



**31 July 2012**

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## **QUARTERLY ACTIVITIES REPORT FOR THE PERIOD ENDED 30 JUNE 2012**

### **HIGHLIGHTS**

#### **Mercury Stetson**

- **Fracture stimulation and production testing of Woodford and Barnett Shales completed**
- **Both Woodford and Barnett shales produced gas to surface**
- **Continued influx of water into well bore caused slugging limiting gas rate**

#### **Triple Crown**

- **Lease expired in mid June and company decided not to renew the lease**

#### **South Africa**

- **Government has stated the technical report into fracking which was due to be submitted in July has been delayed until early August.**
- **The Company continues to work with the Government on approval of its application for an exploration right at Cranemere.**

#### **Maricopa**

- **Wellington Maricopa project produced at an average rate of 17bopd.**

## **Mercury Stetson (earning 50%)**

During the quarter, the Company carried out a fracture stimulation of both the Woodford and Barnett shales.

After fracture stimulation of the Woodford shale, having reduced the water rate to below 10 BBL/hr, the well was put on production test. The gas rate was sufficient to light and run a flare, however it was not sustained due to continued influx of water into the well bore, increasing the pressure on the formation ultimately killing the well.

Following this, and incorporating the results of the Woodford test, a Fracture stimulation was completed on a larger section of the Barnett formation. This well was then flowed back before commencing production testing. The production testing of the Barnett formation in the Mercury Stetson prospect demonstrated presence of gas and the ability to show a continuous production from the formation.

The well slugged continued to slug both gas and frac water, and whilst initial average gas rates were quite favourable, the average gas rate eventually dropped to and stabilised between 50 – 100 mscf/d as a result of the continued return of frac water to the well bore which was impeding production.

Mr Lee Mathews, the engineer supervising the test has advised that he did not expect the gas rate to increase without the installation of a pump to assist in lifting water. It is uncertain what the final rate would be if this work was undertaken, and further Challenger is of the view that production from this well would be unlikely to be economic at this time with gas prices where they are.

The difference in depths between the formations in the original well bore and the side track of up to 500 ft across a lateral distance of only 700 ft provide a clear indication of geological complexity in this particular area. It is likely this complexity has impacted on the production rate.

Whilst Challenger does not currently have 3D seismic in the location of the wellbore, it has seen high quality 3D seismic across the prospect area, a few miles to the South West which is much less complex with minimal faulting, so it does not expect the complexity encountered in this well bore to be pervasive across the prospect area. A small 3D survey across the well bore area which would tie into this existing 3D seismic would provide a significant amount of information on the geological structure of the area, and may assist in understanding the results to date.

Based on the advice of our local engineer in conjunction with the regulatory body, Challenger has decided to plug and abandon the well, given the expectation that further activity in the prospect would be located in a less complex area. This does not restrict further operations with this well bore which can always be re-entered.

## **South Africa (90%)**

During the quarter, Bundu (90% owned by Challenger Energy Limited) continued to support the ongoing assessment of its application for an exploration right located around Cranemere in the Southern Karoo Basin.

The permit is centred around 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 and Falcon Oil & Gas. At Cranemere, the Company is targeting the Fort Brown shales, a massive (up to 5000 ft thick) lower Permian carbonaceous shale. A US Energy Information Administration

report on potential shale gas resources around the world has identified a "Risky Recoverable Resource" of approximately 6.8 BCF per square mile, which based on the size of the application is equivalent to more than 7 TCF of recoverable resource.

In August 2011 the government extended the Moratorium on the award of any new exploration rights in South Africa until February 2012. The Company understands the Government has received the Technical Report from the Technical Committee it set up to review and report on the impacts of fracking in South Africa. At this time the Company has not been advised of the recommendations contained in the report.

The Company notes that Econometrix, South Africa's largest independent macro-economic consultancy has released a study on the potential economic and employment benefits of a successful natural gas development in the southern Karoo basin. The Econometrix report estimates that a relative conservative find of 20 TCF could have an annual economic impact of ZAR80 billion and at 50 TCF the impact on the South African economy could be as high as ZAR200 billion. Hundreds of thousands of sustainable employment opportunities could be created and have a knock-on effect on producers, government and consumers.

Challenger notes the recent statement by the South African Mines Minister, Susan Shabangu, that a technical report on shale gas that was to be submitted to the Cabinet in July will now be submitted in early August.

Challenger expects that following Cabinet review the industry will be provided with clarity on the path forward for the industry and will allow Challenger to plan with certainty the implementation of the exploration program associated with its large permit.

Challenger continues to observe a broadly supportive sentiment in the media and an increased interest in the shale industry in South Africa. The company continues to progress discussions on a potential farm-in with interested parties within this more favourable environment.

