

australianethical

SHAREHOLDER NEWSLETTER

October 2008

Chair's report



A sound year during troubled times

The board is pleased to report that Australian Ethical Investment Ltd has had another sound year in terms of profit and return on equity, with a dividend declaration of \$1.65 per share and a return on equity of 20.6%. While both these figures are somewhat lower than our 2007 record returns, they are very good in light of the market turbulence experienced over the past six months. Our balance sheet remains strong with the ability to finance our strategic initiatives discussed below.

With market volatility at record levels, it is worthwhile to review the fundamental growth prospects of our industry. The board is confident that our growth prospects remain strong, despite the market downturn. Our trusts have held up well relative to the market through the downturn. Our Equity Trust and Large Companies Share Trust in particular have outperformed their respective benchmarks strongly during the last few rocky months.

While the overall ethical market in Australia is still quite small - about \$17 billion - it is growing very fast. Investments that systematically take environmental, social and governance issues into account outgrew mainstream investing by more than double in the year to June 2007. They grew by 43%, from \$12 billion to \$17 billion, compared to 20% growth in the managed investments industry overall.

Within this high growth stream, Australian Ethical has a brand which is true to form, strong, and the envy of many others in the area. However, our brand recognition lags behind where it could be, partly because we have not had the capacity for large scale marketing expenditure and partly because we have focused on deep green niche target markets. We are currently in the middle of a two year project to address this, including:

- the development of marketing messages that are tangible and more accessible than the principles of the Charter
- close work with asset consultants and rating agencies to improve their understanding of our products.

We are confident that this will bear fruit in the next two years.

Our retail superannuation business has steadily grown as a percentage of our total business over the last five years, and now represents well over 50% of our funds under management. This business is much less sensitive to market fluctuations than our managed investments business and we are confident that this part of our business will continue to grow strongly. The board is mindful of recent statements by the government regarding the high cost of retail superannuation funds and has a strategy in place to minimise the impact of any government intervention in this area.

We are pleased to advise shareholders that our search for high quality non-executive directors has borne fruit this year, with the appointment of Andre Morony and Les Coleman to the board. Non-executive directors, Justine Hickey and Andre Morony bring to our board wide external funds management experience, while Les Coleman has deep risk management expertise.

Caroline Le Couteur has indicated that she will not be standing for re-election to the board this year meaning that the board will shortly comprise a majority of non-executive directors. I would personally like to thank Caroline for her significant contribution to the board of Australian Ethical over the last 17 years and for her commitment over that time to our Charter.

We continue our 2007 strategy of broadening our marketing reach beyond our traditional support base. A 2008 strategy meeting also identified the need for a review of our internal IT systems, and this is now underway to ensure our systems are robust to deal with future growth.

I have enjoyed my first year as chair and can personally attest to the qualities of Anne O'Donnell as CEO and managing director of Australian Ethical. While many boards are changing CEO during these troubled times, I have full confidence in Anne to deliver shareholder returns in a sustainable way. Anne has recruited a strong team around her, including Martin Halloran, our new chief investment officer and Paul Harding-Davis, our new head of distribution. I believe this team will take the best of Australian Ethical, which is our people, our ethical investment processes and our Charter, and use them in new and exciting ways which will grow our company into the future.



Naomi Edwards
Chair

Managing director's report



The financial year ended 30 June 2008 reflects a year of two halves. The Australian Ethical Investment group performed strongly in the first half of the year however the full year result reflects the volatility and uncertainty that has been experienced in global financial markets. The Australian Ethical trusts had no direct exposure to any 'sub-prime' investments, however we have experienced the impact of falling asset prices and depressed investor sentiment. The company recorded a consolidated net profit of \$1.65 million. This trading result represents a decrease on the previous financial year's excellent result of \$1.82m. Whilst it is disappointing

to record a decrease in year on year profit, given the difficult circumstances experienced in the financial markets I consider this a good result.

The company achieved strong growth in funds under management during the first half of the financial year with funds peaking at \$645m. This growth and the revenue generated cushioned the impact of downward market movements which occurred in the second half of the financial year. As at 30 June 2008, funds under management totalled \$562m (ex distribution). This compares with funds under management of \$552m (ex distribution) as at 30 June 2007.

The relative flatness in funds under management, combined with some increased costs and additional expenditure on business development, resulted in the cost to income ratio increasing from 76% in 2007 to 80%. This increase is in contrast with the steadily declining trend experienced in the past four financial years. Return on equity was also impacted falling from 26.1% to 20.6%.

The Australian Ethical Trusts performed credibly in a year of poorly performing financial markets with the returns for three of our five trusts exceeding their benchmarks. This was a good result and important as the success and growth of our business is dependant on the performance of the Australian Ethical trusts. We remain committed to investing in quality companies taking into account ethical and financial strength and ensuring our returns are commensurate with the risk profile of an individual trust.

