CarbonFund

Carbon Fund Fact Sheet – Quarter ending 31 December 2024

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 generally 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.

We actively manage the Fund. 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	$89 million
Inception Date	8 November 2018
Portfolio Manager	Paul Harrison
Total Fund Charges (p.a.)	0.96%
NZX Code	CO2

Who is involved?

Supervisor	NZ Guardian Trust Company Ltd.
Administrator	Apex Administration (NZ) Ltd.
Custodian	Apex Administration (NZ) Ltd.
Registrar	Link Market Services Ltd.
Investment Manager	Salt Funds Management Ltd.

Net Tangible Assets (NTA) Value on 31 December 2024

Application	1.8945

CO_2 price on NZX Main Board on 31 December 2024

NZX Close	1.70

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 2024

NZ carbon credits	72.22%
Carbon Fund	23.77%
Aus carbon credits	3.99%
Cash	0.01%

Fund Performance to 31 December 2024

Period	Fund Return
3 months	2.22%
1 year	-6.37%
2 years (p.a.)	-7.27%
3 years (p.a.)	-2.63%
5 years (p.a.)	11.92%
Since inception (p.a.)	10.95%

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,

Leading up to the December NZU auction, ongoing supportive rhetoric and policy from the NZ Government, helped increase market participant confidence in the Emissions Trading Scheme (ETS). There was even a level of speculative interest from market traders as they saw the upcoming auction as the last opportunity for emitters to obtain large quantities of NZUs at $64.00 to meet their surrender obligations in May 2025, as the next auction in March 2025 will have a floor price of $68.00. The resulting growth in demand for NZUs led to a rally in the NZU price, pushing it up against the auction floor price of $64.

Ultimately, the final auction of 2024 resulted in a partial clearance, with 4 million of the available 11 million units sold at the $64.00 auction floor price. The 7 million units remaining unsold will be cancelled, further supporting the tighter NZU supply outlook created by the recently adjusted ETS unit limit settings which significantly reduced the units available at future auctions.

The NZU price rallied briefly above the $64 floor price following the auction, but a week later the market experienced selling pressure from forest owners needing to sell NZUs before Christmas. It also appears that there were too many speculators who thought they were on to a “sure thing”, buying NZUs up to and in the auction in anticipation of a short-term NZU price squeeze post the auction, which did not eventuate.

It is worth noting that the Ministry for the Environment (MFE) is forecasting the demand for NZUs in the ETS will exceed 42 million tonnes over 2025. The forecast supply of NZUs into the ETS is for a total of circa 28 million tonnes, with just over 16m tonnes coming from removal activities (forestry, etc.), 6 million free industrial allocation NZUs, and 6 million auction NZUs (assuming the price bid at auction exceeds $68). As shown in the chart below, the implied forecast shortfall of NZU supply is 23.4 million tonnes in 2024, 14.7m in 2025, 11.6m in 2026, 8.6m in 2027 and 9.0m in 2028. A total shortfall of 67 million NZUs which will all need to come out of the existing NZU holdings.

Interestingly, during the quarter, EY conducted an external review of the MFE NZU stockpile surplus calculation where EY estimated the stockpile surplus to be 14.9m NZUs lower than MFE central case scenario. On the flipside, the Government released the second Emission Reduction Plan (ERP2) plan for 2026 to 2030 which included a forecast of higher NZU volumes available at auction from 2031.

