



31 January 2011

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QUARTERLY ACTIVITIES REPORT FOR THE PERIOD ENDED 31 DECEMBER 2010

HIGHLIGHTS

Triple Crown

- Drilling and logging operations completed on the first well on this prospect
- Over 2,300 ft of gas intersected
- Pre-drill objectives achieved beyond expectations

South Africa

- Black Empowerment Partners Finalised
- Environmental Management Plan submitted and application currently being reviewed.

Maricopa

- Oil sales for the December Quarter of 2,281 barrels
- Wellington Maricopa #6 continued at good rates of oil producing 23 bopd.

Triple Crown prospect – Edward County, Texas 80% WI

Drilling to appraise the Triple Crown prospect was undertaken during the quarter. The well commenced drilling on the 9th November 2010, however it had to be plugged and abandoned as the drill bit became stuck during a routine trip out operation. The rig was skidded across and a drilling recommenced on the 2nd December 2010. This well was drilled to a total depth of 7,431 ft and intersected a combined gas column of over 2,300 ft. Drilling operations were completed after the end of the quarter on 20th January, 2011. Wireline logs including formation imaging log were acquired at this time and the well temporarily secured in accordance with regulations until the next stage of the evaluation program has been finalized.

The well was designed to test the three targets within the Triple Crown Prospect:

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- Ellenburger - Well to determine net pay thickness and presence of gas. Next stage would be to stimulate this well or drill a horizontal well.
- Canyon Sands - Well to determine net pay thickness and presence of gas. Next stage would involve stimulating and testing the productivity of these sands
- Unconventional Gas - Well to test presence of gas via gas shows during drilling and if suitable drilling conditions prevail sidewall cores will be taken to allow geochemical analysis.

The pre-drill objective was to appraise an area with multiple targets that had multi TCF potential and the well has achieved these objectives beyond expectations.

The well intersected a gross gas column of over 2,300 ft, containing zones which logs indicate should produce conventionally, unconventionally or via a combination of both.

The next step is to determine the best completion techniques for the different zones and undertake an extensive testing program. The company anticipates it will be in a position to provide further information on this go forward program shortly.

A detailed discussion on the initial results of each of the zones encountered in this well is provided below:

Canyon Sands and Unconventional Gas Play

An 1150 ft zone in the Lower Canyon Sands was gas charged with very strong gas shows during drilling in the range 2.5 – 7.5% even whilst utilising a heavy brine drilling fluid.

Based on the evaluation to date, this well has intersected a number of gas charged Canyon Sands between 4530 to 5680 ft. This interval contains several sands which have the characteristics of conventional potential pay interbedded in a large unconventional gas zone. The Canyon Sands in this zone are often over-pressured and have the potential to deliver gas at both the rates and volumes required to develop this property on a standalone basis

The unconventional gas zone is a completely new discovery, and preliminary log analysis has indicated that it has all the required characteristics for a successful unconventional resource development. At this time geochemical analysis is being carried out on the side wall cores; utilizing this information an independent unconventional gas expert will be engaged to further analyse the data and provide an independent resource assessment.

The presence of conventional sandstones within the unconventional gas zone, potentially provides completion pathways for large fracture stimulations which may allow co-production of both targets at once.

The go-forward work program for these zones will involve:

- Completion of the physical and chemical analysis of the side wall cores.
- Integration of side wall core analysis into the log analysis to refine the target zones.
- Review completion options, select and prioritise zones to be tested.
- Determine the level of reservoir stimulation required for each selected zone.
- Independent expert assessment of the data to provide an indication of the size of the potential prize.

Ellenburger

A preliminary analysis of the logs from the Ellenburger has been completed and suggests the well intersected:

- Indications of gas throughout the section.
- The actual top of the Ellenburger at 5790 ft MDRT, however there appears to have been a thrust zone in which the “top” of the Ellenburger was repeated three times. In this zone the well also lost circulation whilst drilling with mud. Logs indicate that the section has enhanced porosity and permeability.
- Probable karst-related (fossil cave) porosity with indications of permeable zones, in offsetting wells this interval has the best developed open fractures.
- Enhanced zones of log porosity and indications of permeability which may be related to open fractures and in some instances karst-related porosity development.

