



CarbonFund

Carbon Fund Fact Sheet – Quarter ending 30 June 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	\$86 million
Inception Date	8 November 2018
Portfolio Manager	Paul Harrison
Total Fund Charges (p.a.)	0.96%
NZX Code	CO2

Who is involved?

Supervisor	New Zealand Guardian Trust
Custodian	New Zealand Guardian Trust
Administration Manager	Apex NZ
Unit registrar	Link Market Services
Investment Manager	Salt Funds Management

Net Tangible Assets (NTA) Value on 30 June 2023

Application	1.4534
-------------	--------

CO2 price on NZX Main Board on 30 June 2023

NZX Close	1.37
-----------	------

Investment Guidelines

The guidelines for the Carbon Fund are:

Carbon credits	0% – 100%
Cash & cash equivalents	0% – 100%

Target investment Mix

The target investment mix for the Carbon Fund is:

Carbon credits	98.00%
Cash & cash equivalents	2.00%

Fund Allocation at 30 June 2023

NZ carbon credits	89.81%
Aus carbon credits	4.92%
Cash & cash equivalents	5.27%

Fund Performance to 30 June 2023

Period	Fund Return
3 months	-16.76%
1 year	-34.02%
2 years (p.a.)	-0.73%
3 years (p.a.)	7.36%
Since inception (p.a.)	8.39%

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

SALT INVESTMENT FUNDS LIMITED

Level 3, The Imperial Buildings, 44 Queen Street | PO Box 106-587, Auckland 1143

Email: info@carbonfund.co.nz | www.carbonfund.co.nz

Quarterly Fund Commentary

Dear Fellow Investor,

The New Zealand carbon market is undergoing significant developments, driven by a recent court case, government decisions, and concerns related to the level of forestry in the NZ Emissions Trading Scheme (ETS). This update provides a review of the changes that occurred during the June quarter and what has happened since.

Recent Government Actions and Auction Settings

The ongoing uncertainty created by the New Zealand Government's decision in December 2022 to not follow the recommendations of the Climate Change Commission saw the NZU price drift lower throughout the June quarter culminating in an unsuccessful NZU auction where the government did not secure enough bids to clear the NZUs on offer. The announcement in June of a review of the design of the ETS and its permanent forest category threw the NZU market into free fall. The uncertainty created by the release of such a wide and ambiguous consultation created a huge amount of uncertainty. The consultation is scheduled to close on the 11th of August but with a General Election shortly after, the final decision on what the outcome of this review will look like will be up to the new government, so it is unlikely that any certainty will occur until next year.

ETS Options and Permanent Forest Review

The New Zealand Government's review of the ETS has introduced four options for consideration, accompanied by a separate consultation on permanent forestry. The Government's apparent favoured option is Option 4 which is headlined as *"Emitters will not be able to purchase NZUs from foresters to pay for their greenhouse gas emissions"*. This option would see separate markets for forestry and non-forestry NZUs, with the Government as the only buyer of forestry NZUs. This would likely result in differing prices between the two categories and this differentiation is already being observed in the secondary market, with a reported difference of between \$2.00 to \$3.00 per NZU.

The logic behind such a change is that the perceived price necessary to incentivise forestry plantings is lower (Salt estimates circa \$40/NZU) compared to the price required for substantial emission reductions (Salt estimates above \$70). Given this potential split in NZU pricing, the Carbon Fund has shifted its holdings away from forestry removal NZUs, now solely holding non-forestry sourced NZUs.

Balancing Forestry Growth and Emission Reduction Goals

New Zealand has experienced a surge in investment in new forests, driven by NZU prices. This growth is evident in the 220,000 hectares processed into the ETS for 2022 compared to the existing 300,000 hectares that took over a decade to accumulate in the ETS. Government projections indicate that the ETS could potentially lead to the afforestation of another 645,000 hectares, with around half of this new afforestation being permanent exotic forests. Carbon sequestration via forestry is needed for New Zealand to get closer to its 2030 Paris Agreement commitments and current projections are for an expensive breach of 114m tonnes. However, given that only half of New Zealand's emissions (i.e., demand for NZUs) are included in the ETS, there are concerns that unrestricted afforestation could result in an oversupply of NZUs into the ETS from 2037. There are also questions as to the merits of creating a permanent forest of pine trees.

New Auction settings

A High Court decision in July forced the government to review its decision to ignore the Climate Change Commission advice on the auction settings. As a result, the government has announced new settings for the ETS auctions from December, that significantly reduce the NZU volumes offered in the auction and increase the minimum price that the any NZUs will be sold at auction.

Outlook

The New Zealand carbon market is undergoing significant shifts due to recent legal proceedings, government policy updates, and challenges associated with forestry inclusion in the ETS. Balancing the growth of the forestry sector with emission reduction goals remains a critical concern, prompting the need for well-defined policies and effective market mechanisms to achieve the nation's climate commitments. The new auction settings for the ETS are an immediate positive and we expect that the review of forestry to be a longer-term positive step for the ETS.

The next key event will be the September 6th auction of 13.425m NZUs which will be held under the old ETS settings, including a minimum auction price of \$33.06 NZD. This auction could be viewed by some as the last opportunity to secure auction based NZUs before the new price settings commence from December that have a minimum price of \$60.



Paul Harrison, BCA, MBA, CA