

## INTERNATIONAL DEVELOPMENTS

Worldwide Carbon Markets are evolving, and will without doubt continue to evolve for decades to come.

It's now clear that the international negotiations, conducted within the United Nations system, are unlikely to deliver the type of globally coordinated, regulated market-based approach that was anticipated at the turn of the Century.

Instead, nations and trading blocs have moved to develop tailored responses to climate change, including various forms of emissions trading and carbon pricing mechanisms. These and many other proposals will no doubt be continually introduced and debated.

The two major reports produced for the Australian Government – the Garnaut Report Update and the Productivity Commission's Report "Carbon Emission Policies in Key Economies" – outline a wide variety of actions that are currently being undertaken by governments around the world to address climate change. These include explicit carbon pricing through taxes or trading; the introduction of regulations; government expenditures including subsidies; research and development programs; other (non-carbon) taxation measures; as well as public information.

Closest to Australia, the New Zealand Emissions Trading Scheme (NZ-ETS) remains in place, with the recent review advising the expansion of the Scheme. This is an extremely important development for the company, providing further regulatory confidence for the development of our 45 percent owned CO2 New Zealand business.

The recommendation is that 100% of New Zealand's industrial sector emissions will be covered by 2015 (see Table 1). The suggested timing for expanded coverage is similar to Australia's move from a fixed-price carbon 'tax' to a more fully-fledged emissions trading scheme.

**TABLE 1: COVERAGE OF NEW ZEALAND'S INDUSTRIAL SECTOR EMISSIONS**

Sector	2012	2013	2014	2015	2016	2017	2018	2019
Stationary energy, industrial processes and liquid fossil fuels	50%	67%	83%	100%	100%	100%	100%	100%
Waste and synthetic greenhouse gases	-	67%	83%	100%	100%	100%	100%	100%
Agriculture	-	-	-	50%	50%	67%	83%	100%

Further afield, US carbon markets are being developed on a state-by-state basis. Of note is California, which has introduced a cap-and-trade scheme beginning in January 2012 (the first compliance period commences in 2013). With the Californian economy being the world's eighth largest, it is expected to become the world's second largest carbon market by 2020, leading to an expected 15% reduction in emissions from the business-as-usual case.

The European Union's ETS remains the single largest carbon market, providing most of the demand from Certified Emission Reductions (CERs) produced through the Clean Development Mechanism. The EU has moved to reduce supply of CERs to the European Emissions Trading Scheme after 2012. They plan to do this by excluding CERs created from HFC reduction projects, and by limiting new project registrations eligible to create CERs for the European market to projects in Less Developed Countries. Clean Development Mechanism projects registered before 2012 will still be eligible.

# 12 AUSTRALIA

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An important development this year has been the passage of the Government's Carbon Farming Initiative (CFI) in August. This has created a robust national regulatory framework for carbon offset projects that have been created by CO2 Group.

Projects registered within the CFI will be able to create carbon credits that can be used by companies liable to pay the carbon tax to meet their obligations. They will also provide a source of domestic credits that meet carbon neutrality requirements under the National Carbon Offset Standard (the Australian Government has also provided the basis for export of CFI credits).

In the absence of a domestic carbon price, the Treasury has estimated the size of the CFI market to be about 7,000,000 t CO<sub>2</sub>-equivalent each year through to 2020, given a medium level of global abatement effort.

The passage of the Clean Energy legislation introducing a price on carbon – initially through a fixed-price tax, then through an emissions trading scheme from 2015 – is another major development towards a transparent carbon market in Australia. The carbon price will apply to 500 facilities with emissions greater than 25,000 tonnes of CO<sub>2</sub>-equivalent per year. Large users of transport fuels will be able to opt-into the carbon price from July 2013, thus expanding the potential market for CO2 Group. Importantly, carbon credits created by CFI projects will be the only offset credits able to be used by liable parties during the early phases of the Scheme.

Governments are also utilising environmental approvals associated with large developments to manage future greenhouse gas emissions. Several large projects would be required to undertake specific actions to reduce emissions, should a national carbon compliance scheme cease.

Reforestation is an important initiative under direct action programs, and the Opposition has stated its intention to retain the Carbon Farming scheme if it forms government.

In summary, carbon markets remain highly prospective, developing in a manner similar to other commodities.



*Blue tongue lizard at 'Lee's', West Wyalong NSW planted in 2006 for Eraring Energy. Integrating trees into cleared landscapes provides important habitat for native wildlife.*

# 14 YEAR IN REVIEW

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## A. REVIEW OF OPERATIONS

### i. On-Ground Results

During the 2011 reporting period, CO2 Group planted a total of 4,469 hectares of forest carbon sinks across New South Wales and Western Australia.

