cash equivalents.

Dividend

Final dividend:

35 cents per share, fully franked

Total FY12 dividend:

60 cents per share, fully franked.

In determining the final dividend, the board took into account the following:

- Regulatory requirements, in particular the new capital requirements effective in November 2012;
- The uncertainty in the market;
- Future potential strategic requirements.

Record date:

21 September 2012.

Dividend payment date:

5 October 2012. (The dividend reinvestment plan will not operate in respect of the final dividend.)

	2011 (cents per share)	2012 (cents per share)
Dividends		
Interim	45.0	25.0
Final	100.0	35.0
Special	25.0	-
Total dividend	170.0	60.0

2012 Community Grants



As prescribed in Australian Ethical's constitution, 10% of our profit is donated to charitable, benevolent and conservation purposes as part of our contribution to a positive and sustainable society. This is one of the highest levels of corporate giving in Australia based on percentage of profits. It is something that the shareholders, staff and directors should be very proud of.

Traditionally, the grant recipients have been shortlisted by a small committee of staff members and voted on by employees and directors of Australian Ethical. The committee ensure that each shortlisted organisation or project is of the highest quality and in keeping with the Australian Ethical Charter. This year, for the first time, we invited all our shareholders to vote on which organisation or project should receive grants. Shareholder involvement was high with votes from approximately 150 people received.

Grant applications were received from almost 300 different organisations. There was a skew towards society based projects although the voting was overwhelmingly in favour of wildlife conservation.

Australian Ethical will be donating a total of \$40,000 to 11 organisations as part of its 2012 community grants scheme. This brings the total amount gifted to communities over the last 12 years to more than \$1.3 million.

This year's grants range in size from \$3,000 to \$10,000 and include donations to charities that work across Australia and overseas. The following table shows the breakdown of grant recipients for 2012.

Major grant recipient

Rainforest Rescue – Gunung Leuser National Park, North Sumatra

Rainforest Rescue provided us with a good overview of their project to save the last viable habitat of the Sumatran Orangutan through the protection of the World Heritage listed tropical rainforests of the Gunung Leuser National Park (GLNP) from deforestation and the expansion of illegal oil palm plantations. The GLNP also provides vital habitat for critically endangered species including the Sumatran Tiger, rhinoceros and elephant.

Outcomes of this project will be to remove 60 hectares of illegally planted oil palms within the



boundaries of the National Park, and replant with 60,000 rainforest trees. This work will be done by the local farming communities living alongside the GLNP, creating employment for economically disadvantaged people. These farmers already have an established co-operative where they will propagate and grow the trees in the nursery, and also monitor and patrol the site to prevent hunting and logging.

More information can be found on the website rainforestrescue.org.au/ourprojects/save-arainforest-orangutan.html

The 2012 allocation

Organisation	Project	State
Major Grant \$10,000		
Rainforest Rescue	Rainforest Rescue – Gunung Leuser National Park, North Sumatra	Queensland
Minor Grants \$3,000		
Bonorong Wildlife Sanctuary	Co-operative Eastern Quoll Breeding Programme	Tasmania
Communities @ Work	Yellow Van	ACT
Environment Victoria	Home Planet	Victoria
Free the Bear Fund	Solar Power for Sun Bears	Western Australia
Greening Australia WA	Transforming the Mortlock North	Western Australia
Gunawirra	Inner Suburbs Nutrition Project	New South Wales
Perth Advocates for the Earth	Planting for Black Cockatoos	Western Australia
Sea Turtle Foundation	Sea Turtle Field Research & Monitoring Equipment	Queensland
The Orangutan Project	Wildlife Protection Units	Western Australia
Trees for Evelyn & Atherton Tablelands	Peterson Creek Freeman Revegetation	Queensland

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