The Ellenburger is a tight dolomite which has an inherently low porosity of 3-4%, it relies on the well intersecting sets of near vertical fractures to provide the primary production pathway from the reservoir to the well bore. The effectiveness of these fractures can be enhanced with fracture stimulation and acidisation. In recent times, the optimal method of producing from the Ellenburger in this region has generally been with horizontal wells, as the number of different vertical fracture swarms that are intersected is maximized.

South Africa 90%

As previously announced, Challenger has finalised an agreement which provides for Challenger to meet the requirement of the Broad Based Black Economic Empowerment Act 2003 (“BEE”) for all of its activities in South Africa. Under this act, Challenger is required to provide that 10% of its interests are owned by BEE compliant entities.

Challenger has been fortunate to identify two exceptionally well regarded and connected partners Mr Donald Ncube and Mr H Thompson to join in its activities in South Africa. These individuals not only allow Challenger to meet its obligations under the BEE act but will also provide strong support for its activities through their extensive experience and contacts. Mr Ncube and Mr Thompson will each become owners of 5% of the issued capital in Challenger’s previously wholly owned subsidiary Bundu Gas and Oil Exploration (Pty) Ltd (“Bundu”).

Bundu has completed its initial consultation process, and submitted the EMP within the time periods dictated by PASA. The consultation process raised a number of concerns which have been incorporated into the EMP, and Bundu intends to continue its ongoing consultation process over the coming months to better inform the community about its activities.

Bundu and Challenger have engaged and consulted extensively with PASA with the assistance and support of its new BEE partners to address the concerns raised in its refusal of the previous application. The EMP is the final documentation required by PASA before finalising its assessment of Bundu’s application which is expected to take between 3 and 6 months.

The CR 1/68 well located within the application area flowed high rates of gas of more than 8 MMcf/day of natural gas from the Fort Brown shale during testing in 1968.

The Karoo basin has recently become an area of interest for a number of major international companies, including Shell, Falcon Oil & Gas, Chesapeake and Statoil. At Cranemere, the Company is targeting the Fort Brown shales, a massive (up to 5000 ft thick) lower Permian carbonaceous shale.

In the time since Bundu submitted its original application for the smaller Cranemere project area, the Karoo Basin has become an area of very significant interest for a number of major international companies, including Shell, Falcon Oil & Gas, Chesapeake and Statoil. A number of these have taken an initial 12 month Technical Co-Operation Permit (TCP) which only permits desktop evaluation of existing data over large areas surrounding Bundu's application area as shown in Figure 1.

