



# Shareholder Newsletter

*August 2014*



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## Shareholder Calendar

Record Date for Final Dividend.....	11 September 2014
Payment Date for Interim Dividend .....	3 October 2014
Annual General Meeting.....	29 October 2014

These dates may change at the company's discretion.

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## Contact Us

Phone:	1800 021 227
Fax:	02 9252 1987
Email:	<a href="mailto:enquiries@australianethical.com.au">enquiries@australianethical.com.au</a>
Web:	<a href="http://australianethical.com.au">australianethical.com.au</a>
Post:	Australian Ethical Investment Ltd Reply Paid 3993, Sydney NSW 2001
Registered address:	Australian Ethical Investment Ltd Level 8, 130 Pitt Street Sydney NSW 2000

# Chair and Managing Director's Report

## *Dear shareholder,*

The past year has been an extremely successful one with every aspect of the business performing above expectation.

Our new client intake and net fund inflows are well above forecast and industry averages, our investment performance has beaten mainstream benchmarks, our people are highly engaged and our operations continue to improve their efficiency.

As a result we are almost at \$1 billion in funds under management, our profits are strong and our share price has doubled in the past 12 months.

### External Environment

During the year, there were three key issues in the external environment that impacted our business:

- Market sentiment**  
 General market sentiment has improved over the past twelve months with markets increasing leading to increased funds under management and improved industry inflows. Over the year, the ASX Small Industrials Index increased by 13.1%, the MSCI Global Climate Index increased by 23.8% and the UBS Composite Bond index increased by 6.1%.
- Fossil fuel divestment**  
 The campaign globally to encourage companies, institutions and investment funds to divest their fossil fuel exposed assets has steadily increased. We have actively supported this campaign and we remain the least fossil fuel exposed investment manager and superannuation fund in Australia. We have therefore benefited from the increased awareness amongst the investing public.

- Regulatory change**

The regulatory regime in Australia continues to evolve. The superannuation landscape in particular will only become more stringent with the commencement on 1 July 2014 of the new Prudential Standards. We have invested in our risk and compliance resources to meet the increased requirements.

### Financial performance

Our profits for the financial year to 30 June 2014 have shown a significant improvement over the previous year which was, in turn, a significant improvement on the year before.

This result has been despite a steady reduction in fees, over the past few years, to ensure we remain competitive. This reduction in fees, at the same time as improving our profits, has only been possible due to initiatives undertaken over the past few years to reduce our costs and become a far more efficient organisation.

### Fee reductions

On 30 June this year we reduced administration fees on our superannuation fund from 1.43% to 0.83%, a reduction of 42%. This was in recognition of the fact that our fees were out of step with comparable products and was aimed at passing some of the benefits of recent growth to our members.

## Efficiency improvements

Over the past few years we have made continual cost and efficiency improvements allowing us to manage more funds under management with fewer people. As a broad indication of these improvements, we now manage \$900 million with 34 people (\$26m per person) whereas three years ago we managed \$600 million with 50 people (\$12m per person), essentially doubling our efficiency.

## Investment Performance

We've strengthened the quality of our investment team and processes in order to deliver on our mission of strong performance with best practice ethics.

The performance of our funds continues to be strong over the long term with most having performed in line with or above the median fund in their relevant Mercer surveys. Our Larger Companies Trust was ranked in the top quartile performance across 1, 3, 5, 7 and 10 years for all retail and wholesale All Growth Funds. Since inception the Trust has returned on average 8.1% each year (net of fees).

The long term performance of our flagship Smaller Companies Trust remains well above benchmark returning 9.7% per annum (net of fees) for the last 10 years versus the Small Industrial Index of 5.5% per annum, ranking it 6th in the Australian Equity (All Caps) Mercer Investment Survey.<sup>1</sup>

<sup>1</sup> Based on Mercers Peer Group Category as of 30 June 2014.



Dr Stuart Palmer, Australian Ethical's new Head of Ethics and Corporate Advocacy

## Ethical leadership

This year, we have cemented our position as the leader in ethical investment in Australia. We maintain the highest ethical conviction in our investment selections as well as taking strong stands in encouraging more ethical behavior in the corporate and broader community.

## Appointment of a Head of Ethics

We asserted our commitment to ethical leadership with the appointment of Dr Stuart Palmer as Head of Ethics and Corporate Advocacy. Previously Head of The Practice at St James Ethics Centre, Stuart has also been a partner in a law firm and worked in investment banking. His professional experience has given Stuart a strong background in the practical application of ethics, as well as commercial and market experience and the critical thinking required for his role at Australian Ethical.

