Markets

Carbon - An Evolving Landscape

International Developments

International carbon markets continue to reflect conditions in the wider economy. In particular, the European carbon market, which remains the world's largest in terms of emissions covered, saw suppressed prices.

The international carbon price as reflected by the Certified Emissions Reductions (CER) price also remained weak throughout the year. This low price reflected overall supply/demand dynamics. Supply of credits remained strong as evidenced by a record number of Clean Development Mechanism (CDM) project registrations and CER issuances throughout 2012. These issuances reflect the historic pipeline of CDM projects coming on stream combined with the need for project developers to register projects prior to the end of phase II of the EU Emission Trading Scheme (ETS). During phase III, additional restrictions on CDM project type would mean that CERs from some projects would no longer qualify. Similarly, European Governments allocated allowances based on economic parameters which were agreed prior to the global financial crisis.

The effect of these soft economic conditions also affected demand directly since greenhouse gas emissions were lower than expected when the EU ETS was established. Considering that European demand has been the major driver of investment in Clean Development Mechanism projects, it is clear that until there is a change to address this imbalance new investment in Clean Development projects will be negligible.

Across Asia, China has commenced its plans to develop a number of city and provincial emissions trading schemes and Korea plans to introduce emissions trading in 2015. At the same time, sub-national emissions trading schemes continue to emerge, with California's Cap-and-Trade Program being the most notable. The California Cap-and-Trade program covers 163 Mt of CO2 emissions, currently 35% of the 448 Mt CO2e emitted each year.
By 2015, it is estimated that the Program is expected to cover 85% of the State's emissions.

Closer to Australia, the New Zealand Emissions Trading Scheme continued to closely reflect the international CER price. This pricing outcome is a direct result of government policies, which until 1 January 2013 allowed liable parties to meet 100 per cent of their obligations from imported permits. The net effect of the current scheme is that to date the New Zealand Government has effectively achieved its greenhouse gas abatement through non-domestic action.

Carbon - An Evolving Landscape (continued)

Australia

Australia has committed to participation in the second Kyoto commitment period. This involves additional activities such as forest management in its formal international accounts. This change enabled the former Government to scrap the distinctions between 'Kyoto' and 'non-Kyoto' Australian Carbon Credit Units. Australia's new Government continues to support the Carbon Farming Initiative (CFI) as a way of ensuring that high quality domestic carbon off-sets are available to the market. Carbon offsets produced under the CFI, known as ACCU's, will continue to be treated as financial products and private property.

Legislation to rescind the 'carbon tax' and other parts of the Clean Energy Package has been drafted and will be put before parliament. Full passage of the legislation depends on whether the Opposition enables it to pass in the Senate or whether the Government requires the support of new senators who sit after 1 July 2014. The carbon price is to be replaced by an Emissions Reduction Fund which will purchase carbon abatement from the economy and the Government has budgeted $300 million (2014-15), $500 million (2015-16) and $750 million (2016-17) over the next three years to do this. Offsets created by CO2 Australia are expected to be eligible for purchase by this Fund.

Since introduction of the carbon price, the Clean Energy Regulator has identified 372 potentially liable parties in its "Liable Entities Public information Database". All but three parties met their progressive surrender obligations. Obligations under the carbon price remain in place until at least 1 July 2014.

The Seafood Opportunity

Many analysts have identified major economic changes occurring on Australia's front door-step. This has led to short-hand descriptions as 'The Asian Century'. The scale of the market opportunity is enormous. The Asian middle class is expected to double in size from 2 billion people today to 4.9 billion by 2030 - about a generation away. This economic and demographic shift will drive increased demand for high quality, safe and nutritious food.
The main categories of animal protein that meet this description are poultry, pork and seafood.

To simply maintain 2011 levels of consumption of seafood, by 2030 an additional 30 million tonnes per annum of fish production is needed. To meet expected growth in demand an additional 85 million tonnes of seafood will need to be produced every year by 2030. Against this background 87% of the world's wild fisheries are fully or over-exploited. To meet existing demand aquaculture (the farming of seafood) now produces more than half the world's supply. Thus aquaculture must inevitably expand to meet the growing demand.

The Seafood Opportunity (continued)

Of the many species of seafood now produced, prawns are the most widely traded on world markets. Yet, new sites for aquaculture are limited. Furthermore events over the past few years have demonstrated that continued growth in production of prawns are not a foregone conclusion. Serious disease outbreaks across producing regions have shown that Australia's strict quarantine and isolation from other aquaculture regions are a significant competitive advantage. Prawn production is expected to recover as producers overcome the current disease challenge. However, the need for more supply to meet market demand will remain.

CO2 Group is confident that there will be strong global demand for high-quality well-priced seafood into the future and that Australia through Project Sea Dragon can play its part in supplying the market.

Review of Operations - A Diversified Business Model

CO2 Australia: Carbon Sink Forest Development and Carbon Projects

CO2 Australia has now established over 26,400 hectares of forest carbon sinks reinforcing its pre-eminence in the Australian carbon economy. Our planting program was completed in 2012 with a minor planting undertaken in New South Wales during 2013. Refill operations were minimal for this period due to a combination of strong operations management and positive weather conditions.

Our carbon sink forest development program has transitioned from establishment phase to the management of the estate planted across the wheat belt regions of New South Wales, Victoria and Western Australia. These forests are managed for a broad variety of blue chip Australian and International companies servicing both voluntary and compliance carbon obligations.

CO2's land sourcing activity was reduced as priorities have changed from land acquisition to the transitioning of carbon sink forests and registering these projects under the Carbon Farming Initiative (CFI) legislation. Land acquisition capability has been maintained and market intelligence collation continues. As previously reported we have continued to build 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.

