ASX:CEL
www.challengerenergy.com.au

30 January 2017

Board of Directors:

Michael Fry
(Non-executive Chairman)

Robert Willes
(Managing Director)

William Bloking
(Non-executive Director)

Issued capital:

389,466,818 fully paid ordinary shares (ASX: CEL)

52,250,000 unlisted options and rights

Substantial holders:

LQ Super	11.15%
W&M Brown	7.47%

Registered office:

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QUARTERLY ACTIVITIES REPORT FOR THE PERIOD 31 DECEMBER 2016

HIGHLIGHTS

- **Recommended changes to the Mineral and Petroleum Resources Development Act ("MPRDA") Amendment Bill presented to the Upper House (National Council of Provinces) Select Committee by the Department of Mineral Resources ("DMR") in early November. Public consultations expected to be complete by end March/April.**

- **Preliminary Information Memorandum on the LNG Independent Power Producer Procurement Programme published in early October. Energy Minister states the programme *"is designed to provide imported LNG as a base to trigger exploration as well as upstream development and the reindustrialization of the economy."***

- **Department of Energy ("DOE") gazettes draft Integrated Energy Plan (IEP) and draft Integrated Resource Plan (IRP) Assumptions and Base Case for public comment in late November.**

- **Strategic Environmental Assessment ("SEA") for Shale Gas Development completes second phase with publication in November of the final scientific assessment report.**

- **Given past delays and remaining uncertainties around the timing of exploration rights awards, the Company continues to focus on internal cost control and is also evaluating other projects that could add a further dimension to the Company's portfolio.**

Legislative Framework

As previously reported, the petroleum industry (via the industry associations, the Offshore Petroleum Association of South Africa ("OPASA") and the Onshore Petroleum Association of South Africa ("ONPASA")) has engaged with government to deliver constructive solutions for the legislative framework (the Mineral and Petroleum Resources Development Act, 28 of 2002 - "MPRDA").

The MPRDA Amendment Bill has been referred to Parliament. Having completed its passage through the National Assembly (the lower house of Parliament), the Bill has been referred to the National Council of Provinces ("NCOP") (the upper house of Parliament).

Recommended changes to the Bill were presented to the Upper House (National Council of Provinces) Select Committee by the Department of Mineral Resources ("DMR") in early November.

The DMR proposed that the state's 20% free carried interest be changed to a 20% carried interest with a cost recovery mechanism during the production phase. The holder of an exploration right, which has applied for a production right, is entitled to apply for a downward adjustment of the 20% state carried interest. The Minister of Mineral Resources may grant this downward adjustment following consultation with the Minister of Finance, on a case by case basis, to ensure that projects remain financially viable. It is envisaged that project certainty will be created by agreeing and appending the production right terms and conditions to the exploration right (the terms of production will be settled at exploration stage), subject to renegotiation between the parties at the renewal of the 30-year production right.

Currently black economic empowerment ("BEE") participation under the MPRDA is governed by the Mining Charter but this does not specifically provide for upstream oil and gas operations, and the industry has not been involved in the consultation on this matter. The DMR proposed that the Minister of Mineral Resources be given the power to develop a Petroleum Charter for the upstream oil and gas industry, and that a lower 10% shareholding be reserved for BEE participation. The DMR explained that, after extensive consultation, and given the high cost and associated risk of oil and gas exploration, together with the state's 20% carried interest, this level of BEE participation is considered more appropriate to the industry.

In accordance with the terms of the President's referral of the Bill back to Parliament, further public hearings are required to correct defects in the initial public participation process. This should be the final step in addressing the President's reservations.

Several provinces have now held their own briefing sessions with the DMR, though we understand that a number remain to be completed, following which public consultations will be held. Public consultations have commenced in Kwa-Zulu Natal and it is expected that the other provinces which have already held their briefings by the DMR will set dates for their public consultations shortly. We expect that all of the public consultations will be completed by the end of March/April. Any proposed amendments that may result from this will then follow due process. Challenger's website contains links to recent media interviews and articles that provide further context.

Challenger anticipates further progress with regard to the granting of exploration rights once the MPRDA Amendment Bill has passed through Parliament.

Role of gas in South Africa's energy mix

In early October a Preliminary Information Memorandum (PIM) on the Liquefied Natural Gas Independent Power Producer Procurement Programme (LNG IPPPP) was launched by South Africa's Department of Energy (DoE) at the South Africa: Gas Options conference in Cape Town.