Managed Fund	1 year Quartile	3 years Quartile	5 years Quartile	7 years Quartile	10 years Quartile
Balanced	2nd	3rd	4th	1st	2nd
Smaller companies - Retail	2nd	1st	3rd	1st	1st
Larger companies - Retail	1st	1st	1st	1st	1st
Advocacy	1st	1st	-	-	-
International equities	1st	4th	4th	3rd	-
Cash	2nd	1st	1st	1st	1st

Source: Mercer 30 June 2014. Ranking based on Mercer peer group category.

## Advocacy initiatives

A key focus for Australian Ethical is to influence behaviour in others through our engagement and advocacy activities with the companies we invest in.

Our activities throughout the year include:

- **Engaging with Santos on CSG**  
We've been engaged with Santos about their involvement in coal seam gas both directly and through industry forums. We also supported a shareholder resolution by the Wilderness Society and GetUp! that asked Santos to divest from the Narrabri coal seam gas project. The resolution was not successful, but attracted valuable media coverage of the issues related to coal seam gas extraction.
- **Anti-Abbot Point campaign**  
Together with other activist organisations, we advocated strongly against Lend Lease's involvement in the Abbot Point coal terminal, drawing attention to the project's potential impact on the Great Barrier Reef. Subsequently, Lend Lease announced that they were not proceeding with the project.
- **Divesting from Petratherm**  
Following their announcement that they would be conducting oil and gas exploration in Tasmania, we divested from Petratherm. The company had been focused on the development of geothermal energy technologies.
- **Engaging with banks on fossil fuels**  
We are engaging with the 'big four' Australian banks about improving their disclosure and governance in lending to the fossil fuel sector. We are working with major domestic and international institutional investors to develop global guidelines for the reporting of the greenhouse gas emissions intensity of lending and investment activities.

## Recognition of our industry leadership

During the year we earned certification as a registered B Corporation. B Corporations – also known as benefit corporations – 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.

We are committed to the principles of the Global Reporting Initiative in producing our annual sustainability report. This year we abided by the newly released G4 principles and were one of the few Australian firms to do so.

We are also actively involved with the United Nations Principles of Responsible Investment (UNPRI) through industry working groups. This year we became the only Australian company to voluntarily have our self-certification to the principles independently assured.

## Industry Advocacy: The Future Economy Group

The Future Economy Group is a group of business and environmental organisations that has undertaken research on the impact of natural capital on the Victorian economy and the risks of failing to preserve it. We participated in and provided funding support for their activities. The Group is advocating for State Government action to measure and report natural capital; to remove subsidies which negatively impact the environment; to support a circular system of production and consumption; and to invest in the development of skills needed for the future economy.

## Sales and marketing

Our sales and marketing initiatives have been extremely successful with dramatic results in both new clients and net inflows. Initiatives over the past few years have included investment in our digital communications and social media platforms.

Investment in online engagement provides an extremely effective and efficient means of building awareness and communicating with the ethically conscious investment community.

Platforms such as our website and social media pages as well as *Good Money* magazine are used not just for one way communication. They are 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.



The following are our measures of success:

- **Increase in followers and engagement**  
Our 'followers' on Facebook, LinkedIn and Twitter increased ten fold. Facebook followers increased from about 2,500 to 25,000 over the 12 months providing increased 'reach' and access. Ultimately social media acts as a cost effective lead generation tool. Our 'engagement' levels – those talking about the brand as a percentage of total 'likes' – also remain extremely high by industry standards.
- **Increase in client sign-ups**  
Our new individual client sign-ups averaged 400 per month compared to 160 per month for the previous year. Super fund membership grew by 18.8% for the year compared to an industry average of -0.1%. We also tripled the rate of new super employer clients signing up to use the super fund during the year.
- **Net inflows**  
Net inflows were \$92m compared to \$1m for the previous year. Super Funds Under Management growth was 28.1% for the financial year, versus the industry average of 14.6%.

#### **Purchase of *Ethical Investor***

As part of our digital content strategy, we recently purchased *Ethical Investor*. The publication has been a respected source of industry news and information for over 10 years.

We have refreshed the website and newsletter, increase engagement with subscribers and built 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.

#### **Awards and recognition**

In 2013/14, we won the following awards from industry peer associations:

- *ASFA 'Judges' Selection Award: Social Media Engagement & Growth Strategy'*  
The award was part of the 'Best Use of Social Media' category 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. We also won two other major ASFA awards in late 2013.