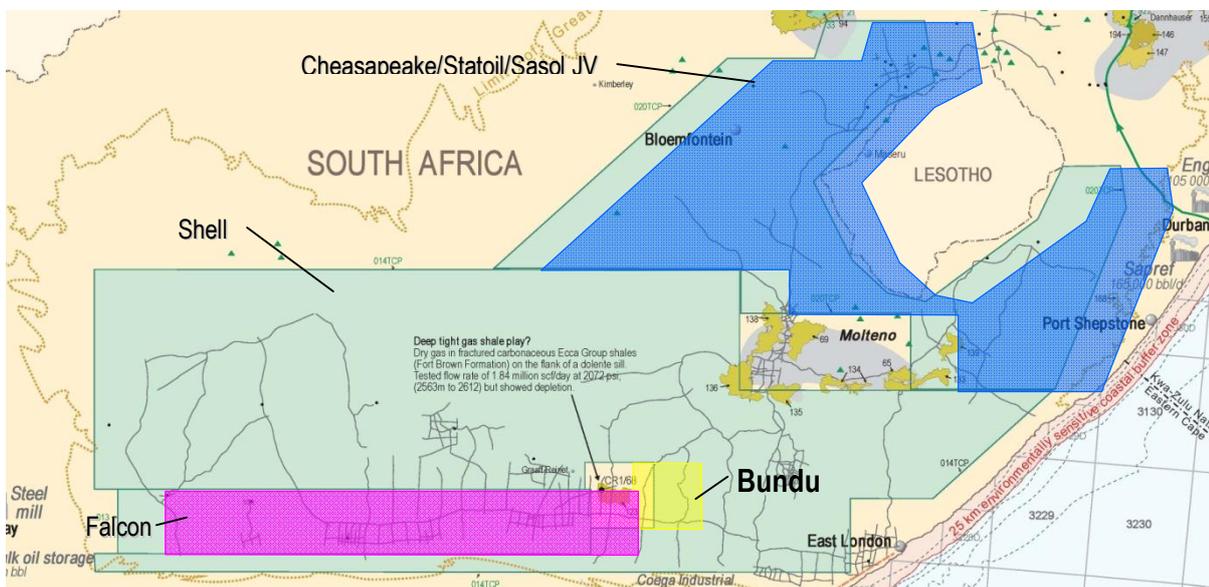


Figure 2 – Current Applications in the Southern Karoo Basin.

Maricopa Project: 50% Working Interest (San Joaquin Basin)

The Maricopa #6 well averaged a rate of 23 bopd during the quarter.

Improved oil prices over the last three quarters have had a beneficial effect on the project with average prices of approximately US\$81.53 per barrel being achieved in the December quarter.

Challenger Energy has a 50% Working Interest. Solimar Energy holds a 50% Working Interest and is the operator.

The Silverthread Project: 18.5% - 20% Working Interest (Ventura Basin)

Solimar Energy is continuing to work on receiving assignments on the lease at Silverthread and is hopeful that a settlement can be reached shortly with the operator Mirada Petroleum Inc. This would provide the opportunity to re-enter, stimulate and re-test the oil zone penetrated in the Nesbitt #5 well.

The Deer Creek Project: 50% Working Interest and Operator (San Joaquin Basin)

The Company is currently evaluating the future of the Deer Creek project and how it fits in with the Company's plans and objectives.

SALES PRODUCTION

During the December quarter 2010, a total of 2,281 barrels of oil were sold from the Maricopa Project. The average price of oil received from the Kern Oil Refinery in the December quarter 2010 was approximately US\$81.53/bbl. The Company's share of revenue from sales for the quarter was US\$186,000.

CORPORATE

During the quarter, the Company raised \$2.9 million in funds via a loan facility to provide additional working capital to fund the drilling and testing operations of the initial well at the Triple Crown Prospect. The facility was a direct, un-secured and un-subordinated obligation of the Company, with interest accruing at the rate of 10% per annum, calculated daily, compounded monthly, capitalised and payable by no later than 1 July 2010. Each of the participants in the loan facility were offered 10 listed options (with an exercise price of 20c and an expiry date of 30 June 2012) for every \$1.00 dollar advanced under the facility

On 31 January 2011, the Company held a shareholders' meeting whereby all resolutions were passed. Forming part of the meeting, shareholders approved the issue of new equity to satisfy the full amount payable under the financing facility.

In addition, the Company announced on 28 January 2011 that it had reached agreement to put in place a financing facility of up to A\$1.25 million to provide additional working capital to fund the evaluation of the results to date and ongoing operations. The facility is a direct, un-secured and un-subordinated obligation of the Company, converting into ordinary shares based on a 15% discount to 5 day VWAP. The Board expect to have full amount payable under the financing facility satisfied through the issue of new equity pursuant to its 15% capacity under ASX Listing Rules. Each of the participants in the financing facility will also be issued 10 listed options (with an exercise price of 20c and an expiry date of 30 June 2012) for every \$1.00 dollar advanced under the facility.

Yours faithfully



Paul Bilston
Managing Director

Appendix 5B

Mining exploration entity quarterly report

Introduced 1/7/96. Origin: Appendix 8. Amended 1/7/97, 1/7/98, 30/9/2001, 01/06/10.