The Australian Ethical Retail Superannuation Fund has continued to experience steady inflow of funds in line with expectations. On 1 April 2008 we transited the administration of our superannuation fund to a new service provider. This process has not been without its difficulties and we have incurred one-off costs as part of this process. Despite these transitional problems it is apparent the move will result in a more robust administration of the superannuation fund. In the past the fee structure of the administrator was linked to funds under management. The new structure is not linked to funds under management and we estimate this new arrangement will result in savings greater than half a million dollars in the current financial year.

When considering the level of dividend the directors are mindful of the significant franking credits held by the company and the need to ensure we have sufficient capital to provide prudent reinvestment into the business. The directors have decided that shareholders will be paid a final dividend (fully franked) of \$1.20 per ordinary share. Added to the interim dividend of 0.45 cents per share, the total dividend for the 2007-08 financial year will be \$1.65 per share.

The Australian Ethical Retail Superannuation Fund was awarded the inaugural Infinity Award at the Conference of Major Super Funds (CMSF) in March 2008. The award signifies the Fund as Australia's most environmentally and socially conscious fund and a leader in sustainable investment and sustainable business practices.

Trevor Pearcey House continues to meet high standards of energy efficiency and to provide our employees with a

comfortable and productive working environment. Interest in the building continues to be strong and this has been very useful in raising the profile of Australian Ethical generally. In July this year, our refurbishment won the Banksia Environmental Foundation award for the Built Environment. The Prime Minister is the Chief Patron of the awards and the win comes on the 20 year anniversary of the awards.

Outlook

A significant portion of investment in the Australian Ethical trusts comes from retail clients. This money has traditionally been 'sticky' in times of market downturn and historically the trusts have not experienced significant outflows. However, Australian Ethical is not immune to market volatility and negative investor sentiment. It is highly likely we will see the impact of these factors in our funds under management and revenue numbers during the 2008–09 financial year. A decline in revenue has the potential to impact company profitability.

Offsetting potential declines in revenue are savings which will flow from changes we have made to our custodian and superannuation administration providers. The company will continue to focus on building and servicing its clients and streamlining its processes, ensuring scalability and efficiency of operations. During challenging financial periods it is tempting to take the easy option and cut costs dramatically and potentially endanger future growth opportunities. Australian Ethical is fortunate in that we have a unique product offering and a very loyal customer base. Whilst we are mindful of the need to monitor our costs closely, we do not intend to undertake any radical changes to our business model at this time.

As previously flagged we are keen to attract increased non-retail investment. We continue to implement strategies which will allow us to tap into the growing commercial interest in sustainable investment. We also believe the rise in shareholder activism offers some exciting opportunities which complement our expertise and have the potential to expand our customer base. We are currently exploring the possibility of bringing to market a product which will tap into this trend.

All the staff at Australian Ethical have been working hard in what has been a very difficult financial market. I would like to thank them for their diligence and commitment. I would also like to thank you, our shareholders, for your ongoing support and I look forward to seeing you at the annual general meeting on 27 November.



Anne O'Donnell
Chief executive officer and managing director

Grants to community organisations

\$60 000

Bluegreen Films - 'Sustainability & Co' a three part documentary series on corporate sustainability and governance will be produced by Bluegreen Films.

\$50 000

MSAP - University of NSW Medical Students' Aid Project will stock a community store with school and household essentials, purchase a motorised canoe, fuel and one year's salary for a canoe pilot to transport the products to remote riverside markets in the Congo.

\$7945

Barefoot Economy

Engineers Without Borders - Tonlé Sap Lake Project

\$5000

Australian Marine Conservation Society

WaterAid Australia

ACT Eden Monaro Cancer Support Group

New Internationalist Publications

Edmund Rice Centre for Justice and Community Education

Pedal Power ACT

\$3000

Fair Trade Association of Australia and New Zealand

Animals Asia Foundation (Australia)

