australianethical

Australian Ethical Shareholder Update

February 2013

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Managing Director's Report

Dear shareholder,

As we move into 2013, it is pleasing to see some bright spots on the horizon. The past few years have been challenging for all involved in financial markets, investors and institutions alike and have had profound impacts on both individual behavior and the saving and investing landscape in general.

Investors have come out of this period with a more discerning attitude to how they invest and who they invest with. There is an increasing awareness amongst the general populace that there are better ways for the world to operate than it has in the past and a desire to align their savings and investing habits with these shifting values.

Companies and institutions have also emerged from the past few years with a substantially changed business if they have survived at all. Those that have survived are the ones with a clear focus on their strategy and a clear and well defined purpose beyond just making money.

At Australian Ethical we are pleased to continue to offer our clients savings and investment products with the highest conviction ethical commitment in the market. Our clients can be assured that we won't compromise our approach and will always take a genuinely long term and whole of planet and society view when assessing our investments. There is no more important area where this is critical than in respect of climate change. Recent extreme weather events as well as increasing evidence that we are heading toward 4 degrees above the long term average, not the 2 degrees the global community agreed to are raising the feeling of urgency around addressing climate change. If there is ever a time that people should invest ethically and sustainably, now is the time.

We address climate change in a number of ways. Our International Fund seeks out companies that are developing innovative ways to reduce energy demand. Our about to be re-launched Climate Advocacy Fund has advocated against high carbon emitting companies to reduce their emissions. And we participate in numerous industry bodies of institutional investors aimed at bringing pressure to bear on companies to reduce their emissions.

As a result we offer our clients one of the lowest exposures to climate related impacts in the market. With increasing concern in the market about the urgency for action on climate change, this is a position we hold very dear.

We are also pleased to be entering the new year with a stronger business better suited to the new environment. We have made a number of improvements to our products, operations and investment processes and, whilst these changes are not quite over, substantial progress has been made. You will note from the descriptions below the significant amount of work that is required to make these changes and we thank our dedicated staff for their commitment throughout this time.

These improvements have delivered the following strong results and outcomes:

- As a result of improvements made to our superannuation fund we were awarded the Rising Star Award for 2013 by SuperRatings;
- Our Smaller Companies Fund returned 16.5% over the period, some 3.3% above its benchmark. This continues to demonstrate our conviction that our clients can invest according to their values whilst achieving competitive returns;
- Our funds under management are at our second highest point in our history (the highest being April 2011) despite the market still being significantly lower than its peak in 2007.

The performance of the share market has been the most positive in the past eight months than it has been for many years. With equity markets more buoyant and cash rates continuing to fall we expect investors to eventually switch their investments back into the equity market and equity funds.

Looking forward, we see only increasing demand for high conviction and committed ethical investing. Our business has been reshaped so that we are better able to meet the needs of our clients. And markets are looking better. We feel good reason to feel optimistic about the future.

Phillip Vernon
Managing Director

28 February 2013

Update on key business strategies

Corporate

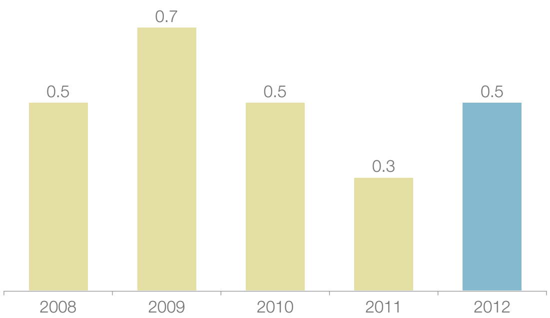
- **Brand refresh** – in the latter half of 2012 we refreshed our brand and have been working to improve the awareness of Australian Ethical in the market with an increase in sponsorships as well as media coverage and articles. Together with improvements in our website and online joining process this has resulted in a record month for online super applications in January 2013.
- **Efficiencies** – we continue to see the benefits of investments in systems and improvements in processes over the past few years with staff numbers reducing from 46 to 34 since the previous year.
- **Company premises**
  - We are currently reviewing our options in relation to the Canberra property.
  - In Sydney we have recently signed a lease on a new office premises which will allow staff to operate from one location. We have balanced cost with sustainability and secured space with a 4 star NABERS rating. The building is owned by Investa, who are well known for their sustainability credentials.
- **New directors** – we recently welcomed new directors to the board. Mara Bun, CEO of Green Cross Australia, Tony Cole, partner at Mercer and Kate Greenhill, previously a partner at PricewaterhouseCoopers. In addition, after two years as Chair, Andre Morony will be stepping down to non-executive director as at 28 February. Steve Gibbs has been elected as the new Chair of the board.

