Challenger Energy Ltd

ASX:CEL
www.challengerenergy.com.au

31 July 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)

53,250,000 unlisted options and rights

Substantial holders:

LQ Super	11.06%
W&M Brown	7.47%

Registered office:

Level 17,
500 Collins St
Melbourne
VICTORIA 3000
Tel +61 3 9614 0600
Fax +61 3 9614 0550

QUARTERLY ACTIVITIES REPORT FOR THE PERIOD ENDING 30 JUNE 2017

HIGHLIGHTS

- **Additional public hearings on recommended changes to the Mineral and Petroleum Resources Development Act ("MPRDA") Amendment Bill concluded on 28 June.**

- **Proposed amendments to be considered by Parliamentary Select Committee, with Minister of Finance stating the Government targeting December for finalisation of Bill.**

- **Key milestone achieved as Government commissioned two-year Strategic Environmental Assessment concludes final phase.**

- **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 MPRDA[1] Amendment Bill (the "Bill") was referred back to Parliament by the President. Having completed its passage through the National Assembly (the lower house of Parliament), the Bill was referred to the National House of Traditional Leaders and the National Council of Provinces ("NCOP") (the upper house of Parliament).

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

The NCOP Select Committee on Land and Mineral and Resources (the "Select Committee") held public hearings on the Bill in each province of South Africa from 25 January to 20 April 2017. In addition to the public hearings in each of the provinces the Select Committee called for written and oral submissions directly and these oral representations were hosted in Parliament from 13 to 28 June 2017.

According to the latest draft Select Committee Plan the public hearings were concluded on 28 June. Challenger understands that the Select Committee will meet with the Department of Mineral Resources and the state law advisors in the third Parliamentary term commencing on 1 August, and thereafter (on 29 August) each province will deliver their proposed amendments to the Bill. Following this 'negotiating mandate' meeting, a final mandate meeting will be held on 17 October, following which the Select Committee will consider the proposed amendments and the amended Bill will return to the National Assembly and, if passed, will be sent back to the President for approval.

The current Select Committee Plan does not anticipate that the Bill will be passed before late October. However, in a nine-point economic plan unveiled earlier this month, Minister of Finance Malusi Gigaba, noted that government has targeted December for finalisation of the Bill.

In late March a number of South African news outlets reported that, during a community engagement meeting on shale gas development at Richmond in the Northern Cape, South African Mineral Resources Minister Mosebenzi Zwane stated that:

> *"Based on the balance of available scientific evidence, government took a decision to proceed with the development of shale gas in the Karoo formation of South Africa"*

and that:

> *"The finalisation of Mineral and Petroleum Resources Development Act (MPRDA) amendments will also help to expedite the development of shale gas."*

Challenger welcomes these positive indicators of progress towards the finalising of key legislation and the determination of the applications for exploration rights received by the government.

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[1] Mineral and Petroleum Resources Development Act, 28 of 2002 - "MPRDA"

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

On 19 July 2017, the Minister of Mineral Resources, Mosebenzi Zwane, gazetted a notice inviting stakeholders to submit representations on a proposed restriction under the MPRDA on the granting of any new application for a prospecting or mining right, the processing of any application for renewal of a prospecting or mining right, and the receiving of any applications for the transfer of a right.

It is unclear whether this moratorium will apply to applications in relation to oil and gas rights under the MPRDA, however the notice is clear that the moratorium will 'not be applicable to applications received and accepted before the date of publication of this notice'. Consequently it is not expected that this will affect Bundu's application.

Role of gas in South Africa's energy mix

In October 2016 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).

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 right application area.

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 November 2016, the DoE gazetted the draft Integrated Energy Plan (IEP) and the draft Integrated Resource Plan (IRP) Assumptions and Base Case for public comment. 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 has been delayed to ensure alignment between the procurement programme and the IRP.

The process has occasioned much public debate on the topic of South Africa's future energy mix. The Council for Scientific and Industrial Research (CSIR), for example, submitted an alternative IRP making the case that the least cost option for new investment in the power sector is a blend of solar PV, wind and flexible power (e.g. gas, CSP, hydro, biogas).

Strategic Environmental Assessment

The South African government-commissioned two-year Strategic Environmental Assessment ("SEA") for Shale Gas Development has now completed its third and final phase with the publication of the "Decision Support Tools Report". A link to the SEA website containing this and the Phase 2 Scientific Assessment Report is provided on Challenger's website.

