Dalrymple of Queensland and the Mighty Greenwash

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Earlier this year, Dalrymple Bay coal terminal was put up for sale by Canadian asset management firm Brookfield (Ticker: BAM). Considering the firms' recent hire of ex-Bank of England governor and sustainable finance proponent Mark Carney,[1] the process should now be running with even more impetus after a covid-19 pause. The Queensland Investment Corporation (QIC) is showing interest:

"[A] stake in Dalrymple Bay coal terminal would be a good strategic investment for the Palaszszuk government given the state's coal boom is likely to continue for decades."[2]

Considering the terminal's 85MTpa coal capacity (~quarter gigatonne CO2 emissions downstream), this would further the Queensland's (QLD) involvement in and support of the coal industry.

- **We opine that Queensland government green bonds (QTC 3% 03/2024, AU000XQLQAD1, and QTC 2.5% 03/2029, AU3SG0001928) are a greenwash**. QLD set a new coal export record in 2019 and would be the second biggest exporter of coal in the world if it were a country. On balance, we find that **investing in a QTC green bond has more negative consequences through providing superficial climate change mitigation marketing cover for the issuer than positive consequences of financing to energy transition and other 'good' projects.**

- **Climate related risks are present for general purpose QTC bonds as well, in our view.** Global climate policy changes will likely drive a quicker depreciation of coal assets relative to the "coal boom" posited above, both in terms of met and thermal coal. It is feasible that climate change will drive a rapid decay of the Great Barrier Reef and increased bush fire risks: both could negatively affect the important QLD tourism industry which in turn would be a credit negative for general QTC bonds. Weakening financial metrics and a quickly rising debt load relative to other Australian states could affect relative value allocations and on the ESG flow side, institutional investor appetite for the coal exposure of QTC could decrease, c.f. the Riksbank's divestment[3] decision late 2019.[4]

- **Brookfield should shut the thermal coal capacity (20% of total) of the Dalrymple terminal prior to a sale**, making the asset more digestible to other investors, we believe. It can be argued that Brookfield made a mistake when acquiring Dalrymple, the world's third largest coal export terminal, in 2009. Shutting thermal capacity with questionable value anyhow should be within the scope of their investments in ESG activities and impact investing.

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[1] "Mark Carney joins Brookfield to launch 'impact investing' fund", Financial Times, 26 August, 2020.
[2] "Dalrymple Bay coal terminal a 'good asset', says QIC boss", Australian Financial Review, 10 Sep, 2020.
[3] "Sweden's Central Bank Ditches Bonds Issued by Major Polluters", Bloomberg 13 Nov, 2019.
[4] "Climate change bond boycott is hypocrisy", AFR, 15 Nov 2019.

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The Dalrymple Bay Coal Terminal Transaction

The Dalrymple terminal has a capacity of 85MT coal per annum. Out of this, approximately 20% is in thermal coal. The port "caters for around 7% of total global seaborne coal exports[5]" and 31% of Queensland's coal exports go through it. Australia, the world's second biggest exporter of coal, exported 393MT in 2019,[6] and is the home to seven of the largest coal terminals in the world, Table 1. Four of those are in turn located in Queensland. Queensland saw a **total exported 226 million tonnes (MT) of coal in 2019,[7] a new record**. Indeed, an independent Queensland would take a clear second place in terms of global exports and move rest-of-Australia to battle with Russia for a third or fourth place.

Table 1. Top ten coal ports of the world. (*) Waratah has a 30MTpa expansions come into operation after this data was released, and Dalrymple is indicated to have an 85MTpa capacity. Other ports may also vary. Source: Global Energy Observatory. Based on 2018 numbers.

Port	Capacity (MT)	Country	State
Waratah Kooragang Coal Terminal (*)	77	Australia	New South Wales
Richards Bay Coal Port	72	South Africa	KwaZulu-Natal
Dalrymple Bay Coal Terminal (*)	68	Australia	Queensland
Mundra Coal Port	60	India	Gujarat
Lamberts Point Coal Terminal	48	USA	Virginia
Hay Point Coal Terminal	44	Australia	Queensland
RG Tanna Coal Terminal, Gladstone	40	Australia	Queensland
Carrington Coal Terminal	25	Australia	New South Wales
Port Kembla Coal Terminal	22.5	Australia	New South Wales
Abbot Point Coal Terminal	21	Australia	Queensland

