Challenger Energy Ltd

ASX:CEL
ASX:CELO
www.challengerenergy.com.au

29th Jan 2016

Board of Directors:

Michael Fry
(Non-executive Chairman)

Robert Willes
(Managing Director)

William Bloking
(Non-executive Director)

Issued capital:

352,025,933 fully paid ordinary shares (ASX: CEL)

65,896,502 listed options (ASX: CELO)

26,000,000 unlisted options and rights

Substantial holders:

LQ Super	11.72%
W&M Brown	7.32%

Registered office:

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QUARTERLY ACTIVITIES REPORT FOR THE PERIOD ENDING 31 DECEMBER 2015

HIGHLIGHTS

- **Positive industry engagement with government on key legislation – progress on MPRDA Amendment Bill and licence application process anticipated soon.**

- **ANC National General Council identifies ongoing power crisis as one of the "specific domestic weaknesses" in the economy undermining growth, investment and confidence, emphasises role of gas and affirms role of Independent Power Producers ("IPPs") to be expanded beyond renewables to include gas.**

- **Continuing economic pressure from electricity supply constraints, lower commodity prices and lower confidence levels lead to reduced growth forecasts.**

- **State power utility Eskom seeks further substantial electricity tariff increases to claw back R22.8 billion of costs primarily related to diesel consumption and reduced revenue.**

- **Farm-out discussions continue pending grant of exploration right.**

South Africa

As previously reported, the petroleum industry has continued to engage with government throughout the year to deliver constructive solutions for the legislative framework (the Mineral and Petroleum Resources Development Act, 28 of 2002 - "MPRDA"). Linked to Operation Phakisa (a government programme aimed at fast-tracking the implementation of solutions on critical development issues, particularly oil and gas) the Minister of Mineral Resources established a bilateral process between the Department of Mineral Resources ("DMR") and the industry associations, the Offshore Petroleum Association of South Africa ("OPASA") and the Onshore Petroleum Association of South Africa ("ONPASA"). These bilateral engagements took into account the frontier nature of South Africa's petroleum industry, along with the imperative to achieve the national development goals as outlined in the National Development Plan and related government policies. 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 South African Shadow Minister of Mineral Resources, James Lorimer, who represents his party on the parliamentary portfolio committee on mineral resources, echoes this sentiment in recent South African media reporting. Mr Lorimer comments on his expectations of the outcomes of revision of the MPRDA for South Africa's oil and gas industry, including the nascent shale gas sector.

He is reported as saying that the bill is likely to re-emerge on the parliamentary agenda and that the concerns of the oil and gas industry have been largely addressed in the new version, with agreement on the wording of the paragraphs that will govern state participation. He is quoted as saying:

> *"The 20% free carried interest will go, for example and there will still be a state interest but it will be a more subdued formulation" and*
>
> *"Exploration and production costs will be covered before the state starts taking its 20% share in profits. This is much more regular across the world and more acceptable."*

As previously reported, in late September the inaugural South Africa Gas Options Conference was held in Cape Town, attracting significant interest and pointed commentary from Energy Minister Tina Joemat-Pettersson with regard to the importance of gas in South Africa's future energy mix.

Minister Joemat-Pettersson stressed that gas will be the cornerstone of the country's base load power. The minister stated that it was vital for South Africa to change its energy mix, noting that the target for gas-fired power generation from 2019 to 2025 to widen South Africa's electricity base could be increased.

The government would play a significant role in developing timely, reliable and affordable electricity, while investment was encouraged in exploration and the development of natural gas resources, the minister said.

In October the governing African National Congress ("ANC") held its National General Council ("NGC"). Held midway between party conferences, the NGC is convened to discuss and debate the "strategic organisational and political issues facing the movement".

Delegates to the NGC were reported to have agreed that priority should be given to making clear decisions on future base load power investments, so as to avoid economically debilitating supply instability medium- to long-term. The ongoing power crisis was stated to be one of the "specific domestic weaknesses" in the economy, undermining growth, investment and confidence.