As expected, members of the farming community have maintained their interest in the CFI, with a keen interest in participation for future carbon sink projects. CO2 continued to develop strong relationships with existing landholders, particularly as we continued the process of transitioning plantings into the CFI regime. The CFI transition process represented the major component of land administration activity through 2013. Substantial milestones were also achieved around the transition of projects into the Carbon Farming Initiative (CFI).

A major work program for the Company has been the transition of the carbon forests estate to the Federal Government's Carbon Farming Initiative (CFI) enabling the production of Australian Carbon Credit Units (ACCUs) which can be used for liable parties' compliance under the Federal Governments Carbon Pricing Mechanism.

CO2 Australia was the first private sector entity to achieve a CFI Methodology Determination in relation to its Reforestation and Afforestation Methodology in February 2013. This paved the way for the Company to commence registration of the 26,400 hectares of reforestation carbon projects that it manages under the CFI. In total, four projects were registered during the year. Having registered this first set of projects, CO2 Group was also successful in realising Australian Carbon Credit Units (ACCU's) on behalf of Newmont Australia's Carbon Farming Initiative (CFI) Reforestation project.

This included successfully realising a Methodology Determination for CO2 Australia's Reforestation and Afforestation carbon accounting system. CO2 Group is the first private entity to have achieved this milestone as well.

CO2 Australia: Carbon Sink Forest Development and Carbon Projects (continued)

CO2 Group remains the only company that has successfully realised ACCU's in relation to carbon sequestration activities. The achievement is a tangible demonstration that we can successfully navigate all parts of the CFI program, from methodology development, through project registration, carbon accounting and the realisation of carbon credits.

CO2 actively works on CFI project recognition processes and continues to submit applications to the Clean Energy Regulator for the registration of projects under the Carbon Farming Initiative. A large field-based carbon measurement program, based on the Reforestation & Afforestation Methodology, continues to be rolled out over much of the carbon estate with the carbon measurement and audit process now forming part of the Company's routine operations delivered on behalf of its clients.

CO2 New Zealand

CO2 New Zealand's planting on the Te Rununga o Ngati Awa farm in the Bay of Plenty will be completed in early spring, bringing to a close the most significant project milestone to date. This outstanding project features an indigenous planting element that will provide value to the environment and the Iwi for the coming generations. The mixture of production species (with other species) and the additional benefits of this type of planting regime developed by CO2 is an excellent blueprint for challenging landscapes in New Zealand.

Market conditions (including market price) are improving, albeit from a low base at around $2 for domestic NZUs and $0.50 for international units. The New Zealand Government's international climate position has resulted in a restriction of international units into the domestic NZ-ETS from 1 January 2013. At present, this is fuelling greater demand for the domestic unit (NZUs), and as a result the business is receiving greater inquiries for NZU volume. CO2 clients holding NZUs were reluctant to sell when prices moved down over 12 months ago, and this stance will prevail in the near term. The supply-demand balance has been heavily influenced by international units over the past two years, but demand is shifting back to NZUs; however supply will become the dominant feature in the coming year.

CO2 Asia

CO2 Asia's portfolio of Clean Development Projects was expanded with the addition of renewable energy projects in Vietnam. The project portfolio has successfully progressed through to registration phase enabling the production of over 1 million Certified Emission Reduction credits (CERs) per annum which are eligible for compliance purposes in the European and New Zealand Carbon Trading Schemes. Whilst CERs are trading at historic lows, our entry point for funding these projects was sufficiently low to ensure that the projects remain profitable at present day prices and provide substantial up-side potential over a 15 year trading horizon.

CO2 Asia (continued)

The CER project pipeline provides additional benefits to CO2 Group providing access to expansion opportunities in South East Asia (including the emerging Chinese and South Korean markets) and the ability of offering liable parties integrated product suites covering a variety of compliance and voluntary instruments.

Carbon Banc™

Carbon Banc, CO2 Group's Environmental Trading Division, continues to expand its recognition of the brand and spread of clients in a somewhat difficult market due to political uncertainty in the environmental sector. Carbon Banc continues to be a major contributor to the Group's revenue base and diversification of the wider Group with the expansion of trading services including international carbon credits.

In the year to September 2013, revenue rose to $37 million and has been driven by a continuing trend among market participants and large corporate liable entities to outsource procurement and environmental credit management functions.

Carbon Banc has continued to expand its client base, especially in the Small-scale Renewable Energy Scheme where existing clients have generated many new leads and channels resulting in new trading partners. Customer loyalty remains high with the total number of customers exceeding 170 and retention rates at 90 per cent.

Western Australian Resources Limited (WARL)

Western Australian Resources Limited (WARL) has continued to progress its development of Project Sea Dragon - a world class, large scale land based aquaculture project in Northern Australia. The project is being developed to meet the growing global demand for high-quality, sustainably produced seafood.

The Company has continued with its overall feasibility assessment process which included a detailed Concept Study. In June this year WARL completed an extensive Pre-Feasibility Study and soon after the Board approved the commencement of the Bankable Feasibility stage for the initial development of a production module of 10,000 hectares of grow out ponds producing annually over 100,000 tonnes of Black Tiger prawns. The production system is fully integrated with a feed mill, brood stock, hatchery and processing facilities.

Furthermore, WARL has secured agreements over several key sites and other optional sites; preliminary environmental surveys have been undertaken prior to commencing formal environmental assessment processes scheduled for Q4 2013.

Significantly, WARL has also commenced negotiations with several parties regarding agreements for future off take of volumes of prawns produced from Project Sea Dragon as well as other parties interested in investing in this significant project.