CO2 Group's land sourcing, acquisition capability, and market intelligence continues to be enhanced as the business expands. We are also aware of the importance of building a firm network of rural land agents, advisors and farming community partners. Our integrated land acquisition expertise, capability and reputation as a proven performer continues to grow in New South Wales and Western Australia – we currently have land purchased and optioned across both of these markets which represent 74% of the 2012 planting program requirement. A CO2 Group planting in Western Australia scheduled for 2012 is expected to be the largest integrated carbon sequestration planting ever established. The property will have 850 hectares integrated into its operations.

Additional land acquisitions were made across both the southern and northern wheat belts of Western Australia, as well as the central region of New South Wales. A key element of our integrated farming systems plantings was the enhancement of our landholder partnerships in New South Wales throughout 2011.

Weather conditions were generally favourable across the country for site preparations and planting during the year. However, dryer conditions have followed the plantings in the central region of New South Wales. Plantings in the southern wheat belt region of Western Australia received intermittent rainfall.

Seed production from the Group's orchards continues to increase. Further seed orchard developments have been successfully established in New South Wales.

### ii. Customers

CO2 Group has continued to expand its blue chip customer base throughout 2011, with the company entering into contracts to deliver carbon sequestration projects for Santos, Newcrest Mining and Bundaberg Brewed Beverages. We are extremely pleased to be partnering with these companies and all present growth opportunities. The advent of the Carbon Farming Initiative, and the passage of the Federal Government's Clean Energy Future package, has created new interest from a number of companies and investors.

CO2 Group has built its operations in the absence of a national emissions trading scheme in Australia. Interest has naturally increased from large emitters with an impending liability under the Clean Energy Future legislative package.

During FY2011, CO2 Group established carbon sinks for Woodside Energy, ACTEW Corporation and Newmont Mining. The company also managed plantations on behalf of other blue chip organisations including Wannon Water, Eraring Energy, Inpex Browse, Victorian Department of Sustainability and Environment, Qantas Airways, Big Day Out, Ripcurl Pro and many others. We have strong relationships with our customers, with new and exciting opportunities to build on these relationships.

During FY2011, CO2 Group continued to diversify its operations. One example is the launch of Yonderr, which provides carbon offsets to the voluntary carbon market, catering to individuals and organisations that purchase carbon offsets. Typically, voluntary carbon offsets are purchased for marketing reasons, to improve tender credentials, or to support corporate social responsibility.

### iii. CO2 New Zealand

CO2 New Zealand continues to achieve outstanding results for its customers within the New Zealand Emissions Trading Scheme (NZ-ETS), through the allocation of New Zealand Units (NZU) for Pre 1990 Forestry.

Owners of pre-1990 forest land in New Zealand are subject to deforestation obligations under the NZ-ETS. The decrease in land value for some pre-1990 forest landowners as a result of these rules will be partially offset by a one-off free allocation of NZUs from the Government.

CO2 New Zealand is currently involved in the mapping of more than 220,000 hectares, realising close to 5.7 million NZUs for customers. This makes CO2 New Zealand the largest land applicant to the New Zealand Government for Pre-1990 forest allocations on behalf of its customers.

Sales of carbon credits from these sources will occur against sales arrangements, mostly between January and March each year. CO2 New Zealand's portfolio of carbon credits has continued to grow, supporting new carbon sink projects as they are able to be sold to the project investor.

Following the government NZ-ETS review released in June, investor-related enquiry in New Zealand has increased markedly. This also follows the commitment of the Australian government to its Clean Energy Bill.

CO2 New Zealand in November announced one planting project with the lwi valued at \$10 million, and looks forward to securing additional projects over the coming months.

### iv. Carbon Banc™

CO2 Group has diversified its revenue base through the successful launch and ongoing growth of its environmental trading division, Carbon Banc™, launched in March of this year.

From March to the end of September 2011, Carbon Banc™ generated in excess of \$11 million in revenue. New customer enquiries are at record levels, and in September alone, the business secured \$4.6 million worth of new contracts.

With a strategy in place to diversify the Company's revenue base, Carbon Banc™ represents one of the most important initiatives to achieve this. As an environmental trading business, Carbon Banc™ provides an access point for customers with obligations under a number of state and federal market-based initiatives such as those associated with renewable energy targets. These initiatives typically produce illiquid markets, and Carbon Banc™ has helped to provide liquidity by attracting new trading customers.

Carbon Banc™ has been most active in the Small-scale Renewable Energy Scheme and the Large-scale Renewable Energy Target, where many new entrants have sought competitive pricing in exchange for certificates. Other environmental markets in which Carbon Banc™ trades include the NSW Greenhouse Gas Reduction Scheme & Energy Saving Scheme, the Large Renewable Energy Scheme and the Victorian Energy Efficiency Scheme.