The expanded role of IPPs was affirmed, together with the desirability of extending the success of the renewables procurement programme to technologies such as coal and gas.

The ANC also emphasised the role of gas in South Africa's future energy mix, arguing gas, including shale gas, could be a "game changer" for the South African economy.

These positive developments take place against a background of continuing economic pressure.

Then Finance Minister Nhlanhla Nene presented his medium-term budget policy statement speech in October, making the point that without economic growth, there is no revenue growth, and without revenue growth, expenditure cannot increase and the nation cannot develop and succeed. The Treasury revised its growth expectations to 1.5% for 2015 and 1.7% for 2016 as compared to February's forecasts of 2% for 2015 and 2.4% for 2016. Nene said that electricity supply constraints, falling commodity prices and lower confidence levels had resulted in South Africa's growth forecasts being revised lower.

In December President Zuma announced that Mr Nene would be replaced as Finance Minister by little-known parliamentarian David van Rooyen. The appointment triggered market reaction and criticism, during which the rand depreciated substantially against the dollar. Within days, President Zuma removed Minister van Rooyen and announced the appointment of Pravin Gordhan as Finance Minister. Mr Gordhan had served as Finance Minister from 2009 to 2014, and was succeeded by his respected deputy, Mr Nene. The reappointment of Mr. Gordhan, to promote "fiscal discipline and prudence," calmed investors and led to a partial recovery of the rand. At a media briefing following his appointment Mr Gordhan emphasised sound fiscal management and sober spending.

The dramatic about-turn in reappointing the well-respected Mr Gordhan is a reflection of the pressure the President's office came under.

The financial pressure on state power utility Eskom has continued. Post the reporting period, the National Energy Regulator of South Africa (NERSA) is to hold hearings on Eskom's application for an electricity tariff increase to claw back R22.8-billion of costs. The utility has submitted an application for the first year, or 2013/14, of the third multiyear price determination (MYPD3), under which Eskom has been granted five yearly tariff increases of 8% until the end of March 2018.

The hearings are likely to centre on whether Eskom should be allowed to recoup various costs, including diesel expenses of R8-billion that were incurred during the financial year.

The other main component relates to a revenue variance of R11.7-billion, owing to lower than anticipated demand during the period.

If approved, the claw-back could result in tariffs rising by nearly 17% from 1 April, 2016, instead of the 8% already sanctioned. This follows a prior grant to Eskom of a 4.69% upward adjustment to the tariff from April 1, 2015, which resulted in a hike of 12.69% in 2015. A further claim for the 2014/15 financial year is also anticipated, and Eskom is reportedly also considering an early MYPD4 application and the possibility of applying for a 10-year tariff path. NERSA is expected to make its determination before the end of February.

Whilst it is difficult to provide precise guidance on the timing of the application determination process, the economic and political fundamentals to resolve the power crisis and grow the economy remain as strong as ever. The potential of natural gas to address these issues is increasingly appreciated and promoted, and the foundations for gas in South Africa's future energy mix are clearly being laid. As described above, Challenger anticipates that there will soon be positive developments with regard to key legislation and progression of the application process.

In the meantime, 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.

Corporate

Whilst working to progress the licence application, management continues to focus on cost reduction, and this is reflected in the reduced expenditure for the fourth quarter and forecast for the coming quarter.

As part of building the Company's profile in South Africa, Challenger presented at the Investec Oil & Gas Conference in Cape Town in October for the second year running. This event runs concurrently with the annual Africa Oil Week and is a by-invitation-only opportunity to meet with selected funds and institutions. Challenger's presentation was well received.

The Company also ran an investor roadshow in Melbourne, Sydney, Brisbane and Perth in November.

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 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 junior company with interests in the basin, alongside Shell and Chevron.

