

29th July 2014

Board of Directors:

Michael Fry
(Non-Executive Chairman)

Robert Willes
(Managing Director)

William Bloking
(Non-Executive Director)

**Issued capital
(as at June 30, 2014):**

329,482,541 fully paid
ordinary shares (ASX:CEL)

65,896,502 listed options
(ASX:CELO)

41,500,000 unlisted options
and rights

Substantial Holders:

LQ Super 12.61%

Pitt Street Absolute
Return Pty Ltd and
related entities 4.96%

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Quarterly Activities Report for the Period Ending June 30 2014

HIGHLIGHTS

South Africa

- **Momentum builds towards processing and approval of applications for shale gas exploration rights in South Africa**
 - Positive statements in Presidential State of the Nation Address
 - New Minister for Mineral Resources reviewing Mineral and Petroleum Resources Development Amendment (MPRDA) Bill passed by Parliament in March – positive developments anticipated
 - Publication of the Technical Regulations anticipated
 - Key policy documents support need to progress exploration
 - Eskom continues to suffer constraints and load shedding

- **Farm-out discussions continue pending award of the exploration right.**

Corporate

- **\$988, 447 raised (before costs and expenses) via a fully underwritten loyalty options issue.**

South Africa

Momentum continues to build towards the determination of applications for shale gas exploration. President Zuma was returned to government in the May election and continued to highlight the importance of exploration efforts progressing. Building on the theme in the ANC election manifesto and his February State of the Nation Address, the President stated in his June State of the Nation Address;

“...shale gas is recognised as a game changer for our economy. We will pursue the shale gas option within the framework of our good environmental laws.”

Post-election cabinet changes include Ngoako Ramatlhodi as the new Minister for Mineral Resources. The Mineral and Petroleum Resources Development Amendment (MPRDA) Bill was passed by both houses of Parliament in March, and is now with the President for assent. Some of the proposed new terms had raised concern with the oil and gas industry. Minister Ramatlhodi is widely reported in the media as having asked the President not to sign the current bill until it can be properly reviewed. Potential outcomes of this may include either specific provisions for oil and gas, or amendments to the legislation or accompanying regulation.

Post the reporting period, the Minister is reported as stating in his address on the Budget Vote to the National Assembly on 15th July that:

“We sit at a crossroads in the history of resources development in our country. The potential of the upstream petroleum industry, both shale gas and increasingly offshore deep-water oil and gas, is profound, and if stewarded properly, has the potential to drive the development of our economy for all our people in a manner contrary to the historic injustice afflicted upon our people by the mining industry.”

And:

“With regard to upstream petroleum industry, our policy position is to enable an investor friendly environment, whilst securing vital state interests. Any legislation or agreement interim or long term has to conform to this formula. In the event that the MPRDA amendments are referred back to Parliament, I intend to drive forward a full democratic process involving all stakeholders to develop this new foundation that underpins the profound potential for the upstream petroleum industry. In the event the Bill is assented to, I reiterate my commitment to a rigorous consultation on regulations.”

“Hence, in the coming weeks we will launch a platform to debate draft regulations already developed, which may provide an interim solution to enable the significant investment required to take place while the long term foundation is being laid. This interim solution has the benefit that it will afford us the opportunity to explore long term and sustainable solutions that can then be incorporated into the overall process. The interim solution is critical now because it allows us to harness the opportunity to capture the scale of investment in this window of opportunity that is available to South Africa.”

This is an encouraging development that should be positive for our industry, and which Challenger fully supports. Whilst the implication is that some time may be required to revisit

the proposed amendments, Challenger believes that the potential benefits of clearer and more appropriate terms for the industry are likely to outweigh this. Additional time taken at this stage could well prove worthwhile in the medium to long term, setting the foundations for a new industry and saving time and money overall.

The publication of the Technical Regulations is also anticipated. It is not yet clear whether these will await potential changes to the legislation, or whether they may be finalised sooner, possibly allowing the regulator, PASA, to progress the processing and award of exploration rights.

Alongside the legislation, key policy instruments include the National Development Plan (NDP), Gas Utilisation Master Plan (GUMP), Integrated Energy Plan (IEP) and Integrated Resource Plan (IRP). The NDP indicates a need to enable exploration for coal seam and shale gas; incorporate a greater share of gas in South Africa's energy mix; lower carbon emissions; and ensure that 90 per cent of the population have grid access by 2030. The IRP highlights the planned introduction of gas-fired generation into the country's generation mix. This was published in 2011 and is in the process of being updated as a "living plan" to take into account subsequent developments in the energy sector, such as shale gas. The GUMP and IEP are being developed by the Department of Energy. The GUMP has yet to be published, but is intended to provide a framework for investment in gas-supporting infrastructure as well as outlining the role that gas could play in the electricity, transport, domestic, commercial and industrial sectors.