Child Wise

Rainforest Rescue

Royal Institute for Deaf and Blind Children

Sustainable Maleny

The Queensland Society for Crippled Children

Asian Women at Work

Bush Heritage Australia

Clean Ocean Foundation

Romero Centre

Trees For Life

Broken Hill & District Hearing Resource Centre

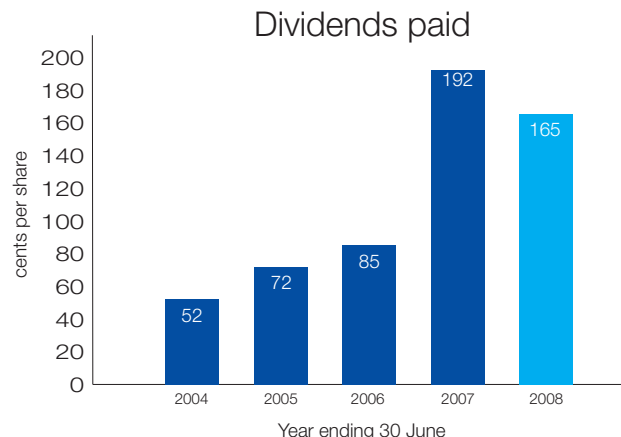
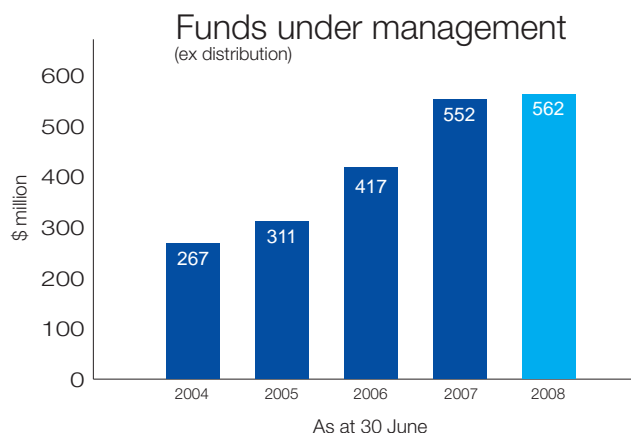
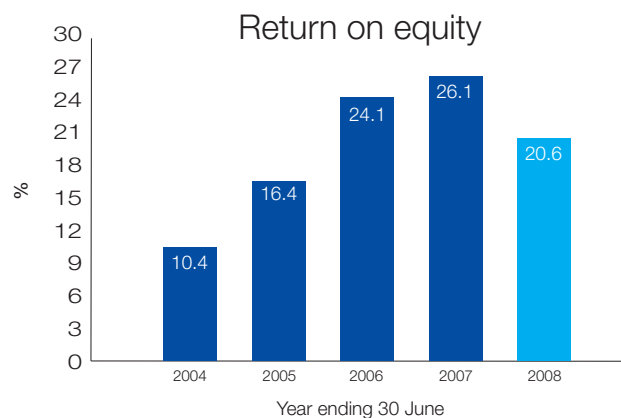
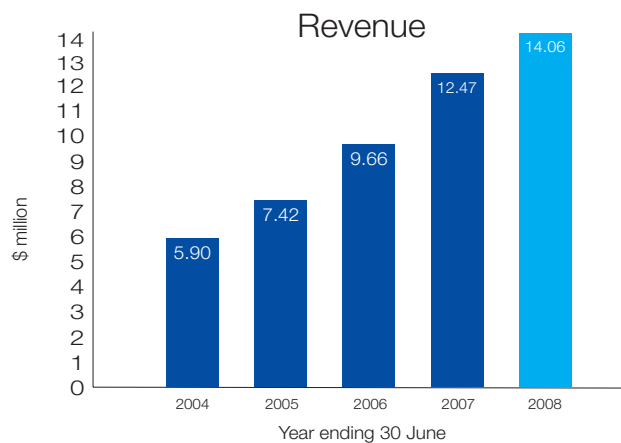
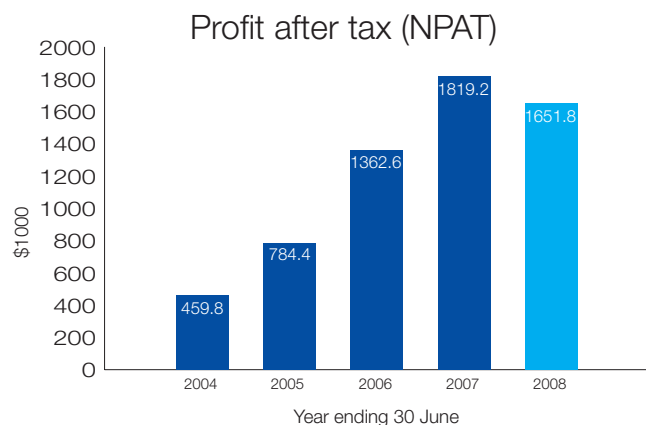
Kuusa Services Centre

The Australian Conservation Foundation

A full description of all the grant recipients is available on the website www.austethical.com.au/cg

Financial summary to 30 June 2008

as at	30 June 2008	30 June 2007	30 June 2006	30 June 2005
Current assets (\$'000)	6 362	5 174	5 176	5 833
Non-current assets (\$'000)	4 790	4 879	3 103	701
Current liabilities (\$'000)	2 658	2 293	1 928	1 456
Non-current liabilities (\$'000)	113	76	77	31
Net assets (\$'000)	8 381	7 684	6 274	5 047



2005 figures in the above tables and graphs have been adjusted where necessary as for first time adoption of Australian equivalents to International Financial Reporting Standards (AIFRS).

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