The Decision Support Tools are intended to translate the scientific assessment into an operational decision-making framework to 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 exploration and development.

The report is an extensive and detailed document, and reaches a number of conclusions such as;

> *"There will be an element of 'learning-by-doing' during exploration, which if sufficiently planned and managed, should not result in disproportionally high risks to the Central Karoo environments and people."*

and

> *"Including more natural gas in South Africa's energy mix would make the energy system more resilient, efficient, cheaper and reliable. Natural gas, regardless of its source, has a desirable set of qualities that coal and oil do not possess. Natural gas can be used in almost all subsectors (power generation, heat, transport, chemicals manufacturing); is easily transported once professionally operated gas infrastructure is in place; is supported by a growing international market; is a more homogenous fuel than coal (thus more flexible and easier to handle); is less CO2 intensive when burnt than coal (if leakage during production and transport is minimised); can be more efficiently used for power generation (more kWh per GJ); has high operational flexibility; and has an end-use cost structure that is capital- light and fuel-intensive, making it economically flexible."*

> *"Because of its high operational flexibility, shale gas could enable the integration of more renewables into the energy mix and reduce the portfolio costs of power generation. The use of relatively low-cost shale gas would enable the creation of a network of gas-fired power stations located in the Central Karoo These power stations have attributes complementary to solar photovoltaic (PV) and wind generation plants*

> *which are inherently variable. Thus a portfolio containing all three is cheaper to build and operate than any one alone, for now and into the foreseeable future. As such, shale gas finds would not change the selected planning scenario for the electricity sector, which already calls for more natural gas and renewables, but would likely make this mix cheaper and cleaner."*

and

> *"This effectively means that > 99 % of the surface area of the Central Karoo will not be directly affected by shale gas exploration and production, even at the Big Gas scenario, meaning that it will be entirely possible to use avoidance as the primary mitigation mechanism in reducing the risks posed by shale gas exploration Phase I ("Exploration") and Phase II ("Appraisal"). There is more than sufficient evidence, that from a perspective of geographical footprint, that shale gas exploration can reach reasonably large proportions without impinging on other land-uses in Central Karoo provided that appropriate avoidance and site-specific mitigation is employed."*

> *"With this in mind, the prescription of exclusion areas for shale gas exploration is an effective approach to risk mitigation and the determination of limits of acceptable change. Exclusions areas can be delimited at two scales: at a course scale – where regional species, trends, features and populations which occur should be protected (the focus of a strategic-level study); and at fine scale – where sensitive features can be 'groundtruthed' and mapped onsite at fine-scale (the focus of an EIA-level investigation)."*

The Decision Support Tools Report contains proposed strategic management actions to mitigate the identified risk factors and a number of maps proposing exclusion areas for shale gas exploration and appraisal across the combined shale gas application areas in the Karoo. These maps are at a large scale but appear to propose extensive exclusion areas across Challenger subsidiary, Bundu's application area, most likely including protected areas that Bundu has already removed from its application area. Whilst noting that the SEA provides recommendations and does not constitute regulation or legislation, Bundu and Challenger are working to assess the likely impact and will provide a further update once this work has been completed.

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. The recent downgrade of South Africa's foreign currency sovereign credit rating to junk status by S&P Global Ratings and Fitch Ratings is expected to add to the pressure on 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

INVESTOR CONTACT
ROBERT WILLES
MANAGING DIRECTOR
CHALLENGER ENERGY
+61 410 479 032

MEDIA CONTACT
ANDREW ROWELL
ACCOUNT MANAGER
CANNINGS PURPLE
+61 400 466 226

CHALLENGER ENERGY (ASX code: CEL,) is focused on the 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.

+Rule 5.5

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	30 June 2017

Consolidated statement of cash flows		**Current quarter $A'000**	**Year to date (12 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)	(28)	(140)
	(b) development		
	(c) production		
	(d) staff costs (not included above)	(34)	(158)
	(e) administration and corporate costs	(73)	(228)
1.3	Dividends received (see note 3)		
1.4	Interest received	1	5
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**	**(134)**	**(521)**

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	465	851
4.2	Net cash from / (used in) operating activities (item 1.9 above)	(134)	(521)
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
4.6	**Cash and cash equivalents at end of period**	**331**	**331**

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	331	465
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)**	**331**	**465**

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	62
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	(60)
9.2	Development	
9.3	Production	
9.4	Staff costs (not included above)	(30)
9.5	Administration and corporate costs	(90)
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				
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: 31 July 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.