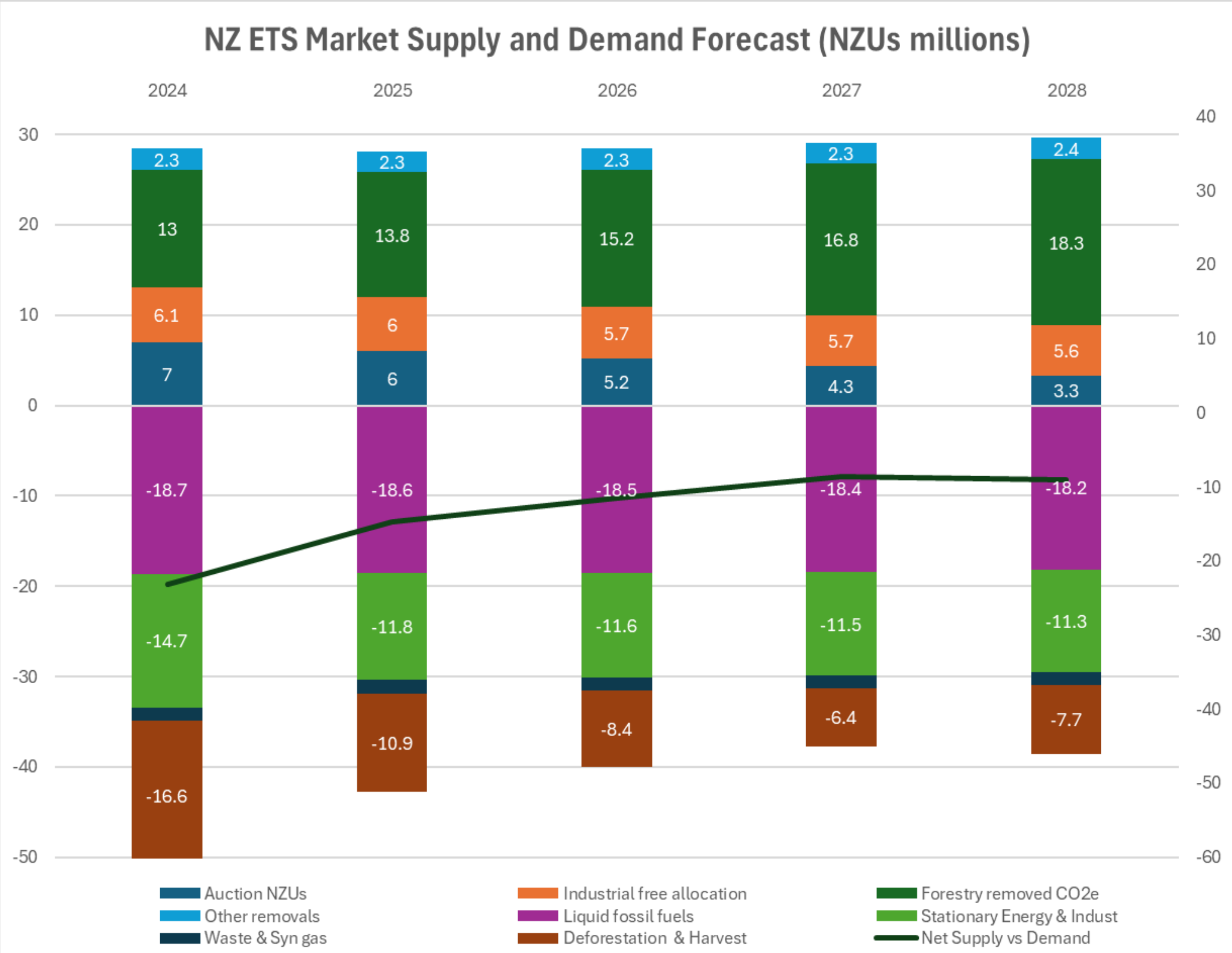
Also, of note with regards to the future supply of NZUs, the NZ Government released its decision regarding whole-farmland conversions to forestry that can be registered within the ETS. The key policy changes include a moratorium on the conversion of productive farmland (Land Use Classification 1-5) to exotic forestry and an annual limit of 15,000 ha of exotic forest planted on LUC 6 land. In addition, farmers will also be able to plant up to 25% of their LUC 1-6 farmland with forestry eligible for the ETS. These changes will ultimately reduce the potential number of NZUs coming into the secondary market and will likely contribute towards the tighter supply forecast over the coming years. These regulations will be introduced in October 2025.

The NTA value of the Fund finished the quarter at $1.895 (from $1.853), moving 2.2% higher, consolidating the circa 18% rally in the previous quarter. This reflected the positive moves during the quarter of the NZU price to $63.75 (from $62.15) and Australian Units (ACCUs) which moved from $36.25 to finish the quarter at $36.80. The NZX traded CO2 price increased to $1.70 (up 4.9%).

The Fund continues to take advantage of the arbitrage created by CO2 units trading on the NZX at below their NTA value and has continued to sell NZUs in order to buy back CO2 units at a level implying a much cheaper NZU price.

With the NZU auction floor price now moving up to $68 in 2025 and only 6 million units available at auction across the whole year, emitters will likely be forced to purchase a large proportion of their obligations from the secondary market. This is expected to provide significant support for the NZU market in 2025 and into 2026.

Paul Harrison, BCA, MBA, CA



Source: MFE and Salt Funds Management