In six months, Carbon Banc™ has partnered with more than 80 customers, as well as establishing trading relationships with some of Australia's major banks, large and medium sized enterprises, energy retailers and generators.

With the introduction of the Carbon Farming Initiative, Carbon Banc™ will continue to expand its operations to meet increased demand for compliance credits. The Initiative also allows Carbon Banc™ to trade CO2 Group's credits in established international carbon markets.

## v. Sustainable Business Practices

CO2 Group is committed to providing multiple solutions for its customers. We have a proven approach to the design and creation of forest carbon sinks, including:

- analysing the carbon sequestration potential of rural landscapes to identify higher yielding sites;
- developing unique commercial investment opportunities through innovative products and services;
- ensuring sustainable agricultural production while maintaining carbon performance;
- returning trees to cleared landscapes that are no longer viable as agricultural enterprises;
- selecting tree species best suited to current and future climates;
- implementing best practice in forest establishment standards; and
- offsetting 100% of the company's direct greenhouse gas emissions.

CO2 Group holds accreditations that require the company to monitor, interpret and report our own carbon emissions, putting in place appropriate, practical and cost-effective actions to reduce our footprint. We actively encourage staff and stakeholders to do the same.

During the year, CO2 Group offset 100% of the company's Scope 1 greenhouse gas emissions through internationally accredited carbon offsets.

Our commitment to sustainable business practices is demonstrated by the following:

### a) Environmental Excellence

In addition to the 22,300 hectares of carbon plantings the company has established, CO2 Group also protects more than 3,500 hectares of remnant native vegetation.

In the heavily cleared landscapes in which CO2 Group operates, remnants present vital refuges for native animals, as well as help to retain the original biodiversity of the area. Small patches of remnant vegetation represent plant communities that may be difficult to find elsewhere.

Remnant vegetation often exists as fragmented or isolated patches across the landscape. CO2 Group's carbon plantings establish links between these patches, considered by ecologists as being extremely important to improve the value of habitat and food source for native wildlife.

In addition to carbon sequestration, CO2 Group's plantings have also been used to reduce the risk of salinity, increase productivity through the reduction of water logging and supporting greater biodiversity on farms.

During 2011, CO2 Group established mallee eucalypt plantings in areas of Western Australia and New South Wales at particular risk of dryland salinity. Introducing deep-rooted perennials such as mallee eucalypts to risk areas assists in mitigating the effects of salinity through increasing ground water use, as well as preventing its damaging rise to the soil surface

## b) The Community

Since our inception, CO2 Group is committed to strengthening local communities. Developing deep and lasting relationships within the rural community comes with regularly communicating with our farming neighbours and related groups in rural Australia. We believe that this is vital to building successful relationships and encourage all our staff to participate in a range of local community forums.

As our customers' businesses grow and our operations expand, rural partnerships with farming families continue to develop – in fact, over 300 farming families across rural Australia are now involved in a range of programs with CO2 Group. These partnerships continue to provide employment opportunities for local communities and contract service providers as part of the site preparation, planting and maintenance phases of our carbon planting programs.

These programs also provide a direct financial injection into the farming enterprise, as landholders are paid for the area of land planted with trees. This strong focus on integration is aimed at implementing long term measures in rural landscapes to address a range of natural resource management issues. It will also have a direct influence on the resilience of rural landscapes at paddock, property and catchment scale.

By integrating CO2 Group's environmental plantings into existing farming and grazing systems, we continue to maintain our strong social licence to operate and have a positive influence on the long term sustainability of our partnering landholders and community. An estimated \$23.3 million has been invested in rural economies during the 2011 year.

To complement our business partnerships, CO2 Group has also sponsored a range of community-based programs. These include the Trundle Bush Tucker Festival, a long running community event aimed at creating culinary delights in traditional camp ovens over open fires. The company also actively supports local rural bush fire brigades, providing sponsorship for fire equipment and other resources within the areas we operate.

CO2 Group has also been a major sponsor of a range of community based conferences. We have been actively partnering within the Lachlan Catchment Management Authority and the Parkes and District Landcare Association to highlight the benefits of the carbon planting program and the potential for landholders to participate in the upcoming Carbon Farming Initiative. CO2 Group was a major sponsor of the NSW Landcare and Catchment Management Forum in Parkes, with staff invited to discuss the Company's operations and lead tours of several carbon plantings within the Parkes Landcare Association district. CO2 Group supported the 2011 Carbon Farming Expo and conference in Dubbo, providing landholders with a range of information, skills and tools to participate in the Carbon Farming Initiative.

CO2 Group has also been working closely with the Trundle Tree Change project and 'rent a farm house'. This is aimed at providing low cost accommodation in existing farmhouses to attract new families to the district, thus strengthening the community and saving local schools.

