THE CARBON MARKET: AN EVOLVING LANDSCAPE

International Developments

As prefaced in our previous reports, individual nations and trading blocs continue to develop a variety of responses to climate change. Over time these responses create dynamics in different parts of the market – the global carbon market is now being built from the ground up rather than the top down.

Reviewing international developments, Australia's Climate Commission produced a report summarising international action on Climate Change. This review showed that the move to regulate greenhouse gas continues to become more widespread, and emissions trading and carbon pricing feature in many national responses to the abatement challenge. Alongside emissions trading are renewable energy targets, electricity pricing policies and fuel efficiency standards. Australia's largest trading partner, China, has started to implement emissions trading; China will pilot different forms of emissions trading across seven cities and provinces. Most advanced in its preparation, Guangdong province, with a population of more than 100 million people, will cover 42 per cent of emissions which have been capped at 660 million tonnes. The market will be the world's fifth largest after Europe, California, South Korea and Australia. Beyond Guangdong, emissions trading is planned for the provinces of Hubei and the city and province of Beijing, as well as Chongquing, Shanghai, Shenzen and Tianjin, with linkages between them developing from 2016.

Towards the end of the reporting year the Australian Government announced that Australia's carbon pricing scheme would link to the European Union's Emissions Trading Scheme, the world's largest carbon market. For CO2 Group, the steady internationalisation of carbon as a commodity will continue to bring attractive growth opportunities. Concurrent with these carbon market developments during 2011, we were confronted with the challenge of over-supply, resulting in low prices. From an Australian perspective, the low Certified Emission Reductions (CER) and European Union Allowances (EUA) spot prices are the result of several factors:

- continued low economic growth in Europe, leading to fewer emissions than forecast and hence less demand
- the structure of the EU carbon market - generous National Allocation Plans and national governments wishing to raise revenue are exacerbating over-supply of government issued allowances
- a rush towards issuance within the Clean Development Mechanism, a response to Europe limiting the use of CERs from new projects to Less Developed Countries after 2012
- the high Australian dollar.

With the EU seeking ways to curtail supply, parts of China starting to develop emissions trading schemes and Korea introducing emissions trading in 2015, it is likely that the current dynamics of the carbon market will not be locked in place for the foreseeable future. The volatility in exchange rates also continues to affect the carbon market. But domestic carbon forest sinks continue to offer a stability hedge in carbon prices.

Closer to Australia, the New Zealand Emissions Trading Scheme has moved to closely reflect the international CER price. This pricing outcome is a direct result of government policies, which allow liable parties to meet 100 per cent of their obligations from imported permits. The net effect of the current scheme is that the New Zealand Government has effectively achieved its greenhouse gas abatement through non-domestic action.

Australia

The Australian Parliament passed legislation to price carbon emissions in the Australian economy. The cost will be borne by large industrial emitters of greenhouse gases. Although generally referred to as 'the carbon tax' the strategic design of the carbon pricing mechanism is in fact very close to an Emissions Trading Scheme with an introductory fixed carbon permit price period.

Australia's carbon price legislation has been in development for several years, and a key milestone was the announcement of a mechanism and timetable that would allow Australia's emissions trading scheme to link to the European Union Emissions Trading Scheme. This development increases the potential size of the market for CO2 Group's products and services, and is likely to encourage the Market to view carbon pricing legislation as a long-term commercial reality.

Linkages between markets will change carbon price dynamics; while much attention has been paid to current spot prices, the renewed action around climate change internationally is likely to have an important effect on prices in the medium term.

Although there is much commentary on carbon policy and much willingness in the Market to offer predictions, CO2 Group remains committed to the carbon forestry business, and our strong, diverse portfolio of international operations that will enable us to operate successfully across a wide range of eventualities.

'Shanklin', Trundle, NSW

OUR PLAN IN ACTION: A RECORD PLANTING YEAR

The 2012 reporting period was a record planting year; CO2 Group planted over 4,500 hectares of carbon forest sinks across New South Wales and Western Australia and completed projects for a number of clients, including organisations that are not liable under the carbon price legislation.

The past twelve months reflects outstanding operational performance delivering a record year for hectares planted, achieved ahead of time and under budget. The Group has continued to drive efficiencies in the service delivery model through procuring quality seedlings, selecting appropriate properties, establishing our plantings to very high standards and ongoing day to day management of the Forestry Estate.

CO2 Group's land sourcing, acquisition capability, and market intelligence continue to develop as the business expands. In 2012 we built on our sound business relationships with the rural network including rural real estate agents, advisors, farming community partners, the legal profession and catchment management authorities, and saw a dramatic increase in interest in our integrated land acquisition program with farmers and graziers.
Since the introduction of the CFI legislation in late 2011, the number of farming community members looking to participate in the CFI has increased by 600 per cent, bringing a steady supply of land for future carbon sink projects.

In 2012 we formed new partnerships and continued to develop the solid relationships with our existing landholders, particularly as we transition the early plantings into the new Carbon Farming Initiative (CFI). Our integrated farming systems plantings estate grew with significant communication about the CFI with our farming partners. Land purchased in 2011 gave us a head start for the 2012 planting year, and all necessary land was secured by early 2012. An additional 730 hectares of plantable land was purchased, and a further 750 hectares is under option for a potential 2013 planting program.

The sites acquired for the 2012 program were concentrated in New South Wales and Western Australia, with a successful expansion into several new districts. Weather conditions remained favourable across the country for site preparations and planting during the year. Seed production from the Group's orchards continues to increase, with further seed orchard developments successfully established in New South Wales.

In 2012 we built on our sound business relationships with the rural network ... and saw a dramatic increase in interest in our integrated land acquisition program

'Shanklin', Trundle, NSW