#### **Triple Crown prospect – Edward County, Texas 80% WI**

Challenger wishes to advise that the land lease on the Triple Crown prospect has expired in mid-June. Challenger has elected not to extend the lease agreement and to focus its resources on its other projects.

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

The Maricopa project averaged 17bopd during the quarter.

During the June 2012 quarter, the average price of oil received from the Kern Oil Refinery was US\$105/bbl.

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

#### **CORPORATE**

During the quarter, the company issued 22M new Shares ("Placement Shares") at a price per share of \$0.025c to raise \$550,000 (before costs) for working capital.

**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)

30 June 2012

### Consolidated statement of cash flows

Cash flows related to operating activities	Current quarter \$Aö000	Year to date (12 months) \$Aö000
1.1 Receipts from product sales and related debtors	81	418
1.2 Payments for (a) exploration & evaluation	(3,332)	(9,762)
(b) development	-	-
(c) production	(19)	(120)
(d) administration	(197)	(891)
1.3 Dividends received	-	-
1.4 Interest and other items of a similar nature received	6	119
1.5 Interest and other costs of finance paid	-	-
1.6 Income taxes paid	-	-
1.7 Other (provide details if material)	-	-
<b>Net Operating Cash Flows</b>	<b>(3,461)</b>	<b>(10,236)</b>
<b>Cash flows related to investing activities</b>		
1.8 Payment for purchases of: (a) prospects	-	-
(b) equity investments	-	-
(c) other fixed assets	-	(11)
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 ö refunds/(deposits) for exploration costs	(143)	235
- deposit for rental bond	-	(7)
<b>Net investing cash flows</b>	<b>(143)</b>	<b>217</b>
1.13 Total operating and investing cash flows (carried forward)	<b>(3,604)</b>	<b>(10,019)</b>

+ See chapter 19 for defined terms.

**Appendix 5B**  
**Mining exploration entity quarterly report**

1.13	Total operating and investing cash flows (brought forward)	(3,604)	(10,019)
<b>Cash flows related to financing activities</b>			
1.14	Proceeds from issues of shares, options, etc.	704	4,600
1.15	Proceeds from sale of forfeited shares	-	-
1.16	Proceeds from borrowings	-	-
1.17	Repayment of borrowings	-	-
1.18	Dividends paid	-	-
1.19	Cost of share/option issues	(188)	(264)
<b>Net financing cash flows</b>		516	4,336
<b>Net increase (decrease) in cash held</b>		(3,088)	(5,683)
1.20	Cash at beginning of quarter/year to date	3,642	6,250
1.21	Exchange rate adjustments to item 1.20	(38)	(51)
1.22	<b>Cash at end of quarter</b>	516	516

**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	147
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	-	-
3.2 Credit standby arrangements	-	-

### Estimated cash outflows for next quarter

	\$Aø000
4.1 Exploration and evaluation	120
4.2 Development	-
4.3 Production	50
4.4 Administration	150
<b>Total</b>	<b>320</b>

### 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	516	3,642
5.2 Deposits at call	-	-
5.3 Bank overdraft	-	-
5.4 Other (Share issues not yet allotted)	-	-
<b>Total: cash at end of quarter</b> (item 1.22)	<b>516</b>	<b>3,642</b>

### 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	Triple Crown Prospect	Lease in Edwards County, Texas, United States allowed to lapse.	80%	-
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 <b>Preference +securities</b> <i>(description)</i>				
7.2 Changes during quarter (a) Increases through issues (b) Decreases through returns of capital, buy-backs, redemptions				
7.3 <b>+Ordinary securities</b>	311,482,540	311,482,540		
7.4 Changes during quarter (a) Increases through issues (b) Decreases through returns of capital, buy-backs	22,000,000	22,000,000	2.5 cents	2.5 cents
7.5 <b>+Convertible debt securities</b> <i>(description)</i>				
7.6 Changes during quarter (a) Increases through issues (b) Decreases through securities matured, converted				
7.7 <b>Options</b> <i>(description and conversion factor)</i>	2,000,000 2,000,000 2,000,000 11,500,000 2,000,000 7,500,000	- - - - - -	<i>Exercise price</i> 25 cents 35 cents 25 cents 15 cents 35 cents 15 cents	<i>Expiry date</i> 28/02/2013 28/02/2015 01/02/2014 20/11/2014 01/02/2015 20/11/2016
7.8 Issued during quarter				
7.9 Exercised during quarter				
7.10 Expired during quarter	3,500,000 105,222,171	- 105,222,171	10 cents 20 cents	30/06/2012 30/06/2012
7.11 <b>Debentures</b> <i>(totals only)</i>				

+ See chapter 19 for defined terms.

7.12	<b>Unsecured notes</b> ( <i>totals only</i> )		
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## 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 July 2012

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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