The PIM describes the scope of the LNG IPPPP for prospective and interested bidders and highlights the opportunities the programme presents to the bidders and to the South African economy. One of the primary objectives of the programme is to develop a gas economy in South Africa, including gas exploration and production from indigenous resources. Nqgura (Coega) (Eastern Cape Province) and Richards Bay (KwaZulu-Natal Province) have been identified as the two feasible sites to develop LNG projects for the first phase. Challenger anticipates that the programme will kick start investment in gas and power infrastructure that may benefit the future production of domestic gas, noting that Coega is proximate to Bundu's exploration rights application area.

Energy Minister Tina Joemat-Pettersson states in the PIM that;

> *"The LNG-to-Power IPP procurement programme is designed to provide imported LNG as a base to trigger exploration as well as upstream development and the re-industrialization of the economy. It is expected to build significant anchor gas demand in the South African economy, while indigenous and/or more regional gas supply is being developed, and over time supplement imported LNG,"*

International Finance Corporation (IFC) principal investment officer Marcel Bruhwiler is quoted as saying that;

> *"We think gas-to-power makes a great deal of sense. Together with renewables, this has proved to work in many other markets,"*

He said the IFC would provide expertise and financing and was confident about the success of the project flowing from the government's renewable-energy programme.

> *"We see the PIM opening further opportunities for private investment in the energy sector. The use of natural gas is an important step in South Africa's energy economy. Together with abundant renewables, gas is a powerful combination and affordable for long-term power supply."*

The Coega Development Corporation, which oversees the Coega Industrial Development Zone, anticipates the investment value associated with the zone's selection as one of two locations for the first phase of the LNG IPPPP to total R25-billion.

As well as LNG importation, storage and handling infrastructure, the Department of Energy reportedly envisages the building of private gas-fired power generation capacity of 1000 MW in addition to the existing 342 MW Dedisa peaking power plant, which recently entered commercial operation and which is also designed for conversion from diesel to gas.

In late November, the DoE gazetted the draft Integrated Energy Plan (IEP) and the draft Integrated Resource Plan (IRP) Assumptions and Base Case for public comment. The closing date for public comments was initially set at 15 February 2017, but the DOE has extended the period for public comment until 31 March 2017. The IRP for 2010-30 was promulgated in 2011 as a “living plan”, and since that time there have been a number of developments in the energy sector in South and Southern Africa as well as changes in the electricity demand outlook. The IEP is described as “a national plan which describes the recommended future energy roadmap for South Africa”, with the objective of guiding policy development, setting the framework for regulations and informing the selection of technologies to meet future energy demand. It covers the entire energy sector whereas the IRP is described as “the country plan which sets out the electricity supply and demand balance and requirements (including the technologies) from 2020 to 2050”. Following the public consultation process, the IRP will be finalised and tabled to Cabinet for approval. The request for qualifications (RFQ) for the LNG IPPPP previously scheduled for November has been delayed to ensure alignment between the procurement programme and the IRP.

In November, the government-commissioned two-year Strategic Environmental Assessment (“SEA”) for Shale Gas Development completed its second phase with the publication of the final version of “Shale Gas Development in the Central Karoo: A Scientific Assessment of the Opportunities and Risks”. A link to these extensive reports is provided on Challenger’s website. The third and final phase will translate the scientific assessment into an operational decision-making framework. This is expected to conclude around March 2017 and is intended to provide the framework that will guide site and activity specific assessment processes, and provide government with the necessary tools to enable responsible decision-making into the future regarding shale gas development. This includes guidance on legislation, regulations, environmental impact assessment processes and monitoring.

Corporate

Whilst working to progress the licence application, management continues to focus on cost reduction and on evaluating potential new projects to add to the Company’s portfolio.

Background

The Karoo Basin, which extends across 600,000 km^2, is located in central and southern South Africa and contains organic rich shales of Permian age with combined thickness up to 5,000 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 CR1/68 well, flowed at a rate of 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 centred on this well.

The US 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 390 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 (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 – is the only unpartnered junior company with interests in the basin, alongside Shell and Chevron.

Yours faithfully

Robert Willes
Managing Director

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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, 01/05/13, 01/09/16

Name of entity

Challenger Energy Limited

ABN	Quarter ended ("current quarter")
45 123 591 382	31 December 2016

Consolidated statement of cash flows			Current quarter $A'000	Year to date (6 months) $A'000
1.	**Cash flows from operating activities**			
1.1	Receipts from customers			
1.2	Payments for			
	(a)	exploration & evaluation (assessing potential new projects)	(38)	(84)
	(b)	development		
	(c)	production		
	(d)	staff costs (not included above)	(40)	(90)
	(e)	administration and corporate costs	(52)	(121)
1.3	Dividends received (see note 3)			
1.4	Interest received		1	3
1.5	Interest and other costs of finance paid			
1.6	Income taxes paid			
1.7	Research and development refunds			
1.8	Other (provide details if material)			
1.9	**Net cash from / (used in) operating activities**		**(129)**	**(292)**