Name of entity

Challenger Energy Limited

ABN

45 123 591 382

Quarter ended (öcurrent quarterö)

31 December 2010

Consolidated statement of cash flows

| Cash flows related to operating activities | Current quarter \$Aö000 | Year to date (6 months) \$Aö000 |
|---|----------------------------|---------------------------------------|
| 1.1 Receipts from product sales and related debtors | 98 | 145 |
| 1.2 Payments for (a) exploration & evaluation | (3,721) | (4,020) |
| (b) development | (4) | (14) |
| (c) production | (32) | (68) |
| (d) administration | (323) | (709) |
| 1.3 Dividends received | - | - |
| 1.4 Interest and other items of a similar nature received | 5 | 19 |
| 1.5 Interest and other costs of finance paid | - | - |
| 1.6 Income taxes paid | - | - |
| 1.7 Other (provide details if material) | - | - |
| Net Operating Cash Flows | (3,977) | (4,647) |
| Cash flows related to investing activities | | |
| 1.8 Payment for purchases of: (a) prospects | - | - |
| (b) equity investments | - | - |
| (c) other fixed assets | - | - |
| 1.9 Proceeds from sale of: (a) prospects | - | - |
| (b) equity investments | - | - |
| (c) other fixed assets | - | - |
| 1.10 Loans to other entities | - | - |
| 1.11 Loans repaid by other entities | - | - |
| 1.12 Other (provide details if material) | - | - |
| Net investing cash flows | - | - |
| 1.13 Total operating and investing cash flows (carried forward) | (3,977) | (4,647) |

+ See chapter 19 for defined terms.

Appendix 5B
Mining exploration entity quarterly report

| | | | |
|------|--|---------|---------|
| 1.13 | Total operating and investing cash flows (brought forward) | (3,977) | (4,647) |
| | Cash flows related to financing activities | | |
| 1.14 | Proceeds from issues of shares, options, etc. | - | 922 |
| 1.15 | Proceeds from sale of forfeited shares | - | - |
| 1.16 | Proceeds from borrowings | 2,405 | 2,405 |
| 1.17 | Repayment of borrowings | - | - |
| 1.18 | Dividends paid | - | - |
| 1.19 | Cost of share/option issues | - | (85) |
| | Net financing cash flows | 2,405 | 3,242 |
| | Net increase (decrease) in cash held | (1,572) | (1,405) |
| 1.20 | Cash at beginning of quarter/year to date | 1,849 | 1,716 |
| 1.21 | Exchange rate adjustments to item 1.20 | 27 | (7) |
| 1.22 | Cash at end of quarter | 304 | 304 |

Payments to directors of the entity and associates of the directors

Payments to related entities of the entity and associates of the related entities

| | | Current quarter \$A'000 |
|------|--|----------------------------|
| 1.23 | Aggregate amount of payments to the parties included in item 1.2 | 98 |
| 1.24 | Aggregate amount of loans to the parties included in item 1.10 | - |

1.25 Explanation necessary for an understanding of the transactions

Directors' fees and salaries

Non-cash financing and investing activities

2.1 Details of financing and investing transactions which have had a material effect on consolidated assets and liabilities but did not involve cash flows

None

2.2 Details of outlays made by other entities to establish or increase their share in projects in which the reporting entity has an interest

None

+ See chapter 19 for defined terms.

Financing facilities available

Add notes as necessary for an understanding of the position.

| | Amount available \$Aø000 | Amount used \$Aø000 |
|---------------------------------|-----------------------------|------------------------|
| 3.1 Loan facilities | 2,405 | 2,405 |
| 3.2 Credit standby arrangements | - | - |

Estimated cash outflows for next quarter

| | \$Aø000 |
|--------------------------------|--------------|
| 4.1 Exploration and evaluation | 1,230 |
| 4.2 Development | - |
| 4.3 Production | - |
| 4.4 Administration | 238 |
| Total | 1,468 |

Reconciliation of cash

Reconciliation of cash at the end of the quarter (as shown in the consolidated statement of cash flows) to the related items in the accounts is as follows.