- *Banksia Foundation 'Leading in Sustainability - Setting the Standard for Small to Medium Businesses Award'*  
Awarded by the Banksia Foundation, a respected not-for-profit that recognises environmental and business excellence.
- *Green Living magazine 'Sustainable Large Business (over 15 employees) Award'*

#### **Investing in our people**

We have increased our attention on training and career development aiming to foster a culture where our people are aligned and engaged with our purpose and vision and have the opportunity to grow develop their careers.

Our talent management strategy is attracting, developing and retaining the most talented employees by providing an environment that encourages employees to grow, contribute and develop in a way that contributes to a sense of making the world a better place and one that reflects the Australian Ethical Charter.

This year, we have focused our efforts in the following areas:

- A focus on communication involving consulting with employees on the 'how' and 'what';
- Growing leadership capability in developing and sustaining a values based culture;
- Enabling a learning and development environment aligned to employee strengths and sense of purpose;
- Cultivating a collaborative team environment as we integrate new hires;
- A focus on creating a performance-based culture supported by equal opportunity and diversity measures.

This year we engaged the independent firm Hewitt's to conduct our staff engagement survey and to provide an engagement score for the first time. This allows us to compare our levels of engagement with industry peers. We were pleased to receive a score of 78 compared to a 'best employer' score of 82.

## Product improvements

### MySuper approval

On 16 September 2013 we received approval from APRA to offer a MySuper product. This authorisation allows us to accept employer super contributions where the employee has not made a choice of funds. This is a key aspect within our strategy to be the default super fund of choice for ethical employers, for example, for B Corps and NGOs.

### Launch of Ethical Fixed Interest Trust

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



Phil Vernon  
Managing Director

## Operational improvements

We made numerous improvements to our operations as a result of 'Superstream' regulatory changes which are aimed at streamlining the efficiency of the industry.

As a result we have improved the process of receiving employer contributions and all rollover requests are now processed within three days.

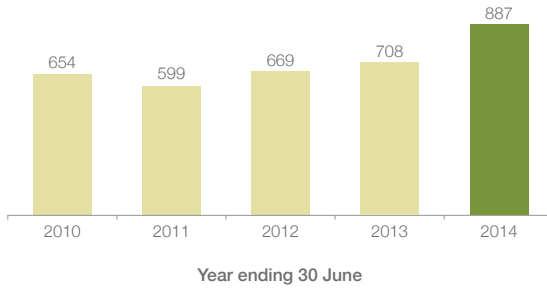
During this period, we consolidated our operations into our Sydney office. Over the past few years the business had gradually evolved to be primarily based in Sydney in order to access the necessary skilled and qualified staff and to be connected with clients, investee companies and intermediaries. The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