Yours faithfully

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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, 01/05/2013

Name of entity

Challenger Energy Limited

ABN	Quarter ended ("current quarter")
45 123 591 382	31 December 2015

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	-	-
1.2	Payments for (a) exploration & evaluation	-	(103)
	(b) development	-	-
	(c) production	-	-
	(d) administration	(128)	(355)
1.3	Dividends received	-	-
1.4	Interest and other items of a similar nature received	1	3
1.5	Interest and other costs of finance paid	-	-
1.6	Income taxes paid	-	-
1.7	Other – VAT refund	12	28
	Net Operating Cash Flows	(115)	(427)
	Cash flows related to investing activities		
1.8	Payment for purchases of: (a) prospects	-	-
	(b) equity investments	-	-
	(c) other fixed assets	-	-
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	-	-
	Net investing cash flows	-	-
1.13	Total operating and investing cash flows (carried forward)	(115)	(427)

1.13	Total operating and investing cash flows (brought forward)	(115)	(427)
	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 (refer 2.1 below)	-	-
1.17	Repayment of borrowings	-	-
1.18	Dividends paid	-	-
1.19	Other – costs of equity issues	-	(2)
	Net financing cash flows	-	(2)
	Net increase (decrease) in cash held	(115)	(429)
1.20	Cash at beginning of quarter/year to date	401	714
1.21	Exchange rate adjustments to item 1.20	(3)	(2)
1.22	**Cash at end of quarter**	283	283

Payments to directors of the entity, associates of the directors, 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	-
1.24	Aggregate amount of loans to the parties included in item 1.10	-

1.25 Explanation necessary for an understanding of the transactions

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	
4.2	Development	
4.3	Production	
4.4	Administration	130
	Total	**130**

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	283	401
5.2	Deposits at call		
5.3	Bank overdraft		
5.4	Other (provide details)		
	Total: cash at end of quarter (item 1.22)	283	401

Changes in interests in mining tenements and petroleum tenements

		Tenement reference and location	Nature of interest (note (2))	Interest at beginning of quarter	Interest at end of quarter
6.1	Interests in mining tenements and petroleum tenements relinquished, reduced or lapsed		Refer to the attached schedule on page 7.		
6.2	Interests in mining tenements and petroleum tenements acquired or increased				

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** *(description)*				
7.2	Changes during quarter (a) Increases through issues (b) Decreases through returns of capital, buy-backs, redemptions				
7.3	**+Ordinary securities**	352,025,933	352,025,933		
7.4	Changes during quarter (a) Increases through issues (b) Decreases through returns of capital, buy-backs				
7.5	**+Convertible debt securities** *(description)*				

+ See chapter 19 for defined terms.

7.6	Changes during quarter (a) Increases through issues (b) Decreases through securities matured, converted				
7.7	**Options** *(description and conversion factor)*	7,500,000 65,896,502	- 65,896,502	*Exercise price* 15 cents 20 cents	*Expiry date* 20/11/2016 30/06/2016
	Performance Rights	2,500,000 4,000,000 8,000,000 4,000,000	- - - -	*Exercise price* Nil Nil Nil Nil	*Expiry date* 30/06/2016 07/04/2016 07/04/2018 07/04/2020
7.8	Issued during quarter				
7.9	Exercised during quarter				
7.10	Options expired during quarter				
7.11	**Debentures** *(totals only)*				
7.12	**Unsecured notes** *(totals only)*				

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 5).

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

Sign here: Date: 29 January 2016
Managing 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 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 and petroleum 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 or petroleum 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 6: Exploration for and Evaluation of Mineral Resources* and *AASB 107: Statement of Cash Flows* apply to this report.

5 **Accounting Standards** ASX will accept, for example, the use of International Financial Reporting 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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CHALLENGER ENERGY LIMITED
SCHEDULE OF OIL AND GAS INTERESTS
AS AT 31 DECEMBER 2015

Cranemere Project (South Africa)

Location	*Gross Acreage*	*Working Interest*	*Status*
Karoo Basin	**870,449**	**95%**	**Application**

Final area is subject to granting of the application.

Mercury Stetson (United States)

Location	*Gross Acreage*	*Working Interest*	*Status*
Grayson County	**~1,987**	**15%**	**15% earned to date with the ability to earn up to 50%**

~1165 acres expired during the quarter.