

21 December 2015

Dear Shareholder,

### **CHAIRMAN'S YEAR-END MESSAGE**

As the year draws to a close, it is worth taking a moment to reflect on events and progress over the course of 2015, and to consider where your company stands today.

At first blush, it may seem that Challenger has been in a holding pattern, awaiting the outcome of government process in South Africa. Whilst it is certainly true that the government is in control of the timeline, a good deal of "heavy lifting" has in fact taken place on the part of your company, the industry in general, and the government.

All of these activities have been working toward convergence on the commonly held objective of progressing the shale gas exploration rights applications, and although it may sometimes seem otherwise, a great deal of progress has in fact been made.

Whilst this has been reflected in our reporting and presentations during the year, I feel it is nevertheless worth summarising the key elements.

These show:

- highly responsive actions by Challenger to meet regulatory requirements as these have arisen;
- deep industry engagement with government to address issues such as key legislation;
- continued progress by government, at both department and regulator level, towards the issuing of exploration rights to applicants;
- repeated acknowledgement by the President of South Africa and senior members of his cabinet of the role gas, including shale gas, should play in planning South Africa's future energy mix; and
- still no sustainable relief for either business or individual citizens from the country's protracted energy crisis.

We now feel that the stage is set for progress on the shale gas front in a far more compelling way than at any time prior to this point.

The seeds were sown in 2014 – the government's Operation Phakisa initiative aimed at kick-starting key sectors of the economy reported back in October, and included a recommendation that the uncertainty surrounding the key mineral resources and petroleum legislation be addressed. In the same month, the government re-started the processing of the exploration right applications that had been on hold since 2011. This set the scene for 2015.

The year began with a major deliverable – along with the other applicants, Challenger’s subsidiary, Bundu, was requested to update its Environmental Management Programme (EMPr) and to undertake further stakeholder consultation. This was a very substantial effort with a significant investment of both time and funds over a relatively short period of time. We believe that we have delivered a high-quality product and have worked hard to engage with stakeholders.

Intensive “on the ground” stakeholder consultation was a requirement of the EMPr updating process, and was valuable to us in terms of better understanding the needs and expectations – often conflicting – of the various stakeholders in the Karoo community of which we plan to become part.

Bundu continued to engage with the regulator, Petroleum Agency South Africa (PASA), responding to requests for clarification as they worked through the EMPr, and updating the overall application in June. We understand that PASA has made good progress with processing the applications and should soon provide its recommendations to the Minister. We are advised that the Minister’s office typically takes one to two months to respond.

Alongside this, the industry has engaged with the government at senior levels via the industry associations in order to resolve the uncertainties in the key legislation (the MPRDA) – especially around fiscal terms. Challenger (via Bundu) has played its part in shaping this. The engagements have been constructive and productive, with convergence on key principles and a clear desire on the part of government to move the process forward.

At this point we anticipate that either a mutually acceptable revision to the MPRDA will be proposed to Parliament soon, or the controversial clauses will be suspended, pending the splitting of the legislation into separate acts covering mining and oil and gas. Either way, it seems this may now be off the critical path and the government can proceed.

The government has also moved forward on the regulatory front with the gazettal of the long awaited Technical Regulations in June. At a policy level, the government launched a two-year Strategic Environmental Assessment (SEA) for shale gas development – an important step as it signals that government is now thinking ahead in terms of high-level policy-setting and decision-making on the basis that the exploration process will result in a commercial resource.

Alongside all of this you will no doubt have seen that senior government figures, including the President, have continued to indicate intent to issue licenses for shale gas exploration. We also reported in our last quarterly report on the increasing emphasis being placed on gas as part of South Africa’s power generation mix, with the Energy Minister indicating that “..gas will be a cornerstone of base load...” and preparing to release a request for proposals for more than 3GW of gas-fired power generation. This is a further signal of seriousness of intent.

Meantime, during the winter months of 2015, South Africans continued to experience at first-hand – at work and at home – the country’s critical energy shortage through “load-shedding” – scheduled power blackouts for hours at a time. Power utility Eskom has received Government bailouts of billions of Rands. It is a matter of national interest, we believe, that exploration gets under way soon, so that informed decisions can be made about the extent to which shale gas can influence South Africa’s energy mix, and thus economic recovery.

On the corporate front, we have worked hard to contain costs throughout 2015 whilst maintaining contact with existing and potential investors. Work has also continued on the farm-in front, with interest from multiple parties, although we anticipate that the award of exploration rights will be required in order to progress this.

While we could have hoped for more definite news regarding the granting of an exploration permit before the close of 2015, we are confident that 2016 will see this and other positive developments. We will have to be ready to move quickly and efficiently, taking stakeholders with us, as the opportunities arise.

On behalf of your board, I would like to thank you for your continued support, and to wish you and your families well for the Festive Season and the year ahead.

Yours faithfully,



Michael Fry

**Chairman**

**Challenger Energy Limited**