| | Current quarter \$Aø000 | Previous quarter \$Aø000 |
|--|----------------------------|-----------------------------|
| 5.1 Cash on hand and at bank | 304 | 1,849 |
| 5.2 Deposits at call | - | - |
| 5.3 Bank overdraft | - | - |
| 5.4 Other | - | - |
| Total: cash at end of quarter (item 1.22) | 304 | 1,849 |

Changes in interests in mining tenements

| | Tenement reference | Nature of interest (note (2)) | Interest at beginning of quarter | Interest at end of quarter |
|-----|---|-------------------------------|----------------------------------|----------------------------|
| 6.1 | Interests in mining tenements relinquished, reduced or lapsed | - | - | - |
| 6.2 | Interests in mining tenements acquired or increased | - | - | - |

+ See chapter 19 for defined terms.

Appendix 5B
Mining exploration entity quarterly report

Issued and quoted securities at end of current quarter

Description includes rate of interest and any redemption or conversion rights together with prices and dates.

| | Total number | Number quoted | Issue price per security (see note 3) (cents) | Amount paid up per security (see note 3) (cents) |
|--|---|-------------------------------------|---|--|
| 7.1 Preference +securities <i>(description)</i> | | | | |
| 7.2 Changes during quarter (a) Increases through issues (b) Decreases through returns of capital, buy-backs, redemptions | | | | |
| 7.3 +Ordinary securities | 122,990,075 | 122,990,075 | | |
| 7.4 Changes during quarter (a) Increases through issues (b) Decreases through returns of capital, buy-backs | | | | |
| 7.5 +Convertible debt securities <i>(description)</i> | | | | |
| 7.6 Changes during quarter (a) Increases through issues (b) Decreases through securities matured, converted | | | | |
| 7.7 Options <i>(description and conversion factor)</i> | 3,500,000 80,299,304 2,000,000 2,000,000 2,000,000 2,000,000 | - 80,299,304 - - - - | <i>Exercise price</i> 10 cents 20 cents 25 cents 35 cents 25 cents 35 cents | <i>Expiry date</i> 30/06/2012 30/06/2012 01/02/2013 01/02/2015 01/02/2014 01/02/2015 |
| 7.8 Issued during quarter | 2,000,000 2,000,000 13,350,000 | - - 13,350,000 | 25 cents 35 cents 20 cents | 01/02/2014 01/02/2015 30/06/2012 |
| 7.9 Exercised during quarter | | | | |
| 7.10 Expired during quarter | | | | |
| 7.11 Debentures <i>(totals only)</i> | | | | |

+ See chapter 19 for defined terms.

| | | | |
|------|---|--|--|
| 7.12 | Unsecured notes (<i>totals only</i>) | | |
|------|---|--|--|

Compliance statement

- 1 This statement has been prepared under accounting policies which comply with accounting standards as defined in the Corporations Act or other standards acceptable to ASX (see note 4).
- 2 This statement does give a true and fair view of the matters disclosed.

Sign here:



Date: 31 January 2011

Managing Director

Print name: Paul Bilston

Notes

- 1 The quarterly report provides a basis for informing the market how the entity's activities have been financed for the past quarter and the effect on its cash position. An entity wanting to disclose additional information is encouraged to do so, in a note or notes attached to this report.
- 2 The "Nature of interest" (items 6.1 and 6.2) includes options in respect of interests in mining tenements acquired, exercised or lapsed during the reporting period. If the entity is involved in a joint venture agreement and there are conditions precedent which will change its percentage interest in a mining tenement, it should disclose the change of percentage interest and conditions precedent in the list required for items 6.1 and 6.2.
- 3 **Issued and quoted securities:** The issue price and amount paid up is not required in items 7.1 and 7.3 for fully paid securities.
- 4 The definitions in, and provisions of, *AASB 1022: Accounting for Extractive Industries* and *AASB 1026: Statement of Cash Flows* apply to this report.
- 5 **Accounting Standards** ASX will accept, for example, the use of International Accounting Standards for foreign entities. If the standards used do not address a topic, the Australian standard on that topic (if any) must be complied with.

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+ See chapter 19 for defined terms.