



31 January 2012

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QUARTERLY ACTIVITIES REPORT FOR THE PERIOD ENDED 31 DECEMBER 2011

HIGHLIGHTS

Mercury Stetson

- Re-entry operation conducted which was partially successful
- Plan to sidetrack and drill new hole to bottom in February 2012
- Land and leasing program continues

Triple Crown

- Drilling and testing program on Ellenburger completed in October 2011
- Large "Slick Water Frac" on selected Hybrid Interval (OGIP 7.4 TCF) to be scheduled for 2012

South Africa

- The Company awaits approval of its application for an exploration right at Cranemere.

Maricopa

- Wellington Maricopa project produced at an average rate of 18 bopd.

Mercury Stetson

A re-entry operation at Mercury Stetson was conducted during the quarter. The re-entry was only partially successful and a decision was made to undertake a sidetrack from the existing well bore at ~5,100 feet and drill a new hole to bottom.

The drilling of a new hole through the two reservoir sections will provide the opportunity to obtain a new mud log, collect fresh drill cuttings and run modern logs in the new hole that will provide a much better understanding of the reservoir compared to re-entering the existing well bore which has been open and exposed to unknown drilling fluids for over 30 years.

Challenger Energy has secured the drilling rig for the side-track program. This rig has been scheduled to move on location in mid to late February.

The Mercury Stetson Prospect, which includes the Barnett and Woodford shales - both proven shale formations. The prospect which is potentially up to 55,000 acres (86 sq miles) has a massive potential gas in place with OGIP estimated at 360 BCF/sqmile. The JV area initially includes 26,000 acres contiguous land position with three pipelines across the prospect. The JV has had an active land leasing program underway through the quarter to extend and add leases within the Area of Mutual Interest (AMI) with an initial target of 35,000 acres across the prospect.

Triple Crown prospect – Edward County, Texas 80% WI

The testing program on the Ellenburger formation of the Triple Crown Project in Texas was completed in October 2011. The testing involved drilling a side track out of the existing well bore and a short horizontal lateral into the zone at top of the Ellenburger.

The sidetrack was drilled from a window milled into the existing casing at approximately 5,400 ft, building angle to enter the target zone horizontally at the top of the Ellenburger approximately 200 ft from the existing well bore. The targets for the side track were a zone at approximately 5,800 ft where a significant volume of fluid was lost into the formation during the initial drilling of this well and a section of the reservoir where formation image logs indicated encouraging natural fracture development.

The well successfully drilled the target zones and whilst drilling through these zones several very significant drilling breaks were observed which provided initial encouragement that significant fractures may have been intersected, however the gas shows did not increase and no commercial gas flow was observed.

A cement plug has been set, which has isolated the Ellenburger leaving the well ready for the fracture stimulation of the "hybrid zone".

HYBRID PLAY

As previously advised, Challenger intends to complete a fracture stimulation on a selected interval as a proof of concept test of the Hybrid Play. The Company has identified an Original Gas In Place (OGIP) within the Hybrid of 7.4 TCF within its existing lease position.

Challenger has selected a zone to fracture stimulate and test. The zone will be fracture stimulated by a large "Slick Water Frac" consistent with the stimulation design currently utilized in other unconventional plays. The objective of this test is to understand the production characteristics of this zone and provide valuable inputs into understanding the potential recoverable resource.

This fracture stimulation is planned for 2012.

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 "Risked 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. Based on this current timetable the company expects the award of this application right in the near term.

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

The Maricopa project averaged 18 bopd during the quarter.

During the December 2011 quarter, the average price of oil received from the Kern Oil Refinery was US\$112/bbl.

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

CORPORATE

No activity to report.

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 ("current quarter")

31 December 2011

Consolidated statement of cash flows

Cash flows related to operating activities	Current quarter \$A'000	Year to date (6 months) \$A'000
1.1 Receipts from product sales and related debtors	75	228
1.2 Payments for (a) exploration & evaluation	(2,829)	(3,570)
(b) development	-	-
(c) production	(20)	(60)
(d) administration	(263)	(495)
1.3 Dividends received	-	-
1.4 Interest and other items of a similar nature received	27	104
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	(3,010)	(3,793)
Cash flows related to investing activities		
1.8 Payment for purchases of: (a) prospects	-	-
(b) equity investments	-	-
(c) other fixed assets	(11)	(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 – refunds/(deposits) for exploration costs	1,299	378
- deposit for rental bond	(7)	(7)
Net investing cash flows	1,281	360
1.13 Total operating and investing cash flows (carried forward)	(1,729)	(3,433)

+ See chapter 19 for defined terms.

Appendix 5B
Mining exploration entity quarterly report

1.13	Total operating and investing cash flows (brought forward)	(1,729)	(3,433)
	Cash flows related to financing activities		
1.14	Proceeds from issues of shares, options, etc.	-	-
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	-	-
	Net financing cash flows	-	-
	Net increase (decrease) in cash held	(1,729)	(3,433)
1.20	Cash at beginning of quarter/year to date	4,605	6,250
1.21	Exchange rate adjustments to item 1.20	(89)	(30)
1.22	Cash at end of quarter	2,787	2,787

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	148
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 \$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	1,600
4.2 Development	-
4.3 Production	-
4.4 Administration	300
Total	1,900

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	2,787	2,569
5.2 Deposits at call	-	2,036
5.3 Bank overdraft	-	-
5.4 Other (Share issues not yet allotted)	-	-
Total: cash at end of quarter (item 1.22)	2,787	4,605

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	214,021,002	214,021,002		
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>	3,500,000 105,222,171 2,000,000 2,000,000 2,000,000 11,500,000 2,000,000 7,500,000	- - - - - - - -	<i>Exercise price</i> 10 cents 20 cents 25 cents 35 cents 25 cents 15 cents 35 cents 15 cents	<i>Expiry date</i> 30/06/2012 30/06/2012 28/02/2013 28/02/2015 01/02/2014 20/11/2014 01/02/2015 20/11/2016
7.8 Issued during quarter	11,500,000 7,500,000	- -	15 cents 15 cents	20/11/2014 20/11/2016
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>)		
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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 January 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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