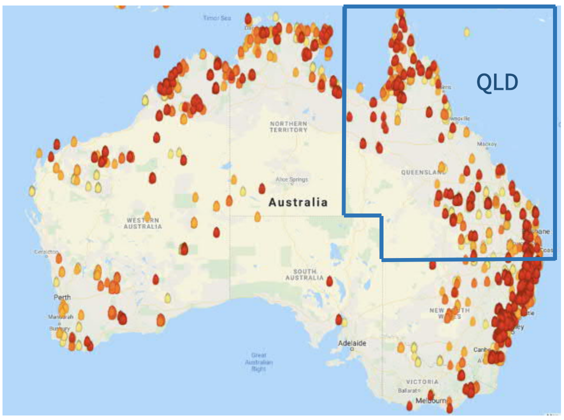
The current owner of Dalrymple, Canadian asset management firm Brookfield, has been attempting to shed the asset since beginning of the year,[8] a natural trade as the asset seems to score a perfect negative correlation to the firm's own ESG statements.[9] The effort will likely be intensified with the ex-governor of the Bank of England and very strong proponent for green finance, Mark Carney, joining Brookfield, which the AFII sincerely applauds. It shall be noted that there is critique of how the Dalrymple asset has been financially engineered, see "Desperate Dalrymple: Brookfield dumps coal ports on mums and dads in ASX float at Queensland moots bail-out."[10]

Dalrymple coal terminal describes itself as: "While our primary goal is to export coal, our terminal is also focused on creating a sustainable future and enriching our local area." The AFII agrees on up to two counts of three in that statement.

[5] Source: Dalrymple Bay Coal Terminal Management: https://www.dbctm.com.au/our-terminal/overview/.
[6] Source: International Energy Agency coal information overview.
[7] "Queensland Ports Break Coal Export Record", Brisbane Times, 24 Jun, 2020.
[8] See "Brookfield delays Dalrymple Bay Coal Terminal sale, IPO.", AFR 11 Mar, 2020. The article outlines both potential investors and other facilitators in the first round.
[9] "We believe that value creation and sustainable development are complementary goals.", company web page link. In this case it appears that the coal infrastructure asset has achieved neither. Brookfield is an alternative asset manager with USD550 billion in AUM.
[10] Michael West Media, 11 Sep 2020. For avoidance of doubt, this is for reference purposes only.

Figure 1. Dalrymple Coal Terminal. Source: Dalrymple Bay Coal Terminal Management.

Figure 2. Australian bushfires 2019-20 season. QLD highlighted. Source: Center for Disaster Philanthropy.



As indicated in the beginning, the Queensland Investment Corporation's (QIC) has a stated interest in buying the asset. The QIC describes itself as "a Government owned investment company owned by the Queensland Government"[11] "to serve the long-term investment responsibilities of the Queensland Government."[12] In line with the quote above, the QIC clearly works in conjunction with the Queensland government to further its investment agenda. To further quote the aforementioned article:

"The Palaszczuk government is keen for a strategic stake in the asset which is a key gateway for the state's coal exports."

The estimated value of the terminal asset is about AUD3bn. There are indications that funding for the purchase would be taken from shaving off a significant amount of the State's defined benefits pension scheme. This comes at the same time as Queensland suffers financial pressures, with state debt expected to top AUD102bn this year. The increase in debt vs pre-covid estimates is a full AUD19bn. Queensland GDP was estimated at AUD 369bn in 2019[13] and state government revenues of AUD60bn.[14] The current rating of Queensland is high AA/AA+, latest affirmed by Fitch in late August.[15]

It shall be noted that on a diversification basis, more exposure for Queenslanders to coal terminal operations seems reckless. Queensland already is the home to four out of the ten biggest coal ports in the world as illustrated in Table 1. Given a population of 5mn in QLD, the average export capacity is 37 tonnes per capita, more than twice of the runner-up, New South Wales (population 8mn) with a mere 15 tonnes per capita. From a macro-economic stand point, recent moves in the coal market as discussed "'Tumultuous times': Australia's coal miners face $17bn export collapse" (Sydney Morning Herald, 28 Sep 2020) does underline downside risks in such concentrated coal exposure.

For reference, we discussed some of the other coal activities in Queensland in "Global investors and the Carmichael mega-mine", where it should be noted that the Carmichael output is closely linked to the Mundra Coal port in India through Adani Group port operator Adani Ports and Economic Zones (ADSEZ), which operates both Mundra and Abbot Point, #4 and #10 on the list in Table 1.