Superannuation & Managed Funds

- **Super fund awarded Rising Star Award 2013** – improvements made to our Superannuation product during the past year resulted in us being awarded the SuperRatings Rising Star Award for 2013. The award is recognition of the benefits to members arising from the changes discussed below.
- **Fee reductions** – we made a number of adjustments to our fees over the past year to make our products more competitive and bring them in line with market best practice. These were:
  - Removal of all fees on contributions. These fees have been uncommon in the market for many years and were a key barrier to many investors;
  - Increasing the member account fee. We were under-market in respect to this fee;
  - Consistent with market practice we commenced reimbursement from the super fund for costs incurred in relation to our external administrator;
  - Lowering the management fees of our superannuation fund.
  - Lowering the management fees for our wholesale Smaller and Larger Companies Trusts.
- **Investment performance** – our flagship managed fund, the Smaller Companies Trust, achieved a return of 16.5% for the six months to 31 December 2012 (against a benchmark return of 13.2%) and continues to rank highly against its peers. Aligned to this our Smaller Companies accumulation option in the super fund returned 15.8% for the same period.
- **Improvements to super administration** – over the next few months we will be transitioning our superannuation administration to a new provider in order to deliver better quality and lower cost service to members. The transition of our super clients' records will commence on 9 March 2013 with a "blackout" period from then until 5 April 2013 meaning that clients will be unable to transact in the normal way. This is necessary and normal in transitions of this nature. During this time our team will be working around the clock to complete the transition so that services to clients can resume in the normal manner.
- **Improvements to our insurance arrangements** – our super fund provides insurance cover to our members via group arrangements. Historically these have only included Death benefits and we are improving these to include Total & Permanent Disablement and Income Protection. These improvements are also occurring over the coming months.
- **Development of a MySuper option** – a key part of our strategy has been to better service ethically aligned and "green" employers with our super fund. The Federal Government has introduced new legislation aimed at simplifying superannuation arrangements for the majority of the investing public. From 1 July 2014, employers must pay superannuation guarantee contributions into a MySuper option where an employee has not exercised a choice to have their contributions paid into a particular superannuation fund. We have elected to apply for our existing Balanced Accumulation option to be authorised by the Australian Prudential Regulatory Authority from 1 July 2013.
- **Climate Advocacy Fund** – The Climate Advocacy Fund and the corresponding option within the super fund are being amended in the following ways:
  - our commitment to advocacy on climate issues will be unchanged, but we're expanding the scope so that we can also advocate on other important ethical issues such as animal welfare, tobacco, gambling and coal seem gas;
  - we are amending the investment structure of the fund from being invested in an indexed investment approach to an ethically screened active investment style, investing in Australian and international shares via our Larger Companies Trust. We believe that this is more consistent with our Ethical Charter;
  - we are disbanding the complex nominee structure that allowed us to put resolutions to companies unilaterally. This was cumbersome and complex to administer and required Australian Ethical (the Company not the fund) to purchase the shares in the companies it wished to advocate against. This was costly and exposed us to investment losses that are unsustainable. Cumulative unrealised losses in respect of these activities amount to $108,000. In future if we wish to advocate on a particular issue to the point of lodging a resolution, we will garner the support of other like-minded retail or institutional investors;
  - going forward the fund will be known as the Australian Ethical Advocacy Fund with the corresponding strategy within the superannuation fund known as the Advocacy investment option.

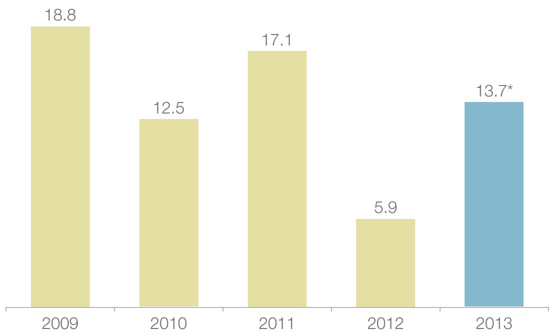
Financial Summary

Profit After Tax ($m)



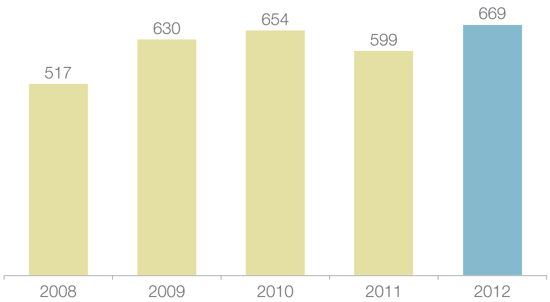
Half year ending 31 December

Return On Equity (%)



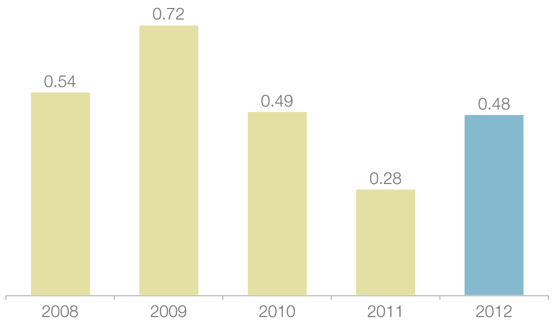
Year ending 30 June

Funds Under Management ($m)