CO2 Group has also commenced a three-year sponsorship of Nuffield Australia, an organisation that awards scholarships to farmers in Australia. The objective is to increase practical farming knowledge and management skills. These scholarships give Australian citizens the opportunity to study farming practices in New Zealand, Europe, Asia, the Americas and other markets.

CO2 Group continues to facilitate understanding and awareness of the ongoing carbon debate at State and Federal political level. In order to inform politicians of the benefits of carbon plantings within the landscape, Michael McCormack, local Federal member for Riverina, accompanied staff on a tour of several integrated plantings in his electorate.

CO2 Group has been nominated as a finalist (one of three) for the Rural Development Award as part of the NSW/ACT Regional Achievement and Community Awards. These awards publicly acknowledge and pay tribute to individuals, communities, businesses and groups who are making a significant contribution to regional and rural areas. They recognise the contribution that businesses make to enhance the social, economic, commercial or environmental prosperity of their region.

## vi. Health & Safety

The health and safety of our people is CO2 Group's top priority. Some of our people and contractors work in remote conditions, presenting unique challenges. Their continued safety is of paramount importance to the company.

We constantly promote health and safety workplace awareness, endeavouring to provide as safe a workplace as practically possible. This is achieved through the continued development and reinforcement of CO2 Group's Health and Safety Management System:

- workplace health and safety policies and procedures are designed to comply with industry standards and to manage identified risks associated with activities undertaken and equipment used by CO2 Group employees;
- workplace health and safety risk assessment of each contracted work request identifying site specific risks and associated preventative actions, to minimise the frequency of incidents and the severity of impact should an incident occur;
- workplace health and safety communication via formal inductions and contractor education; and
- ongoing supervision and general duty of care to one's self and others.

Employees, contractors, suppliers and partners must all demonstrate a duty of care in workplace health, safety and welfare.

During 2011, CO2 Group engaged with more than 200 individual contract service providers who were directly involved in the establishment of CO2 Group plantings.

## vii. Research and Development

With the introduction of the Carbon Farming Initiative (CFI), CO2 Group has placed a strong emphasis on reviewing the technical features of the CFI and the way that they may be applied to existing and future forest carbon sinks. This effort has included undertaking reviews of the application of the legislation and regulations, review of CFI eligibility requirements, and a review of Methodology preparation and approvals processes. We have regularly provided the Department of Climate Change and Energy Efficiency with feedback on technical aspects of the CFI.

CO2 Group has also drafted and submitted a Methodology for consideration by the Domestic Offsets Integrity Committee. This Methodology is based on contemporary peer reviewed science and is consistent with a range of international methodologies including those approved under the Clean Development Mechanism (CDM) and Verified Carbon Standard (VCS). It leverages off the unique expertise developed by CO2 Group through a decade-long commitment to R&D and operational delivery of large-scale forest carbon projects.

The development and deployment of unique tree species and forest types continues to be an area of activity, particularly as the introduction of the CFI has the potential to open up a broader range of landscapes and forest types to commercialisation as forest carbon projects.

Delivery of a new species requires considerable research effort and investment, particularly around in-field evaluation of forest performance, development of detailed carbon accounting systems and the calibration and rigorous testing of forest growth models. In fact, this process can take several years. During FY2011, CO2 Group significantly advanced this evaluation process for a hardy eucalypt species endemic to Queensland that has potential application across large parts of northern Australia.



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A major milestone achieved during the year has been the establishment of a number of diverse, mixed species plantings that have very high biodiversity value associated with them. This means that CO2 Group is now in a position to offer a range of forest types to customers for their carbon abatement needs, including complex forest types that have even greater biodiversity benefit than simpler species mixes. Over the coming year, our technical team will focus on further developing these highly bio-diverse plantings across a range of landscapes.

CO2 Group continues to deliver verified abatement from forests registered under the New South Wales Greenhouse Gas Abatement Scheme (NSWGGAS). We remain one of only two organisations that have successfully achieved this.

As part of our support to the CO2 New Zealand joint venture, CO2 Group staff have successfully realised large volumes of New Zealand Units (NZU's) under the New Zealand Emissions Trading Scheme on behalf of Maori landowners. This has involved conducting carbon accounting across the largest tract of planted forest in the southern hemisphere.

Establishment of genetically improved seed orchards will continue, with seven orchards now established spanning three species and capturing high performing genetic varieties. Seed production from these orchards is coming on line rapidly, with several large-volume seed harvests taking place during the year. This will allow for unique genetic breeding lines to be routinely planted across the carbon estate. Having selected for high sequestration potential, it is anticipated that the use of this improved seed will increase the rate of sequestration, at least during the early years of forest growth. Over time, this 'genetic gain' will be tested through formal provenance trials.