In the meantime, South Africa's national power grid continued to suffer constraints with utility, Eskom, reportedly implementing load shedding. Load shedding status is communicated via schedules on Eskom's website, regular Power Alerts and Power Bulletin broadcasts on SABC TV and radio, the media and SMS to customers. Eskom has been increasingly reliant on diesel-fired generation as backup, reportedly doubling its spend on diesel over the prior year to R10.5bn in 2013/14.

In the meantime, Challenger and Bundu continue to stay close to the evolving situation in South Africa, and the company continues to progress discussions on a potential farm-in with interested parties.

Background

The Karoo Basin, which extends across 600,000 km² is located in central and southern South Africa and contains organic rich shales of Permian age with combined thickness up to 5000 feet. The focus for shale gas exploration is in the southern portion of the basin where the shales are at sufficient depth and where five wells, all pre-1970, intersected the shales with significant gas shows. One well, the Cranemere CR 1/68 well, flowed more than 8 MMcf/day of natural gas from the Fort Brown shale during testing over a 158 feet interval in 1968. The production was judged to be from fractures and secondary porosity in the shales. As first mover, Bundu selected its application area of approximately 1 million acres to be centred around this well.

The U.S. Energy Information Administration (EIA) updated its 2011 report on World Shale Gas Resources in June 2013. The EIA estimates that the Lower Permian Ecca Group shales in the Karoo Basin contain 1,559 Tcf of risked shale gas in-place, with 370 Tcf as the risked, technically recoverable shale gas resource.

To demonstrate the scale of the estimated resource, according to the US Department of Energy 1 Tcf of natural gas is enough to heat 15 million homes for one year, generate 100 billion kilowatt hours of electricity, or fuel 12 million natural-gas-fired vehicles for one year. Significantly the current EIA estimate excludes the thicker Upper Ecca shales on the basis that they have a lower reported total organic carbon content. These Upper Ecca shales include the Fort Brown shale from which gas flowed at the Cranemere CR 1/68 well.

The Karoo Basin has become the focus of intense interest in the past few years, following the initial application to explore for shale gas in the basin by Bundu Oil & Gas Pty Ltd (acquired by CEL in April 2010) in February 2009. A number of major international companies, including Shell, Chevron and Falcon Oil & Gas, are also pursuing exploration rights in the region.

Furthermore, the low economic growth rates and power crisis in South Africa have strongly motivated the government to pursue potential shale gas resources as a catalyst to transform the economy.

As previously noted, Chevron Business Development South Africa Limited (Chevron) has announced an Agreement with Falcon Oil and Gas Ltd to jointly co-operate on unconventional gas opportunities in the Karoo Basin, with the result that Challenger through its subsidiary Bundu Gas & Oil (Pty) Ltd is the only junior company with interests in the basin alongside Shell and Chevron.

Mercury Stetson (earning 50%)

The Company is assessing next steps following completion of plugging and abandonment of the well drilled in the permit during 1Q13.

Corporate

In April the Company announced a loyalty options issue. The loyalty issue was a fully underwritten, non-renounceable entitlement issue under which eligible shareholders were offered one Option for every five Shares held at an issue price of \$0.015 (1.5 cents) per Option, exercisable at \$0.20 each and expiring 30 June 2016. The offer was fully underwritten by Novus Capital Limited.

The issue closed on 14th May and raised \$988,447 before costs of the issue. Funds raised under the offer will go towards;

- Funding the Company's continuing work in support of its subsidiary's application for the Exploration Right for the Cranemere Shale Gas Project in South Africa;
- Developing further business opportunities relating to the project;
- Working capital; and
- Covering the expenses of the offer.

Yours faithfully



Robert Willes
Managing Director

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CHALLENGER ENERGY (ASX code: CEL, CELO) is focused on the fast-emerging, world-scale shale gas province in South Africa's Karoo Basin. The Karoo is strategic, and central to the South African Government's agenda, given the country's power crisis and need for economic growth, jobs and infrastructure development. Through its South African subsidiary, Bundu Gas and Oil Exploration Pty Ltd, Challenger was first to recognise this opportunity and to apply for exploration rights in the Karoo - and has since been followed by Shell and Falcon Oil and Gas, which has brought Chevron in as a joint venture partner.