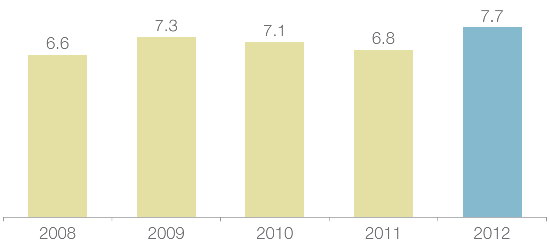
As at 31 December (before distribution)

Basic Earnings Per Share ($)



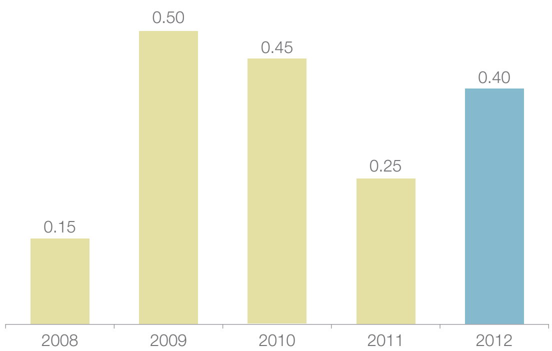
Half year ending 31 December

Revenue ($m)



Half year ending 31 December

Interim Dividend ($)



Half year ending 31 December

* Return on Equity quoted for 2013 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 2013 financial year

Financial results to 31 December 2012

	31 December 2011	31 December 2012	% Change
Funds under management			
	$599.3 m	$669.0 m	12%

	31 December 2011 ($,000)	31 December 2012 ($,000)	% Change
Net profit after tax			
Revenue	6,834	7,737	13%
Expenses	(6,070)	(6,731)	(11%)
Operating profit	**764**	**1,006**	**32%**
Community grants	(37)	(56)	
EBITDA	**727**	**951**	**31%**
Depreciation/amortisation/options/rights	(216)	(197)	9%
Tax	(227)	(267)	(18%)
Net profit after tax	**284**	**487**	**71%**
Adjustments (gross)			
• Add back employment restructure expenses	110		
• Add back legal costs for shareholder actions		56	
Tax on adjustments	(33)	(17)	
Underlying profit after tax	**361**	**526**	**46%**

	2011/2012 (cents per share)	2012/2013 (cents per share)
Dividends		
Interim	25.0	40.0
Final	35.0	To be declared at August 2013
Special	-	-
Total dividend	**60.0**	**40.0**

Key impacts on the results

- **Higher market values** – markets improved significantly over the six months to 31 December 2012 with the All Ordinaries Index increasing 12.8% over the period. Funds under management at 31 December 2012 was $669m, an increase of $42m (6.7%) since 30 June 2012 and $70m (11.7%) since the previous corresponding period of 31 December 2011. Positive market movements contributed $45.6m to the increased funds under management over the period offset by net outflows of $3.2m.
- **Flows** – net outflows for the six months were $3.2m, 0.5% of our total FUM. Net inflows into our superfund remain positive at $9.5m whilst we continue to experience net outflows from our managed funds of $12.7m for the period.
- **Revenues** – during the period a number of adjustments were made to our fees in order to better position our business for the market environment. These had a number of impacts on our revenues.

  Total revenues increased by $903,258 (or 13.2%) over the previous corresponding period due to the following:

  – Revenues based on funds under management (management fees) were lower by $497,682 primarily as a result of a number of fee reductions aimed at making our products more competitive. Specifically, we reduced our fees for our wholesale Smaller and Larger Companies Trusts, our Cash Trust and our superannuation fund;

  – Revenues based on net inflows (up-front fees) have been eliminated as we removed up-front fees on all of our products from 1 July 2012. This was an important initiative as we were one of the last remaining organisations charging fees of this nature and they were due to be removed by legislation over the coming twelve months in any event. This resulted in a reduction of $476,513;

  – We have commenced reimbursing ourselves for expenses incurred for administering the superannuation fund including the costs of our external administrator. This is something we are legally able to do and is standard industry practice. As a result, total revenue has increased by $1,007,357;

  – We increased our per account annual member fee from $53 to $97 per account as we were way below market. This increased revenue by $281,941.

- **Expenses** – Total expenses increased by 6.7% over the previous corresponding period. Main contributors to the result were:

  – Staff costs reduced by 2.5% as a result of lower staff numbers. Staff numbers reduced from 46 to 34 since the previous comparative period;

  – Expenses paid by the company to the external superannuation administrator and custodian increased significantly by some $585,278 as we now pay all these expenses and then seek recovery from the funds;

  – Expenses incurred in respect of the shareholder action of last year resulted in legal costs of $56,363 being incurred for the period.

Interim dividend

In line with the dividend policy the AEI Board confirmed an interim dividend of 40 cents per share fully franked. In determining the final dividend, the Board took into account:

- regulatory requirements;
- expected full year result; and
- future potential strategic requirements.

The record date for the dividend is 15 March 2013. The dividend will be paid on 28 March 2013.

The dividend reinvestment plan will not operate in respect of the interim dividend.

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