2.	**Cash flows from investing activities**		
2.1	Payments to acquire:		
	(a) property, plant and equipment		
	(b) tenements (see item 10)		
	(c) investments		
	(d) other non-current assets		
2.2	Proceeds from the disposal of:		
	(a) property, plant and equipment		
	(b) tenements (see item 10)		
	(c) investments		
	(d) other non-current assets		
2.3	Cash flows from loans to other entities		
2.4	Dividends received (see note 3)		
2.5	Other (provide details if material)		
2.6	**Net cash from / (used in) investing activities**		

3.	**Cash flows from financing activities**		
3.1	Proceeds from issues of shares		
3.2	Proceeds from issue of convertible notes		
3.3	Proceeds from exercise of share options		
3.4	Transaction costs related to issues of shares, convertible notes or options		
3.5	Proceeds from borrowings		
3.6	Repayment of borrowings		
3.7	Transaction costs related to loans and borrowings		
3.8	Dividends paid		
3.9	Other (provide details if material)		
3.10	**Net cash from / (used in) financing activities**		

4.	**Net increase / (decrease) in cash and cash equivalents for the period**		
4.1	Cash and cash equivalents at beginning of period	688	851
4.2	Net cash from / (used in) operating activities (item 1.9 above)	(129)	(292)
4.3	Net cash from / (used in) investing activities (item 2.6 above)		
4.4	Net cash from / (used in) financing activities (item 3.10 above)		
4.5	Effect of movement in exchange rates on cash held	1	1
4.6	**Cash and cash equivalents at end of period**	**560**	**560**

5.	**Reconciliation of cash and cash equivalents** at the end of the quarter (as shown in the consolidated statement of cash flows) to the related items in the accounts	**Current quarter $A'000**	**Previous quarter $A'000**
5.1	Bank balances	560	688
5.2	Call deposits		
5.3	Bank overdrafts		
5.4	Other (provide details)		
5.5	**Cash and cash equivalents at end of quarter (should equal item 4.6 above)**	**560**	**688**

6.	**Payments to directors of the entity and their associates**	**Current quarter $A'000**
6.1	Aggregate amount of payments to these parties included in item 1.2	78
6.2	Aggregate amount of cash flow from loans to these parties included in item 2.3	

6.3 Include below any explanation necessary to understand the transactions included in items 6.1 and 6.2

Payment of director fees.

7.	**Payments to related entities of the entity and their associates**	**Current quarter $A'000**
7.1	Aggregate amount of payments to these parties included in item 1.2	
7.2	Aggregate amount of cash flow from loans to these parties included in item 2.3	
7.3	Include below any explanation necessary to understand the transactions included in items 7.1 and 7.2	

None.

8.	**Financing facilities available** *Add notes as necessary for an understanding of the position*	**Total facility amount at quarter end $A'000**	**Amount drawn at quarter end $A'000**
8.1	Loan facilities		
8.2	Credit standby arrangements		
8.3	Other (please specify)		
8.4	Include below a description of each facility above, including the lender, interest rate and whether it is secured or unsecured. If any additional facilities have been entered into or are proposed to be entered into after quarter end, include details of those facilities as well.		

None.

9.	**Estimated cash outflows for next quarter**	**$A'000**
9.1	Exploration and evaluation	(75)
9.2	Development	
9.3	Production	
9.4	Staff costs (not included above)	(35)
9.5	Administration and corporate costs	(70)
9.6	Other (provide details if material)	
9.7	**Total estimated cash outflows**	**(180)**

10.	**Changes in tenements (items 2.1(b) and 2.2(b) above)**	**Tenement reference and location**	**Nature of interest**	**Interest at beginning of quarter**	**Interest at end of quarter**
10.1	Interests in mining tenements and petroleum tenements lapsed, relinquished or reduced	Mercury Stetson (USA) Grayson County	Gross acreage reduced from 86 to nil during the quarter due to expiry of remaining leases.	Working Interest 15%	Nil
10.2	Interests in mining tenements and petroleum tenements acquired or increased				

Compliance statement

1 This statement has been prepared in accordance with accounting standards and policies which comply with Listing Rule 19.11A.

2 This statement gives a true and fair view of the matters disclosed.

Sign here: ....   Date: .....30/1/2017.............
(Director)

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 that wishes to disclose additional information is encouraged to do so, in a note or notes included in or attached to this report.
2. If this quarterly report has been prepared in accordance with Australian Accounting Standards, 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. If this quarterly report has been prepared in accordance with other accounting standards agreed by ASX pursuant to Listing Rule 19.11A, the corresponding equivalent standards apply to this report.
3. Dividends received may be classified either as cash flows from operating activities or cash flows from investing activities, depending on the accounting policy of the entity.