



# CarbonFund

## Carbon Fund Fact Sheet – Quarter ending 31 December 2023

### Manager Profile

Salt Funds Management is a boutique investment management firm wholly owned by its employees. We are active managers. Our shared investment philosophy is centred on the belief that market inefficiencies exist that can be exploited over time to deliver superior risk-adjusted returns.

Further, the consideration of environmental, social and governance (ESG) factors is integral to the research we carry out. Salt analysts consider the potential for ESG factors to influence long term returns on invested capital (positively and negatively).

### Investment Strategy

The Fund's aim is to provide investors with a total return exposure to the price of carbon credits. The Fund has the ability to buy carbon credits in emissions trading schemes in New Zealand and offshore.

The Fund gains its exposure to the price of carbon credits in the NZ ETS through purchasing and holding carbon credits on the NZ ETS. We may also use swaps or other derivatives to gain exposure to the NZ ETS.

The Fund will also have the ability to buy carbon credits in international emission trading schemes, as well as futures, swaps or other derivatives that provide exposure to international schemes. As a result, the Fund may also provide exposure to the price of carbon offshore.

The Fund is actively managed by us. This means we buy and sell carbon credits on emission trading schemes, or hold cash based on our own analysis and assessment of the market. This includes our assessment of the price of carbon credits relative to the demand and supply of carbon credits and other factors including technological advancements, politics, regulation, fuel prices and even global weather and climate change.

### Fund Details

Fund Assets	\$95 million
Inception Date	8 November 2018
Portfolio Manager	Paul Harrison
Total Fund Charges (p.a.)	0.96%
NZX Code	CO2

### Who is involved?

Supervisor	The New Zealand Guardian Trust Company Limited
Custodian	The New Zealand Guardian Trust Company Limited
Administration Manager	Apex Group Limited
Unit registrar	Link Market Services Limited
Investment Manager	Salt Funds Management Limited

### Net Tangible Assets (NTA) Value on 31 December 2023

Application	2.0232
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### CO2 price on NZX Main Board on 31 December 2023

NZX Close	1.84
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### Investment Guidelines

The guidelines for the Carbon Fund are shown below:

Carbon credits	0% – 100%
Cash	0% – 100%

### Target investment Mix

The target investment mix for the Carbon Fund is:

Carbon credits	98.00%
Cash	2.00%

### Fund Allocation at 31 December 2023

NZ carbon credits	95.9%
Aus carbon credits	3.3%
Cash	0.8%

### Fund Performance to 31 December 2023

Period	Fund Return
3 months	3.47%
1 year	-8.18%
2 years (p.a.)	-0.71%
3 years (p.a.)	15.37%
Since inception (p.a.)	14.67%

Performance is based on NTA movement and is after all fees and 28% tax. Past performance is not a good indicator of future performance.

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## Quarterly Fund Commentary

Dear Fellow Investor,

During the December quarter of 2023, NZU prices continued to cautiously recover, increasing from \$66 to just over \$69 (+4.7%). This was paralleled by a rise in Australia where ACCU pricing rose from \$30 to \$33.50 (+11.7%).

Importantly, New Zealand's newly elected Government stated there will be no change to the Emission Trading Scheme (ETS) settings and carbon pricing via the ETS remains a central policy plank for addressing climate change. This helped the continued recovery of confidence in the NZU market.

Also, of note in New Zealand, was the December ETS Auction of NZUs. There was the entire 2023 years' worth of NZU allocation (15m NZUs) available, but they needed to clear at a price that was above the secret reserve price. Ultimately there were insufficient bids for volume and price to trigger the sale of NZUs and the auction automatically declined to sell any NZUs at auction in Dec.

The 2023 allocation of 15m NZUs will not be carried over into 2024 so the March 2024 will start with a clean slate. The NZUs available at auctions over all of 2024 is 14.1m.

The Climate Change Commission (CCC) included the assumption of 15m NZUs being issued in 2023 in its forecasts of NZU supply. The CCC forecast it was creating a deficit of supply (via the auction settings) that would see the estimated 49m surplus of NZUs already issued, decline to zero by 2030. As the 15m NZUs were not auctioned in 2023, this outcome will be brought forward.

The 2024 ETS auction in March starts with 3.525m NZUs available and a minimum floor price of \$64.00. The first allocation of any extra NZUs via the Cost Containment Reserve is not available until a trigger price of \$184 is reached.

The March auction will be the last auction available to emitters needing to buy NZUs for their 2023-year commitments. It will be interesting to see the level of demand. We suspect that a lot of emitters are currently mostly covered for 2023 as they were the natural buyer of the forestry originated NZUs last year when the previous government consultation put the value of forestry originated NZUs in serious doubt and spooked numerous forestry owners to dump any NZUs held. This was a major boon for the emitters as even under the most dramatic changes proposed, the emitters would be able to utilise forestry originated NZUs in their compliance surrenders, leaving them as the only buyers of NZUs at the time.

The government has continued to state they want the status quo to remain in the ETS and that the ETS is a major plank for meeting our climate change commitments. We believe that it will become more difficult to plant "permanent" pine trees especially in areas that could be utilised for other agriculture as the government seeks to empower local authorities to determine where carbon forestry can occur. This will limit the potential future supply of NZUs. There are a number of factors that will likely underpin demand for NZUs with emissions from population growth (net migration), increased tourism, lower petrol prices, removal of the clean car discount and an overall increase in economic activity all expected to increase demand for NZUs from vehicle use increases. Electricity generators in 2023 benefited from high levels of rainfall which enabled significantly higher use of hydro to generate electricity. For example, Genesis Energy cut its use of thermal electricity generation emissions by over 1.2m tonnes compared to a more normal year<sup>1</sup>. With Southern hydro lakes already below average, the use of thermal to generate electricity looks likely to be at or above a normal year.

Over the December quarter, the Fund sold 65,000 tonnes of NZUs for prices up to \$75.70 and average sale price of \$71.40. In response to the Fund trading below its NTA, and therefore providing a reasonable arbitrage opportunity, the Fund purchased 3.78m CO2 units for an average cost of \$1.86. As a comparison, for the Fund NTA to be \$1.86, the Manager estimates the NZU price would need to be circa \$60 per NZU (which is below the minimum price for NZUs can be sold at auction in 2024).

The unit price of the Carbon Fund traded on the NZX rose 3.4%. The NTA of the Carbon Fund finished the quarter at \$2.02, a rise of 3.5% (after tax and fees). In part, the discount to NTA reflects the current low level of liquidity seen across many NZX listed entities and some profit taking after the Fund's circa 30% rise over the December quarter. The Fund has now returned 15.4% p.a. for the 3 years to 31 December 2023 (after fees and tax) representing a solid, uncorrelated return to the NZX50Gross Index return over the same period of minus -3.5% p.a.



Paul Harrison, BCA, MBA, CA

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<sup>1</sup> Page 18 of Genesis Energy Climate-Related disclosures report August 2023.