Appendix 5B

Mining exploration entity and oil and gas exploration entity quarterly report

Introduced 01/07/96 Origin Appendix 8 Amended 01/07/97, 01/07/98, 30/09/01, 01/06/10, 17/12/10, 01/05/2013

Name of entity

Challenger Energy Limited

ABN

45 123 591 382

Quarter ended ("current quarter")

30 June 2014

Consolidated statement of cash flows

Cash flows related to operating activities	Current quarter \$A'000	Year to date (12 months) \$A'000
1.1 Receipts from product sales and related debtors	-	-
1.2 Payments for (a) exploration & evaluation (b) development (c) production (d) administration	(78) - - (280)	(157) - - (1,173)
1.3 Dividends received	-	-
1.4 Interest and other items of a similar nature received	1	10
1.5 Interest and other costs of finance paid	(1)	(1)
1.6 Income taxes paid	-	-
1.7 Other – Maricopa sale costs - rental income	- 23	(20) 100
Net Operating Cash Flows	(335)	(1,241)
Cash flows related to investing activities		
1.8 Payment for purchases of: (a) prospects (b) equity investments (c) other fixed assets	- - -	- (149) -
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)	-	27
Net investing cash flows	-	(122)
1.13 Total operating and investing cash flows (carried forward)	(335)	(1,363)

+ See chapter 19 for defined terms.

Appendix 5B

Mining exploration entity and oil and gas exploration entity quarterly report

1.13	Total operating and investing cash flows (brought forward)	(335)	(1,363)
	Cash flows related to financing activities		
1.14	Proceeds from issues of shares, options, etc.	826	1,826
1.15	Proceeds from sale of forfeited shares	-	-
1.16	Proceeds from borrowings (refer 2.1 below)	162	162
1.17	Repayment of borrowings	-	-
1.18	Dividends paid	-	-
1.19	Other – costs of share issues	(95)	(145)
	Net financing cash flows	893	1,843
	Net increase (decrease) in cash held	558	480
1.20	Cash at beginning of quarter/year to date	204	282
1.21	Exchange rate adjustments to item 1.20	-	-
1.22	Cash at end of quarter	762	762

Payments to directors of the entity, associates of the directors, 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	119
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 paid during the quarter.

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

During the quarter, short term borrowings received of \$162,435 were repaid via the issue of share options. In total, the share options issue raised \$988,448 (the total of items 1.14 and 1.16 above) before costs.

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 \$A'000	Amount used \$A'000
3.1 Loan facilities	-	-
3.2 Credit standby arrangements	-	-

Estimated cash outflows for next quarter

	\$A'000
4.1 Exploration and evaluation	75
4.2 Development	
4.3 Production	
4.4 Administration	250
Total	325

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 \$A'000	Previous quarter \$A'000
5.1 Cash on hand and at bank	762	204
5.2 Deposits at call		
5.3 Bank overdraft		
5.4 Other (provide details)		
Total: cash at end of quarter (item 1.22)	762	204

+ See chapter 19 for defined terms.

Appendix 5B

Mining exploration entity and oil and gas exploration entity quarterly report

Changes in interests in mining tenements and petroleum tenements

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

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	329,482,541	329,482,541	
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>			

+ See chapter 19 for defined terms.

Appendix 5B

Mining exploration entity and oil and gas exploration entity quarterly report

7.6	Changes during quarter (a) Increases through issues (b) Decreases through securities matured, converted				
7.7	Options (description and conversion factor)	11,500,000 2,000,000 2,000,000 7,500,000 65,896,502	- - - - 65,896,502	<i>Exercise price</i> 15 cents 35 cents 35 cents 15 cents 20 cents	<i>Expiry date</i> 20/11/2014 01/02/2015 28/02/2015 20/11/2016 30/06/2016
	Performance Rights	2,500,000 4,000,000 8,000,000 4,000,000	- - - -	<i>Exercise price</i> Nil Nil Nil Nil	<i>Expiry date</i> 20/06/2015 07/04/2016 07/04/2018 07/04/2020
7.8	Issued during quarter Listed options	65,896,502	65,896,502	<i>Exercise price</i> 20 cents	<i>Expiry date</i> 30/06/2016
7.9	Exercised during quarter				
7.10	Options expired during quarter				
7.11	Debentures (totals only)				
7.12	Unsecured notes (totals only)				

+ See chapter 19 for defined terms.

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 5).
- 2 This statement does give a true and fair view of the matters disclosed.

Sign here:



Managing Director

Date: 29 July 2014

Print name: Robert Willes

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 and petroleum 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 or petroleum 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 6: Exploration for and Evaluation of Mineral Resources* and *AASB 107: Statement of Cash Flows* apply to this report.
- 5 **Accounting Standards** ASX will accept, for example, the use of International Financial Reporting 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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