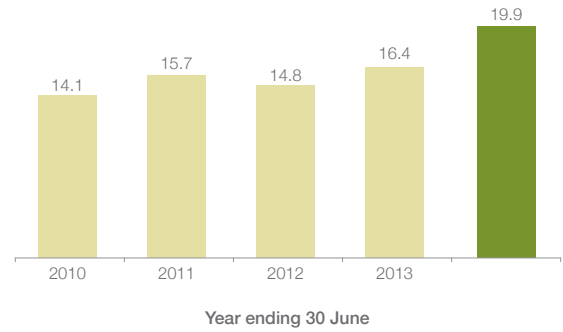
Steve Gibbs  
Chairman

# Financial Summary

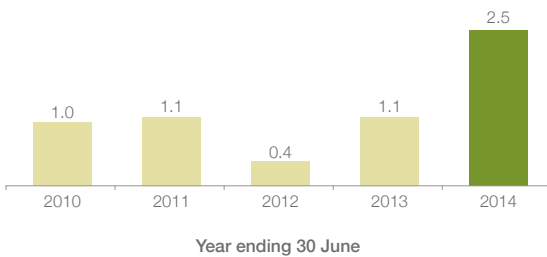
*Funds Under Management (\$m)*



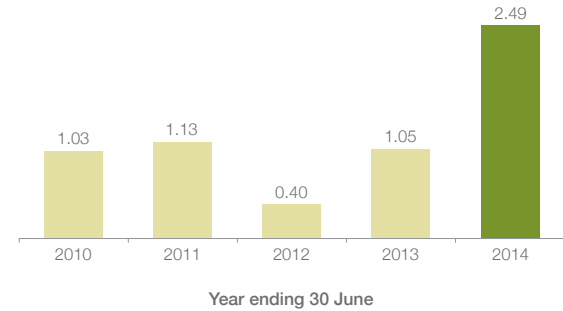
*Revenue (\$m)*



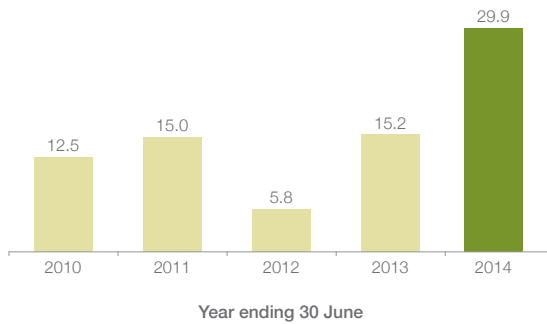
*Net Profit After Tax (\$m)*



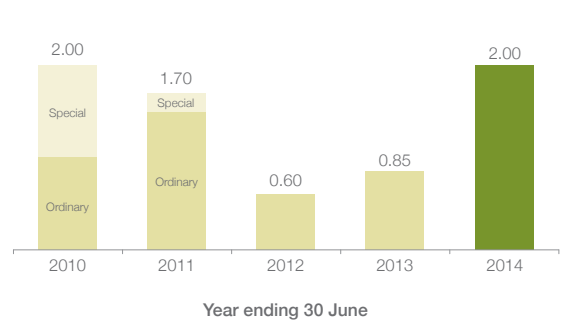
*Basic Earnings Per Share (\$)*



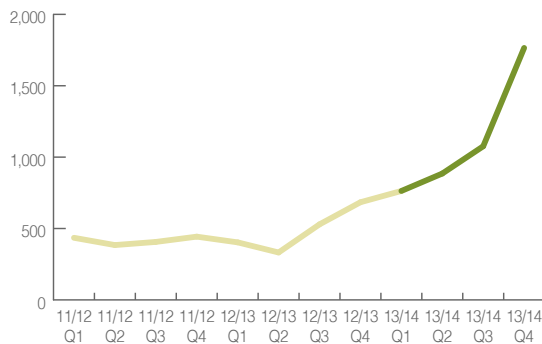
*Return On Equity (%)*



*Dividends Paid (\$)*



*New Clients (by quarter)*



*Funds Under Management*





## Financial results

Profit	2013 (\$'000)	2014 (\$'000)	% change
Revenue	16,378	19,889	21%
Operating expenses	13,006	13,546	-4%
Tax, community grants and other non-operating expenses	2,309	3,800	-61%
<b>Net Profit After Tax (NPAT)</b>	<b>1,063</b>	<b>2,543</b>	<b>139%</b>
Adjustments			
Add back employment restructure expenses	–	409	
Add back property revaluation	436	282	
Add back legal costs for shareholder actions	85	–	
Add back revaluation of listed securities	117	–	
Tax on adjustments	-26	-123	
<b>Underlying Net Profit After Tax (UPAT)<sup>1</sup></b>	<b>1,675</b>	<b>3,111</b>	<b>85%</b>

<sup>1</sup> 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.

Funds Under Management	2013 (\$m)	2014 (\$m)	% change
Opening FUM	627	708	13%
Super flows (net)	18	78	328%
Managed Funds flows (net)	-17	14	n/a
Net Flows	1	92	n/a
Market movement	80	87	10
Closing FUM	708	887	28%

Dividends	2013 (cents per share)	2014 (cents per share)	% change
Interim (fully franked)	40	80	
Final (fully franked)	45	120	
Total dividend	85	200	135%

## Notes to Results

### Key factors impacting the results are:

**Higher market values** – Improved net flows along with strong investment performance increased our funds under management. As our revenues are primarily related to funds under management this had a consequent impact on our revenues.

**More competitive fees** – We have made a number of adjustments to our fees over the past few years which are aimed at making our products more competitive and better value for our clients. This more competitive pricing has had a beneficial impact on net flows in the future.

**Expenses** – Increased expenses include higher variable remuneration due to the positive performance of the company, increased marketing, legal fees due to regulatory change, and increased outsourcing costs due to higher member numbers.

**Impairment to building** – we incurred a further non-cash impairment charge of \$282k with respect to our property in Canberra.

