

17 December 2014

Dear Shareholder,

CHAIRMAN'S YEAR-END MESSAGE

As the curtain comes down on 2014, I would like to take the opportunity to reflect on where Challenger stands today, and to look forward to the exciting year ahead.

After joining Challenger in April 2013, Managing Director Robert Willes has continued to ably steer the Company. In February this year, Challenger added another highly qualified resource industry executive to the board, Bill Bloking, as a non-executive director. Mr Bloking has 40 years' experience in the oil and gas industry and has held senior positions with BHP Billiton Petroleum, Exxon and Esso.

Arguably, the most exciting development of 2014 has come in the latter stages, however, with the Petroleum Agency of South Africa (PASA) advising in late October that it would restart processing the applications for shale gas Exploration Rights in the Karoo Basin.

This represents a major breakthrough for Challenger and its subsidiary Bundu (Bundu Gas and Oil Exploration Pty Ltd, the applicant for the Exploration Right), and the other companies pursuing acreage in the Karoo as the processing of applications for shale gas Exploration Rights in South Africa had been on hold since 2011.

It is a clear indication that the South African Government is ready to move ahead with the appraisal of the Karoo shales to see whether they offer a solution to the rapidly worsening energy crisis that continues to hinder the country's economic development.

As part of the procedure for progressing the application, PASA asked that Bundu review and update the Environmental Management Programme ("EMPr") submitted when its application was originally made in 2010 and also to engage in further stakeholder consultation. The EMPr update and the stakeholder consultation process are to be completed by 27 February 2015, and effectively set the regulatory machine in motion. Golder Associates, an independent environmental consultancy engaged by Bundu, has completed the update of the EMPr and has begun notifying and consulting with interested and affected parties in respect of the revised document.

The new EMPr describes a revised work programme that includes only seismic studies and drilling, the assessment of potential positive and negative impacts related to these activities and proposed mitigation measures to manage potential negative impacts. This is in line with the moratorium on further applications imposed in February this year. The moratorium excluded from its ambit existing Exploration Right applications, subject to the proviso that no hydraulic fracturing will be permitted until such time as the proposed Technical Regulations for Petroleum Exploration and Exploitation (the "Technical Regulations") have been published under the Mineral and Petroleum Resources Development Act, 28 of 2002 ("MPRDA"). This is a measured approach to shale gas exploration, which we fully endorse. We expect that the Technical Regulations will be finalised in the coming months.

In order to fund Challenger and Bundu as they progress through the permit application process, the Company completed a private placement to raise \$1.2 million before associated costs in late November. The placement comprised 20 million new fully paid ordinary shares issued at 6 cents (\$0.06) per share. The shares were placed with sophisticated investors, the majority of whom were existing shareholders in the company.

Prior to the placement, Challenger also raised \$988,447 before costs through a loyalty option issue in April. The issue, which was fully underwritten by Novus Capital, offered eligible shareholders one option for every five Challenger shares held at an issue price of 1.5 cents (\$0.015). There was strong take-up, with the Company receiving valid acceptances for 44,916,960 options from shareholders and Novus allocated an additional 20,979,542 options via shortfall. The options are exercisable at 20 cents (\$0.20), expire on 30 June 2016 and are listed on the Australian Securities Exchange under the ASX code "CELO".

Both of these raisings represent a strong vote of confidence in the Company.

Throughout the year, Challenger and Bundu have continued to build and reinforce key relationships with Government and the Regulator, the industry association, Austrade, the investor community and media in South Africa. Challenger and Bundu also continue to be closely involved in industry consultation regarding proposed amendments to key legislation, specifically the draft MPRDA Amendment Bill. Following the May elections, progress is being made towards a resolution that will be an enabler to South Africa's nascent petroleum exploration industry.

The way ahead

With the aforementioned developments in mind, we look forward to 2015 with enthusiasm.

Real progress is being made now that the processing of the applications for Exploration Rights in the Karoo has started again, and we expect that the Government will award these Rights in the coming months.

The recent capital raise removes funding uncertainty and allows Challenger and Bundu to focus on moving forward with stakeholder consultation and the Exploration Right application process.

The economic rationale for the South African Government to pursue the development of a shale gas industry has certainly not diminished. If anything it has grown stronger, with recent major electricity outages by state-owned utility Eskom. With the prospect of these continuing for some time, pressure on the economy is likely to increase and public concern to rise.

Against this backdrop, Challenger continues its discussions with prospective farm-in partners and we will continue to keep shareholders updated and informed as and when there is material progress.

As an aside, as oil prices have softened recently, it is worth noting that this should have less of an impact on Challenger as a major market for shale gas in South Africa is likely to be power generation. Future gas prices are arguably more likely to be linked to the power market's next-best alternatives of coal, nuclear, diesel and imported gas. Production is still some way into the future. Essentially, the fundamentals have not changed, nor has Challenger's strategy – indeed, lower oil prices may represent an opportunity to add to our portfolio further down the track.

I would like to finish by thanking you for your support during 2014. Best wishes to you and your families for the festive season and the New Year.

Yours faithfully,



Michael Fry
Chairman
Challenger Energy Limited