



CarbonFund

Carbon Fund Fact Sheet – Quarter ending 30 September 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	\$92 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 30 September 2023

Application	1.9554
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CO2 price on NZX Main Board on 30 September 2023

NZX Close	1.78
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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 30 September 2023

NZ carbon credits	94.9%
Aus carbon credits	3.1%
Cash	2.0%

Fund Performance to 30 September 2023

Period	Fund Return
3 months	34.55%
1 year	-12.54%
2 years (p.a.)	0.42%
3 years (p.a.)	16.07%
Since inception (p.a.)	14.68%

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,

The September quarter began with ongoing weakness in NZU pricing following the New Zealand Government's decision in December 2022 to not follow the recommendations of the Climate Change Commission (CCC), higher interest rates increasing the cost of holding trading positions, and the June announcement of a review of the design of the Emissions Trading Scheme (ETS) and its permanent forest category.

In July the market received some positive news when the High Court ordered the government to review its decision not to follow the CCC advice on the ETS settings following a judicial review brought by the Lawyers for Climate Action NZ. The market was then expecting the government to announce its review closer to the September deadline but was surprised when the new ETS settings were announced on the 25th of July.

The new ETS settings included a reduction in the number of units available at auction, a significant rise in the auction floor price and a very large increase in the price at which any cost containment reserve units would become available.

This table shows the outcome of the decision versus the previous settings:

	2023	2024	2025	2026	2027	2028
NZU Auction Units Available (millions)	15.0	14.2	12.6	10.7	9.1	6.9
Auction Unit Reduction vs Current Setting (millions)	-2.9	-2.9	-2.7	-2.8	-2.6	N/A
NZU Minimum Auction Price	\$60.00	\$64.00	\$68.00	\$72.00	\$75.00	\$79.00
Minimum Price Increase vs Current Setting	+\$26.94	+\$28.10	+\$29.33	+\$30.55	+\$30.65	N/A
Cost Containment Reserve Trigger Prices	\$173.00	\$184.00	\$194.00	\$205.00	\$215.00	\$226.00
	\$216.00	\$230.00	\$243.00	\$256.00	\$269.00	\$283.00
CCR (2023) Units available (millions) Tier 1 & Tier 2		2.8	2.6	2.3	2.1	1.9
		4.9	4.5	4.2	3.8	3.4
CCR (2023) Total reserve Units available (millions)	8.0	7.7	7.1	6.5	5.9	5.4

The market responded positively to this announcement and the NZU price steadily recovered from the \$41 mark where it started the quarter up to \$66 where it finished the quarter.

The ETS auctions and what it could mean for NZU supply.

The 6th of September auction was held under the old ETS setting as the new settings do not come into force until the December auction. The September auction had 13.425m NZUs available as well up to an additional 8.0m units from

the cost containment reserve if the bid price went above \$80.64.

To be successful there needed to be 13.425m NZUs bid for above the secret reserve price. Despite the positive sentiment following the announcement of new ETS settings, the auction received an insufficient level of bids (7.7m NZUs bid for) and the government "declined" to sell any NZUs.

The government has previously indicated that if there is not the demand in the auctions it means that the secondary market is operating effectively and the ETS participants are able to acquire the NZUs they need without the government intervening with more NZU supply.

The next auction to be held on the 6th of December has 15.0m NZUs available in the auction with a minimum floor price of \$60.00. The cost containment reserve units are only available if the bidding climbs above \$173.00 per NZU. With the current secondary market price (to which the secret reserve price is linked) around \$69.00, there is the potential for the December auction to result in no NZUs being auctioned. This would mean that the government does not sell any NZUs in 2023 and the market for NZUs will not have had the forecast supply of 15 million new NZUs.

This would be a positive development for the NZU market as it will help reduce the "surplus" NZUs that have already been issued. The CCC has previously estimated that this surplus is circa 49 million NZUs and that by reducing the volumes available to be sold at auction will see this surplus of NZUs consumed by demand in the ETS by 2030. If there are no units sold at auction in 2023 the surplus reduction will be brought forward by 15 million NZUs.

There is still the uncertainty created by the review of the ETS with its four options and the separate consultation on permanent forestry. The consultation is now closed, and it remains to be seen what the new government will do with the information, but the market appears to be taking the view that a radical restructuring of the ETS is now unlikely.



Paul Harrison, BCA, MBA, CA