### Dividend

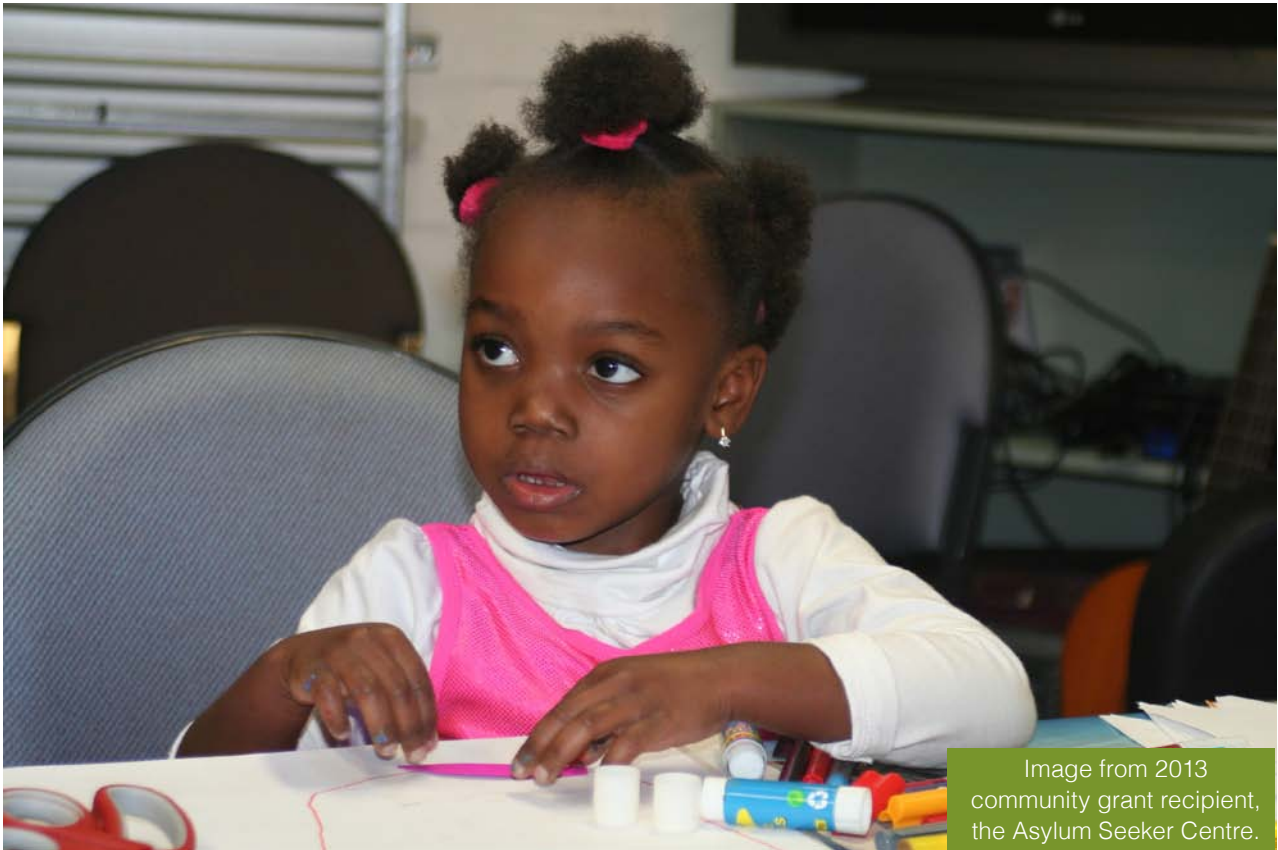
In arriving at the final dividend determination, the board took account of the following factors:

- Our rapidly growing funds under management and hence increasing regulatory liquidity requirements
- Market uncertainty
- Future potential strategic requirements

The full year dividend of \$2.00 per share is the highest dividend the Company has paid from ordinary earnings since listing in 2002.

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# 2014 Community Grants



## *Improvements to our Community Grants program*

As prescribed in Australian Ethical's constitution, 10% of our profits are 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.

This year, in a change from the norm, we have decided to start the process of grant giving after the publication of our annual report instead of months before.

The logic for this is so we know exactly how much money is available to good causes, which in turn gives greater clarity to grant applicants. This change follows feedback from applicants.

The Community Grants process for this year will start in September.



## Contact us

Phone: 1800 021 227  
Email: [enquiries@australianethical.com.au](mailto:enquiries@australianethical.com.au)  
Address: Reply Paid 3993, Sydney NSW 2001  
Web: [australianethical.com.au](http://australianethical.com.au)