[11] QIC information material (linked) .
[12] Queensland Investment Corporation Act (1991).
[13] https://www.ceicdata.com/en/australia/sna08-gross-domestic-product-and-gross-domestic-product-per-capita-by-state/gdp-queensland.
[14] https://www.qtc.com.au/queensland/queenslands-finances/
[15] Fitch rating report here.

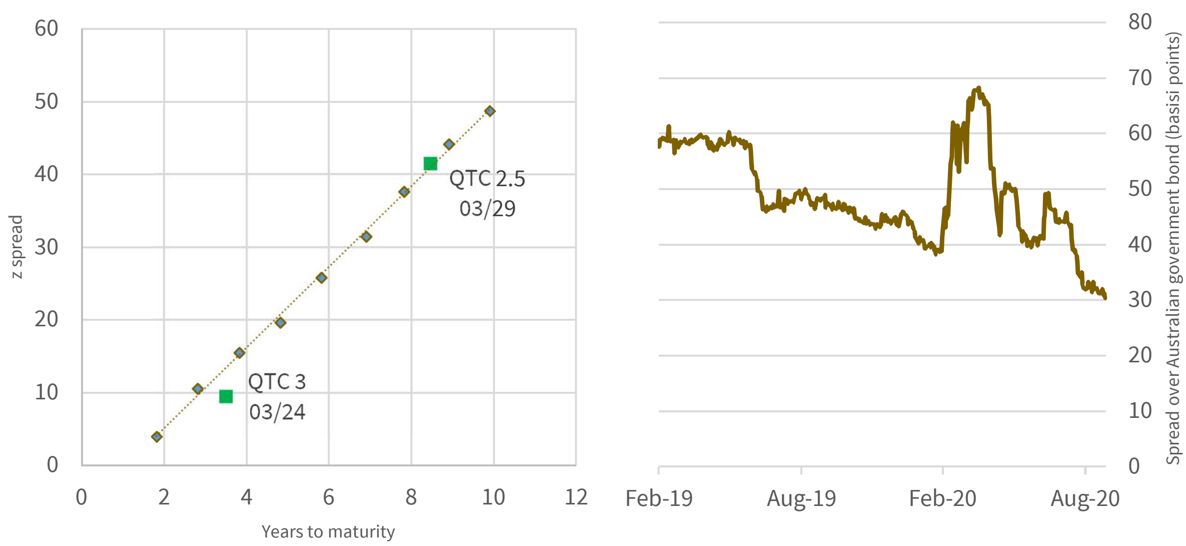
Bond curve considerations

We illustrate the QTC bond curve in Figure 3. The QTC curve mainly trades in AUD, but it should be noted that AUD semi-governmental bonds have been popular investments with for example foreign central banks, as a yield pickup trade versus central government bonds. There is a EUR bond outstanding (XS1523189790) for an amount of €401mn.

Please note that we are not criticizing the green bond framework of QTC per se,[16] but of the intended transformational effect of a green bond on the issuer's broader climate strategy, where we find the QTC green bonds to be abject failures. As a further example beyond the QIC's Dalrymple interest, the Queensland Climate Transition Strategy[17] fails to mention coal even once in a 38 page document. That is not a sign of an issuer transforming due to its engagement in the green bond market.

We estimate the QTC 3% 03/24 bond to trade at least 2bp inside the "non-green" curve. Considering the greenwashing status of the bond which in our view puts it *at best* at the level of a traditional bond in terms of its 'ESG'-features, this seems expensive.

Figure 3. QTC bond curve (left), greenwashed green bonds with square markers, and spread over government bond (right) for the greenwashed green QTC2.5% 2029 bond.



Implications for ESG portfolios and scoring

In our view, neither of the mentioned bonds AU000XQLQAD1 and AU3SG000192 should be held within a green bond or 'ESG' portfolio.

For purposes of the ECOBAR[18] model, we assign scores of 10 to both bonds. This means that holdings of either of those bonds scores the worst possible on the ECOBAR scoring system. Analogously, short positions in those bonds will be assigned an ECOBAR score of 0, the best possible score.

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[16] Green bond framework and second opinion through this link.
[17] Available through this link.
[18] See "Credit alpha and CO2 reduction: A portfolio manager approach", Erlandsson (2017, Addendum 2020)

A final request

The AFII does not endorse specific media outlets but is strongly in support of quality journalism such as the AFR's investigative work on Australian coal industry and politics. Please allow good sources of information to monetize their work.

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